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BOOK REVIEW

ACHIEVING FAIR VALUE: HOW COMPANIES CAN BETTER MANAGE THEIR RELATIONSHIPS WITH INVESTORS

By Mark C. Scott, West Sussex, England: John Wiley & Sons, 2005, ISBN: 0-470-02390-2, 237 pp. (excluding bibliography and index)

The question of being fairly valued has always been the main concern of most CEOs of large public companies as it is the standard benchmark of being successful in the financial market. The concept of fair value simply means that a management has to focus primarily on fundamental, operational value creation and ensure that they are as accurately valued as possible by investors. In ensuring this, management is prepared to invest tremendously in terms of time and cash in managing relationships with the financial markets solely for the reason of controlling the movement of share price as it is seen to be the "primary modern measure of successful management" (p. 2). As a Muslim reader, we cannot neglect the fact that this question of being fairly valued should also be looked into carefully by those Islamic economists who are committed in developing and offering Islamic alternatives to the society.

Achieving Fair Value, authored by Mark C. Scott, explains in detail the concept of fair value, from defining fair value, discussing strategies in achieving fair value to initiating some thoughts on the application of the concept in future decades. The author states that the book was written with the intention to provide a practical introduction to every important element of fair value strategy and to improve a company's ability in managing its institutional investors.

He also stresses that en route his research, he was shocked and surprised to discover how little strategic insight has been developed in the issue of managing relationships with investors. There was no particular research or study done on this subject and it had independently evolved through convenience and with no proper framework. Since it is entirely in the hands of the executive teams to better manage their rapport with fund managers, a major change of mindset on the part of management is desperately required together with the development of a set of analytical tools and strategies to be able to identify active fund managers that might be setting the share price, thus being on the right track in achieving fair value.

The author distinguishes two notions of missions or goals of companies, which are, maximizing profitability and cash flow, and the other being, maximizing share price. Nevertheless, the war on maximizing share price continues and never seems to stop as very few companies appear to win and stay the winner for long. The author puts the blame on the nature of the share price itself, of it being volatile and hence, immensely disruptive to the business concerned. Highly rated shares during a bull run can achieve the lowest returns in the subsequent period of correction. On the contrary, the lowest rated shares during the bull period can enjoy the highest return after the period of correction.[1] The quest of maximum share price is totally embedded in the mind of the management in managing the stocks as this is how investors categorize stocks. Stocks quoted are graded by market capitalization thus grouped into indices, whether the FTSE 100, the Dow Jones Industrial Average or the S&P 500. The author adds that most large cap institutional fund managers rely on index-based investment strategies to initiate weighting of portfolios. Whether a firm is in an index or not has a tremendous influence on the valuation attached to it. As a result, he argues, it is essentially important for a firm to get into and remain in an index in order to be perceived as successful, thus being fairly valued.

The author also mentions the premium cycle (p. 12) which, according to him, would inevitably lead to a misvaluation trap. In responding to perceived expectations by the market, the company is susceptible to a damaging effect of a unsustainable premium and would thus inevitably suffer a 'correction' period, triggered by waning profits where the company can no longer deliver on hugely raised expectations for earnings growth. The author claims that in the correction process, the company can often move from being overvalued to being undervalued and requires fundamental changes to recover fair value.

The author has put it clearly that the best course for a company is to adopt a strategy of fair value before misvaluation takes place. A company must know where to start on the fair value road and the answer, the author believes, is to understand the customers first and in this case, the institutional fund managers.

The book cites two main players in the market system, the company that is issuing shares and the investors who are buying shares. In between come the intermediaries, brokers and fund managers, performing logistics functions, adding as much value as possible at each step and incurring as little cost (p. 27). However, sad to say, these intermediaries do not always function as they are supposed to. They sometimes have biased agendas and interests and eventually, do not perform their basic functions. Their utmost interest would be keeping the fund manager's trading and reserving their goodwill for an upcoming placing by another client. Obviously with these limitations, it is not wise to rely unquestioningly on the house broker as the only source of investors' analysis and insight. The author, in this book, attempts to change this approach of depending solely on brokers' insights of a company to one that encourages the management to focus resources on those investors that matter, whilst strengthening the company's understanding of these investors in the process, with the cooperation from brokers.

The rest of the book talks about the fair value strategy and the methodology of staying in the fair value corridor. The author introduces the so called fair value levers that are most likely to impact against value determining investors.[2] These levers are categorized as 'what we tell investors' which means the disclosure of facts and interpretation (e.g. financial performance measures, operating measures, market indices, strategic objectives, performance guidance, etc.); 'how we tell investors', in other words, what communication channels we use and thirdly, 'what actions we take', i.e. whether we have to resort to fundamental changes in strategy or management to alter perceptions. A fair value strategy demands that a company builds a coordinated set of management processes that enables the synchronization of the levers (p. 79). The book stresses that the relevance and appropriateness of different levers will vary depending on where the firm finds itself in its fair value corridor.

The fair value process is not intended to be prescriptive but rather offers a systematic compilation of core methods a company can employ to improve its interaction with share holders. The author has identified that the core of a fair value strategy is to develop a systematic approach to identifying value-determining investors, investors who effectively set and drive the share price of companies. Having identified these types of investors, the author has logically pointed out that a company with deeper disclosure will ultimately be more accurately valued than a company with lower disclosure. Hence knowing where disclosure should be deepened and when it is to be deepened is a process that demands careful thought and analysis. Therefore, the management should invest in building a good and effective communication process to alter perceptions and condition behaviors, particularly amongst those fund managers that really matter. In other words, the process should move towards targeted communications rather than mass communications (p. 194).

The author finalizes his thoughts by portraying what he expects to happen in the future decades regarding this notion of acquiring fair value. He sees some trends evolving throughout the period of his research. He forecasts, among others, that the shareholder is due to get more complex rather than simple, as non-conventional investors are likely to increase their role. Driven by the onward advance of derivatives, cross-border investment will grow rapidly and volatility of holdings will increase as fund managers come under even greater competitive pressure to maximize annual returns and mandate cycles tighten. He concludes by stating his opinion that the net effect of these trends will be a highly competitive market for companies, but one in which fair value strategies will gain increased credence.

In essence, the summary of the findings is that the notion of fair value actually lies in the hands of the management. Questions on what initiates fair value, who to deal with in order to achieve fair value, how to deal with the people who have the influence in setting the value and ultimately how to sustain the fair value achieved are important issues. The author argues that no actual study has been done on how to better manage relationships with valuable investors, which he has attempted and successfully delivered.

This book can offer much in developing an Islamic perspective to tackling the issue of fair value. A value which is considered fair for an investment would basically bring justice (*ᶜadl*) in terms of pricing for companies and investors. Achieving a fair value, nevertheless, as pointed out by the author, is not an easy task as it requires substantial effort from companies in communicating with and convincing their existing and potential investors. Investors on the other hand, as described in the book, require full disclosure of information, transparency, ethical conduct morality and integrity from companies. These are basically universal values as propagated by Islamic teaching (*al-Qur’Œn*, 2:42). One fundamental element that both companies and investors should uphold is the notion of *amŒnah*. Without *amŒnah*, a company might provide wrong and inaccurate information to investors that could lead them to artificial value or misvaluation, as discussed by the author, instead of fair value. Artificial value caused by misleading information would eventually be adjusted and corrected downward to reflect true information, thus leading to injustice to investors, causing them to suffer loss in wealth.

It is agreeable to say that companies, in achieving fair values, are continuously trying to improve their ability in managing the relationship with investors and this basically involves timely targeted communication to explain, convince and highlight the true and potential value of a company to investors. Islam permits the managing of relationships as long as it is done on the basis of Islamic principles leading to the total disclosure of information, thus assisting investors in deriving investment decisions. Since the author has argued that no particular studies have been done on how to achieve fair value, those concerned should take the challenge and responsibility to tackle and address this universal issue and offer an Islamic alternative, theoretically and practically, to the real world of financial markets.

ENDNOTES

1. Alessandri and Bettis denoted that the market tends to overvalue and undervalue different shares systematically during different periods of the overall market cycle.

2. Coyne and Witter introduced the idea of value determining investor screening. The objective of the screening is to determine when the trading activity of fund managers has coincided with unique and sustained movements in the share prices.

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