In Defense of Shareholder Wealth Maximisation

Diane Denis
London Business School
Centre for Corporate Governance
May 10, 2019
Why do people hate corporations?

- Undue accumulation of power
- Lack of accountability
- Societal ills
- Negative outcomes
- Corruption & fraud
Corporate governance

The set of mechanisms that ensure that investors of financial capital earn the highest possible returns on their investment.

→

Managers should act to maximize shareholder wealth.
Defending Shareholder wealth maximisation

Implications for other stakeholders
• Shareholders as residual claimants
• Shareholder primacy is a misnomer.

Other influences on managerial decision-making
• Media
• Government
Example:
Employees as direct stakeholders

- Underpayment → Low product quality
- Edmans (2012): “The Link Between Job Satisfaction and Firm Value, With Implications for Corporate Social Responsibility,” *Academy of Management Perspectives*
- Overpayment → High product price
- Market wages → Stakeholder governance = Shareholder governance
Problems with non-market solutions

1. What is the decision rule?

2. Cannot be sustained in competitive market
   - Factors of production move to their highest-valued uses.
   - Bargaining power is related to other opportunities and ease of movement.
   - Equity capital is a factor of production.
Shareholders as short-term investors

• Value of shares reflects long-term expected cash flows.
• Stock prices react quickly to changes in circumstances.
• Share ownership is available to all participants.
Financial development & economic growth


Criticisms of market solutions

• Externalities

• Inefficiencies

• Corruption & fraud
Media & corporations

Media influence

• Indirect
• Disseminate information
• Shape opinions
Government & corporations

Government influence

• Direct
• Regulation
• Incentives
• Taxation
Appropriate government roles

- Externalities
- Information inefficiencies
- Corruption & fraud
Finding the balance

- Shareholder governance & corporations
- Corporations & society
- Effective shareholder governance requires
  - Market participants who understand
  - Transparency and information dissemination
  - Enforcement of the rule of law
  - Dialogue re: conflicts