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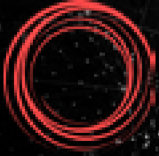

The cosmic link between corporate strategy and company value

In my career as a strategy advisor and private equity investor, the conversation I most often have with CEOs is whether or not they should be responsible for the company's share price. The common wisdom is that leadership teams can't be expected to navigate the vagaries of the capital markets and most CEOs hold to the principle of *"manage the business well and the share price will take care of itself."*

I fundamentally disagree for three reasons.

1. Most listed companies incentivise executives with share options tightly linked to company performance and share price. The assertion that a CEO needn't be concerned with share price is simply devoid of reality.
2. A CEO is responsible for setting the corporate strategy, which enables the achievement of specific outcomes that determine company value. The strategy when executed should i) govern investments in existing and new assets (so called 'capital allocation'); ii) grow revenue; and iii) generate returns in excess of the cost of capital. This in turn creates a flywheel of reinvestment, growth, and returns, which ultimately supercharge shareholder returns.
3. As all venture capitalists will agree, they don't base an investment decision on a concept, but on a leader and a team. The entrepreneurs (the 'who') are more important than the 'what'. Similarly, CEOs must define a highly differentiated purpose, a bold aspiration, and clear strategy that inspire their people, suppliers, customers, and the capital markets if they are to realise a price premium.

The rules have therefore changed. CEOs directly impact the value of publicly listed companies. Leading the business and managing the value of the business are both within their domain of responsibility.

Of course, the scope of a properly defined and executed strategy starts much earlier. I believe there is a direct causal link between corporate strategy and stock market performance and, in my experience, very few CEOs, executives or boards understand this important interplay. All too often, companies create alibis for a lack of market appreciation. My personal favourite is 'sentiment', as in, "the market sentiment has moved against us, our industry or our sector and this is the reason our share price is being punished".

Yes, managing short-term changes in sentiment is challenging because it's influenced by external factors like exchange rates, macro-economics, and geopolitics. But, whether a company is on the right side of long-term sentiment is a choice and, sadly, all too often companies cling to outdated concepts, like 'core business', which as the evidence repeatedly shows when looking back at the great companies of old, can be replaced with 'complacency' and 'lack of foresight'.

Let me explain. In 1900, the most prominent and prosperous businesses were in oil, steel, textiles, and railroads. By 1920, the hot industry was automotive. By 1930, there was a significant decline in global confidence, severely impacting the profitability of steel and oil. After the second world war, the 1950s saw the emergence of telecommunications, entertainment, airlines and aircraft manufacturing. In the 60s and 70s, the world's most valuable companies where in the automotive and energy sectors, with the likes of IBM, 3M, and Eastman Kodak starting the technology and consumer product revolution. In 1980, seven of the ten most valuable companies were in the energy sector, with only one technology company (IBM) featuring in the top 10. Energy constituted more than 30% of the S&P500 market capitalisation. Fast forward forty years to 2020, energy had declined from 30% to less than 2.5%, with six of the largest players being technology companies, collectively comprising more than 24% of the S&P500 market capitalisation.

What does this all mean? What the market values, changes. The attractiveness of industries will morph over time, but the most valuable of companies will always be the disrupters that consistently focus on high growth strategies – companies that create new industries rather than being defined by old ones. Think how much poorer our lives would have been if a company like Apple continued to define itself as a PC company. No access to the world of music on your mobile phone. No Apple Carplay (personally I will not buy any car without it). No iPad for Zoom calls with a virtual whiteboard.

Coming back to the idea of 'core business'. Between 1980 and 2020, energy companies continued to define their 'core business' as oil and gas despite a clear shift towards technology and an increasing capital markets appetite for renewable energy, sustainability, and carbon neutrality. The future growth expectations at the intersect of automotive, energy and consumer business powered the rapid rise of companies like Tesla – which is currently the sixth largest company in the world by market capitalisation, trading at a significant premium to its intrinsic value. Could it be that the likes of Shell and BP – once icons of innovation, among the most powerful and recognised brands in the world – have been disrupted by a new entrant because of their inability to change?

If you dislike change, you will dislike irrelevance even more.

What's next? It may well be space exploration and regenerative businesses designed to restore the planet's health. It will be telling how future growth expectations will inform SpaceX's share price the day it lists. It is already regarded as the most valuable privately owned company in the world. But what is SpaceX? Is it a rocket manufacturing business? A telecoms company? A Mars economy? Just as Tesla's success came at the intersection of automotive, energy and consumer goods, so SpaceX sits at a nexus. The idea of 'core business' has become very dangerous in today's world, especially in the lexicon of capital markets. Don't believe 20-year-old analysts trying to convince companies to 'stick to your knitting' based on the need to compare Company A with Company B in the same industry or sector. It will invariably lead to a flawed strategy that will sacrifice the future of a great business on the altar of a core business definition. The capital markets evidence is this. In 1965, the average tenure of an S&P500 company was 33 years. By 1990, it was down to 20 years, and 18 years by 2012. How do large, successful companies become irrelevant? As the infamous 21st century philosopher, Mike Tyson, said, "Everyone has a plan, until they get punched in the mouth".

Investing only in the business of today (let's call that the 'core business') – and not constantly scanning the horizon for new opportunities that could develop into the business of tomorrow, is a choice. Change is the only constant – whether you are a company operating in 1900 or today. The difference is that in today's digital, connected world operating at the speed of thought, the velocity of change is relentlessly increasing. What has stayed the same is that capital markets will always place a premium on the future growth potential of a business (let's call that 'expectations'). To lock into this premium, agility has become the most treasured of strategic capabilities.

A company's future is a matter of choice, not chance. Strategy is a choice, and strategy directly determines company value.

About the Author

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Louis is the former Global Executive Director for Service Innovation and Growth and former CEO of Deloitte Consulting Southern Africa. He established a global Strategy and Innovation advisory unit at Deloitte, advising large multinational clients in the area of growth strategy and innovation process, and developed significant new businesses for clients across industries.

Louis was also the Group CEO of Capitalworks for 7 years, a leading emerging markets alternative asset manager.

Louis has a longstanding passion for corporate innovation and entrepreneurship, and is a co-founder of Instant Life, a leading direct life insurer, acquired by Barclays Africa in 2016.

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