Manager’s Journal
Transparency is for Overheads!
[Deloitte Consulting senior manager]

Share price transparency should be as outdated a concept as the overhead transparencies used in classrooms and boardrooms of the past.

As earnings season comes to a close, a vast majority of companies continue to focus on short-term financial results and miss the importance of giving the market key non-financial information that is critical to long-term share price growth. This lack of information can cause ‘transparency’ discount that directly affects share value.

While it is accepted for CEOs and board members to focus on financial measures, they may be missing a key part of the picture of their company’s health. And by doing so, buy-side investors who drive stock prices end up with little more than historical background to build their future earnings models.

The problem with this scenario is that independently, historical financial information is limiting and is not necessarily an accurate indication of how the company is going to perform in the future. Investors may apply a worst case scenario to their predictions of future returns that results in a lower-than-warranted stock price.

Without a better-rounded picture of a company, specifically non-financial performance metrics, investors may place a ‘transparency’ discount on the stock price. Investors do not have enough information to determine if they want to buy a stock, nor at what price, are likely to have lower forecasts and target prices.

Simply put, companies that do not give buy-side investors a reason to believe in their future are leaving value on the table.

There are many reasons why companies only focus on the short term financials.

- Some feel the market rewards a company solely based on hitting the most recent quarter's number.
- Other companies compensate their top management on making short-term financial targets.
- Companies may not fully understand the connection between educating the marketplace about their key non-financial performance metrics and share price.
- Top-level executives may be skeptical of measuring the value of certain non-financial factors, such as a talent management, commitment to the environment and innovation

Measurement and monitoring of non-financial factors is becoming more and more important to boards and CEOs. Non-financial factors, including employee commitment, customer satisfaction, brand strength, governance, and corporate social responsibility endeavors all provide critical insight into how the company is performing today and, more importantly, their ability to sustain performance into the future.

Getting a grasp on this information and consistently communicating with investors is vital in reducing the 'fudge' factor built into their cash flow models. The problem is that many companies are not good at measuring and monitoring this information, and have trouble communicating it to the market. According to a recent Deloitte Consulting and Economist Intelligence Unit study "In The Dark," only a little more than a third (34%) of board members and executives surveyed said their companies were "excellent" or "good" at measuring and monitoring non-financial performance indicators. However, nearly three quarters (73%) indicate that they are under increasing pressure to measure this information.

Fortunately for some shareholders, there are companies that do measure and monitor non-financial information very well and are rewarded for it by a premium share price. For example, GE's commitment to building its talent is communicated and understood by investors to the extent that buy-side investors recognize the value it brings to the company's future and contributes to the share price.

Another example is Nike, whose share price is heavily influenced by the strength of its brand. The more the buy-side investor knows about the strength of the brand in its marketplace – market share, advertising and marketing endeavors – the greater the likelihood this will be reflected in the share price as they believe the company can sustain earnings expectations.

But these examples are the exception, not the rule, and even the best get caught in the short-term number game.

It's time for companies to realize that focusing solely on short-term financial numbers is not enough to sustain long-term shareholder value creation. But how does an executive successfully maneuver his or her company towards a long-term focus based on solid non-financial performance metrics? Here are a few suggestions to consider:

- **Reward based on creating long-term value.** Boards need to reward CEOs based on long-term value creation. First and foremost, it's only natural for leaders to manage for how their success (or failure) is rewarded.
- **Create a vision for the company's future based on concrete strategies that presents a credible picture of the future.** A strategy focused on value doesn't get hamstrung by rationalizing past performance or generalizing about the future. It provides a detailed case to prove that you're actively managing for growth, not managing the past. Part of this process may entail putting into place the right mechanisms to measure the key non-financial factors that drive your future revenue growth.
- **Communicate using the words that mean what you are trying to accomplish.** The words you use need to inspire the results you want. This is as important internally as it is when speaking to customers, business partners or investors. For example, if you're interested in growth in cash returns, don't focus the conversation on 'cost.'

A shift away from 'short-term' numbers won't be easy nor generate the immediate results you may want. Getting rid of the 'transparency' in your share price will take time and effort in building your case with investors and communicating it consistently. It’s a gradual process that when implemented correctly and completely, should result in a more valuable organization and continue to deliver value growth for shareholders over the long-term.

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