BUSINESS REPORT (ZAMBIA)

OPINION/ ANALYSIS

Share price obsession is missing the point totally

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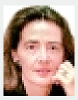

By Ann Crotty

Thanks very much to the reader who recently forwarded me one of the most insightful takes on executive remuneration and the tyranny of the equity market.

The contents of the article relate to the view - gaining much support in the US - that the equity market is the tail that no longer merely wags the dog but risks beating it to within inches of its life.

The view is based on the realisation that equity markets no longer play their traditional role of raising money for brave and determined business people who have a good product or idea but not the money to bring it on to the market.

Occasionally shareholders still do provide funding and so play the traditional investor role. But statistics from equity markets around the globe indicate that these are rare occasions and that over the past 15 years companies have been paying out money to shareholders in the form of dividends and share buy-backs rather than getting money from them.

Shareholders now do little more than gamble. Shareholder X buys into company A because she believes the share price will appreciate sufficiently to make it a better bet (along with the dividend payments) than buying Company B or putting the money in the bank. Or it could just be that the gamble on Company A fits into the risk profile of her investment options.

It is important to realise that the money Shareholder X spends on the shares in Company A does not go to Company A, it goes to Shareholder Y who sold the shares because they no longer suited his risk profile.

Despite the fact that shareholders are little more than gamblers and equity markets little more than facilities for accommodating those gambles, over the past 30 years any company with a stock exchange listing has steadily become fixated on the equity market and its share price.

Management teams no longer focus on growing turnover and long-term profit, but on increasing the share price and, what's more, increasing it in the short term.

Indeed, over the past 15 years or so, as executive pay became tied into share price performance, this tendency moved from a mere "focus" to an obsession.

And so I come to the article. It relates to the views of Roger Martin, the dean of the Rotman School of Management at the University of Toronto. Martin likens the business world to that of the US National Football League and talks of a "real market" and an "expectations market" in both.

"In football, the real market operates when the teams go head to head on the field, score touchdowns, and win or lose the game. In business, the real market is the world of factories, production, sales, profits and losses."

In football the expectations market is about betting on which team will win and by how much. However, at all times the goal for the players and the coach is to win the game in the real market. In fact, dabbling in the expectations market is prohibited by most teams across the world.

In the business world, however, performance in the expectations market is regarded as more important than performance in the real market. And, critically, executive remuneration packages, which now always have a potentially enormously valuable component of share options, ensure it can be no other way. And so in business "winning is no longer about steadily increasing sales or profits over the long term. Winning is about increasing your stock price."

This will not change while executive pay includes share options, which ensures that the tail will continue to wag the dog unmercifully.