The importance of shareholder wealth maximization in business

In modern finance, it is proven that shareholder wealth maximization is the superior goal of a firm and shareholders are the residual claimants; therefore maximizing shareholder returns usually implies that firms must also satisfy stakeholders such as customers, employees, suppliers, local communities and the environment first (Courses Work, Corporate Finance Module, Leeds Metropolitan University). Also, Michael C. Jensen argued that " a firm's value can not be maximized if the management board or shareholders ignores the interest of its stakeholders" (Michael C. Jensen, 2001). Thus, I agree with the argument that the main goal of a firm is to maximize shareholder wealth but it does not mean that management should disregard stakeholders.

To begin with, it is necessary to understand what is shareholder wealth and why maximizing shareholder wealth is superior objective? According to Glen Arnold (Corporate Financial Management, 4th, P. 13), maximizing shareholder wealth is defined as maximizing purchasing power as well as the flow of dividends to shareholders through time and it is a long-term perspective.

In addition, a very important point to explain why shareholder wealth maximization is superior objective is that shareholders are the real owners of the firm, of course, they desire the company's operation will create their returns as much as possible; therefore, management board should make investment and financing decisions with the target of maximizing long-term sharholder wealth. " This assumption is made mainly on practical grounds, but there are respectalble theoretical justifications too" (Corporate Financial Management, 4th, P. 7).

Thus, with practical reason, shareholder wealth maximization is a precise and clear decision as well as a suitable and operationally feasible goal. Also, “ shareholder wealth is represented by the market price of a firm’s common stock” (Contemporary Financial Management, R. Charles Moyer, Jame R. McGuigan, William J. Kretlow, P. 5) and stock prices illustrate clearly about the magnitude, timing and risk connected with profits that stockholders hope to get in future, so management should drive the stock price as high as possible. Furthermore, “ the greater the risk associated with receiving a future benefit, the lower the value investors place on that benefit” (Contemporary Financial Management, R. Charles Moyer, Jame R. McGuigan, William J. Kretlow, P. 5). Thus, maximizing the present value of expected future returns to the owners is also the true target for the firm in term of reaching shareholder wealth maximization and the returns will be represented in forms such as takings of common stock sales as well as healthy periodic dividends.

Besides that, it is also important to realize that the goal of maximizing shareholder wealth has some advantages. Fistly, it explicitly considers the time value of money and risk factors of the benefits expected to receive to the owners. In other words, the elements of timing and risk must be considered by managers as they make an important financial decision, for example capital expenditures. Secondly, if a firm has a decision that can make the market price inceasing, it is a good decision. On in other hand, if it does not achieve the effective result, this should not be taken (at least not voluntarily). Finally, maximizing shareholder wealth is an impersonal aim. If stockholders oppose the company’s policies, they can sell their shares freely and invest their fund in others, however, it is noticeable that the shares should be under more favorable terms than are available under any other stratergy. Also, investors will be possible to sell their shares with the best price if they have consumption pattern as well as risk preference which is not accommodated by the investment, financing and dividend decisions of that firm. They also can purchase shares in firms that closely meet the investor’s needs.

For all above reasons, the shareholder wealth maximization is the superior objective in financial management. However, in term of theoretical reasons, many studies and financial books have proven that shareholder wealth rests on companies which are willing to build long-term relationships with stakeholders. So, focusing on the interests of stakeholders is the most important objective of the company to maximize shareholder wealth. Also, Michael C. Jensen stated that “ A firm cannot maximize value if it ignores the interests of its stakeholders” (European Financial Management, Vol. 7, No. 3, 2001, P. 298)

Firstly, customers can be seen as the top of hierarchy of stakeholders. They are one of the most important factor and greatest challenge to primacy of shareholder interests. It is undebatable that “ no company can create great wealth for its shareholders without a stable and growing revenue base, which can be only reached by having very satisfied and loyal customers” (Marakon Associates, 1993). So, a company wants to have an increasingly growing number of customers who are willing to pay money to have its products and services, it forces to meet the their satisfaction of product quality, reasonable prices, and good services. In other words, the product or service must be meet or exceeds expectations and is acquired at a price no higher than its perceived value.

Also, the grown in sales by creating value for customers will maximize the firm’s stock price in the form of efficient and courteous service, adequate stocks of merchandise (Financial Management 12th, 2008, Eugene F. Brigham and Michael C. Ehrhardt, P. 10). Therefore, the more volume of products distributed, the more shareholder value increased because of a vast profits after selling products and services.

Secondly, employees also are of vital important in stakeholder objectives of the shareholders. They are the primary workforce and the potential source of significant competitive advantage which can create the superior value directly. According to Marakon Associates, 1993, “ pursuing the objective of maximizing value for shareholders also maximizes the economic interests of all employees over time, even when maganement is forced to downsize the company”. Thus, they will be faithful and devote all their skills and talent if company’s management board appreciates their crucial role as well as give the best policies for employees including paying fair wages, maintaining fair hiring practices and safe working conditions, supporting education. In other word, “ the keys to company success is that it must be the motivation for staffs to devote the cream of them” (Financial Management 12th, 2008, Eugene F. Brigham and Michael C. Ehrhardt, P. 10).

Conversely, if the company does not give its mind to improving the employees’ lives and spirits, they will not try their best to produce quality products, resulting in failure in satisfying customers. Consequently, the amount of cash flow is poor, therefore, poor stockholder returns is indisputable.

Furthermore, one factor which will generate unforeseeably great value of a firm is the interests of society as a whole. When businesses take a long-term view, the interests of the owners and society often coincide. (Timothy J. Gallagher and Josehp D. Andrew, Financial Management: Pricnciple and Practice, fouth edition, publishied by Freeload Press, 2007, P. 11). Thus, it is absolutely indisputable that social responsibility with local communities and the environment in which the company operating are become an important consideration for the boards of companies, especially large companies, such as the source of supplies, for expamle rubber, wood, paper from managed forests as well as protecting the consumers and following the local business legislation. Therefore, the more a firm contributes social interests, the more value of trademark it generates.

Another important factor which affect directly to the company's business activity is suppliers. " Suppliers and supply chain management are both crucial to developing and implementing strategies that generate the hightest long-term cash flow" Marakon Associates, 1993. It is clearly acknowledged that suppliers will be stable and reliable partners if the managment board has a fair, reasonable treat to them. This is shown in implementing all provisions of contracts as well as pay the bills on time. Furthermore, if a firm depends mostly on imported materials, it is necessary for it to have a sustainable vendor in order to keep its operation stably.

On in other hand, the positive relation between a company and suppliers wiil be cause great damage if it always attempts to get very cheap prices, even below market levels as well as detaining payments as much as possible. Consequently, the company will receive poor quality materials in term of cheap prices and suppliers will stop supplying if they see company's fraudulent actions such as postpone payments in many times or the firm's financial resource is limited

To illustrate for the important role of stakeholders, the case of Vedan Vietnam (the company of Vedan Group, Taiwan) is one typical example for these arguements. During the operating period from 1991 to 2008 in Vietnam, Vedan has illegal discharged of 43, 000m3 untreated waste water into Thi Vai river per month on avarage. The pollution has been spread to the area along 12 kilometres of the Thi Vai River, as well as 2, 082 hectares of agricultural land in the three provinces of Dong Nai, Ba Ria – Vung Tau and Ho Chi Minh City. In addition, respiratory diseases and interstinal sickness were also increasingly common among local people.

This inhuman action resulted huge losses to the farmers who living depend on fishing, breeding aquatic creatures and building dams. And as stated in the news: Vedan Pollution Kills River Creatures: Can Gio Farmers to Sue (http://www. saigon-gpdaily. com. vn, October 23th, 2008) the company had to pay a compensation of VND1. 8 billion (US$ 92, 300 at today's exchange rate) to the farmers by the end of 2008. But the pollution continued, killing more of the farmers' shrimps and fish and leading them to the brink of bankruptcy. Farmers in Thuan An have piled up bank debts of hundreds of millions of dong.

It cannot be denied that the company’s activities destroyed the human ecology in which it operating and seriously effective for living of the locals. Consequencly, during the two first quarters of this year, Vedan has been facing a boycott the company’s products of customers and supermarket system such as Big C, Coop Mart. As a result, according to the news on thanhniennews. com (Boycott fear forces river polluter payout, 8/13/2010) the Vedan Vietnam General Director Yang Kun Hsiang asserted that they would pay 50 percent of the compensation for HCMC and Ba Ria-Vung Tau within a week after signing an agreement with the local authorities, and the other 50 percent will be paid in early next year with the total of VND30 billion to Dong Nai; VND10 billion to Ba Ria-Vung Tau and HCMC was VND16 billion.

Considedring all arguments put forward, I have finally arrived at the conclusion that the goal of maximizing shareholder wealth is the superior objective in financial maganement of a firm. Still, I strong emphasize that the firm will create shareholder wealth as much as posibble if it realizes the importance of the interests of all their constituent group or stakeholders and satifies them, not just considers to the interets of stockholders.