



Unilever: Why Firms Should Maximise Shareholder Value

If firms lose sight of shareholder value maximisation, they make themselves vulnerable to takeover.

Finance professors tell students that they should maximise shareholder value. Note that this is not the same as maximising profits, a short-term, accounting-driven performance measure. Shareholder value is the present value of expected cash flows from now until infinity, clearly not a short-term concept. In an efficient market, the market value of equity should be equal to shareholder value. If managers believe it's not, in particular if market values are below shareholder value, managers should buy back stock.

One of the reasons we argue that MBAs should focus on shareholder value maximisation is that failure to do so will create an arbitrage opportunity. A bidder can pay a premium for the shares, switch to value maximisation and make a profit in the process. This is a key motivation in the bid for Unilever by Kraft Heinz.

As target shareholders typically ask for a premium of 30 percent, this "takeover threat" only becomes real if the value destruction is at least equal to 30 percent of the market value of the target firm. In other words, if a company trades today at US\$100 million, in order to justify a takeover premium of 30 percent, the company has to be worth at least US\$130 million after the takeover bid. The fact that Kraft Heinz only offered an 18 percent premium for Unilever explains the failure of their bid. Also on the

day of the announcement, Kraft Heinz's stock price increased by 7 percent suggesting that the conglomerate could potentially pay more. So resisting the bid was entirely reasonable.

A shareholder-friendly response

What is surprising is the speedy response of the Unilever board: Immediately after the failed bid, they promised to revamp Unilever to boost profits. As a result, Unilever stock price rose to the level of the Kraft Heinz bid price. It shows the most shareholder-friendly way to respond to an unsolicited bid: Increase shareholder value to become a less attractive takeover target. Although we don't know what the board has in mind, Unilever is a conglomerate of unrelated businesses (food and personal care) that potentially could increase shareholder value by divesting or spinning off part of the company, perhaps the food business, and focus on the personal care business.

Perhaps the restructuring will also result in the removal of CEO Paul Polman, one of the most vocal critics of shareholder value maximisation. In an interview with *Forbes* in 2015, Polman stated that "he was not working for shareholders...slavery was abolished a long time ago." He seemed to be more interested in saving the planet by lowering the

company's environmental footprint than in pursuing shareholder-friendly activities such as share buybacks which he dismissed as financial engineering. This is somewhat surprising as he frequently blamed financial markets to be focused on short-term profits, not on long-term value. If this was the case, he should have bought back undervalued stock to benefit long-term shareholder value. So, depending on the outcome, the Kraft Heinz/Unilever confrontation may well become a classic business school corporate governance case study in what happens when firms don't maximise shareholder value.

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