Growth Strategies | August 4, 2016 | CFO.com | US

‘Shareholder Value’ for Private Companies

Private companies may benefit even more from a shareholder value focus than publicly listed companies do.

Gregory V. Milano

Most people think about public companies when they consider “shareholder value” principles. That’s because public companies have quoted share prices and should develop and execute strategies designed to grow the share price over the long term. Yet although private companies don’t have quoted share prices, they have the same need to drive the right strategies and results as public companies.

Actually, private companies have more need for sound value creation measures and processes than public companies do because of private companies’ lack of share-price feedback.

It’s true that many legendary entrepreneurs have produced enormous value creation with loose business management processes and metrics. That’s not to say well-designed business management processes and metrics are not helpful, but these entrepreneurs had a sharp intuitive sense of what worked and what didn’t. Years ago someone suggested to me that Sam Walton could “smell value creation.” I don’t know much about Mr. Walton’s sense of smell, but I am surely impressed with his vast success.

There’s a lot of confusion on what is shareholder value. What’s meant by “shareholder value” principles? Companies embracing shareholder value begin by accepting the idea that growing the value of the organization over time is beneficial for the shareholders and other stakeholders of the company.

For example, our research shows that companies with strong long- term share price performance tend to increase employment while those with weak share prices over time tend to shed jobs. So what’s best for long-term shareholders actually aligns with balancing the interests of all company stakeholders (employees, suppliers, customers, etc.).

Those embracing shareholder value implement better metrics that more accurately track share prices over time. Because of that, their internal measures and management decisions align well with long-term share price performance. Then they weave those better metrics into every facet of how they develop strategies, plans, budgets, investment policies, and incentives.

Indeed, the incentives may be one of the most important facets of shareholder value for private companies to better align non-owner managers with success and help attract managers when competing with public companies for talent.

There are three reasons that shareholder value principles are important to private companies and should be adopted by them. The first is the sheer size of the organization as it expands. Over time, successful private businesses grow in size and expand into new industry segments and geographies. This added complexity reduces the ability for the

corporate, or family, office to effectively oversee everything. To properly serve customer needs across this broader landscape, some management decisions must be decentralized. But private companies need the proper tools and processes in place to successfully navigate a decentralized terrain.

The second reason shareholder value principles are important to private companies involves succession planning and governance. As second, third, and fourth generation family members enter adulthood, there's often a declining percentage that actively participate in the business. Such passive owners face risks, as the majority of their personal wealth is left in the hands of others. Many times the passive owner doesn't having much direct influence or oversight. What's more, some family members that remain in the corporate ranks may not have the same intuitive business acumen that their parents and grandparents had. Better governance is often needed.

Finally, shareholder value principles can reinforce an ownership culture in management team members who have little or no actual ownership. Many private companies have family oriented cultures in which long-term employees feel almost like part of the family — which is very good. Loyalty, in terms of commitment of the employee to the company and vice versa, is often very strong. Unfortunately, in some cases such cultures can become soft and lose an emphasis on long-term results that existed when the founder ran the show. Such companies make fewer bold investments, are slower to cut their losses on bad ideas, and slowly de-emphasize true accountability.

To be sure, there are some habits of public companies that private companies should avoid. At the top of the list is the madness around quarterly earnings and earnings calls. Private companies should, of course, pay attention to quarterly results in the context of their influence on-longer term results. But they should avoid the adverse short-term behaviors many public companies exhibit in order to achieve results that beat Wall Street consensus estimates.

For example, private companies shouldn't give unneeded discounts in March to pull April sales into the first quarter to hit a contrived target. That often does more damage to the profitability of the company for the year. And private firms should avoid cutting good R&D or advertising spending to achieve quarterly goals, either. In fact, some private companies might find their publicly owned competitors are so egregious in these short- term actions that it creates opportunities, at times, to readily gain profitable market share from them.

Private companies that have grown in size and complexity, experienced generational succession, or are concerned with the evolution of their corporate culture should consider embracing a shareholder value focus. Better measures and business management processes can not only improve governance, help mangers at all levels of a company develop better strategies, and execute them in ways that deliver better results. They can also reward and attract talented managers in ways that can compete with their public company counterparts that offer stock options and restricted shares.

Gregory V. Milano, a regular CFO columnist, is the co-founder and chief executive officer of Fortuna Advisors LLC, a value-based strategic advisory firm.