Shareholders Value Creation— The Pressing Corporate Agenda

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Shareholders Value Creation is the top most priority for the corporate world today. This move has gained added momentum with the rising expectation of the shareholders for their value of money. This article discusses different facets and principles of shareholders value creation from professional perspective.

Generally, if you ask the CEO of any company about his top most priority, the most probable answer will be— 'Shareholders value creation or maximisation thereto'. The whole corporate world throughout the globe has been busy in fulfilling this goal. This has become a mantra intoned with solemnity at every Annual General Meeting and in every Annual Report. Any negligence by any company in this area may threaten its mere existence in the marketplace what to talk about its prosperity or growth. So, all the companies in the domestic sector as well as in the international sector are striving hard to accomplish this goal in their own ways, with the vision and mission they possess, with the forces and strategies they have and with the power and resources they can deploy. After the opening up of the economy, liberalisation of trade and commerce and cross-border flow of fund and technology, this move has gained added momentum with the rising expectation of the shareholders for their value of money and the forward looking statements concerning performance and position being released by the corporates in the media.

Shareholders value implies the shareholders worth in the company concerned, or to put it in simple terms, how much the share capital is backed by the financial net worth of the company. In the era of conventional accounting, when balance sheet was considered to reflect the true and fair view of the financial position of a company, financial net worth of the shareholders of a company was considered to be the summation of share capital and free reserves reduced by any accumulated loss not adjusted against profit and loss account or reserve and as such appearing on the Asset side of the Balance Sheet or any such items appearing on the Asset side.

But now the public perception has extended well beyond the Balance Sheet and shareholders worth is being considered off the balance sheet also in terms of market value and economic value. In terms of market value of shares, shareholders value is the total market capitalisation of the company, which is equal to the market value per share multiplied by the number of shares issued by the company. From the economic angle, shareholders value denotes the economic value of the business after deducting outsiders claim in terms of loan and advances. How these three approaches are related is very difficult to be precisely described. In many cases it has been observed that in spite of reduction in the book value of some stocks, their market prices have increased and there are also cases, where the book value of shares have been increased but in the market it is quoted at a lesser price. It is the market sentiment, which ultimately decides the equation.

But one thing is very clear, to create value, a company has to earn adequate profit to enable it to

go in for a return on investment for the shareholders in excess of the cost of capital. The larger the spread the more is the value and vice versa. How to increase the size of the cake and how big is a big, is the ultimate problem to be addressed. The size of the cake should be big enough to meet the expectation of the shareholders to become successful in the value creating activities. The expectation of the shareholders is guided by what he could earn somewhere else at a similar risk consistently.

Shareholders value creation is not a one-time phenomenon but the corporates should strive to create, sustain and enhance value to their shareholders on a constant and continuous basis as a conscious governing objective. There are several compelling factors such as increasing pressure for delivering expected rate of return, year after year, consistency in growth in terms of business, market share, profit and profitability, intense competitive pressure in the business environment amidst the clamour for socially responsible behaviour as a responsible corporate citizen etc. are pushing the corporates to meet this end. The globalisation of world economy through the integration of national economies with the international economy has further accelerated the necessity to put shareholders value creation at the top of the corporate agenda.

Principles of Value Creation

The basic principle is to identify the specific areas of product, services, price, markets and other investment opportunities and to put its resources in such combinations which can assure an adequate return on a consistent basis to generate a reasonable surplus for the shareholders after meeting the business expenses and expectations of other stakeholders. There are many dimensions and facets of such endeavours with different perspectives based on several strategic functional areas like finance, operation, human resources, marketing etc. The objective is to search for corporate and business strategies that will maximise shareholders value. Some broad principles of such value creation may be stated as follows:

(1) Suitable business design should be focused with emphasis on shareholders value creation and to meet the challenging requirements of the marketplace towards customer selection and value proposition, deciding key milestones and scope of critical activities, selecting the most profitable product mix with strategic control of the profits streams and ensuring coordinated and effective functioning of the organisation towards overall accomplishment of set targets.

(2) Shareholders value objectives are to be transformed into specific smaller scale metrics to be combined in right proportions to show that shareholders value is being increased and to make the goal decidedly clear. These smaller metrics are the usual operational and financial targets decided as planned objectives like increase in net revenue by a certain proportion, earning per share by a certain amount, increase the market value of a share by a certain per cent, increase in the market share by a certain amount etc. These short-term targets can be monitored and tracked by the company to ensure that value adding goal will be accomplished in the long run by the company. If any thing is out of track, necessary remedial measures may be taken by the company at the right moment to avoid any serious departure in the future. Mention may be made of the efforts of some eminent companies in this regard. Cadila Health Care Ltd, a Pharma giant, is working on a value creation programme "DELTA" with a specific goal to "Double the sales and triple the profits at the end of three years from 2003-04." Earning Per Share (EPS) targets were fixed at 10% per year and a target of generating free cash flows to the extent of £150 million was set by Cadbury Schweppes, one of the world's biggest beverage and confectionary company.

Brand management is an important area of value creation. A strong brand is the resultant outcome of quality, price, public image, perception of the customers about the company and its products and several other internal and external factors, which a company can leverage to augment its sales or a premium in price.

(3) Cost control or cost reduction is one of the grey areas, which can enhance shareholders value to a considerable extent. No cost is to be taken as granted and should be challenged to set at the lower levels by reducing and gradu-

ally removing wastes and inefficiencies. In this present competitive business environment a company cannot pass on its dead woods to the customers in the form of price. So such costs should be controlled through improved technology, better work culture and other measures. Cadila Health Care Ltd. launched in January 2003, "PRISM"- a programme to save costs by addressing the entire non-labour spend base, facilitated by an international reputed consultants. This has resulted in development of numerous cost-saving ideas having great potential to improve company's future profits and thus to increase shareholders value.

(4) The other area which is closely related with shareholders value creation is the value added management. It opens up a new horizon of knowledge for decision- making techniques specifically suitable in the typical situations. Value based management demands that every action and decision of a company should be guided by a unique approach called, "Managing for Value" and should in a way or other add to the shareholders value. It increases strategic thinking capabilities of the business and coordinates the whole activity into a bonding force to pursue the organisational goal. Just like in the solar system, all the planets rotate round the Sun, all the managerial function such as planning, staffing, directing coordinating and control should rotate round the shareholders value creation in a corporate system. In today's philosophy of management, the ultimate and long term goal of a corporate to stay in the business is the maximisation of shareholders value, so if any short term decision or action of the management collide with this long term goal, such short term decision or action should be suitably adjusted or modified to fall in line with the long term goal of value creation.

Shareholders value is best created when the interest of the employees, who are directing and operating the organisation can be integrated with the shareholders value creation drive in such a way that meeting the interests of the employees can automatically lead to the shareholders value creation.

(5) Value based management can only be put in place when the corporate leaders will be capable enough to develop outstanding management team possessing strong leadership qualities to lead the team through the process of value based management and to execute targeted strategies for value creation. Work culture should be fine-tuned to adapt to the changes to nurture three major behaviour traits— accountability, aggressiveness and adaptability. All these attributes have a major role to play in shaping the things to the ultimate objective of shareholders value creation. Motivation and communication are two major tools to sharpen the leadership style towards achievement of such ambitious targets and should be practised judiciously.

(6) Shareholders value is best created when the interest of the employees who are directing and operating the organisation can be integrated with the shareholders value creation drive in such a way that meeting the interests of the employees can automatically lead to the shareholders value creation. In management terminology it is called 'Goal Congruence'. One of the leading MNC, while taking the drive for MFV (Managing for Value) based its understanding that value for the shareholders is created when there is close alignment of interest of the employees with that of the shareholders. Based on this principle, system of reward recognition has been introduced in the company wherein the top 30 managers became eligible to participate in the long-term investment plan that linked rewards with performance of the company's shares. In addition, top 150 managers were made eligible to receive stock options. There may be many more examples of goal congruence. Marketing managers' salary may be made variable based on the achievement of their marketing targets. Production managers may be paid incentive based on quantum of production achieved. Higher rewards of the employees help in achieving the targets of production, sales, quality, etc. and thereby add to the goal of maximisation of the return of the shareholders.

(7) Intangible assets in the possession of a company will go a long way in creating shareholders value in this knowledge driven economy. Knowledge has to be leveraged to formulate appropriate strategies and practices to establish links between tangible and intangible value drivers, to assess their capacity to generate values and the methods to measure it. Of the different forms of intangible assets, intellectual capital occupies the most significant position in creating value for an enterprise. Intellectual capital has three major components – human capital, organisational capital and relational capital. Human capital denotes the knowledge, care and skill, competency and efficiency of its workforce. Organisational capital includes the attributes and strength embodied in the company owned items such as systems and procedures, databases, values and culture prevailing with the organisation. Relational capital relates to the values and perceptions of the relationships with the external agencies like customers, suppliers, partners, regulators, banks and financial institutions, credit rating agencies, etc. Intellectual capital adds to the excellence to be achieved by an organisation which can outperform other enterprises with the same levels of tangible assets. This reflects "how the company differentiates itself" from its peers in this competitive era. Now it is perceived and recognised in the corporate world that intellectual capital can only make a company win. So a company should do all its best to leverage the intellectual capital to improve its performance and position.

(8) Another important area of value creation is brand management. A strong brand is the resultant outcome of quality, price, public image, perception of the customers about the company and its products and several other internal and external factors, which a company can leverage to augment its sales or a premium in price. These increases in market shares or increase in price increases the return on investment and thereby adds to the shareholders value creation. Brand possesses a special form of value addition that attracts a customer to the specific product and as such it proves to be a very valuable asset to a company. Now-a-days companies like Hindustan Lever, Procter and Gamble, Xerox, etc. are spending a lot of resources towards brand management. The most contributory factor of brand management is its capacity to generate additional cash flow. It is determined by four factors— its price, growth, costs and investment. Further a strong brand can lower investment levels because of its potential leverage over the supply chain. Through brand management, a company may project its products as self esteemed products by lowering buyer's price sensitivity, synchronising operating processes and through its enterprise risk management capability.

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Conclusion

Shareholders Value creation as a philosophy and as a goal is increasing in importance day by day. The separation of ownership and management in the corporate sector has induced management in a bigger way to go in for this goal. Several principles have been discussed here. But still there are several factors, very difficult to put in black and white, which need the attention and consideration by the corporates. It requires firm will, dedication on the part of the higher management supported by adequate plan and policies, target setting, management by objectives and other management practices. This requires commitment from the entire organisation, proper goal congruence backed by suitable incentive system.

A company has to evolve as a value creating organisation, a performance developer on which it can build shareholders value on a sustainable basis. It must meet the specific financial targets to meet the expectation of the shareholders. It lies at the core of every business to survive and grow. It encompasses several structural and operational aspects of a firm like product line, management efficiency, market standing, project implementation and monitoring, capital structure and such other critical areas of business. Shareholders value creation is not only the necessity but has become the ultimate identity of today's business. ❐