The Trouble with Shareholder Value *Ideology*: New Insights from Economics and Corporate Law

Simone de Colle
IÉSEG School of Management, Paris
www.ieseg.fr

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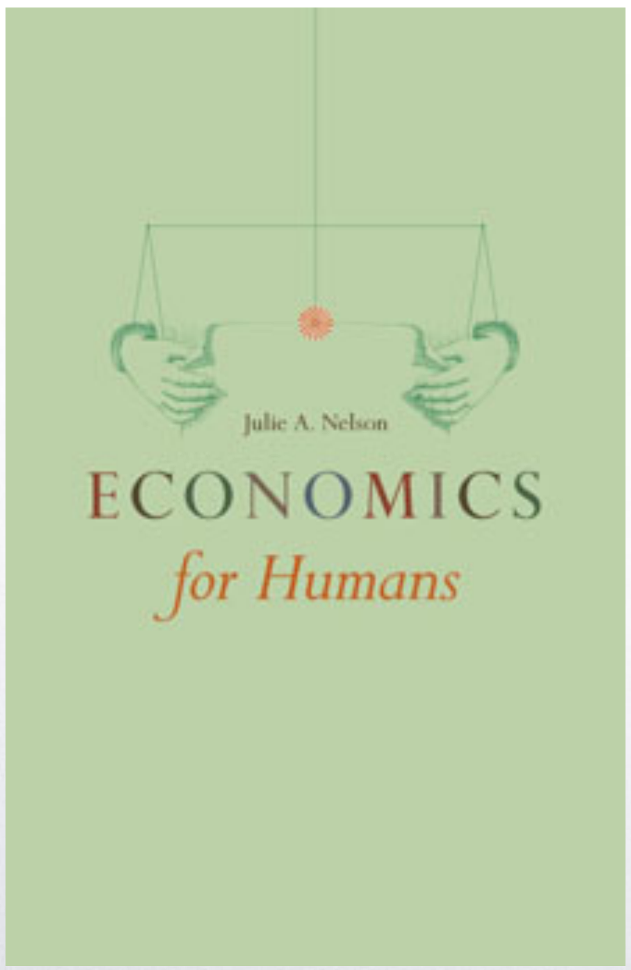
Outline

1. The Economist's perspective: Julie Nelson (2006)
   - The Economics as a Machine ***metaphor***
   - Origin and (damaging) implications:
     The common bias of **probusiness** advocates and **antimarket** critics
   - An alternative view: Economics as *a beating heart*
2. The Corporate Law perspective: Lynn Stout (2012)
   - The Shareholder Value ***myth***
   - Conceptual and empirical flaws of standard (P/A model)economics
   - The need of a new Paradigm
3. Reflections from a Stakeholder Theory perspective
   - The Separation Fallacy (A. Smith, A. Sen, R E Freeman, J Nelson and L Stout all agree on this!)
   - It is already working…(Conscious Capitalism etc)
   - Open questions

1. The perspective of the Economist: Julie Nelson (2006)



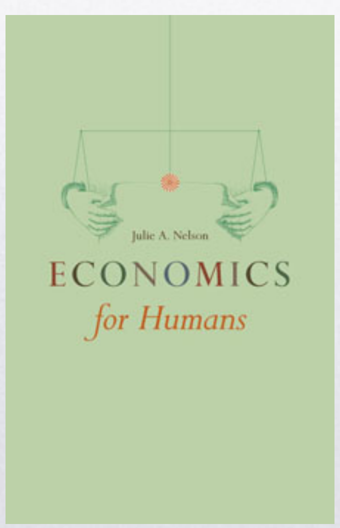
Julie Nelson is Department Chair and Professor of Economics, College of Liberal Arts, University of Massachusetts Boston

“The fact that an organisation is run as a “for profit” in no way requires, either by law or economic “mechanism”, that it must have profit as its *sole* goal”
(Nelson, 2006: 114)

The Problem:
The *Economy-as-a-machine* metaphor

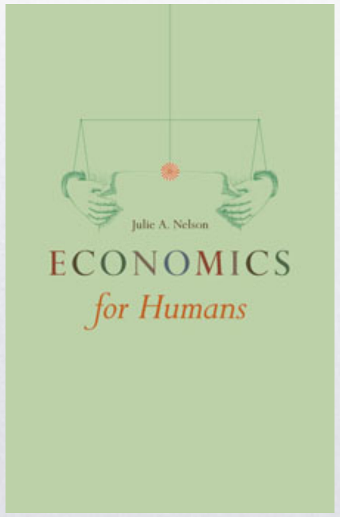
" The capitalist economy can usefully be viewed as a machine whose primary product is economic growth"

- People are driven by *self-interest*
- Good outcomes arise *automatically* ("invisible hand")
- Markets are *impersonal*
- *Amoral* laws & *inexorable forces*



What if the Economy is not a Machine?

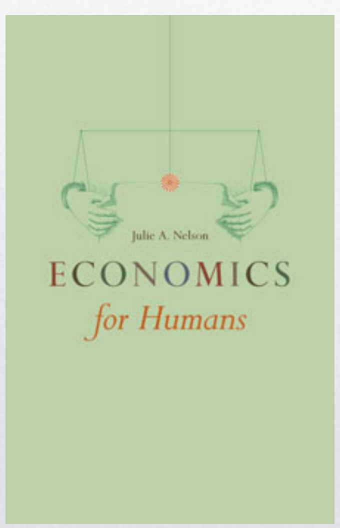
- "The idea that economic systems are inanimate machines operating according to amoral laws is a ***belief***, not a fact"
- "This belief has ***harmful effects***—for life on the planet, for human society, and for you in particular" (Nelson, 2006: 4)



A damaging metaphor

- *Naive and irresponsible* **probusiness policies**
  - probusiness advocates do not think corporations *should* include social responsibility in their purpose

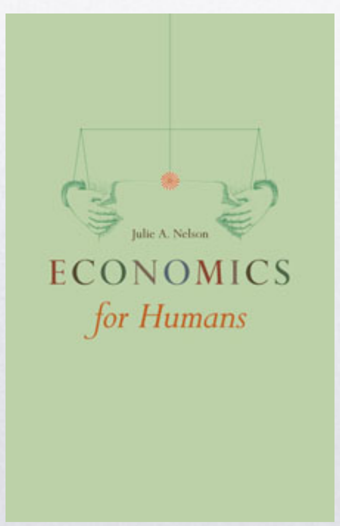
- *Naive and impractical* **antimarket alternatives**
  - antimarket critics do not think that corporation *could* ever be socially responsible



- *It the machine metaphor that tell that ethics is irrelevant to economics and that "economic value" are limited to self-interest*
- *Dialogue is blocked, paradoxically, because both groups assume the economy-as-a-machine metaphor […] the firm is driven to Max profits by inextricable forces* (Nelson, 2006: 54 & 57)

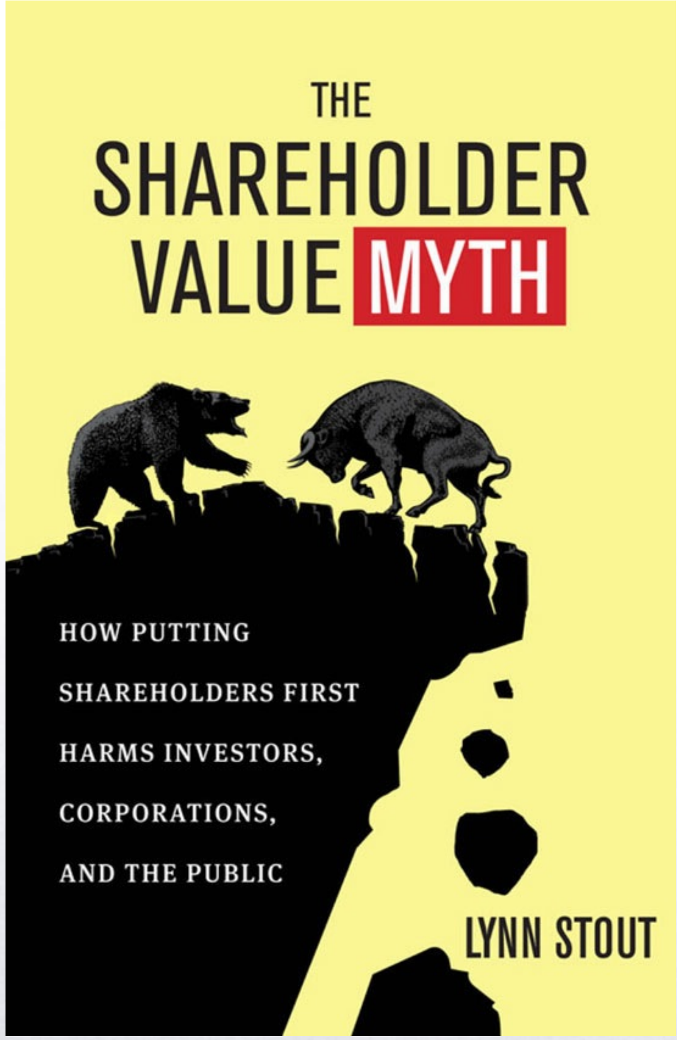
An alternative: metaphor: The Beating Heart

- A *living*, vital organ for the ***body***
- *Moving flows* of lifeblood throughout the body (like the economy is made by the circulation of goods and services)
- A living entity, can be *healthy* and strong, or become weak, *clogged* and degenerate (e.g. unhealthy concentrations of goods and services may pose a risk of heart failure)
- *Adapts* and coevolves with ***culture*** and ***institutions***
- The centre of ***love*** (economy of care)
- A symbol of ***courage*** (we are not clogs in a machine…)



- **"Economy of care" and "business ethics" are not *options*, but requirements**

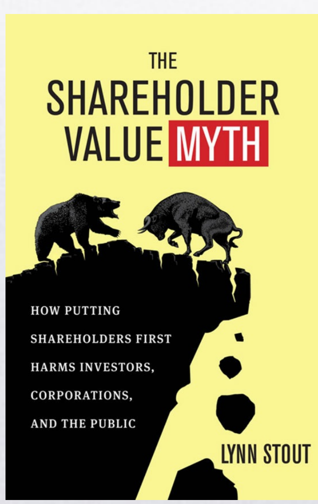
2. The Corporate Law perspective: Lynn Stout (2012)



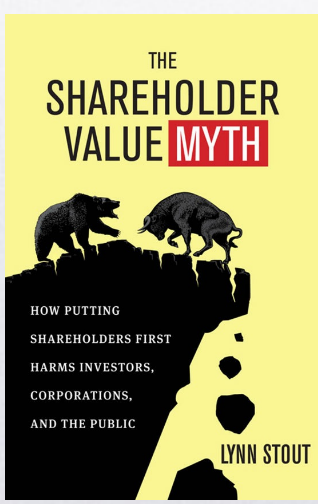
Lynn Stout is Distinguished Professor of Corporate & Business Law, Cornell University Law School

"'Maximize shareholder value' is an incoherent and counterproductive business objective"
(Stout, 2012: vi.)

The flaws of the Principal/Agent model

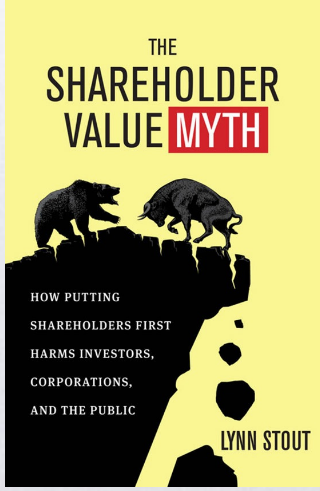


maging effects of Shareholder Value thinki



- *““**Shareholder value thinking** causes corporate managers to focus **myopically** on short-term at the expenses of long-term performance; discourages investments and innovation; harms employees, customers, communities; and causes companies to indulge in reckless, sociopathic and socially irresponsible behaviours. **It threatens the welfare** of **consumers**, **employees**, **communities** <u>**and investors**</u>*

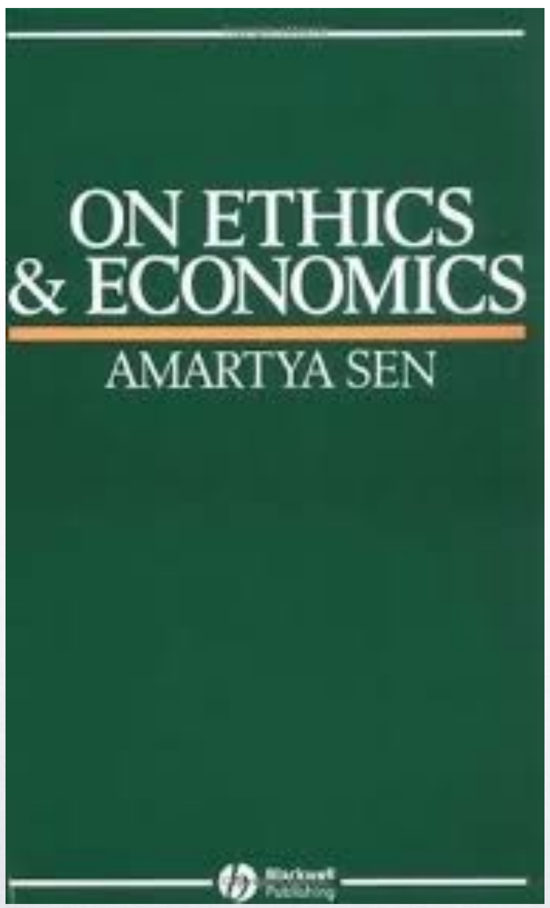
Need for a new paradigm



. Reflections from a Stakeholder Theory perspectiv

Points in common with ST	Julie Nelson	Lynn Stout
The motivation complexity: Critique of the 'homo economics" model from both the economist and the corporate law perspective	***"people care, money is not the only motivation "***	***"most people are not psychopaths [...] Most Shareholders are not psychopaths,***
The Separation Fallacy: Both Nelson and Stout see a common problem in today's view of business—what Freeman (1994) calls "the Separation Fallacy"	***"bringing body and soul together"***	***"Shareholders value different things [...]"***
The need of a new narrative: Nelson and Stout agree that the *language* we use matter to shape our understanding *and* our actions—therefore metaphors, beliefs, ideologies, myths can **be useful or harmful…**	***"the 'machine' metaphor has encouraged the development of irresponsible probusiness policies,***	***"We need a new paradigm [...] Shareholder value thinking is based on wishful thinking, not reality"***
The need to understand (and measure) **Stakeholder Value**, not just *profit*	***"The central question is not profit itself, but how to measure value"***	***"We don't need a single metric"***

Amartya Sen on the “Separation Fallacy” (1987)



Amartya Sen is Thomas W. Lamont University Professor, and Professor of Economics and Philosophy, at Harvard University.

He won the Nobel Prize in Economic Sciences (1998)

I would argue that the nature of modern economics has been substantially impoverished by the distance that has growth between economics and ethics”

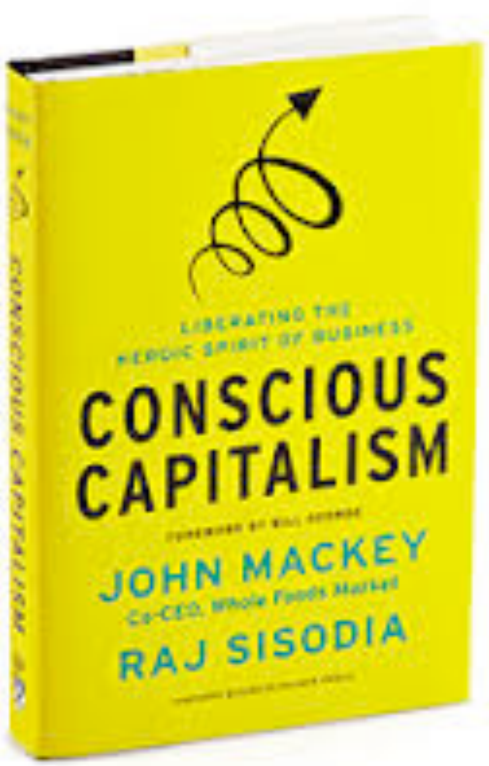
(Sen, On Ethics and Economics, 1987: 7)

…economics can be made more productive by paying greater and more explicit attention to the ethical considerations that shape human behaviour and judgment” (1987: 9)

Is any business applying the

view (and actually being

John Mackey
Founder and CEO of Whole Foods
Co-author of *Conscious Capitalism, 2013*



*I'm a businessman and a **free market** libertarian, but I believe that the enlightened corporation should try to create value for all of its constituencies*

*At Whole Foods, we **measure** our success by how much **value** we can create for all six of our most important **stakeholders**: customers, team members (employees), investors, vendors, communities, and the environment.*

*[**Milton Friedman**'s] argument is **not wrong** so much as it is **too narrow**.*

Open questions

- Do you see further common points/implications between Nelson & Stout and Stakeholder Theory?

- What can we do (more) to promote these ideas within
  - business educators
  - students
  - policy makers
  - corporate managers & entrepreneurs?

- When will we not hear anymore something like this…?

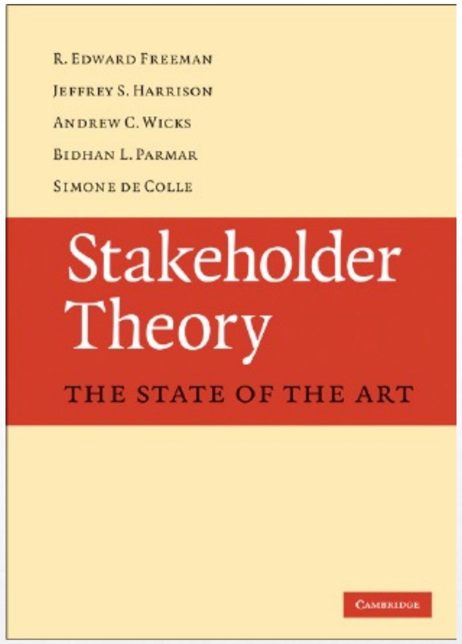
“All what I did was in the interest of ENRON’s SHAREHOLDERS…”

Thank You.

s.decolle@ieseg.fr

What is the ***purpose*** of a corporation?

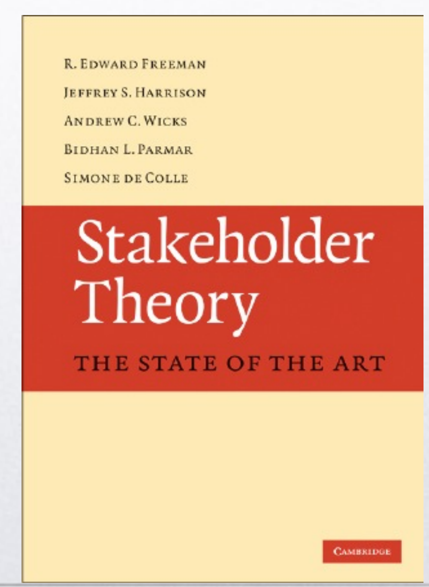
- *Friedman believes that it is* ***maximizing profits****.*
- *We believe that trying to maximize profits* ***is counterproductive*** *because it takes attention away from the fundamental drivers of value: stakeholder relationships.*
- Despite the difference **we believe the Friedman's view is compatible with stakeholder theory:** after all, the only way to maximize value (including shareholder's value) is to satisfy stakeholder interests.



Source: R. E. Freeman, A. Wicks, J. Harrison, B. Parmar and S. de Colle, **Stakeholder Theory: The State of The Art**, Cambridge University Press, 2010.

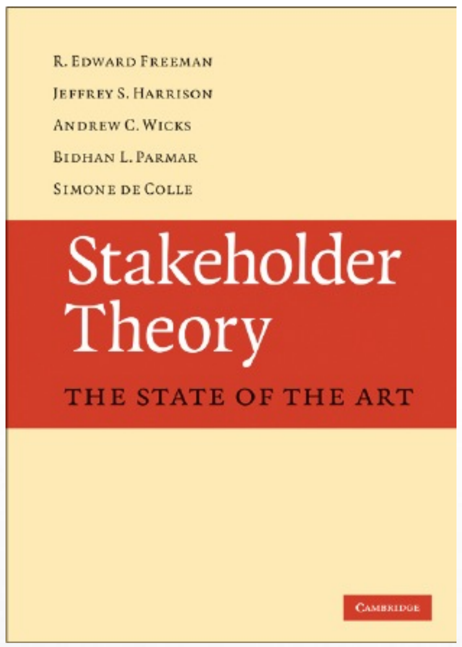
from CSR to Stakeholder responsibility

- **Milton Friedman** wrote (1970), "*It may be in the long-run* ***interest*** *of a corporation that is a major employer in a small community* *<u>to devote resources to providing amenities to that community or to improving its government</u>*" - and he says that it is wrong to call this social responsibility because, ***"these actions are entirely justified in the corporation's self interest".***
  - All this is good for stakeholder theory!
  - We believe (like Friedman) that supporting stakeholder interests is not about "**social *responsibility***"; it's about **capitalism**.



Source: R. E. Freeman, A. Wicks, J. Harrison, B. Parmar and S. de Colle, **Stakeholder Theory: The State of The Art**, Cambridge University Press, 2010,

From *Residual* to **Integrated CSR**



Source: R. E. Freeman, A. Wicks, J. Harrison, B. Parmar and S. de Colle, *Stakeholder Theory: The State of The Art*, Cambridge University Press, 2010, pages 257-259)

	Residual CSR	*Integrated CSR*
CSR definition: key elements	Giving back to society (after profits are made)	Integration of economic with ethical, social and environmental decision-making criteria
Stakeholder focus	Shareholders first, then communities, or others	All stakeholders have moral standing
Economic focus	Profit redistribution (but corporations have to max profit first)	Value creation (and distribution proportionate to stakeholder contributions)
The main purpose of CSR is to..	Sustain legitimacy of business	Contribute to overall success of the corporation
CSR business model	Being responsive to societal claims	Building Partnerships/ cooperating with stakeholder groups
CSR Management processes	Communication; Public Relations	Stakeholder Engagement; (Stakeholder Governance Boards)
CSR activities	Corporate Philanthropy; Sponsorships; Cause-related marketing;	Integration of 'non financial reporting' into traditional corporate reporting; Triple bottom line reporting