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Investor Relations as a means of Corporate Communication in times of crisis - *A Case Study of Starbucks*

In this paper, we examine the role and impact of IR as a means of Corporate Communication in times of crisis. A literature review about IR and its particular role in a corporate crisis forms the theoretical basis of this paper. Subsequently, the paper analyses the case of Starbucks as a best practice example when it faced a crisis from 2007 to 2009. How should companies communicate to their investors during periods of crisis? Is a 'filter' necessary or is honesty always the best policy? What does it take to convince the financial community that the strategic steps being taken will indeed help the company in the long term? This paper attempts to answer these questions. Currently, little to none research exists on the role of IR during turbulent times. By using the case study of Starbucks as an example, we aim to highlight the IR challenges that companies must overcome in difficult times as well as contribute to the body of knowledge on this topic.

"*When writing Berkshire Hathaway's annual report, I pretend that I'm talking to my sisters…though highly intelligent, they are not experts in accounting or finance. They will understand plain English, but jargon may puzzle them. My goal is simply to give them the information I would wish them to supply me if our positions were reversed…I don't need to be Shakespeare; I must, though, have a sincere desire to inform" (Buffett, 1998, p.2).*

Although investors are the owners of the business and provide the required equity capital for a firm to survive, not everyone is in agreement with Buffett's opinions on the importance of honest and direct communication. While many managers are largely unconcerned with them, believing that shareholders are merely one type of stakeholder, others even go as far as claiming that Wall Street needs to be separated from the company, thus allowing management to run the business without shareholder interference (Lev, 2012). Shareholder structure can be classified into three different categories. The first category is the owner-operator structure with the CEO as the largest or even majority shareholder. In this case, communication is easy since it only concerns the shares not owned by management. The second category is where management is controlled by a single large shareholder. In this case, communication is usually direct, with the large shareholder often a Non-Executive Director of the Company, occupying a seat in the boardroom. The third category is where the majority of the shares are free-float, wherein the stock is widely held. Communication between management and shareholders gains greater importance as turnover is high (i.e. shares often change hands), making it more difficult to establish a relationship.

This relationship between a company and its shareholders gains greater relevance in times of crisis. Indeed, no company is protected from the possibility of suffering operational problems and facing negative results (Tafoya, 2013). Especially during the recent financial collapse in 2008, many firms have faced financial headwinds and experienced severe losses in their share prices. In such times, Investor Relations (IR) is a vital part of corporate strategy and communicating closely with shareholders is crucial. This paper is a case study about the Starbucks Coffee Company and its reaction in a time of crisis. After its rapid expansion which had been forced due to great pressure from the financial community, Starbucks got into trouble. As a result, Howard Schultz, the founder and Chairman, was forced to return as CEO. He implemented several far-reaching changes in order to turn the company around. Following his return, the worldwide financial crisis got worse. According to Schultz, particularly during these times, it was vital to successfully communicate these changes to the financial community including shareholders, analysts and journalists (Schultz and Gordon, 2012), a key responsibility of IR.

In this paper, we examine the role and impact of IR as a means of Corporate Communication in times of crisis. A literature review about IR and its particular role in a corporate crisis forms the theoretical basis of this paper. Subsequently, the paper analyses the case of Starbucks as a best practice example when it faced a crisis from 2007 to 2009. How should companies communicate to their investors during periods of crisis? Is a 'filter' necessary or is honesty always the best policy? What does it take to convince the financial community that the strategic steps being taken will indeed help the company in the long term? This paper attempts to answer these questions. Currently, little to none research exists on the role of IR during turbulent times. By using the case study of Starbucks as an example, we aim to highlight the IR challenges that companies must overcome in difficult times as well as contribute to the body of knowledge on this topic.

Defining Investor Relations

Investor Relations (IR), a "function through which companies communicate with their shareholders" in the financial community (Labas, 2009, p.15), is defined by the National Investor Relations Institute (NIRI) of the United States as a

"strategic management responsibility that integrates finance, communication, marketing and securities law compliance to enable the most effective two-way communication between a company, the financial community, and other constituencies, which ultimately contributes to a company's securities achieving fair valuation." (NIRI, 2003 cited in ibid).

The origins of IR date back to the General Electric Company (GE) that started a communication program for private investors in 1953 titled "Investor Relations" (Graves 1985 cited in Labas 2009). Today, most largely publicly traded companies have dedicated IR officers. There has also been a change in the target audience of IR as private shareholders began to lose importance. Instead, greater focus was being placed on stock analysts and institutional investors (Laskin, 2010). However, this is a challenge for top executives that were used to dealing with private shareholders, who were easier to satisfy with the use of mass media and occasional handouts. Financial analysts, on the other hand, are not content with the obligatory disclosure filings, despite the fact that the amount of information provided has increased drastically. Both powerful and knowledgeable, analysts and institutional investors evaluate every action the company takes and are not afraid to criticize or ask questions "that management has not asked itself, or for various reasons does not want to answer" (Morrill, 1995 cited in ibid, p.16). The roles of IR professionals have therefore had to transform from mere information-providers to defenders of managers' actions. If institutional investors criticise company actions, it is the job of IR to offer counterarguments to explain the reasoning behind these decisions. Furthermore, proactive IR practices give rise to the need for anticipating shareholders' reactions in order to be able to react to them in advance (Laskin, 2010).

This has led to an increasing number of financial analysts entering the field of IR in order to assist top management "to package their story for institutional buyers or sell-side analysts" (Ryan and Jacobs 2005, p.69), who demand to know the company's strategy, the management team behind it as well as its vision for the future. Too long had corporate communication lacked a "sense of corporate vision; or long-range strategic rationale" (Budd 1993, pp 45). The focus of IR thus became to "help investors understand the company, its business model and its corporate responsibility (Laskin, 2010, p.19) (See for example Blackrocks CEO letter by Larry Fink (Fink, 2019). IR thus had to not only explain the financial results but also "the nature of the business, its long-term strategy, and non-financial information" as investors increasingly began to "incorporate these higher-level questions into their buy and sell decisions" (Favaro 2001, p. 7).

In the past, reporting was largely dominated by financial aspects. Although important, it only provided one part of the overall business performance, resulting in a greater focus on short-term results (PwC, 2007). Indeed, a major challenge that IR faces is shareholders short-term fixation (Laskin, 2006) with "Wall Street's obsession to beat quarterly numbers…pushing companies to focus on short-term results" (Plitch 2006, p.1). In such a scenario, it is the task of IR to convert speculators into long-term stockowners. IR becomes no longer about just the numbers and instead all about building and maintaining long-term relationships with all the company's stakeholders (Laskin, 2010, p. 25 and Fink, 2019). The development of such a relational approach corresponded with the paradigm shift from transactional-oriented to relationship-oriented marketing in the 1980s & 1990s (Eyuboglu and Buja, 2007; Levitt, 1983). Increasing the holding period of company shares by investors can greatly help stabilize share price volatility and is known as relational investing (Ayres and Cramton, 1994). The exact definition of relational investing, however, remains quite vague and it is unclear who counts as relational investors, only that they hold a large block for a substantial time (Bhagat, Black and Blaire, 2004). “Whenever there’s an established, committed link between a company and one or more shareholders, that’s relationship investing” (Dobrzynsky 1993, p.68).

“Since we have invested the time and effort in building relationships…we are given the opportunity to explain our results and strategies more fully, and have a better chance to be given the benefit of the doubt in situations where investors and analysts are being asked to trust your word than if we didn’t establish the relationship” (Laskin 2007, p. 23).

Trust and credibility in IR are key. While companies are understandably more interested in having a positive image and therefore focus on reporting positive developments via IR, it is important to fight the assumption that companies try to hide bad figures while focusing on the positives of their business. Credibility will never be established unless this takes place. Numerous surveys show that the degree to which a company discloses information plays a critical role in its credibility (Scott, 2005) and earning a reputation for honest reporting and communication practices is highly valuable when dealing with the financial community (Rikanovic, 2005). Failure to do so in the past has led to ‘creative accounting’ and IR practices at companies such as Enron or Worlcom and the current era was brought about by calls for greater scrutiny of disclosure standards and IR that followed those scandals. In a move aimed at improving corporate governance and the accountability of management in the future, the Sarbanes-Oxley Act was passed by the US Congress in 2002, thus strengthening SEC (Securities and Exchange Commission) reporting regulations (Laskin, 2010). According to PwC (2003), comprehensive reporting and greater transparency also result in improved corporate credibility and companies must increase the scope of obligatory financial disclosure (Achleitner et al., 2001; Institutional Investor Research Group, 2005; Rowbottom et al., 2005; Wiesel et al., 2008) in order to extend the horizon of the investors.

Firms often have to decide between focussing on short term share-price maximization or longterm value creation and numerous situations arise where there is a conflict between those two decisions. For example, investing in R&D, marketing or HR/staff welfare often increases costs in the short term and therefore depresses profits or even leads to losses. However, those investments are often necessary to keep a firm competitive in the long run. IR must therefore communicate to shareholders the importance of long term thinking in order to help them to self-select i.e. attracting long term oriented owners while discouraging those only interested in making a quick profit. Shareholders trust management promises, and a flat/negative quarter does not automatically become a sell signal. Instead, investors look for explanations in times of crisis and, if convinced by top management that the fundamentals of the company are still strong, are more likely to hold their shares for longer (Mahoney, 2001). “By creating a class of enlightened investors who give companies patient capital” (Dobrzynsky 1993, p.68), management is free to focus on the long-term competitiveness of the company by taking take decisions that, though might lead to higher costs and lower profits in the short run, but help increase the long term value of the company.

The share price as a measure of a firm’s performance shows how the stock market values the firm with financial markets showing whether publicly traded companies are successful or not. Moreover, the success of a firm affects the firms cost of capital and availability of external funds. Stock prices also influence executive compensation and the tenure of executives as depressed stock prices may attract activist investors, who often replace existing management (Lev, 2012). Therefore, it is in the interest of management and existing shareholders that the stock price reflects the intrinsic value of a firm. Studies show that IR can help to increase the value of a company by up to 15 percent while deficiencies in IR can result in losses that are even greater (Meier-Pfister and Thommen, 2002). IR must therefore aim to successfully address numerous groups in the financial community, including institutional/private investors, brokerage and investment advisory services, the (financial) media and analysts (Labas, 2009). According to Marston (2004), analysts in particular are interested in company strategy including major new projects/developments/business segments that will lead to growth in shareholder value. If successful in causing analysts to revise their expectations, a rise in the stock price, trading volume and analysts’ subsequent earnings forecasts will be the result (Lane and Orgeron, 1992). IR instruments can be divided into non-personal (annual report) and personal instruments (AGMs, analyst conferences); the latter of which is highly valued by analysts as it provides them with a view of the company through the eyes of top management (Henes, 1995;

Labas, 2009; PwC, 2007). Analysts (and investors) expect the CEO and his senior management to interpret the information provided as well as explain recent results in the context of the current environment (Marcus, 2005).

Analyst conferences therefore usually begin with a presentation/speech by the CEO (Düsterlho and Huber, 2004; Labas, 2009; Marcus and Wallace, 1997). The cultural differences in audience expectations between Germany and the US are interesting. While the German audience places great importance on a solid product, technical data, a clear presentation structure, sufficient documentation, and a serious-mindedness style, the audience in the US prefer humour, wit, spirit, modern flair and slogans (Lewis, 2006). Once the CEO has provided the context for the information presented, he/she is followed by the CFO who is ideally suited to help analysts comprehend how the information presented will affect the financials of the company. An important part of his/her presentation is the core idea why the company is/remains a good investment, including strategy statements as well as information about the company's future plans (Labas, 2009). By presenting strategy, measures and goals rather than just figures as well as honestly talking about problems that the company or industry has faced in recent years, a certain credibility is established (Diehl et al., 1998). Analysts forecast earnings prospects and provide recommendations whether a stock should be bought, held, or sold and investors (both institutional as well as private) tend to base their decision on analysts' reports (Bittner, 1996). As a result, analysts rightfully expect a transparent, competent, and comprehensive picture of the company, which requires an honest communication by the company (Labas, 2009). Indeed, a "credible presentation of bad results is better than an implausible presentation of good results" (Meier-Pfister and Thommen 2002, p.44).

The role of IR in times of a crisis

No organization is safe from a crisis and hardly a day passes without some company finding itself in a crisis, with anything that "compromises or challenges an organization's capacity to perform…a potential crisis for the organization and its brand" (Tafoya 2013, p.3). When a crisis hits, investors worry about their investment as the share price tumbles. In such a situation, it is important for management to talk in a straightforward manner about problems and mistakes made in the past as credibility, especially among long term shareholders, can be easily destroyed unless management is candid. At the same time, management must also demonstrate confidence in the future as even longterm oriented shareholder can lose patience and faith that the firm will recover. Effective IR therefore needs to include shareholders in the firm's efforts by providing them with sufficient information regarding not only the nature of the crisis but also what's being done to address it (ibid).

However, strategies that are solely based on an attitude of 'Let's get this problem behind us' tend to fail as they limit their focus to reactionary activities associated with the event, doing more harm than good in the long term. Those responsible for the crisis management plan need to avoid the mistake of simply rushing to 'get beyond the crisis' and instead utilise the opportunity to transform the organization in a sustainable manner. Although crises are inherently negative, this does not mean that companies cannot benefit from them. Tafoya (ibid) therefore proposes the following Crisis Management Model:

Company Audit. Before a crisis management plan can be developed, a comprehensive audit is required into the company's vision, mission, culture as well as its strengths and vulnerabilities. This audit is crucial to contribute to the crisis management efforts as well as the organization's post-crisis activities.

The Crisis and Effects. An accurate and comprehensive assessment of the scope and scale of the crisis facing the company is needed, including information regarding the company's/brand's risk exposure. How is the crisis manifesting itself in the company and among the various stakeholders? How will the company's image be affected now and in the future? Is the company's present leadership capable of managing the crisis or is a change in leadership required?

Recommendations. As mentioned above, while it is important to repair the damage done to the company, it is also crucial to concentrate on fundamental matters such as rectifying policies, procedures and practices that are out-of-date or have proved to be inadequate in the face of the crisis. Answering questions such as 'What can or should a company learn from the effects of the crisis?' or 'What is the future for our organization?' as part of the planning process results in concrete actions, activities, and behaviours that will help make the brand stronger in the face of the emerging crisis. Recommendations must therefore not only address the immediate crisis but also help make the refurbished company better prepared for future crises.

"Few things say 'we're back' like launching the refurbished organization. This is a great way to return from a crisis but it is vitally important that the organization's leadership and stakeholders demonstrate that this post crisis organization is really, 'new and improved'" (Tafoya, 2013, p.164)

Companies can emerge from a crisis with new technologies and products, improved procedures and a lean and improved structure, as can be seen below in the case of Starbucks.

Case Study: Starbucks

One company that can be considered a best practice example of IR in times of crisis is the Starbucks Coffee Company. Founded in 1971, it was bought by Howard Schultz, one of its first employees, in 1987, when it had 11 stores and about 100 employees. Schultz became its CEO and in the following years, Starbucks investors and employees prospered. Schultz introduced health care coverage for all employees and the ownership of Starbucks shares for all full and part-time employees. In 2000, he stepped down as CEO and became chairman. Until 2007, Starbucks continued its rapid expansion and continued to set earnings growth targets higher than 20 percent per year while Wall Street applauded from the sidelines. Over time, however, the pressure on the company grew to meet those targets. The store count more than tripled during that time and stores were opened not only in major cities but also in suburbs and smaller metropolitan areas. Moreover, the company expanded internationally to meet expected earnings growth rates (Schultz and Gordon, 2012).

In an effort to increase efficiency, however, various mistakes were made. New automatic coffee machines were installed that turned out to be too high. While reducing the time to prepare a beverage, they also prevented customers from watching baristas preparing their coffee and hindered interaction. The company had also failed to train its staff properly. As a result, many employees were not able to steam milk correctly or steamed large pitchers which made it necessary to re-steam the milk. This process led to lowering of the quality of the Cappuccino. While increasing Earnings Growth in the short run, these decisions ended up diluting the brand. Furthermore, during that period, Starbucks signed many contracts with hotel chains like Marriott and bookstores like Barns and Noble. Those licensingagreement lead to a loss of control over internals processes and the quality of the coffee. To enhance growth rates, Starbucks also expanded into non-coffee related fields like entertainment and music; CDs were sold in some stores to increase revenues and in others, music bars were installed where customers could download songs. In addition, the company sold books in several locations. Although Starbucks was seen as a kind of trendsetter at the time, Schultz later described this kind of non-core related growth as hubris.

"Over the past 10 years, in order to achieve the growth, development and scale necessary to go from less than 1,000 to 13,000 stores and beyond, we have had to make a series of decisions that, in retrospect, have led to the watering down of the Starbucks Experience, and what some might call the commoditization of our brand. Many of these decisions were probably right at the time, and on their own merit would not have created the dilution of the experience; but in this case, the sum is much greater and, unfortunately, much more damaging than the individual pieces" (ibid, p. 23).

After its rapid expansion, Starbucks was faced with increasing challenges including competition, lower customer satisfaction and sinking same-store sales. Increased competition also came from both sides: On the one hand, there was an increasing number of individual coffee stores offering high quality coffee with premium beans and excellent service while, on the other hand, there were large chains such as McDonalds and Dunkin (Donuts) offering low cost alternatives. McDonalds, for example, introduced its McCafé concept, a coffee-house chain located in existing McDonalds restaurants, thereby taking advantage of already existing space and optimizing capacity utilization. Rapid growth also led to increasing bureaucracy, underperformance of several new stores and cannibalization of existing stores. According to founder Howard Schultz, the fast expansion made Starbucks lose its soul forgetting to focus on serving one customer, one cup at a time (Schultz, 2011). From October 2006 till November 2008, its share price decreased by more than 70% and it experienced slowing growth, store closures and cost reductions after 16 years of continued success.

Biennial Analyst Conference

This biennial event for investors and Wall Street analysts would be the first time that Starbucks' management would have to stand in front of shareholders with the company performing so poorly. It was thus vital to "show the Street how we would rebound. Not by overpromising or making bold predictions, but by confidently reaffirming that we understood and were correcting our problem" (Schultz and Gordon, 2012, p. 221). The conference offered a unique opportunity to "regain credibility and trust on Wall Street by telling our story in more detail than we could on an earnings call" (ibid, p.218).

"[Indeed, there had never] been a more important meeting at which Starbucks needed to communicate [our story] with clarity and confidence…to instil confidence in our ability to build long-term shareholder value. Every company was feeling pain. But Starbucks had a good story to tell. An authentic story, a story about a year in the life on one of the world's most respected brands. A year spent taking stock and taking risks… [It was time to remind people] how far we had come during the crisis" (ibid, p.224).

As the crisis, which Federal Reserve chairman Alan Greenspan had called a 'once-in-a-lifetime credit tsunami', forced companies to redefine themselves as well as their message, Starbucks was not the only company to find itself in such a position. As Schultz himself admitted, "No one had a real handle on this unprecedented moment" (ibid). Although the company was still in the middle of significant structural changes, attendees were expecting a comprehensive picture of Starbucks' future.

The conference, however, did give Starbucks' management team the opportunity to step back from the day to day operational details that had kept them busy for the past few months and focus instead on strategic issues. The areas of international, innovation outside of the retail footprint and unleashing the languishing business units would need to be given attention in the coming year but that was only possible once the foundation of Starbucks, i.e. its US business, was strengthened. Although the previous year had been one of both highs (the successful annual meeting, the new Pike Place Roast coffee blend, the New Orleans charity clean up action) and lows (numerous store closures and layoffs, the failure of the Sorbetto flavour, the sinking market cap); as the leadership team sat around the dining room table two nights before the conference, attempting to put "all the facts together in a cohesive, optimistic story" (ibid), it seemed as if all that they had accomplished in the past year was overshadowed by recent bad news.

"Our comps were down across the board: negative 9 percent in the United States, negative 3 percent in internationally, negative 8 percent worldwide. Nine weeks into the first quarter, it was only getting worse, and we projected missing external earnings estimates of 22 cents a share" (ibid, p.221).

The evening before the conference, as Schultz sat down for dinner with his advisor Billy Etkin, he worried that the share price could drop to $5 or that they could even be taken over. However, Billy reassured him of the importance of staying

"true to your values and true to the company's core. Those are your rudder now. And the seas will calm and the winds will shift, unless you believe that the economy is never coming back. Or that all along Starbucks' value proposition and connections to its customers has been a ruse. Or that the millions of people still walking into your stores every week all over the world are kidding themselves. Now is the time to stay focused on the moves you have to make to rightsize the business, to innovate, and to return to the core. The confluence of these factors will propel Starbucks forward and will make all of today's naysayers positive about Starbucks again. I am absolutely sure of this." (ibid).

As a result, the next day when Schultz went on stage to give his speech, he "was not performing…just speaking honestly, and with each word my conviction in Starbucks' purpose and our potential came rushing back" (ibid, p.225). One by one, each executive team member took to the stage to articulate Starbucks' story. New CFO Troy outlined Starbucks' cost-saving efforts and projections: "$400 million in permanent cost takeouts, $200 million of which would be realized in 2009 on top of the $250 million resulting from actions we had taken earlier in the year" (ibid, p.226), promising that these were sustainable changes to the company's cost structure. Michelle Gass, EVP Marketing, then provided an extensive overview of future plans based on extensive customer research including strategies to maintain the top spot as well as new beverage and food items that Starbucks had brought to market in 2008. Following Michelle was Terry Davenport, CMO who spoke about the new Rewards Programme would both deliver meaningful value while enhancing the Starbucks brand.

At the end of the conference, the main message of the presentation was getting through to the shareholders – that Starbucks was focused on its foundation while being innovative at the same time, ensuring that it would emerge from the crisis in a position of strength. Comments from attendees were largely positive and both investors and analysts believed that the most relevant issues had been addressed. Analysts' notes following the event, although cautious, praised the cost-saving initiatives as well as the balance Starbucks had struck between its premium positioning and offering value to the customer. Despite few criticisms that the company was not taking competition seriously, not advertising enough or slowing new-store growth, Starbucks' share price rose to a daily high of \$9.41 and closed at \$8.61, slightly higher than it began the week. Overall, Schultz felt that the conference had gone off well, since the leadership team had presented a great deal of information with both authenticity and conviction. Although there is "a fine line between confidence and overpromising", he did not believe he "had crossed it that day. I was just stating what I wholeheartedly believed to be true" (ibid, p.231), a key component of effective IR.

Conclusion

In this paper, we have examined the role of IR as a means of Corporate Communication in times of a crisis. No single firm is protected from the eventuality of facing operational problems, giving rise to numerous challenges to be tackled and issues to be overcome. Particularly in such turbulent times, the relationship between a company and its claimholder is of great relevance. We have looked at the case of the Starbucks Coffee Company, the crisis it faced from 2007 to 2009 and how it successfully made use of IR (in particular the biennial analyst conference) to convince its claimholders to keep faith with the company. During crises, companies must sometimes take steps that could cause short-term losses in order to create enduring value for shareholders. Therefore, it is crucial not to merely optimize its business from quarter to quarter but instead focus on the long term if the firm wants to achieve sustainable success for shareholders and all other claimholders. In order to convince the financial community as well as also other claimholders to stick with the company during such a long-term transformation, credibility is key. Focusing on the principles of relational investing, Starbucks was able to hold on to its stakeholders in the long term. By presenting its story in an optimistic, authentic yet simple manner, Schultz and his top management was able to use IR and the biennial conference to convince its claimholders that it would indeed come out of the crisis stronger and improved.

And it did. Following the biennial analyst conference, Starbucks´ stock price increased as the company got back on track in the subsequent months (and years). After having improved the quality of the coffee, regained trust from investors and rebuilt its brand, it saw a return of customers back into its stores with improved Same Store Sales. On a company-level, revenues increased from 9.7 billion USD in the year 2009 to 16.4 billion USD in 2014. Moreover, profit margins grew, and net income rose steadily from 390 million USD in 2009 to 2,068 million USD in 2014. During the same time, earnings per share increased from 0.52 USD to 2.71 USD while the share price reached new all-time highs, more than quintupling during the period from 2009 to 2014 (Starbucks Coffee Company Annual Report, 2014). As can be seen from the above results, its strategy of honest, direct communication in IR seems to have worked for Starbucks. Buffett's sisters would have approved.

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