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Investor Education Centre

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How important is a share price?

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A reader has asked what share prices mean to a company, and should a company be interested when its share price rises or falls?

Although many investors monitor share prices day by day, sometimes hour by hour, there is not as strong a connection between a company's share price and the underlying business as many people assume.

Share prices tend to rise and fall to reflect the ups and downs of a company's earnings, but they can also be impacted by the overall trend in the share market, and by investors' varying expectations about the future. Some days a share price can fall simply because there are more sellers than buyers, or vice versa.

At times, enthusiastic investors can push a share price up, with or without any good news from the company to support their enthusiasm. At other times, investor sentiment can turn negative, driving the share price lower, even though the company is performing perfectly well (which of course presents a good buying opportunity!).

Companies sell shares to the public to raise money. Once the shares have been sold and are in circulation, the price of those shares does not have any direct impact on a company's assets and earnings. If a company sells 100,000 shares at \$1, then it receives \$100,000 which it can use in its business. If the share price then fluctuates, it doesn't change the initial sum that the company received.

However, a falling or rising share price can *indirectly* impact a company. A falling share price could make it difficult for a company to raise funds to pay for future expansion, whereas an increasing share price gives them more flexibility to raise money from shareholders, rather than from the bank. A falling share price can make a company more susceptible to a takeover offer, especially if the falling share price is due to bad management and other parties think they can run the company better.

A share price can also impact a company's reputation as well as its culture and staff morale. A strong share price performance can play an important role in motivating, retaining and recruiting staff; whereas a collapsing share price can often lead to a poor reputation. This is important because, as Benjamin Franklin once said: "Glass, china and reputation are easily cracked, and never well mended".

Some chief executive remuneration packages feature share options, or the ability to purchase shares in the company. Clearly the share price becomes more important to a chief executive when his remuneration is impacted, though my preference is for such packages to focus on company earnings rather than the share price, since the executive can influence the former more than the latter.

While the movements of share prices will always be important to investors, they should be less important to companies and their chief executives. A rising share price will ultimately *reflect* that a company is performing well, but it won't *cause* a company to perform well.

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