Stakeholder interest and wealth

Until now, the discussion between shareholder value perspective and stakeholder perspective has still been argued critically. Some people think that stakeholder interest should be superior over shareholder wealth maximisation , but others argue that shareholder wealth maximisation should be the prime concern. However, it is obvious to realize that shareholder wealth maximisation is the objective of a firm and shareholder wealth maximisation should be superior over stakeholder interest in the concern of the both shareholder interest and stakeholder interest.

Firstly, it is necessary to understand some definitions of shareholder , stakeholder and the theory of shareholder and of stakeholder . Why there has been many debates between two theories ?

Shareholder is an individual or corporation owning stock in a public or private company. Shareholder decides the membership of the board of directors by making a vote. (McGraw – Hill , 2003). ” Maximising shareholder wealth means maximising the flow of dividends to shareholders through time – there is a long-term perspective “. (Glen Arnold, 2008).

Stakeholder are groups and individuals who get benefit from or are harmed by, or whose rights are contravened or regarded by, corporate actions . The list of stakeholder commonly includes customers, employees, suppliers and the community like shareholders and other investors.

As stated by Frederick R. Post , shareholder theory supports that management is allowed to ignore the interest of the the other constituencies while pursuing the interest of the shareholder owners. Moreover, in the perspective of finance, shareholder wealth maximisation is accepted as being obvious logically (Anant K. Sundaram , Andrew C. Inkpen, 2004) .

The stakeholder theory has initial root in the research involving business , society and ethics. The first argument is supported to this theory by Freeman (1984). The stakeholder theory says that managers should pay attention to all stakeholders in a company , including not only financial claimants, customers, communities, governmental officials but also under the environment, terrorists or even blackmailers (Michael C. Jensen , 2001). According to Thomas L. Carson, corporation should be operated for all stakeholders, not just for the shareholders.

However, here are some misled understanding of shareholder theory and stakeholder theory needed to be explained . Sometimes people think that manager can do everything as long as getting profit regardless of ethical issue. But the shareholder theory forces manager to raise profit only through legal, nondeceptive means (Friedman, 1962) . Moreover, it is sometimes said that shareholder theory is not willing to give corporate funds to charitable projects or training employees, but in reality when employees are trained , their skills are improved and maybe the effective work is better then ever before. Also the stakeholder theory is misunderstood that it does not require a firm to focus on profitability. Although the primary objective of the stakeholder theory is the concern of involving parties, it must be attained by balancing the interest of all stakeholders including all shareholders.

In my opinion, shareholder wealth maximisation should be a superior objective over stakeholder interest . Some academic argue that there is a factual and normative consensus 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 interest” (Hansmann and Kraakman, 2000, pp 1 and 9). The logic in factual consensus shows that economic compels managers to maximise shareholder wealth by mass series of different propositions like that firms can be operated effectively thanks to perfect competitive markets for goods and services . After that the pursuit of economic efficiency creates firm-wealth maximisation and the firm wealth maximisation matches shareholder wealth maximisation (Sundaram and Inkpen, 2004). Then competitive market also puts pressure on managers to maximise shareholder wealth. The logic for standard consensus illustrates that economic efficiency maximises social welfare. However, the market is not perfect , there are many conflicts of interest that shareholders can benefit by taking from other stakeholders. For instance, they can renegotiate contracts under changed conditions or adopt an investment policy that redistribute wealth from other stakeholders. Doing favour to shareholder is dependent on their situations., firm’s shareholders are closer to financial default which does not care much their reputation . With the assumption is that perfect competitive market, any firms always want to increase share prices benefits shareholders . It is carried out by selling, buying or holding their shares. But if we skip these assumptions, unanimity can leave. Foe example, if managers know something that investors do not know and realise that the intrinsic value in the stock is higher than its market value. Therefore, what shareholder wealth maximisation is unclear. It depends whether shareholders want to keep or sell their shares. If shareholders want to sell, managers could involve in various costly signaling actions to correct the potential mis-pricing. Adversely, if shareholders do not want to sell, signaling activities are less logical. We also raises questions about the experiences foundations that managers are not even willing pay lip services that they want to maximise shareholder wealth. Because for whatever reason, managers are not ready to publicly approve shareholder wealth maximisation with much enthusiasm. In contrast, they prefer to seeking several targets and shareholder wealth is often not one of them. Furthermore, they are reluctant to show ranking for the various targets they pursue, and even if they do, there is still less evidence that shareholder wealth maximisation plays the top priority .

The stakeholder theory also has drawback like that how to realise corporate social responsibility , for example how to consider all stakeholder's interests appropriately which is often flawed in that they do not take into account the various essential conditions and institutional restrictions of corporate decision making as to the problems of behaviour by the people who influence corporate decisions. Moreover, corporate governance is involved in how business company should be controlled legally. Management has a fiduciary task to serve the interest of shareholder and shareholder wealth maximisation should be objective of the company prescribe how strategy and investment decisions can be made. They show us little about how managers actually do their duty of managing a company to create value for shareholder . There are some ways that stakeholders can be treated unfairly, and each unequal treatment might rise efficiency at the expense of another. Thus, economic system is required to ensure the basis fairness and managers have responsibility to behave toward all stakeholders with fairness and moral concern. A situation can be caused for stakeholder management, then if these legal obligations are insufficient to make sure the equal treatment of all stakeholders. Just corporations should defend and assist the interest of all stakeholders, they should behave all stakeholders fairly.

From the above definitions, we can see that shareholder is one of the dimensions of stakeholder. But if we thinks that considering stakeholder interest as superior over shareholder wealth , it also means we must pay attention to all objectives of stakeholder interest . It is difficult to practice this because various stakeholders has conflicting or different objectives . Shareholder wealth maximisation is a single-value objective focusing on the owners of a company. Shareholder wealth maximisation supplies guide of workable decision as well as support the total value creation of the firm if pursued. In turn, it promote each group reach a greater share. Employees who finding expanded benefits are more likely to obtain these goods if the firm is prospering. And the same argument can be developed with suppliers, customers or investors and other stakeholder group It does not mean that stakeholder is disregarded comparing the owners. Reversely, the interest of other constituencies is needed being aware but the owner is considered first. Because the objective of a firm is to maximise shareholder wealth in the long run , and the shareholders is real owners of a firm. They establish a company to get profit . But to get profit , they must have management strategy for community, employees and customers. Therefore whether they operate their company in which way , the final objective is always to maximise shareholder wealth. The problem is that should we view shareholder wealth maximisation as higher-ranking objective than stakeholder interest or just taking into consideration shareholder value maximisation ignoring the interest of other constituencies ? The answer is that shareholder wealth maximisation should be a superior over stakeholder's interest combining the taking account of other constituencies. Furthermore, to get shareholder wealth maximisation in the long run, a company must care customers, environment. It is obvious that in reality, a company want to survive and operate successfully , it should have many strategies to pay attention to customers such as after-sale services, promotion.

Enron case is a remarkable example to show the failure of shareholder theory in pursuing shareholder wealth maximisation not paying attention to stakeholder's interests. 2001 was the year with the largest bankruptcy reorganisation in American history, it made stock price fallen and Enron is a superlative illustration of largest financial fraud. Enron's stockholders and employees are the most visible victims, and 4000 employees were quitted around the bankruptcy time . Besides, the failure of Enron was because of that the pursuit of intermedia shareholder wealth made it involved risk prone and caused to misapply economics . It requires too much from strategies with regard to the increase in earnings per share. Academic explains shareholder wealth in the mention of management practices that increase productivity. In recent year for fair investors, the practice of shareholder wealth maximisation does not mean patient investment. As an alternative it gets obsessed with short term showing numbers.

In Vietnam, Vedan case is also extraordinary example in the showing the failure of not paying the environment. It is a Taiwanese company specialising in producing monosodium glutamate in Vietnam. Vedan Vietnam was discovered discharging thousands of cubic meters of untreated toxic wastewater directly into the Thi Vai River for nearly fourteen years . It polluted seriously the river basin resulting in economic damage, negative effects on life and health of farmers in the region. As the result, Vedan company must pay 120 millions offered by the damaged provinces. And vedan company agree to pay condensation from now to 2011. And there is worthy-sad truth is that Vedan has been being boycotted gradually in Vietnam. These are two examples making clear that the failure of pursuit shareholder wealth maximisation not caring community. Besides, there are still lot of companies running successfully for a very long time because they know well how to maximise shareholder wealth accompanying care of other constituencies .

In conclusion, shareholder wealth maximisation should be a superior objective over stakeholder interest. However, to get maximise shareholder wealth in the long run, a firm must pay attention to stakeholder interest . Therefore, a firm want to operate successfully, besides maximising shareholder wealth, it should satisfy the interest of stakeholders.