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# Financial marketing in the new Millennium

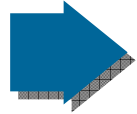
## FuturAct December 15th, 1999

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# Agenda



- Financial market' s realities need to be understood
  - Investors are forward looking
  - Measures that really matter are strategic
- As for any other markets, companies have to build a brand to thrive on the financial market
  - Financial branding is a critical, but difficult process
  - Financial marketing is a new skill to be developed inside executive suites
- Conclusion / Questions

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## Contrary to conventional wisdom, the market's perspective is long term focused

- Conventional wisdom suggests that :
  - Financial market (“Wall Street”) is short term focused, accounting based, irrational, and led by minority shareholders
  - Real market (“Main Street”) is long term oriented, economical, rational, and needs a balance among stakeholders
  - Shareholder value focus could jeopardize the future strategic position of a company and it is opposed to the interest of employees
  - In reality, **the market is forward-looking**
  - Shareholders focus on non financial issues of the company instead of return on equity
  - Shareholders are not requesting 15% ROE
  - The stock prices do not rise with lay-off announcements

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# Investors are extensively using non-financial measures to make decisions

- **In 1997, Merrill Lynch conducted an extensive study on investment decision criteria used by international pension funds**
  - 60 international pension funds, managing 800 billions euros (85% in equity)
  - Classical financial measures (ROE, EPS, ...) are considered the least interesting in an investment decision
  - Pension funds are more interested in the company strategy, and in any information that provides insight into its long term prospects
- **Ernst & Young draws similar conclusions in its «Measures that Matter™» study**
  - 35% of investment decisions are based on non-financial data
  - Analysts' forecasts are improved when they use non-financial data
  - Nature and ranking of these indicators are different for each industry and company
  - Among the Top Ten : strategy execution, management credibility, quality of strategy, innovativeness, ability to attract talented resources, market share ...
- Warren Buffet (sept.99) : “The key to investing is not assessing how much an industry is going to affect society, or how much it will grow, but rather **determining the competitive advantage of any given company and, above all, the durability of that advantage**”.

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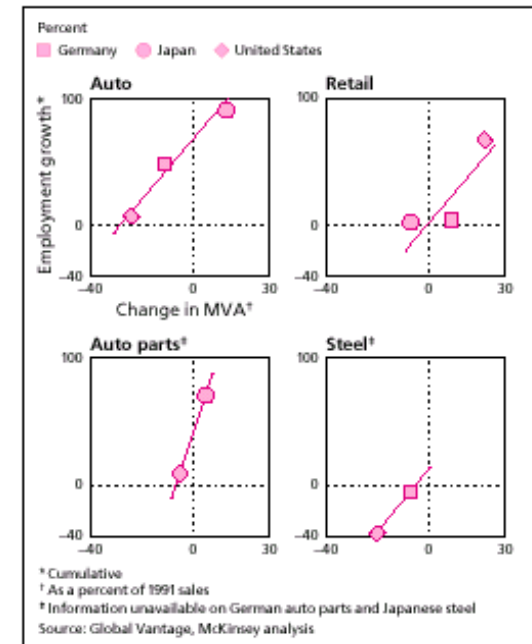
## ...and professional investors are probably more long-term focused than individual shareholders

- Professional investors' requirements are reasonable:
  - Merrill Lynch's study (July 1999) on expectations of 66 European fund managers representing 1735 milliards d'Euros
    - Their annual return forecast for the next 3 years is only 7.5%
    - Market risk premium averages 3.8%
- Warren Buffet : **"If I had to pick the most probable return**, from appreciation and dividends combined, that investors in aggregate--repeat, aggregate--would earn in a world of constant interest rates, 2% inflation, and those ever hurtful frictional costs, it would be 6%. If you strip out the inflation component from this nominal return, **that's 4% in real terms.**

# The financial market contributes to the prosperity of our nations

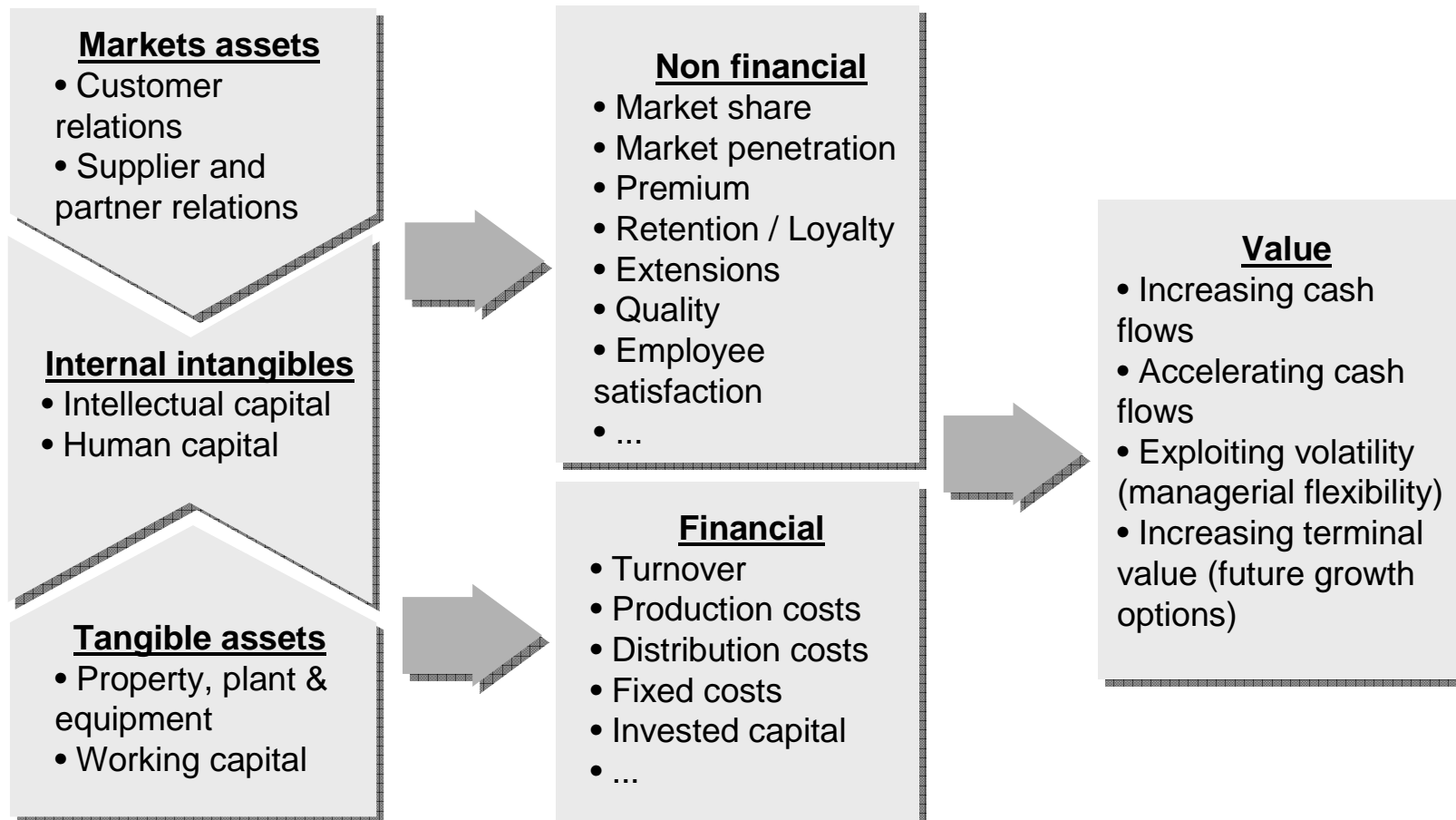
- As demonstrated in several studies, there is no evidence that employment suffers from shareholder value management (see McKinsey's opposite graph)
- In August 1999, the National Bureau of Economic Research performed a study of stock prices reactions to announcements of reductions in force. These 3878 announcements in 1176 large firms during the 1970-97 period collected from the *Wall Street Journal* Index confirmed that, on average the stock market reactions are negative.

Employment growth versus the change in MVA, 1983-91



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# Value mechanisms have not changed, but the focus now is on intangible assets



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# Given this market interaction, a company faces three key challenges in delivering shareholder value

## Understand investors expectations and measures that matter

- What are the financial expectations of the market?
- What measures matter most?
- How do investors assess growth?
- What factors are influencing investors' perceptions of risk?

## Deliver strategies and growth opportunities promised to the market

- What are the key drivers of value in the business model?
- How can the portfolio value of tangible and intangible assets be increased?
- Which growth opportunities are more likely to be rewarded by the market?
- How can the ability to execute on strategy and manage the investors' perception of risk be improved?

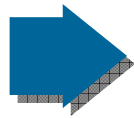
## Disclose and communicate information investors need

- What type of financial and non-financial information should be disclosed?
- How often should this information be disclosed?
- How can shareholders' connections be created ?

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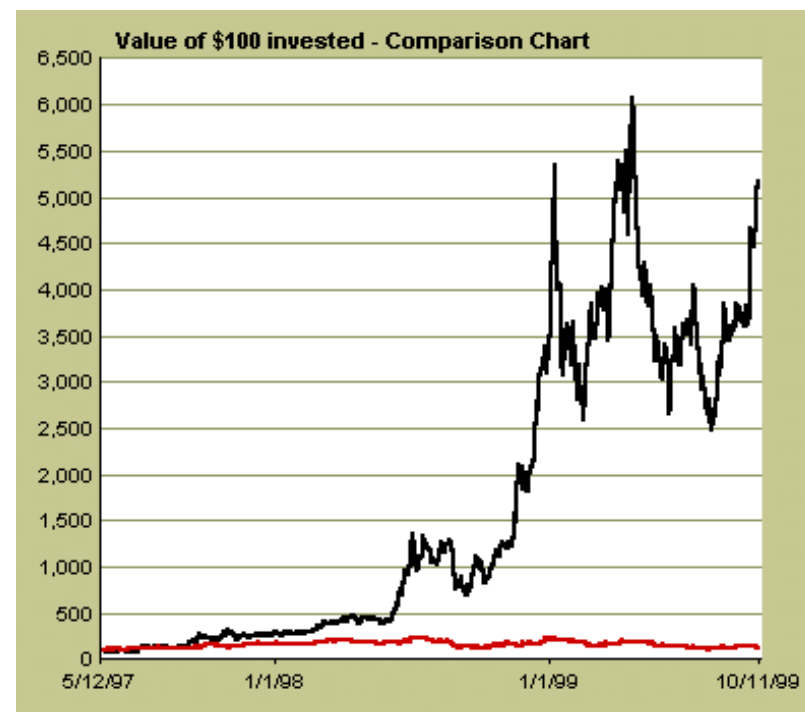
- Financial market' s realities need to be understood
  - Investors are forward looking
  - Measures that really matter are strategic



- As for any other markets, companies have to build a brand to thrive on the financial market
  - Financial branding is a critical, but difficult process
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# Creating a financial brand is a critical success factor for a company

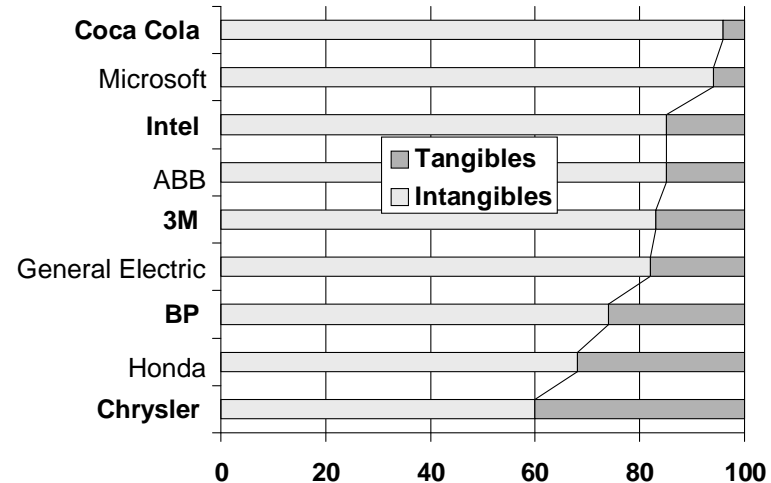
- The financial market is **highly competitive** due to the increase in:
  - Number of listed companies
  - Availability of financial and non financial information
  - Selectivity of analyst coverage
  - Sophistication of individual investors
  - International markets' globalization
- Creating a strong financial brand helps a listed company:
  - Draw investors' attention
  - Gain more financial resources than its competitors
  - Utilize its financial clout to accelerate external growth and develop its customer base
  - Attract the best talents through value linked compensation plans



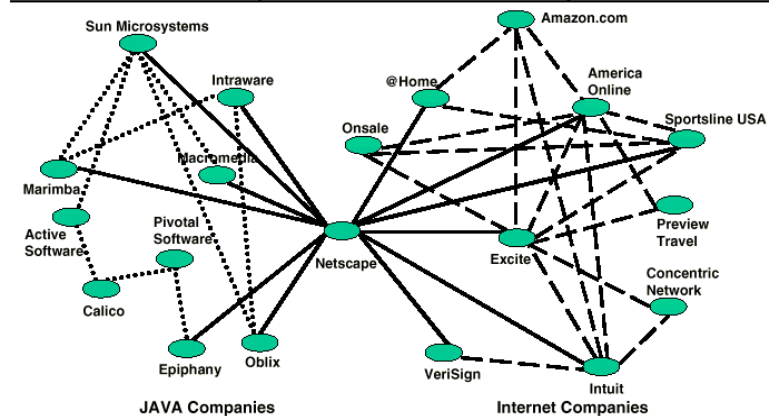
**A comparison of Amazon and Barnes & Noble strikingly illustrates the “value polarization” phenomenon**

# Establishing a financial brand is a complex process

- A financial brand is the company's **promise to deliver in the long run** a specific combination of risk and returns to its current and future shareholders. Implicit in this promise is its ability to create and sustain a competitive advantage
- Competitive advantages and thus market values in the new economy are primarily driven by **intangible** assets and future strategic **growth options**, which are difficult to measure
- **New business models** are continuing to change to reflect today's intangible value drivers, demanding greater:
  - Organizational and strategic flexibility
  - Intangible asset management
  - Network (business web) management
  - Growth options portfolio management



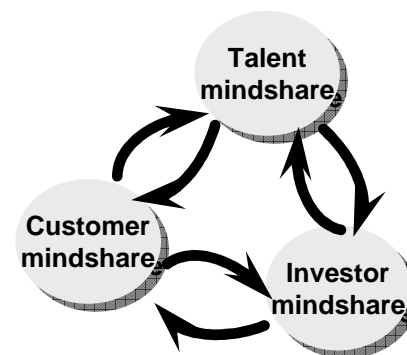
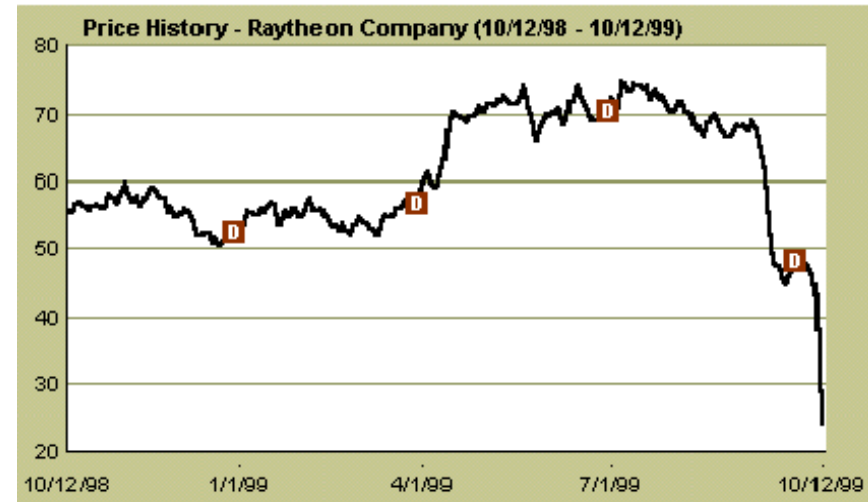
Economic Web—Partnerships across the Kleiner Perkins Family



Source: Fortune, October 26, 1998.

# Controlling the speed of the expectations treadmill is a critical aspect of financial branding

- Shareholders' expectations are setting the **speed of a treadmill**. Exceeding those expectations accelerates the pace of the treadmill and increases the market's requirements
- **An uncontrolled speed generally results in a diving share price**, weaker financial brand, and destroyed credibility. This could create a vicious circle jeopardizing the future development of the company
- Management's responsibilities include:
  - Helping the market **set realistic long term goals** - they can be ambitious, but must be attainable to convince the market and provide the company with the necessary resources
  - Achieving **short term objectives** to convince shareholders that the company is on the right track

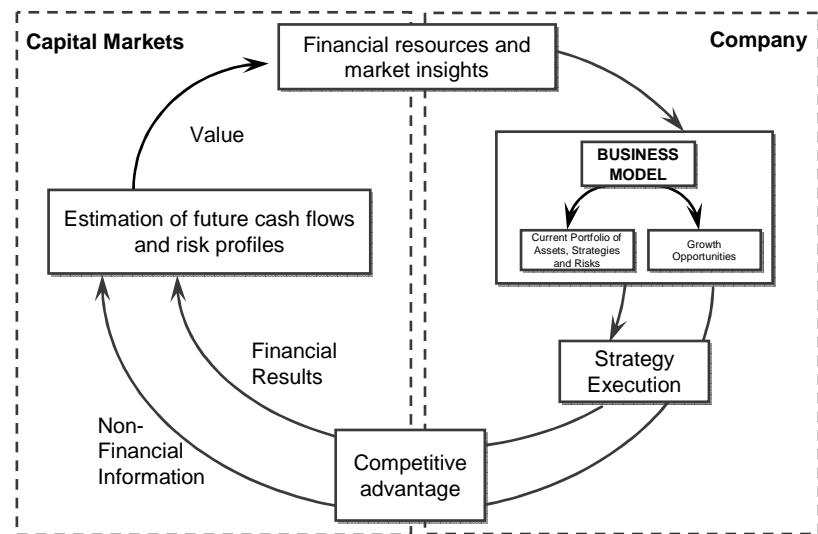


Increasing Investor mindshare is the secret weapon of leading companies.

# Financial marketing is instrumental in creating a strong financial brand

- Leading companies use financial marketing techniques to set and monitor investor expectations, which involves:
  - Constant **monitoring of investor expectations** for the company and its peers
  - **Plans to exceed** these expectations by crafting a business engine capable of maximizing their growth opportunities
  - **Sending of meaningful signals** to the financial community
    - Corporate disclosure of financial and non-financial MTM
    - Coherent financial policy with operating position
  
- **Benefits of financial marketing:**
  - Improve accuracy of the market's valuation of the company
  - Improves management of operations by providing the company with more resources and market feedback

**A new mindset to understand shareholders' expectations**



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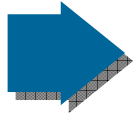
# Investor Exchange<sup>SM</sup> *Diagnostic* exemplifies a financial marketing method

- Investor Exchange<sup>SM</sup> *Diagnostic* is a process designed to help a public company understand its current value competitive position and identify ways to enhance it
- E&Y's Strategic Finance specialists team with executives responsible for the sale of corporate equity (CEO, CFO, M&A VP...) to:
  - **Diagnose the financial value**
    - Understand the market's expectations for the company and its competitors
    - Assess the ability of the company to meet and exceed these expectations
    - Measure the gap between the company and the market's perspective
  - **Identify necessary changes to close this gap, e.g. :**
    - Improve the business model to increase future returns and extend the duration of the competitive advantage
    - Change corporate communication and investor relations to improve the accuracy of the company valuation
    - Promote financial decisions to better signal to the market the competitive stance of the company
  - **Simulate** shareholder value impact of various strategies **in order to prioritize** actions to be taken

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