

Down With Shareholder Value

By JOE NOCERA

I've been known to say that I was present at the creation of "shareholder value."



It's an exaggeration, of course. But in 1982 — literally half a lifetime ago for me — I wrote an article about the first big takeover attempt by T. Boone Pickens. One of his central justifications for the takeover movement that he helped spawn was that company managements didn't care enough about the company's owners, aka the shareholders. Their cash-based compensation wasn't properly aligned with the desires of shareholders. Shareholders, he believed, need to assert their primacy — and force executives to start paying attention to the price of their companies' stock. I later learned that Pickens was not the first person to make this argument — academics had already created the theory that undergirds it. But, at the time, it was still a pretty radical view.

As the expression goes, be careful what you wish for. Shareholder value has long since become the mantra of the business culture. Corporate boards shower executives with stock options to "align" them with shareholders. "Underperforming" companies find themselves under siege from activist investors. Increasing shareholder involvement is viewed as the way to fix whatever ails corporate governance. Over time, "maximizing shareholder value" became viewed as the primary task of the corporation.

And, well, you can see the results all around you. They're not pretty. Too many chief executives succumb to the pressure to boost short-term earnings at the expense of long-term value creation. After all, their compensation depends on it. In the lead-up to the financial crisis — to take just one extreme example — financial institutions took on far too much risk in search of easy profits that would lead to a higher stock price.

Now, though, it feels as if we are at the dawn of a new movement — one aimed at overturning the hegemony of shareholder value. Lynn Stout, a Cornell University law professor, has written a new book, "The Shareholder Value Myth," in which she argues that there is nothing in the law that supports the idea that shareholders should be the only constituency that matters. Other academics, such as Roger Martin, the highly regarded dean of the Rotman School of Management at the University of Toronto, are critical of the emphasis on shareholder value. A number of chief executives, such as Howard Schultz of Starbucks, have said that companies need to have a larger purpose than merely raising the stock price.

And, most recently, in the Harvard Business Review, Jay W. Lorsch, a professor at Harvard Business School, and Justin Fox, the editorial director of the HBR Group (and a former colleague of mine at Fortune), published an article entitled, "What Good Are Shareholders?" Not much, is their answer.

One of their arguments is that the calls for increased shareholder democracy are misguided; shareholders, they write, simply aren't particularly well-suited to be "corporate bosses." They are too diffuse, and too short-term-oriented, especially now that high-frequency trading dominates the market. Indeed, despite the increased emphasis on shareholders the past few decades, companies haven't gotten noticeably better.

A second argument, though, is that the central idea that led us to elevate shareholders above all others is off-base. According to the reigning academic theory, shareholders are "principals" and management serves as their "agent." Thus, it is the job of the principals to keep the agents in line. But, said Fox, "The more you treat executives that way, the more they are going to act like mercenaries, and the more they get away from seeing themselves as stewards of an organization with lasting value."

"Look at almost any company that has lasted," he continued. "It is inevitably because executives see themselves as trying to move the organization forward, and not because they are incented by their pay package to maximize the share price."

Lorsch, for his part, says that he believes that "the function of business in a society is not just a return to investors, but to provide goods and services, provide employment, pay taxes, and so on." A half-dozen other business school professors I spoke to held similar views. To the extent this new movement is taking root, it is in business schools.

Still, it is hard to know yet whether this new movement will have legs. Measuring chief executives on the basis of their companies' stock prices is easy to understand — that was always part of its appeal. Those who want to change that, including Lorsch and Fox, have struggled to come up with breakthrough ideas that would be similarly appealing. Besides, shareholder value is so deeply entrenched, it will be difficult to dislodge.

On the other hand, the other day, Marissa Mayer, the new chief executive at Yahoo, ordered that the stock ticker be removed from the company's internal home page. "I want you thinking about users," she told employees, according to The Wall Street Journal.

That's progress.
