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Is Stakeholder Value a Barrier for Shareholder Value?

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Abstract: Shareholder primacy is the foundational principle of one company generating the biggest interest for shareholders. As the separation of ownership and control, the protection of shareholders has been placed under spotlight and attracted more attention. Honestly, it is quite rational for companies to consider the interest of shareholders as priority, after all, shareholders as investors must undertake the risks of business. Yet, with companies are evolving into large-scale and complex entities, they need to balance multiple constituents of value such as employee's benefits, social obligation, and consumers. Where the shareholder value may generate some conflicts with stakeholder value inevitably, leaving the managers one knotty issue. However, potential conflicts stem from wrong strategies rather than intrinsic features to a large degree. This article will dialectically treat different value orientations in terms of theoretical structure and legislations to prove that proper distribution ratio of interest is the solution.

Keywords: shareholder primacy, stakeholder theory, the duty of directors, enlighten shareholder value, shareholder protection

1. Introduction

Whose benefits ought to obtain more attention and protection is still a knotty issue that does not have a definite and dominant doctrine so far. Shareholder value is located in a more advantageous place in the United Kingdom's corporate governance system compared with other states [1]. Where managers serving for firms have to achieve the objective of maximising shareholder interests. This dominance of shareholder primacy has been even accepted by many who advocate stakeholder theory [2]. Instead, stakeholder value seems to be a broader definition that conventionally includes shareholders, employees, communities, customers, and governments. Some researchers also have regard to the relevant groups should not only be limited to those traditional stakeholders [3]. Actually, the central debate of which value is prime can be attributed to the distribution of resources and wealth. Managers facing different situations should invest more capital on one side. However, that is not to say that concentrating on one specific value will inevitably undermine the other one. Conversely, both shareholder value and stakeholder value can be compatible to some extent. Given parts of stakeholders' interests will better assist firms to achieve shareholder value, and vice versa [4]. In this way, both shareholders and stakeholders can obtain a more possibly vested interest in the long term. This article mainly aims to illustrate that stakeholder value is an excellent catalyst, rather than a barrier, to promote shareholder value by analysing each theoretical strand and relevant legal practice.

2. Shareholder Primacy

2.1. The Origin and Development of Shareholder Value

The term ‘shareholder value’ was generated in the 1980s when managers employed by corporations had to contemplate discreetly what is the effective method of increasing returns to shareholders based on the market pressures [5]. Later, shareholder value was gradually achieved by restructuring and downsizing as a significant tenet of corporate governance. Acquisition and merit started to be more common as well because the free market is being quite intensive and competitive. Those not productive and efficient companies will wind up or be taken over. This method is to achieve an effective allocation of capital and resources [6]. Equally, shareholder value is introduced to monitor and mitigate underperforming operations. However, the factors that spark the appearance of shareholder value are diversiform and complicated.

First, with the nature of investors, essentially, shareholders are endowed with claiming residual interests of the company [7]. They provide enormous capital to corporates, which are one indispensable part that will maintain corporates ordinary operation. In return, the directors whom shareholders appoint have the fiduciary duty to create vested interests back to shareholders [8]. Of course, the conflict of interests is ineluctable for different groups sometimes. However, there is a high risk that shareholders must undertake limited liability according to their contribution amount. Hence, shareholders have the right to obtain more residual interests of the enterprise. In addition, original shareholders who establish the corporate expect to maximise their interest and have higher returns. Accordingly, one view is advocated, suggesting the only thing that managers need to do is to make much more money for shareholders and not care anything else such as corporate social responsibility [9]. Nevertheless, this view is too absolute and isolates shareholder value with other values. More shareholders recently start to concentrate on the company’s long-term interests. Where it is impossible just to have regard to shareholders solely.

Second, shareholders still stand in a vulnerable position is an important factor [10]. They appeal to get more protection from managers because they will lose all money invested in companies and have no adequate safeguards once the company is eliminated by the equity market. Although shareholders can nominate directors, establish a supervisory board and act articles of association, those ways are limited, compared with those stakeholders who protect themselves by the terms of the contracts. After all, no one can easily attain day-to-day supervision. Furthermore, those public companies listed on the stock exchange can raise capital from society at the expense of dispensing share ownership. However, this means that management and supervision become thorny because of the distribution of shareholders widely. Dispersed share ownership makes shares diluted with a lower threshold of being shareholders. Companies have no alternative but to recruit well-qualified elites as directors to run the companies on behalf of shareholders as a whole. Hence, a requirement of ensuring a doctrine of shareholder value arose as the separation of ownership and management. This is because there is no a direct stake between directors and shareholders. Shareholder primacy is the best way to mitigate those behaviours that may harm shareholder interests by directors in flavour of directors’ own interests. Shareholders, inter alia, in quasi-partnership or private companies are the only constituency whose relation with the corporation cannot renew periodically [11]. They cannot exchange stock they own to others quickly and easily due to the rigorous restriction of corporate law. Consequently, they assert the shareholder primacy to protect their interests too.

Thirdly, with the influence of shareholder value exclusively, directors are more likely to make a more effective decision [12]. In other words, if directors only focus on one objective—shareholder primacy, they can get a clear blueprint that may guide them to a bigger success fast in operation, creating more interests for both companies and shareholders. Meanwhile, those potential equity investors who are informed that shareholder primacy is the central principle are willing to place their

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money on companies [13], as this action with low risk and high returns. Conversely, directors need to undertake more obligations in order to strike a balance between shareholder value and stakeholder value. It is said that multilateral values are pretty tough to administer and judge for the court. This ambiguous obligation may become an excuse for directors to escape their fiduciary and rationalise the most egregious behaviours such as self-dealing or profit for themselves. Nevertheless, neither maximum value for shareholders nor whole companies' interests can come true without considering the long-term programme. Whether or not this model of sole value can form a positive impact on the long-term plan, rather than short-term interest, needs more practical samples to prove.

2.2. How Is the Law Designed to Protect Shareholder Value?

Company law imposes primary duties on directors, such as acting within powers [14] and duty to promote the success of the company [15]. This requires directors to act bona fide and exercise powers endowed by companies for a proper purpose [16]. The principal objective of that is to give shareholder value the best protection. The first and foremost thing is to understand to whom directors owe their duties. The two major theories are nexus of contract and the organic theory that decide the nature of companies. Some claim that shareholder is the owner of the company [17]. However, the Company Act regulates that the directors fulfil general duties to companies with separate legal personalities. This is not to say that shareholders interest is not inconsistent with companies' interests. Shareholders can bring derivative and personal actions against directors for a wrong done to the company or private loss [18]. Other legal constraints are functioning to limit the expansion of directors' power to the extent which they maintain the shareholder value, such as disqualification of directors, fair dealing, and information disclosure. Apart from the above mechanisms with direct intervention, internal incentive measures are also necessary. Stock-based compensation seems to be a good impetus for directors to protect shareholder value much more, but it also seduces directors into engaging in high-risk trading irrespective of the long-term programme meanwhile. The law concern protection of shareholder value is not perfect.

As for the professional-managerial organ, shareholders can actively intervene as well. At the start of establishing companies, original shareholders have the right to create an article of association to decide the specific regulation of board structure, apart from those legislations has been acted by Company Act. Shareholders, of course, can appoint and fire directors in the general meeting according to their function in companies, which is a tool that guarantees directors act in line with shareholder interests. A non-executive director is also appointed as monitors of executive management, especially in large companies, showing the strict board structure. Moreover, Executive remuneration is another method to control directors' behaviour. A director is not entitled to be paid for his service unless there is a clear regulation.

In conclusion, shareholder value adopted widely has proved it has unique merit, and it is worth being protected by law. Shareholder value can bring huge interest to shareholders and further generate possible treasure for the whole society. This is the reason why shareholder supremacy, undergoing a great body of analysis and refocusing, has been the cornerstone in the United Kingdom and some other states. However, shareholder value would not achieve the expectation if treated as a completely independent part.

3. Stakeholder Value

3.1. The Development and Implications of Stakeholder Value

As globalisation and unicorn companies appear, the company per se has become a subtle composite including various vested or potential interests for individuals and society. No one group in relation to the company's success should go unrecognised [19]. This means that sole shareholder-oriented value

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is not enough to tackle those new issues. Theorists who have criticised stakeholder theory also started to change their attitude [20]. The prerequisite of stakeholder theory is to balance different interests among different constituencies [21].

First, strategic stakeholder management can be divided into instrumental and normative approaches [22]. The most distinguish is whether or not regrading maximisation interest as the ultimate objective. To be more specific, once the instrumental approach fails to generate more interest, corporates might give up this way. Conversely, the normative approach is an instinctive approach to take care of stakeholder value that is treated as one part of corporate interest. Consequently, stakeholder theory is a vehicle to balance between interests and ethics. This means that corporates need to undertake more social obligation, and their decisions will affect stakeholders, generating shareholder activism targeting corporate governance and performance to achieve this better [23]. Actually, the normative approach is more helpful to sustain companies' long-term development, in that shareholders have a propensity to venture capital, but stakeholders care stability [24]. This can explain why the market value of firms is not sufficiently discounted to reflect the corporates' real finance. Without considering stakeholders, directors may increase the share value shortly by fabricating false annual reports or transactions that devastate the base of corporates, leading corporates to finally stand on the brink of insolvency. Hence, stakeholder theory, sustaining stakeholder relationships based on trust and cooperation mutually [25], is an indispensable part. That, in return, can promote corporates who fulfil the social obligation to achieve strategic interest. Both shareholder and stakeholder values can attain a win-win result by adopting the normative approach.

Secondly, stakeholder group is regarded as determined concerns to improve company financial performance. That shows that pursuing maximisation interest does not conflict with protecting stakeholder value. Stakeholder value can create more interest for shareholders. This interest is usually indirect, but will influence the decision making sometimes. For example, diversity may attract more elites who are well-equipped with the know-how to flow into firms [26],[1] and further promotes firms' competition in one industry. Likely, offering excellent services and products can win customers' trust, which makes firms leave a positive reputation in the market. Later firms will occupy the share of the market easily and quickly. Both situations prove that company financial performance can be enhanced with the help of stakeholders. At least, the expense of devoting additional corporate resources pointed at important stakeholders is less than the return firms receive. This not only protects stakeholder value, but also maximises shareholder value by constituting a long and steady relationship with the most intimate stakeholder group.

Finally, the company is a product of team cooperation. Company enterprises will not survive without those inputs made by investors, employees, and communities [27]. Although the capital invested by shareholders is the foundation to maintain the company operation, stakeholder value is equally important as one kind of external ingredient. In one survey, only 36% of companies set shareholder value as their ultimate objective. Those companies will have regard to more stakeholder value based on their strategic business. Unfortunately, stakeholder value is a wide scope mentioned before, which may not be in line with shareholder value, and different stakeholders also get a conflict of value with others. This means that directors owed fiduciary duty have to use discretion to make a prime decision in flavour of companies. They should pay more attention to the relative stakeholder value according to the nature of the companies' industry. However, those companies with a high risk in health do not invest more in employee protection. Apparently, those companies, sacrificing specific stakeholder value, do have not a perfect system to brace them to maintain business in the long term. They will be eliminated without the supports of stakeholders.

[1] Gail Robinson, Kathleen Dechant, 'building a business case for diversity' (1997) 11 AME 21, 24.

In a nutshell, stakeholder value does not jeopardise shareholder value at all. Instead, it plays a more important role in present companies, creating a promising future based on long-term interest.

3.2. How Is the Law Designed to Protect Stakeholder Value?

Unlike the other EU countries, whose corporate objective is stakeholder-oriented, the United Kingdom will concentrate on shareholder primacy. Nevertheless, the UK has gradually made changes and yielded to the whole market environment where the UK is deviating from shareholder primacy [28].

First, initiating corporate governance reforms has been on the agenda. The UK Government expect to keep a more stakeholder-friendly position via a series of reports such as Cadbury, Greenbury, and Hampel. Both board accountability and information disclosure enable stakeholders can generate more influence on the management and supervision. However, The Company Law Review proposing enlightened shareholder value is a cornerstone that discards the narrow conventional shareholder theory. Company Law Reform Bill 2006 also proposed more requirements based on ESV [29]. Directors must have regard to multiple factors that may promote companies to success, including the interests of the company’s employees, the collaborative relationship with customers, business partners, and social obligation. In addition, the UK Government also has established external supervision by appointing a corporate social responsibility (CSR) minister to consider whether or not corporates’ activities resonate with their social obligation [30]. One of the main objectives of The Company Law Steering Committee is to balance the interests of different stakeholders [31]. For example, a two-tier board that allows for employee participation in the supervisory board is a good reflection of employee value [32]. Consequently, those efforts directly reflect the UK Government endeavours to protect stakeholder value by legislation that clarifies corporates’ obligation and managers’ duty.

Second, Operating and Financial Review (OFR) is equally applicable to stakeholders in light of its inclusive feature [33]. OFR aims to improve transparency and information flows by requiring disclosure on financial matters. More importantly, it also mandates that corporates disclose the development and performance of the business, factors related to the environment, employees and the community that may influence corporates’ long-term performance. This way can help stakeholders, like suppliers or investors, have comprehensive knowledge about the situation of companies’ finance and operation, where they can decide whether the investment is worth and safe. Meanwhile, that will curb the high-risk operation for those corporates connected with social interest, like engaging about environment or food safety, which will protect a wider range of potential stakeholders. Nonetheless, the high expense of disclosure may become a hurdle that managers risk concealing parts of details. Therefore, the OFR ought to clarify what is the necessary information disclosure and further lessen corporates’ burden. By and large, the OFR, to some extent, can guarantee a promising corporate’s future as well as facilitate stakeholder value.

The action made by the UK government proves that Pluralism is a better method to achieve maximum shareholder value. Therefore, protecting stakeholder value is a necessary legal strategy for making decisions.

4. Conclusion

This article has explored and evaluated both shareholder value and stakeholder value and legal practice designed to protect them, respectively, proving that stakeholder theory is not a barrier to shareholder value. To recapitulate, shareholder value, undoubtedly, is an indispensable element that cannot be ignored in any company. Once the scale of interest tilts toward stakeholder value unfairly, those shareholders who obtain less interest will lose the impetus of investment, which must cause the breakdown of the corporate system and further result in recession. Of course, the view that shareholder value is the only factor that should be considered in decision-making is also naïve in that the business relationship is becoming more complicated currently. The core is to judge what is the most reasonable distribution ratio of interest for different groups. Different operation strategies and industries should have different value priorities. This is the reason why enlightened shareholder value and Pluralism are purposed popularly. Consequently, a good stakeholder relationship is a positive fuel rather than a barrier. Stakeholder theory, not conflicting with shareholder value, is a brace that can maintain corporate in long-term development. As long as balancing the interests of all those affected, both shareholder and stakeholder value will be met and co-exist.

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