Debate: Should Business Schools Teach Students to Maximise Shareholder Value?

Since the financial crisis, the merits of shareholder value maximisation have been called into question. Is it the most effective path for sustainable business growth or should we consider alternatives?

The idea that the objective of the firm is to maximise shareholder value has become the centre of fierce debate. It has been blamed for creating short-term incentives that force companies to take unnecessary risks and for contributing to a widening wealth gap.

Even Jack Welch, the former CEO of General Electric and widely regarded as the personification of the idea that the firm’s purpose is to maximise shareholder returns has called it the “dumbest idea in the world”.

Proponents, however, point to the risk that shareholders take when investing their money in firms. They maintain that companies must be attractive to raise capital and must remain nimble in an increasingly competitive landscape. Prompting the question, should shareholder value maximisation be the aim or the byproduct of a competitive pursuit of economic gains for firms?

In the following in-depth articles, our experts debate whether students should only be taught shareholder value maximisation as the purpose of the firm or whether it is time to consider alternative models that could be more effective at achieving sustainable business.

"We should teach our students that there are alternatives to the view that the purpose of business is shareholder value maximisation"

David Rönnegard, INSEAD Visiting Scholar & N. Craig Smith, the INSEAD Chaired Professor of Ethics and Social Responsibility

Educational and professional institutions have significant influence in setting norms for legitimate organisational practices. In this sense, business schools play an important normative role when they convey the paradigms through which managers should analyse the corporate environment. If business school students only get taught that shareholder value maximisation (SVM) is the purpose of the firm, then this is the most likely lens through which they will see their future professional roles.

What is often left out from such a lesson is that profit is not the same as shareholder value and furthermore directors are unlikely to face a legal requirement to maximise shareholder value. Intellectual honesty demands that this be taught. CONTINUE READING

"Maximising value for shareholders is the best way for firms to stay competitive and
Theo Vermaelen, INSEAD Professor of Finance

In a recently published paper Craig Smith and David Rönnegard argue that business schools should teach stakeholder value maximisation, on equal footing with the current practice which focuses on shareholder value maximisation. Their argument is basically a legal one, arguing that recent changes in legislation no longer specify that board members have a fiduciary responsibility to maximise shareholder value. They also point out the existence of so-called B-corporations (Benefit corporations) in the U.S. who make the explicit promise to make a positive impact on society at large.

However, in our finance courses we don’t teach shareholder value maximisation because it is a legal obligation. We teach it because other objective functions are not sustainable in a world with a competitive labour market for CEOs and a competitive market for goods and services.

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