Effective Investment Management Is All About Revenue Growth and Being a Good Seller©

Arthur Lipper

The following observations assume the companies under consideration for investment are generating revenue; they may be publicly listed or privately owned. The policies relating to unlisted shares are different and will be addressed in the latter part of this writing.

Successful portfolio investment management is an exercise in discipline. The necessary discipline is in creating and abiding by holding duration policies.

The objective of the portfolio manager is to be holding a list of winning positions, in terms of cost versus market value or achievement of projected results.

Buying decisions are, relative to selling decisions, easier for the manager to make as there isn't the natural need for justification of the buying decision in the case of current valuation being less than cost, or otherwise disappointing.

Assuming that 24 months is a reasonable period of observation, positions should be reduced or eliminated if the company's revenues fail to have increased by the level anticipated at the time of the purchase. The growth of revenues is, in part, the measure of a company's marketing success in providing present and potential customers with positive value.

Profits are the measure of company management's ability to increase revenues in excess of costs. If revenues continue to grow, profits will either grow, at least proportionately, or steps will be taken to correct the situation.

From the investor's perspective, it's all about revenue growth and ideally all portfolio holdings should be, at least, at the level of reasonable expectation.

At a time when I was advising investment fund managers, I suggested that portfolio selling decisions should be made by other than those who made

the original buy decision. This was not a view embraced by the investment managers, since although they spent most of their time considering possible new holdings, they didn’t want to lose the authority to hold or sell their existing positions.

I believe that in most cases, over the years, great investment management performance has been achieved by the managers who were great sellers. Unfortunately, the natural tendency of many investors is to accept disappointing results and continue to hold a position. The investor is hoping for the best and accepting company management's ever-optimistic projections. This is usually a mistake, influenced by a reluctance to recognize a poor purchase decision and is usually a portfolio performance deflator.

In the case of privately-owned companies, investors can, as we suggest, invest directly in the revenues of the company, through purchasing a royalty-entitling payment of an agreed percentage of the company’s gross revenues, for an agreed period. The equity investor can also usually purchase shares from companies in which the owners are prepared to surrender the benefits of private ownership. The shares will theoretically increase in value if the company increases and maintains its profitability. The value of royalties, using our approach, is not theoretical -- royalties are collected immediately based on the company’s receipt of revenues and distributed to investors quarterly.

Royalty agreements can contain company repurchase options or minimum revenues and therefore royalty payment assurance terms. It’s all about revenues, so why shouldn’t the investor focus on the revenues and not the reported profitability of the privately-owned company?

The equity investor in a privately-owned company could also require, as a condition of investment, a put which is only activated were the revenues or reported profits to be less than an agreed level in or for an agreed period.

Of course, the initial investor has leverage in negotiating the terms of acquisition, but only prior to making the investment in the company. A subsequent investor, buying the shares or royalty from an initial investor, does so accepting the terms of the asset being purchased.

Investing in companies, especially early-stage companies, is all about the prospect of revenue growth, so why is It not better to invest directly in revenues, rather than assuming the greater risk of partial ownership of the company?

Royalties are the better way of BOTH investing in and financing of privately-owned companies.

Arthur Lipper, Chairman
British Far East Holdings Ltd.

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