Thought Piece:

'Shareholder Value' in the UK

When Will Thorndike wrote his now-legendary book on eight "unconventional CEOs and their radically rational blueprint for success" in 2012, all eight of the so-called 'Outsiders' were from US businesses. The US is rightly seen as the centre of the universe when it comes to 'getting' the importance of high returns on capital and capital allocation, the act of an enterprise directing its surplus capital to its most rational use. That is in no small part due to the genius of Warren Buffett (the ultimate 'Outsider') and the central part that capital allocation played in Berkshire Hathaway's exemplary value creation over its 60+ year history. Buffett has been very generous in sharing his wisdom on capital allocation and for those who followed his annual letters and his approach, it is clear that it is indeed the key to maximising an enterprise's value creation. His line that he is a better investor because he is a businessperson (and vice-versa) might sound superficial but it is profound. The 'CIO-as-operator' learns how to generate high returns on capital, and the 'CEO-as-investor' learns a) how to recognise when there is surplus capital and b) how to deploy that surplus rationally. Swapping perspectives can be extremely powerful.

In his 1987 letter, Mr Buffett made the wonderfully subtle but astute point: "after ten years on the job, a CEO whose company annually retains earnings equal to 10% of net worth will have been responsible for the deployment of more than 60% of all the capital at work in the business". This is likely a very under-appreciated point. Mr Buffett's letters regularly call-out some of the great contemporaneous managers and capital allocators. The reputation of Henry Singleton (of Teledyne) is sealed as the exemplar of share buybacks. Don Keogh, Tom Murphy and other contemporaries of Buffett like Sam Walton and John Malone all were recognised as exceptional capital allocators and business managers and now have the enduring legacies to match. But to those of us in the UK, these might be deemed remote, of a different era and engaged in what might seem distinct or niche businesses.

It is genuinely exciting and goose bumpy when a genius reveals 'the method'. But sometimes we still need those exemplars to be closer to home, showing evidence that we can actually put the method into practice, reassurance that the magic works in our environment. Which begs the question: are there any such exemplars closer to home that we could offer for the yet-to-be-written UK version of Outsiders?

Yes, there are. Actually, quite a few!

Simon Wolfson, CEO of Next, holds the mantle today as the UK's best CEO and capital allocator. His 25 years of shareholder communications reveal a clarity and consistency that Mr Buffett would undoubtedly approve of greatly. He would also approve of the huge value creation that resulted. There are others in the UK too that we greatly admire like David Barber, Tom Kirby, Mike Ashley, and Tim Martin, each creating shareholder value through astute capital generation and allocation. Importantly, they employ similar techniques but in their own style and across vastly different end markets.

Sir Brian Pitman is another shoo-in for the UK version of the Outsiders book. Pitman was best known as the legendary CEO of Lloyds Bank in the 80s and 90s. He was less well-known as the Chairman of the aforementioned Next at the time when Simon Wolfson took over as CEO and crucially when it first began to show its capital allocation prowess via its astute buybacks (which began in 2000). We have looked closely at Wolfson's journey as a capital allocator and we strongly suspect Pitman was highly influential. Pitman (who sadly passed away in 2010) already wrote what could be the outline for an Outsider profile and is a must-read. In

that 2003 HBR article, ('Leading for Value') Pitman outlined in some detail his quest for shareholder value at Lloyds Bank. If there is one article an incoming UK CEO might seek for inspiration it is surely this one.

Pitman's chosen nomenclature ('Shareholder Value') might seem to some as run-of-the-mill. As a press headline today it often connotes negativity, a myopic focus on share prices or asset-stripping. Actually, in its most authentic form, shareholder value accrues most in a business when all its stakeholders (customers, employees, the social good and shareholders) are very well looked-after. Pitman absolutely 'got' this and set about a crusade to instil Shareholder Value in its best form as a deep culture trait with Lloyds. A learner, he approached Buffett's friend Roberto Goizueta at Coca-Cola and proved that Shareholder Value transcends diverse end markets. Strong capital allocation works as well for a global soft drinks brand as it does a UK retailer or a UK housebuilder. This is not to suggest Pitman's chosen road was an easy one and his mini memoir reveals the recurring internal friction at all levels of the business, not least his board (though he did get some slack from the board as a new CEO and said he made use of his "honeymoon period" well!). Over his tenure the value of Lloyds multiplied 40-fold and his legacy is cemented as one of the UK's best CEOs, a true Outsider and inspiration.

"Getting people to concentrate on things that really create value for the company demands something else: the transformation of their beliefs" – Sir Brian Pitman

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