Context

Institutional investors seem to be forced to invest in ways which damage economies, societies and environment

► We need to improve the stewardship of investments and the quality of relationships
► Companies and their shareholders are interdependent and have the opportunity to co-create a sustainable future
► We need to shift our focus from short-term transactions to long-term relationships
Challenges with current valuation approaches (e.g. DCF, CFROI)

1. They provide one, theoretically correct, valuation for a listed firm while
   - the actual market values constantly fluctuates and
   - investment returns represent the change in price not the price itself
2. They are static until their next update, which is normally earliest in a quarter
3. They struggle to integrate non-monetary key performance indicators of business
Can any quarterly updated DCF explain Apple’s share price development?
The Corporation and its stakeholders

Illustrative example with selected stakeholders

- Shareholders
- Employees
- Corporate Pensions
- Suppliers
- Banks
- Bondholders
- (Social) Media
- NGOs
- Customers
- Local communities
- Government
- Unions
- Hermes Investment Management
The Corporation and aspects of its relationships

Stakeholders relationships aspects

Illustrative example with selected stakeholders and relationships

Firm

Shareholders

Cash Flows
Earnings Momentum
Dividends
Growth Potential
Reputation
Corporate Environmental Responsibility
Customer Service
Brand Value
Trust
Healthy & Safety
Corporate Social Responsibility

Bondholders

Capital Structure
Corporate Governance

Banks

Transparency

Suppliers

Commodity Prices
Long term vision
Corporate Legal Responsibility

Government

Tax

Corporate Pensions

Risk Management
Leadership

Employees

Customers

Earnings Momentum

NGOs

Growth Potential

Local communities

Corporate Environmental Responsibility
Customer Service
Brand Value
Trust
Healthy & Safety
Corporate Social Responsibility

Unions

Illustrative example with selected stakeholders and relationships

HERMES INVESTMENT MANAGEMENT
Valuation of the equity of a firm

Currently dominant valuation approach

► Value of Firm = Assumed Cash Flows / (Empirical Discount Factor * Assumed Adjustments)

Dynamic Valuation by Relationship Aspects

► Change in Market Value of Firm = Change in National Market Environment + Change in industrial market environment + change in global market environment + Change in Relationship Aspects
Questions and conclusion

1. How can we measure good relationships and how do they relate to value creation?
2. Do we need to quantify relationships in the non-financial areas?
3. How do externalities arise out of poor relationships?
4. How do fund managers respond to this proposal?
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