Exploratory Note 6
Shareholder Primacy – Theory and Implications

INTRODUCTION

What, if anything, is the social responsibility of business? This question has been long been considered by academicians and practitioners alike; however, there is no definitive answer to speak of—that is, at least, not as of yet. But, in finance, though there are different perspectives to be sure, there is far less debate: there is no social responsibility of business beyond maximizing shareholder value.

SETTING THE STAGE – A FEW CINEMATIC CLIPS

Before delving into the theory, let us consider a few clips from *Other People's Money* and *Wall Street*—the latter of which has had a notable impact on the mindset of financiers for nearly three decades.

What do you think of the different mindsets?

STOCKHOLDER THEORY

Now, thinking back to your introductory course in finance: what is the primary concern of financial managers?

How are we to operationalize such a purpose?

Aside from the fact that the introductory textbook said so, why should this be the case? Consider Milton Friedman, a Nobel Laureate and dominant proponent of shareholder primacy:

> "[T]here is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud."

Further:

> "In a free-enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which generally will be to make as much

> money as possible while conforming to their basic rules of the society, both those embodied in law and those embodied in ethical custom."

Does such a strong fiduciary duty exist?

From the perspective of stockholder theory, is there room for any of the following: increasing salaries or wages, making corporate donations, or cutting down on pollution?

STAKEHOLDER THEORY

While Friedman and the idea of stockholder theory are extraordinarily strong in their influence over the discipline of finance, their reach is limited—in fact, many disciplines regard the idea of shareholder primacy as being much too narrow and, accordingly, prefer the several variants of stakeholder theory.

What are the different stakeholders in a business?

Ignoring executive window-dressing, do stakeholders matter? If so, do they matter more than shareholders?

Consider downsizing: if it is in the best interests of the firm's financial condition to downsize, should job losses stop management from making changes deemed necessary?

What about offshoring? What are the tradeoffs? Do the pros outweigh the cons?

CONCLUSIONS

For better or for worse, finance is very much a shareholder-centric discipline at present. Over time, this may or may not change; however, for the foreseeable future, this is very much a mindset to which entrepreneurs will need to become accustomed if outside money is being utilized.