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WHITE PAPER

# MiFID II: THE NEW REALITY FOR INVESTOR RELATIONS



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The deadline for compliance with the EU's MiFID II legislation is now just weeks away, and a tremendous amount of work has been done on both the buy and sell side, quantifying, implementing and testing new technology and processes in an effort to comply with the new regulatory requirements. Compared with six months ago, the sense of urgency on both sides has palpably increased, and virtually every asset manager and sell side firm, EU-based or not, **now has MiFID II's January 3rd implementation date front and center in their thinking.**

However, while financial industry participants have generally pivoted from wishful ignorance to active preparation over the past 18 months, one group of MiFID II stakeholders still seems to have its collective head in the sand: **Investor Relations (IR) Teams.**

A core goal of MiFID II is increased transparency around the dealing and process of financial instruments and as the implementation deadline draws closer, it is becoming clear that a side effect of this increased transparency will be margin compression for both buy and sell-side firms.

One of the primary areas where the new regulations will have a direct impact is the production and consumption of research. Under the new rules, research can no longer be bundled in with trade commissions. It must be given distinct pricing and its consumption must be broken out in highly granular fashion. This has already prompted a broad re-evaluation of sell-side research by asset managers and the realization that they 1) read only a fraction of the research that is sent to them, and 2) much of what they do read, does not materially help them generate alpha.

The recent decision by a number of the leading global asset managers to opt to pay for research and corporate access out of their own pocket i.e. P&L, is adding further weight to this ongoing evaluation of what services are actually valuable. The approach being taken by many of the industry leaders to make payments for research out of operating costs will not only impact profit margins for those asset managers but importantly will also lead to a completely different mindset when it comes to the consumption of services. Individuals evaluate the value of a service completely differently when it is "their" money and the days where PM's and Analysts would consume services without regard to cost are gone.

It is within the context of this changing landscape that McKinsey & Company produced a study that forecasts a 30% reduction in spending on research, equating to \$1.2 billion, annually<sup>1</sup>. The significant impact this will have on the operating margins of sell side research providers will in turn lead to an evaluation by research providers of which companies under their coverage universe are "profitable" and whether maintaining coverage is sustainable in the long-term.

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1. McKinsey & Company; Reinventing Equity Research As a Profit-Making Business; June 2017; Page





## New Realities For IR teams

How does this impact IR teams? Like other participants in global finance, most IR teams have followed MiFID II's development with interest and are aware of the industry changes it is already driving. However, if the results of our *Extel 2017* survey are any guide, they remain largely unprepared to meet the real challenges presented by MiFID II, not least of which will be performing the multitude of tasks that have historically been provided by the sell-side.

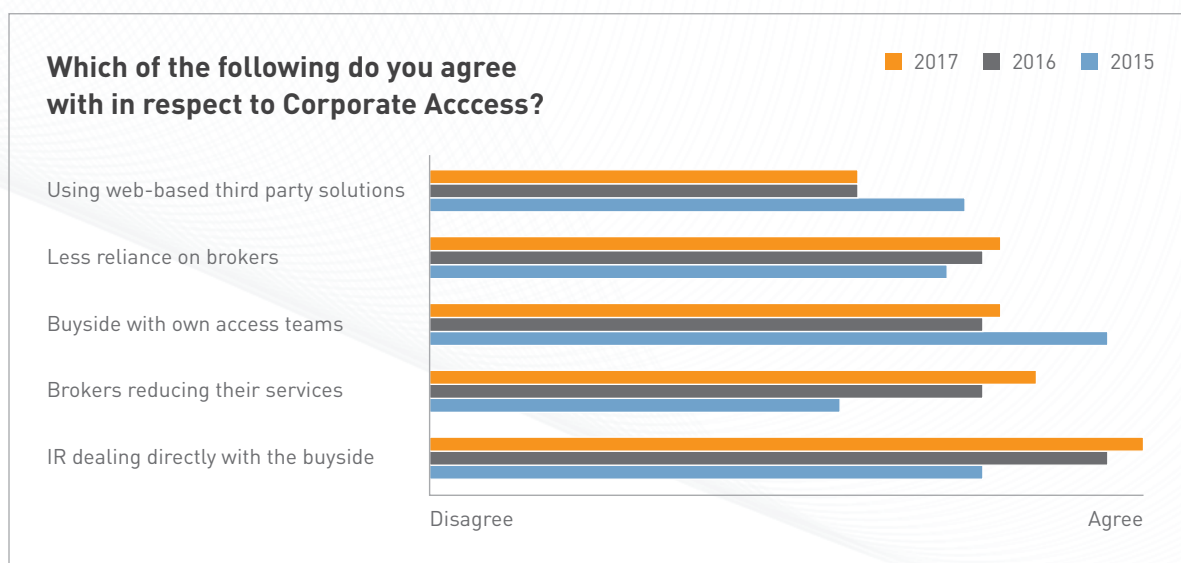
It is inevitable that the unbundling of research from commissions will result in a reduction in coverage from the sell-side for smaller companies or those without strong brand and industry recognition, the only question is by how much? Sell-side firms will focus their resources on the companies for which there is clear client demand for research and corporate access, and the IR departments at all the others will have no choice but to fill the void. For small to medium-sized businesses with smaller IR teams, this increase in work will be particularly significant.

Fund managers consistently report that corporate access continues to be fundamental to their investment process and irrespective of MiFID II, this will not change. Which means that without the sell-side acting in their traditional role as intermediary, direct requests to IR teams from

fund managers for access to management will materially rise. At the same time, without the sell-side's knowledge of the investment community, IR teams will have to independently discover and maintain these relationships, something that is both highly time-consuming and challenging.

In practice, IR teams should assume MiFID II means fulfilling many of the functions and outreach capabilities previously provided by sell-side firms. They will need to:

- Attract and maintain the attention of investors and analysts *without* the benefit of ongoing sell-side and/or third-party research coverage.
- Efficiently organize and manage an increased level of inbound inquiries.
- Handle all aspects of roadshows and meetings, including investor targeting, marketing, event execution and attendee follow-up.
- Develop proactive, strategic approaches to both investor targeting and outreach.
- Develop, execute and maintain a comprehensive communications strategy to provide proper information flow to replace any reduction in sell side coverage and contacts.







Yet although many in IR seem to intuitively know their world will change come January 3rd, to date they have not mirrored the preparation undertaken by their buy and sell-side counterparts.

Data from the WeConvene Extel 2017 survey of more than 3,000 IR professionals shows that while IR teams are broadly aware of the impact associated with research unbundling, including less reliance on the sell-side, a reduction in analyst coverage and much greater direct interaction with investors, the survey also revealed that an increasing number of teams are adopting a wait and see approach with regard to their own preparations. In fact, when asked whether using a web-based third-party solution would help with corporate access, significantly fewer agreed in comparison to 2015 – when MiFID II wasn't even on the radar of the vast majority of people in the finance industry. It seems a contradiction – you're going to be asked (and soon) to do a lot more with at best flat resources, yet your interest in leveraging modern technology to help you do so is waning.

Relatedly, IR teams are not asking for additional financial support to handle the extra work and demands on time that the MiFID II fallout will bring. In fact, the survey showed IR budgets among segments of the small and mid-cap market are actually *decreasing* at a time when additional resources are almost certain to be required.

Indeed, between 2016 and this year, IR budgets have been heavily trimmed in the areas of external IR services, website development and annual meeting prep. Conversely, and an indicator that IR teams do know what's coming, only two budget areas saw an increase in 2017 – roadshows/investor meetings and formal disclosures (annual report filings, etc). Yet reducing web presence and external IR capabilities ahead of MiFID II seems very shortsighted, given the tremendous assistance both can bring under resourced IR teams.

## So what's going to happen?

Although not specifically contemplated, or even mentioned, in MiFID II, there is no avoiding the impact it will have on how those in IR do their jobs. Implementation of the new regulations is going to fundamentally change how the sell-side approaches the facilitation of investor contact, access and information for their corporate clients. In fact, we believe significant pressure is going to be placed on IR teams that are already lacking resources even before the effects of MiFID II come into play.

Nonetheless, those that are taking a wait and see approach will quickly find out that investors are rapidly changing how they want to organize corporate access and are not likely to be too understanding of the companies that can't accommodate the new way in which they want to operate. MiFID II has been a known quantity, for at least a year, and off-the-shelf solutions have long existed to help IR teams thrive in a post-MiFID II world. All else being equal, IR teams must therefore find ways to accomplish much more with less, and rely more on their own internal organizational and administrative capabilities in order to develop new investor relationships, maintain their corporate access programs and fulfil information distribution requirements. Investors will expect nothing less.

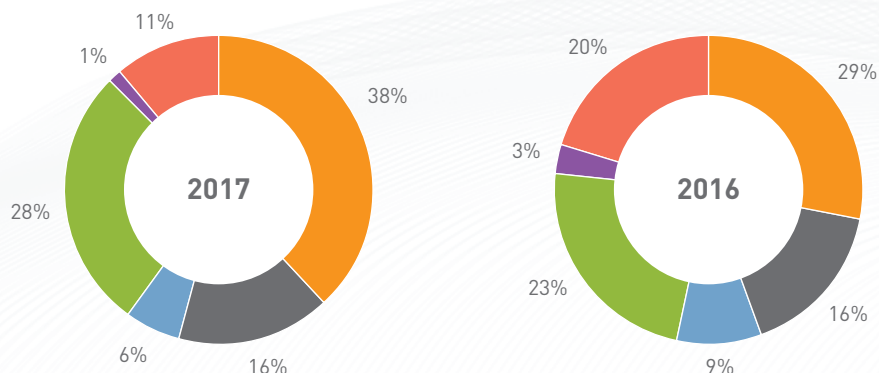
The answer? Technology. Almost by definition, IR teams – especially those at smaller firms – must embrace technology in order to leverage the resources they have to meet the demands expected of them. Short of an increase in budget and staff, there will simply be no better way to remedy the emerging gap between what is required to maintain a successful IR program and what existing resources can deliver. IR teams are not alone in this regard – technology is also being heavily utilized by the sell-side and all types of asset managers to comply with every facet of the MiFID II requirements.





## Allocation of IR Budget

- Roadshows/Investor meetings
- Analyst/Investor days
- IR website
- Annual report/Formal disclosure
- AGM
- External IR service



In fact, if the main purpose of IR is to foster greater awareness of a company and ensure a diversified and well-informed shareholder base, then IR teams will actually be remiss in *not* utilizing technology to the fullest extent possible following MiFID II's implementation. Beyond just aiding IR teams in the efficient administration and organization of investor interactions and outbound communication, technology and in particular platforms that connect investors with corporates will become the preferred method by which fund managers seek to organize corporate access. With margins under pressure, asset managers are also looking at every way possible to operate more efficiently and new technology platforms are a major area of focus.

In other words, if you're part of the IR team at a small-company and you haven't explored technological solutions as a way to better adapt to a post-MiFID II world, then you are now behind the curve. And if you're in the U.S., be careful about assuming the SEC's October 2017 decision to grant a temporary reprieve from some of MiFID II's research requirements means you will be exempted from the change your European peers are currently navigating; a wholesale re-evaluation of how sell-side research is produced

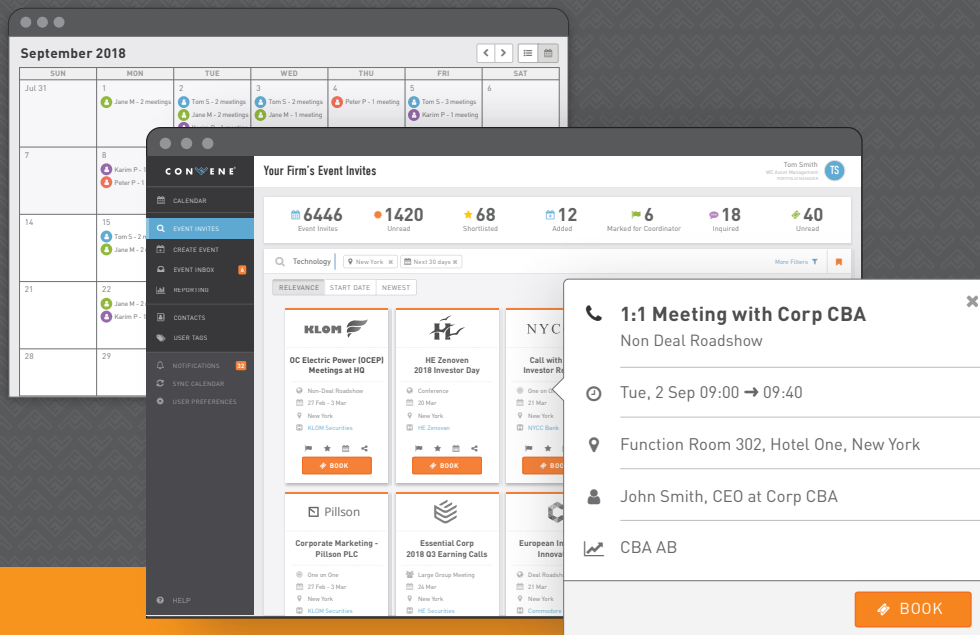
and consumed is going to happen globally regardless. Like trying to put the genie back into the bottle, MiFID II has resulted in asset managers across the globe evaluating the value they receive from the research they consume. Compliance with MiFID II is quickly becoming the global standard for industry best practice, which means even in the US, analyst coverage for smaller firms will decline as a result.

Ultimately, the changing industry dynamics that will characterize the industry following MiFID II will mean a lot of the activity, organization and behind-the-scenes work done by the sell-side is going to fall back onto IR teams. For all but the largest companies, there is now a requirement to develop a new set of tools and processes. Yet it seems many in IR are not taking the upcoming shift seriously enough, and leaving themselves and their companies exposed as the landscape starts to change. To meet the expectations of management, existing shareholders and a buy-side audience making significant changes to how they operate, IR teams should explore how technology can ensure they remain relevant, efficient and effective within the new realities of a post-MiFID II world.



# ABOUT WECONVENE

**WeConvene** is a global, independently owned web-based platform that automates corporate access consumption and evaluation for the investment community. Events large and small directly impact investment strategies and WeConvene provides value to buy-side, sell-side and corporate organizations by enabling efficient discovery, booking and tracking of meetings.



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