

SHAREHOLDER VALUES, NOT SHAREHOLDER VALUE

The Role of 'Ethical Funds' and 'Ethical Entrepreneurs' in Connecting Shareholders' Values with Their Investments

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This article rebuts the still-common assumption that managers of capitalist entities have a duty, principally or even exclusively, to maximise the monetary return to investors on their investments. It argues that this view is based on a misleadingly simplistic conception of human values and motivation. Not only is acting solely to maximise long-term shareholder value difficult, it displays, at best, banal single-mindedness and, at worst, sociopathy. In fact, real investors and managers have rich constellations of values that should be taken account of in all their decisions, including their business decisions. Awareness of our values, and public expression of our commitment to exemplify them, make for healthier investment and, in the long term, a healthier corporate world. Individuals and funds investing on the basis of such values, in companies that express their own, display humanity rather than pathology.

Preamble

I always enjoyed the discussions that Michael Whincop and I had about the interaction of ethics and economics. Each of us could see an important role for these disciplines, as well as our common discipline of law. We also shared an appreciation of the institutional context within which much of the drama of life is played out. In understanding the behaviour of individuals and the choices they make, it seemed axiomatic to each of us that ethics and economics have a lot to say. This was also true of the institutions in which they operate. Michael had a strong interest in 'the new institutional economics'¹ and I had a strong interest in 'institutionalising ethics' right through the 1990s.² This formed the basis of some fascinating and fruitful discussions.

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¹ Oliver Williamson, one of the leading proponents of the 'new institutional economics', published a number of influential works — see Williamson (1975, 1995, 1996).

² Sampford (1991), pp 185–222. The primary focus of discussions on institutionalising ethics has been in public sector ethics: see, for example, Preston and Sampford (2002); Sampford (1994), pp 114–38. Some discussion has, however, moved beyond the public sector to include business — see Sampford

Those discussions would have been an important part of the latest project we had planned together — an ARC linkage project on socially responsible investment starting this year, in which Michael and I would team up with other academics and an NGO that cared about making capitalism work for the benefits of the environment and those who live within it.³ The thoughts offered here are preliminary ones which we looked forward to discussing with Michael. We anticipated his thoughtful reaction and guidance on the insights provided by the best of new economic thinking. They are, accordingly, less well developed than they would have been had we the benefit of his wisdom. However, they are offered out of respect for the interdisciplinary interests we shared and valued, and as an example of the kind of issues that can benefit from the vortex where ethics, economics, law and institutional design can indicate important insights into the way we live our lives and some of the potential solutions to our collective problems.

— Charles Sampford

Introduction: The Siren Call

In the past decade, corporations and the investment community were routinely urged to concern themselves with only one thing: shareholder value. Corporate governance ‘experts’ promoted the idea that managements and boards should pursue a single goal, be it ‘profit’, ‘bottom line’, ‘shareholder value’ or ‘long-term shareholder value’.⁴ This obsessive focus and pursuit could be hyperbolically compared with that generated by the Sirens in Homer’s *Odyssey*. The singularity of this goal was so prevalent that board members of very large corporations — themselves decent individuals committed to a range of values — believed that it was *unethical* to consider issues other than shareholder value in their deliberations. Board members who did champion the importance of the social dimension in corporate governance did so from the standpoint of profit maximisation.⁵

When universal superannuation was introduced, there was a widespread assumption that the only goal that future retirees were concerned about was the total value of their payout. The idea that the employees might make collective decisions about how their superannuation should be invested based on other values was regarded as quite shocking. Rather, all superannuation should be handled by ‘professional’ wealth managers whose sole goal was maximising

(1993) — and the legal profession — see Sampford and Parker (1995), pp 11–25. For a general discussion, see Sampford (1996), pp 139–43.

³ The Chief Investigators of the project *The Ethics of Socially Responsible Investment* were originally Professor Charles Sampford, Professor Michael Whincop and Dr Magendanz (with Dr Virginia Berry as Research Fellow). The project is now progressing with Professor John Farrar, Bond University, taking Michael’s place in the lineup.

⁴ See, for example, Elton and Gruber (1995).

⁵ Arrow (1973). There has been some basis for arguing that maximising profit is a legal requirement as well — although we would argue that this involves an extension of law and legal principle to a counter-intuitive absurdity.

the dollar value of superannuation funds. However, this approach is based on a misleadingly simplistic image of human values and motivation — a corporatised version of neo-liberal economic theory in which economic man⁶ seeks to maximise profit for himself.⁷

The increasing demand for alternative investment funds such as ethical or socially responsible investments (and their success)⁸ makes explicit individual investors' concerns with other values — something not captured by traditional rational choice economics. Ethical entrepreneurs and ethical funds should, therefore, see it as their role to help integrate individual investors' values with their investment decisions.

Pragmatic Reasons for Resisting the Siren Call

The 'shareholder value' approach appears simple, and it is sold on this basis. But there are two reasons why the siren call provided by such simplification ought to be resisted: the first concerns the difficulty of knowing what will maximise long-term shareholder value; the second relates to issues of individual agency.

It is difficult to know how exactly to go about maximising long-term shareholder value. Although the end may be conceptualised in a simple and intuitive way, the means of achieving it are sometimes manifold and complex. They may involve recruiting and keeping staff, delivering good products/services at a competitive price, and developing good relations with customers, suppliers and communities while complying with regulatory requirements. They may also involve identifying risks and developing plans to minimise them. Real managers' jobs are about developing plans to simultaneously achieve a variety of goals which are supposed to further (and therefore effectively value) a number of different ends. It may be that these goals are merely instrumental values to achieving the supposedly single value, but this does not necessarily mean that the manager does not have to manage for them. It might be said that the supposedly single value arbitrates between the different instrumental values. Unfortunately, life does not generally permit such easy choices. A company cannot decide to sacrifice its employees for its customers, or its customers for the community of which it is a part and which

⁶ The concept of economic man was developed in the nineteenth century. The idea portrays the individual as if he were always and only motivated by the desire to make money at the expense of all other human desires. For simplicity's sake, we will refer to economic man in traditional masculinised terms throughout. The issue of whether economic man is explicitly (or exclusively) male is discussed in, for example, Hewitson (1999). For further reading see Nelson (1996).

⁷ This is, itself, a bastardised version of utilitarianism, which saw morality in terms of maximising happiness. It could be said that economic man is a theoretical construct as preposterous as socialist man. The socialists invented the latter as an explanation for the future. Simplistic economists invented economic man as an explanation of the present. At least the misguided socialists had the excuse that the future is hard to predict and understand. The simplistic economists have no such defence.

⁸ See, for example, Sparkes (2002) and Allen Consulting Group (2000).

regulates it. If a manager attempts to sacrifice one, the business will eventually fail.

We might try to rescue values other than profit by arguing that these other values (and ethical values in general) are in the long-term self-interest of the shareholders. This is generally true; we do not deny it. However, we should be wary of this formula for various reasons. First, as John Maynard Keynes reminds us, 'in the long run we are all dead'.⁹ A life lived solely for self-interest is ultimately self-defeating, since all those efforts come to nought at death. Second, as mentioned above, it is not possible to reliably work out what will actually maximise profit over the longer term. It is actually easier to follow ethical principles which you believe to be generally advantageous. Finally, if others think that you are only adhering to various values because you believe that it is generally in your long-term self-interest to do so, they will always be wondering whether this is the exception. Such an exception might be where acting against ethical or other declared values will be more profitable than sticking to them. They will have to take one of two kinds of precaution — either spend more time contracting to ensure that you do not have the opportunity to cheat them or, more simply, just deal with someone else. This is why some have argued that this kind of 'fanatical ethical behaviour', stating values and living up to them, is actually likely to be more profitable.¹⁰

The second reason for resisting the siren call concerns issues of agency. An individual who would act unethically to maximise corporate profits, while ignoring all other values, might seek to maximise his own fortunes regardless of other values like 'shareholder value'. (This is basically the problem with seeking an amoral person to further your own interests at the expense of others.) Why should he cheat only your customers and suppliers? Why would he not go for the trifecta of cheating the shareholders as well? (Indeed, we saw this with Alan Bond and other entrepreneurs in the 1980s whose shareholders cheered on their amoral business practices, not realising that they would be the next victims.) We have seen a similar phenomenon in the recent share meltdowns and in some of the current scandals. In fact, pirates, robber bands and the mafia generally had extremely strong, and stringently enforced, codes of behaviour which recognised loyalty to other members of the group above all else. If corporations are to behave as if they owe no duties other than to their shareholders, they will need similar kinds of criminal codes. The alternative, of course, is to recognise that there are other values for public corporations and that real managers manage for a number of values. They believe that recognising them will advance the corporation on the various measures on

⁹ Keynes (1923).

¹⁰ This is not unknown to economic theory. Those who advocate markets argue that the profit motive is often a better way of achieving social goals than seeking to achieve them directly. This argument merely reverses it. Sometimes the best way to achieve profits is to further generally accepted goals — in particular, behaving ethically and seeking to further values other than your narrow self-interest.

which it is asked to perform. However, they do not see their managerial role so simply as managing for only one value.

Where managers do insist that there is only one value, one should be personally cautious of them. If the value they trumpet is financial reward, then one should be especially careful. If someone states that the only thing that anybody values is money, they should be taken seriously. While they are obviously ignorant of the ways of the real world and real people (sufficient to disqualify themselves from ever making predictions about behaviour), we should certainly give them credit for knowing themselves. If we hear an individual say that everyone is selfish or that everyone acts to maximise their own wealth, we should treat it as an accurate statement of their values.¹¹ We should also suspect that such a statement is an admission of the speaker's sociopathy. For that is precisely what economic man is: a sociopath whose only norms concern self-gratification and who holds no other norms except for instrumental reasons.

The literature on sociopathic behaviour is generally confined to criminology and psychology, where questions are concerned primarily with its origins and responses (and for psychologists' treatment). But the question of what ought to be done if this particular behaviour becomes universal — or merely universal among all economic and political actors — is not examined. Luckily, the criminologists and psychologists are correct. Sociopathy is not universal or even particularly common. Real shareholders and real executives do have a broader set of values (despite the economic ideology occasionally demanding that they either do not or should not enjoy such normative reasonableness).

Normative Reasons for Resisting the Siren Call: Real Shareholders and Real Shareholder Values

Long-term shareholder value is not the only deceptively simple answer that has been given to the question of what should motivate corporate behaviour. Originally, the goal was seen as profit, and subsequently as 'shareholder value'. Each of these was substituted for the earlier because of perverse incentives created by that simple answer. Where once the sole goal was profits, it was recognised that a profit in the corporate entity did not automatically translate to a benefit for the shareholder. Hence shareholder value was

¹¹ We should also be careful about their policy prescriptions. If someone tells you that everyone seeks to maximise their own wealth, then how do we know that their policy prescriptions are for the benefit of all or merely for their own benefit (or possibly those who pay them — on the rebuttable presumption that they have not found a way of cheating them)? If the world is as they say it is, and everyone seeks to maximise their own wealth, then why would they advocate a policy that was better for the society rather than just better for them? (This actually turns public choice theory against those who advocate public choice theory. While we do not know whether other policies are being propounded by 'rent-seekers' keen to gain a benefit from the decisions of public bodies, we know that they consider it the only rational and proper thing for them to do to put forward policies that will benefit them.)

trumpeted, taking into account the value of shares and the value of dividends paid. However, the manipulations of shares and their occasional rapid downturns (sometimes after a 'genius' CEO left or just before a less talented 'genius' was sacked) led to a recognition that shareholders were interested in what shares were ultimately worth to them, rather than what the market could be persuaded to pay for them from day to day. However, each siren call offered comfort in a single value that would simplify the lives of business managers and fund managers. Although that one value has varied from time to time (profit, shareholder value, long-term shareholder value), the siren call remains the same. It is a corporatised version of neo-liberal economic theory in which economic man seeks to maximise profit for himself.¹² The biggest problem is that virtually no shareholders would be so narrow as to value only the long-term price of the shares in which they invest; other values are relevant to any rational calculation of which shares they should invest in.

What do shareholders value? Even if they were the cardboard cut-out parody of economic man, they would nevertheless value more than the monetary price for which their shares can be sold today or at some point in the future. Shareholders are not merely investors. They are workers, members of communities, breathers of air, drinkers of water and parents of similarly varied people. It may well be that an investment that is slightly less profitable might increase the number of jobs significantly. Someone who is a member of that community might benefit because this increases taxes, decreases welfare payments, and thereby increases the possibility that they will have adequate health care in their old age. More directly, one of those jobs might be theirs or their child's. Accordingly, the idea that companies should manage for shareholder value on the assumption that shareholders are economic man collapses.

Such a move might seem inappropriate to those who hold that 'shareholder value' simply means the marketable value of the shares. But why should shareholders only be interested in that? Indeed, the marketable value of shares is, for them, merely an instrumental value towards the achievement of their real goals. No one can tell them that they should raise to the apex of their moral lexicon what can only be a means to their own ends — least of all a manager who is supposed to be serving them.

Not only is the move appropriate, it is natural for the ethically minded.¹³ When you invest, you are still a moral agent responsible for your choices. If you invest in a company destroying a rainforest or the lives of its workers, your actions are contributing to those effects. If you invest in a company that is exploiting workers or exporting weapons to dictators, your actions are

¹² This is another example of the bastardisation of utilitarianism, which saw morality in terms of maximising happiness. Since happiness can be measured in so many ways, calculating it was beyond the scope of their mathematics. More corrosively for economics, utilitarianism took into account the distribution of wealth in calculating happiness where Jeremy Bentham's subversive 'law of diminishing utility' meant that a shilling in the hand of a poor man produced more happiness than a shilling in the hand of a rich man.

¹³ For a comprehensive discussion of this idea, see Kutz (2000).

contributing to those effects as well. To say ‘I am an investor, I have to maximise the value of my shares whatever the consequences of that action’ is no defence. It seems like a pale reflection of the Nuremberg defence of acting under orders — except that you are not being ordered to invest on pain of being sent to the Russian front, you are ordering yourself to maximise your returns on pain of getting a lower dividend. If the Nuremberg court gave short shrift to the former, think how pathetic the latter looks.

We are not seeking to threaten would-be ‘economic men’ with either commitment as sociopaths or economic war crimes tribunals. What we are saying is that if you invest in corporations that compromise your values, you are not being true to yourself. Indeed, you are betraying yourself. If you do not ask value questions, you are not a smart investor but an investor who has not considered what you are about and why. Ethics is about asking hard questions about your values, giving honest and public answers and trying to live by them. This can be a difficult process, but what is the alternative? If you do not ask yourself questions about your values, you condemn yourself to ignorance of your own morals and make it likely that you will unwittingly act contrary to your values. If you do not give honest answers, you are only kidding yourself. If you do not give public answers, you are merely being two-faced, projecting yourself as someone less worthy than you are. If you do not live up to your own values, you make yourself a wicked person as defined by you.

Being ethical does not involve denying yourself. Rather, it is about discovering yourself and living up to being the kind of person you have discovered. This is not to say that there aren’t hard choices involved, as we may find ourselves facing conflicting values. However, if we do not seek to live up to our own values, we are a failure on our own terms — in terms of the values that we hold important. This may seem to make life more complicated — and life is already complicated — but it is only through asking ourselves questions about our own values and living up to them that we can chart *our* course through that complicated world (as opposed to a path chosen by others). Even if this is difficult in some of our institutional existence (at home, at work and, given the oddities of amateur sporting associations, at play), it should be easy when we are making investments.

If an investor decides to take into account values other than maximising the price of his shares, he is showing how economic man can integrate his schizoid personality to *reintegrate* his economic and other personalities. The more religiously minded might say that ethical investment allows economic man to regain his soul.

Of course, this is not to say that the long-term price of shares is irrelevant. The ethical investor is not donating to charity but investing in enterprises which have realistic plans for turning a profit while furthering, or protecting, values that the ethical investor holds dear. Indeed, the ethical investor may consider the investment *more* profitable because he or she is, in a sense, ‘right’ about the value (because others will come to see its importance or because alternatives will fail as environmentally or ethically unsustainable). This is where ethical entrepreneurs — those who create such corporations, formulate plans to make money by furthering other values, sell them to investors and

then carry those plans through to vindicating success — have a critical role. This is also where ethical fund managers have a role in identifying the corporations that further values other than merely shareholder value.

It is important to note the plural here — *values*. One commonly held assumption about ethical investment funds is that there is only one set of values that investors might adhere to. There are, in fact, numerous values, and individual investors differ greatly in the criteria they use to determine what values are important and why.

Ethical investors consider a range of issues when determining which institutions to invest in. These include issues such as human rights (exploitation and/or discrimination of employees — pornography, child labour, sweat shops), environment (mining, logging), potential health hazards (tobacco, alcohol, genetically modified foods) and threats to social and/or political stability (arms trade). How an individual investor determines the degree of importance of such issues will depend on their individual values.

Some investors may have very strong ethical views. Some of those who found 'ethical funds' or judge companies for the purpose of social responsibility indices may well have strong views — and judge companies, funds and investments generally on that basis. However, others may legitimately disagree. For us, a fund is ethical as a matter of process not of substance. It is not ethical because it adheres to a single externally determined set of values. Rather, it is ethical because it states what its values are and seeks meaningful evidence to determine, with a reasonable degree of reliability, that the companies they invest in promote those values. A corporation is ethical if it similarly states its values and establishes credible procedures to make it highly likely that they will live by those values. Ethical companies and ethical funds should enjoy a symbiotic relationship and attract the participation of ethical managers and the investment of ethical investors. Investors, managers, companies and funds will be ethical because their values are public and because investors, managers and companies are accountable for promoting those values.

Conclusion

The values of individuals, corporations and funds may differ over issues such as the manufacture of weapons, remuneration of senior executives, exploitation of employees and so on. If companies are upfront about their values, it will be easier for managers to choose which companies to work for and it will help fund managers and investors choose which companies to invest in. As soon as values other than share price are deemed relevant, an efficient market should respond to this fact.

The research project on the ethics of socially responsible investment which was to commence with Michael aims to examine how ethics can make it easier for ethical investors to choose investments that further their articulated values. It seeks to develop an approach to ethical investment that will allow for greater alignment between investors' values and their investments, and thereby strengthen the ethical credentials of ethical investment funds. There are various ways this can be achieved. We could, for example, have multiple funds, which

collectively seek to further particular sets of values from which investors can choose. Or we might advance the idea of ‘matrix funds’ where corporations are listed against certain positive and negative values. The range of responses must await the conclusion of the project.

We wish Michael could have joined us in this project. We will try to think how he might have reacted to the research and take guidance from his work, his thinking and his inspiration.

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