

IRO

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Investor Relations Quarterly

NATIONAL INVESTOR RELATIONS INSTITUTE

Jim Kerr

UNISYS

Director of Investor Relations, Unisys

Unisys has always used technology to your shareholder's benefit. You were webcasting your earnings calls long before Reg FD.

That's right. Our philosophy has always been that all shareholders, institutional and individual, have equal access to our information. We've proactively embraced technology, especially web-based technology, to make that happen. That's why we've placed such an early and heavy emphasis on enhancing our investor website and using of webcasts.

You moderated a panel on investor relations websites at the NIRI Annual Conference. Any overall conclusion from that discussion?

Given that the session was standing-room only, I'd conclude that, more than ever, IR practitioners understand the importance of their website to communicate with investors. They're eager for information on how to do that - for new ideas, for best practices, for tools and techniques. It's my belief that ultimately IR websites will be the key disclosure vehicle for all corporate financial information.

The Unisys investor website is ranked among the top in the world by IR Web Report. How did you get it to that point?

Through a lot of focus and hard work. We built our IR team in 1997 with the goal to create a world-class, "self-service" portal that investors could use as a basis for researching us... ideally before contacting Investor Relations. Our site's come a long way since that time, although we still have a lot more work to do.

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Getting on Board

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Editor's Note

Corporate governance leaped higher on the investor relations agenda in the wake of major corporate scandals, prickly with compliance issues and pinching already strained resources.

Leave that topic to the attorneys and compliance officers, said many IROs.

But as the contributors to this *IRQ* point out, good corporate governance is broader than that. It involves strategy development, shareholder-value-building, relationships with key corporate constituencies and communication—lots of communication. As the topic develops, it carries more emphasis on governance than enforcement. We are well-grounded in these roles, many IROs now say.

Our particular focus in this *IRQ* is the changing relationship between corporations and their boards of directors. In part it is mandated. Legislators and the Securities and Exchange Commission are steadfastly shifting the board makeup to distinguish it from management. That affects not only what boards do but also how they go about meeting their responsibilities. In part the relationship between companies and their boards is changing because the times demand vigilance and accountability, and that overlay of scrutiny extends to corporate governance.

Moreover, IROs themselves—perhaps unintentionally—are accepting the role of corporate conscience. It is not hard to see how that role evolves for practitioners used to being at the intersections of financial performance and communication, confidentiality and disclosure, marketing and measurement.

In this issue, too, we look at several academic research pieces with practical implications for how the IR function works and how practitioners frame their programs. The research from accounting professors in particular reminds us of another fundamental intersection in the practice of IR—that of finance and communication.

The dynamic nature of IR keeps us engaged. In the last issue of *IRQ* we explored our profession's preparation for the so-called seat at the table. Now we're talking about how governance is shaping IR's role. Are you ready professionally to pull up a chair?



Connie Harrison

October 1, 2004

WHITE PAPER

Structural Strength

A Team Approach Provides the Best Support for the Triangle of Corporate Governance

[4]

BY RICHARD H. KOPPES, J.D.

Of Counsel

JONES DAY

MORE THAN TWO YEARS AFTER MAJOR CORPORATE SCANDALS rocked this country and brought about passage of the Sarbanes-Oxley Act, relationships between shareholders and the corporations that they own remain skeptical and tense. Interest in corporate governance remains high among shareholders, government regulators, the media and the public at large. And this interest—often accompanied by tension—can be expected to continue into the 2005 proxy season because reform of shareholders' proxy access has stalled at the Securities and Exchange Commission.

Given all of this, how can the investor relations officer help ease friction and facilitate better relationships among the participants in the corporate governance triangle of the board, management and shareholders? The answer is straightforward: be part of or, if necessary, help create the company's corporate governance team.

In addition to the investor relations officer, the corporate governance

team is likely to include the corporate secretary, the public relations officer and possibly the general counsel and the CFO. An important function of the team is to help keep the company proactive rather than reactive to shareholder issues and corporate governance trends.

As someone who has been active in these issues for more than 18 years and with experience on all three sides of the corporate governance triangle, I see the need for this kind of team effort on the part of corporate officers. My experience as a director of two publicly listed companies demonstrates that this function is too important to rest with—or be dumped on—one corporate office.

MAKING THE TEAM

The IRO who carves out an effective role on the corporate governance team fills a number of functions.

The first involves serving as the intelligence and communications link between the investment community, broadly defined, and the company's board and senior management. Recognizing that the board is elected to represent shareholders, the IRO needs to keep directors informed on who the company's investors are and what shareholders think of its strategy, performance and governance. The IRO should make this report directly to the board on a regular basis.

Second, IROs should play a role in educating new independent directors about the company, its shareholder base and issues associated with its industry sector. IROs are especially well-equipped for this responsibility because they regularly handle such topics with the Street.

Third, along with other members of the corporate governance team the IRO can serve as the corporate conscience, advising senior management and the board on the right thing to do on shareholder and corporate governance issues. For example, if there is a nagging issue that has generated

or is likely to generate a shareholder proxy proposal but is not in the shareholders' best interest, the IRO should urge that the matter be removed or resolved before it becomes a contested issue.

The recognition that some issues provoke controversy leads to the fourth role that IROs can play on the corporate governance team. When issues are contested, the investor relations officer needs to be an effective spokesperson for the management's and board's position. By the nature of investor relations, the IR practitioner is viewed as someone who can garner support among both institutional and individual shareholders.

The investor relations officer clearly can fill an important role in facilitating communication and information flow among the three sides of the corporate governance triangle. The scandals of the last few years have made that role more essential and critical. From my perspective as a director—and I hope this is also the management viewpoint—this role thrives on a team approach, with corporate officials working together on the important issues of corporate governance. ■

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ACADEMIC RESEARCH

Interpretive Initiative

Earnings Announcement Plus Analysts' Knowledge Can Trigger a Forecast Flurry

GETTING ON BOARD
[7]

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ACADEMIC RESEARCH

FINANCIAL ANALYSTS PRODUCE LARGE NUMBERS OF EARNINGS forecasts. Firms frequently have earnings forecasts produced by multiple analysts. But the role that information plays in encouraging multiple analysts to forecast earnings for the same firm is not well-understood.

Recent research suggests that active analysts following large firms mainly process and interpret publicly available accounting disclosures. Studies also suggest that the forecasts' primary informational contribution comes mainly from the analysts' own interpretations of firms' public disclosures. This interpretive role helps explain why some firms are followed by relatively large numbers of analysts and why a flurry of earnings forecast revisions often follows earnings announcements.

[8] These results suggest that firms' investor relations activities may be important in helping analysts develop the background knowledge that they use to process companies' accounting disclosures. This perspective on the analysts' role and their interactions with investor relations professionals contrasts with the widely held notion that analysts obtain most of their information directly from the management of the firms that they follow. Interestingly, Regulation Fair Disclosure appears not to preclude investor relations professionals from answering the sorts of questions that analysts use to develop background knowledge that in turn helps them process firms' accounting disclosures.

RESEARCH ON ANALYSTS' INTERPRETIVE ROLE

One stream of academic research focusing on the analyst community suggests a high degree of similarity in analysts' forecasts, in terms of both value and accuracy. It also suggests that the level of agreement among analysts about forecasted earnings increases as the earnings announcement approaches.

Potential explanations include the common information set available to analysts, their similar forecasting procedures, their sharing of information about their forecasts and incentives for them to conform to the average forecast.

Those explanations are consistent with the role of analysts as important intermediaries or conduits of public information as well as with the general

presumption that firms' disclosures are consensus-increasing events. The explanations also suggest that once a corporate earnings report is released, any given individual analyst's forecast is largely a substitute for other analysts' forecasts and for the information contained in the financial report.

This early research leaves key questions unresolved. For example, why do large groups of analysts frequently produce forecasts for the same firm, especially after earnings releases? And if forecasts made soon after earnings announcements just repeat the information contained in the earnings announcements, why does the market react to those forecasts? More broadly, the early research also left unexplained the informational role of multiple analysts' earnings forecasts in augmenting the financial reporting process.

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A NEW EVALUATION FRAMEWORK

Early studies of analyst forecasts examined their variation and demonstrated that the degree of dispersion decreases over time, especially around earnings announcements. Those studies typically suggested that changes in dispersion reflected an increased level of consensus among analysts around earnings announcements.

In a paper in *The Accounting Review* in 1998, Orié Barron, Oliver Kim, Steve Lim and Doug Stevens provided the framework for a new analytical model. It showed that analyst forecast dispersion reflected both the relative degree of private information in forecasts and the amount of uncertainty about upcoming earnings. In other words, it is not possible to draw inferences on the degree to which analysts' forecasts share common information simply by examining the level of dispersion in the forecasts.

This important insight provides a backdrop for our discussion of recent research developments and the role played by analysts' earnings forecasts.

The research by Barron, Kim, Lim and Stevens offered a relatively simple model that shows how properties of analysts' underlying information can be

inferred from characteristics such as the number of forecasts, the dispersion of those forecasts and errors in the mean forecast.

Under the assumptions that each analyst has some information that is common across all analysts as well as some unique information and that analysts' earnings forecasts reflect their full range of information, the 1998 research showed how two key properties of analysts' underlying information—uncertainty and consensus—could be inferred from the pattern of analysts' earnings forecast errors. Consensus is a measure of the degree of commonality in analysts' earnings forecast errors—the across-analyst correlation in their earnings forecast errors. Thus, consensus can be thought of as the commonality of analysts' information.

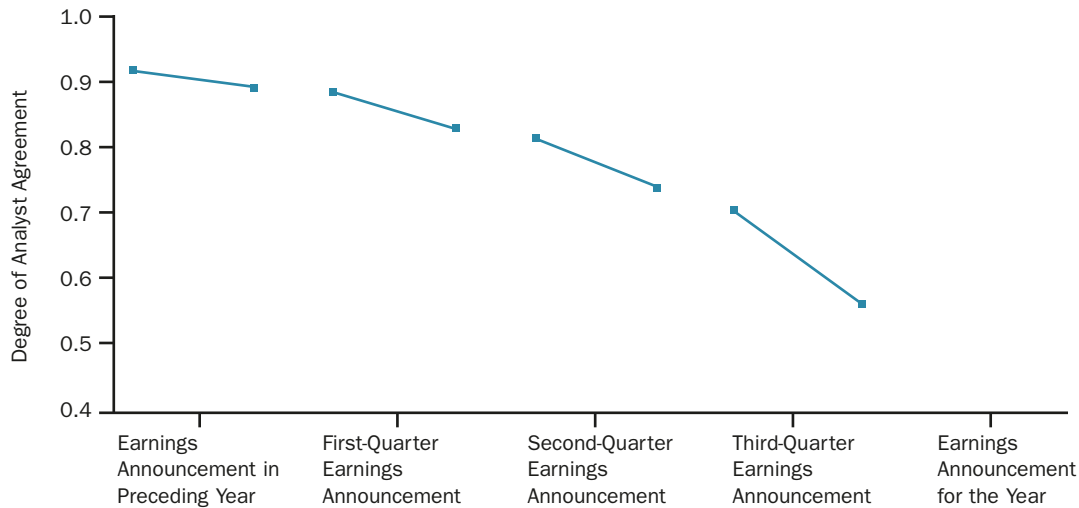
If consensus equals one, then all of the individual analyst forecasts are identical, and all contain the same information. Lower levels of consensus indicate that analysts share relatively less common information and, thus, there is a relatively greater informational contribution from each individual analyst. Notably, the research by Barron, Kim, Lim and Stevens did not define consensus simply on the basis of dispersion in analysts' forecasts.

EARNINGS ANNOUNCEMENTS AND INFORMATION CHANGE

Several recent empirical research papers have used the Barron, Kim, Lim and Stevens framework to examine properties of analysts' information in different settings.

Barron and Kim, along with Donal Byard, in an article in *The Accounting Review* in 2002 examined changes in the earlier research's consensus measure around the time of earnings announcements. The primary sample used by Barron, Byard and Kim consisted of annual analysts' earnings forecasts for a sample of 990 firm-years from 1986 to 1997. The researchers examined how analyst consensus changes over approximately a 14-month

FIGURE 1: DECREASE IN ANALYSTS' CONSENSUS



window preceding annual earnings announcements, with an emphasis on changes in consensus around prior earnings announcements in this 14-month window.

The 2002 research selected firm-years where the earnings announcement dates for current-year annual earnings, current-year first-, second- and third-quarter earnings and prior-year annual earnings all were available on the Compustat database, and actual earnings-per-share data was available from the I/B/E/S database.

For example, in analyzing the 14-month period before the announcement of 1997 earnings, Barron, Byard and Kim’s research focused on activity around the 1996 annual earnings announcement and the first three quarterly announcements in 1997. For the four earnings announcements leading up to the current annual earnings announcement, the researchers required that there be at least two analysts who had issued

forecasts of annual earnings for the current year in a 45-day period before the earnings announcement and also updated their forecasts in the 30-day period after the earnings announcement.

Figure 1, which plots the median consensus for the sample of 990 firm-years, illustrates the main findings of the 2002 study:

1. Fourteen months before the annual earnings announcement, consensus started out at a fairly high level, close to its limit of one.
2. Consensus decreased as the current annual earnings announcement approached.
3. Consensus dropped around the four earnings announcements leading up to the current annual earnings announcement.
4. The drops in consensus around earnings announcements seemed to be the dominant source of the overall decrease in consensus over the entire period examined.

The results in the 2002 study, suggesting that consensus as defined in the earlier research project falls around earnings announcement times, thus contrasted with previous research employing dispersion in analysts' forecasts. The lower consensus after the earnings announcement indicated a relatively greater informational contribution from each individual analyst.

To test if there is a larger decrease in consensus when there is more revision activity by analysts, Barron, Byard and Kim also examined the relationship between decreases in consensus around those four earnings announcements and the number of analysts forecasting for a firm. Their study found that in all cases the change in consensus was negatively correlated with the number of forecast revisions around the earnings announcement, indicating that increased analyst revision activity is associated with larger drops in consensus.

Taken together, these results indicated that the informational contribution of individual analysts is relatively greater soon after previous earnings announcements and when there is more competition among analysts. In sum, the evidence indicated that much of analysts' private information about future annual earnings is triggered by previous earnings announcements. That finding is consistent with the observation that analysts' private information mostly comes from their processing of public accounting disclosures.

DISCLOSURE QUALITY AND INFORMATION PRECISION

Under additional assumptions, the study by Barron, Kim, Lim and Stevens introduced two more measures of analysts' underlying information: the precision of their common information and of each individual analyst's private information. These measures require the additional assumption that each individual analyst's private information is of the same precision. This is equivalent to assuming that all analysts have roughly the same ability.

In a paper published in the *Journal of Accounting, Auditing and Finance* in 2003, Donal Byard and Ken Shaw used those measures of the precision of analysts' common and private information to examine the effect of firms' disclosure quality on the quality of information reflected in analysts' earnings forecasts. The measures of firms' disclosure quality developed from annual surveys of large U.S. firms conducted by the Association for Investment Management and Research's *Corporate Information Committee Report* from 1985 to 1995.

In those surveys, independent industry committees of AIMR (now CFA Institute)—whose members are analysts who follow firms in specific industries—separately assess and rank the quality of annual report disclosures, quarterly report and other disclosures, and investor relations activities. The AIMR annual and quarterly report scores represent a proxy for the quality of public information—which generally is driven by

accounting practices—while the investor relations score primarily indicates the quality of firms’ meetings with analysts, conference calls, presentations, annual meetings and other interactions with the investment community.

For each year with available AIMR disclosure scores, Byard and Shaw used analysts’ earnings forecasts made after the first-, second- and third-quarter earnings announcements to measure information precision. The researchers then compared the precision of analysts’ common and private information against the three measures of firms’ disclosure quality—annual and interim reports and investor relations—along with the size of the quarterly earnings surprise that preceded the forecasts and market capitalization as a control variable for firm size.

Byard and Shaw’s findings can be summarized as follows:

1. The precision of analysts’ common and private information increases as firms’ overall disclosure quality increases.
2. This increased precision of analysts’ common and private information results primarily from the quality of firms’ accounting disclosures—the information contained in their annual reports and quarterly and other disclosures.
3. There is no direct relationship between the precision of analysts’ private information and the quality of firms’ investor relations activities.

Using the same AIMR dataset of firms’ disclosure quality, a paper by Mark Lang and Russell Lundholm published in *The Accounting Review* in 1996 found that firms with higher-quality disclosures attract a larger analyst following. The results of the studies by Barron, Byard and Kim and by Byard and Shaw indicate that much of analysts’ private information derives from their processing of firms’ accounting disclosures, suggesting that analysts prefer to follow firms with more forthcoming disclosures

because the enhanced information helps them add value by developing unique insights.

DIFFERENTIAL INFORMATION INTERPRETATION

Another stream of analytic research, sometimes referred to as models of differential interpretation, examines how new private information can be triggered by public disclosures.

Papers by Oliver Kim and Robert Verrecchia in the *Journal of Accounting and Economics* in 1994 and 1997 modeled how public disclosures trigger the release of new private information for market participants—namely analysts—with superior information processing abilities. In those models, each analyst recognizes a signal that by itself does not sharpen the earnings. However, combining that knowledge with the information in an earnings announcement enables the individual analyst to develop new private information. This unique interpretation is then incorporated into the analyst’s forecast revision after the earnings announcement.

Analysts might obtain such indirect knowledge before or after the triggering public earnings announcement, and it can come in many forms: It might be firm-specific knowledge about events affecting future performance, such as planned capital expenditures, or industry-specific knowledge, such as competitors’ particular market strengths.

Barron, Byard and Kim offered examples of two analysts and how they developed unique information. The first was a CPA who understood when and how specific accruals would affect and reverse future earnings. The second was a former political economist who correctly expected that backorders from an international customer would soon decline and decrease future earnings. Neither analyst could use the indirect knowledge in isolation, but either could combine it with reported earnings to produce uniquely privately inferred information about future earnings.

IMPLICATIONS FOR IR

This insight regarding the interpretive role of analysts—especially the notion of background knowledge that they use to process firms’ accounting disclosures and produce unique insights—suggests a potentially important role for firms’ investor relations activities. Investor relations officers can help analysts develop their background knowledge for interpreting accounting disclosures. Informal contact with management and IROs, perhaps through analyst meetings and conference calls, can be an important source for the background knowledge that analysts use to build their interpretive skills.

This insight into the interpretive role of analysts also helps explain why some firms have extensive analyst coverage and why much of analysts’ revision activity is concentrated soon after earnings announcements.

THE EFFECT OF REG FD

The research suggests that a key role of firms’ investor relations activities may well be to provide analysts with background knowledge that enables them to produce unique insights from the public disclosures. What then, is the potential impact of Reg FD on analysts’ information environment?

Reg FD is intended to prevent selective disclosures to a few analysts who along with privileged clients can profit from what the regulation describes as “their superior access to corporate insiders, rather than from their skill, acumen, or diligence.”

Importantly, however, Reg FD also states that “... an issuer is not prohibited from disclosing a non-material piece of information to an analyst, even if, unbeknownst to the issuer, that piece of information helps the analyst complete a ‘mosaic’ of information that, taken together, is material. Similarly, since materiality is an objective test keyed to the reasonable

investor, Reg FD will not be implicated where an issuer discloses immaterial information whose significance is discernable by an analyst. Analysts can provide a valuable service in sifting through and extracting information that would not be significant to ordinary investors to reach material conclusions. We do not intend, by Reg FD, to discourage this sort of activity. The focus of Reg FD is on whether the issuer discloses material nonpublic information, not on whether an analyst, through some combination of persistence, knowledge, and insight, regards as material information whose significance is not apparent to the reasonable investor.”

Thus, Reg FD does not appear to preclude disclosures that help analysts develop their background knowledge—the variable knowledge they use to process firms’ public disclosures.

[17]

ANALYSTS’ BACKGROUND KNOWLEDGE

In providing interpretations of firms’ accounting disclosures, analysts essentially use some background knowledge, such as industry knowledge, to process information in firms’ accounting-based disclosures. High-quality investor relations may be a source that analysts use to develop that background knowledge.

This suggests that investor relations professionals can play an important—but perhaps indirect—informational role for analysts. Such an indirect informational role, where investor relations professionals answer questions that help analysts develop their background knowledge, would not appear to be precluded under Reg FD. ■

ACADEMIC RESEARCH

Down for the Count

Market Performance May
Benefit From Leaving
Intangibles Unmeasured

[18]

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THE 1990s WITNESSED EXPLOSIVE GROWTH IN COMPANIES' investments in intangibles such as research and development, brand equity, information technology, process engineering and human capital

development. Such investments are essential in building a firm's competitive advantage and future profitability.

Yet current accounting practice fails to recognize them as assets. Expenditures on research and development are measured and reported as a line item on the income statement but are not recognized as assets on the balance sheet. Other intangible investments are not measured at all and remain commingled with a firm's operating expenses.

The situation raises a fundamental question about accounting for intangibles: Are regulators mired in arcane accounting principles, or are there valid reasons not to give specific accounting recognition to intangible investments?

[19]

CONVENTIONAL WISDOM

Conventional wisdom in the academic community holds that the failure to recognize intangibles has seriously undermined the relevance and usefulness of accounting reports.

Empirical findings demonstrate that accounting metrics such as book value and operating earnings correlate better with observed stock returns when estimated intangibles are capitalized and amortized than when they are expensed. The line of reasoning is that the capital market treats intangibles as assets, so accountants' reluctance to do the same contradicts the efficiency of the stock market and defies investors' informational needs, potentially resulting in the mispricing of firms' securities. This argument favors measurement and recognition of intangibles.

On the other hand, the Financial Accounting Standards Board contends that because intangibles cannot be measured with reasonable precision, any attempt to recognize them would open the door to earnings management and measurement errors, which undermine the credibility of financial reports.

LESS MEASUREMENT, MORE INVESTMENT?

In a study published earlier this year in the *Journal of Accounting Research*, we investigated the measurement of intangibles from a broader perspective. We incorporated the main concerns of both sides in the debate—the value relevance of intangible investments versus the inevitable measurement errors. The key question for our study was how the nonmeasurement or noisy measurement of intangibles affects firms' incentives to invest in them.

Previous studies have been silent about the effect of accounting measurement on firms' incentives to undertake intangible investments. We argue that an understanding of such incentives is crucial to accounting policy regarding intangibles.

Accounting rules are not neutral. They have real effects. When managers invest in intangibles, they are concerned not only with long-term strategic effects but also with how such investments affect current market valuations. If investment in intangibles adversely affects the accounting metrics to which the market responds, then the incentive to invest is diminished.

UNINTENDED CONSEQUENCE

Let's consider an accounting system in which intangibles are not measured and are left commingled with operating expenses. Under those circumstances, a firm's reported income measures its true operating profits less any expenditure on intangibles.

However, the nonobservability of intangibles does not mean that the market would price the firm as if its investment in intangibles were zero. In an efficient market, investors understand the value relevance of intangibles and form an unbiased assessment of the firm's investment in such activities.

Their evaluation rests on observation of the firm's tangible investments and an understanding of managers' incentives to affect the firm's future profitability. The price that the market assigns to the firm reflects that collective judgment. This degree of rationality in beliefs may appear to be far-fetched, but empirical evidence has confirmed it.

Because the firm's reported income does not distinguish between operating profits and investment in intangibles, the market makes adjustments to the accounting report based on how it values the investment. The market then uses the adjusted number and its opinion of the firm's intangibles to shape expectations of future operating profits.

That process gives managers a strong incentive to reduce investments in intangibles. Accounting practices allow the cutbacks to be made without being directly visible to the market. As a result, a decrease in investment in intangibles flows directly to the bottom line, in effect raising operating profits. The market views higher operating profits as good news, causing the market valuation to rise.

The fact that a firm's investment in intangibles is nonobservable induces managerial myopia and hampers investment in those areas. However, the market is not fooled. The underinvestment is rationally anticipated, and the firm is priced accordingly. Thus, while there is no mispricing of the firm's securities, the firm's equilibrium price and investments are lower, confirming the conventional wisdom that non-measurement of intangibles has negative consequences.

Can accountants remedy the underinvestment problem by measuring a firm's investments in intangibles? Consistent with FASB's concerns, we believe that such measurements are inherently imprecise. Three kinds of unavoidable measurement errors are associated with intangibles:

1. Because of the fuzzy boundaries between operating expenses and intangible assets, some operating expenses could be classified as intangible assets or vice versa.
2. Not all of the expenditures on intangibles turn out to be productive. The unproductive component is random and *ex ante* is difficult to separate from the productive component. Such inseparability implies that the random unproductive component would be erroneously classified as an intangible asset.
3. Attempts to distinguish between tangible and intangible components of a firm's investment will result in misclassifications between the two kinds of investment.

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Our study shows that although all three measurement errors are detrimental, the first—misclassifications between operating expenses and assets—is the most important. This kind of error would be present in a firm's reported income but washed out in its reported net cash flow. Therefore, both reported income and net cash flow become important accounting metrics, and both are used to assess the distribution of future operating income.

Market valuations would assign positive weights to both accounting numbers. But valuations based even partially on current net cash flow create a disincentive for investment for essentially the same reason as the non-measurement of intangibles. The disincentive arises because investment decreases reported net cash flow, which is one of the accounting metrics to which the market assigns positive weight.

The larger the weight that the capital market assigns to the firm's net cash flow, the smaller the incentive for investment. This weight in turn increases with the degree of measurement errors in the firm's reported income. In general, any factor that impairs the credibility of a firm's

reported net income—be it earnings management, poor quality audits, ambiguous accounting standards or another factor—decreases the role of reported earnings and increases the role of net cash flow in the market’s valuation of a firm.

Such lack of credibility is enormously detrimental to the firm’s shareholders because it creates a disincentive for many desirable managerial actions that would decrease the firm’s net cash flow in the short run but provide significant future benefits.

WEIGHING THE CONSEQUENCES

Thus, regardless of whether intangibles are left unmeasured or are measured with noise, corporate managers have incentives to underinvest in them. Which accounting system is the lesser evil?

We found that when intangibles are not measured, the extent of underinvestment depends on only the technological parameters that determine the optimal proportion of tangible to intangible investments. If accountants measure firms’ intangible investments, the extent of underinvestment depends critically on the degree of measurement errors.

Combining the two results, we concluded that measurement and reporting of intangibles are desirable only when two conditions are satisfied:

1. Intangibles can be separated from operating expenses with sufficient precision.
2. The importance of intangibles compared with tangibles in the firm’s technology is sufficiently high.

In all other cases, the preferred accounting treatment is to leave intangibles commingled with operating expenses.

Because the two critical factors identified by our study vary across industries, a uniform accounting standard that is mandated for all industries and all publicly traded firms will hurt some and benefit others. There is no one-size-fits-all solution. As in most regulatory situations, regulators need to make difficult trade-offs among the preferences of different groups of economic agents. ■

ACADEMIC RESEARCH

The State of IR

Survey Finds Pace-Setting U.S. Corporations Value Investor Relations Practice

GETTING ON BOARD
[25]

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ACADEMIC RESEARCH

LARGE UNITED STATES-BASED CORPORATIONS TAKE INVESTOR relations seriously, invest senior managers' time in IR activities and recognize that a consistent program raises management credibility and increases market value.

Those are among the findings of our 2003 survey of chief investor relations officers at major U.S. corporations. The survey results give corporations a guide to evaluate their investor relations activities and provide an overview of corporate investor relations practices that academics can use to enhance classroom capital markets discussion.

Large corporations with publicly traded common stock use investor relations activities to make voluntary disclosures of company performance and prospects and to gather feedback information from key financial market constituents. Voluntary disclosures are those that are not required by law and may be quantitative, qualitative (explaining strategy), retrospective (explaining results), or prospective (explaining forecasts). Feedback information includes identification of key investors, learning what investors want to hear as opposed to what management wants to say, and discovering which communication techniques analysts, portfolio managers, individual investors and the financial media prefer.

Investor relations officers in the survey said that:

- Investor relations activities account for a significant part of senior managers' time.
- IR's most important goals are providing fair and impartial information across the spectrum of investors and helping assure a fair market value for a company's common stock.
- IR's most important objectives are generating buy-side interest and maintaining contact with current constituents.
- IR's most important benefits are increased management credibility and higher stock market value.
- Companies tailor their investor relations messages and communication techniques to fit key investors' preferences.
- One-on-one conversations with top management and with the investor relations staff are the most important means of communicating with securities analysts.
- Internet-based communications are the preferred way to communicate with individual investors.

- IR professionals consider securities analysts' reports to be accurate and insightful.
- If companies stopped providing earnings guidance, securities analysts would not lose interest in the company, but analysts' forecasts would become more variable and more volatile.
- Securities analysts are important in influencing market opinion but are too concerned with a company's short-term prospects.
- Investor relations specialists do not feel pressured by analysts.

IR'S EXPANDING SCOPE

The classic description of investor relations, based on the National Investor Relations Institute's definition, recognizes IR as a strategic activity using the disciplines of finance, communications and marketing to provide present and potential investors with an accurate portrayal of a company's performance and prospects.

Typically the goals for investor relations activities focus on two key purposes:

- Assuring a level playing field for all investors by providing information on a timely, fair and impartial basis
- Supporting the likelihood that the financial marketplace adequately values a company's stock.

IR's relevant constituencies are individual investors, sell-side securities analysts, buy-side analysts and portfolio managers, institutional investors and the financial media. Among the basic tools that investor relations specialists use to reach these constituents are corporate Web sites, presentations to securities analysts, headquarters and facilities visits, one-on-one interviews,

responses to constituent inquiries, webcasts, conference calls, news releases, company-sponsored conferences and guidance on earnings estimates.

The significant growth in corporate investor relations activities during the past two decades is a strong indication that corporations view IR as a value-adding activity. Three factors appear to have affected the surge in corporate investor relations activities.

1. Globalization of capital flows has resulted in a more heterogeneous ownership base and has forced corporations to become more adept at meeting the differing information needs of varied groups of investors.
2. The investment community's need for information other than what is provided in financial statements and other mandatory disclosures has increased significantly. Investors have become somewhat frustrated with traditional financial reporting frameworks that rely heavily on investment in plant and equipment to explain wealth creation and do not do a good job explaining other value drivers such as human capital and strategic relations with suppliers and customers.
3. A fair amount of academic research supports the idea that enhanced investor relations can add to common stock value.

INVESTOR RELATIONS' ROLE

Investors base equity valuations on a composite picture of leadership, performance, philosophies, strategies, practices and plans for the future. When a corporation provides full, accurate and timely information, it is likely that investor perceptions will be consonant with corporate reality and that the company's common stock will be valued appropriately. Conversely, when information is deficient, the likelihood is good that investor perceptions will diverge from corporate reality and that the stock will be overvalued or undervalued.

In light of those realities, the goals of investor relations are to minimize false investor perceptions that are due to information deficiencies and provide enough data to present a full and accurate picture of the dynamic and complex reality of a company's situation. Investor relations specialists achieve this goal by transmitting information at lower cost, making information more understandable and helping correct misinformation.

Traditional finance theory suggests that investor relations activities are ineffective and will not affect stock prices because they merely repackage existing information. Many academics have not been convinced of the importance of investor relations probably because of the supremacy of the efficient markets paradigm, which contends that information about a firm is costless, available to all and easily understood by potential investors. However, as Michael Brennan and Claudia Tamarowski argued in their article in the *Journal of Applied Corporate Finance* in 2000, "These conditions are clearly not satisfied in practice...firms are complex institutions with strategies, plans, commitments, personnel policies, competitive threats, and managerial succession problems... that can have a major effect on the value of shares... yet none of them can be assessed adequately by reading traditional corporate financial statements."

Finance theory does allow a benefit for investor relations activities if they make the market more efficient by transmitting information at a lower cost, making information more understandable or helping to correct misinformation. Since 1992 the academic community has provided evidence suggesting that investor relations activities make the market more efficient by:

- Increasing the number of analysts following the company.
- Reducing investor information asymmetry.
- Increasing market liquidity.

- Lowering the cost of equity capital.
- Increasing common stock value.

RESEARCH METHODOLOGY

[30] Our study used a closed-end survey instrument that was intended to provide insight into the current state of investor relations activities of large United States-based corporations and to capture the opinions of corporate investor relations specialists about the importance of various investor relations practices. The survey questions were developed from a careful study of the issues being discussed in both practitioner and academic literature. They also adapted questions used in a recent study of European corporations' investor relations practices reported in 2004 by Claire Marston of the School of Management at Heriot Watt University in Scotland.

By design the survey's participants were knowledgeable investor relations professionals, managing their companies' investor relations activities or belonging to the senior management team. Almost three-fourths of the respondents said that their companies consider investor relations to be a professional career path and not a training ground for executive talent.

RESULTS

As the data in Figure 1 indicates, investor relations departments are not long-time corporate units, do not have large operating budgets and are not heavily staffed. However, as the data in Figure 2 suggests, investor relations appears to be an important senior management activity, and senior managers spend a significant amount of their time on IR activities.

The respondents think that communicating company performance and prospects to current and potential investors, helping assure a fair market value for a company's common stock and providing fair and impartial information across the spectrum of investors are the most important

FIGURE 1: CHARACTERISTICS OF IR DEPARTMENTS

	Respondent Average
Years in existence as a corporate department	16.1
2003 annual operating budget	\$1,131,213
Number of full-time investor relations professionals	2.58

FIGURE 2: PORTION OF MANAGEMENT TIME SPENT ON IR ACTIVITIES

	No Time Spent on IR	Up to 5% of Time	5% to 15% of Time	More Than 15% of Time
President	5.2%	36.5%	40.5%	17.8%
CEO	1.9%	32.8%	53.8%	11.5%
CFO	1.9%	7.7%	59.6%	30.8%
Chief Accountant	28.9%	42.3%	13.4%	15.4%

investor relations goals, as indicated in Figure 3. It is worth noting that these goals are consistent with the theoretical arguments supporting a value-added benefit to the practice of investor relations. The data also indicates that respondents consider the most important investor relations objectives to be generating buy-side interest and maintaining contact with current constituents. Asked about the most important investor relations benefits, survey participants cited increased management credibility and increased stock market value, both of which are consistent with the investor relations objectives recommended by financial market theoreticians.

The responses summarized in Figure 4 indicate how investor relations specialists rank their constituents' information needs. From their perspective, audiences most value explanations of results, expectations and strategic plans.

FIGURE 3: RELATIVE IMPORTANCE OF IR GOALS, OBJECTIVES AND BENEFITS

	Little Importance	Moderate Importance	Major Importance
Goals			
Communicate performance/prospects to current investors		7.69%	92.31%
Communicate performance/prospects to potential investors		7.69%	92.31%
Help assure stock is adequately valued	3.85%	21.15%	75.00%
Provide information on a fair and impartial basis	3.84%	23.08%	73.08%
Provide market feedback to management	3.85%	32.69%	63.46%
Monitor company's shareholder mix	30.77%	40.38%	28.85%
Objectives			
Maintain contact with current constituents		21.15%	78.85%
Generate buy-side interest	1.92%	19.23%	78.85%
Generate prospective constituents	5.77%	38.46%	55.77%
Generate sell-side interest	26.92%	53.85%	19.23%
Develop and maintain media relations	67.31%	25.00%	7.69%
Generate individual investor interest	75.00%	21.15%	3.85%
Benefits			
Increased management credibility	7.70%	26.92%	65.38%
Increased stock price	15.47%	36.54%	48.08%
Increased number of patient shareholders	26.92%	34.62%	38.46%
Decreased stock price volatility	26.92%	48.08%	25.00%
Increased market liquidity	34.62%	40.38%	25.00%
Increased number of shareholders	44.23%	34.62%	21.15%
Improved corporate governance rating	25.00%	55.77%	19.23%
Improved access to capital markets	48.08%	32.69%	19.23%
Increased number of analysts following	46.16%	38.46%	15.38%

Approximately 90 percent of the respondents said that they can identify their key investors. Among those IROs, almost 87 percent attempt to determine key investor motivations and information needs, 64 percent attempt to determine key investor trading patterns and 71 percent tailor investor relations messages and communication techniques to fit key investors' preferences.

As the data in Figure 5 indicates, investor relations specialists believe that different constituents — sell-side analysts, buy-side analysts and port-

FIGURE 4: RELATIVE IMPORTANCE OF CONSTITUENTS' INFORMATION NEEDS

	Moderate Importance	Major Importance
Explanation of results	9.62%	80.77%
Explanation of long-term prospects	17.31%	73.08%
Company's long-term strategy (2+ years)	32.69%	59.62%
Company short-term strategy (1-2 years)	36.54%	55.77%
Explanation of lines of business	38.46%	44.23%
Cash flow situation	30.77%	44.23%
Forecast of short-term prospects	30.77%	36.54%
Explanation of accounting policies	40.38%	30.77%
Dividend policy	30.77%	26.92%
Corporate governance issues	23.08%	25.00%
Management pay issues	30.67%	13.46%
Explanation of R&D	42.31%	9.62%
Management succession plans	38.46%	5.77%
Social/environmental issues	9.62%	7.69%

folio managers, financial media and individual investors — rely on different information mechanisms. One-on-one conversations with top management and with the investor relations staff and responses to telephone inquiries rank as the most important means for conveying the investor relations message to buy-side and sell-side analysts. Although the data is not shown, IROs think that company Web sites, analyst society meetings and company fact books are not good mechanisms for communicating with analysts and portfolio managers. News releases, responding to telephone inquiries, and e-mail news releases appear to work best with the financial media, and Web sites rank No. 1 for communicating with individual investors.

Discussions with several investor relations specialists suggest that Internet-based investor relations activities will become an increasingly important mechanism for communicating with all constituents. Of the responding companies, 98 percent use Internet-based investor relations — especially Web sites — but Internet-based investor relations appears to

FIGURE 5: RANK OF MOST IMPORTANT IR COMMUNICATIONS PREFERENCES

Rank	Sell-Side Analysts	Buy-Side Analysts	Individual Investors	Financial Media
1	One-on-one sessions with top management	One-on-one sessions with top management	Company Web site	News releases
2	Respond to telephone inquiry	Respond to telephone inquiry	News releases	Respond to telephone inquiry
3	One-on-one sessions with IR staff	One-on-one sessions with IR staff	Respond to telephone inquiry	E-mail news releases
4	News releases	Road shows	Internet release of information	Internet release of information
5	Company conference	Respond to e-mail inquiry	Respond to e-mail inquiry	Company Web site

[34]

be used more to communicate with individual investors than with other constituents. On average the responding companies receive 324 Web site inquiries each week, have 512 constituent names on their e-mail distribution lists, had held 7.30 investor relations webcasts over the 12-month period before the survey, and attract 238 viewers to each webcast.

An investor relations topic that is drawing increasing discussion is the need for and potential benefits of real-time disclosure of corporate information. Real-time disclosure most likely would be Internet-based and would greatly increase the importance of Internet-based investor relations activities. Even so, for now respondents think that real-time disclosure will have limited effect on the practice of investor relations.

It appears that the responding companies have a significant number of professional constituents who actively participate in company IR events, as shown in Figure 6. And the data in Figure 7 shows that corporations conduct a variety of events and arrange numerous one-on-one sessions to meet the information needs of their constituents. This outcome reinforces data in

FIGURE 6: PROFESSIONAL INVESTORS' PARTICIPATION IN IR EVENTS

	Average Number on Company Invitation List	Average Participants Last 12 Months
Sell-side analysts	32.77	25.33
Buy-side analysts	220.08	109.62
Portfolio managers	226.37	105.00
Financial media	13.60	4.49

Figure 5 that indicate that one-on-one meetings are among the best ways to communicate with professional constituents.

On average, 44 securities analysts follow each responding company. In the 12 months before the survey, the analysts prepared 162 reports on each company. Approximately 96 percent of the respondents thought that securities analysts' reports on their companies were accurate and insightful. Seventy-one percent of the responding companies provided analysts with guidance on annual earnings forecasts, but only 44 percent provided guidance for quarterly earnings forecasts. When guidance was provided, it usually was in the form of a range of estimates and rarely a precise earnings number.

When asked what was likely to happen if companies stopped providing earnings guidance, 63 percent of the respondents said that analysts would not lose interest. However, 75 percent believed that analyst forecasts would become more variable, and 67 percent predicted that forecasts would be more volatile. Thus, the respondents appear to believe that earnings guidance enhances information consistency across the financial marketplace. Approximately 69 percent of the responding companies have formal disclosure policies and almost 85 percent have disclosure committees as defined by the Securities and Exchange Commission.

Few analysts' reports—about eight a year on average—were sent to companies for comment before they were released publicly. When asked for

FIGURE 7: NUMBER OF IR EVENTS

	Average Number During Last 12 Months
General meetings (road shows)	8.31
Analysts society presentations	2.63
One-on-one meetings with IR staff	70.57
One-on-one meetings with top management	43.47
Analyst field trips to company facilities	7.83
Company-sponsored conferences	1.79

comments, most companies limit themselves to correcting factual errors and do not comment on the accuracy of the report’s forecasts. The comments generally are provided by the company’s chief investor relations officer.

As shown in Figure 8, respondents do not feel pressured by analysts. They think that analysts are important in influencing market opinion. They also noted that analysts are too concerned with a company’s short-term prospects. The respondents strongly believe that effective investor relations leads to outcomes that are consistent with the theoretical justifications for investor relations.

CONCLUSION

The results show that the practice and theoretical support for investor relations activities are consistent—providing fair and impartial information across the spectrum of investors so as to help assure a fair market value for a company’s common stock. Companies value the practice of investor relations as an important corporate activity. The fact that all of the responding companies had investor relations departments and that senior corporate managers spend a significant amount of time participating in investor relations activities is evidence that these corporations believe that investor relations activities reap positive benefits.

FIGURE 8: RESPONDENTS' ASSESSMENTS OF IR-RELATED ACTIVITIES

Analysts	Mean Score*
Pressure my company for inside information	2.71
Are too concerned with short-term prospects	4.04
Are important in influencing how the market views the company	4.12
Effective IR	
Helps reduce the cost of capital	4.21
Helps ensure a fair market price	4.27
Helps reduce stock price volatility	4.10
Helps improve liquidity	4.04

*Scale of 1 to 5, with 5 indicating strong agreement and 1 strong disagreement

Because investor relations is a topic that has not been actively considered by researchers, future research can expand in many ways on the results presented in this paper. For example, further study could identify the respondents and analyze whether different investor relations practices are associated with differences in company size, profitability, risk, trading market, liquidity, governance rating or other factors. Also, it may be useful to develop an investor relations quality rating and then study whether companies with high ratings outperform companies whose ratings are low. It would also be useful to discover what investor relations constituents think about corporate investor relations practices.

The field of investor relations has grown substantially in recent years and has found its niche in corporate business practice. As a relatively new field, it has not yet been investigated in depth by researchers. This study provides a basis for beliefs of investor relations officers and opens the door to a variety of potential research inquiries. ■

PERSPECTIVES ON IR

The Ascendancy of Corporate Governance

IR in an Enforcement Environment

INVESTOR RELATIONS OFFICERS' INTERACTION WITH CORPORATE governance has taken on new depth—and new challenges—as the subject has gotten more attention in the wake of corporate scandal, spawned more lawsuits, and pushed regulators and legislators to offer new solutions. In this Perspectives on IR, experts talk about the effects of heightened corporate governance attention on boards and IR practice.

THE LITIGIOUS ENVIRONMENT: HIGH-STAKES LITIGATION RAISES THE ANTE FOR COMMUNICATIONS

BY JANET L. FISHER, J.D.

Partner

CLEARY, GOTTlieb, STEEN & HAMILTON

In arguments that grow more shrill with time, the securities class action has been both hailed as an efficient enforcement tool and decried as a source of abuse. Initiatives to limit class actions are controversial at best

and have not been significant deterrents even when implemented. In an era marked by financial scandal, the vigor of the plaintiff's bar now finds its match in the aggressive enforcement efforts of the Securities and Exchange Commission and the Department of Justice.

Today's enforcement environment and the realities of high-stakes litigation affect the practice of investor relations, compelling executives and IROs to rethink how they approach even fundamental responsibilities like communication with investors.

In a class action a plaintiff brings suit on behalf of an injured class of similarly situated persons. Securities class actions are confined to federal court and subject to strict procedural limitations and sanctions for abusive practices. The class action is itself procedural, with no effect on the elements of a claim or the statute of limitations, which can range up to five years in the case of private actions for securities fraud.

Knowing when to expect a class action is a first step in planning communication strategy, and there are some obvious red flags. They include the need for financial restatement; a significant stock price decline, perhaps over an extended period of time; the failure of a significant business initiative or acquisition, and the dismissal of a senior executive when operations are troubled. Disclosure that a company is under formal or informal SEC investigation or has received a Wells notice signaling imminent SEC action will attract keen interest among the plaintiff's bar.

The Sarbanes-Oxley Act's requirement for management's report on internal control becomes effective this year, and a report by the company or its auditor identifying a material weakness in control could well spark litigation. The same is true of SEC correspondence about a company's filings with the agency, including its annual and quarterly reports, which the SEC recently announced will be published on its Web site.

Once an action is filed, investor inquiries are sure to follow—often in

proportion to media coverage of the situation. Although transparency in disclosure is an important aspiration, companies should be cautious when communicating about litigation. Pitfalls abound when informal remarks stray from carefully considered disclosures in SEC reports.

For U.S. companies, a key concern is Reg FD's prohibition against selective disclosure of material nonpublic information. Although enforceable only by the SEC, this prohibition is being invoked with increasing frequency. And, as the recent action against Siebel Systems demonstrates, the SEC will not hesitate to name an investor relations officer as someone who aids or abets a violation.

[40] The SEC's actions under Reg FD are reminders that its staff pays attention to statements by company personnel in interviews and similar settings. The staff on occasion has issued warnings to companies that in its view have misrepresented the gravity of an asserted violation or the scope of an investigation. For that reason, targets of securities enforcement and criminal actions sometimes find it appropriate to clear press releases with the SEC and the U.S. attorney before dissemination.

Civil—or even criminal—charges can be brought if the commentary involves a knowing or reckless misstatement. Both the SEC and the plaintiff's bar have sued companies and individuals for disclosures that they consider incomplete or misleading. In its indictment against Martha Stewart, for example, the U.S. government even claimed that statements made by or on behalf of the defendant were false and misleading and were intended to manipulate the trading prices for stock of her eponymous company, thus preserving the value of her own holdings. That count ultimately was dismissed, but it remains a powerful caution against undisciplined communications or a strategy of using the press to make the company's case.

Allegations about corporate misdeeds necessarily entail assertions about individuals who may also be named as defendants or be targets of

SEC or criminal investigations or proceedings. Should misconduct be confirmed and personnel dismissed, there is a natural tendency to direct blame toward those persons. This is a risky tactic, however, and can lead to unfortunate results if the company's public association of an individual with wrongdoing leads to a defamation suit.

Settlement of a case brought by the SEC can further restrict what can be said. Increasingly companies enter into settlements without either admitting or denying wrongdoing. The SEC has not delayed in expressing strong criticism when it believes that settling parties are taking advantage of that posture. In at least one case the SEC released its views to the press, bringing a new wave of unwanted public attention to the defendant's alleged misconduct. In the recent action involving Lucent, the SEC went further by asserting that the company's remarks during an interview undermined an agreement in principle for a settlement. The price for this perceived lack of cooperation with the agency was a higher penalty.

With all of these restrictions, how should investor relations officers approach investor inquiries when a class action or similar high-stakes litigation is pending? Public curiosity will be intense. Doubts are often resolved against the company and can depress the stock price. In such an environment, providing easy access to information that the company has chosen to disclose—after an appropriately deliberative process—may at least convey to investors the company's desire to be as transparent as the law and good sense allow. For example, where developments are fast-breaking, the company might create a temporary, dedicated area on its Web site to collect all official statements such as press releases or materials made public in reports on Form 8-K.

Counsel should carefully vet news releases, but investor relations personnel also should be involved to gauge their impact, whether on a specific proceeding, other actions, or the company's operations and prospects. If

the development will attract significant inquiries, investor relations also can play a role in compiling likely questions and answers and an internal script that helps keep company personnel focused on key points and better prepared to avoid common pitfalls. Counsel should review scripts relating to sensitive developments to avoid revealing information that may have the benefit of attorney-client privilege. And keeping track of informal communications through transcripts—always a best practice—takes on added importance given the possibility of challenge by governmental authorities or private plaintiffs.

[42] Communication about a pending action is sometimes required. Periodic reports and prospectuses for securities offerings must be materially accurate and complete and therefore must include updated disclosure. Discovery that a material disclosure was inaccurate when made would generally trigger a duty to correct the misstatement. In some jurisdictions, courts have endorsed a duty to update even if the disclosure was not inaccurate when made.

Companies with securities listed outside the United States similarly may have local law obligations to update disclosure and will wish to make the new information available in the U.S. market if it is material. As with less formal communications, these disclosures should be crafted with care to avoid missteps, and the IRO should participate to the extent called for by the company's disclosure controls and procedures.

Dealing with an avid press and unsettled investors is the special art of investor relations personnel, but the watchword during high-stakes litigation should be prudence. At those times, it may be better to follow the old proverb, "Think much, speak little, write less."

BOARD EDUCATION: THE ACCOLADE OF EXCELLENCE COMES WITH AN OBLIGATION TO KEEP LEARNING

BY MARGARET M. FORAN, PH.D.

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Pfizer’s board of directors has earned a reputation for excellence, in large part due to an emphasis on learning that starts as individuals join the board and continues throughout their tenure—as well as outside the Pfizer environment.

Members of the Pfizer board are engaged, independent-thinking individuals, committed to understanding their governance oversight and fiduciary responsibility to shareholders and stakeholders. The Pfizer board governs with the purpose of building long-term value for shareholders and stakeholders and operates within a tradition of award-winning excellence and a deep-seated practice of setting high standards.

Both new and sitting directors need meaningful and relevant information that helps them make appropriate judgments as directors. The company also provides updates on corporate governance best practices and the legal requirements attached to board service. In organizing continuing education for new and sitting directors we strike an important balance — presenting the necessary facts, information and decision-making tools but also providing underlying reasons for proposals. Knowing rules and regulatory mandates is unquestionably an important facet of director education, but directors also need to be able to make a connection with the board’s culture and values and give voice to their collective wisdom in the boardroom.

Four dynamic quadrants characterize director education pathways at Pfizer, which often overlap and reinforce one another:

1. Orientation for new directors and committee chairs.
2. Director continuing education.
3. Shareholder communications.
4. Feedback and interaction with analysts and institutional investors.

DIRECTOR ORIENTATION AND EDUCATION

[44] Pfizer's new-director orientation program encompasses written materials, oral presentations and site visits. Each new director participates in a detailed orientation process, and all directors participate in periodic continuing education. At minimum the instruction covers organizational, technical, financial, legal and regulatory topics and competitive challenges and opportunities. The orientation and continuing education alike include background materials, meetings with Pfizer senior management and visits to Pfizer facilities.

Beyond structural information, it is essential that new directors understand the culture of the board and the climate of trust and respect that encourage questions and critiques and set genuine expectations for acting according to the highest standards of ethical behavior. More than a decade ago the Pfizer board defined corporate governance principles to guide its oversight responsibilities. The principles are part of the orientation for new directors and are monitored and evaluated at least annually to keep them up to date with board and committee functions.

Directors continue to learn from a variety of sources, including each other. Pfizer staff members and the board's corporate governance committee use results of the annual board evaluation process and individual director comments to help tailor continuing education for board members. The committee's checklist of issues to be addressed over the course of the year provides a built-in mechanism for annual review, including

the skills and disciplines required of board members in the context of the current makeup of the board.

The board makes periodic site visits to Pfizer facilities worldwide, where directors meet and are briefed by managers and frontline employees. These on-site discussions provide directors with opportunities to gain first-hand knowledge of operations, ask questions and share perspectives on their observations with each other.

Pfizer’s continuing education process can quickly integrate external events, as the Sarbanes-Oxley Act and the New York Stock Exchange corporate governance listing standards have illustrated. Pfizer was fortunate in that most of the new rules were already well-established practices, but their implementation gave the board an opportunity to re-examine what constitutes effective service among directors.

PUTTING HIGH VALUE ON COMMUNICATION

Communication to the board from shareholders and stakeholders has always been a high priority at Pfizer. We have a long tradition of answering shareholder letters and inquiries. Last year, even before mandated guidelines on shareholder communication took effect, Pfizer’s board provided an additional e-mail pathway for shareholders to reach committee chairs or nonmanagement directors as a group.

The Pfizer staff distributes communications to the board or individual members as appropriate. Summary reports are made available at least on a quarterly basis. While arming the board with tools and internal information to help fulfill their responsibilities to shareholders, we also try to help them see Pfizer through the eyes of our investors. Thus our fourth educational initiative is to expose the board to external feedback from Wall Street and the global investment community.

One of the key missions for the corporate governance department that Pfizer created in the early 1990s was to develop a more proactive communication process with institutional investors. Opening up a dialogue with the company's owners has provided substantial opportunities for both sides to listen and learn. Changing the dynamics of the relationship to one of respect and dignity made for more productive discussion and debate, and this enlightened dialogue is an integral part of the information that we provide to our directors.

About 30 sell-side analysts follow Pfizer and regularly provide earnings forecasts and recommendations. Their steady stream of reports represents a reliable mirror of external perceptions of past successes, contemporary issues and future challenges.

Therefore an integral component of directors' monthly pre-meeting background package is a representative sample of recent analyst reports, accompanied by our investor relations team's summary of key developments and issues. Augmenting this regular flow of information are periodic presentations, usually by the chief financial officer, on associated topics such as equity market dynamics, competitor results, stock price trends and institutional holdings.

The overall goal: to enrich the board's understanding of developments, opportunities and threats that are germane to the company's performance.

Our experience is that these insights deliver substantial benefits. They help board members develop a shared external view of Pfizer. That view complements their internal perspective of management's goals and performance and helps leverage the individual experiences that each member brings to the table. The net result of these educational initiatives is to enhance board members' ability—both individually and collectively—to identify and address those strategic and operational matters that merit their attention.

The Pfizer board has earned the reputation of being a board of excellence, but it also recognizes that obligations accompany this accolade — including a commitment to lifelong learning both inside and outside the boardroom.

CORPORATE GOVERNANCE: CONSTRUCTIVE DIALOGUE YIELDS MUTUAL BENEFIT

BY JAMES E. HEARD, J.D.

Vice Chairman

INSTITUTIONAL SHAREHOLDER SERVICES

Effective communication enables constructive dialogue. And in this high-stakes market environment, constructive dialogue is the key to aligning board decisions with shareholder priorities.

As corporate governance plays an increasingly important role in investment decision-making and ultimately in the pain or pleasure a company experiences in the capital markets, embracing these emerging themes can help investor relations officers earn a welcome presence at the board table.

Just as the governance landscape has changed profoundly since the darkest days of Enron, Tyco and WorldCom, the language of the IRO has evolved beyond quantitative metrics to qualitative methodologies — from P/E ratios and earnings estimates to shareholder value transfer and separation of roles. Companies increasingly are measured against higher corporate governance standards, and that is having a discernible impact on how investors reach buy and sell decisions. Whether a money manager views poor governance as an unwanted portfolio risk or sees good governance as an opportunity to drive value, it is up to the IRO to understand and communicate to management how corporate governance factors affect that analysis.

The media, which play a substantial role in molding investor perceptions, have proved dogged in their quest to uncover the next Enron and no

doubt will continue aggressively pursuing corporate governance issues. Given the exponential increase in the impact that corporate governance can have on reputation, the mere hint of malfeasance can land a company in media cross hairs.

EMERGING TRENDS

These days it is difficult to watch television without witnessing a makeover—a program in which experts transform a person, house or life in the span of a 60-minute program. Investor relations professionals and their peers in matters of corporate governance are poised to participate in equally compelling transformations—the major makeovers taking place within corporate boardrooms.

In response to ugly corporate fiascos like Enron and WorldCom and subsequent far-reaching legislation, company after company has altered the face of its boardroom. For many it has been a challenging process. But this year's proxy season suggests that discomfort and change are paying off in the form of tangible corporate governance progress.

The 2004 proxy season saw increasing willingness among institutional investors and corporations to discuss issues and develop mutually agreeable solutions. IROs have played a key role in this communication. In a positive trend, confrontation between shareholders and corporations has been replaced by constructive dialogue, and there is evidence to suggest that the outcome has been mutually beneficial to both parties. Examples of this willingness to reach agreement include:

- A 66 percent decrease in proxy fights compared with 2003's battles for the boardroom.
- A 5 percent decline from the number of shareholder proposals that made it to the ballot last year.

- A drop in the number of poison pill proposals to 52 from the year-ago 91.
- Boards moving to implement more than 70 majority votes on previous shareholder resolutions.
- Forty boards taking action on poison pills and 50 adopting annual elections of directors.
- ISS urging clients to withhold voting support for director nominees at 32 percent of companies this year compared with 38 percent last year and 52 percent in 2002.

The decline in ballot challenges indicates that many boards have responded to repeated calls for change. True, 2004 brought a handful of headline-grabbing cases in which stubborn CEOs and directors ignored shareholder concerns. Those highly charged disputes drowned out the quieter and far more important trend of many boards making substantive and positive changes.

Investor advocacy related to executive compensation also has had a positive impact. ISS recommendations to clients to vote against stock option plans dropped to 25 percent this year from 32 percent in 2003 and 40 percent in 2002. That trend is the result of better alignment between executive compensation plans and investor concerns.

Do these positive trends reflect Sarbanes-Oxley? The shadow of ballot access? New exchange listing standards? The increase in active ownership through proxy voting? The unification of large and small investors? No doubt there are multiple influences, but the numbers from this year's proxy season show that constructive dialogue and better understanding between companies and their shareholders are improving enterprise accountability and transforming hundreds of U.S. companies from ugly ducklings to corporate governance swans.

THE IRO AS CHIEF INTELLIGENCE OFFICER

IROs are in the perfect position to be the intelligence officer for their companies and boards. IROs can best assess what is on the minds of investors and enable constructive dialogue and sound leadership. The continuous dialogue between IROs and investors can serve as a critical early warning system. Working with the corporate secretary or other appropriate colleagues involved with governance matters, the IRO can play an important role in aligning a company's governance practices with shareholder priorities.

[50] Connecting with the right people within investor institutions is crucial. Dialogue with corporate governance officers, compliance officers or members of the proxy committee provides an invaluable level of understanding of how governance is playing into decisions to buy or sell the firm's stock. The most recent proxy season demonstrated the importance of effective communication between companies and their shareholders, which can mean the difference between a board making governance improvements that shareholders applaud and companies paying the price for ignoring shareholder concerns.

The world of corporate governance is evolving from confrontation to constructive engagement—to the mutual benefit of corporations and investors alike. The more that IROs have a solid understanding of key corporate governance issues and emerging trends, the better positioned they will be to provide meaningful guidance and enlightened recommendations within the boardroom.

DIRECTOR EVALUATION: WOULD THE BOARD SAY NO TO CEO COMPENSATION?

BY NELL MINOW

Editor

THE CORPORATE LIBRARY

“The responsibility of our board—a responsibility which I expect them to fulfill—is to ensure legal and ethical conduct by the company and by everyone in the company. ... What a CEO really expects from a board is good advice and counsel, both of which will make the company stronger and more successful; support for those investments and decisions that serve the interests of the company and its stakeholders; and warnings in those cases in which investments and decisions are not beneficial to the company and its stakeholders.”

That was how Enron’s then-CEO Kenneth Lay described directors’ responsibility in an April 1999 speech at the Center for Business Ethics at Houston’s University of St. Thomas.

On paper, Enron met most corporate governance best practices. The company’s code of ethics was similarly impressive. But the board of directors waived conflict of interest rules three times in order to set up the special-purpose entities that ultimately led to the company’s downfall.

More important, we now know that the board granted the waivers contingent on Enron’s having specifically approved controls in place and the company’s providing regular updates, none of which ever happened. Had anyone on the board ever asked, “Whatever happened to those controls and updates?” the loss of billions of dollars and thousands of jobs might have been prevented.

“Why have intelligent and decent directors failed so miserably? The answer lies not in inadequate laws—it’s always been clear that directors are obligated to

represent the interests of shareholders—but rather in what I’d call ‘board-room atmosphere.’”

Warren Buffett’s comment in Berkshire Hathaway’s 2002 annual report further demonstrates the disconnect between form and substance in corporate governance, a problem that has grown worse in the compliance-oriented, checklist-based implementation of Sarbanes-Oxley and revised Exchange listing standards.

Post-Enron reforms have put a lot of emphasis on the independence of directors. But in a disclosure-based system, that means too much focus on what I call résumé independence and not enough on independence of mind. In the annual report quoted above, Buffett also said,

“The current cry is for ‘independent’ directors. It is certainly true that it is desirable to have directors who think and speak independently—but they must also be business-savvy, interested and shareholder-oriented.... Over a span of 40 years, I have been on 19 public-company boards (excluding Berkshire’s) and have interacted with perhaps 250 directors. Most of them were ‘independent’ as defined by today’s rules. But the great majority of these directors lacked at least one of the three qualities I value. As a result, their contribution to shareholder well-being was minimal at best and, too often, negative. These people, decent and intelligent though they were, simply did not know enough about business and/or care enough about shareholders to question foolish acquisitions or egregious compensation.”

Buffett acknowledges his own failings as a director, particularly in approving excessive compensation. “Too often, collegiality trumped independence,” he noted.

There is no disclosure requirement that reveals the courage and integrity required for effective oversight by directors. That can come only

from a review of their decisions. Investors increasingly recognize that a governance risk factor can be as significant in investment decision-making as cash flow or the bond rating. According to studies by McKinsey & Co., institutional investors are willing to pay a premium of up to 18 percent for effective corporate governance.

And governance increasingly is recognized in pure market terms as a significant indicator of investment risk. In 2004, for the first time, Moody's downgraded a company's debt rating on the basis of corporate governance concerns so severe that they undermined management's credibility. Governance concerns were a factor in at least four other downgrades. Wall Street analysts now routinely list governance indicators in their assessments of equities.

Increasingly it will be the responsibility of IR professionals to explain to these constituencies how their companies' governance structures provide the necessary checks and balances to minimize risk and maximize return.

In order to evaluate corporate governance, however, it is essential not to let the forest of judgment get lost in the trees of checklists and compliance. Intuitively appealing measures may not be significant in evaluating governance risk or board effectiveness.

More than 2,000 academic studies have failed to show any reliable predictive connection between shareholder value and popular items like independent directors. Director stock ownership does correlate to enhanced performance, but there is a chicken-and-egg problem in determining causation: Do directors provide better oversight when they have more at risk, or do they buy more stock when they believe the company is going to do well? And, of course, stock in highly performing companies is worth more than stock in poorly performing companies.

It is impossible for outsiders to evaluate the effectiveness of the board based on structural indicators or directors' qualifications. As has been

thoroughly reported, the chairman of Enron’s audit committee not only was an accountant but also the dean of the accounting department at Stanford’s business school. As we have seen many times, a company can do very well—for a while at least—with a strong CEO and a weak board.

The best way to understand a company’s governance is to look at how the board handles its toughest decisions, starting with CEO pay. Whether the board tips the balance toward shareholder value says a lot about its ability to say no to the CEO when necessary.

As Buffett says, “The acid test for reform will be CEO compensation. Managers will cheerfully agree to board ‘diversity,’ attest to SEC filings and adopt meaningless proposals relating to process. What many will fight, however, is a hard look at their own pay and perks.”

There is no better indicator of genuine director independence, competence and commitment than the CEO compensation plan. If directors cannot say no to excessive pay, they send the wrong signal not only about the importance of reaching the company’s strategic goals and the creation of long-term shareholder value but also about their role in making sure that the CEO leads the company in that direction.

Other essential indicators include the transparency of financial reports and the clarity and execution of the company’s overall strategy. Other elements like CEO succession planning, director stock ownership and crisis response are indicators of the board’s leadership and ability to add value.

The Corporate Library believes that compensation, accounting and strategy represent the most important tests for directors and therefore provide our most important evidence of board effectiveness. Others share that view, and the challenge for IROs is to make sure that interested audiences get the information that they want and need. ■

CASE STUDY

Squeeze Play

Balancing IR Responsibilities to the Company, Board, Management and Investors

SAILCLOTH & SADDLES' MANAGEMENT TEAM ALREADY WAS accustomed to fielding inquiries from directors before the Sarbanes-Oxley Act and new regulatory policies pushed boards to take a more active role in corporate governance.

As manager of investor relations, Lynn Trendt was making presentations at board meetings several times a year and supplementing them with interim written updates. That communications pattern took shape soon after Sailcloth & Saddles completed its initial public offering five years ago. Seven of its nine board members then were company executives or major financial backers. They were keenly interested in trading volume, stock price and institutional investors' purchases.

Lynn easily slid into responsibility for tracking and packaging financial community information for directors and executives. She had worked at the distributor of leisure equipment for eight years before the IPO took place. Sailcloth & Saddles was her first job after she completed her MBA, and her financial analysis and strategic planning responsibilities expanded as the company grew.

As a respected go-to person for major corporate projects, Lynn had helped organize much of the analysis leading to the IPO, worked with outside counsel to prepare related documents and helped the investment bankers articulate Sailcloth & Saddles' growth strategies. Giving her responsibility for IR was a natural step for the company and her career. And it was just as natural for her to organize training sessions for new board members and respond to directors' requests for additional information. That standing in the company served Lynn well. With encouragement from the CEO and CFO, she turned most of her financial analysis responsibilities over to colleagues and focused her efforts on strategic planning and investor communications.

Sailcloth & Saddles' leadership was committed not only to growth but also to what its CEO described as growing up. In that vein, he actively sought out new directors to replace insiders on the board. Although he kept the management team lean, he clearly defined responsibilities and reassigned duties as jobs expanded along with the company's progress. The high level of interaction between directors and management was omitted from that assessment process. Truth be told, Sailcloth & Saddles saw itself as a model of good board-management relations.

Lynn's workload grew as she carried out her duties as IRO and essentially functioned as staff for the board. Her contact with directors—along with her insight into Sailcloth & Saddles' strategic planning process and her skill at understanding how particular requests often foreshadowed bigger issues—gave her a unique perspective on emerging priorities in board discussions.

Then came an information request that gave Lynn pause. A director was asking for product sales figures, margins, stock performance and changes in institutional ownership during a period that Lynn recognized as coinciding with a senior executive's tenure in his previous position. She

also knew from her strategic planning experience that the line of business that he had headed had tentatively been identified as a candidate for disposition and that management was quietly reducing its resource allocation pending a final decision. She was also aware that the director had opposed the executive's promotion. As Lynn considered how best to address the director's inquiry, her roles seemed to be on a collision course.

Lynn may well have had an early glimpse of a turning point at Sailcloth & Saddles that itself could be affected by how she responds to the director's request. IRQ turned to practitioners and counselors for advice for Lynn as well as a broader perspective on what happens at the intersection of investor relations, growing emphasis on transparency and two-way communication between companies and the investment community, and more active boards without separately funded staff support.

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ABOVE THE FRAY

At a time when IROs are striving to increase their visibility with the board, Lynn Trendt appears to be in an enviable position. She has earned a high degree of credibility with board members. She's their go-to person on matters about Sailcloth & Saddles' performance as well as Street perceptions. Management holds a similar view. One earns this high degree of credibility only by building a reputation for giving straightforward, responsive, non-politicized answers.

The request at issue here—a director gathering performance information for a time that coincides with a particular executive's assignment—most likely is symptomatic of a bit of bad blood between this board member and management. The board was not involved in the management reassessment process, and this board member opposed this particular manager's reassignment. The request for information on sales figures or margin performance during this manager's tenure sounds legitimate enough, although it implies that the executive's performance was

less than stellar and was a sore spot with the board member. But the apparent attempt to correlate this manager's performance while heading a former division to overall company issues like stock price performance or changes in institutional ownership seems a bit of a stretch. This board member is pursuing a political agenda.

Although the situation is personally distasteful, my advice to Lynn is to respond to the board member's request. And unless the board member specifically told Lynn to hold this request in confidence, she should advise the CEO of the request and her response.

However, if the board member asked Lynn to hold the request in confidence or implied that she should do so, she should honor that and not tell the CEO. Violating the board member's confidence will forever damage Lynn's credibility and effectiveness with the board, because sooner or later it will come out that Lynn told the CEO about the query. Moreover, the CEO likely will become extremely emotional when he eventually finds out that Lynn did not give him a heads up. But the emotion of that moment will pass and the incident will serve to reinforce Lynn's integrity, something that has longer-lasting value to both the CEO and the company.

In sum, the advice to Lynn is to perform the role of facilitating the flow of information and stay out of the politics.

Politics are a fact of corporate life. Political gamesmanship used to be limited mostly to inner-management posturing. But with boards more and more turning to investor relations officers for information, there is increasing probability that IROs will get caught in the same kind of board vs. management velvet vice that squeezed Lynn. How do you keep from getting caught in a political squeeze play? How do you survive one? Plan for it. How much easier it would have been for Lynn had she earlier established ground rules for her role and made them known both to the board and the CEO. Her ground rules would have conveyed that the only way

she could best serve both the board and the company was to be an independent counselor and keep confidential information to herself.

Being an IRO is more a calling than a job. A job says you work for one constituency—management. A calling says you work with equal integrity for all stakeholders—board members, management and investors. It demands courage to stay above the fray. I urge Lynn to stand firm, maintain her independence and ensure her credibility. By doing so, she will earn the respect of all of Sailcloth & Saddles' stakeholders and fulfill her role as their counselor, confidant and credible representative.

Jay S. Gould is senior vice president and director of investor relations at Huntington Bancshares, Inc.

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USE THE PROPER CHANNELS

As the manager of IR, Lynn's financial analysis and strategic planning responsibilities caught the eye of those in power. It appears as if this particular director is taking advantage of Lynn's role in the company. With Sailcloth & Saddles portrayed as a model of good board-management relations, politics and bureaucracy should not play a part.

Lynn now faces an ethical dilemma, but the company also must decide how much power and control board members have over personnel decisions. The board has a duty to protect the company's stockholders, but does it have the right to handpick members of management? Is this what Congress and the SEC intended?

With ethical decisions—business or personal—the golden rule has always been the vanguard. If Lynn was not asked to keep the information request confidential, she should share the request with her direct supervisor, even if the information can be used to thwart the lines of communication between the board and management. It is not her duty to respond in a stealthy fashion, without asking questions.

Given that the board does not have support staff, it should be the duty of the corporate secretary to act as the liaison between management and directors. In fact, the director would have been better served to request the necessary information directly through the company's legal counsel, which would have provided the additional protection of attorney-client communications should the matter reach litigation.

Transparency is certainly a key to being a respected public company. Most boards have taken this to heart by becoming more involved in day-to-day business and compliance activities in order to offer insight and suggestions where possible. Still, the roles are clear: Boards have a duty to stockholders to ensure that management is running the company properly, and it is management's responsibility to focus on improving operations and planning for the future.

Natalie S. Hairston is investor relations officer and chief governance officer at ENGlobal Corporation. ■

Technology and IR

CLICK ON CORPORATE GOVERNANCE

MICHAEL J. REILLY

The first round of Internet-centered adherence to new corporate governance norms is drawing to a close roughly five years after vendors started rolling out modular solutions for companies feeling the heat of changing investor attitudes.

Corporate scandals, increased vigilance following the dot-com breakdown and shareholder unease with corporate stories that didn't pan out encouraged investor demands, which ultimately found enforcement in Reg FD and the Sarbanes-Oxley Act. Ratings groups arrived on the scene, pushing the bar higher by categorizing many aspects of governance and measuring performance against their scales, effectively setting up horse races among companies wishing to garner institutional and regulatory favor.

As might be expected, those trends fashioned a new paradigm for Internet best practices regarding corporate governance, which in turn has fostered annual ranking exercises. General Electric won the large-cap corporate governance award in *IR Magazine's* 2004 competition, marginally beating the honorable mentions

given to Pfizer and Cisco.

On the GE Web site the corporate governance discussion can be found in "Our Commitment," a major section highlighted on the home page. This titling is instructive in analyzing how GE achieved the top corporate governance rating in the prestigious industry competition.

Investors at the main investor relations page can also find the governance discussion path, a great example of cross connections on a user-friendly Web site. There are many in the information matrix that comprises GE's Web presence.

Examples from GE and other companies that *IR Magazine* cited for leadership in corporate governance put to shame the approach to governance that prevails elsewhere on the Internet, where the operative measure seems to be checking the boxes and complying with a minimal prescription.

As influential investment community members increasingly scrutinize corporate Web sites, standing out from the pack takes more than just ensuring that the *i's* are dotted and *t's* are crossed. Posting an excellent Web site requires

wholesale dedication to as much transparency as business prudence allows. Commendable practices on the Web site connect with the real backbone of governance—commitment, the same word generally cited as forming the highest-level umbrella for all things related to governance.

GE's investor site reflects the company's character. Not long after the World Wide Web began to make business inroads GE recognized that it would have to master this medium. And it did. The company began by teaching its managers about using the Internet. Employees at all levels were encouraged to get to know the new medium by creating their own Web sites. Within 18 months all across GE the World Wide Web came to be perceived as a normal means of business communication. Subsequently the company has repeatedly redesigned, adjusted and tested its Internet presence as it constantly seeks improvement.

Similarly, as the focus on corporate governance unfolded, the company's natural response was to get it right in every way. Use of the Internet was simply a given. With that approach, it is no surprise that GE has achieved an award-

winning corporate governance site, which you can access at www.ge.com/en/commitment/.

Across its site GE uses open communication based on what a customer might seek, properly structured but not overdone linkages, cross-references, interaction and mapping. Those techniques come together to build large and realistic responses to constituent needs. Information is straightforward, uncluttered by needless images and unnecessary bells and whistles.

In effect, GE transferred to investors the kind of best response it would give to its most valued customer. It is a pattern worth mimicking. ■

WHAT DIRECTORS NEED TO KNOW ABOUT IR

BESS GALLANIS

Building Value Through Investor Relations is the first in the “Board Perspectives” series created by investor relations consultant Michael Rosenbaum to educate corporate directors in this new age of corporate governance and increased accountability to shareholders.

Building Value is an investor relations primer on Wall Street’s valuation creation process and the board’s role in IR. It is also useful for new IR practitioners, especially those who come to the role from finance and have limited background in the principles of market research, investor targeting, marketing and communication that shape an effective IR program. The series will focus on the intersection where the boards of directors, corporate management and outside investors meet.

“For better or worse,” Rosenbaum observes in his introduction, “the board’s job is to protect and grow the shareholders’ investment. ... Up until now, directors played a small role in that process, viewing it from 30,000 feet. Today, that perspective is too distant.”

Making his case, Rosenbaum points out that the additional oversight and



Board Perspectives: Building Value Through Investor Relations

MICHAEL ROSENBAUM

CCH, Inc.
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compliance responsibility that Sarbanes-Oxley requires of corporate directors has given them a more direct role in building investor support and valuation. Until now, board communication to investors has been indirect, generally taking the form of committee statements published in the proxy. The author argues that directors’ expanded role will include direct contact with investors to generate further shareholder support and enhance overall corporate credibility.

The book is an excellent and up-to-date view of IR practices, useful to

directors and practitioners alike. It helps readers understand how Wall Street makes investment decisions, analyzes companies' current and future values based on tangible and intangible factors, and discusses how investors commonly react to board decisions like dividend increases, stock splits and share buybacks.

The book is well-organized and its contents easily accessible. Each chapter begins with a strategic "View From 30,000 Feet," then addresses tactics from "In the Trenches." Valuable sidebars develop specific concepts or case studies.

From a tactical perspective, *Building Value Through Investor Relations* lays out the mechanics of building and executing an effective program. The chapter with guidance about how to budget and implement an investor relations program is particularly useful. As an adviser, Rosenbaum has a keen sense of the need to set goals, benchmark results and understand the return on the IR investment.

Building Value Through Investor Relations is a thorough and thoughtful insight into a valuable corporate function. It is a must-read for corporate directors and should be on every IRO's bookshelf. 

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