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The Modern Corporation Statement on Management

BACKGROUND

The rise of modern corporations has been accompanied by an expansion of salaried executives who have replaced owner-managers. With this expansion, the new class of managers/executives came to regard themselves as stewards of large and complex corporations, and not principally or exclusively as agents for the owners. Emerging as a self-styled ‘profession’, there was a continuous debate around the necessity for the corporation to be responsible to the collective and to its stakeholders. During long parts of the twentieth century the professed intent was to balance and synthesize a plurality of interests in order to ensure the long term survival and success of the corporation, pursue national strategic interests, create employment, support networks of suppliers, develop new technology as well as create an adequate or satisfactory return for shareholders (Marens, 2012; O Sullivan, 2001).

The rise of agency theory in the late 1970s and early 1980s challenged this understanding of management. Arguing that markets rather than managers provide an efficient allocation of scarce resources, it pushed an agenda in which the corporation had to pursue one single goal – the maximization of shareholder value (MSV) and that managers should be incentivised to respond to (financial) market forces. This idea gradually gained traction through teaching in US economics departments and business schools and has today become a highly influential doctrine which infuses senior executive thinking, investors thinking, corporate governance theory and public policy and regulatory decision making (Khurana, 2007; Harvey, 2009).

IMPACTS OF MSV

1. Shareholders without commitment. The distancing of shareholders from the long-term prospects of the firm is enhanced through limited liability, the liquidity of their investment, and, more recently, high velocity trading. This means that the commitment of shareholders is no longer to firms, but to short-term profits only (Davis, 2009; Muzrichi, 2010; Mayer, 2013).

2. Senior management without commitment. The rise of MSV means CEOs find themselves in increasingly precarious positions with shorter tenure. As a result, senior executives rapidly move between firms which means that they have a shorter term decision making horizon, and rarely stay in a position long enough to deal with the problems that their initiatives aimed at increasing shareholder value creates (Useem, 1993, 1996; Dobbin and Zorn, 2005).

3. Poor quality management. The focus on MSV has led many companies to adopt generic management practices. The most obvious example of this is firms chasing so-called celebrity CEOs who tend to be highly paid but tend to fail in their assignments. Research suggests that firms tend to be more successful when they rely on firm or industry specific management rather than generic management practices (Khurana, 2004; Ghoshal, 2005).

4. Race to the bottom in employment conditions. Firms with a strong focus on maximizing shareholder value tend to concentrate upon squeezing costs to produce immediate returns, and so reduce the quality of employment (e.g. wages, pensions provision, and job security) when it is not outsourced, offshored, etc. This has a tendency to encourage regulatory dumping as different countries tend to create the conditions that will allow particular corporations to do this (Davis, 2009).

5. Increasing inequality within the firm. The focus on MSV has led to a rapid divergence between the rewards received by those at the top and those at the middle and the bottom of firms. As a result, the rewards from productivity gains during the past two decades have gone to top management and shareholders rather than to employees in the form of wages and benefits. This is reflected at the macro
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(societal) level with well documented increases in within-country inequalities in almost all Western countries over the past thirty years or so leading to a return towards increasingly rigidified class structures allowing for less and less mobility in many of those countries (McFall and Percheski, 2010).

6. Declining innovation. The focus on maximizing shareholder value has led many firms neglecting investing in areas like research and development in favour of ploughing money into measures which create immediate increases in shareholder value (such as paying dividends and share buy backs). The result is that future performance which comes from spending on innovation is effectively undermined (Lazonick and O’sullivan, 2000).

7. Restructuring efforts. An emphasis on narrow financial performance encourages the use of corporate restructuring efforts, such as mergers, acquisitions, buyouts and demergers in order to impress financial markets (Krippner, 2010). The vast majority of organizational change efforts are motivated by the imperative to create value for shareholders and fail to deliver long term productive capability. Such restructuring efforts tend to divert attention from the core business without receiving the benefits and result in layoffs and plant closures which have devastating effects on relations with stakeholders and thus destroy shareholder value in the longer term (Davis, 2009).

8. Increased systemic risks. The combination of MSV with limited liability leads to systemic moral hazard. the shareholders of corporations benefit from the short term value created by inconsiderate risk taking while being shielded from the medium/long term losses for the corporation and for society that may come from this kind of inconsiderate risk taking: privatization of profits and socialization of costs (Djelic, 2013). Some examples include banks which create toxic financial products in order to maximize returns to shareholders in the short term, but created huge problems for the wider financial system in the longer term. The cost of the failure has been born by other groups in society, particularly ordinary savers and public service and benefit recipients (Crouch, 2011).

RETHINKING MANAGEMENT PRACTICES

Backed by questionable notions of law and economics which have become embedded in corporate governance and accounting regulations, many managers now act on the basis of a folk wisdom that shareholders are the only important constituency, which leads them to deliver short-term strategic decisions, high executive remuneration, and offshoring strategies with regard to manufacturing and finance. This comes at the detriment of broader and longer-term perspectives on the purpose of the firm in modern societies and has created worse management and less competitive companies. It is ironic that the obsession with MSV has actually destroyed long-term shareholder value and that it has significantly decreased the average life span of corporations during the past 30 years (Davis, 2009).

The time has come to rethink the over-riding commitment to MSV. This involves revitalising a model in which companies are understood to have multiple and often competing goals – with producing returns to shareholders as only one of them.

References


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