

A new way to measure long-term firm performance and shareholder value

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Business leaders and investors are increasingly rating companies not just on short-term financial performance but on their ability to create long-term value for shareholders.

Today the most commonly used metrics to gauge a firm's success are profitability ratios such as return on capital (ROC), total shareholder return (TSR) and earnings per share (EPS). While these provide useful information, they are focused on the short-term and do little to reflect underlying [economic performance](#) or to precisely capture the creation (or destruction) of long-term shareholder value.

To address this gap, Phebo Wibbens, INSEAD Assistant Professor of Strategy, and Nicolaj Siggelkow, the David M. Knott Professor at The Wharton School of the University of Pennsylvania, have developed a new tool they call Long-term Investor Value Appropriation (LIVA).

LIVA, as introduced in a recent paper, "Introducing LIVA to measure long-term firm [performance](#)", published in the *Strategic Management Journal*, uses stock price data to measure the degree to which a [company](#) has created and destroyed shareholder value by calculating a backward-looking net present value (NPV) over a given period.

This is best explained using an example such as Apple which between 1999-2018 had a LIVA of 1.002 trillion dollars. This number indicates that if an investor bought all outstanding shares of the company in 1999 at the market price, borrowing the money for the purchase at a cost equal to the average market return, and then sold the shares at the end of 2018 at the [market price](#), using the money received as well as dividends and share buy backs to repay the 'debt', they would have \$1.002T left in the bank.

Because LIVA is based on share price, expectations as well as earnings are factored into the result.

Unlike many other [performance measures](#), the LIVA metric:

- Is not weighted in favour of firms that outperform relative to

their size ensuring it is driven by companies with significant economic impact.

- More accurately captures the actual economic effect of major corporate events such as M&As, spin-offs and bankruptcy
- Values both profits and growth
- Reflects the long-term value creation of a firm's entire shareholder base.
- Is particularly suited for settings in which there is a long period before strategic actions are reflected in performance. In these cases, it is difficult for measures such as ROA and CAR (cumulative abnormal returns) to pick up long-term performance consequences.

Because it is an additive measure, LIVA is simple to aggregate over multiple companies or time-periods. To assist with this the authors have created a database including more than 500,000 observations of 45,000 firms using 20 years of statistics from the Compustat North American and Global Security databases. Managers and researchers can access the LIVA database and web app by going to www.liva-measure.com/. They can use our tools there to compare a firm's long-term performance against its peers, the best and worst performing companies globally or across a specific region or industry.

Users are also able to break down the LIVA to identify which parts of the firm have performed well at specific moments and to identify which strategic decisions have created or destroyed value—assisting executives and investors to make better-informed strategic decisions in the future. Media and public policy makers can use LIVA to assess the performance of listed companies, groups of companies, sectors or geographies.

In their paper, Wibbens and Siggelkow use case studies of companies such as Circuit City and Best Buy to show how the LIVA approach provides more direct links between strategic actions and organisational

performance.

Their study reveals the markedly different strategic insights that can come from using LIVA compared to commonly used short-term ratios measures such as ROA and CAR (cumulative abnormal returns). For instance, they show how the much-recognised U-shaped relationship between organisation acquisition experience and organisation performance is largely driven by short-term investor expectations and vanishes when using 10-year LIVA.

By helping decision-makers to measure and focus on long-term value creation, metrics like LIVA are also likely to have a broader societal impact.

"Managers concerned mainly with short-term metrics such as quarterly earnings growth will be tempted to make quick cash at the expense of suppliers, customers and broader society," said Wibbens, noting that, "In the long run these actions will likely backfire due to customer protests or stricter regulations, ultimately destroying value. LIVA provides managers with a metric that can help them gauge long-term value creation and consider which [strategic decisions](#) can allow their firms to flourish."

More information: Phebo D. Wibbens et al, Introducing Liva to Measure Long-Term Firm Performance, *Strategic Management Journal* (2019). [DOI: 10.1002/smj.3114](https://doi.org/10.1002/smj.3114)

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