THE VALUE-BASED MANAGEMENT APPROACH: FROM THE SHAREHOLDER VALUE TO THE STAKEHOLDER VALUE

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ABSTRACT
The ongoing discussion about the adequate management form and the purpose of organizations in the contemporary postmodern society have once again gained in importance and interest after the financial crises of 2008. Different management concepts have been developed throughout the time, which propose objectives for organizations and thus managerial goals, activities and decision making. Considering the value based management approach and the stakeholder theory, we propose a shift in the value based management: from shareholder value to stakeholder value.

KEYWORDS: *value based management, value maximization, stakeholder, shareholder.*

JEL CLASSIFICATION: *G32, L21, M14*

1. INTRODUCTION

Value Based Management (VBM) represents a modern approach in the governance and steering of corporations, focused on value creation. CIMA (2004) defines the concept as „a managerial process which effectively links strategy, measurement and operational processes to the end of creating shareholder value". VBM provides consistency of mission, strategy, culture, communication, organizational structures and decisions process, but most of all it enables performance measurement and alignment of the performance with reward and motivation instruments. This leads to concentration on three main components: *creating value, managing for value* and *measuring value*. VBM generates long-term changes in the business processes, in the organizational values and in the manner of assuming responsibility. Haspeslagh et al. (2001) reaches the conclusion that VBM is more about cultural than about financial change. Depending on the corporate purpose and the values prevailing in the firm, the implementation of VBM is different for each company. The corporate purpose can either be economic (shareholder value) or it can aim at other constituents directly (stakeholder value).

Academic literature is focused on two different approaches in VBM: *shareholder value approach* (Friedmannian theory) and *stakeholder value approach* (prior works of Freeman, 1984, Mitchell & Agle & Wood, 1997 or recently the refined model of Fassin, 2009). Based on this theoretical foundation, we witnessed an ongoing discussion about the appropriate form of management in contemporary postmodern society. The theory has gained in importance and interest once again throughout and after the financial crises, shareholder oriented management being held

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responsible for many of the inadequate or erroneous approaches, that lead to these fatal developments.

2. SHAREHOLDER VALUES: ECONOMICAL POSITIVISM

The concept of Shareholder Value was defined 1986 by Rappaport in his work "Creating Shareholder Value". The basis of this theory is the shareholder and his interests, that are seen as the centre of all strategic actions. Shareholder value considers profitability hence value creation exclusively from the shareholder or investor perspective. This objective prevails over the other responsibilities of the corporation. Organizations are seen as instruments of their owner, therefore they have to deliverer value for them. Value within this concept is measured with share price, dividends and economic profit. The basic assumption is that the role of organizations within a society is economic efficiency and through maximizing shareholder value also the social wealth will be maximized. It does not out rule the interest of stakeholders and the responsibility towards them, but it sees these interests rather as a means than as an end itself.

The financial benefit for the shareholder is the single most important goal, that can be reached through the long-term maximization of company value. Company shares represent investment decisions with an upfront payment, while all future paybacks come in form of dividends and/or growth of share prices (Schneider, 1992). This view assumes that shareholders will invest in those shares that promise the highest cash flows under a certain risk-gain profile.

The evolvement of this concept to a leading one has two reasons: firstly it gave an answer to the fundamental question which factors are the main drivers for company success; secondly it was a reaction to certain environmental developments in the end of the 1980s. Koslowski (1999) sees three main developments:

- As a consequence of globalization, competition regarding capital increased considerably.
- The organization control tightened and company takeovers increased, so it was dangerous for management not to commit to shareholder value and not to act accordingly.
- Based on the first two aspects, the pressure put on by shareholders on the management for a higher orientation towards competitiveness grew.

The concept of shareholder value answered the question regarding how to considerate shareholder interests, namely through maximization of company value. The reasons for this answer were:

- following the interests of shareholders the risk of equity withdrawal from the company is minimized;
- shareholder value management will positively affect the company market value and thus prevent under-evaluation on the stock markets based on inefficiencies;
- the control function played by the capital markets provide a higher congruence between the interest of shareholders and managers through competitive efficiency. This also leads to interest protection of small shareholders that otherwise wouldn't have influencing power.

The mentioned congruence respectively incongruence between the interest of shareholders and managers is a decisive point in the shareholder concept. The theoretical basis for this can be found in the Property Rights Theory and Principal-Agency Theory (Picot et al., 2008).

3. A SECOND CHOICE: THE STAKEHOLDER VALUE–BASED MANAGEMENT

Shareholder value concept always had its defenders and its critics, but it has never been so much criticised as throughout and after the financial crisis 2008. Many of the mistakes made in this time have been attributed to this concept. The main points can be dividend in methodological and content based critique:

a) Methodological critique points refer mainly to data completeness and data reliability (Janisch, 1992, p.96).

In order to calculate company value, complete and transparent data is needed. A complete information basis is often an issue, because of information asymmetry.

Data reliability is also problematic, because in order to use the shareholder value methods, assumptions have to be made regarding future profits and environment developments. Deviations between assumptions and reality can have high impacts and should be seen as inherent to the system. Main factors that are under deviation risk are assumptions regarding: operative cash flows (Brune, 1995), capital costs (Bischoff, 1994), assumption period and residual value (Copeland et al. 1998).

b) Content critique points mainly refer to the underlying management understanding. Especially the solely concentration on quantitative measurement instruments, the short term orientation of companies and the monistic objective systems have been widely criticized.

Regarding the quantitative issue Eccles (1991) noted: „What gets measured gets attention, particularly when rewards are attached to the measures.“ None of the qualitative aspects that have high impact on business success are factored in, like customer satisfaction, company image, innovation potential etc.

The short term orientation that arises can lead to underestimating all projects that have longer break even points, like investments in innovation and research (Bleicher, 2004).

The monistic concentration on value for shareholders has been criticized by many authors and practitioners, because it leads to neglecting other stakeholders, that might be of key importance to the autonomy, to the development potential and thus to the survival of the company (Bleicher, 1991).

Clarkson (1995) defines a company "as a system of [...] stakeholder groups, a complex set of relationships between and among interest groups with different rights, objectives, expectations, and responsibilities...." and emphasizes the importance of stakeholder as "...the corporation's survival and continuing success depend upon the ability of its managers to create sufficient wealth, value, or satisfaction for those who belong to each stakeholder group, so that each group continues as a part of the corporation's stakeholder system. Failure to retain the participation of a [...] stakeholder group will result in the failure of that corporate system..."

Stakeholder value emphasizes the necessity of a broader responsibility than just the achievement of profitability, seeing the organization as a responsible entity that serves all parties involved. The concept was developed in USA in the 1950's as a response to shareholder value. The basic assumption is that social responsibility is an organizational matter and that society is best served by pursuing joint-interests. The profitability represents a very important way for creating value but is merely one of the points to be considered. A company is not seen as an instrument for its shareholders, but as a coalition between various suppliers and interest groups. Post et al. (2002) define the term "Stakeholder" as: "individuals and constituencies that contribute, either voluntarily or involuntarily, to its wealth-creating capacity and activities, and that are therefore its potential beneficiaries and/or risk bearers".

Robert Wood defined in 1950 four main stakeholder groups "...customers, employees, community, and stockholders...". He states that when the needs of the first three groups are satisfied, the forth group, the stakeholders, profit in the long term. This point of view is the centre of stakeholder value theory. Freeman (1984) defined stakeholder as „"...any group or individual who can affect or is affected by the achievement of the organisation's objectives...". Less broad definitions define stakeholder as only those groups that have an economical relevance to the success of the company.

The development of the stakeholder value concept can be interpreted as an answer to the shareholder value concept. It takes up some of the critique points addressed to shareholder value management, but it also has its weaknesses: firstly the basic question arises if interests other than the ones of stakeholders are of that importance that they should be implemented in the corporate objectives; secondly the implementation is difficult because of operationalisation and complexity issues (Friedman, 1970):

a) Attempts have been made to find a quantitative measurement system in order to safeguard the operationalisation of this concept, but still there is no satisfying answer. Some examples are the Stakeholder Value Added Model by Figge (2002) or Market Adapted Shareholder Value Approach by Wellner (2001). Scorecard models like the one from Kaplan and Norton (2004) have helped though introduce stakeholder value into company steering.

b) The implementation is very complex due to certain factors like defining the relevant stakeholders and their needs, which are usually dynamic and heterogeneous. This often leads to objective conflicts and thus to problems regarding benefit optimization. The answer of how to balance the divergent interests has not been given yet.

On top of that the management is in a double role: on one side they are responsible for fulfilling the needs of all relevant stakeholder groups, on the other side they are a stakeholder group themselves. Thus they are in a conflicting position.

Related theories have been developed based on the Stakeholder Value concept like “Corporate Social Responsibility” that takes into consideration the impact of organizational activity on the environment and on the society. Another theory was founded by Elkington (1997). He called it “Corporate Accountability” in which he demands the issuing of sustainability reports from all significant organizations. In the last few years more and more companies issue such a report. Studies made by Kolk et al. (2005) show that while 1999 only 35% of companies issues such a report, 2005 the number increased to 52%. On a political scale this subject gained in importance. For example the European Committee has approved certain rules about the integration of sustainability reports on a European level. In the same time also the capital markets recognized the importance of this topic, as they introduced a sustainability index in 2008.

4. CONCLUSIONS: SHAREHOLDER VALUE VERSUS STAKEHOLDER VALUE

The literature review indicates that the obvious difference between the two approaches consists in the orientation of management responsibility, seen as a contractual obligation by the supporters of the first concept and as a moral obligation by the followers of the second approach. However, the argument for determining which concept is the most appropriate one is not finished yet.

Bötzel and Schwilling (2000) argue that maximization of company value should be the only objective, while all other objectives should be put on second place. Copeland et al. (2001) as well as Pitman (2003) note the importance of having only one main goal for the company. They reason that more goals trigger confusion, inefficiency and loss of competitiveness. On the other hand Jensen (2001) and Friedman & Miles (2002) argue that if managers want to maximize company value for the shareholder in the long run, they have to also represent the interests of the main stakeholder groups like employees, clients and suppliers. Collier and Agyei–Ampomah (2007) emphasize the implicit social contract between organizations and society and thus argue in favour of stakeholder value.

Claes (2008) enumerates authors from the academic literature (e.g. Cools & Van der Ven, 1995; AICPA, 2000; Copeland et al., 2001; Jensen, 2001; Wallace, 2003) who explained why companies that try to satisfy the interests of many stakeholder groups end up not completely satisfying any of them. At the same time these authors admit that companies cannot ignore the needs of stakeholder groups.

Wallace (2003) balances both concepts, arguing that companies have to first satisfy the shareholders in order to be able to satisfy the main stakeholder groups. From a different point of view he notes that up to a certain point the higher the benefits for the stakeholders, the more value for the shareholders.

While not judging them in terms of supremacy, we consider that in a time of fundamental economic and social change, the stakeholder view is the most appropriate framework for strategic thinking, likewise the value based management approach.

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