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IR update

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Successful Practices!

Sitting Around the IR Campfire

By Carol Metzker

Since time immemorial, humans have sat around the campfire swapping stories about the day's hunt, trading pictures and sequences of the day with all who would listen. The narratives share more than the context and details of the day — what action happened and the outcome or direct lessons from the story. They share judgments, beliefs and values. Sometimes told once and sometimes repeated to the point of legend, stories teach us, change us, entertain us and move us to action.

To kick off June — the start of campfire season and NIRI's annual conference — and to kindle the sharing of tales, several IROs have recounted their experiences and success stories with *IR Update*. As we gather for the annual conference, the largest meeting of IRO professionals in the world, let these stories inspire you or help solve similar challenges; adapt them to fit your situation and build on their successes. Welcome to the IR campfire!

Case Study: Rebuilding Credibility Step by Step

Plug Power, Inc., had its work cut out. Only months after its October 1999 IPO, the company violated agreements with GE, the marketer of its alternative energy systems, when its technology development took longer than expected. The market lost confidence in the company, and its stock price plunged from triple-digit post-IPO prices to

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Trust but Verify

By Eugene Donati

"Trust but verify." With that aphorism they made famous, Ronald Reagan and Soviet leader Mikhail Gorbachev worked to end the Cold War. Trust was central to Reagan and Gorbachev; verification was the necessary support to ensure that trust was always well-placed.

"Trust but verify" seems to be the same magic formula we are using in investor communication today, to restore investors' faith in corporate data, in our profession and in the investment process. It is not a pretty scenario we are trying to reverse: alleged selective disclosure, earnings engineering, creative accounting, outright corporate frauds, auditing debacles, analysts' duplicity and investment banking hypocrisy.

The only problem with our "trust but verify" solution is that we have been working almost exclusively on the verify side of the equation. The push for greater transparency, more nonfinancial reporting, the adoption of

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Trust but Verify

Reg FD, increased SEC oversight for auditors and analysts, and other steps taken recently by government, the exchanges and corporations themselves have one goal: to facilitate the verification of corporate data.

But what about trust? Have we forgotten it? Can we really expect to restore investor confidence without restoring a basic foundation of trust?

No amount of disclosure will be sufficient until investors again trust those doing the disclosing. It's not a given that trust will grow automatically in an atmosphere laden with verification. In his book *Trust: The Social Virtues and the Creation of Prosperity* (Free Press Paperbacks, 1996), Francis Fukuyama points out that trust and verify are the opposite ends of the same continuum. "The more people depend on rules to regulate their interactions, the less trust they have in each other," Fukuyama suggests. So in an odd way, Reg FD, etc., could destroy trust even further, or at least provide no ground for it to grow, if Fukuyama is right.

One reason we may have become so heavily dependent on verification is that trust is very awkward to define. Ask yourself, how do *you* define trust? Chances are good that your answer boils down only to a feeling — to the idea that trust exists when somebody trusts you, which of course is not much of a definition.

Trust is often more easily defined by describing what it isn't.

For instance, trust is not the same as credibility. Anthropologist Mary Douglas writes that credibility grows from two roots: structure and usage. Disclosing corporate data on a regular schedule to an established audience meets Douglas' definition; it also makes your IR program credible. But if trust was nothing more than credible data projection, IR could be handled solely over the Internet without the mediation of an IRO — or a CEO, for that matter! There obviously is something more to trust, and it involves the human presence in the communication process.

Trust is also not the same as confidence. Robert Bruce Shaw, a management consultant who specializes in organization and leadership, points out that confidence arises from specific knowledge of a circumstance and is built on reason. But trust goes one further, he says, and contains a robust element of faith. Applying this to IR, not every potential investor can have complete, specific, prior knowledge of your company before investing. So in restoring investor confidence, just enhancing investors' specific knowledge of your company is often not enough. Faith that your representations meet an investor's informational needs has to enter the picture. And typically, if Shaw's thesis is to be followed, when a degree of faith enters in any investment decision — as it must — so, then, does trust.

Eugene Donati, *Clark & Weinstock*

Disclosure and trust are clearly different; the word "disclosure" signifies a distinct lack of trust. "Disclosure" has built into it a sense of involuntary or undesired disgorgement of information. Disclosure, in the world of IR, also signals the necessity for a legal framework to enforce it. While legal structures can allow strangers to work together in the absence of trust, these structures increase transaction costs substantially, Fukayama has shown in his research. So an investment process geared more toward disclosure is more inefficient and costly, a problem that a dose of trust could lessen.

Trust is not the same as reliability, and trust is also not the absence of distrust. Reliability is a function of timeliness, but just because a quarterly report comes out on time doesn't mean investors can trust it. Shaw points out that trust and distrust are not an either-or, static decision between two parties but vary by circumstance and consequence. The threshold between trust and distrust moves according to the degree of vulnerability one is willing to take on. Trust always involves some amount of vulnerability that trust could be misplaced.

Trust becomes necessary because of complexity, German sociologist Niklas Luhmann believes. In the complex circumstances of modern organizations (including corporations), no one person could comprehend or verify all necessary data but must trust others' representations and interpretations, Luhmann wrote in his book *Trust and Power*. Applying Luhmann to our purposes, an IRO must trust upper management to impart honest and materially complete information; in turn, investors must rely on the IRO. Otherwise, informed investing would become impossible, given the complexity of modern corporations. Sooner or later, an investor must trust a company's representations and representatives, since a single investor could never know enough on his or her own.

For all that trust is necessary in building relationships among investors, trust is not always a good thing. The con man, after all, depends on trust to bilk his unsuspecting victims. Trust taken for granted can be "foolish, naive, gullible and blind," as Robert Solomon and Fernando Flores point out in their book, *Building Trust in Business, Politics, Relationships and Life*. That is why, they contend, choosing trust involves skill and commitment.

Solomon and Flores remind us that the key question about trust is not simply asserting its importance but rather how we can build it. Becoming trustworthy, they contend, begins with an honest understanding of trust but also encompasses everyday routine and practices.

Trust does not and will not come from ever-greater levels of detailed data or disclosure. Trust must be a conscientious choice on the part of both the IRO and investor that signifies a willingness and commitment to be vulnerable. In the case of an IRO, vulnerability signifies a willing openness of information and a complete and easy availability to all investors, beyond what may feel prudent or comfortable. On the part of the investor, vulnerability is resurrecting faith that a company's reporting systems, operations and other practices are designed and function with the investor's best interest in mind.

In all these contrasts and considerations, one element about trust becomes absolutely clear: It is a human-mediated process. Trust thus becomes the one element of an investor relations program that cannot be established in the absence of the IRO. Thanks to technology, credible reporting, full and fair disclosure and confident dissemination of corporate information theoretically could occur without the intervention of an IRO. But trust cannot. Building and maintaining authentic trust in an era of distrust has become the chief task of investor relations officers today. Technology and regulation have shored up the verify side of IR. In fact, our almost exclusive emphasis on verify simply has brought everyone to an informational parity, which in itself is a good thing, but leaves an IRO little way to differentiate her or his IR program. If you want to differentiate your IR program, now is the time to turn to trust, which is the infinitely harder task. IR

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RESOURCES

Trust in the Balance: Building Successful Organizations on Results, Integrity and Concern by Robert Bruce Shaw (Jossey-Bass Publishers, 1997)

How Institutions Think by Mary Douglas (University Press, 1986)