2014/15

School of Management

Foundations of Modern Management
Capitalism and the Public Limited Company

Thursday 25 September 2014
15.00-18.00
Windsor Auditorium

Please email if you wish to receive an electronic copy of this outline and/or the PowerPoint slides

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Overview: This 3-hour session, Foundations of Modern Management, is offered to all specialist MA/MSc students in the School of Management as part of your induction. A subtitle, 'Capitalism and the Public Limited Company' is adopted to offer greater focus.

Attention is devoted to events during the last half-dozen years, namely the current global financial crisis. A historical perspective is also used as a way to contextualize discussions of capitalism's future. In addition, a range of data sources are used; and multiple stakeholders are considered.

In the first part of the session we examine **the crisis of capitalism**, namely in the current period since the collapse of Lehman Brothers in September 2008. An editorial in the *Financial Times* (12 May 2009), "Shareholder Value Re-Evaluated," is instructive.

In the second part, three **themes associated with the public limited company (PLC)** are addressed:

- Gordon Gekko's 'greed is good' address from *Wall Street* (1987) is used to help examine a **corporate governance problem**, namely the potential conflict between shareholders (as financial owners of the PLC) and board members and senior executives (who have effective management control);

- The Walmart [originally Wal~Mart] Cheer helps us to explore **relationships with and between key stakeholders**. Relationships range between cooperation and competition with key stakeholders including shareholders, employees, customers, suppliers, and society. One is reminded that Walmart appears first on the Fortune Global 500; and

- *The Corporation* (2003) and Henry Mintzberg's question 'who should control the corporation' are opportunities to investigate **criticisms of and alternatives to the PLC**.

Six one-page attachments follow. The first four represent some of the key sources we will be using; the final one addresses reading management at Royal Holloway and online resources.

Financial Times **(12 May 2009) on "Shareholder Value Re-Evaluated"**

Shareholder value re-evaluated

Improving products, motivating employees and pleasing customers are the best ways to create value for investors

A PALACE REVOLUTION in the realm of business is toppling the dictatorship of shareholder value maximisation as the sole guiding principle for corporate action. As so often with regicide, many of the knives are in the hands of the old regime's own henchmen. Jack Welch, the former chief executive of General Electric who ushered in the reign of shareholder value maximisation a quarter of a century ago, now believes that "shareholder value is the dumbest idea in the world". But this revolution will not eat its own children – not Mr Welch, and more importantly not shareholders at large, who rather stand to benefit from being less fetishised.

In capitalism, private companies fulfil the social function of providing goods and services people want by competing for consumers' purchases. Companies that compete well – whose products consumers choose – are rewarded with profits. Since profits ultimately redound to the owners' advantage, holding managers accountable to shareholders best ensures that companies remain profitable and keep their products attractive to customers.

This basic model of economic organisation (supplemented with the government's requisite role as regulator and provider of public goods) is still sound; it fuelled unparalleled economic growth throughout the second half of the 20th century. Shareholder value maximisation as a principle of management, however, goes much further. It says that companies should take shareholder returns as their *operative* goal. Its most extreme version argues that executives should single-mindedly aim to increase the stock price even in the short run.

> Shareholder value, like happiness and many of life's other good things, is best achieved by not aiming at it too directly

But the theory confuses cause and effect and conflates goals with metrics. Competent executives' dedication to improving products, to motivating employees, and to pleasing customers will usually be reflected in higher profits and stock prices. But such results are measures, not causes, of business success. As this crisis shows, efforts to boost stock prices far from guarantee stable or secure earnings.

> Managers must know... that if companies strive to make good products and generate trust... profits will follow

Shareholder value maximisation presupposes efficient capital markets where companies' stock prices fully capture their future profitability and nothing else. The bubbles that ballooned and burst in the past decade show that in the short run, and over surprisingly long periods, capital markets can be remarkably inefficient. In a bubble, each individual investor maximises short-term return by following the herd – but the herd as a whole must lose money when the bubble bursts.

Clearly, strong total shareholder returns – capital gains from the share price plus a flow of dividends – are what ultimately matter to investors. But there are reasons to think that shareholder value, like happiness and many of life's other good things, is best achieved by not aiming at it too directly.

Take compensation policy. It makes sense partly to align executives' or employees' remuneration with the stock price through share awards. But some such schemes, particularly involving share options, can create incentives to game the stock price rather than create sound and sustainable business practices. Their vesting period, typically three years, may have encouraged managers, especially in the banking industry, to take dangerous short-term business risks, the catastrophic results of which only became evident long after the options had been monetised.

Good business results often require long-term relationships based on trust between managers, employees, customers and suppliers. But long-term trust between two parties is impossible unless their respect for each others' interests is anchored in something deeper than the effect on the next quarterly profit numbers.

None of this undermines the model of capitalism that leaves to private market actors the power to decide how capital should be deployed. Instead it has implications for how market actors ought to use that power.

Managers must know – and they must communicate to shareholders – that if companies strive to make good products and generate trust with customers, suppliers and creditors, profits will follow for the well-run business. Investors must permit and encourage that focus and not obsess about short-term results. Directors – independent directors in particular – have a special responsibility to create this mutual understanding.

If they do, companies will enjoy more stable and sustainable profits, dividends and the prospects for the stock price improves. In the end this secures value for shareholders better than actively maximising the stock price is likely to do. Shareholder value maximisation is dead; long live shareholder value. ■

12 May '09

Wall Street (1987) with Gordon Gekko addressing the annual general meeting of Teldar Paper

See http://www.americanrhetoric.com/MovieSpeeches/moviespeechwallstreet.html; http://www.youtube.com/watch?v=PF_iorX_MAw.

Wall Street should be viewed in the aftermath of insider trading scandals of the 1980s (search Ivan Boesky and Mike Milken). Gekko [Michael Douglas] plays a corporate raider (using insider information). Gekko's address is known for 'greed is good'. However, we can read the full address alongside the thesis of Berle and Means (first articulated in 1932 in *The Modern Corporation and Private Property* on the separation between financial ownership and management control, as one consequence of dispersed share ownership. Finance-capitalists as activist shareholders exist today such as Carl Icahn and Bill Ackman. See the influential UK-based PIRC http://www.pirc.co.uk/ as 'the voice of responsible shareholders'.

Gekko: Well, I appreciate the opportunity you're giving me, Mr. Cromwell, as the single largest shareholder in Teldar Paper, to speak.

Well, ladies and gentlemen, we're not here to indulge in fantasy, but in political and economic reality. America, America has become a second-rate power. Its trade deficit and its fiscal deficit are at nightmare proportions. Now, in the days of the free market, when our country was a top industrial power, there was accountability to the stockholder. The Carnegies, the Mellons, the men that built this great industrial empire, made sure of it because it was their money at stake. Today, management has no stake in the company!

All together, these men sitting up here [Teldar management] own less than 3 percent of the company. And where does Mr. Cromwell put his million-dollar salary? Not in Teldar stock; he owns less than 1 percent.

You own the company. That's right – you, the stockholder. And you are all being royally screwed over by these, these bureaucrats, with their luncheons, their hunting and fishing trips, their corporate jets and golden parachutes.

Cromwell: This is an outrage! You're out of line, Gekko!

Gekko: Teldar Paper, Mr. Cromwell, Teldar Paper has 33 different vice presidents, each earning over 200 thousand dollars a year. Now, I have spent the last two months analyzing what all these guys do, and I still can't figure it out. One thing I do know is that our paper company lost 110 million dollars last year, and I'll bet that half of that was spent in all the paperwork going back and forth between all these vice presidents.

The new law of evolution in corporate America seems to be survival of the unfittest. Well, in my book you either do it right or you get eliminated.

In the last seven deals that I've been involved with, there were 2.5 million stockholders who have made a pretax profit of 12 billion dollars. Thank you.

I am not a destroyer of companies. I am a liberator of them!

Greed clarifies, cuts through, and captures the essence of the evolutionary spirit.

Greed, in all of its forms – greed for life, for money, for love, knowledge – has marked the upward surge of mankind. The point is, ladies and gentleman, that greed – for lack of a better word – is good.

Greed is right.

Greed works.

And greed – you mark my words – will not only save Teldar Paper, but that other malfunctioning corporation called the USA.

Thank you very much.

***The Corporation: The Pathological Pursuit of Profit and Power* (2003)**

The modern business corporation, created 150 years ago, is now a significant social institution that promises good corporate citizenship, such as consumer choice and better wages and working conditions, without the coercive push of governments and unions. The corporation seeks to present itself as human, benevolent, and socially responsible. But, is this the case?

No, according to *The Corporation*, which is a film based on a book (of the same name) by Joel Bakan. The corporation, as a legal person, is cast as a psychopath. The corporation assumes limited liability for its actions and no moral obligations in its pursuit of profit and power.

The Corporation (film) is divided into 23 chapters available on YouTube http://www.youtube.com/playlist?list=PLFA50FBC214A6CE87. (Chapters 11-15 are the ones with the strongest marketing element.) In addition, there is a dedicated website http://www.thecorporation.com/ designed to be educational.

The growth of 'Big Business' – represented today by the likes of firms listed on the Fortune Global 500 and FTSE 100 – is a recently development, starting from the mid-19th century. (Conservative business historian Alfred Chandler has been a good chronicler, though *The Corporation* adopts a different perspective.)

In *The Corporation* the likes of Noam Chomsky, Michael Moore, Naomi Klein, and Vandara Shiva offer criticisms of the business corporation. Economic globalization and regulation have diminished the state's capacity to protect the public interest.

Correctives are considered:

- Shareholder democracy is a position adopted by Robert Monks to reassert a link between financial ownership and management control. Milton Friedman represents maximizing shareholder value for the owners; see "The social responsibility of business is to increase its profits," in the *New York Times* (13 September 1970) http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html

- Consumer democracy is put forward by Ira Jackson. It has received less attention than shareholder democracy. Consumer boycotts are an example.

Both seem to be based on the notion of competition and choice by individuals – hence the reference to democracy – as either shareholders or consumers. 'Competition doesn't always work, but without some sense that it might be beneficial, it's hard to talk sensibly about capitalism and corporate power' (Tim Hartford, July 2005).

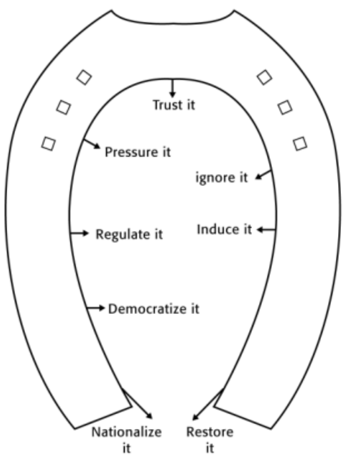
However, external regulation is needed to curb corporate behavior is another alternative. This is a position Bakan makes in the book. Regulation has gained increased attention during the global financial crisis, particularly if financial stability is considered as a form of a public good. Of course, corporations also lobby government to influence the direction of regulation.

It is useful to consider *The Corporation* alongside Henry Mintzberg's question, who should control the corporation?

Henry Mintzberg (1984), "Who should control the corporation?," *California Management Review* 27(1): 90-115

'Who should control the corporation, specifically the large, widely held corporation, how, and for the pursuit of which goals? The answers that are eventually accepted will determine what kind of society we and our children shall live in' is how Mintzberg begins.

How to balance economic and social goals of the business corporation? Mintzberg adopts a conceptual horseshoe. The left side represents social goals; the right side economic goals. 'Nationalize It' and 'Restore It' (to shareholders) are opposites in terms of these two (competing) goals. Yet Mintzberg also suggests these two positions share a common trait (hence why they are close together in the horseshoe, as opposed to a traditional, linear political perspective of left versus right). Both 'Nationalize It' and 'Restore It' are distrustful of the corporate managers to make the correct decision to balance economic and social goals. Thus 'Trust It' (to the corporate managers) is far removed from both 'Nationalize It' and 'Restore It'.



Nationalize It: Government takes over the corporation and determines its behaviour.

Democratize It: Goals of corporation are broadened by changing the basis of power, that is, allowing various groups to participate in managing it.

Regulate It: Government has an active, formalized role in determining what the corporation does.

Pressure It: Change is brought about through pressure campaigns by special interest groups and others.

Trust It: Balance between economic and social goals as managers believe it is their moral duty to act responsibly. There is a status quo in the power system and managers retain control because they will act responsibly.

Ignore It: Social goals are attended to because 'it pays to be good' (the corporation's economic interests to attend to social goals).

Induce It: Management recognizes the conflict between economic and social goals, but the economic goals win out with social goals only attended if it pays in economic terms.

Restore It: Corporation is controlled by its rightful owners, the shareholders, who are interested only in economic goals.

British Private Equity & Venture Capital Association (BVCA)

See http://www.bvca.co.uk/

There is a relationship between the PLC and both private equity and venture capital.

The British Private Equity & Venture Capital Association (BVCA) describes itself as ‘the industry body and public policy advocate is the industry body and public policy advocate for the private equity and venture capital industry in the UK’. The BVCA’s ‘aim is to aid understanding around the activities of our members, promote our industry to entrepreneurs and investors as well as to Government, the EU, trade unions, international media and the general public. We communicate the industry's impact and reinforce the crucial role our members play in the global economy as a catalyst for change and growth’. See the BVCA’s vimeo clip ‘An A-Z of Private Equity and Venture Capital Companies’ http://www.bvca.co.uk/AboutUs.aspx.

In addition see http://www.bvca.co.uk/PrivateEquityExplained.aspx for explanations of private equity and venture capital:

‘Private equity and venture capital is finance provided in return for an equity stake in potentially high growth companies’. ‘Private equity firms typically look to invest majority stakes in underperforming companies that have the potential for high growth. Growth in the businesses is delivered by working with the company’s management team to improve performance and strategic direction, making complimentary investments and driving operational improvements’. ‘Venture capital firms, in contrast, invest in companies in the seed (concept), start-up (within three years of the company’s establishment) and early stages of development. In areas such as clean technology, digital media, life sciences and the internet, venture capitalists invest their capital and expertise to develop new products and technologies’.

‘Private equity and venture capital firms are long-term investors, typically investing in companies for around 5-7 years. This means a commitment to building lasting and sustainable value in the businesses they invest in. The only way to realise returns for investors is to sell a business in better shape than when it was acquired. Typically firms will sell their stake in a company by listing on the public markets or selling to a strategic buyer’.

‘Private equity and venture capital firms raise funds to invest from sources such as pension funds, endowments and sovereign wealth funds’.

See the following as examples of venture capital firms:

Accel Partners http://www.accel.com/ (Dropbox, Facebook, Spotify, Wonga)
Balderton Capital http://www.balderton.com/ (Betfair, Love Film, Wonga, Zopa)

Reading Management at Royal Holloway and Online Resources

Your individual programme directors and course coordinators will offer specific readings. You should become familiar with College's Library http://www.rhul.ac.uk/library/home.aspx in particular how to access and conduct searches using two key databases: Business Source Premier and ABI Inform Global http://eresources.rhul.ac.uk/kb/Management.

For some, Peter Drucker is the nearest management has to a philosopher (see, for example, http://www.druckerforum.org/). *The Practice of Management* was originally published in 1954, and has remained in print. His treatment of the business corporation as a social organization with multiple stakeholders has regained currency. A good portion of *The Practice of Management* is available from HarperCollins http://www.harpercollins.com/browseinside/index.aspx?isbn13=9780060878979.

Management has a specialist language. The weekend edition of *The Financial Times* is an excellent place to start. In addition, the *FT* also has two gym workouts in management: Masters http://mastersgym.ft.com/; and MBA http://mbagym.ft.com/. The journalist and novelist John Lanchester is also worth reading: *Whoops! Why Everyone Owes Everyone and No One Can Pay* (2010) and *How to Speak Money* (2014).

BBC's Radio 4 http://www.bbc.co.uk/radio4/ is excellent for speech radio. This includes news but also programmes of current affairs. Many of these programmes address issues related to business, management, and economics.

How performance is measured is of interest. The credit rating agency Standard and Poor's has assumed greater significance in recent years (including its impact on nations), so it is worthwhile to see what S&P does http://www.standardandpoors.com/ratings/en/eu/. The Fortune Global 500 is a ranking of the largest business corporations http://money.cnn.com/magazines/fortune/global500/. The S&P and the Fortune Global 500 also introduce you to industrial sectors and how comparisons can be made amongst business corporations.

A political science perspective on capitalism is available as a Yale University Open Course. Capitalism: Success, Crisis, and Reform is delivered by Douglas Rae http://oyc.yale.edu/political-science/plsc-270. You should be able to follow his lectures. It was taped in 2009 so Rae addresses the immediate aftermath of the global financial crisis.

Referencing is an essential part of academic work (which includes your dissertation). The following are recommended:

- The APA Style – author-date citation system including the so-called Harvard system – is used in business and management http://www.apastyle.org/ . For an online tutorial http://www.apastyle.org/learn/tutorials/basics-tutorial.aspx; and
- Purdue University's OWL (online writing lab) has summaries of the styles for use by students writing academic papers http://owl.english.purdue.edu/owl/section/2/. In particular, select the APA Style http://owl.english.purdue.edu/owl/section/2/10/.

Finally, many of you will have elected to pursue a specialist MA/MSc programme as a termination degree. This means you should start reviewing material associated with job applications (particularly if you wish to be employed by September 2015). McKinsey & Co has excellent information http://www.mckinsey.com/; go to 'Careers' and then 'Apply' (where you will find case studies, problem-solving tests, interview tips, and what competitive firms look for in hiring). The 'Career Centre' at Michael Page http://www.michaelpage.co.uk/ is also useful. Of course, there is Royal Holloway's Careers Service http://www.rhul.ac.uk/careers/home.aspx.