Shareholder value: yes, but for whom?

"*The virtuous cycle of shareholder value creation*" was the title of an article published in 1997 in the McKinsey Quarterly, but also the implicit or explicit words used in thousands of annual reports (especially in CEO messages) published since the mid-1990s.[11] One of the most trumpeted buzzwords from the last decade, "managing for shareholder value" is at best a tautology – which company would dare to say it does not have to give a decent return to its owners? – and at worst a spin put on company information – and results that are sometimes not heading at all toward value creation. The simplest way to define it would be through the "profit cycle" based on income statement figures:

- Revenue > Net profit > ROE > EPS > Dividend paid (stable at worst, increased at best).

More sophisticated mathematical calculations are discussed in economic literature. A "neutral" definition of shareholder value creation is given by IESE professor Pablo Fernandez:

- Created shareholder value creation = Equity market value x (Shareholder return - Required return to equity).[12]

Whatever the definition, these last decades' burst bubbles and boom busts have cost a lot in shareholder value, except for the savviest investors and… stock-option beneficiaries. Having added the word "sustained" to shareholder value does not much change the hard realities. Especially for individual

11 "*The virtuous cycle of shareholder value creation*" by Jacques Bughin and Thomas E. Copeland (McKinsey Quarterly, May 1997), which states that "*shareholders and job seekers have a common interest: high returns on capital.*" Another example of high-return but nevertheless near-sighted and highly ideological business economics.

12 "*A definition of Shareholder Value Creation*" by Pablo Fernandez, IESE Business School (April 2001). Paper available at http://papers.ssrn.com.

investors, who now own less than 50 percent of equity shares in the U.S., down from 90 percent in the 1950s. Actually, the Enron chart profile shown above looks very much like a number of other price graphs, e.g. for financial institutions' stocks before and after the late-2000s financial crisis.

Following a few other analysts, FT commentator Michael Skapinker has also pointed to "*the short-term nature of [shareholder] holdings*", increasingly held by institutional investors, often operating under the influence of short-term driven analysts.[13] Whether they are private or institutional, investors tend to buy, trade and sell more shares in less time than in the past. "*In the old days finance was treated as a modest helper of production*," wrote Paul Sweezy, who added: "*It tended to take on a life of its own and generate speculative excesses in the late stages of business cycle expansions*."[14] Now, some refer to the system as "financialized" or as a "speculation-based" economy.[15] Lawrence E. Mitchell sums up the metamorphosis: "*Previously, a small number of equity investors had treated stocks much like bonds, preferring those with hard assets backing each share... The new form of speculation [is] based on a growing willingness to own stock issued not on the basis of productive assets or past profits but on the possibility of profits to come*," preferably in the short term.[16] Exactly what Enron was all about.

"*Shareholder value is a result, not a strategy… Your main constituencies are your employees, your customers and your products.*" Who said that? Jack Welch! Yes, the legendary

13 "*Every fool knows it is a job for governments*", in the Financial Times (November 18, 2008). Read also: "*Economic Implications of Changing Share Ownership*" by Benjamin M. Friedman (Harvard University, October 1996), available at http://papers.ssrn.com.

14 Paul M. Sweezy: "*Economic Reminiscences*", in the Monthly Review (May 1995).

15 Including Paul Sweezy, or John Bellamy Foster (see "*The Financialization of Capital and the Crisis*", on www.monthlyreview.org, April 2008).

16 In "*The Speculation Economy. How Finance Triumphed Over Industry*", by Lawrence E. Mitchell (Berrett-Koehler, 2007).

ex-CEO of GE, made famous as one of the leaders of the share holder value movement, "*a man who ruthlessly downsized and restructured in pursuit of… shareholder value.*" Words of (late) contrition? As Toronto University's professor Roger Martin puts it: "*The pursuit of shareholder value simply fails as a unifying theory to produce value in business.*"[17]

17 Jack Welch's quotation and journalist comment from India's Economic Times: "*Shareholder's value's not the issue*" (March 19, 2009). Roger Martin: "*Fixing the Game: Bubbles, Crashes, and What Capitalism Can Learn from the NFL*" (Harvard Business Press, 2011). Roger Martin is dean of the Rotman School of Management at the University of Toronto.