# MIFID II

The impact on FTSE 250 companies

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BRUNSWICK

## Summary

Small- and mid-cap companies have always found it tough to get analyst attention and access to investors. Thanks to the law of unintended consequences, Mifid II is making it even harder.

Almost a year in, 1.4 million paragraphs of new rules, designed to strengthen investor protection and make financial markets more efficient, resilient and transparent, are challenging FTSE 250 companies in unexpected ways.

At one end of the spectrum they have led to cutbacks in sell-side analyst coverage at the large banks, particularly of small and mid-cap stocks. At the other they have provoked consolidation among the smaller brokerages.

For FTSE 250 companies that's a double whammy, with a big effect on company coverage. They can no longer rely on analysts and sales teams to tell their story to the investment community. Instead, they must develop a deeper understanding of their investor base, closer relationships with their shareholders, and new tools for reaching the right investors.

## What's happened?

Mifid II came into effect in January 2018, requiring banks and brokerages to charge asset managers separately for investment research rather than bundling the fees into the cost of executing trades. Many banks and brokers historically provided research for free to lure fund managers to trade with them. The legislation was designed to reduce conflicts of interest and inject transparency across the financial industry.

As a result, many asset managers, who now must pay separately for research out of their own budgets, have cut back their consumption of sell-side analyst research. Commissions have dropped as much as 28% in the UK during the first quarter compared with the same quarter in 2017.[2]

For their part, banks have streamlined analyst teams, focusing on star analysts and key sectors. The result is:

- A 3% drop in average number of analysts covering FTSE 250 stocks in the last six months[3]
- Evaporation of experience and quality in sell-side research content
- Fewer expert voices contributing to consensus earnings forecasts
- Difficulty identifying and engaging with new investors

Small- and mid-companies have seen research coverage fall to an average of 0.6 analysts, and roughly 200 companies have no coverage at all, making it increasingly difficult for companies to reach investors.[4]

It's tough too for the analysts. Several large investment banks appear to be offering lowball, "predatory pricing" for research services to guard market share. This has put pressure on boutique banks that rely largely on research revenues to survive. More than a fifth of boutiques surveyed by Euro IRP reported declining revenues in 2018.[6] Lacklustre performance by small- and mid-cap stockbrokers such as WH Ireland, Cenkos, and Arden Partners has prompted predictions of consolidation across the industry. Recent news that Santander is in talks to acquire small-cap UK broker Peel Hunt shows that interest is not confined to UK players. One independent research provider predicted that half the boutique research houses could be out of business within 12 months.[7]

Not only is there a shortage of analysts to carry the message, there's also a decline in investors to carry the message to: in the wake of the Brexit vote in June 2016 vote, U.K. equity funds have now seen 15 months of continuous outflows, according to Investment Association data. That behaviour is beginning to spread; for the first time since 2016, the world's biggest investors are pulling money from European fund managers. Compared with net inflows of US$285bn into long-only funds throughout 2017, investors withdrew nearly US$178bn between March and June 2018 alone.[1]

### Declining corporate access services

It is becoming clear that investors are unclear about how to obtain and pay for corporate access under Mifid II, though access is not explicitly placed within the payment requirements that research is subjected to,

Many have opted to avoid the uncertainty altogether and arrange their corporate access directly with the companies themselves. In the past year, fund managers like BlackRock, Fidelity, Wellington, Norges, and T. Rowe Price have hired internal heads of corporate access from the large banks.

Now that that they must absorb the cost of a company meeting themselves, investors have become more reluctant to meet with those companies in which they have little or passing interest.

As a result, a management team that previously had a full slate of investor meetings now finds big gaps in in its roadshow meeting schedules.

### An opportunity for activists

Who can benefit from this? Well, in the UK, activists are increasingly targeting small- and mid-cap companies on the basis that they are under-researched and under-valued. With less information flowing to the market for the reasons we've described above, there can be inefficiencies in pricing and liquidity that can be exploited by an activist investor.

Shareholder activism is no longer a US phenomenon, and 2017 was the first year that international activity surpassed US activist campaigns. By the end of September last year, more than 100 European companies had been targeted publicly.

Activists have developed sophisticated social media campaigns to reach their target audience in real time and gain support, starting with search engines and paid advertisements to target key audiences. US activists have developed sophisticated ways of getting their point of view across - in its campaign against Akzo Nobel, shareholder activist Elliot used links embedded within digital communications to drive traffic to its dedicated campaign website ("microsite"). The use of used graphics and videos also help maximize engagement with shareholders.

In response, companies must look beyond traditional semi-annual investor roadshows and traditional media outlets and ensure that they have a dynamic and responsive communications infrastructure in place.

## The changing model of investor relations

In an environment of reduced sell-side support and coverage, investor relations must move away from the historic model of responding to market fluctuations and investor needs as they arise.

Today, investor relations officers must anticipate events and communicate with the investment community in a complex landscape. They need to attract the attention of investors and analysts, manage increased levels of inbound inquiries, and develop strategic approaches to investor outreach.

The use of digital distribution channels for company investor communications has become a business imperative. A recent survey by Brunswick found that nearly 70% of investors made an investment decision or recommendation based on digital media.  Company websites and online business reports are now standard practice, and - where face-to-face meetings used to be the standard form of investor engagement - companies face increased demand for timely virtual events such as such as webcasts, video conferences, webinars and web conferencing.

## Conclusion

Perhaps because it now costs too much, perhaps because there aren't enough brokers, traditional reliance on the brokerage community to connect companies with potential investors is misplaced.

Constant shareholder communication and shareholder management are key. Today's investors receive company news through digital and social media channels - according to Brunswick research, 90% of fund managers scan LinkedIn, Twitter or Google when researching a company to monitor the chatter around a company and follow journalists who might post scoops online.

Among so many avenues of information, investor relations teams should step into the gap once filled by analyst coverage and become experts in their sector, communicating detailed knowledge in a credible and effective way. A company that communicates consistently across all channels ensures that its long-term business strategy is understood and creates a stronger alignment with investors.

Sources: 1 Financial News, August 30, 2018, 2 ITG, 3 Financial Times, July 30, 2018, 4 Downing, August 16, 2018, 5 Financial Times, September 9, 2018, 6 Euro IRP Members Study, 2018, 7 Euro IRP, Members Study, 2018, 8 Hardman & Co, 9 Hardman & Co

## Who we are

Brunswick is an advisory firm specializing in business critical issues. We help companies build trusted relationships with all of their stakeholders.

We would be delighted to talk to you about the impact of MiFID II and how to use digital and social media to improve your investor communications.

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## How Brunswick Can Help

The table below summarized the immediate, concrete actions companies need to take and explains how Brunswick's Investor Engagement team can help.

| IR Priorities | Why does this matter? | How Brunswick can help |
|---|---|---|
| Ensure that your IR team is fully resourced | • With potentially less research coverage, IR teams will play a critical role in communicating the company's narrative to the investor community<br>• Current IR teams will come under increasing pressure as responsibilities expand to handle increased requests for information, direct contact with investors, and guidance queries<br>• IR budgets might need to increase | • End-to-end communications support to IR teams<br>• Advice and practical implementation of investor narrative, intelligence on investor landscape, and better distribution of equity narrative through non-traditional channels |
| Understand the investor landscape | • Investors will have to pay for corporate access under MiFID II, limiting range of interest<br>• IR executives need to become more familiar with a wider range of non-holders and smaller investors<br>• With the increase in passive investments, it will be important for corporates to understand how investors will vote on the issues that matter (e.g. transparency, remuneration, ESG) | • Provide unconflicted investor intelligence on: non-holder target list, key jurisdictions, passive funds<br>• Evaluate and support governance and sustainability communications<br>• Benchmark against peers on ESG issues |
| Sharpen the investor narrative | • With fewer analysts covering a stock, ensure that the message is clear, effective, and reaches the right audiences<br>• Particularly important for small and mid-cap stocks to be proactive in selling their own story | • Help to develop, market test and refine investor narrative<br>• Conduct investor perception studies to align investment case with business case<br>• Train management and support at investor events including Capital Markets Days and AGMs |
| Expand monitoring of sector trends | • With expected contraction in overall research coverage, look to other resources for information on macro and industry trends | • Knowledgeable, objective discussion of sector drivers<br>• Brunswick Insight conducts specialised surveys and focus groups<br>• Digital monitoring of sector triggers |
| Use non-traditional platforms | • With less research available, consider digital marketing channels that target investors directly | • Brunswick digital team support includes: LinkedIn, Twitter and Facebook targeting, digital marketing campaigns, digital-only financial media, social media listening<br>• Video and infographics communicate an investment case concisely and effectively |
| Consider additional coverage options | • Asset managers likely to be more selective in the research that they buy<br>• Small and mid-cap stocks likely to be overlooked<br>• Boutique investment firms and paid-for research might be a solution | • Communicate on behalf of the company<br>• Engage with analysts to manage understanding of the business and investment case |