With the fall of communism over a decade ago, capitalism has emerged as the dominant economic ideology in the world. Unfortunately, the results produced by ten years of global capitalism have not been uniformly positive. Saturation in the developed markets, a widening gap between rich and poor, growing levels of environmental degradation, and concern that the developing world may be losing control over its own destiny have combined to create drag on the global economy. The terrorist attacks in the U.S. on September 11, 2001 made it clear that the world is inextricably interconnected and that poverty, hopelessness, and perceived exploitation in one part of the world will not remain geographically isolated. Increasingly, global capitalism is being challenged to include more of the world in its bounty and protect the natural systems and cultures upon which the global economy depends. The idea of sustainability has come to represent these rising expectations for social and environmental performance. Global sustainability has been defined as the ability to “meet the needs of the present without compromising the ability of future generations to meet their needs.” Similarly, sustainable development “is a process of achieving human development . . . in an inclusive, connected, equitable, prudent, and secure manner.” A sustainable enterprise, therefore, is one that contributes to sustainable development by delivering simultaneously economic, social, and environmental benefits—the so-called triple bottom line. Beyond this broad consensus on terminology, however, there remains disagreement among managers regarding the specific meaning of and motivation for enterprise-level sustainability. For some managers, it is a moral mandate; for others, a legal requirement. For still others, sustainability is perceived as a cost of doing business—a necessary evil to maintain legitimacy and right to operate. A few firms have begun to frame sustainability as a business opportunity, offering avenues for lowering cost and risk, or even growing revenues and market share through innovation.

For most firms, the pursuit of enterprise sustainability remains difficult to reconcile with the objective of increasing shareholder value. Indeed, some have even advocated that creating a more sustainable world will require firms to sacrifice profits and shareholder value in favor of the public good. By starting with legal or moral arguments for firm actions, however, managers inevitably underestimate the strategic business opportunities associated with this important issue. To avoid this problem, managers need to directly link enterprise sustainability to the creation of shareholder value. The global challenges associated with sustainability, viewed through the appropriate set of business lenses, can help to identify strategies and practices that contribute to a more sustainable world and, simultaneously, drive shareholder value; this we define as the creation of sustainable value for the firm.
If anything has changed in the business world over the last couple of decades, it is the pace of business change. Yesterday’s high performers are often today’s laggards, if one can still find them listed at all. Many of yesterday’s shining stars, whether in the realm of business thought or business action, mistook what was superficially new for what was really new, responding to the cacophony of boom and bust rather than to the steady creak of a tectonic shift. Companies that aspire to sustainable high performance must attend to sustained. Because of these fundamental sustained changes, the task of managing shareholder wealth also has altered, requiring innovative, more expansive ways of thinking about resources and how they can be used to create value for today and tomorrow. Management that ignores the implications of these changes risks mismanaging both the most important component of their valuation as well as their most important value-creating resources.

Shareholder Value Is a Multidimensional Construct

Figure 1 illustrates the basic components for our shareholder-value framework. The model is built using two well-known dimensions that are a source of creative tension for firms. The vertical axis in the model reflects the firm’s need to manage today’s business while simultaneously creating tomorrow’s technology and markets. This dimension captures the tension experienced by the need to realize short-term results while also generating expectations for future growth. The horizontal axis reflects the firm’s need to grow and protect internal organizational skills and capabilities while simultaneously infusing the firm with new perspectives and knowledge from the outside. This dimension reflects the tension experienced by the need to buffer the technical core so that it may operate without distraction, while at the same time remaining open to fresh perspectives and new, disruptive models and technologies.
Corporate governance is a much debated topic. One reason for the debate is the recent scandals stemming from excessive managerial compensation and earnings manipulation. Critics have proposed various remedies, including better disclosure, separation of the positions of CEO and chairman, changes in board composition, and stricter codes of conduct (see Hermelin and Weisbach 2007). Much of the discussion can be understood as attempts to make sure that corporations, particularly public corporations, are run for the benefit of shareholders. It can also be interpreted, however, as a debate about the purpose of the corporation—or about whose interests the corporation should ultimately serve (Jensen 2001). Various academics have joined the debate, arguing that there is a widespread consensus that managers should strive to maximize shareholder value, and that doing so maximizes social welfare. There is also a claim that competitive forces push managers, regardless how reluctant, to set shareholder-value maximization as their main corporate target.

Moreover, it investigates the existence of a consensus by examining what managers say about shareholder value on their corporate Web sites. Finally, it asks whether shareholder-friendly declarations actually translate into better stock-price performance. The argument of a normative consensus is made especially by academics in law and finance. Accordingly, we are witnessing a widespread agreement that “corporate managers should act exclusively in the economic interests of shareholders,” and that “the best means to this end—the pursuit of aggregate social welfare—is to make corporate managers strongly accountable to shareholder interests” (Hansmann and Kraakman 2000, pp. 1 and 9). Bradley and Sundaram (2003, p. 4) reason along similar lines and state that we are witnessing “a conversion to the notion that the
purpose of the business corporation is to enhance shareholder value." A normative consensus is also implicit in the corporate finance textbooks. According to Brealey, Myers, and Allen (2006, p. 15), for example, the fundamental objective of corporate finance is to maximize the current value of the firm's shares.

The normative consensus is complemented, some say, by economic forces that compel managers to pursue the target of shareholder-value maximization—for example, according to Morck, Shleifer, and Vishny (1988), in the capital markets. We contend that the logic of this argument and the existence of a widespread consensus are debatable.

The ultimate reason for the lack of a consensus is that shareholder value has distributional implications—the firm's surplus should eventually be paid out to shareholders. Yet centuries of conflicts for the appropriation and control of scarce resources have shown that a lasting consensus on how company resources and rents should be distributed is hard if not impossible to achieve. Nonetheless, the paper should help clarify many questions related to a policy of focusing on shareholder value, including its social justification, its tie to competitive markets, its implement ability, and its practical relevance. That clarification would seem to be important also in the current debate about corporate governance. Whether economic theory implies that shareholder-value maximization really increases social welfare. In theory, competitive markets for goods and services do put pressure on firms to cover costs. They do not compel them, however, to maximize profits, let alone to maximize firm or shareholder value, defined as the market value of the firm's equity. The same conclusion applies to competitive capital markets.

A policy of shareholder-value maximization is an ill-defined goal to begin with. Moreover, not every shareholder is better off when stock prices increase or worse off when they decline. It is therefore not always clear what managers should do even if they wanted to benefit shareholders. Ultimately, however, consensus is an empirical question. The results of an examination of what 1,298 firms in 8 different countries write on their Web sites. If there were a widespread consensus about the merit of that target, managers would be glad to disclose a preference for it, but they do not. The target of shareholder-value creation is often not even mentioned. Common-law countries are the same in this respect as civil-law countries, in spite of being supposedly friendlier to shareholders (La Porta et al. 1998; La Porta, Lopez-de-Silanes, and Shleifer 2006). We also examine whether firms that state a preference for shareholder value perform better than other firms. However, firms willing to make an open commitment to shareholders live up to their words: their stock performs significantly better than that of other firms.

II. NORMATIVE CONVERGENCE: SHAREHOLDER-VALUE MAXIMIZATION VERSUS SOCIAL WELFARE MAXIMIZATION

Let us start with the assumption that shareholder-value maximization corresponds to firm value maximization. Jensen (2001, p. 11) argues that
Shareholder value creation in the automobile industry in India

firm-value maximization maximizes social welfare. "Two hundred years of work in economics and finance implies that in the absence of externalities and monopoly (and when all goods are priced), social welfare is maximized when each firm in an economy maximizes its total market value." Under Jensen's assumptions, competitive markets and firm-value maximization do indeed contribute, according to the First Fundamental Welfare Theorem, to increased social welfare (Salanié 2000). Formal proofs that the market equilibrium in complete markets is Pareto-optimal are in Debreu (1959) and Arrow (1964).

There are, however, at least two problems with the notion that firm-value maximization in competitive markets maximizes social welfare.1 The first is that Pareto optimality does not imply maximization of social welfare. For example, not everyone is willing to accept the initial distribution of wealth and resources as desirable. Other allocations are possible, which means that many alternative competitive equilibriums are in principle feasible, and it is not clear which one is best from the point of view of society as a whole.

The second problem is that the necessary assumptions for the First Fundamental Welfare Theorem are rarely, if ever, met in practice. As pointed out by Jensen (2001), information and transaction costs, nontraded goods and services, public goods, externalities in production and preferences (envy, jealousies, etc.), and nonconvexities of production (natural monopolies) and preferences can prevent the achievement of a competitive equilibrium (see also Salanié 2000).

In particular, concerns about fairness affect how people make decisions and how they feel about the distribution of scarce resources (see, for example, Statman 2005). It is fairly well documented, for example, that an increase in everybody's wealth is not necessarily Pareto-efficient if some of us receive little and others a lot (see Bazermann 2002, and the literature cited therein). Individuals might therefore object to firm- (and shareholder-) value maximization because it leads to or maintains what in their view is an unfair resource distribution. One should also point out that, even if firm-value maximization did contribute to higher social welfare, one would still have to prove that the same is true of shareholder-value maximization. With perfect and complete capital markets, firm-value maximization is consistent with shareholder-value maximization. Intuitively, since shareholders are entitled to a payout only after the contractual claims of the remaining stakeholders have been satisfied, they have an incentive to generate as much firm value as possible to be able to benefit from a larger residual. Any deliberate deviation from a policy of firm-value maximization would be known to shareholders who could costlessly rewrite contracts with their managers to correct the deviation. The problem is that markets are not perfect. As a consequence, firm-value maximization is not always the same as shareholder-value maximization. Shareholders can benefit by taking from other stakeholders in the firm. For example, they can follow wasteful policies with a sufficiently high upside potential when the firm is close to defaulting on its debt obligations (Jensen and Meckling, 1976). They can also renegotiate contracts under the pretext of changed economic conditions, refuse to fulfill implicit contracts such as the informal promise of no layoffs or the promise of higher compensation in the
case of good performance (Shleifer and Summers 1988; Neumark and Sharpe 1996), and misappropriate resources.

III. COMPETITIVE FORCES AND SHAREHOLDER-VALUE MAXIMIZATION

Conceivably, competition in the markets for goods and services and for capital could compel managers to maximize shareholder value. Let us therefore begin with a closer look at the possible role that the markets for goods and services might play in that respect. After that, we examine the case of capital markets.

**Markets for goods and services and shareholder-value maximization**

One of the tenets of economic theory is that competition induces resources to move to their highest-valued use, a process that brings about an efficient allocation of production factors. For example, if the marginal productivity of labor is higher in manufacturing gas turbines than in growing wheat, labor will move out of farming and into manufacturing. Even though systematic evidence is lacking (Allen and Gale 2000), and even though there are various reasons why firms might be able to resist competitive challenges, it would be hard to deny that competition forces inefficient firms to cut costs and focus on customers' needs. Those that do not adapt are eventually driven out of the market, and their managers lose their jobs and the associated power and prestige. Competition, however, simply sets a survival condition, namely, that firms cover their contractual costs (Alchian 1950). Maximizing economic profits, let alone firm or shareholder value, is a target that goes beyond simply covering costs. Profit maximization involves generating the highest economic rents from current operations (a short run perspective). Maximizing firm-value involves making decisions that lead to the highest capitalized value of the flow of future economic rents (a long run perspective). And maximizing shareholder value, as a first rough approximation, involves distributing the rents from a firmvalue- maximization policy to shareholders (as opposed to distributing them to other stakeholders or dissipating them subsequently in unprofitable strategies).

Yet competitive markets for goods and services are not the only markets that could impose the target of highest shareholder value on managers. There are also capital markets. It would seem that truly open capital markets leave managers no option but to maximize share prices. What follows briefly addresses that claim.

**Capital markets and shareholder-value maximization**

Stock markets exploit differences between the market price of stocks and their perceived intrinsic value. When investors believe stocks are underpriced, they have an incentive to buy. In extreme cases, they might be tempted to obtain control to make managerial changes (Manne 1965; Allen and Gale 2000). This takeover threat would seem to induce managers who care about their jobs to pursue policies that increase shareholder value. In contrast, when investors think that stocks are overpriced, they tend to sell or short. In that situation, however, the incentive to boost share prices even further is
questionable since it would be a policy destined to fail. Worse, it would be a policy that would send investors false and misleading signals and thereby put managers’ jobs at risk (Jensen 2005). According to Jensen, a better policy might be that of trying to eliminate the overvaluation. In any case, because of the possibility of overpriced stocks, capital markets do not generally encourage managers to increase share prices.

Hence, competitive markets do not seem to induce shareholder-value maximization. Our logic, however, has assumed that shareholder value is an implementable target and that all shareholders support higher share prices. What follows casts doubts on the validity of that assumption.

IV. SHAREHOLDER-VALUE MAXIMIZATION: AN ILL-DEFINED TARGET THAT MIGHT LACK UNANIMOUS CONSENT

With full information and perfect and complete capital markets, anything the firm does to increase share prices benefits shareholders. This is true whether they want to buy, sell, or simply hold their shares. But when we drop these assumptions, the unanimity can go away. Because of other concurrent financial interests, not all shareholders are better off when share prices increase or worse off when they decline. Moreover, in imperfect markets, shareholder value becomes an ill-defined target. Hence, managers would frequently not know what to do to benefit shareholders even if they wanted to. Let’s discuss this ill-definition first.

A. Ill-definition

The main reason why shareholder value is an imprecise corporate target is its time dimension. It is unclear whether it refers to the present or to the future. Suppose managers are aware that the stock’s intrinsic value is higher than its market value. If so, it is unclear what shareholder-value maximization means. It makes a difference whether they want to sell or hold their shares. If they want to sell, then it is important that the current stock price be high: managers could engage in various costly signaling activities, including share buybacks, to correct the potential mispricing. In contrast, if shareholders do not want to sell, costly signaling activities make little sense (Miller 1987). Differential horizon problems are not unusual. They have been observed, for example, among mutual fund shareholders (Johnson 2004) and among institutional investors in the market for corporate control (Gaspar, Massa, and Matos 2007).

Moreover, they are apparent when investors follow dividend-capture or IPO flipping strategies. Hence, should shareholder-value-maximizing managers try to benefit short-term shareholders or should they ignore them?

Diverging interests

The second problem with the shareholder-value target is the potential lack of unanimity among shareholders because of conflicting interests. This
phenomenon can best be illustrated by comparing the preferences of large and small shareholders. Large shareholders can use their voting power to: (a) legally (or illegally) extract private benefits of control (including tunneling via self-dealing transactions; see Johnson et al. 2000); (b) impose their tax preferences; (c) greenmail the company; (d) ask the firm to pursue policies suited to their personal risk exposure (in family firms, for example, family members might be bound by contractual agreements and therefore be unable to diversify their portfolios); (e) discourage financing decisions that could dilute control; (e) force their strategic views on the firm; and (f) impose their preferences with regard to liquidation, going public (Gompers 1996), and going private transactions. Large shareholders might therefore benefit from managerial decisions even if share prices decline. Small shareholders have different interests. The literature on the private benefits of control offers plenty of arguments and evidence regarding the lack of unanimity between small and large shareholders (see, among others, Barclay and Holderness 1989; Dyck and Zingales 2004).

As it turns out, the lack of shareholder unanimity is not restricted to the conflict of interests between large and small shareholders:

(a) Some shareholders might simultaneously be bondholders, creditors, suppliers, employees, or competitors of the firm. Their net financial interests might therefore be at odds with those of other shareholders (see, for example, Loderer and Zgraggen 1999). Similarly, some shareholders might derive non-pecuniary benefits from the firm and therefore have different interests than other shareholders. Governments, for example, might try to induce the corporations they are invested in to contribute to non-financial goals such as full employment or national security. They might therefore oppose restructuring decisions even if they mean higher stock prices;

(b) Shareholders might have different information and therefore hold different views about the most appropriate investment policy. These disagreements surface, for example, at the time of proxy fights;

(c) Shareholders might face different taxes. Depending on their tax bases in the computation of capital gains, for example, shareholders who sit on unrealized losses might oppose share buybacks and liquidation decisions even if that would increase stock prices.

In principle, shareholder disagreement could be resolved with side payments. Side payments, however, are sure to work perfectly only in frictionless markets. In the real world, these payments may not be possible because of information and transaction costs. The problem of diverging interests could also be overcome if shareholders sorted themselves in different investor clienteles. Yet even that would not guarantee unanimity because of the many dimensions the diverging interests can take and because shareholders’ preferences change. Hence, stockholder disagreement can subsist.

In sum, there is no compelling case that competition pressures managers to seek the highest stock price. Competitive markets for goods and services do
not demand that. And neither do competitive capital markets. Moreover, shareholder value yields an ambiguous corporate target, and one that might lack unanimity. Ultimately, however, whether there is widespread consensus that firms should maximize shareholder value is an empirical issue. In what follows, we investigate whether managers are willing to pay at least lip service to shareholder-value maximization. We should stress that we are not trying to figure out what managers actually do. All we want is to document whether managers disclose a preference for shareholder-value maximization, at least in words. If there is indeed consensus, we should observe clear adherence in print to the goal of shareholder-value maximization, whatever that might mean. We also want to know whether firms that claim to pursue that target perform better.

N Vswanatham and Poornima Luthra (April/June 2005) with the increasing global competition, companies are focusing their efforts on creating shareholder value in order to survive the intense competition. In view of this, it is becoming important for companies to measure the value they create for their shareholders. Keeping track of the value created year-on-year enables companies to evaluate past decisions and make decisions that will improve shareholder value.

With the increasing focus on core competencies, many companies are outsourcing their information technology (IT) related activities to third party software service providers. Example, Indian software companies have become global leaders in providing these services due to their access to lower cost labour and highly skilled workforce. These software service providers have been facing severe backlash from the West where jobs are being lost due to outsourcing. With such challenges, it becomes important for the companies to become aware of their position (in terms of shareholder value creation, revenue and expenditure) in comparison with their competitors. Knowing these will enable the companies to define and redefine their strategy to improve their profit margins and also capitalize on their individual strengths to enhance shareholder value creation.

Copeland et al (1994) discuss the benefits of shareholder value measurement and Lambert & Burduroglu (2000) provide methods for measuring this value. Lambert & Burduroglu (2000) discuss SPM, while Stewart et al (2002) discuss EVA. Stapleton et al (2002) have applied the SPM to players of the athletic footwear industry. Walters (1999) develops the general operating value drivers for EVA. Such an analysis would enable firms in this industry to know their competitive advantages and disadvantages, and provide focus on the key areas of improvement of shareholder value.

Measuring shareholder value

Value-based performance measurement: Performance measurement is the method of assessing a company’s progress towards achieving its preset goals. Through key performance measures, an organisation’s strategy is linked to its operations. The objective of performance measurement and management is to increase the shareholder value, profitability, growth,
competitiveness, quality, customer satisfaction, etc. of an organisation resulting in improved performance (Moncla & Arents-Gregory 2003).

An important concept in performance measurement is benchmarking. Benchmarking is the systematic process of searching for the best business practices, innovative ideas and effective operating procedures to fuel progress and improvement (Bogan & English 1994, p. 1). Benchmarking enables companies to compare their key performance measures internally or externally. An organisation can study practices and measure performance from within itself, or against its industry peers. Benchmarking helps organisations refine their strategy through the re-examination of products, prices, practices, strategies, structures and services against competitors and other industry leaders (Bogan & English 1994, p. 9).

Models for measuring and predicting shareholder value
A particular category of performance measures are financial performance measures. Financial measures indicate to top-management whether their strategy execution is leading to better bottom-line results (Niven 2003, p. 19). The financial metrics are based on information obtained from balance sheets, income statements and cashflow statements (Bogan & English 1994, p. 57). Some examples of these metrics are revenue, gross profit, operating income, net income, earnings per share, long-term debt, cash flow, debt/equity ratio, etc. By adopting a performance measurement system based on financial measures, companies can identify the key performance metrics that would result in improved financial outcomes. As customers place an increasing demand on companies to provide “value-added” services, it is becoming vital for companies to be able to measure the value of these services in order to justify a premium price for the services and ensure continued profitability (Lambert & Burduroglu 2000). Many organisations have adopted a new breed of performance measures that are based on shareholder value, known as value-based management.

Shareholder value is the financial value created for shareholders by the companies in which they invest (Christopher & Ryals 1999, p. 2). A shareholder is any holder of one or more shares in a company. The evidence of being a shareholder is in the form of a stock certificate. The shareholder value theory states that a company creates this value when it meets or exceeds a cost of capital that suitably reflects its investment risk (Lambert & Burduroglu 2000, p. 10).

Companies are choosing to employ a system of measuring shareholder value for many reasons (Copeland et al 1994, p. 22). First, value is the best metric of performance as it is the only measure that is comprehensive and hence is useful for decision-making. By increasing shareholder value, companies can maximize the value for other stakeholders (customers, labour and government (through taxes paid) and suppliers of capital). Second, shareholders are the only stakeholders of a company who simultaneously maximize everyone’s claim in seeking to maximize their own. Finally, companies that are unable to create shareholder value will find that capital flows away from them and towards their competitors who are creating shareholder value.
Michael Durant (2007): paper entitles “Economic Value Added: The invisible hand at work” examines EVA is both a measure of shareholder Value and also a measure of performance. The value of business depends on investors’ expectations about the future profits of the enterprise. Stock prices track EVA far more closely than they track earnings per share or return on equity. A sustained increase in EVA will bring an increase in the market value of the company. As a performance measure, Economic Value Added forces the organization to make the creation of shareholder value the number one priority. Under the EVA approach stiff charges are incurred for the use of capital. EVA is changing the way managers run their business and the way Wall Street price them. When business decisions are aligned with the interest of the shareholders, it is only a matter of time before these efforts are reflected in a higher stock price.

More recently, creating value for a firm’s shareholders - widely accepted objective for the firm - has been incorporated into the strategic management literature through what is termed value based planning (Hax et al., 1984). This approach provides a conceptual and operational framework for evaluating corporate strategy. At the same time, academicians have considered value creation issues to mergers and acquisitions (Rappaport, 1981), divestiture decisions (Alberts and al., 1984), business unit evaluation (Arzac, 1986), marketing strategy and company sales (Kerin et al., 1985), and asset growth (Fruhan, 1984 and Higgins et al., 1983).

Rappaport (1987) has defined the value drivers as growth rate, operating profit margin, income tax rate, working capital investment, fixed capital investment, cost of capital and value growth duration. J. Caby et al. (1996) and Ben Naceur et al. (1998) have combined the measures of value creation with the value drivers in order to know empirically the main determinants of the value creation process.

Sustainable value creation is of prime interest to investors who seek to anticipate expectations revisions. (Michael. J. Mauboussin and Kristen Bartholdson, 2002)
Michael J. Mauboussin and Kristen Bartholdson (CSFB, Equity Research, 2002) says, "Ideally, corporate managers try to allocate resources so as to generate attractive long-term returns on investment. Similarly, investors try to buy the stocks of companies that are likely to exceed embedded financial expectations. In both cases, sustainable value creation is of prime interest."

What exactly is sustainable value creation? We can think of it across two dimensions. First is the magnitude of returns in excess of the cost of capital that a company can, or will, generate. Magnitude considers not only the return on investment but also how much a company can invest at an above-cost-of-capital rate. Corporate growth only creates value when a company generates returns on investment that exceed the cost of capital.

The second dimension of sustainable value creation is how long a company can earn returns in excess of the cost of capital. This concept is also known as fade rate, competitive advantage period (CAP), value growth duration, and T. Despite the unquestionable significance of this longevity dimension, researchers and investors give it scant attention.

How does sustainable value creation differ from the more popular sustainable competitive advantage? A company must have two characteristics to claim that it has a competitive advantage. The first is that it must generate, or have an ability to generate, returns in excess of the cost of capital. Second, the company must earn a higher rate of economic profit than the average of its competitors.
As our focus is on sustainable value creation, we want to understand a company's economic performance relative to the cost of capital, not relative to its competitors (although these are intimately linked, as we will see). If sustainable value creation is rare, then sustainable competitive advantage is even more rare, given that it requires a company to perform better than its peers.

We can visualize sustainable value creation by looking at a company’s competitive life cycle. (See Exhibit 1.) Companies are generally in one of four phases (see Appendix B for a breakdown by industry):

- Innovation. Young companies typically see sharp increases in return on investment and significant investment opportunities. This is a period of rising returns and heavy investment.

- Fading returns. High returns attract competition, generally causing economic returns to gravitate toward the cost of capital. In this phase, companies still earn excess returns, but the return trajectory is down, not up. Investment needs also moderate.

- Mature. In this phase, the product markets are in competitive equilibrium. As a result, companies here earn their cost of capital on average, but competition within the industry assures that aggregate returns are no higher. Investment needs continue to moderate.

- Subpar. Competitive forces often drive returns below the cost of capital, requiring companies to restructure. These companies often improve returns by shedding assets, shifting their business model, reducing investment levels, or putting themselves up for sale. Alternatively, these companies can distribute their assets through a bankruptcy filing.

One of the central themes of this analysis is that competition drives a company’s return on investment toward the opportunity cost of capital. This theme is based on microeconomic theory and is quite intuitive. It predicts that
companies generating high economic returns will attract competitors willing to take a lesser, albeit still attractive, return which will drive down aggregate industry returns to the opportunity cost of capital. Researchers have empirically documented this prediction.

To achieve sustainable value creation, companies must defy the very powerful force of reversion to the mean. Recent research on the rate of mean reversion reveals a couple of important points. First, the time that an average company can sustain excess returns is shrinking.

This reduction in sustainable value creation reflects the greater pace of innovation and a shift in the composition of public companies (i.e., today there are more young public companies than 25 years ago). Second, reinvestment rates and the variability of economic returns help explain the rate of fade.

For example, a company that generates high returns while investing heavily signals an attractive opportunity to both existent and potential competitors. Success sows the seeds of competition. Why is sustainable value creation so important for investors? To start, investors pay for value creation. Exhibit 2 provides a very simple proxy for how much value creation investors have anticipated for the S&P 500 since 1980. We establish a baseline value by simply capitalizing the last four quarters of operating net income for the S&P 500 by an estimate of the cost of equity capital.

We attribute any value above and beyond this baseline value to future expected value creation. The exhibit shows that over one-third of the value of the S&P 500 reflects anticipated value creation, a ratio that has increased in recent decades.

Exhibit 2: Rolling Four-Quarter Anticipated Value Creation

Source: Standard and Poor’s, Aswath Damodaran, CSFB estimates.
More significant, sustained value creation is an important source for potential expectations revisions. At this point, we must draw a critical distinction between product markets—the markets for the goods and services that companies produce—and capital markets. Companies seek to understand the industry and competitive landscape so as to make decisions and allocate resources in a way that maximizes long-term economic profits. In contrast, investors seek to understand whether or not the expectations reflected in today’s price are likely to be revised up or down.

So companies and investors both use competitive strategy analysis, but for two very different purposes. Companies try to generate returns above the cost of capital, while investors try to anticipate revisions in expectations. If a company’s share price already captures its prospects for sustainable value creation, investors should expect to earn a risk-adjusted market return.

We will spend most of our time trying to understand how and why companies attain sustainable value creation in product markets. But we should never lose sight of the fact that our goal as investors is to anticipate expectations revisions. Exhibit 3 shows the process and emphasizes the goal of finding and exploiting expectations mismatches.

**Exhibit 3: The Link Between Market Expectations and Competitive Strategy**

Over the years, legendary investor Warren Buffett has consistently emphasized that he seeks businesses with sustainable competitive advantages. He often invokes the metaphor of a moat. He suggests that buying a business is akin to buying a castle surrounded by a moat. Buffett wants the economic moat around the businesses he buys to be deep and
wide to fend off all competition. He goes one step further, noting that economic moats are almost never stable; they’re either getting a little bit wider, or a little bit narrower, every day. So he sums up his objective as buying a business where the economic moat is formidable and widening. Our goal in this report is to develop a systematic way to explain the factors behind a company’s moat.

What Dictates a Company’s Destiny?

Peter Lynch quips that investors are well advised to buy a business that’s so good that a dummy can run it, because sooner or later a dummy will run it. Lynch’s comment begs an important question: What dictates a firm’s economic returns? Note that we are not asking what determines a company’s share price performance (which we know is a function of expectations revisions), but rather its economic profitability.

Before we answer the question, we can make some empirical observations. Exhibit 4 shows the spread between cash flow return on investment and the cost of capital for over 90 industries in the United States. Our sample includes in excess of 1,500 companies. We see that some industries have positive economic return spreads, some are neutral, and some don’t earn the cost of capital.

Next, we analyze the companies that make up a value-creating industry (Exhibit 5), a value-neutral industry (Exhibit 6), and a value-destroying industry (Exhibit 7). The important observation is that even the best industries include value-destroying companies, while the worst industries have value-creating companies. That some companies buck the economics of their industry provides some insight about potential
sources of economic performance.

Exhibit 5: Financial Service Industry—Value Creating

Source: CSFB HOLT estimates.

Exhibit 6: Telecom Equipment Industry—Value Neutral

Source: CSFB HOLT estimates.
Another important issue is industry stability. Stable industries, generally speaking, are more conducive to sustainable value creation. Unstable industries, in contrast, present terrific challenges and opportunities. But the value migration in unstable industries tends to be greater than that of stable industries, making sustainable value creation that much more elusive.

We can measure industry stability a couple of ways. One simple but useful proxy is market-share stability. This analysis looks at the absolute change in market share for the companies within the industry over some period. (We typically use five years.) We then add up the absolute changes and divide the sum by the number of competitors. The lower the average absolute change in the industry, the more stable the industry is. Exhibit 8 shows the market-share stability for seven industries. We see relative stability in the ready-to-eat cereal, soft drink, and beer markets, while batteries, personal computers, and autos demonstrate greater change.

Source: CSFB HOLT estimates.
Many authors and researchers have their own point of view and they have evidence for that from that. Here, we have an interesting research related to shareholder value creation which was Published in Critical Perspectives on International Business, 4.1, pp. 55-74, 2008. The purpose behind taking this paper is only to understand the different point of view by some genuine authors to avoid lop sided thinking and for that the whole paper has been put over here:

**MAXIMIZING SHAREHOLDER-VALUE: A PANACEA FOR ECONOMIC GROWTH OR A RECIPE FOR ECONOMIC AND SOCIAL DISINTEGRATION?**

Brendan McSweeney

Royal Holloway, University of London

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### Exhibit 8: Market-Share Stability

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<td></td>
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<td>0.1</td>
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<td>0.1</td>
</tr>
<tr>
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</tr>
<tr>
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<th><strong>Soft Drink</strong></th>
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<th>2001</th>
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<td>16.8</td>
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<td>Cott</td>
<td>2.9</td>
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<td>0.9</td>
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<tr>
<td>Royal Crown</td>
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<td>1.8</td>
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<td></td>
</tr>
<tr>
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<table>
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<th>2001</th>
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<tr>
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<td>45.4</td>
<td>48.8</td>
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<td>Miller</td>
<td>21.9</td>
<td>19.3</td>
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</tr>
<tr>
<td>Coors</td>
<td>10.0</td>
<td>11.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Other</td>
<td>6.8</td>
<td>5.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Pabst (includes Stroh)</td>
<td>11.7</td>
<td>5.0</td>
<td>8.7</td>
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<tr>
<td>Heineken</td>
<td>1.6</td>
<td>5.0</td>
<td>3.4</td>
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<td>Labatt USA</td>
<td>1.2</td>
<td>2.0</td>
<td>0.8</td>
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<tr>
<td>Gamberinus</td>
<td>0.6</td>
<td>1.6</td>
<td>1.2</td>
</tr>
<tr>
<td>Barton</td>
<td>0.8</td>
<td>1.7</td>
<td>1.9</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100.0</td>
<td>100.0</td>
<td></td>
</tr>
<tr>
<td><strong>Average Absolute Change</strong></td>
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<table>
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<tr>
<th><strong>Metal Cans</strong></th>
<th>1996</th>
<th>2001</th>
<th>5 Year Change</th>
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<tbody>
<tr>
<td>Ball Corp.</td>
<td>33.0</td>
<td>32.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Metal Container Corp. (private)</td>
<td>29.0</td>
<td>22.0</td>
<td>2.0</td>
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<td>American National Can</td>
<td>27.0</td>
<td>22.0</td>
<td>5.0</td>
</tr>
<tr>
<td>Crown, Cork and Seal</td>
<td>19.0</td>
<td>20.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Other</td>
<td>1.0</td>
<td>4.0</td>
<td>3.0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>100.0</td>
<td>100.0</td>
<td></td>
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<tr>
<td><strong>Average Absolute Change</strong></td>
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Purpose – To examine the claim that the pursuit of maximum value (wealth) for shareholders optimizes economic and social benefits for society as a whole.

Design/methodology/approach – Evidence cited in support of the claim and the methodology employed by its supporters are examined. Counter-evidence from a wide range of disciplines, including accounting, economics, finance, and medical sociology, is considered.

Findings – The evidence does not support the claim. Bias and severe methodological flaws in its supporters’ research is revealed. Considerable evidence of adverse consequences is identified.

Originality/value – A paper which draws from an unusually wide range of disciples to expose the fallacy a number of powerful myths about the economic and social benefits of making maximizing shareholder value the primary aim of corporate governance.

The view that maximizing shareholder-value (a stock market’s valuation of a company’s shares) should be the central aim of corporations is justified not merely on the basis of the shareholders’ rights as owners but on economic efficiency and wider social wealth grounds. As Hansmann and Kraakman state: “The point is simply that now, as a consequence of both logic and experience, there is a consensus that the best means to this end (that is the pursuit of aggregate social welfare) is to make managers strongly accountable to shareholder interests” (2001: 441). Only fools or knaves, it is implied, oppose a policy of maximizing shareholder value. Criticism is foolish because it ignores the fact that such an orientation is the most effective way of achieving economic growth. Other models of capitalism are inefficient and should be abandoned. Criticism of the greatly increased wealth of a transnational elite and the immense increase in the pay and other benefits of chief executives and other ‘visionary’ leaders of many major corporations is knavish as it is driven by the ‘politics of envy’ – an irrational and spiteful emotion which ignores the fact that whilst some have benefited more, everyone is better off. We all get a slice of the action. Maximizing shareholder value, we are told, also maximizes social wealth. ‘Trickle-down’ and other processes improve the lot of everyone. It’s a “virtuous cycle” (Bughin and Copeland, 1997). Deadbeat companies (and countries) can be transformed into innovative, entrepreneurial, efficient companies and countries if they aim every time and every where to create the greatest value for shareholders. This makes winners of us all: ‘the rising tide lifts all boats’.

Evidence
But how far is the ubiquitous and evangelized advocacy of maximizing evidence-based? And is there counter-evidence of adverse economic and human consequences (social and biological) of the implementation of this model?
Is there a substantial body of evidence demonstrating that running corporations solely in the interests of shareholders ultimately benefits everyone? And additionally, is it true that we all shareholders now through pension funds. Is there what Peter Drucker (1976) calls “pension fund socialism ... worker and capitalist are one and the same person”?

One might think so from the volumes of supportive literature. But what is the quality of that literature? It is riddled with confirmatory bias and at odds with the evidence. Preformulated commitment to the desirability of an exclusive focus on maximizing shareholder value underpins arguments and data selection which are spun in the language and form of scientific research. Basic rules of valid empirical research are widely broken. Instead of solid empirical support the rhetoric of maximizing shareholder value is dominated by anecdotes; crude notions of causality; exaggerated predictive power; ridiculously simplistic views on the internal workings of companies, and an unreal and utopian/dystopian notion of markets. These flaws are now discussed.

Anecdotes:
These take the form of naming a ‘successful’ company (or companies) and attributing their achievements to their commitment to maximizing shareholder value (c.f. Rappaport, 1998; Ehrbar, 1998; Grant, 2002). Less frequently, poorly performing companies (or companies) are also named and their inadequate results are said to be a result of their failure to focus on maximizing shareholder value. There is nothing wrong with using vignettes about companies as illustrative examples. They may help explain views. But such anecdotes are not evidence. Missing from these tales of success as a consequence of seeking maximum shareholder value are examples of equally successful companies which do not have that aim. Also absent are details of failed or poorly performing companies, which have themselves sought to maximize shareholder value. Using the names of successful companies as evidence of the efficacy of pursuing maximum shareholder value is as good as, or rather as bad as, that employed by astrologers in the popular press who provide details of single instances as evidence for generalizations about the characteristics of all people born between certain dates. For example, evidence of the assertion that ‘Leo’s’ are assertive is of this type: Leo features prominently in the astrological chart of Britain’s former fierce Prime Minister: Margaret Thatcher. Ignored are the timid ‘Leo’s’. It would be equally valid – that is invalid – to say X Company is successful, its CEO plays golf, therefore playing golf leads to corporate success. Or that Y ‘smoked’ all his life and died aged 101, so smoking is good for one’s health.

Citing the names of multiple companies which supposedly had been successful as a result of a shareholder maximization policy would not – even if based on rigorous sampling - overcome this flaw. The scientific term for this problem is sampling based on the dependent variable. It is recognized as a basic research error in attributing causality (March and Sutton, 1997). If some successful and some unsuccessful companies have the same policy, if surviving and dead patients took the same medicine, it is spurious to attribute success/survival to the actions also taken by the unsuccessful/dead parties. By only looking at companies deemed to have performed well one can never show what makes them different from companies which perform less well.
Peters & Waterman’s (1982) legendary *In Search of Excellence* relied on this basic error but the anecdotal shareholder-value literature does not even get that far. Instead of partial samples of the successful we merely get one or a few ‘examples’.

And there are other flaws with using anecdotes as evidence. Espoused policies and enacted policies are not always the same. A pronouncement of commitment from the named company to the maximization of shareholder value is wrongly treated as sufficient evidence of the implementation of that policy. Furthermore, even when there is commitment to maximizing shareholder value in a named company, the mere attribution of success to that policy – rather than to any other possible cause, or combination of causes – is not evidence of causality. As Ragin (1987: 27) observes: “rarely does an outcome of interest to social scientists have a single cause ... social causation [involves] different combinations of causal conditions [and] specific causes may have opposite effects depending on context”. Wensley (1997), points out that despite vast data processing it has not been possible to find any single variable that accounts for more than 10% of variation in business performance. To support the claim that shareholder-orientated companies perform better than companies which incorporate additional interests, anecdotal use of the names of countries, not just companies, is also used sometimes. McKinsey & Company, Inc., et al. (2000), for instance, claim that: “shareholder-orientated economies perform better”. The evidence advanced is the recent performance of the US economy – with occasional references to very selective aspects of the UK’s record. Again, absent is any systematic comparison of large numbers of shareholder and non-shareholder-orientated economies. What does such evidence show? Studies of governance differences within developed countries do not show as a statistical matter that overall a shareholder-value orientation results in better performance (Gompers et al. 2003). And there are two further problems with the ‘shareholder-orientated economies perform better’ claim. First, it supposes that there is uniformity of orientation/practice within each “economy”. And yet, extensive empirical evidence points to internal diversity within countries – even within the US (e.g. O’Sullivan, 2000). Secondly, the time-period over which cross-country comparisons are made is always too short. It is implied that the ‘superiority’ of the US economy has been very long-standing. And yet, when the performance of the US economy was lagging behind its main rivals, the maximization of shareholder-value was the object of much external and internal criticism. Michael Porter, for example, in a *Harvard Business Review* essay called “Capital Disadvantage: America’s Failing Capital Investment System” (Porter, 1992) argued that the bank centered capital markets of Germany and Japan allowed executives to manage in the long-term while US managers; fearfully driven by a sharp focus on quarter to quarter earnings growth which was enforced by the stock market’s fickleness; invested myopically. A vast amount of ‘declinist’ literature was produced in the US reflecting a crisis of confidence. In the 1981-95 period the US had the lowest rate of overall productivity change in the OECD. In the 1970s the German dual board and co-determination system was upheld by many as the model – to the point that the Bullock Committee in the UK (Department of Trade, 1977) recommended its adoption. Later, the Japanese system - or more widely, the ‘east Asian model’ - became the ideal until the crisis of the Thai badht in mid-
The ‘Asian miracle’ was relabelled ‘crony capitalism’ – the ‘tiger economies’ were seen as ‘paper tigers’. Yesterday’s model of emulation is today’s model of aversion.

The cure-all

How is a shareholder-value maximizing model supposed to succeed? The literature on business and management is vast and varied. There is no consensus and a dispassionate reader would readily acknowledge the complexity of the field. Mintzberg et al. (1998), for instance, identify 10 different approaches to strategy. In 1996 Mikridakis noted some 43 different management theories – a score which no doubt has expanded since then. But every so often a glamorized cure-all/explain-all becomes fashionable. We humble scholars trying to systematically examine and test have, it seems, yet again failed to see the wood for the trees.

What do the advocates of shareholder-value maximization offer as the route to improving the management of companies? With circular logic companies are exhorted to cut out waste – defined as anything that is not enhancing shareholder value. But how can money spent wastefully be distinguished from what is vital or enhancing? As Geroski and Gregg state: “it is very difficult to be sure whether overheads are ‘fat’ or ‘muscle’, particularly when some support services have subtle and potentially long-run effects on corporate performance” (Geroski and Gregg, 1997: 14). Schilling and Hill (1998) estimate that up to two-thirds of new products that actually reach the market do not produce a financial return. In retrospect ‘waste’ can be identified. But can it be done in advance? If we acknowledge in-eliminable uncertainty of outcomes in significant areas of business then many decisions will necessarily be imperfect (Rubin and Weisberg, 2003; McSweeney, 2000; Danto, 1985; Keynes, 1936; Knight, 1921. The outcomes cannot be guaranteed or predicted. But if certainty is assumed then it can be concluded that correct decisions are always knowable in advance, and not just retrospectively. That foolish assumption is the bedrock of a significant section of the maximizing shareholder-value clericy. For many management consultancy firms it is also a very lucrative assumption. A range of certainty assuming calculative techniques - generically called ‘value based management, often with proprietary names, such as Economic Value Added (EVA™), Total Business Return, Cash Flow Return on Investment, Economic Value Management, Discounted Economic Profits– which purport to enable every major and minor decision in companies to enhance shareholder value are advanced by major management consultancy firms – and by some academics. EVA, said Fortune (1993), is “the real key to creating wealth ... it drives stock prices”. William Smithburg, Chairman of Quaker Oats, said that: “The best way to deliver enduring shareholder returns ... [is to] focus on a concept called Economic Value Creation” and because of that he “slept better at night knowing that our divisions are clearly focused on the things that will contribute to shareholder value” (quoted in Enterprise Magazine, April 1993). Mottis and Ponssard (2001: 45) claim that: “long-term observations do point to a strong correlation between adopting VBM-based incentives and long-term stock returns”.

The logic is that as it is supposed that a company’s current stock market value is the discounted value of all future cash flows which will accrue to the shareholders – that the key to creating maximum shareholder value is to
ensure that each decision within a company generates the maximum discounted cash flow. The aggregate of the micro-level decisions ensures maximum shareholder-value. As Jim Meenan, then Chief Financial Officer of AT&T, stated “when you drive your business units towards EVA, you’re really driving correlation with market value” (in Walbert, 1994) (see also McKinsey & Company, Inc., et al., 2000).1 If the adverse consequences of the application of value based management were not so immense their claimed potency would simply be risible. They rely on the nonsensical assumptions of complete information, known preferences, and no uncertainty. These may be convenient for mathematized scribblings on blackboards or in journal articles, or for those who want to pretend that they can provide an answers ‘machine’, but the assumptions do not match the conditions of the real world. They are false theories but with very real consequences. Organizations are conceived of as analogous to simple, static, and closed physical entities. There is no room for novelty, for surprises, for human reflexivity. The calculative shareholder value enhancing techniques presume the availability of information which, as King (1975) states: “only God could provide”. Forecasting is difficult if it really is about the future (McCloskey, 1991). The practical, get-on-and-do it, it’s what the sophisticated do rhetoric of shareholder-value based management is not how the world works. It is a fantasy. The techniques are deduced from an unreal notion of perfect knowledge. But uncertainty cannot be escaped. Choices made in real time are never made with complete information. As Gigerenzer et al. (1989) observe “no amount of mathematical legerdemain can transform uncertainty into certainty” and as Albert Einstein noted: “Not everything that can be counted counts, and not everything that counts can be counted.” Jan Mouritsen of Copenhagen Business School states that “EVA is a very sorry representation … if it is possible to calculate the net present value [discounted cash-flow] of an organization over the long run, then the strategies proposed cannot be very interesting” (1998: 480). Jack Welsh, former CEO of General Electric, puts it more bluntly “shareholder value is not an objective. It is the product of great people doing great things, not consultants selling EVA calculators and all that crap”.2 Mottis and Ponssard’s (2001) eulogy (above) relied on data in Hogan and Lewis (2000) which covered a period of rising share prices so that everything (including the colour of CEO’s socks) could be correlated with stock prices. And crucially they omitted to mention that Hogan and Lewis also found equal share price growth by non-adopters of value based management. The flaws in the idea that incorporating maximizing shareholder-value into every corporate decision are evident not only from an awareness of conceptual defects in the notion of calculating the discounted cash flow of such decisions, but also from empirical evidence. In fact, just about every study of the application of discounted cash flow techniques within organizations points to the absurdity of seeking to side-line complexity and uncertainty through the application of a mere numerical technique. Independent studies of the degree of correlation of EVA (and other variants) with the absolute level of changes in stock market valuations of companies find it is at best miniscule and often negative (Biddle, et al., 1999). For instance, a study of 582 US companies found a correlation in only 18 companies. In 210 companies the correlation was negative (Fernández, 2003).
Correlation does not prove causality, but without correlation causality is clearly absent.

The perfect market
What is supposedly different about shareholder-orientation - whether linked or not to calculative techniques, such as EVA – is that it ensures that company actions are market, and especially capital market, orientated. In place of the whims or the self-interest of managers, is a vast, dispassionate, analytical process which provides correct valuations, efficient allocation of resources, and effective incentives: the market.

Friedrich von Hayek states that: “The peculiar character of the problem of rational economic order is determined precisely by the fact that the knowledge of the circumstances of which we must make never exists in concentrated or integrated form but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all separate individuals possess … to put it briefly, it is a problem of utilization of knowledge which cannot be given to anyone in its totality” (1945: 519). For him, the rational and optimal alternative is the market which he conceived as an epistemic device, a discovery procedure for processing, concentrating, and concisely transmitting (via price signals) information dispersed throughout society.

Hayek did not regard market ‘knowledge’ as perfect, but the notion of capital markets in the ideology of shareholder-value does so in two key respects. First, in efficiently processing all dispersed knowledge, and secondly, in correctly anticipating the future. Hence, the value of a company’s shares is said to be the sum of its future cash flow discounted back to the present. Even if individuals or institutions cannot comprehensively predict with accuracy, the market can do so. Michael Jensen states “[There is] no other proposition in economics which has more solid empirical evidence supporting it” (1978). But does the evidence support this view? The Wall Street Journal describes it as “The most remarkable error in the history of economic theory” and George Soros calls it “absurd” (2003: 3). There is an immense body of empirical studies demonstrating market irrationalities and imperfections.3 These include: dominance of short-term horizon (Benzarti and Thaler, 1995); irrational exuberance (Shiller, 2000); herd mentality (Arthur, 2000); bubbles (Shleifer, 2000); panics and over-reaction to prospects of losses (Campbell and Limmack, 1997); the week-end effect (Wang et al., 1997; Keim and Stambaugh, 1984), and so on. Cooper et al., (2001) found in a study of the period June 1998 to July 1999 – a time of exuberance for shares in Internet companies - that the inclusion of a ‘.com’ suffix in a firm’s name resulted in a 53% increase in price. Even firms with very limited links to the Internet who added a ‘.com’ suffix got a 23% increase in price.4

But, even if we ignore these imperfections in markets, managers and other employees in companies have to make multiple micro-decisions with imperfect information, faced with unavoidable uncertainty, and with limited control. Hayek asks: “what is the problem we wish to solve when we try to construct rational economic order?” He observed that “on certain familiar assumptions the answer is simple enough. If we possess all the relevant information, if we can start from a given set of preferences, and if we command complete knowledge of available means, the problem remains purely one of logic … The conditions which the solution of this optimum
problem must satisfy have been fully worked out” (1945: 519). These assumptions are, of course, unreal. They are the false assumptions, Hayek argues, upon which Soviet state planning was built. He speaks of “the absurdity of … starting an analysis with a situation in which all of the facts are supposed to be known” (1984 [1925]: 257). But ironically, the shareholder-value clerisy, horrified no doubt about the notion of state planning, suppose that such knowledge can be identified within companies provided there is commitment to a wholly shareholder orientation.

**Shares as a source of finance**

But even if ‘the’ market cannot function as an effective guide for micro-decisions within companies, does it not act as effective evaluator of corporate performance through moving investment from underperformers to better performers? As we have seen above, the host of market irrationalities – speculative bubbles, for instance – is inconsistent with that view. As Lee states: “empirically we find that news about fundamentals explains only a fraction of volatility in returns … stock prices move for reasons that have little to do with fundamentals … smart investors need to consider “fashions” and “fads” as well as “fundamentals” (2001) (see also Shiller, 2000; Summers, 1986). Here is an illustrative example. On the 12th January 2003 the share price of the Anglo-Dutch company, Corus, fell as low as 4p. There was panic selling of the shares after a Dutch court upheld the right of the supervisory board of one of Corus’ subsidiaries to block the sale of part of Corus’ aluminium division. Almost 483 million Corus shares were sold that day. Consistent with the market’s irrationality, an analyst from BNP Parisbas, in a circular to investor clients, stated that: “Even at 4p, Corus shares are not worth buying.” Yet even on the basis of a highly pessimistic view the scrap value alone of the assets were worth at least 36p per share. In early 2007, without any major changes in management operations or market prospects since 2003, the company was sold at a price of over 600p per share. The hysteria in the stock markets in January 2003 about Corus was not a rational assessment of fundamental value.

Even if it is supposed that this example is an exception and the wider evidence of market irrationalities is ignored - that is, if it is assumed that capital markets are entirely, or almost entirely, rational – there is another fundamental reason why the effective allocator of scarce investment resources claim is misleading. Stock markets are primarily mechanisms for the transfer of ownership of stocks/shares, rather than to provide investment funds (Berle and Means, 1967). Only when a share is issued for the first time does the amount paid possibly (not always) become available for investment (or other uses) by the issuing company. Whenever a share is sold again the payment is to the owner of the shares, not the company which first issued them. The stock market is a second hand, third-hand, fourth-hand … nth-hand market. Very rarely is it a first-hand market. In most countries, including the US and the UK, the stock market is not, and never has been an important source of investment funds for major corporations. Instead, as Mary O’Sullivan points out, throughout the twentieth century corporate retentions (that is profits not distributed to shareholders and capital allowances) and debt (borrowings) have been the main sources for business investment (2000: 78).
From the late 1920s (the period for which O’Sullivan’s data starts) corporate retentions overall in the US have never been less than 66% of all sources of funding over any five or six year period. Shares have provided less than 18% and only reached close to that level (17.8%) in 1927-30 when companies sold large amounts of stock to speculators. During the period 1982-7 shares provided only 3.1% of net sources of funds for the 100 largest US manufacturing companies. Between 1940-1978 only 8% - and between 1960-1987 only 13% - of Fortune 500 companies issued/sold shares more than once (Ellsworth, 2002). But even the relatively small funding from new stock issues overstates the amount of investment funds via the stock market as funds from shares have “generally been used not to finance investment in new productive assets, but to transfer financial claims over existing assets” (quite often through an initial public offering (IPO) when the founders of a company sell their shares – they, not the company, get most or all of the money) – or “to restructure balance sheets” (O’Sullivan, 2000:79) (for instance, to pay off loans). Corbett and Jenkinson (1996, 1997) have shown that during the quarter of a century they studied (1970 to 1994 inclusive) the net contribution of stock markets to the financing of corporate investment in the non-financial sector in the US, UK, Germany and Japan was at most a tiny source of funds - indeed it was negative for the UK and the USA.5 Of course, it is possible to identify a few individual companies for whom new shares have on some occasions been an important source of investment funds. But overall, as Table 1 (below) shows, as a source of funds, contrary to the rhetoric which has justified so much inequality and privilege, stock markets have either been negative, that is, net extractors not providers (for the UK and the US) or trivially small providers (for Germany and Japan).

**Table 1**

<table>
<thead>
<tr>
<th>Source</th>
<th>Germany</th>
<th>Japan</th>
<th>United Kingdom</th>
<th>United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal</td>
<td>78.9</td>
<td>69.9</td>
<td>93.3</td>
<td>96.1</td>
</tr>
<tr>
<td>Bank Finance</td>
<td>11.9</td>
<td>26.7</td>
<td>14.6</td>
<td>11.1</td>
</tr>
<tr>
<td>Bonds</td>
<td>-1.0</td>
<td>4.0</td>
<td>4.2</td>
<td>15.4</td>
</tr>
<tr>
<td>New Shares</td>
<td>0.1</td>
<td>3.5</td>
<td>-4.6</td>
<td>-7.6</td>
</tr>
<tr>
<td>Other</td>
<td>10.1</td>
<td>-4.0</td>
<td>-7.6</td>
<td>-15.1</td>
</tr>
</tbody>
</table>

Data source: Corbett and Jenkinson, 1997:74

The images we so often see on television of the fevered activities of expensively suited men and women surrounded by batteries of computers in ‘investment’ locations in Wall Street, the City of London, and elsewhere are not, as is usually suggested, pictures of a highly paid elite investing in companies – most of the time they are simply gambling, not on dogs or horses but on share prices. Descriptions of shareholders as “investors”, as “wealth creators”, and calls for companies to “payback”, to “return” cash to shareholders reinforce the myth of shareholders as significant providers of funding to top companies.
Upwards distribution of wealth

Even if stock markets have not been significant sources of investment funds, indeed any funds for companies, hasn’t the huge increase in the volume of share dealing and the value of shares improved the financial position of everyone directly, or indirectly through pension funds? The percentage of US households ‘owning’ stocks directly or indirectly – the latter largely through pension funds – rose from about 19% in the early 1980s, to 32.5% by the end of the decade, to 41% in 1995, to 49.5% in 2002. In the UK, by the end of the 1990s stock ownership, direct and indirect, had risen to nearly 50%; in the Netherlands to 33%, 23% in France, 20% in Germany, and 15% in Italy (Ireland, 2005: 55). In Europe, by the end of the 1990s more than 17% of households in France, Germany, Italy, the Netherlands and the UK were holding stock directly. But, has this been “taking capitalism to the people” (J. Moore cited in Ireland, 2005: 55)? According to Madsen Pirie of the Adam Smith Institute, privatization in the UK has lead to “the largest transfer of power and property since the dissolution of the monasteries under Henry VIII”. But, as we shall see, just as the beneficiaries of Henry VIII’s actions were an already rich elite, so too have been those who have overwhelmingly benefited from the stock market expansions. The concentration of wealth in the US is “extreme” (Wolff, 1998), as it is in the UK.

In 2001 the wealthiest 1% of Americans owned over one-third of total wealth and the next wealthiest 9% owned another third. That is, the wealthiest 10% owned two-thirds of total wealth (Kennickell, 2003). The concentration of wealth is even more extreme when residential wealth is excluded from the calculations - as it is by most analysts as most people cannot liquidate their home, otherwise they would have to live on the sidewalk. In 2001, the richest tenth of the US population owned over three-quarters of non-residential wealth. The richest 5% owned nearly two-thirds. By contrast, the bottom 50% of the population owned less than 2%. In relation specifically to shares, in 2001 the wealthiest 10% owned more than three-quarters of corporate shares. In contrast, the bottom half of the population owned only 1.4% (Ireland, 2005). Poterba (2000) estimated that in 1998, even when indirect ownership through pensions is included, the wealthiest 10% owned over 86% of corporate shares; the bottom 80%, that is eight out of ten people, owned a mere 4.1%. So much for Drucker’s “pension fund socialism”. Data for the UK is much more difficult to obtain than for the US. However, the broad details are clear. “The distribution of wealth in the UK is also highly skewed, with extreme concentrations once again in the wealthiest 5-10 percent of households ... it is extremely unequal” (Banks et al., 2003: 23). And over the past few decades that inequality has continued to increase (Ireland, 2005; Dorling, et al., 2007). By 2003 the wealthiest 10% of the population owned almost three-quarters of marketable wealth (excluding value of homes) and the most wealthy 25% owned 85%. Including the value of homes, the wealthiest 25% owned 72% (HM Revenue & Customs, 2006). As in the US, the elite now own the vast majority of shares. Despite the rise of the so-called share [or equity] culture most people possess very few, if any, financial assets. Even in countries where share ownership has become more widespread, “shareholder primacy”, as Ireland states, “remains in essence the
primacy of a small privileged elite; the primacy of the wealthiest ten percent” (Ireland, 2005: 67).

Envy

But aren’t criticisms of wealth inequalities just based on a desire to ‘level-down’ for its own sake; or driven by envy of success? Isn’t criticism “the politics of envy”. As we have seen, claims about the positive impact of a shareholder valuation on economic development and aggregate social wealth are unfounded. But not only is the evidence of positive consequences absent, there is evidence of major adverse effects. Mary O’Sullivan (2000), Richard Ellsworth (2002), Richard Heller (2002), John Kay (2003a,b), and others have argued that focusing on shareholder value – rather than on product or service quality – ironically results in lower shareholder value in the longer-term. Rather than enhancing innovation and development of companies, the shareholder-value as objective (rather than outcome) prioritises narrow short-termism (Ellsworth, 2002; O’Sullivan, 2000). Baumol (2002:13) argues that “virtually all of the economic growth that has occurred since the eighteenth century is ultimately attributable to innovation”. As Francis Bacon noted 400 years ago, if you don’t innovate someone else will.

But how many significant innovations were inspired by a desire to maximize shareholder value? Which is likely to be the most motivating for research and development staff: curiosity or a desire to increase remote shareholders’ wealth?; patient investment or a demand for quarterly returns?; a recognition that failures are inevitable or a rapid readiness to punish? Are we really to suppose that the principal motivation of Alexander Fleming - the discoverer of antibiotics - was a desire to set-up his own company and make a fortune? Innovation takes time and inevitably there are failures, failures which are necessary for learning (Freeman, 1974; Dodgson, et al., 2005). It also requires investment of funds with unpredictable returns. Studies of the actual contexts of successful innovation identify complex formal and informal, market and institutional networks, norms and incentives (Mckelvey, 1996). Major developments involve extended interactions among researchers in different organizations such as universities and firms (Dodgson, et al., 2005). Without the fantasy of perfect productive and competitive knowledge and foresight of the shareholder value clericy, the returns on innovation investments are always unknowable. But the consequence of reduced investment is knowable: it is decline. The short-termism of the shareholder-value model, its emphasis on distribution of profits rather than their retention discourages such patient investment (O’Sullivan, 2000). Maximizing shareholder-value is an appropriate model for running down a company and a country, not for building them up (Lazonick and O’Sullivan, 2000).

The politics of envy or the politics of greed?

Shareholder value is part of a politics which is not merely indifferent to wealth inequality, but which accelerates it. In the UK inequality is back to the levels it was before the Second World War. In the past year the number of poor children, as defined by the government has grown by 100,000 (The Economist, 28 August, 2007). By 1979, both income inequality and relative poverty were at, or near their lowest levels. What followed was the most brutal reversal of all countries in the world with the exception of New Zealand (Hills,
Maximizing shareholder value is both symptom and cause of greater wealth inequality. £43 billion in savings have been accumulated by the 35,000 people who work in the City of London; there has been a 29% rise in the sales of Bentleys and a waiting list of five years for Rolls Royces. Partners/directors in City firms earn enormous bonuses; for example, last year two partners in GLG Partners received bonuses of between £200 million and £250 million each. The remuneration of top executives of major companies has increased enormously. The median pay of a FTSE director is more than £1.5 million; that of a CEO almost £3 million. “In 1991, the average [US] large-company CEO received approximately 140 times the pay of an average worker; in he 2003, the ratio was 500:1” (Bebchuk and Fried, 2004: 1). And the trend continues to rise (Mendoza, 2007). Based on a study of giant firms, Froud et al. demonstrate that whilst these firms grew no faster than GDP the pay of the CEOs rose much faster. In 2006/07 alone the pay – or what is sanitized as compensation- of full-time directors of the UK’s top companies soared by 37% following a rise of 28% in 2005/06.7 During 2006/2007 average earnings in the UK rose by 3.4% in the private sector and by 3.1% in the public sector. But it seems that even these enormous levels and increases in pay are regarded as insufficiently motivating and so top management must also be incentivized by stock options and various bonus schemes linked to share prices to ensure a focus on shareholder value maximization. And yet, despite the shareholder-value bluster about incentives, there is no identifiable link between such pay increases and corporate performance (Core et al., 2003). It is a “cash machine” for top executives (The New York Times, November 8, 1998). As Dalton et al.’s review of more than 220 studies showed, share ownership and other share price linked schemes have no consistent effect on corporate financial performance (2003). As Froud et al. point out “top managers … appear to be an averagely ineffectual officer class who do, however, know how to look after themselves (2006:7). And as we have seen, the notion that we are all part of some sort of communal ownership of shares through pension funds ignores that fact that the vast majority of shares are owned by an elite. In any event, in the UK and the US in recent years the pension benefits of many employees, especially new entrants, have been diminished, as has job security.

But so what? The espoused neo-liberal view is that the rich can get as rich as they like and in any event – through ‘trickle-down – the rest of us will also get better off. We all get a piece of the action. But this is a triumph of fantasy over fact. Not only do countries with greater overall wealth inequalities show lower levels of
economic growth (Glyn and Miliband, 1994), but they also have lower life expectancy, higher maternal mortality, and a higher proportion of low birth-weight deliveries. The association between absolute levels of wealth/poverty and the quality of peoples’ health is widely known. Absolute levels of poverty or wealth are respectively bad or good for a person’s health. Individuals’ circumstances, such as family assets and earnings, are good predictors of longevity – at what age one dies.

**Health**

But there is far less awareness that wealth inequality per se is bad for national health, whatever the absolute material standards of living are in a country (Wilkinson and Pickett, 2006, 2007; Asafu-Adjaye, 2004; Smith, 1996). The rise even of diseases such as cardiovascular diseases and cancer (and its decline amongst the rich elite) is a very rapid response to rises in wealth inequality (Kaplan, et al., 1996). Multiple studies, across a wide range of countries, have related relative inequality to infant mortality, life expectancy, height, eyesight, mental breakdown, tooth decay, and morbidity. The richer live longer, the poorer die earlier, the richer have fewer ulcers, the poorer more, and so on (Matthews et al., 2006). The lower down the social ladder one is, the more detrimental the health effects. One dies earlier and whilst alive the quality of one’s health is inferior, not necessarily because one is poor but because one is poorer. One does not just have fewer financial assets but fewer biological assets.

Between 1981 and 2002 the expected number of years spent in poor health in the UK rose from 6.4 to 8.8 for men and from 10.1 to 10.6 for women. Among the developed countries it is not the richest societies which have the best health, but those which have the smallest wealth differences between rich and poor. “Inequality”, Richard Wilkinson states, is “the most important limitation on the quality of life in modern societies” (1996: 14). And as Smith says, the “principal culprit” of this rise in ‘developed’ countries is “easy to find: the stock market surge” (2001: 16). The boom in share prices has brought significant benefits only to those at the very top of the wealth distribution” (Ireland, 2005: 72). In the US between 1989 and 1998, the real value of tangible assets increased by only 14% and the real value of financial assets other than shares by 38%. On the other hand, the real value of shares rose by 262%. Policies which facilitate maximization of shareholder value inevitably lead to greater inequality and undermining the health of many in a nation. The social and biological assets of many are undermined. When Tony Blair famously said in opposition to higher taxes, and in some cases any taxation, on the super rich that “it is not a burning ambition for me to make sure that David Beckham earns less money“, he was acting, as C. Wright Mills said, as one of the powerful at the centre of public decisions “who do not themselves suffer the violent results of their own decisions” (1944). If attempts to challenge this situation and its causes - the politics of greed – is ‘the politics of envy’, let us have more of that politics.

The continuing rise in life expectancy, in many countries, including the US and the UK - that is the rise in the average age at death, despite a rising wealth
inequality – might seem to contradict the argument that greater wealth inequality causes poorer health. But, most people currently dying were born and have lived for quite some time in a period of declining – not increasing – inequality. So, rising life expectancy mortality does not falsify the argument. Multiple cross-national studies have shown that that higher levels of social expenditure and taxation as a proportion of gross domestic product are associated with longer life expectancy (and with a variety of positive health indicators). But furthermore, like all averages, mortality averages smooth out a lot of variation. Studies in the US, UK, and elsewhere, have shown rising life expectancy rates do not apply, for instance, to residents of deprived areas (McCarron, et al., 1994; Ben-Shlomo, et al., 1996). Overall, over the past twenty years the US has fallen from 11th in world ranking of life expectancy to 45th (CIA, August 2007). The UK’s current rank order is 37th.

The rise of the ideology and practice of maximizing shareholder value – or more accurately shareholder wealth - is not a triumph of economic efficiency. Instead it reflects and reinforces the growing power of an increasingly assertive financial elite. Maximizing share value is not equivalent to maximizing corporate, national economic, aggregate social value. It is not a new idea, but it is not a mere fad or fashion. It reflects and reinforces structural changes. It is best seen as “one aspect of the more general shift in the last thirty years or so in the balance of class forces around the world” (Ireland, 2005: 70). Its vigorous reemergence involves a “shift in the internal social relationships within states in favour of creditor and retainer interests, with the subordination of productive sectors to financial sectors” (Gowan, 1999: vii). In ‘developed’ countries, the disparity of wealth is greatest in those where the ideology of shareholder-value is strongest. The financial marketization focus of the shareholder-value model is a crucial part of wider neo-liberal politics. Although it is a long-standing notion in economic theory it was greatly strengthened by the end of the Cold War, which marked the closure of a distinct era in geopolitics and international relations. Since then; especially, but not exclusively in Anglo-American countries; there has been a growing dilution or abandonment of the institutions which had been built up to “civilize capitalism” (Kristensen, 2005). The rich are now less constrained. Both the ideal and the fear of an alternative to capitalism have gone. Increasingly, we see changes in models about income distribution and the comparative rights of capital and labour (Traxler, et al., 2001). Labour is increasingly treated as “nothing more than an expendable commodity” (Ireland, 2005: 70).

Of course, this is not true of all companies. And even from the exclusive perspective of shareholder-value, serving other interests is prudential and pragmatically necessary en route to achieving that goal. Richard Ellsworth’s comparison of customer-focused and maximizing shareholder-wealth focused companies found that “a corporate purpose focused on providing value to customers not only is competitively superior to a purpose of maximizing shareholder wealth, but also typically produces greater long-term returns to
In contrast to the often rabid advocacy of the exclusive rights of shareholders, the courts in the US state of Delaware (where the majority of the Fortune 500 are incorporated) have made it clear that maximizing shareholder value is only required when a company ceases to exist (liquidation), or where there is a change of control. For this purpose, a merger of two publicly held firms would not result in a change of control provided the merged entity is controlled by a disaggregated group of shareholders. About half of the states in the US have enacted some form of stakeholder-oriented laws. These vary from the permissive to the mandatory. An example of the former is Pennsylvania, where the board may consider ‘the effects of any action upon ... employees’. An example of the latter is Connecticut, where directors are required to consider (inter alia) ‘the interests of the corporation’s employees’.9 The UK’s Companies Act 2006 states that “a director of a company must act in the way he [sic] considers, in good faith, would be most likely to promote the success of the company for the benefit of its members [i.e. shareholders] as a whole, and in doing so have regard” amongst other matters to “the likely consequences of any decision in the long term,” and “the interests of the company’s employees”.

But whatever the legal requirements or permissions, companies whose shares are traded on stock exchanges are persistently pressurized to maximize shareholder value – in the short-term - by financial institutions whose control of shares has risen from about 10% in the US and 25% in the UK in the 1950s to current levels of control of around 64% in the former country and 84% in the latter. Shares can readily be bought or sold and instantly transferred across national borders. Ownership does not require any knowledge of the underlying assets or employees. That detachment encourages excessive extraction, impatience, speculation, and flight. An exclusive focus on maximizing shareholder value - diverts attention and resources from the processes which create long-term business development: commitment, involvement, creativity and innovation. Instead it encourages and enables a parasitical relationship of shareholders with companies. It is vampire capitalism not productive capitalism.

The power of the shareholder value model “has been amplified through its acceptance by a worldwide network of corporate intermediaries, including international law firms, the big accounting firms, and the principal investment banks and consulting firms – a network whose rapidly expanding scale give it exceptional influence in diffusing the ... model of shareholder-centered corporate governance” (Ireland, 2005: 77)(see also Carter and Muller, 2006). Included in that network, also, are a host of lavishly funded right-wing think tanks and some academics who have largely been responsible for developing, and in even greater numbers promoting, theories which legitimate the shareholder-value model. As George Monbiot says: “the socially destructive notions of a small group of extremists have come to look like common sense” (2007: 27). Much of the pressure for the model came and continues to come from the US, or rather, from a section within the US; from finance capital, “as part of a more general pressure to compel governments worldwide to adopt neo-liberal economic and social policies” (Ireland, 2005: 80). That pressure has been direct (through persuasion, incentives, or coercion) and indirect, through bodies such as the
IMF, World Bank, and WTO which are dominated by it. Its influence within the EU is also significant. And of course, within many countries it has found willing partners.

That is not to argue against a positive role for stock markets, or a need for external scrutiny of companies, but to reject the view that the short-term interests of shareholders should override any other interests of corporations or wider society.

The economic and social arguments in favour of a shareholder-value model are not evidence based and there is considerable evidence of significant and increasing adverse consequences. Some wealth may trickle down to some - but most streams up to the elite. It is not possible to say whether the model will continue to increase its power over corporations and governments. Will it ultimately engulf those countries such as France, Germany and Japan where economic institutions are far more socially embedded than in Anglo-American countries? It has made some but still limited inroads in those countries, especially in the latter. But it is difficult to know whether, ultimately, the countervailing forces will be strong enough. On competition and industrial policy, the European Commission has demonstrated an increasing enthusiasm for neoliberalism – notwithstanding “the wishful thinking of trade unions and the ‘social dimensions’ rhetoric of politicians” (Streeck, 2007: 540). If unrestrained, finance capital will have even greater power over our labour: there will be increasing employment insecurity, ill-health, stress, and probably violent and other crime and social upheaval. As academics, we can at least try to question claims which are not evidence-based, indeed which are often contradicted by the evidence, and to consider in whose interests particular policies serve. In a recent conversation with a fellow academic, he first boasted about his financial assets and then pronounced “we are all neo-liberals now”. Even those fortunate enough to have such assets should be wary of denial about the current and future dangers of de-civilization.

About the author

Brendan McSweeney (PhD LSE) University of London Professor of Management at Royal Holloway, University of London is a member of the editorial boards of Critical Perspectives on International Business, Organization Studies, and Accounting Forum. He has published papers on a wide range of topics in scholarly journals such as: Accounting, Organizations & Society; Human Relations; Journal of International Business Studies; Journal of Organizational Change Management; and The Political Quarterly. His jointly edited book (with Chris Smith and Robert Fitzgerald) Remaking Management: Between Global and Local was published in Spring 2008 by Cambridge University Press. He has been a consultant to a wide range of private and public sector organizations, most recently the Government of Japan.

1 AT&T soon abandoned EVA as did Quaker Oats whose share price fell after it adopted EVA.
2 Welsh was also echoing John Stuart Mills’ recognition of the paradox that self-interested behaviour does not necessarily promote self-interest (Mills, 1873).
3 “Fundamental valuation efficiency” and “information arbitrage efficiency” are distinguishable (Tobin, 1984). Evidence of the latter is not sufficient evidence of the former. But in any event, inefficiencies of both types are readily identifiable in stock markets (Shleifer, 2000).
4 Fund management firms such as Foreign & Continental and Philips & Drew which tried to avoid buying shares in these companies got “the cold shoulder” from “pension funds” (Thrift, 2001: 426). Many companies such as Marconi which bought into them suffered huge losses.
5 The main reason for shares being a negative figures (an extraction - not a source of funds) is mergers and acquisitions where a firm uses cash to buy the shares of another firm but does not obtain cash through the issue additional shares.
6 In Germany, during 1980-84 (inclusive) and 1990-94 (inclusive) the figures for new shares are also negative, not positive (Corbett and Jenkinson, 1997: 77). For data on sources of investment funds in Italy and Spain see Cobham (2004).
7 Reducing wealth inequality through taxing the super-rich would it is has been claimed by Reagan, Thatcher, Bush, Blair, Brown and others have very deleterious effects on the economy by discouraging what they grandiosely call ‘entrepreneurship’ and ‘leadership’. Edwin Locke of the right-wing Ayn Rand Institute proclaims that “on tax day thank the rich and support lifting the tax yoke of them” (2002). But by far the two most important factors in determining wealth-inequality are inheritance and chance –two factors that have nothing to do with entrepreneurship or leadership. Somehow the ‘leaders’ of leading German, Korean, and Japanese companies do not require such hugely disproportional incomes and bonuses as their US and UK counterparts.
8 As the dominant type of pension scheme is of defined benefits employee members of such schemes have not benefited from increases in shares prices. The shareholders of the firm as the residual claimants are the beneficiaries (Gordon, 1997)(For UK evidence see: Hussain, 2000).
9 In 1883, the English Court of Chancery was asked to decide whether the provision of ex gratia benefits to employees was contrary to the interests of the shareholders. In delivering his oft-quoted ‘cakes and ale’ judgment, Lord Justice Bowen was ruling in a case (Hutton vs West Cork Railway Company) in which there had been a change of control – the company had been taken over and he ruled against the old managers paying themselves a large bonus. In most circumstances (i.e. not a closure or not a change of control) he ruled that ‘liberal dealing with servants’ i.e. employees of a company was permitted.

Agens Wimmer in ‘Bussiness Relationship as value Drivers?’ says, The understanding of the process of value creation, seeing through the causal relationships is the precondition of effective and efficient decisions. Rummler and Branche (1990) emphasise that the lack of success of companies is frequently caused by their inability to understand the factors influencing organizational and individual performance.
The shareholder value added components (cash flow from operation, discount rate used for evaluation, the debt used for financing, according to Rappaport 1998) are influenced by various value drivers. The value creating elements listed by Rappaport (1998) are factors expressed in money, but their development can be influenced by the management’s decisions regarding operations, investments and financial issues. Each company must find the factors through which the value creating process can be influenced.

Lebas’s model of the performance tree (1993) shows the multidimensional character of performance. The operations and the firms' processes influence the value created for the customer and through their market consequences (sales revenue) and related costs influence the financial result. Every company must find the key factors (“the roots of the tree”, value drivers, performance drivers or action variable, with different terms in the different approaches) adjusted to its own objectives and processes. Through these key factors the company can influence the achievement of its goals and its effectiveness and efficiency, through which it can achieve a competitive advantage.

In this work, we argue that business relationships could be important elements, influencing factors of value creation by decreasing costs and increasing value provided for business partners, customers as well as suppliers. The importance of process orientation is emphasised and the process-oriented thinking prevails in many concepts and methods. The concept of supply- and value chain or the idea of process-oriented management (suggested by Rummler and Branche, 1990) attempt for effectiveness, efficiency and success are exceeding the frontiers of the company. Companies are starting to recognise that enhancing their own efficiency is not enough, they have to become the part of the most effective supply chain (Cooper 1996). Therefore, besides internal processes the relationships with business partners are increasingly important for firms’ performance. Business relationships could become factors supporting the process of value creation.

From the above literature review by different authors and researchers and considering present research problem, in this study we look closely at the primary methods used by different firms to incentivize managers to focus on creating shareholder value and to monitor their effectiveness in doing so. We can conclude that...

- The practices of the firms engaged in implementing value-based management differ widely. Some VBM firms find themselves suffering from bloated investments that no longer earn competitive returns. The immediate need is to implement a performance measurement and reward system that encourages managers to rationalize their investment in assets, determining what is necessary to carry on the firm’s operations and disposing the excess. For the other companies, the primary need for VBM may be assessing the value of strategic alternatives. Choosing the
right VBM approach should be as much about how the method aligns with management’s reason for adopting VBM as any argument of superiority of one method over another. So having a clear understanding at the outset of what you want to accomplish is absolutely essential.

Firm do not have the luxury of being able to wait for their value creating efforts to run their full course before attempting to access their success. The interim performance of the firm and its business units must be measured periodically to recognize and reward those responsible. A very real need exists for a single-period performance metric that can measure historical performance in a way that appropriately reflects value creation for the period. There is no choice if we are to monitor the firm’s operations over time. The roots of VBM represent improvements over traditional accounting metrics but still have their limitations. No matter how impressive a presentation, do not fall prey to strong claims for VBM metrics that a single period measure will correlate highly with firm value year in and year out. You will be disappointed.

• Successful VBM programs have certain common attributes:
  ✓ Top management support-genuine commitment not simply token involvement,
  ✓ Links to compensations,
  ✓ Investment of time and money in educating the firm’s workforce about how the program works, and
  ✓ Simplicity valued over complexity.

The tools of VBM not finely calibrated instrument. So you should view the use of your VBM system to create shareholder value more like using a tugboat no nudge a super tanker into port, rather than using a sophisticated laser guidance system to direct smart bombs down smokestacks!

Summing up, all these we can say that no value-based management system is perfect, nor do all firms derive the same benefits from implementing VBM. Measuring performance accurately is more problematic for firms in rapidly changing markets where value is tied more closely to the firm’s future growth opportunities than with its assets in place. Regrettfully, there is no “Holy Grail” when it comes to selecting and implementing a value-based management system. However, even with the above-noted limitations, there remains considerable potential for unlocking significant shareholder value in many firms.