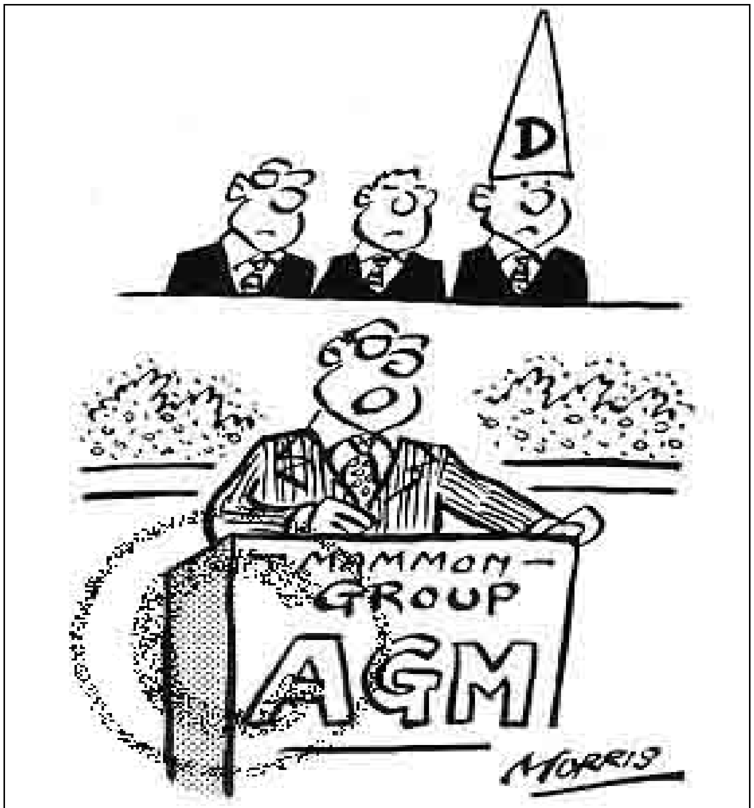
# The Importance of Share Price to a Listed Company




"... and who was responsible for this drop in our share price, I hear you ask..."

As an Analyst, I often attend various Broker and Analyst meetings after the release of financial results in order to get a better insight of the company's performance for the respective period and also to determine where the company is going in the future.

However, it is always interesting to see how much the host of the meeting, which is the listed companies themselves, is concerned about the share price of the company. Also, most of these companies are hardly ever satisfied with their share price and always want to see it higher than where it closed on the last day of trading. The question is "why do they care?" after all, the company itself does not receive any cash benefits from appreciation in share price. The company only receives capital when it issues shares to the public for the first time on the primary market.

So, why is management almost obsessive about the share price of a company? Well, the most obvious reason would be that the management has a vested interest in the company and as such would stand to benefit from appreciation in the share price. It is very common for the upper management of a listed company to receive salary incentives in the form of stock options which are tied to the share price of a company. Also, there are instances where the founder of a public company holds a substantial interest in the shares outstanding. Thus, it is very clear that in such cases, the management of a listed company would be very concerned with the movement in the share price for personal wealth reasons.

However, there are other reasons for a company and its management to have a strong interest in its share price that is not so obvious to the everyday investor. For instance, one of the reasons for issuing stock options is to align the objectives of management with the interest of shareholders. In any business book or course one of the first things you would learn is that it is the job of management to produce the greatest returns for shareholders. This brings me to my point- owning shares means you are a shareholder and in fact an owner of the company. In the long run, the value of a share is based on the performance of the company. So while the management may not have any control over price in the short term, poor performance in the long term may be an indication that management is not performing up to standard and in some extreme cases shareholders can overthrow current management in a proxy battle. Thus, management would be concerned about share price as it is a reflection of their performance.

Takeovers are another reason why the management of a public company would be concerned about its share price. Such that, if a company's share price is falling at a rapid rate it would mean that the company would be more likely to be acquired as the share would be much cheaper and bidders would be better able to make offers to shareholders. This is especially so for companies with shares which are widely held as opposed to closely held. It is much easier to convince many with few than it is to convince few with many, especially when the latter are involved in the day to day running of the business or where there is a founder. As a result, it is in the best interest of the management of a listed company to ensure that its share price remains relatively stable so as to ensure that there is little or no likelihood of being taken over.

Conversely, a company with a share price that is appreciating at a constant rate would have an advantage in acquiring other companies. This is so because the company can fund an acquisition through the issue of new shares instead of using cash resources or employing debt. A company with a strong share price driven by significant amounts of demand would easily attain a fully subscribed offer.

Moreover, a company may be seeking additional equity financing for reasons other than acquisitions and when there is high demand for a share, the company can easily offer new shares to the market to raise capital. However, it is important that the company does not dilute its share capital too much as this can have a negative effect on existing shareholders.

Should a company decide to do financing outside of the stock market, for example through a bank, its share price still plays a significant role! This is because a company's share price is linked to its earnings and thus a strong share price reflects strong earnings potential. As such, a strong share price over the long term is a good indication of the company's ability to meet debt requirements. Creditors will be more willing to lend money to a company with a healthy and strong share price than one with an anemic price that shows little or no growth potential for the long term. Additionally, it could mean receiving cheaper financing through lower interest rates, since there is less risk of default.

Then there is the simple argument of “Ego”, especially in Trinidad and Tobago, where the culture is such that each person is trying to outdo the other!! The same goes for companies and their management! It is seen as prestigious to have a share price that is strong and also one with soaring growth potential. Companies such as these would receive positive coverage from analysts and investment professionals in the financial industry, which in turn provides a form of free publicity and advertising. Even employees of the company feel a sense of pride knowing that their company’s share price is outdoing the competition- for instance. In effect, a strong share price is like a vitamin pill for morale!!!

So, we can now see that a company’s management could be concerned about its share price for reasons other than personal wealth- which seems to be the first reason that comes to mind. If management were to turn a blind eye on the performance of the company’s share price, it could lead to negative consequences such as: discontented owners or shareholders; greater potential for takeovers; difficulty in raising capital through equity markets and financing through debt; and finally it can even have a negative impact on self esteem and morale of the company as a whole.