Book Review Symposium on “Shareholder Value Myth” by Lynn Stout

Olivier Weinstein*

The Shareholder Model of the Corporation, Between Mythology and Reality

Abstract: The corporate governance thought has been dominated since 30 years by the shareholder primacy model. Lynn Stout present us, in his brilliant book, *The Shareholder Value Myth*, a very clear and conclusive argumentation against this view. In my comments, I consider first some key critics of the shareholder value ideology and its foundations. Next, I address the question of the real nature of shareholders, and shareholders’ interests, essential in the argumentation of Lynn Stout, before coming to critical issues concerning directors and managers. That is, first, the normative question of director’s duties, and secondly the factual question of the nature of the top management in contemporary capitalism.

Keywords: corporate governance, theory of the firm, organization

***Corresponding author: Olivier Weinstein**, Faculté de Sciences économiques, University Paris 13, 99 avenue JB Clément, Villetaneuse 93430, France, E-mail: olivier.weinstein@wanadoo.fr

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The public corporation is undoubtedly one of the major institutional innovations of industrial capitalism, which has been contributing, in the form it has taken from the late nineteenth century, to dramatically reshape economy and society. As stated by many lawyers, economists, and historians, the public corporation has been the central instrument of the development of first the western economies, and then the overall world economy. The economic, social, environmental, and even political consequences of actions by these companies are today, more than ever, of the highest importance. The conditions under which these large companies are managed, the goals they pursue, the interests defended by their managers, and more generally the conditions under which they are governed are therefore of critical importance. These issues have been addressed since the early twentieth century, and they are especially relevant today.

However, these questions have been engaged, since the 1980s, to a specific conception of the corporation, derived from the contractual theory of the firm, and more precisely from agency theory; this conception has had major consequences for the behavior of the firm and the overall development of our economies, in relation with the huge development of financial markets. That conception is expressed in the shareholder primacy model presented by Henry Hansmann and Reinier Kraakman (2001) as “The End of History for Corporate Law”. This model covers two key theses: (i) the corporation should be managed in the sole interests of its shareholders; and (ii) the market value of shares is the only, or at least the primary measure of the interests of the shareholders. The combination of these two principles leads to the *shareholder value* doctrine, which had dominated the corporate governance thought and the actual strategies of most corporations since 30 years ago: the maximization of the shareholder value – measured by the market value of shares – has to be the only, or at least the main objective of the managers of a public corporation. It is this ideology that is tackled by Lynn Stout in a particularly brilliant and impressive book: *The Shareholder Value Myth*.

What Lynn Stout qualifies as “the conventional shareholder-oriented model” remains today the mandatory reference for any discussion or any writing on corporate governance, even if it has been widely questioned,¹ not only after

¹ See, for example, Clark (2013), in this issue.

the 2008 global financial crisis, and even if we have more and more evidence of the pernicious effects of this shareholder ideology on corporate behavior. That is why the book of Lynn Stout is particularly welcome. It offers us, in the first place, a very clear and conclusive argumentation, based upon a methodical collection of empirical as well as theoretical arguments against this view. She aims to show why shareholder value ideology is divorced from the orientations of the US corporate law and from the reality of the relations between shareholders and corporate directors, and why it cannot be considered as an efficient as well as a socially desirable way to orientate corporate management.

I will present my comments as follows: I consider first some key critics of the shareholder value ideology and its foundations. Next, I address the question of the real nature of shareholders, and shareholders' interests, essential in the argumentation of Lynn Stout, before coming to critical issues concerning directors and managers. That is, first, the normative question of director's duties, and secondly the factual question of the nature of the top management in contemporary capitalism.

1 The critics of the shareholder value ideology

The “conventional” shareholder model can be justified in different ways. There is a legal justification, according to which corporate law made the managers accountable to the sole shareholders, and therefore that corporate directors have a legal obligation to maximize shareholder wealth. There is an economic justification based on the contractual theories of the firm developed over the last 40 years, and more specifically, the Jensen and Meckling agency theory. To be brief, it tends to affirm (and claims to demonstrate) that the mode of business organization in which managers are the “agents” of shareholders and where are set incentives that have the effect of “aligning” the interests of managers and shareholders, provides the greatest economic efficiency. Finally, there is more pragmatic justification according to which to make managers accountable to the shareholders alone is the best way to control them and orientate their behavior, in order to avoid conflicts of interests among executive management and shareholders.

Lynn Stout methodically criticizes the legal as well as the economic arguments supporting the shareholder value thinking. She shows us clearly that the US corporate law does not support the idea that corporate directors and managers should promote the maximization of shareholder value. As a matter of fact, “maximizing shareholder value is not a managerial obligation, it is a managerial choice” (op. cit., p. 33). This key statement deserves further thought: we need to understand how and why corporate managers (as well as most

business leaders and observers) were led to endorse this view and reshape their behavior in accordance. The economic agency theory has clearly played a critical role in the promotion and justification of the shareholder value principles. Lynn Stout is right, in my view, in explaining that the agency model does not capture the real structure of the public corporation. But, we should probably consider what was the basic purpose of that theory (as well as other aspects of the new contractual and financial theories elaborated in the same period). The supporter of the agency theory, or of other contractual theories of the firm (like Demsetz), fully recognizes that the shareholders are not the owners of the firm (Demsetz, 1967; Fama, 1980): in the contractual view, the firm is nothing more than a “nexus of contracts,” therefore, it has no meaning to say that somebody “owns” the firm. The shareholders are, in this view, just the owners of one factor of production, the capital.² The key thesis of agency theory is not that the managers are the agent of the shareholders because of the economic (or legal) “nature” of the corporation. But that to make of the managers the agent of the shareholder (and to align the interest of the managers with the interest of the shareholders) is the most efficient way to organize the firm.³ I think that Jensen and Meckling (or others) never give a serious theoretical or empirical demonstration of such a thesis. Actually, agency theory must be regarded as a “performative” theory,⁴ (or a “normative view of corporate structure and governance,” as Hansmann and Kraakman put it) rather than a positive one. Its purpose was not so much to describe what a corporation is, but what it should be, aiming to transform the managerial corporation of the post-war period into a new form. And, unfortunately, it has largely succeeded. As Simon Deakin (2011, p. 40) puts it: “the reality of the contemporary corporation increasingly mirrors this view.” We will return later on this issue: the shareholder value ideology has been the linchpin of a transformation not only of corporate governance principles, but also more globally of the overall structure and behavior of most large public corporations.

From this perspective, the main questions are: What have been the outcomes of these transformations? What have been the results of the domination of the shareholder ideology and of the shareholder value objective? It is of course a huge – and critical – issue. What Lynn Stout shows us is that, *even as regards to company’s performance and investor returns*, there exist no robust

² A proposition which is equally wrong: the capital used in production is not the property of the shareholders, but *of the firm itself*. See Biondi (2012) and Weinstein (2012).

³ See Weinstein (2012).

⁴ By “performative theory” we mean a theory that play a role in constructing the reality they are meant to describe and by influencing the behavior of economic agents. See Callon (2007).

empirical evidence that a shareholder-oriented corporate governance gives particularly impressive outcomes. An important aspect of her argumentation lies in the questioning of the mode of evaluation of economic performances. She highlights in particular two key points. The first one is the most known and has been the subject of many comments: the shareholder value model leads to systematically favor short-term financial results at the expense of the long-term economic (and even financial) performance of the firm. This has led in particular to the rise of financial and accounting manipulations, up to some scandals of the 2000s. But the second one is not less important. Lynn Stout further reminds us that what may seem effective for a particular company (and for some shareholders) may have negative effects on others. This implies that the search of maximum shareholder value by each and every corporation may result in “reducing aggregate shareholder wealth over the long term” (op. cit., p. 53). This should remind us that the search by each economic agent of its immediate interest (or what he thinks is his interest) can often lead to the impoverishment of all (or at least of the great majority). It is actually a fundamental issue, which, beyond the issue of shareholder value, concerns the limits of pure market coordination in an economy characterized by complex networks of interdependencies and active organized entities (Biondi, Canziani, & Kirat, 2007).

But what appears here is the main orientation chosen by Lynn Stout in its critics of the shareholder value ideology: not so much its implications for the other stakeholders, or its more global economic and social consequences, but its implications *for the shareholders themselves*. The implications of this approach and the issues it raises shall be discussed in the following.

2 Shareholder value and shareholder interest(s)

What appears to me as the major and distinctive thesis supported by Lynn Stout is the statement that the shareholder value principle, understood as the pre-eminence of the goal to maximize the (short term) share market return, is not in accordance with the actual interests of the shareholders. Thus, in my view, while the book provides a sharp critic of the “conventional shareholder primacy thinking,” it also preserve a shareholder primacy view, in an amended form which seems to have some similarities with the “Enlightened Shareholder Value” conception of the duty of directors, legally imposed in the United Kingdom, by the *Companies Act 2006*.⁵ The directors must give primacy to the

⁵ See Keay (2007), and Clark (2013), in this issue.

interests of shareholders, even if they may, in some circumstances, take into account the interests of other stakeholders. Coming back to the two key principles underlying the conventional shareholder primacy thinking, Lynn Stout retains the first, at least in a more flexible formulation, but totally rejects the second. It means that (1) the directors are still considered as the “trustees” for the shareholders, they are supposed to manage the firm *in the interests of the shareholders*, but (2) this does not mean that managers have a duty to maximize the market value of the firm, for the reason that the market value of shares is *not an adequate measure of the interests of the shareholders*.

At the same time, Lynn Stout supports a director primacy view, in which a large autonomy is given to the directors as regards to the management of the firm. Such a director primacy seems to be in line with corporate law, as for, during most of the twentieth century, the dominant trend in the United States and abroad has been to give an increasing autonomous power to managers. For Lynn Stout, this director primacy is justified mainly by the very fact that it is *in the interest of the shareholders*. And thus, in this view, shareholder primacy and director primacy are, I think, perfectly complementary. The directors are in charge of the identification of what the “real” interests of the shareholders are, and above all they have to decide what the best compromises between the interests of *different categories of shareholders* could be.

Here is one of the key aspects of Lynn Stout’s argumentation: we need of a clear understanding of what the shareholders really are. She rightly support the view that it is meaningless to speak of “the shareholder” or of “the interest of the shareholders,” as if “the shareholders” were a real unified class, or even an individual economic agent.⁶ Actually the important fact is the great heterogeneity of the shareholders population. There are very different types of shareholders, according to their size, their nature (individual or institutional), their objectives, and their values. There are “short-term speculators” and long-term investors, for instance. A first implication of the diversity of shareholders, and of shareholders’ interests is that it seems impossible to manage the firm according to a “single-value objective” contrary to Jensen (2002), and thus to consider the maximization of the market value of shares as the basic objective of corporate managers. But the most important thing is to consider what the various types of investors, and the most powerful and active one are in today capitalism. It is only this way that it is possible to determine what it means to defend the

⁶ The contractual theory of the firm deals with the relations between shareholders and managers by implicitly considering a “representative shareholder” treated as a single economic agent, in the same way the micro-economics of markets reduces all firms to a “representative firm”.

interests of shareholders, and what could be the trade-offs between the interest of diverse types of shareholders.

It is a well-known fact that one of the key factors for the transformation of corporate capitalism since more than 30 years has been the increasing importance of institutional investors, the evolution of their behavior, and the rising power of new financial actors. The rise of the shareholder value ideology cannot be separated from the increasing influence of this financial capitalism. It is true that the various (large) shareholders do not necessarily have the same objectives, and the same vision of what their interests are. As noted in the book, there are short-term speculators and long-term investors, as well as investors with diversified portfolios, and others involved in one or few firms. And the degree and form of activism of the large investors are not the same, a dimension which can be very important as regards to the orientation of corporate behavior. Yet it remains, I think, a dominant tendency, resulting from the overall evolution of the financial system (and of the corporate structure, as we will see later on): an increasing importance given to share market prices, and short-term earnings. This tendency comes, as explained by Lynn Stout, on one side from deregulation and the development of new financial tools and trading methods based on information and communication technologies, and, on the other side, from the increasing importance of the institutional investors, and the evolution of their management methods and techniques (and the “culture” of their managers), and notably of the mutual and pension funds (not to speak of hedge funds). These investors have not just become active players in the financial markets, they also tend to intervene in the firm’s objectives, and their modes of governance,⁷ on occasion aggressively, even when they cannot, and do not want to actively interfere in the firm’s strategies, because of the large number of firms in which they have interests. By various ways, shareholder activism has become a major feature of the new financial capitalism that has been built since the 1980s.

A fundamental point concerns the opposition between individual shareholders, and collective shareholders, namely, institutional investors. The predominance of the second type of shareholders change radically, I think, the vision we can have of the “shareholders or investors as a class,” if it is possible to view shareholders in this way. It seems clear that the direct influence of individual investors and shareholders is today very limited (apart from a very

⁷ Even the large pension funds, which are yet long-term investors, and are managing diversified financial portfolios, can intervene directly to require from a firm a high short-term profitability, or some modifications of their governance system. The delegation of management to specialized assets managers has been probably a major factor in a drift towards short-termism (Deakin, 2011).

small number of very wealthy men), as compared to the influence of large financial actors (including some of those big fortunes). Its lead to a major question: which interests will the corporate managers promote, or are supposed to promote? For which investors are corporate managers' trustees? If we follow the Lynn Stout's approach, the directors do not have so much the duty to arbitrate between heterogeneous shareholders, but rather to refuse to follow the orientations promoted by the most influential shareholders.

Actually, if we take into consideration the dominance of institutional investors today, and the fact that they tend to promote, more or less actively, the shareholder value objective, how to escape all the negative effects of this orientation, perfectly highlighted by Lynn Stout (and others)? There seems to be two possibilities, corresponding to two conceivable lines of reform. The first one concerns mainly the financial system. It lies in promoting a greater role for *long-term investors*.⁸ But it probably involves profound changes in the way these institutions are managed, particularly with regard to the delegation of management to specialized portfolio managers, and the methods of performance evaluation that govern their management system. It implies probably also more global transformations of the overall financial system which actually promotes, at all levels, short-term objectives, and the only "rational" behavior considered as legitimate,⁹ that is the maximization of the value of a portfolio. The second one concerns directly the corporate governance system. It consists in completely free the corporate directors from the influence of shareholders, including the most powerful institutional investors. In other words, it means affirm or reaffirm a strict principle of directors' primacy. It is the approach favored by Lynn Stout, expressed fairly well by the metaphor of the "Shareholder as Ulysses." The effectiveness of the corporate firm came from the fact that it permits to "tie the hands" of the shareholders by transferring the capital to the corporate entity, under the director's authority, thereby protecting the shareholders "from each other's possible future poverty [and] from the siren song of opportunism" (Stout, 2012, p. 80).

It should perhaps be wondering if it is that easy to tie the hands of institutional investors (and if they are truly ready to let those bindings go). Anyway, two questions arise regarding the managerial behavior, a normative and a

⁸ That is to say, for the advocates of this approach, mainly pension funds, insurance companies, and sovereign wealth funds. This is presented by some French scholars, as the core of a "renovation of finance." See Aglietta and Rigot (2009).

⁹ As Lynn Stout put it: "The structure of modern stock markets, combined with the rhetoric of shareholder primacy, creates almost insurmountable obstacles to prosocial investing behavior" (op. cit. p. 105).

positive one. First, it is useful to revisit the old question: which interests the directors should they defend, in other words, “For whom are corporate managers trustees?” following the famous Dood’s paper. And secondly, considering the characters of the present-day capitalism and the evolution of the corporate system, whose interests are they likely to focus on, and more broadly what tends to determine their behavior?

3 Director’s duties and the shareholder/stakeholder debate

Much of the arguments given by Lynn Stout could be used, I think, to question any notion of shareholder primacy, that is the idea that the directors should favor the shareholders’ interests, even if long-term ones.

The key issue is the following: What can justify privileged relationships between managers and shareholders, rather than treating in the same way the relations between the managers and the various stakeholders? As soon as it is recognized that the shareholders *are not the owners of the firm*, that one of the key dimensions of the modern public corporation is the strict separation between the assets of the enterprise and the assets of the investors, and that the existence of large and liquid financial markets make that the capital providers may at any time withdraw from the firm through the share market,¹⁰ there remains few room to justify any special relations between directors and shareholders. Especially when one takes into account the fact that, as recalled by Lynn Stout (op. cit., p. 68), the average holding period for equities listed on U.S. markets is today of roughly four months. From another more pragmatic point of view, a classical argument against stakeholder governance is that it would introduce conflicts of interests inside the company (and give excessive discretionary power to the directors). But if, as explained by Lynn Stout, the directors have any way to arbitrate between the interests of diverse stakeholders, could they not just as well arbitrate between the interests of various stakeholders?

We know that the emergence of the modern corporation, and the development of share markets, has radically changed the nature of the business firm

¹⁰ Even if it is true that all shareholders cannot withdraw their outlays simultaneously and that “stocks are only liquid on the margin” (Stout, 2012, p. 79). But it is only in some phase of crisis that the shareholders find their money lock in. The transformation of the financial system since the 1980s has probably strengthened the possibility for investors to invest in firms for limited periods. The venture-capital system seems a good example.

from, on one side, the individual enterprise (creation and property of one individual) or the close corporation, where the partners remain closely tied to it, towards, on the other side, the modern enterprise legally structured around one or more corporations, marked by the dispersion and mobility of shareholders (Strasser & Blumberg, 2011). This fact has been well recognized since the beginning of the twentieth century. It means a radical transformation of *the relations between the investors and the firm* from a close and long-lasting association to an almost complete separation. The evolution of the financial system since the 1980s has reinforced this movement, putting in particular increasing problems as regards to the relations between industrial and financial objectives.

That's why, I think, the view according to which the managers have the duty to defend the interest of *the corporation*, as opposed to the interests of the shareholders, deserves consideration. It seems that in most countries, notably Anglo-American ones, the law precisely prescribes that directors must act in the interests of the corporation. But the problem is that the notion of "interest of the corporation" can be interpreted in multiple ways (the interpretation being delegated to the courts). And it could therefore lead both to a stakeholder vision (the interest of the company incorporates the interest of various stakeholders) or a shareholder vision, eventually taken in a broad sense (the search for maximizing the value of the company, which itself can be equated to shareholder value in the medium and long term) (Marshall & Ramsay, 2013). Such an interpretation seems to result in a corporate governance conception similar to the one promoted by Lynn Stout.

But I do not think that it is correct, from an economic viewpoint, to identify the value of the corporation with the long-term shareholder value (and the maximization of the long-term value of the firm with the maximization of the long-term market value of shares). The precise meaning and implications of such a notion as "the interest of the corporation" would deserve a specific exploration. In very general terms, it can be interpreted as the search of the continuity and expansion of the firm,¹¹ treated as a real entity, and of its capacities to create value, by the cooperation between the various stakeholders directly involved in its economic activities of production and distribution. From this perspective, the director's duty is to favor this long-term capacity to create value, and to organize the distribution of this value between the stakeholders, and not just to defend the creation of value *for the shareholders*.

¹¹ One must remind here the necessity of distinguishing between *the firm* as an economic entity, and *the corporation* as its legal form, as explained by Robé (2011). It means that it probably would be better to speak of the interest of *the firm*.

A more precise view of what the interests of the corporation are implies the choice of a conception of what a firm is, and the way to evaluate its activities. Is the firm a specific institution devoted to production, or a portfolio of activities, or even a quasi-financial institution oriented towards the valorization of financial capital? One of the main purposes of the agency theory, and more generally of the contractual theorization of the firm has been to impose a new view of what a firm (and a corporation) is, in such a way that it has no meaning to speak of the interest of the corporation (which is nothing but a “legal fiction”).¹² It is important to note that, even if we retain a quasi-financial conception of the corporation, its interest – in the short or the long run – is not the same as that of the interests of the shareholders. The maximization of the value of the firm is not the same as that of the maximization of the shareholder value, the market value of the company’s stock. In the first case the objective is the maximization of the profit of the firm, in the second case the maximization of the portion of the profit distributed to the shareholders. In other words, the shareholder value is only a part of the overall value created by the firm’s activities. Why consider that portion as the sole, or the main objective of the firm? And, if we refuse to do that, can we continue to consider that the running of the corporation has to be oriented towards the interests of the shareholders, even in a long-run perspective?

The idea supported by Lynn Stout seems to be that the search of the “shareholder collective welfare,” and the defense of the interest of the shareholders “as a class,” in a long-term perspective, will not contradict the interests of the other stakeholders, or the search of social welfare. First, because it is in the well understood interest of the shareholders and of the corporation to take into account the stakeholder’s interests,¹³ and secondly because, actually, the real interests of the “universal investors” incorporate various individual and collective interests other than just the immediate value of their financial investments.¹⁴ Thus, “the old, stale ‘shareholders-versus-stakeholders’ and ‘shareholders-versus-society’ debates” would be outdated.

¹² That is why, as explained by Jensen, it is important to minimize the “free cash flow” retained by the company, and thus “to motivate managers to disgorge the cash rather than investing it at below the cost of capital or wasting it on organization inefficiencies” (Jensen, 1986, p. 323), for the benefit of the shareholders, of course.

¹³ “To build enduring value, managers must focus on the long term as well as tomorrow’s stock quotes, and must sometimes make credible if informal commitments to customers, suppliers, employees, and other stakeholders whose specific investments contribute to the firm’s success” (Stout, 2012, pp. 114–115).

¹⁴ “Humans, whether they hold stocks directly or through mutual and pension funds, are not just investors. They are also consumers who buy products, citizens who pay taxes, and organisms that breathe air and drink water” (op. cit., p. 90).

The primary objective of the Stout's book is to bring to light the destructive effects of the *shareholder value* ideology and the resulting practices, and to convince the reader of the necessity to abandon it completely. It is, in that respect, particularly impressive and effective. I presume that the author chooses for this purpose what she thought to be the most effective strategy, particularly towards the business world. It consisted in showing that, even leaving aside the "traditional" stakeholder or corporate social responsibility issues, in order to emphasize *the effective interest of the shareholders*; it appears that the *shareholder value* ideology has to be rejected.

There remains, in my view, important theoretical and practical differences between the "enlightened" shareholder primacy view implicitly supported by Lynn Stout, and alternative and more radical conceptions of corporate governance, notably as regards the "nature" of the large corporation, and its relations to society. I wonder if the preservation of a vision of the corporation based on privileged relationships between managers and shareholders, even with the abandonment of the shareholder value dogma, may not have questionable consequences as regards to the orientation of corporate management.

Yet, the major implication of the rejection of the shareholder value ideology through the line of argument chosen by Lynn Stout seems to be based upon a strict director's primacy view.¹⁵ This leads to a major question: What will be the director's behavior, what direction will they be inclined to give to corporate strategies, taking into account the present organizational structure of capitalist economies?

4 Director primacy and the transformations of the corporate structure and the managerial class

The book supports clearly the independence of corporate directors and the leading role of the board of director "charged with serving the best interests of (as case law puts it) "the corporation and its shareholders" – including long-term shareholders, shareholders eager to make *ex ante* commitments to stakeholders, diversified shareholders, and prosocial shareholders" (op. cit., p. 119). Can we be sure that the directors, liberated from the pressure of the shareholder value ideology and of activist shareholders, will choose to manage their firm according to the long-term interests of the shareholders (and the corporation)?

¹⁵ "The objective of any particular corporation may be best determined not by regulators, judges, or professors, or even by any individual shareholder or group of shareholders, but by a board of directors" (op. cit., p. 115).

The understanding of who the directors and top executives are and what determines their behavior is as important as the understanding of the nature of “the shareholder.” Is it possible to identify in that respect some significant tendencies? This is a complex (and not new) question, and a crucial one, in order to have a valid evaluation of what can be the evolution of the corporation, and more particularly the future of the “shareholder primacy” rules. The evolution of managers’ behavior from the period of managerial capitalism (until the 1970s) to the present finance-dominated capitalism has been one important aspect of the overall transformation of modern capitalism.

The progressive domination of the shareholder value ideology can only be understood by putting it back in the context of these organizational changes, which were a major break in the history of capitalism. There is a lot of evidence showing the important if not radical transformation of the corporate policy orientations since the 1980s in the direction of an increasing importance given to the shareholder value objective: the growing share of the corporate profit distributed as dividends (to the detriment of self-financing); the preservation of the level of dividends, even when the profit are falling; the implementations of new types of financial manipulations intended to increase the market value of shares, or the profit by share (dilution; shares buying back; selling of assets, like buildings...) (Lazonick, 2012).

The diffusion of the shareholder ideology and of new principles of corporate governance, and their promotion by an increasing number of institutions and academic or professional experts have played a major role in this evolution. This ideological dimension has been accompanied, and in some respects preceded by major transformations in the structure of the modern corporation¹⁶ incorporating profound change in the characters of its managerial system, and by that way in the organizational position and “habits” of corporate directors and executives. Without being able to consider here all the dimensions of these transformations, we will just mention some aspects crucial for our purpose. Three points are worth noting.

There has been first, during the 1960s, the progressive decentralization of the large multidivisional corporation towards an organization in “strategic business units,” treated as profit centers. This new structure has been accompanied by what was called the “management by numbers.”¹⁷ The return on investment (ROI) has been used as a measure of performance since the 1920s (Biondi, 2006); what have been important, however, is the transformation in the way it has been used, as

¹⁶ Usually analyzed as the dissolution of the large integrated “Chandlerian Firm”. For a more detailed analysis of these transformations, see Weinstein (2010).

¹⁷ The adoption of decentralized profit-planning and capital-budgeting systems based on the discounted cash flow methodology. See Baldwin and Clark (1994).

clearly noticed by Chandler (1994): it became an objective for itself.¹⁸ The second feature is the huge increase in the number of mergers, acquisitions, and above all divestitures and thus the creation of a so-called “market for corporate control,” implying an organized business of buying and selling of corporations or units of corporations (Chandler, 1994) becoming a central component of the corporate system. The third transformation is the more important for what concerns us here: the segmentation of the managerial structure, that is to say a rising division between top management and middle management, with top executives being more and more focused on financial indicators, in order to allocate capital between autonomous profit centers. Chandler strongly emphasizes the importance of this evolution, which he saw as a major break: “This separation [between the top managers at the corporate office and the middle managers responsible for maintaining the competitive capabilities of the operating divisions] affected the competitive strength of American companies and industries far more than the separation of ownership and management had” (Chandler, 1994, p. 19). The new modes of executive compensation and the incredible increase of the CEO’s compensation levels have greatly strengthened this managerial segmentation and the detachment of the top managers from the rest of the managerial apparatus.¹⁹

These changes have had two key implications. The first one is a new dominant conception of the corporation as a collection of assets, or a portfolio of activities, managed mainly on the basis of financial performances.²⁰ The increasing importance given to *market-based performance evaluation*, closely linked to the revival of the free market ideology – and the efficient market theory – provided the basis for the conversion to a shareholder value conception of the corporation. The second one is the emergence of a new type of top management through the transformation of both the profile of top executives and the composition of boards of directors.

As soon as 1982, Abernathy (1982) points the substitution of managers with scientific and technological training for finance specialists, at the running of large

18 “Statistical ROI data about performance, profit, and long-term plans were no longer the basis for discussion between corporate and operating management. Instead, ROI became a reality in itself – a target sent down from the corporate office for division managers to meet. Since managers’ compensation and promotion prospects depended on the ability to meet targets, these middle managers had a strong incentive to adjust their data accordingly” (Chandler, 1994).

19 As shown by Lazonick (2011), the evolution of executive pay system has essential implications for the overall corporate system.

20 It is what Fligstein (1990) has called a “Finance conception of control”, substituting for the previously dominant “Manufacturing conception of control”, and “Sales and marketing conception of control.” The “Shareholder value conception of control” came after this financial conception.

companies. This is part of a new view in which a good manager, well-trained, can handle any type of business (O'Sullivan, 2000). Thus, more often these new executive officers do not come from the company itself, but are professional managers with a generalist expertise in management, often heavily financial oriented (and most often ignoring the production management issues). What is important is that they build their careers not so much inside one company, but by passing from one company to another, often remaining in each company for a relatively limited period of time. This has the effect of narrowing the managerial horizon and to favor a short-termist drift of the firm's behavior, in accordance with a financial and shareholder value orientation. The other major factor of transformation of executive officers' behavior has been of course the new modes of compensation, and particularly the rising importance of stock-options.

The composition of the boards of directors has evolved in parallel, from a preeminence of executive managers of the firm or outsiders linked to the company activities (Chandler, 1994; Allen, 2011), to a rising number of "independent" outsiders, including current or retired CEOs from other companies (Englander & Kaufman, 2004). As we know, all the reports on corporate governance insist on the importance of a large number of "independent" directors, completely detached of the firm's activities.²¹

These changes lead to a new type of CEO which does no longer identify with his company, but much more with the class to which he belongs and for which financial results are the "normal" preoccupation. This could only have major consequences as regards to their vision of the nature of the corporation and of their own function (and interest). The result has been, during the 1990s, the shift towards a new "managerial creed" (Englander & Kaufman, 2004) from the technocratic conception of the corporation of the post-war managerial period, in which the main objective promoted by the directors and chief officers (and the overall "technostructure" to use the Galbraith terminology) was the efficiency and growth of the firm, to a "proprietary" or a patrimonial view, in which the corporate directors and senior officers became mainly asset managers in search of the maximization of shareholder wealth.²²

²¹ A key question is then: Who actually chooses the members of the board? It seems that the CEOs have dominated the selection process, and that the rising number of outsiders, and the reduction of the boards size, actually strengthened their power (Englander and Kaufman, 2004).

²² Englander and Kaufman (2004) show how this mutation has been completed, in the United States, within the *Business Roundtable* which groups the CEOs of the large U.S. corporations. After a long period of intense debates and oppositions, the changeover has been completed and codified in 1997 with the publication of a report on corporate governance, agreeing with the shareholder principles. The decisive factor that has led to this evolution is, according to Englander and Kaufman, the new modes of executive compensation and the role of stock-options.

5 Conclusion

The characteristics of the present corporate system, and the various forms it can take would deserve a much deeper investigation. The important fact is that the financial conception of the corporation built since the 1980s, and the resulting transformations of the firm's structure and strategies, of management methods and tools, including accounting systems,²³ as well as of the relations between finance and industry, has profoundly shaped the patterns of behavior and the configuration of interests, inside and outside corporations. The shareholder value thinking is just one the visible facet of a more global and radical transformation of the corporate and financial system our economies have experienced since the 1980s, and which are at the root of the current crisis. It has been certainly a pivotal component of that transformation, and its importance came from the transformations it induces in the management norms, the "habits" and the interests of the managers. This applies in particular to corporate directors and CEOs, and this is why the shareholder value maximization has become a managerial *choice*, as Lynn Stout put it.

A real and deep transformation of what Lynn Stout called "the conventional shareholder primacy thinking," and an effective abandonment of the shareholder value principle, involving the questioning of many corporate practices, imply a reconsideration of the overall system to which that thinking is linked. The denunciation of the ideological character of the today dominant shareholder value thinking is a first crucial and necessary step in that direction. In that respect Lynn Stout gives us one of the best and most incisive "Essays in Persuasion."

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²³ More particularly with the development of the fair value accounting. See Biondi (2011).

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