

CHAPTER ON PERCEPTION WORK FROM:

CRISIS OF CHARACTER – Building Corporate Reputation in the Age of Skepticism.

by

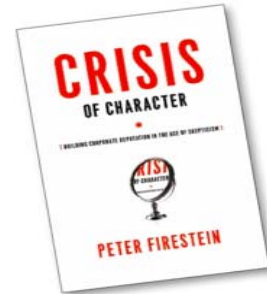
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Chapter 7

Strategy 2: See Yourself through Stakeholders' Eyes

Market Intelligence and the Art of the Perception Study

We live in a world of wildly diverse stakeholder interests. Any company lacking a thorough understanding of its various audiences—their prejudices, perceptions, and attitudes—navigates in darkness. Before you can hope to convince the world of your merit, and investors of your value, you must first know how they think. Without such market intelligence, all communications are guesswork.

A strong reputation among investors and analysts requires systematic listening that allows managers to become personally sensitized to their thinking. Such listening offers management a potent influence over the investment conversation about the company. It helps protect the company from its own excessive tendencies by maintaining a continuous outside reference by which management can judge its

actions. It helps the company identify those actions that will make friends of enemies and buy critical time and support when future crises occur.

The Value Paradox

A company's most important external constituency is its investors. The gulf that lies between many companies and their investors can be summed up in what I call the value paradox. This term describes the dynamic by which management builds its company according to specific ideas of value that relate to production, innovation, operations, logistics, and so on. Yet its ultimate goal is to create share value, which is assigned by the market according to models that may bear little resemblance to management's own idea of value creation. So, although a corporate leader works every day to build a more valuable company, the company's market value is determined largely by outsiders operating according to their own independent principles. Management's failure to reconcile the two means that much of the value the company has built goes unrecognized and unrewarded.

The company's ability to encompass both its own internal theory of value and the market's is essential to achievement of a higher share price. Much of this effort boils down to investor communications. Is the company disclosing the information investors need in order to value its shares? Is management accessible and responsive? The company must learn to communicate on the basis of what the market wants to know rather than the internal story with which management may have fallen in love.

So before you communicate, you must know your investors' valuation methodologies as well as their opinions of management, its strategy, its competence to execute that strategy, its level of transparency, and how it compares to the competition. The good news is that all of these things are knowable. And the mechanism by which they can become known is the perception study.

The Perception Study and Its Variations

The perception study involves a consultant who, on behalf of the company, interviews influential investors and other stakeholders, then reports their opinions back to management. A trusted third-party interviewer can guarantee anonymity to respondents and therefore enhance the candor of their commentary.

While heavily used in investor relations, the perception study is adaptable to a company's entire range of stakeholders. When applied to the non-financial arena, it can uncover opinions of the company's standing in civil society—an asset of growing importance in the age of the Internet and universal scrutiny. The expansion of perception work into the social arena creates an opportunity for corporate leaders to engage NGOs that are focused on environmental and labor issues, for example, well in advance of the emergence of any public opposition to the company. Such engagement develops information and identifies the external conversations that, if pursued, will promote the smooth running of the company in its social environment.

Perception study methodologies fall into two categories: quantitative and qualitative.

Quantitative Perception Studies

With the increasing attention paid to issues of corporate reputation, new approaches have been developed to help companies understand how to improve their images. These methodologies leverage technology to analyze the beliefs consumers and other stakeholders harbor about a company in dozens of different dimensions. They measure customer opinion of brands and levels of worker satisfaction. They dissect newspaper and magazine articles by the thousands. Determining numerical values in each of these areas should enable a company to identify many of its objective deficits. If you get a low score on employee satisfaction, for example, you know to invest there.

Quantitative studies have their roots in consumer research. Dozens of respondents are asked narrowly focused questions to which they can give yes or no answers, or answers that reflect the respondent's relative judgment in values typically ranging from 1 to 5. Data gathered by aggregating large numbers of quantitative interviews lends itself easily to charts and graphs and plays well to a PowerPoint culture. Management may learn, for example, the relative percentages of investors who do and do not think its financial disclosure is adequate. It may find out that performance of the investor relations director has gone from a 3 last year to a 4 this year. Like virtually all information, this is useful. But it can hardly deliver the nuance to tell management how investors value its shares.

Qualitative Perception Studies

Qualitative studies also involve an interviewer who asks questions, but the answers are recorded in the form of commentary. These results are more textured and have the advantage of communicating nuance. Qualitative responses can be idiosyncratic, subjective, and highly opinionated. In other words, they have the possibility of rendering a rounded and comprehensive picture of investors' views about the company.

The qualitative perception study is limited only by the finite nature of the questionnaire. This is no minor limitation, however, because the value of the result derives directly from the questions asked. So the source of the questions is a determining factor in the quality of the intelligence the study ultimately delivers. If your questions are prompted by your prior conversations with the market—the last conference call or road show, for example—you'll find that the answers to those questions are predictable. Often companies believe their ability to predict the answers they get from a perception study proves they have a sound grasp of the market's thinking. "We got confirmation of what we already knew," they often say. Delusional may be too strong a word, but such an interpretation often represents a false sense of security. This illusion of predictability arises not from a sound grasp of investor sentiment, but from the fact that answers they get to specific questions match the prior conversations that put the question on their agenda in the first place. The results of the perception study, in other words, are limited by the questions the company knows to ask.

The Open Perception Study™

The critical insight needed to generate the most valuable results from any perception study is that those results are limited by the questions the company and the consultant know to ask. A study restricted by a set of questions—*any* set of questions—therefore fails to do justice to the depth, variety, and intelligence of institutional opinion on any significant company. The challenge is to break the self-reinforcing cycle and find out what investors are thinking regardless of the questions the company has thought to ask them. Management can access this depth of intelligence through open-ended, curious discussions with investors conducted by a qualified third party. Such conversations, carried out through a methodology I've developed and named the Open Perception Study™, reveal not only what investors think, but why they think it. While a questionnaire can be useful in launching such a conversation, only intelligence derived from discussions that go beyond the questionnaire gives management access to investor sentiment that is free of its own prejudgments. Such an open-ended conversation delivers the most valuable kind of intelligence there is—answers to questions the company didn't know to ask. Such intelligence is predictive and provides a valuable indicator of the issues that will arise among investors in the future.

Narrative-based Research

The effectiveness of the Open Perception Study derives from a methodology called narrative-based research. Unlike a quantitative perception study, little if any of the open-form commentary can be represented in a bar chart. An Open Perception

Study will never tell management, for example, that 43 percent of the company's growth-oriented investors think it should divest a certain division. What it *may* tell management, however, is what investors think of that division, how it fits (or doesn't fit) the overall business, and whether it supports the company's greatest business potential. Moreover, the company will receive a wealth of varying ideas on this division rather than a reduction of all responses to a single point. Such market intelligence generally makes life more complex for management, not simpler, but complexity is the commodity you buy when you decide to run a large business. The benefit you receive from narrative-based research is simply the best ideas that those who are committed to the company, and who understand it, are thinking at a given time. Those are precisely the people who decide the value of the company through their decisions to buy and sell its shares.

Such open narrative with investors offers an extra bonus: emotion. Neither the company nor the perception study practitioner should ever forget that investors consider themselves dependent on the credibility of the company for their livelihoods. Every portfolio manager has his own management and his own investors looking over his shoulder. He knows that at some point they'll require him to justify his investment decisions. So it's hardly an infrequent occurrence in the practice of the perception study to hear comments made with emphasis and, certainly at times, with emotion. In referring to one of my clients, whom many considered to be on a profligate acquisition binge, a portfolio manager once told me: "I'm no longer going to support his Napoleonic complex." Combined with other comments that arose during the same inquiry, this gave me the conviction to advise

the client unequivocally that his explanation of the economic benefits of acquisitions had to become much clearer and more complete. The company's presentations to investors underwent something of a transformation after that, and life with its investors eventually sailed into calmer waters.

Demand-driven Communications

In discussing the value paradox above, I described the chasm between ideas of value creation held by management and those held by investors. A parallel distinction can be made with regard to the company's market communications. Does management frame its conversation with the market in terms that interest investors? Or has it fallen into the habit of delivering its story the way its executives have grown accustomed to telling it to each other? Positive change in investor attitudes, and therefore in share price, can best be achieved when management speaks its investors' language. That becomes demand-driven communications, and it's very different from the all-too-customary communications model in which management attempts to mold market opinion by spoon-feeding it information.

Intelligence developed through an open methodology enables a company to practice demand-driven communications. The following examples suggest some types of themes on which such a company can address the market:

- Do investors believe we've done what we said we would do? Any discrepancy here presents a credibility problem. What gaps do we have to close?
- Do we and our investors interpret our results the same way? If we're succeeding in increasing margins, for example, do they see it the way we do—as proof of improving performance—or as underinvestment in the business that will come back to haunt us?

- Do they think we're disclosing all we should? Or do they think we're withholding as much as we can get away with, perhaps while claiming to be protecting competitive intelligence?
- Are we meeting competitors' technology challenges better than investors think we are? Would adding clarity on this point strengthen the argument for buying our shares?
- Have we proven the investment case for the acquisitions we've made? If not, what backing and filling must we do to remove investors' possible doubts about our discipline and strategy?
- Have we taken full advantage of our credibility with investors? If our perspective on our market will enable them to make better decisions, should we not let them benefit from our close-up view?

Educating Management Instincts

The kind of intelligence management derives from answers to the above questions delivers more than information. The nuanced commentary it carries can play a fundamental role in developing management's sensitivity to the subtleties of market thinking about the company. This "education of management instinct" goes far beyond the necessities of communication. It helps corporate leadership make informed judgments and anticipate critical issues. If building shareholder value constitutes the company's primary operating principle, and if value depends on market perceptions, then intelligence about those perceptions is central to enabling management to design strategies for desired outcomes.

M&A: How to Get the Answer Without Asking the Question

Management instinct, informed by the predictive value of an Open Perception Study, places the company in position to forecast how the market will react to future events it hasn't even announced yet. By indicating the market's probable response, such intelligence can inform management's thinking about many kinds of strategy.

One area where management instinct can make or break a company lies in decisions regarding mergers and acquisitions. In a world where companies are often rewarded only for growth, buying it in the form of an established enterprise may seem the quickest and easiest way to please investors. Acquisitions, however, are generally so hard to price, so difficult to integrate into the existing company, and so generally unpredictable that investors' response to them is often to sell the stock while they wait to see what happens.

There's a great deal on the line when a company is considering an acquisition, but the last thing in the world management can do is ask investors what they think about it. Competitors would be all over the target company, its price would rise, and the acquiring company's own investors would kill the deal by talking it to death.

There are two different approaches to resolving this challenge, and they can be used in tandem. Both leverage the open methodology's capacity to get answers to questions without ever asking them.

First, a company—with the help of a sophisticated market intelligence practitioner—can structure a conversation with investors that identifies their attitudes toward the attributes of a transaction without ever mentioning the deal itself. Let's say the contemplated acquisition would add assets along a certain product line. General questions about that part of the business would reveal investors' opinions about strengths, weaknesses, and possible market opportunities. If the interviewer were to pursue the subject by asking how the investor thinks management should address its challenges in this area (as he would have done for other parts of the business, as well), the answer might involve developing strength

in certain markets and reducing commitment to others. This might well indicate how the investor would view the acquisition under consideration. There's also more than a small chance the investor will suggest an acquisition strategy outright, perhaps even mentioning a target. The interviewer would then capture this intelligence without ever having raised the subject.

A second line of questioning that's particularly fruitful in uncovering investor attitudes toward specific potential acquisitions involves probing the subject of cash allocation. If you ask a series of investors an open-ended question about what they think of a company's cash allocation strategy, you're bound to receive a rich spectrum of answers. Respondents will suggest that the company buy back its stock, or raise the dividend, or issue a special dividend. They may say the company should invest in organic growth, targeting specific business lines. Or they may raise the issue of acquisitions. Because the subject of acquisitions is introduced by the respondent, it opens the door for a line of questioning by the interviewer that is potentially revealing of attitudes toward acquisitions without giving anything away. In fact, the interviewer need not know anything about acquisition options the company may be considering in order to deliver valuable intelligence on investor attitudes on the subject.

The Perception Study in Real Life

Every substantial publicly traded company is the focus of concentrated investor analysis and judgment. The investment community is populated by some of the world's more intelligent people, and each of them is paid to be sharper and more

observant than the others. Capital flows into and out of stocks are swift and massive, which, for corporations, means their fundamental value can vary dramatically with investors' perceptions of their results and the contours of their businesses.

Every company is unique, and perception studies, even when conducted for the same company a year apart, present distinctive, compelling stories. The following brief sketches of a few studies indicate the variety, and perhaps a bit of the drama, involved in managements' efforts to run their companies and tell their stories in a landscape that never stops changing:

- A company with a world-famous brand feels imprisoned because its customers—and therefore its investors—hold such loyalty for the brand that the company can't diversify for growth without alienating its base. Conducting a perception study identifies the flexibility that exists within the brand, indicating the areas where diversification may be accepted, and where it won't.
- An industrial company is the undisputed technology leader among its peers. It's known for hiring the best and the brightest engineers, and its shares trade at a significant premium to its competitors. It faces the challenge of inducing investors to continue to pay the premium, or to increase it, at a time when its technology is reaching a degree of complexity that few financial players can assess. A perception study tells this company that flaunting the sophistication of its technology will do little to increase its share price unless it shows investors the added value each major piece of that technology brings to its customers and how it compares to competitors who are working feverishly to close the gap.
- A highly esteemed investment bank encounters pressure on its market share because competitors are growing through acquisitions. Its own acquisition record isn't good, and management is searching for a strategic way forward. A perception study tells this bank that investors value it for its wealth management and fixed-income origination businesses, and more than a few will sell its shares if it starts buying other banks. They don't believe it has the expertise to acquire or price well. And they don't think it has the ability to integrate operations. They believe in its ability to grow its businesses organically, and they value it because it's been—so far—mistake free.

- A spectacularly successful global conglomerate that has grown through what appears to be an indiscriminate buying spree has alienated its investors by failing to stick to an announced discipline of adding assets only in under-represented geographies and disciplines. A perception study shows that investors still see its CEO as buying everything that comes up for sale, and they're starting to rebel. In response, the company remakes its disclosure strategy and begins to offer significantly greater detail on the economic underpinnings of each acquisition it makes.

The Perception Study as Communication

Companies often find that the act of conducting a perception study creates, in itself, a new kind of engagement with investors and other influencers. Through hundreds of perception-study interviews conducted for corporate clients, I've often received such comments about the company as, "I've been waiting for them to make this call for five years." In addition to the market intelligence a perception study offers, the company's simple demonstration of interest in investors' opinions can change attitudes toward its transparency and its capacity to adapt.

The overriding message that perception studies deliver to company managements is that the elements of investor psychology are knowable. The dissonance that managements experience in their relationships with investors is generally rooted in investor mistrust of management intentions. Yet investors are always looking for reasons to buy, and a robust perception study is likely to show management the specific path to building trust—in terms both of communication and operation of the business.

One would assume, then, that there's strong interest in market intelligence among companies that are undervalued and trailing in their industries. But as a

consultant working in this field over many years, I've found that those companies are generally not the ones who are curious about what their investors think. Companies that mandate in-depth perception work generally turn out to be industry leaders. Getting in-depth market intelligence is just one of the hundreds of things they naturally do to stay on top. They seem to understand intuitively that if you want to know what the market thinks, you have to ask.

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