To the Graduate Council:

I am submitting herewith a thesis written by Thomas Joseph Denk entitled "A Case Study of Investor Relations at Lowe's Companies, Inc." I have examined the final copy of this thesis for form and content and recommend that it be accepted in partial fulfillment of the requirements for the degree of Master of Science, with a major in Communications.

Paul G. Ashdown, Major Professor

We have read this thesis
and recommend its acceptance:

Accepted for the Council:

Vice Provost
and Dean of The Graduate School

A CASE STUDY OF INVESTOR RELATIONS AT LOWE'S COMPANIES, INC.

A Thesis

Presented for the

Master of Science

Degree

The University of Tennessee, Knoxville

Thomas Joseph Denk

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DEDICATION

I dedicate this thesis to my parents, who have always encouraged me to endure.

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ABSTRACT

This exploratory case study examined developments in investor relations and annual reporting since 1960 and also examined the specific practices of Lowe's Companies, Inc., from the time it became a public company in 1961.

Data were gathered through a series of interviews with the investor relations staff of Lowe's and an examination of company documents.

Investor relations at Lowe's developed under the direction of Robert Strickland, the company's current chairman of the board. The investor relations department initiates communication with the investment community and openly discusses the company through the annual report and through verbal communication.

One main objective of an investor relations program is to maintain an efficient valuation of a company through communication. The staff at Lowe's explained the purpose of investor relations and annual reporting as aiding in lowering the company's cost of capital by increasing awareness and reducing the perceived risk to investors.

This study suggests that a company can significantly contribute to its efficient valuation by initiating and maintaining communication with the investment community. It also suggests that a communications-oriented top management is important to the effectiveness of an investor relations program.

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CHAPTER I

INTRODUCTION

The stock market crash of 1929 brought attention to the potential risks the public faced by investing in the stocks of publicly held companies. The Securities Acts of 1933 and 1934 were passed in response to the crash to help reduce investor risk by requiring public companies to distribute information about operations through annual reports and annual meetings.

This legislation created an opening for a specialized communications function called financial public relations to emerge in the 1940s. Public companies concerned with informing investors of the merits of their businesses turned to financial public relations practitioners to help them formulate and execute FPR plans. Initial objectives were to publish an annual report and hold an annual meeting, though the purposes of these objectives were not sharply defined.

> Vague reference was made to gaining loyal support of shareholders for top management decisions. Many must have wondered . . . about the viability of the objective as shareholders willingly sold out to corporate raiders in return for quick profits. (Hughes, 1970, p. 65)

Nevertheless, the role of shareholders and their importance to the success of a company became topics of interest as public companies sought to attract investors by communicating their stories. How financial public relations could help a company depended on management's perception of the stockholder, Business Week (1962) reported:

> Where management sees the stockholder clearly as the owner of the company, its communications, ideally, will

> be built around the principle of "full, frank, and factual disclosure" of any information that can have a bearing on the owner's investment. This is not to say that its communications program will necessarily be broad. But it will show a healthy respect for the wants, needs, and potential power of the stockholder owner. (Business Week, 1962, p. 144)

By the 1950s, investment bankers, who work as agents to find buyers for corporate securities, became aware of how publicity could affect the price of a stock, particularly the stock of smaller companies. Since the banker's biggest problem was getting price support for new stock issues six months or so after the initial offering, the promise of planned publicity was attractive to the bankers, Hughes noted. Investor relations departments responded by trying to get favorable stories published in newspapers and magazines.

By the 1960s, many managers had begun to think of stockholders as an important audience, evidenced by the growth of financial public relations. Business Management (1968) reported:

> Today, perhaps 25 percent of all publicly held companies have some kind of FPR program, over and above their regular PR programs. It's considered the smart thing to have, the smart thing to talk about, and the smart thing to budget for. (p. 47)

However, the publicity orientation of investor relations became suspect as a result of two significant developments, Hughes reported. The first was a 1963 SEC report on the stock market, which disclosed that some reporters and financial publicists were making more on their stock speculations than they were from their salaries. This eventually led to the development of a "code of ethics" to monitor practitioners.

The second development was the position security analysts were attaining in the investment decision-making process. Analysts, Hughes wrote, were becoming the most important people on Wall Street. These developments shifted the focus of investor relations from publicity to close relationships with analysts, relegating media relations to a supportive role.

Executives also became increasingly aware of the use of common stock as currency, Hughes noted. Selling stock to investors was an inexpensive way to finance corporate expansion, depending on the stock's price in relation to the company's earnings per share. Informing investors of the company's financial position was an important step in assuring a successful offering. These conditions also had an impact on the development of investor relations:

> In this environment, which placed such a heavy emphasis on all types of communications, financial relations flourished--not as a narrow publicity or annual report writing function as in the past, but as a total communications service. (Hughes, 1970, p. 65)

Mellott (1960) saw a relationship between the separation of the investment community from the corporate community as a key development in the need for financial public relations. He discussed his views in an address before the Finance Club of Harvard University's Graduate School of Business.

> It is only within the comparatively recent past that the financial community has become distinguished from the corporate community to any significant degree. Ownership, and the capital it represents, once were identical with management. But such identical status is now the exception rather than the rule. (Mellott, 1960, p. 2684)

The rapid growth of business through technological advancements led many companies to seek capital through public stock offerings, causing business owners to give up partial control of their companies to investors.

> In these circumstances, corporate progress has become increasingly dependent upon the approval of many people. We find here the first motivation for financial community relations. Today, if new capital is to be available to a business enterprise, the corporation is confronted with the need and the responsibility for informing the investing public of its merits. (Mellott, 1960, p. 2684)

Mellott touched on the main motivation growing businesses had for conducting financial public relations activities: the need for capital. Firms that could finance growth internally had little need for FPR, since its financing needs didn't require outside capital. However, firms interested in raising capital through public stock offerings became aware of the role communications could play.

How investor relations has continued to develop is the subject of this case study. The New York Stock Exchange now lists more than 1500 companies, each with the responsibility of publishing an annual report and holding an annual meeting. Investor relations has expanded beyond just these two mediums, however, to include many other methods of communicating a company's story. By conducting a literature review covering investor relations practices from 1960 to 1986, and by examining the IR efforts of a public company, this study seeks to provide an overview of investor relations' development and to raise questions about its future.

CHAPTER II

METHODOLOGY

This study is an exploratory study which seeks to generate hypotheses about investor relations at public companies by examining the literature on the topic since 1960 and by examining the practices of one company. The single-case study method was selected as an appropriate format because of its manageability and because of its usefulness in providing data. The case study method, the specifics of this particular study and the limitations of both will be discussed.

In his book Case Study Research, Yin (1984) set out to "guide investigators and students who are trying to do case studies as a rigorous method of research." He compares case studies to other research strategies, discusses case study designs and how case studies are conducted, and then discusses methods of analyzing findings and composing the final report.

Yin, president of COSMOS Corp., a social science research firm, wrote that the case study, like other research strategies, is "a way of investigating an empirical topic by following a set of pre-specified procedures." In general, case studies are the preferred strategy when how or why questions are being posed. Case studies are also preferred in examining contemporary events when "the relevant behaviors cannot be manipulated," he wrote.

Case studies rely on many of the same techniques as historical studies,

> adding two sources of evidence not usually included in the historian's repertoire: direct observation and systematic interviewing. Although case studies and histories can overlap, the case study's unique strength is its ability to deal with a full variety of evidence--documents, artifacts, interviews, and observations. (Yin, p. 19)

Though the case study method is useful for the above-mentioned types of research, Yin wrote that "many researchers have disdain for the strategy . . . single- and multiple-case studies have been viewed as a less desirable form of inquiry than either experiments or surveys."

The problem revolves around the "lack of rigor" in case study research:

> Too many times, the case study investigator has been sloppy, and has allowed equivocal evidence or biased views to influence the direction of the findings and conclusions. (Yin, p. 21)

Yin says this accusation can be directed at other research strategies as well, since "bias can enter into conducting experiments . . . designing questionnaires . . . or in conducting historical research."

Another concern about case studies is that they provide little basis for scientific generalization. "How can you generalize from a single case?" is a frequently asked question, and the answer is not easy, Yin wrote. Yet the same logic applies to experiments.

> Scientific facts are rarely based on a single experiment; they are usually based on a multiple set of experiments, which have replicated the same phenomenon under different conditions. (Yin, p. 21)

Case studies, like experiments done once, are not generalizable to populations or universes. Instead, the goal of the investigator is to "expand and generalize theories." Generalizations are not automatically accepted as theory, however. As Yin wrote, "a theory must be tested through replications of the findings."

Another observation Yin made was that propositions are generally the starting point in conducting research. Propositions "direct attention to something that should be examined within the scope of study." Not all studies address propositions, however:

> Some studies may have a legitimate reason for not having any propositions. This is the condition in which a topic is the subject of "exploration." Every exploration, however, should still have some purpose. Instead of propositions, the design for an exploratory study should state this purpose. (Yin, p. 30)

As previously stated, this study's purpose is to generate hypotheses about investor relations at public companies by looking closely at the practices of one company. As an exploratory study, its usefulness is not in its support of initial propositions, but in producing propositions for future research.

I. RESEARCH DESIGN

The use of a single-case design instead of a multiple-case design places limitations on the conclusions of the study. According to Yin, the findings of a multiple-case study are often considered "more compelling, and the overall study is therefore regarded as being more robust." One drawback, however, is that multiple-case studies "can require extensive resources and time beyond the means of a single student or independent research investigator."

As the format of this study was being considered, it was determined that the single-case format, despite its limitations, was appropriate and would provide sufficient data from which conclusions could be drawn. As Yin wrote,

> Overall, the single-case design is eminently justifiable under certain conditions--where the case represents a critical text of existing theory, where the case is a rare or unique event, or where the case serves a revelatory purpose. (Yin, p. 47)

The process of selecting an appropriate topic for study began in the summer of 1984 when a series of interviews with investor relations executives in Dallas was conducted. Four questions were asked: Why are you in financial communications? How important is investor relations to the success of a company? What is your biggest challenge? If you had 10 weeks to do an in-depth study of one aspect of investor relations, what would you choose?

A variety of ideas surfaced, but the most appropriate was to do a case study on one company. Lowe's Companies, Inc., a North Carolina based specialty retailer of building materials and related products for the home construction and home remodeling markets, was suggested as a prospect because of its unique annual reports.

A letter was sent to Lowe's investor relations vice president to propose the study and to gain approval. Because the company's headquarters were easily accessible and its investor relations staff agreed to participate, Lowe's was selected as the company to examine for the study.

The next task was to complete an extensive review of the literature on investor relations and annual reports from 1960 to 1986. As an exploratory study, the purpose of collecting and analyzing this data was to gain a better understanding of the field and to generate questions and hypotheses which could be studied further. In the written report, this background section provides an overview, giving the reader an opportunity to observe trends and developments which have influenced the field of investor relations.

The remainder of the report is the result of personal interviews with Lowe's investor relations staff, including the company's chairman of the board, Robert Strickland, vice president Cliff Oxford, director of research Henry Roemer, and corporate secretary Irene Phillips. Bill Brantley, former vice president of investor relations at Lowe's, was also interviewed. Additional information was gathered from the company's annual reports and from articles found in various business publications.

The first series of interviews took place in October, 1985 at the company's headquarters. During a two-day visit, Oxford, Roemer, Phillips and Brantley were interviewed; additional information was obtained from the company's library. The interview with Strickland took place in January, 1986. Each interview was taped.

Although a specified set of questions was used during the interviews, many other questions were asked as a result of answers given. This open-ended format, though imprecise, was a practical way to maximize the amount of information that could be gathered in a short time.

II. LIMITATIONS

Yin discussed some of the potential hazards of case study research:

> The demands of a case study on a person's intellect, ego, and emotions are far greater than those of any other research strategy. This is because the data collection procedures are not routinized. The skills required for collecting case study data are much more demanding than in experiments and surveys. (Yin, p. 56)

He continued by listing some of the skills needed to produce a quality case study. Included were the ability to ask good questions, the ability to be a good listener, having a firm grasp of the issues being studied, and remaining unbiased by preconceived notions. He wrote that an investigator must have the ability to interpret the information being collected and not just record the data in a mechanical way.

Concerning the effects of bias on the investigator, Yin wrote that all the other skills will be useless "if an investigator seeks only to use a case study to substantiate a preconceived position. Case study investigators are especially prone to this problem" (Yin, p. 59).

The data collection process also presents a problem because the researcher is trying to remain objective while being immersed in his "unit of analysis." The researcher must also be able to adapt to changing circumstances:

> For interviewing key persons, the investigator must cater to the interviewee's schedule and availability, not that of the research team. The nature of the interview is much more open-ended, and an interviewee may not necessarily cooperate fully in answering the questions. (Yin, p. 69)

Interviews, Yin wrote, are "an essential source of case study evidence because most case studies are about human affairs." Yet the interviewer is subject to the problems of bias, poor recall, and poor or inaccurate articulation. He suggested that interview data be compared with information from other sources to alleviate potential problems.

As this case study progressed through the interviewing stage and more was learned about Lowe's, difficulties arose in maintaining an unbiased, objective position. As Yin commented,

> The expertise with which these activities are conducted will improve with practice. Thus, one desirable sequence is for an investigator to complete a relatively straight forward case study before attempting to do a more complex one, from a managerial standpoint. (Yin, p. 76)

Concerning analysis of data collected, Yin had a similar comment:

> Case study analysis is the most difficult stage of doing case studies, and novice investigators are especially likely to have a troublesome experience. Again, one recommendation to the novice is to begin a case study career with a simple and straight forward case study, even if the research questions are not as sophisticated or innovative as might be desired. (Yin, p. 119)

Conclusions drawn from this study must be regarded with these limitations in mind. Also, Lowe's financial success over its 25-year history as a public company cannot be considered as representative. Consequently, generalizations made are not applicable as theory without replication. Nevertheless, as a hypothesis-generating case study, this project will be useful in expanding the body of knowledge on investor relations and especially in raising questions for further research.

CHAPTER III

DEVELOPMENT OF INVESTOR RELATIONS

Financial public relations had a shaky start building its credibility on Wall Street. Editor & Publisher (1963) reported that in 1962, an SEC task force operating under a congressional mandate conducted an 18-month investigation of 46 companies, all of which conducted significant PR activities. The group recommended enactment of a federal law "forbidding public relations men to tout stock through 'intentional or reckless dissemination of false and misleading statements.'"

According to the study group's analysis, the materials

> . . . ran the gamut from straight-forward reporting of corporate affairs to what can only be described as deliberate attempts to falsify a company's financial position and prospects.

The task force found the techniques of financial public relations suspect:

> The varied techniques of financial publicists are often designed to create a snowballing effect, with the well-planned story gaining momentum and scope as it travels from management to publicist to analyst to financial writer to adviser to salesman to investor. Techniques include the placement of articles favorable to the client in the columns of the financial press, the use of "contacts" and personal influence with persons with brokerage firms and investment advisory services, and the entertainment of financial writers and security analysts. (Editor & Publisher, 1963, p. 81)

The credibility of all firms who practiced FPR was affected by the lack of integrity some men exhibited, who tried to take advantage of the success of a rapidly growing field. Consequently, practitioners who were ethical in their efforts came up with a means by which ethics could be judged.

In 1963, the Public Relations Society of America authored a Financial Code with the help of the SEC to monitor the practice of financial public relations. Goss (1964) reported that the Code had 10 principal provisions dealing with the major criticisms levied against the profession.

> This Code of Financial Public Relations Practices is worthy of study and support. Financial public relations will continue to gain greater stature in the years ahead because intelligent practitioners will want to observe high standards such as are embodied in the Code. This will pay dividends to public relations people, to their business clients, and most important, to the investing public. (Goss, 1964, p. 8)

I. EMERGING ROLE

Although a "body of knowledge" had not emerged, the practice was gaining credibility and continuity as to what its role was. Even so, some public relations executives were not impressed with FPR's emergence. Business Management (1968) reported some of the reasons why:

> Over the years, the typical public relations executive has gained his basic experience in marketing or some related activity, such as advertising. In other words, he hasn't been sufficiently sophisticated about accounting, corporate finance and the stock market to deal effectively with the investment community and to provide it with information in the special form and manner that it likes. (p. 47)

Financial public relations had its own spokesmen, however. Men who owned firms specializing in FPR spoke out to refute those who questioned its usefulness by explaining what FPR should and could do and who it was for. One such spokesman was Theodore H. Pincus, president of the Financial Relations Board, Inc., a Chicago-based firm specializing in financial relations counseling. He defined FPR in Business Management (1968):

> I think most of us would agree that the business of financial public relations is not--and should not be--to promote corporate stocks. Rather, its business is to provide investment information with the purpose of imparting more and more knowledge about companies to more and more people. (p. 47)

Pincus also expounded on the necessary role FPR played in the world of investing:

> Financial public relations can be of great help to a company that is going somewhere. FPR can help this kind of firm primarily because there's a tremendous investment information gap in this country. No potential stockholder knows every pertinent fact about every potential investment. FPR can do a great deal to bridge this gap and increase familiarity with and demand for a stock. (p. 48)

Practitioners were beginning to build a reputation on Wall Street and in the press, which perceived them as linking companies and investors. A security analyst commented in a Public Relations Journal (1973) article that financial public relations in the past consisted of "the supervision of mailings and an occasional cocktail party spent 'plugging' the companys' stock" (p. 17). The analyst said financial public relations was now a "multifaceted discipline, arraying a band of skills in communications, law, economics, current affairs, and more than a passing knowledge of cross-currents in the stock markets of the world" (p. 17).

Nevertheless, investor relations did not develop as quickly as some believed it should have. Glenn Saxon Jr., of General Electric

Company, one of the first to embark on a sustained IR effort, defined the major hindrances that slowed the progress of investor relations:

> First, share owners are in a poor "competitive position" to attract management's sustained attention because of the incessant urgency of the primary business functions, especially research and engineering, manufacturing, marketing and employee and general public relations. This every-day-of-the-year urgency is lacking in investor relations. (p. 32)

Saxon claimed investors seldom could get the attention of company management despite their ownership role. He said management was under obligation to devote time to the interests of shareholders.

The second hindrance, according to Saxon:

> An oppressive political and social "climate of opinion," dating back to the stock market crash of 1929. Regulatory legislation enacted following 1929 reflected a prevailing attitude of distrust and bitterness toward securities and everybody connected with them. The distrust and bitterness have not entirely abated. (p. 32)

This climate was not helped by management's unwillingness to look closely at the behavior of its stock, Saxon said. He believed managements should take the initiative to establish realistic prices through communication. He stated that a no-communication response was not in the best interests of shareholders or the company.

He continued:

> The third hindrance to optimum development of investor relations may be described as management thinking which is not adequately oriented to the balanced consideration of share owner interests. Some managements have treated their share owners as though they were a group wholly outside the company and not very important to its success. (p. 32)

Given these hindrances, Saxon discussed the difficulties in establishing an investor relations program in companies whose top management is reluctant to look into the advantages of pursuing a sustained effort.

In 1965, Carol Loomis of Fortune reported on the merits of an investor relations program, perceiving its goal to be the attainment of a higher price-earnings ratio. Elevating this ratio, which is a measure of a stock's trading value in relation to the company's earnings, effectively increases the wealth of management:

> It is probably not mere happenstance that the financial p.r. "industry" has grown to its present imposing size during the period in which stock-option programs have acquired their great popularity. Obviously, any executive holding options or owning stock outright is going to gain--often considerably--from a successful financial p.r. program. (p. 185)

Loomis also reported that the embarrassment managements feel because the goal of elevating the P/E ratio is well known keeps them from arguing firmly that higher price-earnings ratios are also in the best interests of all stockholders, not just top management.

Another important development came in 1970 when the National Investor Relations Institute (NIRI) was formed. It is an organization made up of financial, investor and public relations officers from corporations and from outside public relations and financial counseling firms.

According to Glenn Saxon Jr., the organization's first president, NIRI was formed to make it easier for analysts to identify reputable specialists, and to forestall the possibility of government intervention in corporate financial information activities.

Business Week (1970), reporting on the establishment of NIRI, cited some of its goals:

> Directors of NIRI see much of their task as one of education and communication. . . . It also intends to be "the representative voice" of the investor relations community to federal and state legislatures and executive agencies. It might testify at SEC hearings on disclosure. (p. 79)

Another indication of the sustained growth of the field is evidenced by the fact that a number of consulting firms went public around 1970. _Barron's_ (1970) reported that John De Nigris Associates, Inc., was the first. At the time, De Nigris had been in business for two years, had 10 full-time employees and $157,870 in annual billings.

Wall Street Consultants, Inc., was to make its initial public offering in the Spring of 1970, offering its shares at 91 times fiscal 1969 earnings, _Barron's_ reported. The offering price ($10 per share on 1969 net of 11 cents per share) reflected no press agentry by the firm, board chairman Donald Kirsch claimed. Kirsch emphasizes to prospective clients that public relations techniques are of no avail on Wall Street "unless you have a good story to tell" (Loehwing, 1970).

Kennedy and Dennis (1971) raised some important questions about investor relations in their discussion of the "theory of random walks." They believed the empirical results shaping this theory, which addresses the subject of stock market prices, produce interesting food for thought for IR practitioners.

According to their research, a stock price myth exists among many investor relations practitioners:

> Among the more disturbing myths that abound in public relations is the idea that there is necessarily a correlation between a corporation's efforts to communicate with the financial community and favorable impact on the company's stock price and price earnings ratio. (p. 26)

Kennedy, a chartered financial analyst and professor of finance at the University of Arkansas, and Dennis, an instructor of economics, added that the results in favor of the theory of random walks are still far from conclusive. Nevertheless, they maintain that practitioners too often erroneously believe their efforts have a significant effect on stock prices. The researchers believe this view is incorrect.

The random walk hypothesis, which first emerged when Louis Bachelier presented a thesis to the Faculty of Sciences of the Academy of Paris in 1900, states that "the future path of the price level of a security is no more predictable than the path of a series of cumulated random numbers" (Kennedy & Dennis, 1971).

Kennedy and Dennis explain that the concept of an efficient market is the base from which the random walk theory builds. They define an efficient market as:

> . . . a market where there are large numbers of rational, profit-maximizers actively competing, with each trying to predict future market values of individual securities, and where important current information is almost freely available to all participants. (p. 26)

Because "perfect" knowledge is possible through the availability of low cost information, the theory states that competition will cause the full effects of new information on stock prices to be reflected instantaneously.

Kennedy and Dennis point out that advocates of the theory question even the role of technical and fundamental security analysis. Henry Wallich, professor of economics at Yale University, said the same social value "could probably be obtained with a fraction of the manpower now emloyed in security analysis."

Roman Weil (1980), professor of accounting and director of the Institute of Professional Accounting at the University of Chicago, also questions the value of investor relations:

> All evidence shows that the market determines the value of a stock efficiently and that investor relations efforts have no effect on the value. But, it's a rare manager that is willing to entrust the value of his company's stock to a theoretical construct. (Weil, 1980, sec. 2, S-10)

In their effort to view investor relations objectively given the empirical evidence in favor of the random walk theory, Kennedy and Dennis conclude that the appropriate function of investor relations is as "the prime information conduit between corporations and their investment publics," with the important responsibility of providing full and timely disclosure of relevant corporate events. They don't discount the role investor relations fulfills, but view it perhaps more skeptically than those who practice it. They add that companies can and should execute investor relations programs, but believe a more realistic look at what it can accomplish is necessary.

IR practitioner David Cates (1973) agreed, summing up the effect investor relations should have:

> The stock market process will ultimately accord your shares the price they deserve. There is nothing you can do about this except bring your performance to the attention of analysts and investors. (p. 102)

The objective of an investor relations program, he contends, should never apply

> . . . to the attainment of a given P/E ratio, but rather to such ends as the intrinsic disclosure quality of your program, the effective reach of this program, the type and location of shareholders, and the improvement of the broker/dealer mechanism. (p. 102)

Michael Seely (1980), president of Investor Access Corp., has also supported the random walk theory, believing it has opened up the way for investor relations to become a more measurable, precise practice.

Calling it modern portfolio theory, or MPT, Seely states that it can be a teacher for practitioners:

> As MPT demonstrates, the stock market deals with what it knows and, inevitably, discounts for uncertainty. If management exercises initiative in communicating company information to investors, the company's stock is more likely to be efficiently valued. If management fails in this respect, the stock often sells below fair value. (Seely, 1980, p. 24)

Seely said a well-executed investor relations program is a key contributor to market efficiency. He notes that large companies, usually followed closely by professional investors, should evaluate their investor relations programs to determine the point where they are merely repeating known information. Smaller companies without a noticeable following, called "less-efficiently valued" companies by Seely, may have a more important stake in executing an investor relations program:

> For the less-efficiently valued companies, the notion of market efficiency is hard to substantiate. The reason is simple. The market acts on what it knows. It discounts for uncertainty. If it doesn't know about a company, it doesn't act on it. (Seely, 1980, p. 25)

Seely notes that research conducted by Rolf Banz, from the University of Chicago, demonstrated that smaller firms have offered higher risk-adjusted returns than larger firms for 40 years. The reason: investors demand higher returns when only limited information is available. The higher returns investors require translate into expensive financing for "less-efficiently valued" companies, Seely says.

This, Seely claims, is where a sound investor relations program can help a company:

> Such a program's principle objective is to contribute to the efficiency of the market in the company's securities.

> The program must reflect an understanding of the valuation process, the company's characteristics vis-a-vis those of investment alternatives, how investors perceive the company and its peers, and their relative prospects. (p. 25)

Through such a program, Seely continues, less-efficiently valued companies can "identify and remedy the sources of market inefficiency in their securities."

II. IR INVOLVEMENT: WHO DOES IT?

The executive assigned to the investor relations job normally comes from a financial or communications background. Because the responsibilities involve regular contact with security analysts, companies are interested in individuals who already have an understanding of the numbers and know how to translate them.

According to Robert McIntyre (1961), the financial PR person first had the obligation to present accurate information. Interpretation came only when asked for. Donald Kirsch, co-founder of Wall Street Consultants, Inc., stressed that a person asked to interpret had better be well equipped:

> He must be able to delve into the intricacies of finance as well as any senior security analyst or top financial reporter. If he can't, he had better get out of the business. (McIntyre, 1961, p. 43)

Colleagues of Kirsch have criticized practitioners who lack technical skills. Theodore Pincus, president of the largest financial PR agency, the Financial Relations Board, Inc., stated in a Business Week (1969) report that he believed only 14 firms were "professional," meaning at least half their staffs were made up of security analysts and financial writers. Jack O'Dwyer, who writes a PR newsletter, agreed: "There are a lot of phonies who don't even know such terms as rights issue or price/earnings ratio" (p. 118).

Miller (1974) discussed the differences between the general field of public relations and investor relations, which he said is bound by rules that define its functions. These rules, Miller states, should be learned, as well as the fundamentals of accounting and corporate finance. He claims, however, that a business degree is not necessary:

> True, a degree in business administration or several years experience in a financial environment can be invaluable. However, an ambitious practitioner can embark on his own self-education program even if he or she doesn't understand the difference between capital surplus and unrealized appreciation. (Miller, 1974, p. 31)

Barrett and Werner (1974) wrote about the problems involved in recruiting competent practitioners. They found a tendency in corporations to turn exclusively to their public relations departments for assistance in setting up an investor relations program, which the researchers found to be insufficient. Finding the right people was reviewed as "the single most important problem facing a corporation in recruiting and mobilizing the human resources required for its investor relations efforts" (Barrett & Werner, 1974, p. 62).

Osgood (1981), looking at the decade of the eighties, believed the IR practitioner would become more closely associated with the capital formation process, which he defined as "determining the sources of future capital." His analysis:

> I believe that investor relations people--as part of the capital formation team--are going to have to become much more knowledgeable about what is going to affect business' capital-raising ability. . . . And they are going to have to become much more active in shaping public attitudes as to how capital is allocated, by whom and for what purposes. (Osgood, 1981, p. 8)

Sandler (1981) reported that a Pensionforum survey of several hundred U.S. companies indicated that about 8 percent of the pension officers responding said they also acted as the investor relations contact. Sandler suggested one reason for the combination was because of the "language" used in each job.

However, she also reported problems that would result from such a combination:

> Even a full-time investor relations officer has trouble striking a balance between staying home answering analysts' calls and going out on the road to promote the company's interests. Add to this the dual demands of overseeing the pension fund from your home office and visiting money managers in theirs, and the going can be rough indeed. (Sandler, 1981, p. 154)

Obviously, backgrounds of practitioners will always differ, but what won't change is the common body of knowledge each must be familiar with. The investor relations person must command the respect of the financial community, and he cannot do this without a substantial understanding of accounting and finance, plus the ability to interpret numbers into meaningful projections.

III. COMPONENTS: WHAT'S INVOLVED?

The foundation of an investor relations program is actually the Securities Exchange Acts of 1933 and 1934, which made financial communications mandatory. Companies began by publishing annual reports, adding other ingredients according to need. Today, investor relations programs are made up of a myriad of communication vehicles, reflecting SEC requirements and company needs.

The SEC has increased disclosure requirements over the years, attempting to improve the flow of information from companies to stockholders and potential investors. Companies are required to file annual reports, prospectuses, registration statements, quarterly financial reports, statements of legal proceedings, and an expanded "10-K" statement describing the business the company is engaged in, competitive conditions, sources of raw materials, number of employees, management compensation and anything else that could have an influence on investment decisions (Rubin, 1973, p. 10).

In disseminating information to its varied audiences, companies should strive for consistency (Savage, 1970, p. 123). Consistency even when the news is bad is more effective than instituting "stopgap" measures:

> Credibility can only be established through consistent dialogue with the financial community--and this credibility is essential when stock prices turn downward. Every publicly owned corporation needs and should have such a policy and program. (Savage, 1970, p. 123)

Savage contended that those companies with reputations for reliable investor relations have considerably less difficulty in obtaining equity capital (p. 123).

In explaining the role of investor relations, Savage referred to Graham and Dodd's book, Security Analysis. These authors took the position that corporate management had a responsibility not just to manage the company profitably, but to assure the company's stock commanded the best market price. This, he says, is the purpose of investor relations: to establish and maintain a fair market value for a company's securities (Savage, 1970, p. 122).

How did he see this task fulfilled? By linking the company to specific audiences:

> Investor relations links a publicly held company and the financial community of stockholders and would-be stockholders, security analysts, portfolio managers, investment departments of banks and insurance companies, and mutual funds. (p. 125)

On a daily basis, the principal function of the executive is to serve as an information source. He aids the analyst be providing information and interpretation, helping him better understand the company. He communicates with his audiences using both the written and spoken word.

Miller (1974) pointed out the importance of verbal communication as compared to written:

> The one thing mightier than the written word is the spoken word. What really gets things accomplished on Wall Street--or any other financial center--is direct, personal dialogue between members of top corporate management and the individual investment professional. (Miller, 1974, p. 26)

In explaining investor relations, Pincus (1974) discussed the importance of being aggressive. He said an aggressive approach makes both the analyst's and the broker's job easier. He agreed with Savage in refuting the myth that an aggressive company loses credibility as soon as earnings turn down:

> Earnings downturns or other unfavorable news never hurt a company's credibility; only surprises can do that. A company that is openly communicative, on a consistent basis, has little to fear. That means regular, frequent and wide ranging contact with the financial community--which gives investors fair warning of any unfavorable development. (Pincus, 1974, p. 111)

Halbrecht (1975) noted that the function of investor relations varies among companies. Factors that affect a company's program include its size, the nature of its public offerings, its current and prospective strengths and weaknesses, and the industry or industries it competes in. He agreed, however, that the responsibility every investor relations specialist has is to be a communications link.

The managing director of Drexel Burnham Lambert's corporate finance department also spoke of the different goals companies of different sizes have for investor relations. He stated that investor relations people have to be sensitive to the marketplace to know where to devote their energies.

> I find that IR reflects the economics of the marketplace. IR in a company with a $20 million capitalization is totally different than IR for a company with a billion-dollar cap. Everything that is effective in marketing is targeted. IR is marketing. You're targeting your marketing program at different audiences as you grow. (Public Relations Journal, April 1984, p. 25)

Halbrecht agreed that one of the most important specific tasks of the IR person is to establish credibility. Another responsibility Halbrecht mentioned related to the specific knowledge required of the professional.

> Another key responsibility is to know exactly and in detail how his company makes money. This is what The Street really wants to know. Without this knowledge, the investor relations executive cannot be effective for his company. (Halbrecht, 1975, p. 20)

Halbrecht mentioned the importance of providing feedback so management can keep abreast of important trends that can affect company securities. The investor relations person is responsible for informing management of changing disclosure requirements as set by the SEC.

Halbrecht also discussed the necessity of top management support to assure the success of an investor relations program:

> Many managements fail to see that a successful investor relations program calls for the total commitment and honest participation of key executives. Not even the best investor relations executive can carry out an

> effective program if management does not provide him early and complete access to information and will not give his counsel a fair hearing. If management is not willing to do these things, it would be better off not having an investor relations manager. He simply cannot succeed. (Halbrecht, 1975, p. 23)

Barrett and Werner (1974) also discussed the importance of top management support:

> The most important guideline seems to be that, ideally, the investor relations executive should report to the CEO. This is because personnel in this function must deal with and be responsive to corporate policy and strategy. (Barrett & Werner, 1974, p. 63)

An investor relations program is more than a collection of components which are used to respond to public owners. The task of responding to inquiries and meeting disclosure requirements is mandatory. On the other hand, a company cannot wait to be discovered. It must be on the offensive, given the competitive nature of the financial markets (Noll, 1983, p. 66).

IV. EFFECTIVENESS: DOES IT WORK?

There has been much debate concerning the usefulness and effectiveness of investor relations since it was first recognized as a specialized profession. There appears to be an equal number of supporters and detractors. Many developments have strengthened the position of the supporters, but the evidence is inconclusive as to measuring investor relations' impact on a company. A few examples will serve to tell the story.

Rockwell (1965) wrote of the success Aeroquip Corporation had as the result of an investor relations program. According to the company's president, Peter F. Hurst, Aeroquip greatly improved its financial strength with sound investor relations:

> In 1950 we were traded over-the-counter and had less than 800 stockholders. Today we are on the NYSE with 4,100 holders. One reason for this growth was the exceedingly effective job our financial PR counsel did in developing wide interest in our shares. (Rockwell, 1965, p. 648)

Pincus (1967) wrote that most companies have a pretty good idea of what investor relations does, but few understand why or how it works. He says its existence, which is justified by practitioners on the grounds that it "improves the corporate image among the investing public," is not based on a solid enough foundation.

Objectives, techniques and results are not nearly as well-defined as they should be, Pincus said. He defined 11 different areas where investor relations effectiveness could be measured, including primary markets, flow of inquiries, brokerage recommendations, brokerage sponsorship, security analyst opinion surveys, institutional interest, institutional holding, average daily trading volume, number of shareholders, stock exchange qualification and price/earnings ratio (p. 28).

Pincus clarified his position on the 11 measurements and how a practitioner is to approach them:

> It would be a gross mistake for any financial relations practitioner to ever assume full credit or blame, for progress or lack of it, in any one of these yardsticks. . . . But it's equally unforgivable . . . to fail to use and explain the only set of measurements it really owns. (Pincus, 1967, p. 30)

Baer (1971) discussed the problem of measurement and the lack of literature detailing "specific, universally acceptable means of measuring financial public relations progress and accomplishment." What does exist, he said, is superficial. Yet he reported that it is not difficult or costly to measure IR effectiveness. He claimed financial relations could be measured more easily and more economically than any other type of public relations.

Three measurement gauges are available, Baer stated. The easiest to apply is measurement of action initiated by the public relations firm or department. This includes the volume of news releases and letters written, the quantity of financial analysts contacted, and the number of hours expended.

A second type of measurement assesses the direct responses to actions: number of column inches resulting from news releases issued; number of market letters written by analysts visiting the company; and response to the annual report, to name a few.

The most reliable technique, according to Baer, but the least used, is aligning results and objectives to determine if the investor relations effort contributed to attaining the objective. He gave some examples:

> A broker courted, or introduced to management, makes a market for the first time; a retail house reports it has begun trading the company's stock because of recent publicity articles and mailings it has been exposed to; an analysis of transfer sheets reveals a wider geographic distribution of shareholders, following a series of analyst meetings in the area where the largest numbers of new stockholders now live. (Baer, 1971, p. 21)

Midland-Ross provides a concrete example of a company that has tried to shape its investor relations effort in such a way that its success could be measured more effectively. The company was not happy with its meager following on Wall Street, so it set out to find the reasons why it wasn't followed.

The director of IR conducted a telephone survey of some 50 research directors from Wall Street to find out why the company wasn't attracting a wider audience (Reier, 1981, p. 265). He found that most considered the company too boring and complex to bother trying to figure it out. So the IR director decided to expand the existing program.

First, he simplified the analysis of the company by expanding the annual report to include more information on company operations and long-term growth strategy. He also created a fact book containing material not in the annual report.

The company then began a direct mail campaign to stockbrokers, distributing reprints of magazine articles about various aspects of the company, particularly its technological achievements. It also allotted all of its advertising budget for full-page ads in The Wall Street Journal, describing the company's most innovative products.

According to Reier, the aggressive program helped convince as many as 10 Wall Street analysts to follow the company, double the number when the investor relations director undertook the program.

Leonard Wilson of First Manhattan said the company's IR work encouraged him to become a regular follower.

> They have tried to give us a stream of hard information, not soft, fuzzy stuff. If they were less accommodating, I might have said it would be impossible to get to know the company properly. (Reier, 1981, p. 266)

The investor relations director, however, was cautious about attributing success to any one element of the program. Instead, he maintained that the combination of all the things he did "added up to a steady drumbeat in the investment community" (Reier, p. 266).

Another example of an investor relations endeavor that seems to verify its effectiveness is the program Allright Auto Parks, Inc., of Dallas undertook to "test the waters" (Roalman, 1980, p. 39).

One of the smaller NYSE companies, it realized it had little visibility among analysts, brokers or the investing public. Because it didn't want to spend much money, the company took advantage of a scheduled executive committee meeting in Denver and stayed another day to meet informally with the financial community, local press representatives and shareholders who chose to attend.

> Sixty-eight thousand shares were traded in the seven days following the meeting (up from an average of 6,000 shares a week before the meeting). The price of the stock rose 25 percent and, after three months, the total number of shares (not including those in street name) in the Denver area had increased 23 percent. (Roalman, 1980, p. 39)

Despite these successes, investor relations is not without critics. Some question the way programs are carried out, while one study questions whether independent IR firms succeed in achieving their "goal."

Murray (1980) discussed some of the major weaknesses of investor relations, citing various critics who claim too many IR departments do not perform adequately. These underachievers fail to keep the investment community informed in a full, fair and timely fashion, he wrote. Harold M. Williams, then chairman of the SEC, summed up the problem:

> Mechanical application of minimum standards is substituted for meaningful corporate dialogue. What appeared at one time to have the potential of becoming useful disclosure becomes boilerplate. (Murray, 1980, p. 77)

A survey of 137 major corporations conducted by the Opinion Research Corporation revealed that 27 percent of the respondents lacked specific programs geared to the needs of security analysts, a key audience. Commenting on this result, Robert G. Gulian, editor of the Investor

Relations Newsletter, said it reflects "investor relations directors' unpreparedness and unwillingness to work hard enough at their jobs" (Murray, 1980, p. 78).

Analysts have other grievances about IR men, Murray wrote. Included were slow responses to inquiries, limited access to key executives, and an ignornace of how financial analysis works. It was argued that many managers have such a limited understanding of accounting, economics and regulatory laws that they cannot speak the language of analysts.

Murray wrote that analysts are also dissatisfied with the quality of many corporate reports, citing the lack of discussion of corporate goals and strategies, inadequate information on pension fund accounting and liabilities, and the scarcity of data on changing currency values, cost replacement and new products.

In defense of the field, investor relations managers asserted that the profession is young. In most cases, IR executives are not part of the decision-making process. Their job often amounts to putting a "good face" on what has already been decided.

Critics look at these explanations as excuses rather than bona fide reasons for deficiences, Murray said. Doug Nelson, director of corporate communications at VSI Corp., sided with the critics, who claim managers fail to assert themselves in their corporate roles. Nelson said it took one full year of asserting himself before he was able to launch a full program which exceeded minimum requirements.

> I hear other investor relations specialists say their top managements won't listen to them. That's nonsense. If they know what they're doing, they'll keep at it until they make their point. (Murray, 1980, p. 78)

A study published in 1973 investigated the effects independent investor relations firms have on common stock prices, providing another contrast to investor relations success. Gillies and Dennis (1973) looked into how successful independent firms were in attaining their "goal" of favorably affecting stock prices, as implied in the selling brochures of various firms.

Modifying an equity valuation model developed by Myron J. Gordon, the researchers performed two basic tests in their study:

> In the first test, the sample corporations were grouped into a sample of unlisted securities. The modified Gordon model was unable to discover any effect on the corporation's common stock price by independent investor relations firms. (Gillies & Dennis, 1973, p. 379)

Gillies and Dennis also applied the model to the securities of lesser known corporations, assuming that if an investor relations firm was able to affect a company's stock price, it would be more likely in such a group. They also reported no effect among lesser-known companies.

The second group of tests contained before and after samples of companies who hired one of six large investor relations firms. Gillies and Dennis felt that a large firm may be better able to affect its client's stock price than a small firm:

> The sample tests made with only the large investor relations firms resulted in the same conclusions; namely, there was no statistically significant difference in the population from which before and after samples were drawn. (Gillies & Dennis, 1973, p. 379)

It is interesting to note that in the literature, most writers commenting on evaluation and measurement refrain from directly attributing a stock price rise or other positive results to investor relations. They are careful to point out that practitioners who are looking for direct cause and effect results are misunderstanding the role of investor relations. For the most part, professionals agree with the notion that the effect of the investor relations function on stock price cannot be precisely determined. Instead, the evaluation should focus on the quantity of inputs provided to the investor's decision-making process:

> Operationalizing objectives in this manner allows the investor relations effort to be evaluated on a basis other than stock price or P/E multiple movements which all too often occur despite an excellent and otherwise successful investor relations program. (Barrett & Warner, 1974, p. 65)

V. FUTURE OUTLOOK

One of the most interesting and potentially far-reaching developments in measuring the effectiveness of investor relations is the use of modern portfolio theory, initially developed as an approach to making investments under uncertainty (Foster, 1978, p. 236).

In portfolio theory, the investor is concerned with the distribution of the return on his entire portfolio. Foster (1978) stated that the characteristics of individual securities are only important in terms of their effect on the distribution of the portfolio return. Applied to investor relations, the "individual securities" in the "portfolio" are the various businesses a company is involved in.

Guided by some of the tenets of modern portfolio theory, AMF and its IR consulting firm analyzed the company's portfolio of businesses in much the same way a portfolio of stocks would be analyzed. They calculated the volatility and rate of return on each of AMF's businesses using a beta-like measure, then compared the results to what an investor could earn on a risk-free investment (Siegel, 1982, p. 192).

Through the process, they learned how AMF's stock performance compared with the performance of other stocks of similar "quality," whether it was fairly priced by investors, and how the company's three businesses would be valued as separate companies.

J. Edward Sheridan, the company's chief financial officer and director of investor relations, concluded from the analysis that some of the pieces in the "portfolio" were actually damaging the whole. The solution: AMF sold its poorly performing Harley-Davidson motorcycle division. According to Siegel, AMF's stock shot up to 28½ by the end of 1981, its highest price in seven years.

Michael Seely, president of Investor Access, has completed MPT-type studies for a number of firms. He claims the techniques of MPT can test responses in the marketplace to different balance sheet, accounting and communication policies, enabling IR people to identify, before such steps as stock repurchases or stock splits are taken, what the market reaction has been in similar situations (Siegel, 1982, p. 192).

Kessler (1983) gave several examples of companies that have benefited from using modern portfolio theory to help target their investor relations. Each company's program was effective in a different way: Unilever N.V. and Philips Lamb, two giant Dutch companies, were suddenly "discovered" by Wall Street; Louisiana Land & Development successfully fought off a strong group of dissidents in a bitter proxy fight; and Sensormatic Corp. consistently kept its P/E multiple among the top 10 percent of actively traded stocks (Kessler, 1983, p. 50). The common thread that joined these companies together was an effective IR program:

> That is, a program that can identify the direction a company wants to take, sort out the desired shareholder base, and then set out to tell the company's story in a way that brings the market closer to management's (and the IR people's) view of reality. (Kessler, 1983, p. 50)

Kessler strongly supports investor relations as a bona fide business service that produces real, measurable results. He cited a price study by Benjamin King, "What Causes Price Changes?", which found that just 20 to 25 percent of the variation in price in stocks had anything to do with the companies themselves. Kessler pointed to these statistics as an opportunity for investor relations to have an impact on stock prices, being careful to attribute some influence to "esoteric" market and industry forces.

Despite these supporting examples, Seely believes IR still does not have the respect it should have from the investment community, business writers or corporate executives:

> The practice is still flawed by the responsiveness of cynical practitioners to unrealistic management expectations, by eager consultants willing to mindlessly condemn the stock market's appraisal (of a client) and by the apparent lack of a coherent body of knowledge to guide the practice. (Kessler, 1983, p. 50)

Seely argues that stock market prices are generally fair, given the amount of information available on a company; he believes the stock market is not "fooled." He claims that IR can be effective when management properly evaluates its position:

> Effective IR can come about only when management explains the disparity between the "intrinsic" or fair market value and the actual stock market value to important shareholders and potential investors. (Kessler, 1983, p. 51)

Once management has explained the disparity, Seely explains, the company "still has considerable opportunity to increase share price through stock repurchases and corporate restructuring."

Seely has been one of the main advocates of MPT, which he characterizes as "the emerging technology of valuation." He believes investor relations' future lies with this technology, which has proved itself in numerous client situations demonstrating that IR's potential influence is much greater than imagined.

Seely said the body of valuation knowledge has yielded two basic and unassailable conclusions:

> Any company-initiated effort to maximize stock price must begin by explaining any disparity that may exist between intrinsic and market values; and managements of efficiently valued companies--those whose stock prices are fair, and most are--often can further boost sustainable share price. (Seely, 1983, p. 21)

Seely looks to modern finance as a teacher, telling financial communicators four things: "trust market prices; there are no financial illusions; investors don't pay companies to do for them what they can do for themselves; and the market can be led." He goes on to explain each assumption, making this comment about valuation:

> The technology of valuation demythologizes the value creation process, defines the palate of the market, and takes us ultimately to where shareholder value is created, transferred or destroyed--in the firm's strategic decisions, and how they are conceived and communicated. (Seely, 1983, p. 22)

Seely wrote that investor relations has been a good business to date, but he believed it lives on "borrowed time." He offered this analysis:

> For the investor relations craft to survive, much less grow in stature, will depend on what we contribute to management decisions affecting shareholder value. Tremendous potential to do so clearly exists and the benefits already can be discerned in the actions of early adopters. (Seely, 1983, p. 24)

CHAPTER IV

HISTORY OF ANNUAL REPORTING

Investor relations owes its birth most directly to the annual report, a document public companies are required to distribute each year.

In the pre-income tax days, when owners were often managers and large shareholders were automatically elected to the board of directors, reports were not necessary. Nevertheless, some companies saw advantages in publishing a report of some kind.

It was during the late 1800s that the issuance of corporate annual reports became a more common practice, although disclosure was on an irregular basis and included a minimum of information. Some firms attempted to disclose anything considered relevant, while others published nothing.

The Pennsylvania Railroad Co., for example, issued a 197-page report in 1892, with Bethlehem Steel and General Motors following its lead by also producing long reports. DuPont, on the other hand, issued a modest six-page pamphlet for 1907 with enough information in it to satisfy the company's handful of large stockholders, who were either managers or directors.

Many companies did not participate, however, and investors grew restless. In 1895, the New York Stock Exchange urged stockholders to pressure management into issuing regular financial reports. When that didn't work, the Exchange passed a resolution requiring all listed companies to produce an annual report. The resolution stated that each listed company must publish at least once a year

> a properly detailed statement of its income and expenditures . . . and also a balance sheet, giving a detailed and accurate statement of the condition of the company at the close of its last fiscal year. (Meyer, 1979, p. 212)

Most of the reports issued, however, were sketchy documents that were of little value to investors.

Then, in 1903, two years after it had become one company from the merging of 12 others, U.S. Steel surprised the investing world by publishing a 36-page annual report which listed everything from revenues and earnings to "a description of every sizable piece of equipment the company had purchased during the year--all of it certified by accountants Price, Waterhouse & Co." (Dun's, January 1978, p. 21). Balancing out the written portion were 20 pages of photographs of the company's grimy steel mills spewing smoke. Scientific American called it "probably the most complete and circumstantial report ever issued by any great American corporation."

Oddly enough, the report was seen by many stockholders as wasteful; other corporate leaders saw it as a bad precedent. U.S. Steel's chairman, Judge Gary, had a conviction on disclosure that was uncommon:

> Gary stated from the outset his conviction that stockholders had a right to know what was being done with their money, and he pledged "the fullest possible publicity regarding the corporation's affairs." (Dun's, January 1978, p. 21)

Other companies reluctantly published reports, although there was no rush to follow U.S. Steels' lead. A New York Stock Exchange survey in 1926 found that only 339 companies, or 35 percent of those listed, were publishing reports, many considered unacceptable. National Biscuit Co., for example, disclosed nothing but earnings in its report. Other companies merely compiled mountains of statistics, following no format. In 1927, the year Judge Gary passed away, The Wall Street Journal complained amidst all the confusion that most reports "do more to deaden than to arouse the stockholder's interest."

As Dun's recorded, it took a disaster--the 1929 stock market crash--to bring about reform. In 1932, the New York Stock Exchange tightened its rules and required that annual reports of listed companies be independently audited. In 1934, the new Securities and Exchange Commission applied a similar rule to all public companies.

Given the mandate to publish reports, companies took a greater interest in content, realizing ownership of their companies was changing from a few large shareholders to thousands of small shareholders. Reports therefore took on a larger role as the shareholder base was dispersed.

According to Richard A. Lewis, president of Corporate Annual Reports, Inc.,

> the regular issuance and systematic distribution of the annual report gave it the substance of a fixture or institution. It was history, it was record, it was the all-encompassing source document of the corporation. The leading edge of corporate thinking was often first disclosed in the annual report, either through a direct policy statement or indirectly through the placement of emphasis. (Lewis, 1972, p. 6)

Stockholders, however, were not completely tuned in to reading annual reports. Disillusioned by the lean stock market of the 1930s, the intensity of their interest in reports was questionable.

Nevertheless, after World War II investor interest was rekindled and companies became more aware of the role the annual report could play. One key factor in the growth in importance of annual reports was the speed at which companies began transforming themselves, Lewis wrote.

In technologically advanced societies, the total output of goods and services doubles every 15 years. In this environment the United States' Gross National Product went from $464 billion to $1 trillion in just 17 years, with businesses moving through rapid stages of growth and change. IBM, for example, earned $46.5 million in 1954; by 1970, the company was the world's foremost producer of computers, recording profits of $1 billion.

Naturally, annual reports also changed as companies developed into multi-faceted conglomerates consisting of many businesses. Many improvements in content were made as companies tried to educate shareholders:

> Use of per-share data became more widespread. The need for comparative data was recognized. Long time periods were included in financial comparisons. The effectiveness of comparative data was increased with the use of percentage increases or decreases for the years covered. (Financial World, October 1974, p. 90)

Companies began using the report to communicate with employees, customers, potential investors and community leaders. Managers were receptive to suggestions that the annual report should include an outlook for the company and the industry. With an expanded audience, care was taken to make reports more aesthetically pleasing.

Through the 1960s and the 1970s, more changes and improvements were made. Reports came in odd sizes so they would be singled out. Companies began discussing social responsibility. They also became more candid in explaining declining sales and earnings trends:

> Problem areas that had been avoided before, such as labor costs, excess competition and government regulation, were discussed in detail. New ways were found to make the reports more readable and candid at the same time . . . hard to read footnotes were sharply reduced or eliminated. Social responsibility discussions had expanded to include such subjects as pollution, conservation, recycling and equal employment opportunities. (Financial World, October 1974, p. 90)

Other developments in the 1960s and 1970s also emerged. In the 1960s, when Wall Street was the perceived target audience, reports tended to be very dramatic. In the 1970s, when the economy slipped, the goal was to look economical but financially strong, according to Hershman (1981). The emphasis was on financial information, charts and tables.

In the 1980s, Hersham wrote, many large companies are focusing their editorial material on a single theme each year, covering one aspect of the company--management, new products, technological developments, productivity or capital spending projects. A popular format is the "newsweekly magazine" style. Designers are using bigger and bigger type for body copy and headlines to draw readers, she wrote.

As Hershman concluded, reports in the years to come will probably be more of the same--big pictures, big type and bright colors. Designers will have the challenge of making these elements look new, since "everything's been done before," she wrote. "But that hasn't stopped them yet."

I. CONTESTS: AN AID IN DEVELOPMENT

Contests have also played an important role in the development of annual reporting standards. Financial World began rating annual reports in 1941, when "the stock market was plummeting, Big Board volume was running under a million shares a day and the nation was gearing up for total war" (Lyons, October 1974, p. 74). Results of the first survey revealed that only 25 of the 250 reports submitted met the disclosure standards of that day, while only 45 of the companies had tried to upgrade their report standards over the 1930s.

But a precedent was begun, and for the first time corporations had a way to compare the quality of their annual reports:

> That first survey helped lay the foundation for important corporate reform. For one thing, independent and objective scrutiny of annual reports and the nation's corporate disclosure system had begun--something that was in the wind but discussed only in theory since the Securities and Exchange Commission was established early in the thirties. (Lyons, October 1974, p. 74)

The format of the contest was directed toward continual improvement rather than trying to establish an arbitrary standard of excellence, Lyons wrote. The competition took on "the spirit of encouragement rather than criticism," he said.

There were 766 reports submitted in 1942, 1,000 in 1943. According to Lyons, the competition encouraged companies to be candid even in those early years:

> There is evidence that more and more managements are pursuing the policy of taking the shareholders into their confidence by supplying all essential information, and in a form that can be quickly grasped and easily understood. (Lyons, October 1974, p. 74)

In 1944, Financial World established an independent board of experts to judge the reports, insuring objectivity and expertise, Lyons said. The chairman of the five-member panel was Dr. Lewis Haney, then a professor of economics at the New York University School of Finance. According to Lyons, the philosophy of the Haney panel in picking winners played an important role in the development of todays' annual reporting standards.

Haney commented that the purposes of the annual report are varied:

> Reports may be directed toward at least four different groups, and accordingly have at least four different main purposes. . . . They may be prepared for the benefit of the stockholder . . . they may be prepared for the employee and be concerned mainly with employee relations. They may be prepared for the customers . . . and be designed to promote sales. Or, finally, they may be directed toward the general public and may constitute propaganda with reference to legislation, taxes and the like. (Lyons, October 1974, p. 75)

By the early 1950s, standards for writing the annual report had been set, standards still valid today, Lyons wrote. Financial World first listed the requirements needed to qualify for a "Merit Award" in 1949, including an attention-getting cover design, a highlights page of key financial statistics, a table of contents, management descriptions, a president's letter explaining important data, narrative reviews of the year's progress, a simplified financial statement with comparisons to previous years, a 10-year statistical comparison to indicate trends, and information on who the stockholders are.

Another magazine, Institutional Investor, began surveying leading security analysts in 1972, asking them to pick the best reports in the industries they followed. Qualities listed in those reports chosen first in their industries included

> completeness of information, discussion of trends and projection of operating results; ideal breakdown of operating and financial data; informed industry comment as well as company material; extensive breakdown of sectors of the business and detailed descriptive sections. (Institutional Investor, September 1976, p. 123)

According to the magazine, analyst comments in support of their choices revolved around two basic characteristics: the quality of information contained in reports and the quantity. By the term "quality," the magazine commented, analysts mean clarity in organization and presentation of material.

Some contests, unfortunately, have missed the point in their awards, one writer commented. The author wrote that content is often overlooked in contests because of the high standards for appearance:

> I wrote an annual report that won a lot of awards. In one of the shows in which the report appeared, the credits for it were dutifully listed: client, design firm, art director, designer, photographer, printer, press run. But not a word about writer. I was both bemused and amused . . . by the apparent lack of understanding of the overall purpose of an annual report that the omission showed. What the report said had been disregarded; all that seemed to matter was how it looked. (Public Relations Journal, August 1974, p. 12)

There are many contests still today, although the prestige of winning a particular award is questioned by some. Nevertheless, contests have contributed to the development of annual reporting standards and are likely to continue doing so.

II. ROLE OF THE ANNUAL REPORT

Depending on who the question is directed to and whether the person is from a business background or a communications background, the role of the annual report is sometimes seen differently.

Those in communications see the report as a written representation of the company; financial data almost seems secondary in importance. To finance oriented people, however, the written sections of the report pale in comparison to the financial statements. They see the report as a means by which an assessment of a company can be made primarily through the numbers rather than through the narrative.

From the communications point of view, R. S. Callvert, then an assistant vice president of public relations at AT&T, said this:

> The annual report is the most important single document issued by a corporation. . . . Most, if not all, of the functions of the annual report serve public relations purposes . . . first of all, and obviously, the annual report is the basic document for communication between management and shareholders. (Callvert, January 1965, p. 11)

For AT&T, the annual report was the fundamental document used to communicate with security analysts and others in the financial community. Callvert said it was regarded as the most important report made to regulatory authorities, plus the year's principal statement to the press.

Callvert also said the narrative section had as its main purpose the expression of the goals and objectives of the firm

> plus something of its spirit. Just what sort of company is it? What is it trying to accomplish? What does it contribute to society generally? These rather intangible matters can't be expressed in the balance statement, but they are important to the less experienced purchaser of stocks and to the public generally. (Callvert, January 1965, p. 12)

Brian Wilson, then the financial public relations manager for American Can Corp., shared a similar view of the annual report's role, calling it "the chief corporate communications vehicle of the year" (Wilson, September, 1974, p. 24). American Can's report required what Wilson called

> a graphics and verbal framework to convey the dimensions and directions of the business as they change from year to year, as well as providing meaningful financial and operational data to the shareholder and financial community.

Similarly, Elinor Selame of Selame Design said annual and quarterly reports "reinforce a well-planned corporate identification and instill in the investor a feeling of confidence that the company is, indeed, knowledgeable and well-directed" (Selame, September 1975, p. 16). She said annual reports are being used by many companies to meet different marketing needs and therefore are designed to attract and inform stockholders, analysts, employees, suppliers and the press.

Business Week also reported that more companies are using reports as marketing tools "that build images and provide product and financial data for analysts, customers and investors" (Business Week, April 1979, p. 114).

Away from the communication value of reports and toward their usefulness to investors, George Benston, a professor of finance at the University of Rochester's Graduate School of Management, had this to say:

> The formal presumption about corporate annual reports is that they contain news. And the essence of the news is thought to be in the financial statements. (Benston, April 1976, p. 73)

Benston studied the question of whether financial statements could be used to make buy and sell decisions, and therefore be of practical use to investors. He was trying to determine if stockholders could find new information in annual reports that would allow them to make a profit based on that information. His research and that of others suggests that

> the information in annual reports has already been discounted by the market by the time investors receive it. The studies have also concluded that preliminary earnings announcements have also been discounted by the market. The news is old before it is released. (Benston, April 1976, p. 73)

Reiling and Burton (1972) agreed with Benston that reports should give investors a better basis for weighing a company's earnings potential.

They wrote that reports offer plenty of information about past performance, but are "inadequate as instruments for evaluating the corporation's securities" (Reiling & Burton, 1972, p. 45). The authors urged that more information be included in financial statements to give investors an idea of what a company's future performance would be.

Reiling, at the time a visiting associate professor at the Harvard Business School, and Burton, chief accountant of the SEC, agreed that more complete historical data would improve the predictive power of financial statements. However, they wrote that an experiment should be undertaken in the use of predictive forecasts because "they are needed; they can be provided with a requisite degree of quality; and the objections to their use are outweighed by the advantages."

The authors summarized by pointing out that limited action has been taken to supply the investor's information needs beyond standard financial reporting. They concluded that

> future expectations should be reported to current and prospective investors by those in the best position to predict the company's future--its management. (Reiling & Bruton, 1972, p. 55)

Pincus (1977), discussing a capital squeeze that had the potential to drive mid-sized companies into a forced sale of equity at low prices, wrote that managers must realize investors are looking to them to help minimize risks. He said companies seeking equity capital must "level with investors and explain what they are doing about not-so-obvious problems."

Pincus also discussed the importance of helping investors understand company goals:

> The biggest single missing link in most company stories is the accent on future probability. This does not entail forecasting; it involves . . . the sharing of management's viewpoints and objectives. In short, it means presenting the company's growth potential in an entirely new way--one that's clear, meaningful, useful to investors, and yet conservative. (Pincus, 1977, p. 24).

Pincus commented that most annual reports do little to significantly reduce investor risk, adding that companies need to take a fresh look at annual report content.

Regarding the kind of additional information that would make an annual report more useful to investors, Appleman (1978) conducted a survey asking investment managers and security analysts to rank the factors they saw as most important to an investment decision. Quality of management was the near unanimous answer:

> The single most glaring flaw in corporate communication . . . is failure to do justice to the perception and competence of management. It is not so much a matter of quantity--since management appraisers are adept at reading between the lines--as a commitment to faithful representation. (Appleman, 1978, p. 10)

Rowling (1978) also was outspoken about the role annual reports should fulfill. He wrote that the only function of the annual report is to help investors decide whether to become or remain a shareholder in a company.

Rowling's perception of shareholders is that they are transient owners who buy certain stocks because they believe they can make money, not because they are biased toward the product the company sells. He cited an SEC study of small investors to back his statement that the annual report "is a major--if not the major--factor in an investment decision." The study revealed that the annual report is probably the single most important source of information about a company available to small investors. Ninety-one percent of the 4,400 shareholders surveyed said they read annual reports, while 77 percent said they read them "very" or "somewhat" thoroughly.

Dowling concluded by referring to the study's finding that just 17 percent of the investors surveyed said they relied primarily on a broker for investment decisions. "By implication, the company itself--and primarily the annual report--is an important source of information," he wrote.

Money magazine asked corporate executives, security analysts and investor relations consultants what the value of an annual report is to the investor:

> The annual report, by itself, is not a sufficient basis for making investment decisions; further research is necessary--for example, a check into the prospects for the industry as a whole. It's slipshod, however, to make investment decisions without studying a company's latest annual report and preferably the two previous ones. (Rolo, 1979, p. 90)

Although Benston's conclusions reveal that annual reports do not contain any new information, they are still apparently useful and accomplish other goals. The Opinion Research Corp. conducted a study in 1979 and found that 93 percent of the 788 financial analysts surveyed considered the annual report "the most useful written communication" a company produces. Analysts rated the annual report first among 16 corporate communication tools used to convey information to potential investors (Paskowski, 1981, p. 66).

III. HOW EFFECTIVE ARE THEY?

An anonymous writer editorialized in Dun's that annual reports rarely report. "Too often," the author wrote, "the annual report resembles one of those relief maps, with the cheerful news blown way up and the uncomfortable facts smoothed over." The problem, as the author saw it, was that annual reports do not do what they are supposed to do: "tell the shareholder what the company has been up to, what its competitive position is, the condition of its finances . . . the unvarnished facts."

The solution given was to allow independent organizations to put reports together, much the way accounts are audited:

> I know enough about the pliability of accountants to realize that such a procedure wouldn't automatically assure more accurate and meaningful annual reporting. But it might just right the balance a little. (Dun's May 1970, p. 33)

In agreement was a writer who discussed management's failure to address the average stockholder. Girdler (1963) wrote that management should "break almost completely with the traditional form and language of today's report," giving greater leeway to writers trained in magazine writing and editing.

He placed part of the blame for figure-heavy annual reports on contests, which he said have inflicted a "grievous wound" on the annual report as a communications tool. Although he agreed the motive behind establishing contests was pure, one serious mistake was made: selecting security analysts as judges. "This was akin to asking Picasso to select the covers for the Saturday Evening Post," he wrote.

Because they are sophisticated specialists who make their living analyzing numbers, analysts obviously will rate highly those reports providing the most numbers. "It soon became known to company executives that they couldn't hope for Oscars unless they loaded their reports with figures in the most minute detail," Girdler wrote. This led to the production of annual reports written to the specifications of "an unrepresentative group of men" rather than to stockholders:

> It would help if writers, journalists, and communications experts were to become the judges of what is to be said to the oppressed stockholder. (Girdler, July 1963, p. 26)

IV. PROBLEMS IN EVALUATION

Girdler's comments illuminate one of the problems that occur in evaluating the effectiveness of annual reports. He and many others believe reports should be directed to the average stockholder, while an equal number believe reports should be written for analysts. Others say the report can be written to both audiences effectively. Apparently, there will always be disagreement about the ingredients of the "perfect" annual report, as well as disagreement over who the report should be written to.

Foy (1973) writes that annual reports should be written to shareholders instead of analysts. To increase readership, he said reports must present "easily absorbed data and plainly written prose in a more sprightly and expressive fashion, and in a livelier and more readable format." Foy, former chairman of the Koppers Co., wrote that even those reports whose format is aimed at the individual shareholder usually don't communicate because most of the information is geared toward analysts, investment advisers and professional investors.

Characterizing the typical shareholder as a highlight reader, Foy recommended a format that can compete with magazines and newspapers for the investor's attention:

> For my money, the masterpiece of instant business information transfer is that jewel, the second column under "What's News" on the front page of The Wall Street Journal. There, in a few concise paragraphs, the reader finds condensations of what's inside the Journal for the day. . . . Why not issue an annual report that starts with a cover designed to pull readers inside to a discussion of general interest? (Foy, 1973, p. 50)

Cato (1983) wrote that very few companies, despite claims to the contrary, actually aim their annual report at the individual stockholder. He said the financial community is clearly the prime market. Annual reports have become "sophisticated products," he said, even though opinions about what a report should contain and what it should do "vary as much as definitions of precisely what an annual report is."

Meyer (1979) wrote in agreement that companies are really making pitches to potential shareholders and Wall Street analysts who influence investment decisions. Executives often use the reports as platforms for "preaching their philosophies and touting themselves and their companies," he wrote. Meyer said it is "hardly a coincidence" that responsibility for producing the report shifted from the chief financial officer to the head of public relations in many companies.

Carlson (1974) wrote that the company's story should be told four times to reach all segments of its audience. The financial highlights, the president's letter, the body narrative and the statistical review should each contain vital information that will satisfy analysts, general shareholders, and more serious shareholders and investors.

William Dunk, president of Corpcom Services, Inc., wrote that companies are realizing the annual report can be directed at a number of audiences in addition to investors, making it a "multi-audience" document. He said some companies are producing special reports for registered representatives, security analysts, portfolio managers, bankers, customers and suppliers, and employees that are takeouts from the annual report:

> These abridgements of the annual report are extractions of the essence pertinent to each specialized constituency. Companies that have produced mega-reports for shareholders are producing these mini-reports to have something that is readable. (Dunk, 1980, p. 12)

Regardless of who the perceived audience is, critics agree annual reports are lacking in several areas. Duff & Phelps, Inc., a Chicago-based investment research company, conducted a survey analyzing the deficiencies in annual reports.

Commissioned by Arthur Andersen & Co., one of the nation's largest CPA firms, the company looked at the annual reports of 329 of the biggest U.S. corporations. It found that analysts singled out the management discussion section of a typical report as having the greatest room for improvement. "Bias was exhibited in 20 percent of the reports, and excessive promotional language was found in 7 percent," the study found.

Duff & Phelps said managements typically fail to explain the causes or significance of developments, choosing rather to simply repeat numbers from financial statements. Investors need to know how important a new product is relative to total sales, a perspective not often given, the study said.

Forward-looking information was called for by the study, including "data on plans (capital expenditures, plant construction, new product introduction, and financing) and forecasts (speculation about future outcomes)."

Miller and Pagani (1981) reported on the ineffective way small companies tend to produce annual reports, which have great potential if done properly. They wrote that small companies fail to take advantage of the annual report because of "management myopia," especially concerning the budget:

> Because the shareholder base is small, the print run generally is only a few thousand copies, which substantially increases the per-copy cost. Management often reacts to this cost by cutting corners in the wrong places--fewer pages, no charts, graphs or photography, and selection of low-bid printers and typesetters without regard for quality. (Miller & Pagani, August 1981, pp. 12-13)

Foote (1983) agreed that the annual report, when properly handled, can be the most efficient vehicle for small- and medium-sized companies. By discussing strengths and weaknesses, the company can use its annual report to position itself for future growth, he said.

Paskowski (1981) reported that many companies fail to disclose business segment activity. She cited comments from members of the National Federation of Financial Analysts' Corporate Information Committee, which reviews reports from 500 companies in 32 industries each year. The committee found geographical, divisional and product line information inconsistently presented in many reports, and found foreign operations data inadequate.

Not all annual report readers are negative in their assessments, however. Some are positive and upbeat, choosing to look at the progress made in recent years rather than the deficiencies that still exist.

Institutional Investor commented in its annual survey in 1974 that the overall quality of annual reports improved considerably in one year:

> Whether this was in response to the increased pressures from the analytical community or to the more detailed disclosure requirements put forth by the various regulatory agencies or even stemmed from corporate managements' own desire to tell more, some clear patterns emerged: U.S. companies are not only breaking out more divisions in their annual statements to shareholders, but they are also engaging in a more candid discussion of their operations than ever before. (Institutional Investor, September 1974, p. 103)

Anreder (1978) commented on an addition to annual reporting that has greatly improved their effectiveness: the requirement to identify the sources of volume and profits. Annual reports now provide more solid information, he said:

> Not that there isn't room for improvement. Nor that the financials of every company disclose everything they're supposed to as fully or as clearly as they should. Still, a review of the current crop demonstrates that more than ever before they merit investors' attention. (Anreder, April 1978, p. 4)

Financial World declared the days are gone when companies regarded the annual report as a "once-a-year nuisance to be thrown together with a lick and a promise." Instead, managements are looking at the report as a prime vehicle for reaching an expanding audience, resulting in improved reports.

The magazine's top award went to W. R. Grace & Co. in 1979 because the company's report addressed a wide range of people.

> What was most impressive about the Grace report . . . was the degree to which we felt readers looking for different levels of information . . . could find what they wanted easily in the report. What set Grace . . . apart from the rest was the degree to which readers seeking to move from general to specifics, or from details back toward overview, were helped by the organization and presentation of the report. (Financial World, October 1979, p. 75)

Institutional Investor reported that analysts admit companies who provide accurate and detailed information in the annual report can have "a meaningful impact on the quantitative and qualitative sponsorship of its stock." The reason: if hard times hit, it is important that the company is understood by the financial community. An informative annual report as part of a corporate communications program can only help.

Samuel Bishop, president of Annual Reports, Inc., a New York-based financial services firm specializing in marketing equities to individual investors, stated succinctly his analysis of the state of annual reporting:

> There will never be a definitive text on the perfect annual report. It's best to encourage new ideas and creative thinking in the presentation of the corporate story. (Public Relations Journal, September 1975, pp. 36-37)

CHAPTER V

LOWE'S COMPANIES, INC.

I. COMPANY HISTORY

Lowe's began quietly when L. S. Lowe opened a hardware store in North Wilkesboro, N.C., in 1921. According to the company's 1971 annual report, it wasn't until 1940 that the future of the hardware store was perceived as going beyond the town of North Wilkesboro.

In that year, L. S. Lowe's daughter, Ruth, sold her interest in the hardware store to her brother, James Lowe, for $4,200. She also married H. Carl Buchan Jr., who was then employed by the Atlantic & East Carolina Railroad.

In 1942, Buchan enlisted in the U.S. Army and James Lowe joined the Army Air Corps, leaving the operation of the store to Mrs. Buchan and her mother. When Buchan was injured and discharged in 1943, Jim Lowe offered him half interest in the store if he would inventory the stock and pay him the amount of the inventory.

Buchan tallied a $12,500 inventory consisting of notions, dry goods, snuff, produce, groceries, small miscellaneous hardware and building material. He sold out all the stock except the heavy hardware and building materials, believing the business' future "is limited only by our own imagination and ability."

Buchan was innovative and bold, according to the annual report. He envisioned his stores as mass marketers of building materials. According to the <u>National Home Center News</u> (NHCN),

> The main reason for the business' growth came from the simple yet revolutionary idea of Carl Buchan. At a time when virtually all building materials in the country were sold through a rigid distribution system . . . Buchan and Lowe began buying from the manufacturers and selling directly to the builders, eliminating the wholesalers. (NHCN, December 17, 1984, p. 62)

His success at mass marketing eventually led him to build more stores. In 1949, Lowe's opened its first expansion store 40 miles from North Wilkesboro. Later, Buchan and Lowe purchased a car dealership and a cattle farm together. Buchan devoted himself to the marketing of building materials, while Lowe committed himself to automobiles and cattle. In 1952, Buchan traded his interest in the dealership and farm for Lowe's interest in the two stores.

"Predictions were that I would fail; my trade connections said that I would not last beyond 90 days," Buchan was quoted as saying. But 90 days later he opened the Asheville, N.C., store and Lowe's was on its way. Sales increased from $4.1 million in 1952 to $27 million in 1959, with 12 stores added along the way.

The company's management team began to develop in 1954, when former clerk Petro Kulynych became vice president in charge of purchasing. Leonard Herring came to Lowe's as an accountant in 1955 and became secretary and treasurer in 1956. Joe Reinhardt was hired to work in the company's data processing department and later integrated warehousing, materials handling and data processing. Robert Strickland came to the company in 1957 from the Harvard Business School and worked in advertising and marketing. John Walker, a sales executive at General Electric, became Lowe's sales manager in 1958.

Buchan's vision continued to enlarge as sales reached $30.7 million in 1960. "I now desire to build this business into the largest and most successful of its type in the world, owned and controlled by those who have built it," he said.

In his endeavors to keep employees interested in the company's welfare and to make them wealthy besides, Buchan instituted a profit-sharing plan in 1956. According to NHCN, many people increased their income considerably as a result of Buchan's vision.

> The wealth was created because Lowe's profit sharing--established by founder Carl Buchan--which preceded the current Employee Stock Ownership Plan, allowed employees to benefit from the extraordinary increase in the value of the company's stock, which sold for 31 cents in 1962 adjusted for splits compared with $24 today (1984). (NHCN, December 17, 1984, p. 74)

Unlike other profit sharing plans in which only 10 to 25 percent of the employees' money is invested in the particular company's stock, with the remainder placed in other investments, Lowe's plan had 70 to 90 percent of its total invested in Lowe's stock. The stock's performance from 1961 to 1978, during which time it was selected as one of the top 50 growth stocks, accounts for the fact that many employees became millionaires.

Long before anyone became a millionaire, however, Buchan died of a heart attack in October, 1960, at age 43. His vision nonetheless had affected his young management team, who worked together to carry out Buchan's plans.

Realizing they were virtually unknown to the financial community, the management team established their credibility by recruiting respected businessmen. Edwin Duncan, president of the Northwestern Bank, was recruited to become the CEO, and the firm's legal counsel, William McElwee, was appointed vice president and a director. Investment banker George Cadwgan became the third outside board member.

According to the annual report, Buchan's planning had called for the Lowe's Employees Profit Sharing Plan and Trust to buy blocks of his stock periodically during his lifetime and the balance at his death. During 1961, the management team agreed on a suitable plan of action: they borrowed $5 million to purchase the firm from Buchan's estate for the profit sharing plan, giving Lowe's employees the opportunity to own the company they helped Carl Buchan build. The company then went public to repay the loan and embarked on what the annual report called Lowe's Growth Phase.

From 1961 to 1971 stores were increased from 15 to 75, sales from $31 million to $169.7 million, earnings per share from 23 cents to $1.56, and net worth from $5 million to $30.5 million. In 1970, Duncan stepped down as president and the executive committee, consisting of Herring, Kulynych, Strickland, Reinhardt and Walker, became the Office of the President. Duncan retained his title as chairman, and Cadwgan and McElwee remained as board members.

Though it faced some turbulent times in the 1970s due to an unstable economic environment, the company continued to grow. From 1971 to 1981 the number of stores grew by 11 percent, sales by 17 percent, earnings per share by 9.9 percent and net worth by 19 percent.

By 1978, however, management by committee through the Office of the President became unworkable in a company of Lowe's increasing size. A New York consultant was called in to study the situation; he recommended Herring for the post of president and CEO, and Strickland as chairman. The 1978 annual report announced the change to investors as "an evolutionary and positive step in the organization of Lowe's." It said the change was made

> to more effectively utilize the experience of these executives in different areas simultaneously--to continue Lowe's present business, to strengthen its financial and operational base, to research and develop new areas for growth and profitability, to respond to new demands for Board responsibility, and most importantly, to train and develop new leaders for Lowe's for the 1980s.

The company's 1984 earnings surpassed $61 million on sales of close to $1.7 billion, and shareholder's equity reached $341 million. As a tribute to Lowe's growth as the industry leader, National Home Center News featured Lowe's in its tenth anniversary issue, allocating 90 pages of the magazine to coverage of Lowe's.

II. OUTLOOK

According to Strickland, Lowe's management has worked since 1978 to change Lowe's from a professional orientation to a more retail-oriented business. The company has repositioned itself to where the consumer has become the core of Lowe's business, with retail sales now exceeding sales to professionals.

National Home Center News (NHCN) disclosed in its special report on Lowe's that the company's retail sales nearly doubled from 1979 to 1983, reaching $724 million. Lowe's, the nation's largest building material retailer, posted total sales of close to $1.7 billion for fiscal 1984.

Lowe's is positioning itself to "have it both ways," NHCN reported, serving both the builder and the consumer.

> If Lowe's succeeds at retailing, as seems likely, and no other chain develops a pro sales expertise, then by the end of the decade Lowe's will be uniquely positioned, perhaps invulnerable. (NHCN, December 17, 1984, p. 25)

Lowe's decision to shift its emphasis from professional to retail sales was due in part to a deep housing recession in the early 1980s. Although the importance of pro sales has not diminished, the company has learned that "diversification can cushion results in a down home building year," NHCN reported.

The company's expansion plans hinge on filling in present markets with additional stores, enlarging the size of its existing units, moving into cities of greater population with larger stores and purchasing faltering chains, NHCN reported. The expansion represents a "bold move for the chain, which over its history has positioned its stores primarily in 'Smalltown America' in the southeast."

Financially, the company is in good position to fund its expansion. According to NHCN, Lowe's has one of the strongest balance sheets in the home center industry, and by some measures in the retailing field.

In a 1984 Statistical Review of the Retailing Industry, Lowe's was "an outstanding performer in earnings power, and Lowe's tops the other firms by small margins in return on common shareholder's equity" (Gurczynski, December 17, 1984, p. 115). The study, produced by First National Bank of Chicago, also revealed that Lowe's 15 percent debt-to-equity ratio is one of the lowest in the industry, "giving Lowe's an outstanding, fiscally conservative balance sheet."

By keeping a fair-sized cash reserve and a low debt-to-equity ratio, Gurczynski wrote, Lowe's is positioned to take advantage of favorable opportunities in the financial markets.

> Using the proceeds of the planned debt placement along with earnings generated by operations and its current cash balance, Lowe's will have the funds needed to carry out its "5 + 10 = 20" expansion strategy. It will be able to add 5 percent in new stores and an additional 10 percent

> in space to existing units to equal a 20 percent increase in sales floor space. (Gurczynski, December 17, 1984, p. 120)

III. SUMMARY

National Home Center News Editor Wyatt Kash wrote that Lowe's went through an important metamorphosis for the past five years which is likely to put it in "an enviable strategic position before the end of this decade."

The transformation, he wrote, involved much more than the company's store remodeling campaign and internal thrust toward consumer retailing.

> The real change is the reorientation of the mindset of Lowe's people, and indeed a company culture, that once placed the contractor high above the consumer in importance, where now, both are of equal importance. (Kash, December 17, 1984, p. 13)

Nevertheless, Lowe's is playing a catch-up ballgame, Kash wrote. He said the company's efforts to remerchandise and remodel its stores has been "imaginative and sweeping," but progress appears slow when compared to the rapid changes occurring in the rest of the home center industry. Consumers in many of Lowe's markets are taking advantage of the choices they have due to the fact that they can shop at more than one retailer. Although Lowe's has "done its homework well," Kash wrote, so has the competition.

Yet a new "wave of excitement" has overtaken Lowe's employees regarding the new series of larger stores the company has opened recently, an attitude that will be important to the company's future.

> That excitement comes at a time when Lowe's, for the fourth year in a row, will post retail sales exceeding builder sales--in what proved to be another strong home construction year. The combined effect will yield an

> estimated $1.7 billion for Lowe's by the end of the fiscal year (1984), catapulting it a half-billion dollars ahead of second-ranked W. R. Grace. (Kash, December 17, 1984, p. 13)

The ability to convert warehouse and storage areas to retail sales floors gives Lowe's "tremendous potential to increase sales substantially, almost overnight," Kash wrote. The way the company has repositioned itself in the professional business will also translate into higher sales and profits. "Lowe's has successfully begun marketing itself to a host of light industrial, government and commercial customers," Kash wrote, accounting for 20 percent of the company's pro sales.

Kash wrote that Lowe's has "an overwhelming head start over the rest of the home center and building supply industry in bracing for the long term." He concluded:

> Aside from a host of independents, few retailers are in as strong a position as Lowe's to capitalize on the full potential of the professional and commercial side of the market. Lowe's may be playing catch-up ball now, but in the long run, it may be the industry playing catch-up ball with Lowe's. (Kash, December 17, 1984, p. 13)

IV. DEVELOPMENT OF INVESTOR RELATIONS

In its 1970 annual report, Lowe's explained its developing philosophy of communicating with shareholders:

> From the beginning, Lowe's management has believed in aggressive balanced growth, and has attempted both to communicate this story to its stockholders and to translate this policy into action and a sustained growth performance record in sales and earnings.

The true beginning of its stockholder communications was in 1961, when the company went public. Robert L. Strickland, currently Lowe's chairman of the board, recalled the way he assumed responsibility for the annual report.

Strickland joined the company in 1957 to manage the firm's advertising and marketing. Following the death of Carl Buchan in 1960, the company went public to repay a loan secured to buy the company from Buchan's estate. Once the company was publicly held it was required to publish an annual report to shareholders.

As Strickland recalled, the management team said, "Gee, we need to do an annual report. Strickland, you do it. You're an English major" (Strickland, personal communication, 1986). Prior to attending the Harvard Business School, Strickland earned a degree in English from the University of North Carolina.

To help with the first report, Strickland contacted Matt Phelan, a manager at an Atlanta-based communications firm. Phelan, who has continued to work with Strickland on all subsequent reports, walked him through, establishing a standard to model later reports after.

Phelan's practical skills combined well with Strickland's strong interest in maximizing shareholder value to create what Strickland called a unique, differentiated and consistent annual report, elements which the company has tried to maintain in all of its investor relations efforts. Strickland wrote the reports from 1961 until 1978 when Deborah Kelly was hired to work in investor relations. Later Kelly was replaced by Bill Brantley, who left in 1984 to establish his own consulting firm. The current investor relations staff consists of Strickland, vice president Cliff Oxford, and director of research Henry Roemer, plus a departmental secretary and a librarian.

In 1972, Financial World magazine selected Lowe's 1971 annual report as the "best annual report of all industry." Strickland was given the opportunity to discuss Lowe's "annual reportsmanship" in an article appearing in the magazine's awards issue.

Strickland wrote that Lowe's reports fell into three distinct phases: the first phase covered the first six reports; the second phase was the 1968 report; and the third phase began in 1969 and was to continue.

The size of the reports grew over the years, he wrote. The 1964 report had just 12 pages, and said "space does not permit a full account of our winning combination:"

> With hindsight, that clearly was inadequate annual reporting. In 1967 and 1970, we followed the old dictum of cutting back the size of the reports when sales and profit growth were not up to their normal exuberance. I believe this was and is a mistake. All of our corporate stories need telling, annually and completely. (Financial World, October 25, 1972, p. 102)

Strickland wrote, however, that the physical characteristics were secondary to the conceptual and editorial approach of the reports. The phase one reports were based on what he called the "cliche" format:

> "Last year the theme of the report was Organization. This year, let's concentrate on our Product Line. Then next year we can completely treat Marketing. . . ." This represented a deadly assumption that our shareholders and other audiences remember last year's report and are waiting breathlessly for the next episode of the unfolding Lowe's story. We were apparently trying to develop a sort of psychological penpal relationship with our readers. (Financial World, October 25, 1972, p. 102)

Strickland believed this approach was not acceptable, even though a good theme could increase readership and provide "graceful continuity." He wrote that "it cannot substitute for the structural basics."

The second phase was the 1968 report which described Lowe's completely, Strickland wrote. Although the report received an award, phase two began and ended with that report. As Strickland wrote, he got one of those "Oh, no!" feelings when the report came back from the printer.

> The thought pattern was something like this: "Okay, you set out to describe Lowe's, and you did it better than in previous years. But is Lowe's an isolated entity, just spinning around in space somewhere unconnected to the rest of the world? Aren't you absolutely dependent on, or subject to, many outside factors? Well, how can you tell the story of Lowe's without positioning the company in the economic scheme of things?" (Financial World, October 25, 1972, p. 102)

According to Strickland, analysts also provided feedback on the reports, which led him to pursue phase three beginning with the 1969 report. In it the company was described in a less "confining" way so it would not be visualized in terms of just its product line or some other aspect. His approach:

What We Are, includes by description:
1. Our Suppliers of Merchandise
2. Our Suppliers of Money
3. Our Suppliers of Services
4. Our Employees
5. Our Customers
6. Our Shareholders

What We Do, includes:
1. Selecting Opportunities
2. Determining New Store Locations
3. Motivating the Personnel
4. Motivating the Market
5. Writing the Business
6. Growing and Expanding

Strickland wrote that this comprehensive format allowed him to pack the reports full of charts and graphs and to discuss statistics having a major impact on Lowe's success. The reports would include information on retailing, construction, housing starts, savings and loans' funds, the Gross National Product, and trade and competitive comparisons. Lowe's growth would be analyzed by store, by product and by customer in a 5-year review; a 16-year review of performance would be included as well as 5-, 10- and 15-year compound growth rates for each period.

This format has been used ever since, and has greatly aided the company in responding to inquiries:

> The annual report is a tool for management. If it is organized well, it requires us to keep less files. It answers more questions more readily. If an analyst calls and says, "What was your sales per square foot?" we're not guilty of not having provided that information. We can tell him, then refer him to the annual. Also, that reinforces the need for them to use that document as a source. (Roemer, personal communication, 1985)

Another change occurred in 1967 when the first readership interest survey was conducted, making the annual reports "a vehicle for two-way communication." The results of each survey are published in the subsequent report. Strickland concluded:

> Like most companies, we use the annual report as a principal corporate communications publication and distribute it to a number of diverse audiences. We structure and edit much of the content for analysts and other professionals, but we try to keep the narrative in layman's language as we meld it all together. (<u>Financial World</u>, October 25, 1972, p. 102)

V. CURRENT PRACTICES

In the 1981 annual report, an article summarized the function of investor relations at Lowe's, giving credit to Strickland's annual reporting:

> Traditionally, IR at Lowe's has stood on the sound foundation of an incomparable annual report, begun more than 20 years ago by Bob Strickland and which over the years has become the most honored annual report in America.

In addition to a "well-thought-out" annual report, Lowe's "weds the twin thrust of active and frequent communication with securities analysts and portfolio managers . . . who in the most real of senses are the determiners of Lowe's future value" (1981 annual report).

In its attempts to communicate creatively each year, Strickland said, Lowe's has used a variety of approaches in its annual reports. Strickland and investor relations vice president Bill Brantley asked a group of analysts who follow the industry to participate in a group interview for publication in the company's 1980 report. Six analysts gathered in New York to discuss Lowe's and "the climate in which Lowe's does business." The interview was published "for the information, and hopefully, the benefit of all shareholders, most of whom never see the writings of a securities analyst."

Many other efforts have been made each year to communicate more clearly and directly with shareholders and other audiences, in fulfillment of the goal of Lowe's IR efforts: "The single-purpose goal of this vital function is appropriate evaluation of the company at all times by an increased number of investors" (1981 annual report, p. 32).

Director of research Henry Roemer explained in more detail the purpose of Lowe's efforts:

> The whole concept of annual reporting and investor relations is intended to lower the cost of capital for the company by increasing awareness and reducing the perceived risk to the individual security holder and helping them understand management, helping them understand the investment. (Roemer, personal communication, 1985)

In its profile of Lowe's in 1981, National Home Center News (NHCN) devoted one section to the company's investor relations, defined in its 1983 annual report as

> The professional practice of ways to keep investors--past, present and potential--fully informed about all events--

> internal and external--which are needed or will help investors make an informed judgment on whether to buy, sell or hold stock.

Mark Appleman, editor and publisher of the Corporate Shareholder, a biweekly newsletter for investor relations executives, said Lowe's "is probably among the best in the country" at investor relations, according to his research.

NHCN reported that others feel similarly about the quality of Lowe's IR efforts. The newspaper said it is generally acknowledged that

> an effective investor relations program can communicate a company's accomplishments and potential, which may ultimately affect the availability of capital by maintaining the stock price at a fair market value. (NHCN, December 17, 1984, p. 118)

Analysts, it reported, are "laudatory" about the Lowe's investor relations program. However, Lowe's return on its IR investment is something that not all believe can be precisely determined. Board member George Cadwgan told NHCN that he wondered

> whether the benefit company stockholders get from long years of putting out some of the best reports in America can be proven. The truth of the matter is it's not possible. (NHCN, p. 118)

Brantley, Lowe's former vice president of investor relations, takes the opposite view. "I disagree that investor relations is intangible. You can quantify it every day through the stock price. Lowe's carries a premium to the industry." He continued: "A good investor relations program is worth one P/E (price/earnings ratio) point, if not two. At Lowe's, one point is worth $36 million" (NHCN, p. 118).

Brantley also discussed the importance of price appreciation as opposed to securing a solid bottom line, which he said does not necessarily affect price appreciation. Getting the company's message across is the key to price appreciation, he said, and Lowe's spends "something under $1 million a year" to do that.

As NHCN reported, Lowe's IR program includes quarterly reports and meetings with analysts, "a comprehensive, original and readable" annual report and various field trips where investment professionals have an opportunity to observe Lowe's operations and interact with its management (NHCN, p. 118).

What analysts regard as being the most useful aspect of Lowe's program is not "the plethora of numbers and facts" which are included in Lowe's comprehensive reports, NHCN reported. What is more important, according to one buy-side analyst, is

> access to various people in the company in various disciplines. In any investment decision, having access to people running the business is critical. The investor relations guy is just repeating what he's heard in the lunch room. (NHCN, p. 118)

Another analyst commented that Lowe's does not seem to be afraid of the truth:

> Many, many corporations, regardless of size, typically don't have the sense of confidence that Lowe's does to allow people to talk in the organization.

The analyst said he values the rapport that exists between the company and analysts; when he has a question that has him stumped, he can call the company and get a quick answer, he said. Another analyst commented that Lowe's effort to communicate openly and honestly

> gives you a better insight, better appreciation and feel for their strategy and their capabilities of executing that strategy. It boils down to a confidence level when you recommend the stock. The more you know about any given company, the higher degree of confidence you should have, the more you feel comfortable with management. (NHCN, p. 118)

Brantley and his successor Cliff Oxford both believed investor relations really boils down to marketing the company. Brantely said that relationships established through regular contact between company executives and the investment community are extremely important. These relationships can influence an analyst to favor Lowe's in an investment choice between Lowe's and comparable companies, he told NHCN.

Oxford talked about the next step for Lowe's:

> To become a more visible corporate citizen and to work toward enhancing our position not only by sharing information with our investors, but also in government relations--legislation that can affect our company. (NHCN, p. 121)

Oxford's comment about the direction of Lowe's investor relations is very similar to a comment made in the Public Relations Journal in 1961 concerning annual reports:

> The financial report must go beyond the financial statements and statistical measurements. It must bring into focus those factors--past, present and future--that explain how the business cycle, governmental fiscal and regulatory policies, supply and demand and other economic elements relate to and affect the progress of an organization. (Watkins, February 1961, p. 16)

Concluding its article on Lowe's IR efforts, NHCN reported that other industry leaders believe Lowe's "highly visible" investor relations program "has helped establish on Wall Street that the home improvement retail industry is a distinct, investment-quality industry."

VI. IR PHILOSOPHY

According to Strickland, the fact that Lowe's shareholders were mostly employees when the first annual report was produced created an interesting motivation. As an elected member of the board of directors, Strickland said he was aware that he was working on behalf of shareholders to maximize shareholder value. One essential ingredient to accomplishing that goal was consistent communication, he said.

As a member of top management, Strickland said he was fortunate that he didn't have to persuade the others to consider the value of consistent communication, or to have investor relations accepted.

A concrete example of how Strickland's philosophy has become established at Lowe's came through in the comments of former vice president Bill Brantley. Concerning disclosure responsibilities in general and the annual report in particular, Brantley said most companies see it as

> an onerous job that they'd just as soon get over with as fast as possible. It's an interference by the SEC in the business of the company that outsiders don't have any real business being in . . . very few companies see it the way Strickland sees it, as something that can enhance the entire company. (Brantley, personal communication, 1985)

Strickland agreed with Brantley, who guessed that less than 5 percent of all companies look at investor relations and annual reporting as Lowe's does. Strickland said that many in top management are out of touch--they are tuned out to the benefits of investor relations and in many cases don't believe it is necessary.

Examples of Strickland's analysis surfaced in an article on investor relations appearing in Institutional Investor. Square D, an electrical equipment manufacturer, has a reputation among analysts as being "standoffish" and uncooperative. "Not one of us has even seen the CEO of Square D," one analyst said. "We wouldn't recognize him in the middle of Times Square with no one else in sight."

Because of its erratic earnings record, the company has not been helped by being secretive about its performance; its lack of communication causes analysts to attach a higher risk to investment in the company's securities.

> Square D's policy does affect my evaluation of the company. It may not affect my estimates, but it definitely affects my judgment of the risks involved. And I believe it affects the stock price. (Archbold, October 1977, p. 169)

Strickland said many in top management feel analysts "run" the company and push them around. By contrast, Strickland enjoys "being challenged intellectually" by Wall Street's best and considers them "unpaid consultants" to his business whom he is willing to court.

Irene Phillips, corporate secretary in Lowe's investor relations department, has accompanied Strickland at analyst meetings. "When you go to these analyst meetings, you realize how they feel about him, and how much they're in awe and respect him. He's a brilliant man" (Phillips, personal communication, 1985).

Oxford commented that the investor relations philosophy at Lowe's reflects Strickland's attitude about open communication with investors and analysts:

> He makes this work in here very exciting and very challenging because he himself takes a great deal of interest in public relations, corporate relations and investor relations. That in itself gives us the latitude to seek out new sources of data. We're not layered in a situation where we can only just do so much and go so far. He is a gifted speaker, he's a very gifted writer, he's a very gifted communicator. (Oxford, personal communication, 1985)

Strickland spoke of the importance of differentiation to a company, or its ability to continue to position itself for growth. He said Lowe's current strategy is to market its stock "not with the industry, per se, which is down, but as a top stock in any portfolio."

In the 1970s, Lowe's enjoyed such a position. According to Strickland, it was one of the 50 favored growth stocks. The company benefitted from the prevalent "one-decision" mentality of that decade--investors would buy a company's stock and hold it forever.

Nevertheless, Lowe's went through what Strickland called

> a lean nine-year period where the stock was low despite dividend and earnings increases. We had to "walk by faith," believing investor relations was useful despite the lackluster performance of the stock. We believed in the company. (Strickland, personal communication, 1986)

Henry Roemer concurred, saying that a company's policy on disclosure should not change because of the performance of the company.

> The important thing . . . is whether it was a good or a bad year, you've got to communicate and you've got to continue building credibility. A good annual report in a good year that says that is great. An . . . annual report that tells things may not be roses, but puts the best foot forward for the company, and puts it forward in a factual and reasonable way . . . is still a good annual report. (Roemer, personal communication, 1985)

A company, however, must position more than its stock, Strickland said, referring to how Lowe's positions itself among competitors. In 1967 Lowe's began to include a market research section in its reports to give investors a chance to compare the company with competitors. Business and Society Review selected Lowe's as having one of the best 10 annual reports in 1978 because of its market research.

> Lowe's Companies is the smallest of these 10 corporations (IBM, Polaroid, Coke, Chrysler, Nabisco, AT&T, Citicorp, Shell and Tenneco), but it produces the best annual report. . . . By the time you finish reading this report there isn't much you won't know about the company: its sales mix, the number of customers served, sales per store, sales per square foot, average customer purchase, return on assets, performance compared to other retailers, personnel philosophy, profit-sharing program, number of shareholders and where they live, explanation of the Lowe's stock certificate, a corporate history, a foldout financial analysis that's carried back 16 years, and an index to help you find anything you may have missed. (Moskowitz, 1978, p. 49)

Lowe's interest in two-way communication is evidenced by its shareholder survey, an annual tradition for many years. It provides the investor relations staff with feedback concerning the effectiveness of its reports. A sample of the comments received regarding the 1984 report shows that most regard the report as helpful, but some perceive it as being overdone. Positive comments:

> I prepare a couple research reports using about 200 annual reports for basic data. Lowe's is one of the best. . . . This is one of the best organized annual reports I have seen. I commend those planning and producing this report. The editorial and visual approach brings out the special character of your company. . . . This is the most easily absorbed and at the same time interesting annual report I have read. . . . As a Lowe's employee I enjoy the privilege to own stock in and continue to invest my money in a dynamic company which will provide for my family when I reach retirement age. (Shareholder survey responses, 1985)

Not all shareholders or analysts are enamored with Lowe's reports, however. Some of the negative comments:

> Report is too ostentatious. . . . Too much junk. . . . Overall, I'd like to see Lowe's spend less money on the report and increase the dividend with the savings. . . . Spent too much on annual report. Wasteful. . . . It was a beautiful and well-organized report. It might even win a prize from Financial World or Forbes--but is it worth it to your business? How about cutting out fat and paying more dividends? (Shareholder survey responses, 1985)

Despite the negative comments, Strickland's annual reporting philosophy is not likely to change drastically. He said he decided to tell the whole story of Lowe's each year at the risk of boring "old friends" to give new investors a grasp of Lowe's.

One subjective benefit of Lowe's investor relations effort was being recognized in the book, <u>100 Best Companies to Work for in America</u>, by Levering, Moskowitz and Katz. According to Strickland, the authors never would have heard of Lowe's had it not been for its investor relations.

> One of the authors received our annual report from a guy on the West coast. It was the best he'd seen. Consequently, he decided to look into the company. (Strickland, personal communication, 1986)

VII. SUMMARY

As each member of Lowe's investor relations department commented, Strickland's philosophy has been the guiding hand behind all of the company's investor relations efforts. Oxford commented that Lowe's philosophy has stemmed in part from the fact that the company's roots are in "a little tiny town in the middle of nowhere."

> Lowe's has always been a small regional company located in a very small, southern town that was a good distance from any major airport. We are not easily accessible to investors, to suppliers, to manufacturers. They have to make an effort to come see us. . . . Therefore, we felt we had to go one step ahead in this tool (annual report) to expose ourselves to the public when they typically do not see us personally or have that much contact. (Oxford, personal communication, 1985)

Roemer also referred to Strickland's pioneering ways which laid the foundation for the company's current philosophy of open communication. He spoke of the benefits which Strickland must have perceived years before:

> We at Lowe's have always had a very open and gracious relationship with security analysts. I think that pays off for us. They become our spokesmen and friends on the Street when we're not there. That's the way it should work. (Roemer, personal communication, 1985)

Likewise, Brantley spoke of how the attitude of the investor relations department is a reflection of Strickland's presence:

> My attitude was if this is an obligation (producing the annual report), why not make it into something more than an obligatory thing? Make it into something that is enhanced all up and down the line and turn it into something that is very significant. (Brantley, personal communication, 1985)

Finally, corporate secretary Irene Phillips summed up what is the prevalent attitude toward Strickland and toward working at Lowe's:

> He is just absolutely admired in this company. It's wonderful to sit down and talk with him. When you have a chairman of the board who meets anybody in the hall and knows virtually everybody by name, can come in and sit down to the smallest one of us, it has an effect on all of your people. You're really very loyal. If you were around Lowe's long enough you'd realize the people here, they not only really like the company, but they feel like I do: they're working for themselves, too. That makes you really try to make money for Lowe's. (Phillips, personal communication, 1985)

CHAPTER VI

SUMMARY AND CONCLUSIONS

I. SUMMARY

Lowe's Companies, Inc., started as a small-town hardware store in 1921 and later became a chain in the state of North Carolina. Fulfilling the vision of its original owner, Carl Buchan, the store expanded throughout the Southeast to become the nation's largest building material retailer. In 1986, Lowe's operated more than 280 stores from North Carolina to Texas.

In 1961, shortly after Buchan's death, the management team arranged to buy the firm from Buchan's estate for the profit sharing plan, giving Lowe's employees the opportunity Buchan had wanted them to have: to own and control the business they helped build. The company went public to finance the transaction and embarked on its plans for growth.

As a public company required to disclose its performance to shareholders, Lowe's began its investor relations efforts in 1961 with its first annual report. Its current chairman, Robert Strickland, was responsible for the company's investor relations efforts. In 1986 Strickland still heads that group. His staff consists of vice president Cliff Oxford, director of research Henry Roemer, a corporate secretary and a librarian.

The company's exceptional performance over its 65-year history has provided it with a corporate story that has been noticed on Wall Street, evidenced by the stock's performance since it was first traded over the counter in 1961. Strickland started with the desire to maximize shareholder value, viewing his communication of the company's story fully and candidly as essential to that goal.

Over the years, the company in general and Strickland in particular have been recognized and have received awards from various organizations for an exceptional job, as compared with other public companies, in communicating with shareholders and other audiences interested in the company. Most recently, the firm's 1984 annual report received the second place citation in Financial World's "best of all industry" annual report contest. Awards are not specifically sought by the investor relations department, however:

> We do not do our reports or allocate our budgeting or try to do something just for an award. It's nice that they are there. I think that would be a pretty shallow position, trying to please judges vs. trying to please your shareholders and trying to please your employees who see the report. I think our goals are just set high enough to where we typically do win as we go along. . . . We're out there to achieve as much as we can in disclosing data to our shareholders and employees. (Oxford, personal communication, 1985)

The company's investor relations philosophy can be traced to Strickland, who until 1978 carried out all of the IR activities. In 1978, the Office of the President was disbanded in order to set up a more effective management structure. Strickland became chairman of the board and recruited an investor relations professional to carry out daily activities in order to maintain the frequency of communication he felt was important. Since that time the IR staff has been increased to four to more effectively communicate Lowe's story to shareholders and the financial community.

Lowe's philosophy appears to be one of the reasons its performance has not gone unnoticed. As a "small-town company" with headquarters off the main thoroughfares, Lowe's has chosen to consistently communicate its strategies by taking its story to the financial community. In order to be recognized as a growth company, Strickland said, "It isn't enough just to do well. You've got to do well, and you've got to communicate how well you've done. You've got to get credit for it" (Strickland, personal communication, 1986).

Business Week (1962) reported that a firm's ability to communicate effectively with its shareholders depended on management's perception of the shareholders. Lowe's management appears to be mindful of the shareholder's importance, given the fact that a large number of its shareholders have always been employees. Consequently, the company has commented in its annual reports that "from the beginning, Lowe's management has believed in aggressive balanced growth, and has attempted . . . to communicate this story to its stockholders" (1970 annual report).

Mellott (1960) wrote that the rapid growth of companies in the 1950s and 1960s forced them to seek outside financing through public stock offerings, causing business owners "to give up partial ownership to investors." Lowe's history indicates that management didn't necessarily "give up" partial ownership to investors, but rather purposely included them, according to Buchan's intentions, as joint beneficiaries in the company's growth.

As an example, its employee stock ownership plan (ESOP) holds more than 25 percent of all the company's stock, a proportion that increases each year as the company makes annual contributions to each employees' account to buy more stock. One reason Lowe's ostensibly was included in Levering, Moskowitz and Katz' book, 100 Best Companies to Work for in America, was because of its concern for employees:

> The Lowe's ESOP served as a model for ESOPs now being created all over the country. Strickland . . . insists that profit-sharing made the company successful, helping to motivate people. He cites figures showing that Lowe's sales and profits per employee are more than double those of the three biggest retailers (Sears, Kmart, and J.C. Penney). "What is more Republican than making people capitalists? And what is more Democratic than sharing the wealth?" Strickland said. (Levering, p. 191)

The attitude of Lowe's employees supports Strickland's view that the ESOP makes them feel like part owners, giving them "an unusual degree of commitment to the success of the enterprise" (Levering, p. 191). Lowe's was also chosen by Business and Society Today as one of the top 10 companies regarding social responsibility because of its corporate reporting and its stock ownership plan, Strickland said.

Theodore Pincus, president of the Financial Relations Board, Inc., a firm that specializes in financial relations counseling, wrote that investor relations' "business" is "to provide investment information with the purpose of imparting more and more knowledge . . . to more and more people." Similarly, Lowe's 1981 annual report stated "the single-purpose goal of this vital function is appropriate evaluation of the company at all times by an increased number of investors."

Saxon (1964) discussed some of the reasons investor relations has progressed slowly, indicating the most obvious shortcoming was management's lack of interest in investor needs.

Strickland, in contrast, sees himself as working on behalf of shareholders to maximize shareholder value, a description not uncommon in top management. However, his involvement with investor relations activities provides evidence in support of his statement.

An article on investor relations in Chemical Week (1984) highlighted the importance of top management's attitude and involvement in a firm's investor activities:

> An extremely important requirement for a successful investor relations program . . . is a strong commitment from top management. Without that, investor relations will not be the truly effective financial tool that it can be. (Chemical Week, February 15, 1984, p. 35)

Likewise, a Public Relations Journal article in which a panel discussed investor relations mentioned the importance of top management:

> Like any other program within a corporation, IR should have a focus, reflect overall corporate strategy, and have defined lines of responsibility between the top executive and investor relations. . . . If you don't have the involvement of top management, don't bother with IR. . . . The programs that seem to be effective and useful are the ones that do have the backing of top management. (Public Relations Journal, April 1984, p. 20)

Until 1978, when the first full-time investor relations specialist was hired at Lowe's, Strickland produced each annual report and took care of all other investor-oriented activities. His hiring of an assistant was an affirmation of what Savage (1970) wrote in the Harvard Business Review:

> Obviously, the chief executive of a corporation cannot spend all his time carrying the gospel of financial progress to captains of the investment industry; nor can they, in turn, give all their working hours to such meetings. Acknowledging this, both sides have independently delegated the day-to-day conference function to others. (Savage, 1970, p. 126)

The potential danger of abandoning the function because the daily responsibilities have been given to the assistant apparently have not materialized at Lowe's. Savage wrote that

> When the investor relations executive has the good fortune to be associated with a top management that is sensitive to his function, the experience is an uncommonly rewarding one. (Savage, 1970, p. 127)

Lowe's current investor relations vice president, Cliff Oxford, had this to say about investor relations at Lowe's:

> The real success of this function and this department in the company is because of our chairman of the board. He is a great believer in communications. This department reports directly to the chairman of the board . . . all other departments report through other lines of responsibility . . . this is the only department that actually comes under his domain. (Oxford, personal communication, 1985)

II. CONCLUSIONS, FUTURE RESEARCH

This study's purpose was to generate hypotheses and raise questions for further research. Observations and questions from reviewing the report and potential areas of research will be discussed.

The perspective management has on the role of stockholders is one determining factor in how intensive investor relatons efforts will be. Where management sees the stockholder as owner, IR efforts are typically going to be more extensive and qualitative; where the stockholder is seen as a nuisance, IR can become mechanical and investors might have trouble getting a true evaluation of a company.

One important person closely associated with true evaluations of companies is the analyst. As key figures on Wall Street, analysts play an important role for public companies. It was brought out in this report that the quality of the relationship between management and analysts can be an important factor in whether or not a company's stock is efficiently valued.

This brings to mind the importance of the human element in IR. Do analysts remain objective in their recommendations or does their "feel" for management play an important role in their analyses? Managers with an exuberance would seem to have an advantage over those who are not as personable if company performance was similar.

One analyst quoted in this report said a lack of communication "causes analysts to attach higher risk" to investments in those companies who aren't open. "It may not affect my estimates, but it definitely affects my judgment of the risks involved. And I believe it affects the stock price" (Archbold, October 1977, p. 169).

Management's attitude toward analysts seems to be important. They can become "unpaid consultants" whose evaluation can be helpful. It seems beneficial to let them in on all that can be known about a company to give them the opportunity to make accurate judgments.

Another statement addressing the subjective side of IR was made by Michael Seely of Investor Access. He wrote that shareholder value is created, transferred or destroyed in a firm's strategic decisions and how they are "conceived and communicated." His statement brings out an important concept investor relations relies on: how actions are viewed by the investment community. Although the most important element is still the strategic decision, advocates of IR claim the way that decision is conceived and communicated can affect the efficient valuation of the company.

This same subjective element has to be considered in whether or not an IR executive can maintain objectivity in producing an annual report. It was noted by Duff & Phelps that bias is not uncommon in annual reports. How can objectivity be maintained?

Another area of interest is the importance of shareholder wants. According to Rowling (1978), the main desire of shareholders is to make money. This means their desire is to see their investment appreciate in value. According to Strickland and others in top management, the goal of all public companies should be to maximize shareholder value.

It seems from the observatons made in this study that it is important to tie top management compensation to the performance of the company's stock. This would assure that managers work on behalf of stockholders since they themselves have much at stake. Strickland attributes Lowe's success in part to its employee stock ownership plan, which essentially ties all employees to the performance of the company. Because they see potential for great gains if they work hard for the company, there is strong incentive to work hard.

Similarly, it seems one of the best ways to motivate management to maximize shareholder value is to reward them according to the company's performance. Concerning investor relations, this raises the question of whether or not there is a relationship between the intensity of an IR program and the extent to which management compensation is tied to stock performance. It would be interesting to observe the differences in the investor relations programs of two firms, one whose management receives stock options as compensation and one whose management does not. It would also be interesting to compare the IR programs of two firms that both employ stock ownership plans to observe the differences between the two.

Similarly, a study could be done comparing companies whose managements are compensated through stock options to those whose managements are not to determine which type of company has the more "efficiently valued" stock. It would seem that the company whose stock is more efficiently valued would be the one whose management is compensated through stock options.

Another goal of investor relations is to lower a firm's cost of capital. Generally, shareholders require a greater return on their investments the more risky the investment. For example, an investor can be quite certain IBM will still be around in six months. Because there is little perceived risk in investing in IBM, investors have a relatively safe investment that pays a conservative, steady rate of return. For IBM, this translates into a lower cost of capital because it is not perceived as a risky investment.

A study by Rolf Banz documented in this report showed that smaller firms offer higher risk-adjusted returns than larger firms because "investors demand higher returns when only limited information is available." The higher returns investors require translate into expensive financing for these "less-efficiently valued" firms.

Roemer pointed out that "the whole concept of annual reporting and investor relations is to lower the cost of capital . . . by increasing awareness and reducing the perceived risk to investors." It would be interesting to do a study on investor relations' role in lowering a firm's cost of capital by comparing two companies, one using IR to eliminate "market inefficiencies" in its securities by initiating contact with the investment community and the other trusting the market to accord its securities their proper value. Would there be a significant difference in cost of capital?

Since all public companies are required to produce an annual report, every firm supposedly has an equal opportunity to be noticed, based on the efficient market hypothesis. Thus, every public company is engaged in investor relations if only through the annual report and annual meeting. It would be interesting to look at two firms whose IR activities consist only of the report and the meeting to compare their cost of capital. Would it be significant if one firm's annual report, judged by a security analyst, was seen as superior and that firm's cost of capital was lower?

Concerning the quality of annual reports, it would also be interesting to look at other firms besides Lowe's that put out what are considered by analysts to be good reports to see what kind of arrangements they have for producing the report. Is it significant that Lowe's chairman of the board has been so involved in IR or are there many ways to set up an effective IR staff?

In their study on independent investor relations firms, Kennedy and Dennis (1973) found there to be no correlation between positive movement in a company's stock price and investor relations activities. Roman Weil of the University of Chicago was also quoted in this report as saying "all evidence shows that the market determines the value of a stock efficiently and that investor relations efforts have no effect on the value."

It would be worthwhile to replicate Kennedy and Dennis' study since this report gave examples which seemed to indicate that IR activities do affect a company's valuation. Allright Auto Parks, Inc., for example, attributed the increase in the trading of its stock to an informal meeting with Denver's financial community, its press representatives and some of the company's shareholders.

Another study could look at what happens at two companies that go public, one without IR support and the other initiating consistent communication with the investment community. Which company's stock would be more efficiently valued? Do those companies personally contacting analysts and other members of the investment community have a more efficiently valued company than those waiting for analysts to call? If there was no significant difference between the two companies, why initiate contact with the investment community?

Although contests for annual reports are plentiful, this report found that awards are a secondary goal. According to Cliff Oxford, a company's main objective should be to meet disclosure requirements and communicate clearly. If these goals are met, awards are likely to come, but they are not a priority.

Also, as the "most important single document" a company issues, how essential is it that the report be "perfect"? Evidence from this report indicates that a company should try to produce its report according to the "perceived image" it wants to project, but more importantly, the report should be candid in discussing all aspects of the company. A legitimate evaluation is that "there will never be a definitive text on the perfect annual report. It's best to encourage new ideas and creative thinking in presenting the corporate story" (Public Relations Journal, September 1975, p. 36).

Finally, regarding the company's story, one of the most important factors that affects the status of IR at a company seems to be how well the company performs. It seems logical that a growth company would be glad to talk with analysts.

As this report pointed out, Lowe's has had considerable success and is positioned to continue growing as the industry leader throughout the 1980s. Because of its performance, Lowe's has a "sense of confidence" other companies "typically don't have," according to one analyst. The company can afford to be open and candid because it seemingly has nothing to hide. The company has only to gain from being openly communicative--who wouldn't invest if they were given time to get to know the company?

Despite its long-term success, however, Lowe's went through a period when its stock was not efficiently valued, according to Strickland. It was a nine-year span during which the contributions of investor relations were questionable. Nevertheless, Strickland continued to initiate communication because he "believed in the company." This position seems to be important and applicable to all firms because a company's stock will not always be efficiently valued by management's standards. The important thing is to continue communicating on a regular, consistent basis regardless of what the measurable outcome is. Ultimately, the product (the company) must sell itself--investor relations' role is to locate potential buyers and make sure they get the whole story.

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APPENDIX

APPENDIX

Consolidated statements of changes in financial position

Lowe's Companies, Inc. and subsidiary companies
Dollars in thousands

Fiscal years end on January 31 of following year	Fiscal 1984	Fiscal 1983	Fiscal 1982
Funds provided:			
Net earnings	$ 61,443	$ 50,615	$ 25,131
Charges not requiring funds:			
Depreciation	14,805	12,034	11,178
Deferred income taxes	3,443	3,926	3,485
Funds from operations	**79,691**	**66,575**	**39,794**
Deferred income	—	1,273	—
Long-term debt borrowings	48,944	11,699	14,501
Disposals of fixed assets	990	7,517	690
Stock issued to ESOP	—	—	5,951
Sale of common stock	—	53,740	—
Total funds provided	**$129,625**	**$140,804**	**$60,936**
Funds applied:			
Dividends paid	$ 11,600	$ 11,600	$ 9,800
Fixed assets acquired	69,794	39,383	22,601
Current maturities and repayment of long-term debt	8,347	16,041	7,132
Redemption of fractional shares of common stock	—	33	—
Other	5,674	1,541	38
Total funds applied	**95,415**	**68,598**	**39,571**
Increase in working capital	**$ 34,210**	**$ 72,206**	**$21,365**
Changes in working capital components: ( ) = Decrease in working capital			
Accounts receivable	$ 2,661	$ 19,270	$ 27,281
Merchandise inventory	43,168	37,565	54,006
Other current assets	(986)	294	1,607
Current maturities of long-term debt	(1,225)	(227)	(1,215)
Accounts payable	(14,588)	(19,835)	(42,621)
Employee benefits payable	(2,697)	(6,421)	(1,828)
Accrued salaries and wages	(990)	(4,552)	(3,455)
Other current liabilities	(5,612)	(3,192)	(3,009)
Income taxes payable	4,524	396	(2,672)
Working capital changes before cash*	**24,255**	**23,298**	**28,094**
Increase (decrease) in cash*	**9,955**	**48,908**	**(6,729)**
Cash,* beginning of year	**74,249**	**25,341**	**32,070**
Cash,* end of year	**$ 84,204**	**$ 74,249**	**$25,341**

*Cash and cash equivalents
See accompanying notes to consolidated financial statements

Consolidated statements of current and retained earnings

Lowe's Companies, Inc. and subsidiary companies
In thousands except per share data

Fiscal years end on January 31 of following year	Fiscal 1984	% sales	Fiscal 1983	% sales	Fiscal 1982	% sales
Current earnings						
Net sales	**$1,688,738**	**100.0%**	**$1,430,576**	**100.0%**	**$1,034,032**	**100.0%**
Cost of sales	1,262,394	74.8	1,071,437	74.9	772,986	74.8
Gross profit	**426,344**	**25.2**	**359,139**	**25.1**	**261,046**	**25.2**
Expenses:						
Selling, general and administrative	269,347	16.0	231,732	16.2	187,199	18.1
Depreciation	14,805	.9	12,034	.8	11,178	1.1
Employee benefits (Note 7)	20,802	1.2	17,114	1.2	10,666	1.0
Interest (Note 11)	2,314	.1	1,368	.1	4,478	.4
Total expenses	**307,268**	**18.2**	**262,248**	**18.3**	**213,521**	**20.6**
Pre-tax earnings	**119,076**	**7.0**	**96,891**	**6.8**	**47,525**	**4.6**
Income tax provision (Note 6)	57,633	3.4	46,276	3.3	22,394	2.2
Net earnings	**$ 61,443**	**3.6%**	**$ 50,615**	**3.5%**	**$ 25,131**	**2.4%**
Earnings per share	**$ 1.70**		**$ 1.40**		**$ .75**	
Dividends per share (Note 5,8)	**$ .32**		**$ .32**		**$ .29**	
Shares outstanding — weighted average (Note 8)	36,248		36,193		33,333	
Retained earnings (Note 5,8)						
Balance at beginning of year	**$ 209,534**		**$ 171,134**		**$ 155,959**	
Adjustment for five-for-three stock split:						
On shares issued to ESOP February 1, 1982					(156)	
On shares sold on February 8, 1983			(583)			
Redemption of fractional shares			(32)			
Net earnings	61,443		50,615		25,131	
Cash dividends	(11,600)		(11,600)		(9,800)	
Balance at end of year	**$ 259,377**		**$ 209,534**		**$ 171,134**	

See accompanying notes to consolidated financial statements

Consolidated balance sheets

Lowe's Companies, Inc. and subsidiary companies
In thousands except per share data

	January 31, 1985	%	1984	%	1983	%
Assets						
Current assets:						
Cash	$ 1,740	.3%	$ 12,622	2.4%	$ 2,035	.5%
Short-term investments	82,464	13.0	61,627	11.8	23,306	5.9
Accounts receivable–net (Note 11)	97,319	15.3	94,658	18.2	75,388	19.2
Merchandise inventory (Note 2)	248,268	39.1	205,100	39.4	167,535	42.6
Other current assets	2,579	.4	3,565	.7	3,271	.8
Total current assets	**432,370**	**68.1**	**377,572**	**72.5**	**271,535**	**69.0**
Property, less accumulated depreciation (Notes 3 and 5)	195,237	30.7	141,238	27.1	121,406	30.9
Other assets	7,737	1.2	2,100	.4	559	.1
Total assets	**$635,344**	**100.0%**	**$520,910**	**100.0%**	**$393,500**	**100.0%**
Liabilities and shareholders' equity						
Current liabilities:						
Current maturities of long-term debt (Note 5)	$ 7,083	1.1%	$ 5,858	1.1%	$ 5,631	1.4%
Accounts payable	125,003	19.7	110,415	21.2	90,580	23.0
Employee benefits payable (Note 7)	19,989	3.1	17,292	3.3	10,871	2.8
Accrued salaries and wages	14,652	2.3	13,662	2.6	9,110	2.3
Other current liabilities	22,141	3.5	16,529	3.2	13,337	3.4
Income taxes payable	550	.1	5,074	1.0	5,470	1.4
Total current liabilities	**189,418**	**29.8**	**168,830**	**32.4**	**134,999**	**34.3**
Long-term debt, excluding current maturities (Note 5)	**92,488**	**14.6**	**51,891**	**10.0**	**56,233**	**14.3**
Deferred income taxes (Note 6)	10,854	1.7	7,411	1.4	3,485	.9
Total liabilities	**292,760**	**46.1**	**228,132**	**43.8**	**194,717**	**49.5**
Deferred income (Note 9)	1,236	.2	1,273	.2	—	—
Commitments, contingencies and litigation (Note 10)						
Shareholders' equity (Note 8):						
Common stock–$.50 par value; issued and outstanding 1985 36,248,475; 1984 36,248,475; 1983 33,333,333	18,124	2.9	18,124	3.5	16,667	4.2
Capital in excess of par	63,847	10.0	63,847	12.3	10,982	2.8
Retained earnings	259,377	40.8	209,534	40.2	171,134	43.5
Total shareholders' equity	**341,348**	**53.7**	**291,505**	**56.0**	**198,783**	**50.5**
Total liabilities and shareholders' equity	**$635,344**	**100.0%**	**$520,910**	**100.0%**	**$393,500**	**100.0%**

See accompanying notes to consolidated financial statements

VITA

Thomas Joseph Denk was born in Rochester, New York on May 15, 1960. He attended elementary schools in Fairport, New York and graduated from Fairport High School in June 1978. The following August he entered Western Kentucky University and in December 1982, he received a Bachelor of Arts degree in Public Relations.

In the fall of 1983 he accepted a graduate assistantship at The University of Tennessee, Knoxville and began study toward a master's degree. He received a Master of Science degree in Communications in December 1986.