Shareholder wealth maximization and stakeholder capitalism model economics essay

The Anglo-American markets are described by a philosophy that a firms objective should follow the shareholder wealth maximization (SWM) model. Anglo-American is defined to mean the United States, United Kingdom, Canada, Australia, and New Zealand. This theory presumed that the firm should try to maximize the return to shareholders, as measured by the total of capital gains and dividends, for a certain level of risk. On the other hand, the firm should minimize the risk to shareholders for a given rate of return. The SWM model assumes as a universal truth that the stock market is efficient. The share price is always correct because it reflects the expectations of return and risk as perceived by investors. It quickly incorporates new information into the share price. Share prices, in turn, are considered as the best allocators of capital in the macro economy. The SWM model also treats its definition of risk as a universal truth. Risk is defined as the added risk that the firm's shares bring to a diversified portfolio. The total operational risk of the firm can be eliminated through portfolio diversification by the investors. Therefore, this unsystematic risk, as known as diversifiable risk, the risk of the individual security, should not be a prime concern for management unless it increases the prospect of bankruptcy. Systematic risk, as known as non-diversifiable risk, the risk of the market in general, cannot be eliminated. This reflects risk that the share price will be a function of the stock market.

Corporate wealth maximization model

In contrast to the SWM model, Continental European and Japanese markets are characterized by a philosophy that a corporation's objective should be to maximize corporate wealth. Thus, a firm should consider shareholders on a par with other corporate interest groups, such as management, labor, the local community, suppliers, creditors, and even the government. The goal is to earn as much as possible in the long run, but to maintain enough to increase the corporate wealth for the benefit of all interest groups. This model is also called the stakeholder capitalism model. The definition of corporate wealth is much broader than just financial wealth, such as cash marketable securities, and unused credit lines. It includes the firm's technical, market, and human resources. " as a result, it goes beyond the wealth measured by normal financial reports to take in account the firm's market position as well as the knowledge and skill of its employees in technology, manufacturing processes, marketing and administration of the enterprise." The corporate wealth maximization (CWM) model does not assume that equity markets are either efficient or inefficient. It does not really matter, as the firm's financial goals are not fully shareholder-oriented. In any case, the model assumes that long-term " loyal" shareholders should influence corporate strategy, not the transient portfolio investor. The CWM model assumes that total risk, that is, operating and financial risk, does count. It is a specific corporate objective to generate growing earnings and dividends over the long run with as much certainty as possible, given the firm's mission statement and goals. Risk is measured more by product market variability than by short term variation in earnings and share price.

Comparison of Shareholder Wealth Maximization and Stakeholder Capitalism Models

Shareholder Wealth Maximization Model

Stakeholder Capitalism Model

Based on the assumption of share price efficiency i. e. the share price in the market reflects intrinsic value and shareholders' wealth

No assumption on share price efficiency

Firm's objective is to maximize shareholders' wealth by achieving the highest possible total return to equity (including both capital appreciation and dividend distribution)

Firm's objective is to maximize corporate wealth but return to equity is constrained by the interest of other stakeholders such as creditors, employees, governments, etc.

Only systematic risk is a prime concern for management as unsystematic risk is supposed to be diversified

Total risk (operating and financial risk) is considered by management

Corporate strategies are directed by the board on behalf of shareholders

Corporate strategies are influenced by long-term stakeholders rather than mobile portfolio investors

Journal 2:

Shareholder Wealth Maximization

According to the maximization model, there are three types of maximization in a company, which are shareholder maximization, stakeholder-owner maximization and total stakeholder maximization. Shareholder maximization is a particular case of stakeholder-owner maximization, where only the pure owner interest as supplier of risk-capital is considered in the maximization. The stakeholder-owner has particular resources and interests which are important for the commitment of other stakeholders and thus for the economic performance of the venture as a whole and for the distribution of stakeholder benefits. Examples of such stakeholder-owners would include managers within the company who were also shareholders or suppliers who had an interest in the ownership of the company. Total stakeholder maximization includes the advantages for all groups, such as employees, local communities, shareholders, suppliers, customers, investors and partners.

Among the three maximization of a company, shareholder wealth maximization plays a significant role and indeed more important than the other two, which are stakeholder-owner maximization and total stakeholder maximization. Many assume that total stakeholder maximization is the most important maximization for a company, yet in reality, such maximization is not easy to achieve. Under the new field of corporate social responsibility, many company are encourage to take the interests of all stakeholder (not only shareholder) into consideration during their decision making process. This is a process where the conflict of interest between shareholder and stakeholder eventually happen. For example, if the general public is part of the stakeholder considered under corporate social responsibility (CSR) governance, a conflict might occur when the company decide to carry out operation that would increase the profit of the company, specifically shareholder but at the mean time the operation may cause more pollution to the environment, which is at the disadvantage of the public (the stakeholder). In short, total stakeholder maximization can be hard to achieve as a profit and earning for a group of the stakeholder (shareholder) can sometime be the disadvantage and loss of another group of stakeholder (group other than shareholder) or vice-versa.

The general type of maximization that companies pursue is stakeholder-owner maximization. Maximization of shareholder value is actually a special case of stakeholder-owner maximization. Under restrictive assumptions, the shareholder maximization is larger or equal to stakeholder-owner maximization. Generally, the main objective of most companies is to maximize its value to its shareholders. Value is represented by the market price of the company's common stocks, which is a reflection of the firm's investment, financing, and dividend decisions. Otherwise, the companies should minimize the risk to shareholders for a given rate of return. In reality, companies are more concern about shareholder wealth maximization as this is what the company is portraying to the public. Take an example, if a company focus more on its stakeholder-owner maximization rather than the shareholder wealth maximization, the shareholder (including general public who own an amount of the stock of the company) may gain less or no profit and in some cases even suffer a loss. In this situation, it can bring a negative influence to the perspective of others towards the company which will then lower the value of the company and in the long run, curbs the development of the company.

In conclusion, shareholder maximization is more important than the others. This is because shareholders are solely the holder that finance a company or provide finance for a company development. However, stakeholder-owner maximization too must be taken into consideration as they may be the human resources or the resources that mainly contribute to the performance of a company.

Journal 3:

Is Shareholder Wealth Maximization immoral?

Shareholder Wealth Maximization

A company that implements shareholder wealth maximization indicates that its goal of management is strive to maximize the return in term of capital gain and dividend paid to its shareholders.

The ultimate objective of all activity within the firm is the maximization of shareholder wealth. However, financial economists should be increasingly aware of growing dissent from, or at least equivocation on, that standard finance definition of corporate objectives.

The idea in shareholder wealth maximization model is that shareholders are the group that take the greatest risks and thus deserves special treatment is a fiction.

In shareholder wealth maximization model, managers make decision on the basis of stock price maximization. The first myth is that making decisions on the basis of stock price maximization is amoral, that is morally value neutral. The second myth is one commonly held by business ethicists, namely, that decisions premised on shareholder wealth maximization are strictly immoral.

The myth that making decision on the basis of stock price maximization is morally value neutral held by financial economists because belief in it can exempt them from any moral self-examination. Shareholder wealth maximization serves as a conduit of ethics rather than a net determinant of ethical behaviour.

Besides, every firm strive to pursue shareholder wealth maximization leads to maximum aggregate economic benefit, they think that it's not just benefit to the shareholder but also the society. This will come about as scarce resources are directed to their most productive use by businesses competing to create wealth. The implication of such a defense is that shareholder wealth maximization is morally neutral. In addition, a manager acting in accordance with shareholder wealth maximization is not exercising any particular moral judgment. For example, the manager makes decision that act in the interests of whoever has the greatest economic influence on the company's stock price.

On the other hand, the business ethics literature clearly rejects shareholder wealth maximization as an ultimate justification for decisions in business, and they apparently proffer some more ethereal, less material ultimate justification as an alternative.

Besides, as a justification for behavior, shareholder wealth maximization is rarely sanctioned by business ethicists because this model just emphasis on the interests of shareholders. This model focuses on the equity market value which is revealed in the company's stock price. A manager pursuing shareholder wealth maximization is concerned with anything that affects the company value. In fact, stock price is increasingly being determined by a series of intangible factors such as employee relations, credit quality, environment sensitivity, product reliability, cultural sensitivity and whatever society values.

A management group that is insensitive to the needs and concerns of stakeholders will not flourish financially and, of course, a company that does not flourish financially will not be able to help stakeholders. So, shareholder wealth maximization is not morally neutral and not simply immoral. It neither favors strictly material objectives, nor does it unfairly favour stockholder over other stakeholders.

In accepting shareholder wealth maximization as the objectives, business professional should not abrogate all moral common sense when making any decisions. Only through sound moral judgment on the part of individual managers can the organizational premise of shareholder wealth maximization be morally justified.

Journal 4:

Globalizing Asia: Towards a New Development Paradigm

Journal 5:

The U. S. Capitalism Model Has Failed

Stakeholder Capitalism Model

Stakeholder capitalism model says that company should make decisions by taking into account the interests of all the stakeholders in the firm. Stakeholders include all individuals or groups who can significantly affect the welfare of the firm in the aspects of not only the financial claimants, but also employees, management, customers, local community, supply chain members, local or national government and creditors. One of the important variables in this model is considering all stakeholders' interest as they are people who support and sustain the company.

In the stakeholder capitalism model, it is argued that firms should pay attention to all their supporters that can affect the firm. Managers and boards of directors of company have vital roles on making decisions that suit multiple competing and inconsistent constituent interests. However, there are different demands and interests from stakeholders. Customers want low prices, high quality, expensive service and so on. Employees want high wages, high quality working conditions, and fringe benefits including vacations, medical benefits, pensions and the rest. Suppliers of capital or known as shareholders want low risk and high returns. Communities want high charitable contributions, social expenditures by firms to benefit the community at large such as build hospital, donation, stable employment provided, increased investment, and so on. In making these critical decisions, company must specify how to make the tradeoffs between these often conflicting and inconsistent demands from various stakeholders.

Many managers and directors of organizations still embrace stakeholder capitalism theory even will be failed at last if they are competing with firms that are behaving so as to maximize value. The theory allows managers and directors to manage company resources in the way they like because the management of the resources in stakeholder capitalism model is inexplicable. Therefore, this allows self-interested managers to pursue their own interests at the expense of society and the firm’s financial claimants. It may permit managers and directors to invest in their favourite projects that diminish firm value. As a result, agency cost increases because management of company does not act in shareholders’ interest. Management is given free authority to do almost whatever they want to. So, they may not follow or implement what shareholders require them to do. The other variable is free power. Managers are empowered to exercise their own preferences in spending the firm’s resource. If the management uses the authority given wisely, company will sustain growth and vice versa.

I would prefer stakeholder capitalism model because not only owners, investors, and managers able to share profits but also employees, suppliers and other individuals or groups that related to firm. In stakeholder capitalism model, employees are involved in management decisions and profit distribution. The benefit of the stakeholder capitalism model is cooperative relationship between employees and management that allows steady productivity for sustainability of the firms.

If there is few goals such as maximize profits, market share, growth in profits, and others, this will make management has no idea what to achieve. The management cannot focus on a single goal thus makes the firm inefficient. As to solve this, firm can specify the tradeoffs among different groups of stakeholders. Effects of the decisions no matter good or bad that are affecting firm are listed out. For example, cash flow, operating and financial risk which are the main concerns of every corporation. Another variable is single goal. Single goal set allows company to concentrate on accomplishing single purpose as to satisfy stakeholder's interest and it requires a deep knowledge on choosing the single goal to achieve.