Insights into Investor Relations in the German Mittelstand
A Mixed Method Approach to Understand the Significance of Financial Communication in German Small and Mid-Sized Companies

ABSTRACT

For years, academia and management have ignored Investor Relations (IR) in Germany. Although larger public companies have caught up with international standards, public small and mid-sized companies in Germany, the so called Mittelstand, *has not yet matched the efforts. This is counterintuitive, as over 99 per cent of German companies can be assigned to the Mittelstand and offer interesting investment opportunities for all stakeholders. This paper proposes a mixed method approach to show Mittelstand companies the potential benefits of properly executed Investor Relations. For this reason, the paper shows first findings of qualitative research and offers further research possibilities. Furthermore, it underlines the importance of communicating with all relevant stakeholders.*

Key Words: F*inancial Communication, Investor Relations, Small and Mid-Sized Companies, German Mittelstand, Mixed Method Approach*

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1. Introduction

"Then someone mentions "Investor Relations." Oh, you think - that's the nitty-gritty stuff like stock transfers and requests from little old ladies looking for their dividend checks. That's the clerical stuff that's handled in the back office by guys with green eyeshades and sleeve garters. Why should you concern yourself with such mundane matters?" (Brown, 1995, p. 44).

Investor Relations (IR) in the smaller and mid-sized companies in Germany, or short *Mittelstand*, is a topic, which has been ignored by academia and management for years. The professionalization of IR in the United States began to advance, in the 1950s (Köhler, 2015) and reached a first peak by the 1970s (Laskin, 2014). While the view represented by the quote above was overcome in the United States, the German market was not as developed. In fact, IR was not considered an established management practice in Germany until the late 1980s. Over the last years, however, the field has gained increasing acknowledgement in larger German companies (Köhler, 2015).

However, this acknowledgment has not transferred to smaller companies that operate in the German Mittelstand (Köhler, 2015). 99 per cent of all German companies belong to the Mittelstand. Investors, who ignore the Mittelstand, consequently ignore most investment opportunities. Furthermore, the current interest rate environment generates a lack of plausible investments within the market. This presents a mismatch.

Although all public companies must disclose certain information, smaller companies organize their financial communication less professionally (Köhler, 2015). One reason might be that the topic was rarely a focus of a thorough academic research. Managers of smaller companies thus might feel there is a lack of theoretical foundation to properly execute IR. Consequently, a probable positive impact of properly executed IR on the companies might be neglected. Therefore, it might be useful to gain insights into Investor Relations in the German Mittelstand from an academic point of view. These insights can additionally serve as a basis for further theoretical research.

1.1. Phenomenon under Study & Research Question

From a scientific as well as managerial perspective it thus makes sense to take a closer look at Investor Relations in small and mid-sized firms in Germany, which generally are clustered into the German word Mittelstand. In the past, when investigating larger public companies, the focus was put on investors as the main target group of IR. This, however, does not consider other, similarly relevant stakeholders of IR, such as analysts, employees, or journalists. In the past, IR mainly concentrated on shareholders, while neglecting its stakeholders. Additionally, the instruments of IR should be reviewed. Mandatory, for example ad hoc publications, and voluntary, for example press releases, publications have been studied from the perspective of larger companies in Germany. It should be examined if and how the previous findings can be applied for the German Mittelstand. Therefore, the research question arises:

Is properly executed IR important to the German Mittelstand?

In the following, this question shall be answered. In order to do this, firstly, a comprehensive literature review will be introduced.

2. Literature Review

As mentioned in the introduction, Investor Relations have gained a higher profile within larger companies on the one hand and among investors on the other (Kollmann, 2005). This development can generally be attributed to three main reasons. Firstly, the development of the financial markets themselves, which have become progressively complex (Kollmann, 2005). Secondly, the need to decrease information asymmetry between companies and their stakeholders due to an increase of regulations (da Silva Rodrigues & Galdi, 2016). Thirdly, a public loss of trust in financial institutions (Sapienza & Zingales, 2012). The combination of these factors has led managers of larger German companies to give Investor Relations marketing an increased priority.

Managers of larger German companies have realized that properly executed IR-management might increase the investors and public's trust in the company as well as decrease information asymmetry. Trust can only be achieved via open and honest communication as well as building long-term "well-functioning relationships" (Hansen, 2010, p. 2). Simply following the rules of legislation and regulatory institutions by applying obligatory financial communication might therefore be too shortsighted. Mandatory publications are, for example, annual general meetings or annual reports. They can either be implemented by legislators, for instance a government or regulating institutions, such as accounting standards (Köhler, 2015). By definition, all German public companies are obliged to fulfill these requirements. It thus becomes prevalent that a mere focus on these publications might not be sufficient to build and maintain trust. If only concentrating on what has to be done, IR might ignore possibilities to build a lasting relationship with its audience.

Hence, a constant dialogue between the company and its target groups may be beneficial. It might be significant to communicate with investors and other stakeholders on a regular basis and outside of the boundaries of regulation. This is where voluntary IR-instruments such as press releases or websites become significant. They might be helpful in developing a more informal and trusting relationship between smaller companies and the public. Additionally, they could decrease information asymmetry and complexity, as they reveal more information to relevant target groups (Köhler, 2015).

Which are the '*relevant target groups*' for Investor Relations in German Mittelstand companies? Contrary to intuition and most common definitions, this paper argues that only focusing on investors as recipients of IR-information might fall short. Mandatory as well as voluntary IR-instruments have a variety of other significant recipients. For instance, analysts play an important role for smaller companies, because their verdicts may have a substantial impact on stock prices and the perception of investors on a company (Bragg, 2010). Moreover, journalists cannot be neglected, as they are central multipliers of information within the financial market, as are employees (Köhler, 2015). When implementing the IR-instruments, all target groups should be kept in mind.

3. Methodology

Hereafter, the methodology to answer the research question is outlined. According to de Vaus (2001) asking 'why' something arises can be allocated to explanatory research, while asking 'what' leads to descriptive research. The main purpose of explanatory research is to describe why certain phenomena happen and to predict occurrences in the future (Sue & Ritter, 2012). Explanatory research is often used for explaining phenomena that has not been researched in

detail before; it helps the researcher to understand the problem more efficiently and in detail (Yousaf, 2018). It thus does not give conclusive evidence, but a first insight into the previously unexplored topic of implementing IR-instruments in the Mittelstand. As part of the explanatory research, a qualitative as well as quantitative approach was chosen. Often, the combination of qualitative and quantitative research methods is called 'mixed methods', which will be explained in more detail in chapter 2.2. (Driscoll, Appiah-Yeboah, Salib, & Rupert, 2007, p. 19). To gather the information necessary, a qualitative, interview-based approach was chosen as a first step. Then, a quantitative method will be used, by distributing and analyzing a survey questionnaire.

According to Flick (2014) "qualitative research aims at understanding the phenomenon or event under study from the interior" (p. 90). Given the relatively unexplored topic, this method seems to be appropriate to gather first in-depth information on a specific topic (Ritchie, Lewis, Nicholls, & Ormston, 2013). The quantitative study can be used to verify the information gathered in the interviews (Steckler, McLeroy, Goodmann, Bird, & McCormick, 1992). Quantitative research is often connected to better generalizability (Brannen, 1992). Therefore, the results of the questionnaire can serve as a basis to confirm if the answers provided in the interviews may apply to the whole Mittelstand. In the following, the methodology will be explained in detail.

3.1. Research Focus

Keeping the phenomenon under study in mind, the research of the paper focuses on the target groups of IR in the Mittelstand, on the one hand, and the voluntary and obligatory instruments of IR, specifically used within the Mittelstand, on the other hand. For this reason, three members of the target group were interviewed to get a first impression of this topic.

The questionnaire will be developed after evaluating the answers from the interviews in detail. It will also concentrate on the opinions of the distinct target groups on the instruments. It is of importance, to get survey answers from respondents, who are also familiar with the German Mittelstand, i.e. target group members. Here, the distinction of the target groups from the interviews also makes sense. The respondents are likely to be experts on the instruments they are familiar with and most probably also have a sound understanding of the other instruments. This way, the applicability of the answers to the Mittelstand can be more easily ensured.

3.2. Research Design

Qualitative research relies primarily on induction. Induction can be defined as "the process of inferring a general law or principle from observation of particular instances" (Rothchild, 2006). The inductive process starts with a specific observation and ends with a theory. In this case, the first observation was the increasing implementation and success of IR-instruments in larger German public companies. Then, the question arose why most of the public companies in Germany, namely Mittelstand companies, neglect proper execution of Investor Relations. It would seem logical, that the positive effects of efficient IR-implementation also apply to the Mittelstand. This hypothesis must be tested and confirmed principally with the help of qualitative research, as it will give first detailed insights into the topic at hand.

In this paper, a mixed method was chosen, more precisely, a sequential exploratory design. This means, that first, the qualitative data are collected, then analyzed. In a next step, the

quantitative data are collected and analyzed (Creswell, 2009). As a final stage, the interpretation of the whole analysis will be completed, and the research question can be answered.

As a first step, three interviews with German target group members were conducted, all three in German. Interviews belong to the most common form of collecting data in qualitative research (Milena, Dainora, & Alin, 2008). Each interviewee was asked the same set of semi-structured questions to collect the in-depth information that are necessary to get a first overview of IR in the Mittelstand. This form of interview uses an interview guide with open-ended questions that should be answered by all participants (Jamshed, 2014). The guide assists the interviewer in structuring the answers systematically, especially if a greater number of interviews is conducted (Jamshed, 2014). Open-ended questions assisted the interviewer in receiving detailed insights into the topic at hand. Besides, it might help interviewees to speak more honestly. The answers can "provide a direct view into a respondent's own thinking" (Roberts, et al., 2014, p. 1065). Additionally, posing open questions might "add richness" to the interview (Krosnick & Presser, 2009, p. 9) and "avoid bias" (Singer & Couper, 2017, p. 119). This makes sense, as the research topic is relatively unexplored. Thus, the answers can be used to get a first understanding of the target groups' perspective on IR in general as well as its instruments.

After the interviews have been analyzed in more detail, a questionnaire will be constructed, distributed to a specific sample group, and evaluated. The questions in the questionnaire will be based on the answers of the interviews, the number of questions will be chosen accordingly. To ensure a higher response rate, though, the questionnaire should be kept rather brief (Nulty, 2008). The survey will include a combination of multiple-choice and open questions as well as 7-point Likert scales. The closed questions will each give the respondents a set of choices; the open questions allow them to use their own words (Krosnick & Presser, 2009). 7-point Likert scales are used, because they are more likely, to measure the participants' honest evaluation (Finstad, 2010). This would help to get an authentic opinion on the phenomenon under study and a first step towards answering the research question. The questions will be grouped in distinct categories, with varying forms of questions in each category, starting from more general to specific topics (Krosnick & Presser, 2009). This might assist the participants in structuring their thoughts and thus support them in answering the survey questions. The results from the analysis of the questionnaire, in combination with the insights of the interview, will lead towards a final answer of the research question. In the next section, the planned data collection and sampling will be outlined.

3.3. Data Collection & Sampling

A sample is used as a representation of a population (Greener, 2008). It would be extremely time and cost intensive to ask all relevant stakeholders of IR-communication in the German Mittelstand, therefore a characteristic sample must be chosen. In line with explanatory research, the samples of the qualitative part will be rather small, as it will primarily give first, but not final answers to the research question (Yousaf, 2018).

Although probability sampling tends to be more representative and have a lower sampling error (Greener, 2008), non-probability sampling is more feasible in this case. It means that the three interview partners were not randomly selected, but purposefully chosen (Greener, 2008). A portfolio manager and investor, an IR-officer, and an experienced CEO of a IR-agency

were interviewed. After the first three interviews, more interview partners shall be chosen to get more qualitative information about the topic

The questionnaire can be distributed using snowball sampling. The researcher can use the initial group to contact other stakeholders, especially ones from their own target group. It would be desirable to contact about 200 stakeholders overall. This will probably lead to an adequate response rate, particularly when keeping the design of the survey from chapter 2.2 in mind. The snowball technique should be monitored closely, though, as it might reduce the representativeness of the sample. The next section will describe the research setting.

3.4. Research Setting

The research setting can be defined as "the physical, social, and cultural site in which the researcher conducts the study" (Given, 2008). Thus, the research setting is the environment in which the research is conducted. First, the research setting of the interviews will be explained. The interview questions were distributed before the interview, so the respondents had time to prepare their answers. All interviews were conducted face-to-face. The three participants were interviewed separately by the interviewer. Face-to face interviews are "characterized by synchronous communication in time and place" (Opdenakker, 2006). This means that the interviewer and respondent are in the same room, preferably a quiet one, and speak to each other in person, rather than on the phone. Besides the actual answers, the interviewer can take social cues, for instance voice or gestures, into account when interpreting the results (Opdenakker, 2006). It should be noted, though, that face-to-face communication might increase the risk of interviewer bias. The interviewer might, intentionally or unintentionally, influence the respondent through her own behavior (Opdenakker, 2006).

As the questionnaire will be designed based on the interviews, the setting has not been finally decided. However, it is plausible to conduct an online survey, or more precisely a web-based survey as they have many benefits over postal or other printed questionnaires. Web-based surveys can be completed on websites; the prospective respondents may be invited via a link, which makes the process relatively cheap (McPeake, Bateson, & O'Neill, 2014). Additionally, it has been established that the sample size for the survey should be appropriately high, so the research results can be reliable. Online administration thus is a viable solution, as many respondents can be reached cost efficiently (Sue & Ritter, 2012). Online communication is fast, making it a feasible way of contacting the respondents. Nevertheless, online surveys should be distributed with care, as their response rates are significantly lower than for paper-based surveys (Nulty, 2008). The next chapter will outline the possible analysis of the data.

4. First Findings

As described in the previous chapter, three interviews were conducted. More qualitative as well as quantitative research will follow to explore this important topic further. However, the interviews can be utilized to get some first insights into the topic.

Every interviewee was convinced that properly implemented IR-instruments could add value to a company as well as the stakeholders. All three interview partners were sure, that future legal obligations alone will foster the meaning of IR in Germany. They think that IR could be explicitly favorable for smaller companies, because investors never ignored the large enterprises in the first place (Rinke, 2017). Moreover, they believed personal communication with the public could be especially beneficial. This means, that obligatory publications are

probably not sufficient, because they mostly neglect the possibilities of personal interactions. Also, they were rather skeptic if small and mid-sized firms lived up to their potential. In fact, the portfolio manager is certain that bigger companies manage IR more professionally, but small and mid-sized companies are particularly dependent on a solid relationship with investors and other stakeholders. This is a discrepancy which needs to be solved, e.g. by thorough training in IR for managers and employees.

The experienced CEO of the IR-agency stated that it might make sense for Mittelstand companies to focus their IR-measures on specific investors and analysts, who are willing to consider smaller companies, instead of wasting resources on advertising to an incompatible audience (Rinke 2017). Underlining this point, the interview with the investor showed that he will invest in companies which communicate with them constantly. Trust to the managers will make investors stay committed in the long-term. Personal communication could thus assist German Mittelstand companies in winning investors as well as analysts and keeping them for an extended period (Rinke, 2017). The previously depicted mismatch between investors that look for opportunities and smaller German companies that look for capital could potentially be solved.

In the next section, the limitations of the paper will be presented, followed by managerial implications.

5. Limitations & Managerial Implications

The paper contributes to the field of financial communication, in general, and Investor Relations in Germany in particular, although it has some limitations which will be addressed next. The first and most relevant limitation of this paper is that only three interviews were conducted. Although the interview partners were highly knowledgeable and could give first insights into this relatively unexplored topic, more qualitative research is needed to verify the first findings. Particularly, more target group members or stakeholders could be interviewed, from various industries. Additionally, the planned quantitative survey would probably be beneficial in verifying the results from the qualitative research.

Generally, two limiting factors should be kept in mind. The first one is reliability, which means that repeating measurements will lead to same results, with a certain chance of error (Carmines & Zeller, 1979). In this case, it would mean that the repetition of the interviews will generate comparable replies for the answer of the research question. The next aspect is validity, which can be divided into external and internal validity. A research method is valid, if it measures what it states to measure (McLeod, 2013). Internal validity refers to the causal relationship between the independent and the dependent variable (McLeod, 2013). It can be amended by controlling extraneous variables. In this case, it would mean to control for the variable 'industries' or 'age', for instance. External validity means that the results of the research can be generalized. Due to the low sample size in the interviews, this factor should be kept in mind. However, the aimed representativeness of the sample and the survey sample might be able to correct this factor.

After assessing the most relevant limitations, the managerial implications will be presented in the following. It is expected that future interview partners as well as survey participants will approve and add on to the first findings. It is quite probable that managers in the Mittelstand have undervalued the positive effects of properly employed IR-instruments in the past, especially voluntary instruments. In the past, they might have focused solely on the obligatory

measures. This falls short, as only the employment of voluntary instruments will increase the trust in the comparably unknown investment opportunities. Therefore, more resources should be spent, without neglecting the obliged legal communication. Particularly, the interviewees underlined the importance of personal communication in order to develop a trusting relationship. Although, this means investing more time and money in the short-term, it will be advantageous in the long term. Additionally, the paper has shown that smaller companies in Germany should not solely focus their IR-efforts on investors. IR has other significant target groups that should not be neglected.

In order to properly execute obligatory as well as voluntary IR-instruments that will add value to the German Mittelstand, managers should make financial communication a priority. The responsible departments and employees should be aware of why IR is important, why and how all relevant stakeholders can be reached, and how important IR-instruments can be implemented best. Clear goals should be defined and annual plans should be developed. Furthermore, the top-level managers, such as the CEO or CFO, should receive training, as they often publicly represent the company within the financial community and other relevant target groups. Eventually, the creation of a designated IR-department might be a necessary step towards professionalizing the communication.

Although these steps require initial investments and an increase in budgets, it might assist the smaller companies in professionalizing their IR. In turn, the target groups will take the companies more seriously. Consequentially, managers of smaller and mid-sized German companies should value IR, because it will promote their standing within the financial community and assist them with securing long-term capitalization.

6. Conclusion

This paper offered some new and relevant academic inputs for German Mittelstand companies. Investor Relations in Germany has come a long way during the last years. It has established itself as an independent research topic and is an acknowledged part of communication for larger companies. Small and mid-sized firms in the Mittelstand often have not realized the potential yet. Therefore, the research question of this thesis was: *Is properly executed IR important to the German Mittelstand?* It has been established, that public companies do IR, because they are obliged to do so. They must disclose certain information and they must hold specific meetings.

Investor relations, though, is not just about obligation and focusing on investors. It is about communicating openly with all relevant target groups. The paper has given a first research impulse for smaller and mid-sized companies by pointing out the relevance of IR for them. More qualitative as well as quantitative input is needed, but the first findings as well as managerial implications are a promising beginning. Especially, because this paper has emphasized that properly executed IR is indeed important to the German Mittelstand.

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