

## Successful alternatives

There's no shortage of successful alternatives to the shareholder-driven enterprise.

When analysts want to know how the retail recovery is going, they check the sales figures from John Lewis – a store chain owned by its employees, through shares held in trust. First with the news is often Associated Press, the world's oldest and largest news organisation, run as a not-for-profit cooperative. If the analysts then go to lunch, the chances are they'll eat food supplied by Cargill – still a privately owned company, despite having grown to a \$100bn turnover with 160,000 employees.

The card they pay the bill with could well be supplied by Nationwide, a mutually owned building society; or by the Co-Op, a bank set up by a consumer cooperative. And if the bill gives them a headache, any tablets they take are most likely to come from Alliance Boots – now in private equity ownership, after venture capital group KKR bought out the previous shareholders in 2007.

These seemingly diverse businesses have at least two things in common. All are remarkably successful, and none is owned by stock-market shareholders. What's puzzling about them is that, according to the shareholder value thesis, they shouldn't be market leaders. They should have failed.

Employee cooperatives are meant to fail because they pay themselves too much can't expand, being unable to invest enough or unwilling to take on new people who might drag their wages down. Family-owned businesses are supposed to suffer weak management because the founding family draws out too much capital, and parachutes its own members into executive roles that should go to professionals. Consumer cooperatives are meant to lack the funds and the cost-cutting ferocity to hold their own against the supermarket PLCs.

Advocates of external shareholding say that without it, companies will be unable to raise enough long-term capital, meaning they either stay too small or run up unsustainable debts. That's meant to be especially problematic for mutual financial institutions, like

building societies, which don't have a pool of shareholders' equity to draw on when a downturn shrinks their assets.

And venture capital is supposed to support start-up and early-stage companies, floating them on the stock market once they get established. It's not meant to buy them out from the stock market when they've already grown to multinational size.

So why haven't the shareholder-owned rivals wiped these alternative business forms out? Why, conversely, have Boots and other giants of the London and New York stock exchanges sought private buyers so that they can escape the shareholders' attention?

One big problem is the short-termism that sets in when the share price is used as an indicator of managerial performance. Owners watch the share price day to day, and study the quarterly and half yearly trading statements, for assurance that they're maximising earnings per share. With a time horizon often measured in weeks, managers will hesitate to launch any product or workforce development projects that initially subtract from profit, and might take years to pay back.

Large shareholder-owned companies do still achieve innovation and attract talent - but usually by buying it in, from smaller privately-owned firms that developed it first.

Companies that don't raise capital through external shares were meant to collapse under the weight of their debts. But in fact, it's the newly active shareholders who often pressure management to borrow more – on the basis that while dividends on shares are discretionary, interest payments on debt are compulsory, and so force wayward managers to pay out the free cashflow rather than absorbing it on expenses.

While companies that buy themselves out of the stock market also tend to run up heavy debts, they tend to get longer to pay them back. A bank lender or venture capitalist may want to retrieve their capital in five years or so - but that's often five times as long as impatient shareholders will wait for their return.

So although it was meant to be non-shareholder companies that have difficulty raising funds for investment, it's often been those with shareholders that find they can invest

least and are forced to pay out the most. PLCs have been at the forefront of outsourcing or subcontracting production, casualising the workforce and selling-and-leasing back the physical assets – reducing cost, but often losing control of their supply chains, and ruining workforce morale as pay and job security decline.

For employee-owned partnerships and cooperatives, morale and motivation play a big part in success. If you shop regularly in John Lewis, you often find you're being served regularly by the same staff. They tend to stay, and make an effort, because they've a direct share in the profits that results – in contrast to the rapid turnover of staff in PLC chains, who know that any extra profit they make is heading for a distant owner's pocket.

Above all, the shareholder value idea puts enormous faith in the efficiency of stock markets – to forecast future profits accurately, discount them to present value at an appropriately low rate, and so set a share price that correctly evaluates the long-term worth of present management strategy.

We know from hundreds of studies that stock markets are never so blissfully efficient. Share prices fluctuate much more than they should, often deflected by irrelevant events. They jump when managers announce an instant reward to shareholders, like a buyback, but tend to sink when they start something strategic

Witness the punishment inflicted on Carphone Warehouse when it moved into fixed-line telecoms, or Morrisons when it acquired Safeway – moves that were massively rewarding a few years down the road, but bemoaned at the time by shareholders for whom twelve months is often too long.

Stock markets don't just have great difficulty putting sensible and stable valuations on individual shares. They also go through boom-and-bust cycles that disrupt the prices of all shares, making listed companies' costs of capital into something of a lottery. And there's a long-term worry that, as societies age and more people retire, pension funds that used to channel money into stock markets will start drawing it out again, putting a long-lasting drag on all outstanding shares.

No wonder many private companies, mutuals and cooperatives try to line up one another as business partners, keeping their supply chains PLC-free. And no wonder 'going public' has lost much of its old appeal. Major stock markets are now shrinking, as more large companies seek a way out of them, in order to rediscover their past creativity and operating freedom. The revolution didn't just devour its children – it may well have ended up demolishing the canteen.