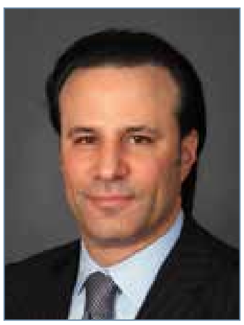
An Epidemic of Value-Eroding Communication

By Adam J. Epstein



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At its core, effective communication is about two things: knowing your audience, and making sure your message is tailored to that audience. Get one of those things wrong, and communication will be strained. Get both of those things wrong, and you're probably not communicating at all.

Attention board members of the nearly 50 percent of exchange-listed companies with market capitalizations below $300 million: Your company likely gets both of those things wrong on a regular basis, negatively impacting shareholder value.

Speak to the Real Investors

Unlike large public companies whose stocks are predominantly owned by institutional investors, retail investors own the majority of shares in smaller public companies. Though there are many reasons for this, it often comes down to math.

For example, if an institutional investor has a minimum position size of $1 million and is willing to devote up to 20 trading days to acquire a stock, that means the fund would need to acquire an average of $50,000 of that stock per trading day. In order to acquire $50,000 of stock per day without pushing the stock price up appreciably, the stock would need to trade at least five times that amount, or $250,000 per day.

The mathematical reality for small public companies with stocks that trade less than several hundred thousand dollars per day is that in the absence of a financing where institutional investors can buy stock directly from the company, only retail investors can buy stock on the open market, since they characteristically buy in much smaller increments.

Why does this matter? Unfortunately, generations of small-cap officers and directors have erroneously believed that exchange-listed companies should principally market their stocks to institutional investors. Consequently, an inordinate amount of time, energy, and money is wasted by small public companies communicating to institutional investors that can't—and won't—buy their stocks due to trading illiquidity.

Armed with this information, small-cap directors should make sure management is communicating to an audience that can actually buy their stocks.

Messaging That Works

CEOs of small public companies often lament to fund managers that they regularly disseminate good news to no effect and that their companies are substantially undervalued. They are often right, but for the wrong reason.

Many small public technology and life sciences companies, for example, issue press releases that even a seasoned industry analyst would be challenged to understand, much less a typical retail investor. These companies mistakenly believe that if they communicate in a highly sophisticated manner, their company will garner institutional plaudits. Instead, they are just speaking miles over the heads of the only constituency that can buy their stocks: retail investors.

Here's a poignant exercise for officers and directors of, say, small-cap technology or life sciences companies: At your next family gathering, show attendees a recent company press release. After 15 to 20 seconds—about the time an average investor will spend reading a press release—ask them to explain in their own words what the company does and what the press release conveys. If you're like most people who have undertaken this exercise, it might be the most valuable communication lesson you've ever had.

An informed board is the antidote to this epidemic. Their admonition to the C-suite should be clear and concise: "If retail investors are the only investors who can functionally buy our stock, then Mary and John Q. Investor better be able to understand what our company does. If they don't, they won't buy our stock. And neither will anyone else."