

CEES

Working Paper No. 53

July 2004

Shareholder, stakeholder-owner or broad stakeholder maximization

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Shareholder, stakeholder-owner or broad stakeholder maximization¹

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Abstract

With reference to the discussion about shareholder versus stakeholder maximization it is argued that the normal type of maximization is in fact stakeholder-owner maximization. This means maximization of the sum of the value of the shares and stakeholder benefits belonging to the dominating stakeholder-owner. Maximization of shareholder value is a special case of owner-maximization, and only under quite restrictive assumptions shareholder maximization is larger or equal to stakeholder-owner maximization. Broad stakeholder maximization is the sum of the returns to all stakeholders also including the shareholders of a company. Although it may be the ultimate goal for Corporate Social Responsibility to achieve this kind of maximization, broad stakeholder maximization is quite difficult to give a precise definition. There is no one-dimensional measure to add different stakeholder benefits not traded on the market, and therefore there is no possibility for practical application. Broad stakeholder maximization instead in practical applications becomes satisfying certain stakeholder demands, so that the practical application will be stakeholder-owner maximization under constraints defined by other stakeholders' interests. These constraints vary for different stakeholder owners and new standards for Corporate Social Responsibility and more active political consumers will strengthen these constraints.

¹ Paper presented at the IAFEP (International Association For the Economics of Participation) 12th Biannual Conference, St. Mary's University, Halifax, July 8-10, 2004:
Mending the Global Economy: A Role for Economic Participation

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Introduction

In the 1960'es and 1970'es most companies were seeking *Corporate Wealth Maximization*. The firm should fulfill a specter of goals for a broad constituency of interest groups (Stonehill and Dullum 1990). In the 1990'es it became common for company boards to focus on *shareholder value* with maximization of the returns to the shareholders. The recent development of *Corporate Social Responsibility* (CSR) is now changing the pendulum back to a broader approach of value-creation for the broad group of stakeholders. However, the discussion often lacks clarity about what is really meant by the different terms. Based on the analytical stakeholder approach (Mygind 2001) I will in this paper try to clarify the terms and I will show that shareholder maximization is a special case of what can be called stakeholder-owner maximization. Broad stakeholder maximization connected to CSR is an ideal form, which can only be satisfied under quite strict assumptions. By using the stakeholder approach it is possible to explain the importance of the identity of the controlling owner also in relation to the other stakeholders and the degree of satisfaction of their interests.

The analytical stakeholder approach

The *analytical stakeholder approach*¹ is introduced to make a distinction from the *normative* stakeholder approach (Evan and Freeman 1983) demanding that all stakeholders shall take part in the governance and the returns from the company. In contrast, the analytical stakeholder approach does not suggest that specific stakeholders shall have special rights. The analytical approach simply emphasizes that the analysis of enterprise governance must be based on the actual distribution of rights to different groups of stakeholders with different interests, resources and abilities in relation to the governance of the company (Mygind 2001). An important part of the description of the governance structure of a specific company is the distribution on stakeholders of these different rights: to control, to the income flows, and to the accumulated wealth. It is essential for the analysis, which stakeholder holds the dominating control of the company, that is, the identity of the dominating owner of the company. In the following I will stress the importance of the distinction between the pure owner/ shareholder, with no other interests than maximizing the value of the shares and other stakeholder-

owners, where the specific identity of the stakeholder-owner has strong consequences for the maximization function of the company and the returns to other stakeholders. Different stakeholders have different attitudes and relations to other stakeholders, and therefore not only their evaluation of their own benefits is specific, also their weights given to satisfaction of other stakeholders' interests vary and determine the actual objective function of the company.²

I will first more precisely define shareholder returns and stakeholder returns and then apply these terms to the analysis of pure shareholder versus stakeholder-owner maximization. Then I will contrast owner-maximization with broad stakeholder maximization. When are these two types of maximization following each other and when are they conflicting? I will stress the problems of measurement of broad stakeholder maximization and point to the practical application as owner-maximization under constraints given by the relations between the company and the stakeholders.

Shareholder, stakeholder and stakeholder-owner returns

The value of a company is determined by the return to the stakeholders. The stakeholders are those involved and affected by the activities of the company (Freeman 1984). The pure shareholders are the capital providers without other interest than maximum return on their shares as future dividends and capital gains given a certain level of risk. The *returns to shareholders* measured as the present capital value are³ V .

The return or benefits to stakeholder, i , in a given company, is denoted as B_i . It is both the monetary and non-monetary returns in excess of what the stakeholders are willing to accept given the alternatives from other companies. This is the extra benefit the firm transfers to the stakeholders compared to a situation where the firm did not exist. Thus, these benefits do not include the remuneration they could get in the best alternative.

For consumers of a whole industry with a homogenous product the consumer-surplus in the traditional supply and demand scheme can be used as an illustration. The demand curve indicates the utility of the consumers, that is, what they are willing to pay

at different quantities offered. The part of the demand curve lying over the market price indicates that some consumers are willing to pay more than the ruling price for a certain number of products. If we assume that there is no price-discrimination this free value can be taken as stakeholder benefits to the consumers, who get the goods at a lower price than they are willing to accept.

Figure 1 gives a parallel example of returns to the employee stakeholders: A certain company attracts a group of employee, who for simplicity can be assumed to be homogenous seen from the point of view of the company. The company will offer the same wage and working conditions for each of these employees. To attract them the company must pay a competitive wage and offer competitive working conditions. However, the employees are differently attracted to the company because their situations and their preferences vary. They have different transportation costs, different attitudes to the company – e.g. some workers may have family connections to the company, and some have special preferences for the company’s specific employee-policy etc. Therefore, some of the employees are in fact willing to work for the company at a lower price. This price is the *transfer earning* subjectively determined by each employee. In figure 1 it is starting with the lowest to the left and then increasing for each extra worker. Depending on the specific technology in the company each additional worker has a certain marginal value product of labor, which is assumed to fall from a certain input level. It will pay off for the company to hire additional workers up till the point where the transfer earning curve and the MVPL-curve intersect. At this point the firm will pay the wage, W , which is just enough to attract the last employed worker. The wage can be assumed to include all the variable average labor costs. For a given worker the *economic rent*, that is, the difference between the transfer earnings and the wage makes up the *net private benefits* or the individual employee *stakeholder benefits*. The size of these benefits is the subjective measure by each employee. The area between the wage-line and the curve is the total employee stakeholder benefits and the area over the wage-line limited by the MVPL-curve is the surplus to the company.

A high level of net private benefits, on Figure 1 employee stakeholder benefits, indi-

cates that the company gives a relatively high wage and/or has relatively favorable working conditions compared with other companies. The figure can illustrate efficiency wage setting ((Shapiro and Stiglitz, 1984) by an upward move in the wage-line. An efficiency wage (and “efficiency working conditions”) not only result in high benefits for the employee. To secure these benefits the employees may work harder, have lower turnover etc. resulting in an upward shift in the level of MPVL. Following this policy the firm may continue to increase the wage and improve the working conditions as long as the corresponding increase in MVPL continues to increase the total surplus, and such a movement will both increase the surplus and the stakeholder benefits.

Figure 1 can also illustrate the importance of relation specific investments: Assume that the employees through special training programs build up their specific human capital connected to the company. This increases their productivity and may lead to a wage increase. The transfer earnings will not increase since the upgrading of skills is specific to the current company. Therefore, the net stakeholder benefits also increases.

Since the transfer-earnings are based on the existing best alternative for the employees, the stakeholder benefits also indicate the loss for the employees if the company closed down. In this way the stakeholder value is a measure of the importance for the employees of the continuation of the company and their employment contract. The risk of unemployment is included in the estimation of the transfer earnings.

The stakeholder returns also include negative effects on stakeholders such as pollution affecting the surrounding community. The general public can be taken as the supplier of the company’s “license to operate”. In return the society gets tax revenues and a specter of positive externalities such as employment, technological spillovers, self-enforcing clusters for economic development etc, but possibly also negative externalities in the form of pollution and health risks of the employees. If the price for the license to operate is zero the net-benefits are simply the sum of the benefits minus the costs estimated by all the persons affected by the externalities. To clarify the terms I give some examples of returns to different stakeholders in table 1 and 2.

Table 1: General stakeholder and stakeholder-owner benefits

stakeholder benefits	stakeholder-owner benefits - costs
net-benefits in excess of remuneration/price necessary for the stakeholders to go into contract with company	The owner can fulfill specific stakeholder-owner preferences: self-governance, secure stakeholder benefits avoid hold up problems for relation-specific investments, strengthen position in negotiations with firm as counterpart, appropriating rights from minority shareholders, Cost of ownership: risk concentration, decision making costs for groups of owners, activity outside core competence

Table 2: Examples of stakeholder benefits

	stakeholder benefits: B_i	stakeholder-owner benefits: BO_i
manager	some self-governance prestige (size of company etc.) fringe benefits, career-opportunities	full self-governance secure specific human capital - costs of ownership: risk-concentration
employees	return on specific human capital wage, safety, quality of work-place, self-governance, training higher than transfer earnings (no wage-discrimination)	self-governance (restricted by group majority) secure specific human capital - costs of ownership: risk-concentration, costs of decision making
supplier (business-customer)	higher price, stability (lower price, stability)	no hold up problem = secure relation-specific investments - costs of ownership, activity outside core competences
consumer	better quality, lower price than willing to accept (consumer surplus, no price discrimination)	stable deliveries avoid monopoly-pricing - costs of ownership: risk-concentration, costs of decision making
creditor	higher security than necessary (better information, lower risk)	full inside information - costs of ownership, activity outside core competences
community local/national	higher tax, employment, local activity, technological spill-overs (compared to no activity) net benefits of externalities: health, education, pollution, problems of measurement and conflicting preferences	- costs of ownership: definition of owner-interest, governance problem

What is the background for these stakeholder benefits? Why does the owner of the company not incorporate these benefits by price- and wage-discrimination and pressing down the worker related costs? The answers lie in specific investment, transaction costs, and efficiency wages.

Specific investments done by the suppliers to the advantage of both the company and the supplier – e.g. payment for employees' investment in specific human capital – mean often an addition to the wage-level. Since this investment is relation-specific the return is not included in the normal market remuneration and there is no market outside the company to determine the exact level. Therefore, the division of the return is determined in the negotiations between the owner and the specific stakeholder – a game of reciprocal monopoly - and it can be expected that part of the benefits will go to the employees.

High transaction costs in relation to price- and wage-discrimination and e.g. in relation to determining the negative effects of externalities like pollution or positive effect of higher health standards is another explanation why some stakeholder benefits are not tradable and included in the shareholder value. Although the different rights are specified the Coase-theorem does not apply when high transaction costs make it impossible to internalize the externalities. However, state regulation is often used to overcome the problems of externalities. The state represents the broad group of diversified stakeholders and state regulation overcomes the problem of transaction costs in relation to specifying and enforcing the contract between the company and this broad group of stakeholders.

The tables also include *stakeholder-owner benefits*, noted as BO_i . Stakeholder-owners are stakeholders who control the firm through ownership. As owners they supply the company with certain resources such as their ability to govern the enterprise and monitor the manager. The owners may also supply critical resources like risk-capital entrepreneurship, networks etc. Because of high transaction costs they will only supply these resources in combination with ownership. Therefore, the total value produced by

the company depends on the identity of the owner. At the same time the owners can govern the company in a direction, which maximizes the satisfaction of their own preferences.

The tables give some examples of these special owner-benefits connected to controlling the firm: Through ownership the stakeholder-owner can get benefits, which could not be included in a market contract between the stakeholder and the firm (Hart 1995). Manager- or employee-owners can fulfill goals of self-governance. For the group of employees, this will be restricted by the necessity to follow the majority within the group of employee-owners. Being the owner a certain stakeholder gets a strong position in securing the specific investments related to the firms' activities. This is the case for all the stakeholders connected directly to the firm's value chain as suppliers or customers. The higher the net-benefits the more interested the stakeholders will be in the continuation of their specific relationship, and the best guarantee will often be direct control through ownership of the company.

The owners strengthen their position both in relation to the firm and in relation to other stakeholders in the negotiations for the remuneration on their specific investments in the firm. Employee-owners will not only secure their specific investments, but probably also get a higher remuneration in return for their specific investment. At the same time the distribution of benefits for other stakeholders can in most cases be expected to change. This happens both because of a change in the owners' preferences and a change in the negotiating positions between the new owner and the different stakeholders. The owner-benefits are not only connected to a stronger position in the game of distribution of some of the stakeholder benefits. It can also include the possibility of appropriating owner returns from non-controlling owners (minority shareholders).

There are also costs of being owner. These costs are first of all related to risk concentration, a problem which is especially important for managers and employees investing both their jobs and their capital in the same company. For employee ownership the costs of decision-making in the group of employee owners may be quite high, espe-

cially if the group of employee owners is quite heterogeneous with conflicting interests (Hansman 1988). The cost-side can also include the costs for e.g. a supplier of going into the owner-role in a business outside the core competence of the supplier firm.

Shareholder versus stakeholder-owner maximization

Now the different types of maximization can be defined. We will first divide the owner-maximization in stakeholder-owner maximization and the special form of

maximum shareholder value = V_{\max}

This is the value of the company seen from the point of view of the *pure shareholder* without other stakeholder interest than maximizing return on the share-capital. But also other stakeholders' can be owners of the company and the identity of the dominating stakeholder is crucial. The different stakeholders have different goals and different skills for directly managing the company or governing the manager and different interests and abilities to appropriate part of the surplus. Therefore, the share-value, V , and the benefits of the different stakeholders vary with the type of the controlling stakeholder indicated by the subscript j , below. Maximization for stakeholder-owner, j , owning a proportion, a , of the company, is⁴:

$\max (aV_j + BO_j + B_j)$.

V_j is often lower than V_{\max} . because the stakeholder-owner appropriates returns from the other shareholders. On the other hand, the specific stakeholder may have some advantages, better information, networks, different forms of synergies, so that the total productivity increases. However, most of this increase will probably go directly into the pockets of the stakeholder-owner.

Assume the company initially is following a pure shareholder maximization strategy and the share-value has reached the maximum level on the market, V_{\max} . Stakeholder j gets B_j in stakeholder benefits, and we assume that this investor gets the same stake-

holder benefits after a takeover. On top of this the investor gets the stakeholder-owner benefits of BO_j . The investor pays the current market price for the necessary share of ownership aV_{\max} . Stakeholder, j , have an incentive to take over the firm if:

$$aV_{\max} + B_j < (aV_j + BO_j + B_j) \Rightarrow a(V_{\max} - V_j) < BO_j$$

The stakeholder, j , will take over the company paying the value of the shares aV_{\max} if the private benefits are larger than the fall in value of the shares owned by this new stakeholder-owner. There may be a governance problem seen from the point of view of the minority owners. The controlling owner takes all the stakeholder-owner benefits although he owns less than 100% of the shares. The minority shareholders, who own $(1-a)$ of the company have a loss of $(1-a)(V_{\max}-V_j)$. To protect the minority-shareholders it can by mandatory bid be obliged for the new majority owner to buy not only the proportion a , but in principle all shares at the agreed price. For $a = 1$ the value for the stakeholder-owner must be higher than the shareholder-maximization value.

$$V_{\max} < V_j + BO_j$$

Stakeholder-owner maximization is seen from the point of view of the specific stakeholder. There will be some situations where shareholder maximization is highest and some, where stakeholder-owner maximization is higher. In a perfect market the identity of the owner will not be important, because all the possible benefits for the stakeholder-owner can be contracted with the company. The manager will not want to take over the ownership when all the benefits can be included in the manager contract. From the point of view of the pure owners it will pay off to give special benefits to the manager, if it improves the performance of the company. In this case shareholder maximization will be higher than stakeholder-owner maximization. But if it is not possible to make this kind of contract because of high transaction costs of specifying and controlling the benefits and contributions stakeholder-owner maximization may exceed the maximum shareholder value. Therefore, the company seen from a certain stakeholder will have a higher value than pure shareholder maximization.

What is the possibility for the share market or the market for control of unlisted companies to include the stakeholder-owner returns in the valuation? Only under quite restricted circumstances this may be possible. If the market is informed about the possibility of these stakeholder-owner returns it may to some extent be built into the share price. This will not be the case if the stakeholder takeover is unexpected, but if the general type of ownership in the specific industry is ownership by a specific type of stakeholders there will be formed a market price for these specific stakeholder benefits like in the farming case given below:

Assume that a group of employees has strong stakeholder benefits because of self-governance and securing their specific human capital. At the same time ownership can function as an effective motivation tool for the employees and the costs of ownership in relation to collective decision making are relatively low. Assume also that the existing owners cannot make a contract, which includes these benefits without de facto giving up their ownership rights. The employees are willing (and able⁵) to buy the shares for a higher price than the market value for pure shareholders as reflected on the share market. The maximization of stakeholder-owner value implies that the insiders take over a dominating share and take control over the company. The takeover may imply that some of the returns on the shares are directly transferred to returns on labor. This means that if some outsiders still have shares left, they may lose value. In this way the controlling owners have appropriated rights from the minority owners.

Another case is *family farming* (Mygind 1992). Large scale farming through external ownership may be more efficient from a narrow economic point of view, but such a view does not include the satisfaction a farmer gets by being his own master. In other words, the individual farmer may sacrifice some income and/or deliver a higher effort because he is governing himself compared to the situation where he is a wage-earner in a large farm. These benefits are in many cases not possible to contract between the farmer and an external owner, because the farmer cannot get enough self-governance without actually taking over most of the ownership rights⁶. The positive value of the

self-governance benefits most often exceeds the costs of smaller scale, so stakeholder-owner value in this way exceeds the shareholder value. Family farms are at the same time an example where the actual market value of ownership includes the stakeholder-owner benefits because family farms are so widespread.

A *strategic investor*, which in some way is linked to the value chain of the target company (supplier, customer, competitor), may want to take over the company, because synergy effects can improve the total profit of the two companies. In this way there are stakeholder-owner benefits to the strategic investor. These values are not reflected in the shareholder value of the target company before the deal is made public. Therefore, this is another example of stakeholder-owner maximization. However, if both companies are listed on the stock exchange the deal may in fact increase the total shareholder value of the combined companies, and in this sense the acquisition can be taken as an activity to increase pure shareholder value⁷. Even if the companies are not listed. If the acquisition increases the total value seen from the point of view of the pure owners, we can still talk about shareholder maximization.

The general public may get higher net-benefits if *the state* owns and operates e.g. a hospital. In this case the net-benefits (total benefits - transaction costs - other costs) are higher for the state than private ownership. However, these benefits must be evaluated by a political measure stick, where equality, public health considerations, the value of prolonging life, the negative effects of taxation etc. will be rated differently depending on the dominant political attitudes. In some countries the stakeholder-owner benefits of the general public will be valued so high that the state will take over the company, while in other countries a similar company will be run by a private company if the public owner-benefits here get a lower rating.

In general we can talk about owner-maximization. The identity of the controlling owner has strong impact both on performance, on the returns to the owners, and on the benefits to other stakeholders. In this respect the shareholder maximization by the pure owner without specific stakeholder interests can be taken as a special case of owner-

maximization. Pure shareholder maximization is relevant when the specific stakeholder-owner benefits are non-existing or lower than the corresponding fall in shareholder value. But if the total value is higher with stakeholder-owner takeover, maximization implies a takeover by the stakeholder-owner who is willing to pay the highest price. This is the stakeholder who gets the highest return from a takeover. The takeover price will be equal to or most often lower than the total stakeholder-owner value, since the stakeholder owner will not pay more than necessary for the takeover.

Broad stakeholder maximization

The total value of the firm including all the stakeholders, the shareholders as well as the stakeholder owner is:

$$\text{Total stakeholder value} = V_j + BO_j + \text{SUM}_i B_{ij}$$

The j specifies that both the share value and the benefits to different stakeholders depend on the identity of the stakeholder controlling the firm. The summation over the i 'es assures that all the different stakeholders' benefits are included.

As indicated in table 2, there are strong measurement problems concerning the stakeholder benefits. It can be argued that these problems make the term meaningless (Jensen 2001). When we have stakeholder-owner maximization we have only one set of private benefits, and it can be assumed, that these benefits are measured subjectively by the specific stakeholder-owner. The owner calculates the value of controlling ownership seen from stakeholder-owner point of view. The specific stakeholder-owner can in this way make the exact decision about the weight between current and future income, between financial returns and e.g. the value of self-governance etc. The stakeholder-owner has a specific subjective measurement stick to bring different dimensions of the objective function down to one dimension. This one-dimensionality is necessary to give a precise meaning of the term maximization, and to decide whether one decision is better than an alternative decision (Jensen 2001).

One-dimensionality is not possible to establish for the non-owner stakeholders' benefits, because these benefits are typically not traded and compensated directly over the market, but based on subjective evaluations. Market based contracts with the different stakeholders cover only the transfer price of the transactions, not their rents. The multiple dimensions raise the traditional problem in economics about the impossibility of comparing utility between different individuals.

To the extent that the owner maximizes both the owner-value and the broad stakeholder value at the same time there are no problems with multi-dimensionality. According to Jensen (2001) this is in fact the case because the owners' maximization of the market value also means that the stakeholder values are maximized. The basic assumption is that all the contracts, which are mutually favorable for the company and the different stakeholders, are implemented in the process of owner-maximization. This is the case in figure 1. Both the net-benefits of the employee stakeholders and the surplus of the company are maximized at the chosen wage and employment level.

The use of efficiency wage setting and employee participation are examples of mutually maximization of owner value and broad stakeholder value. Higher wages and employee participation give returns to the company because of higher motivation, more creativity, higher productivity, lower turnover, easier recruitment of high quality labor etc. We have again a win-win situation with both an increase in the owner value and in the benefits for the stakeholders.

However, often owner-maximization does not lead to broad stakeholder maximization. We could have a zero-sum game situation where the owner increases the owner-value by cutting the benefits of the stakeholders. An example could be price-discrimination transferring some of the consumer surplus to the company, or it could be wage discrimination. In Figure 1 this would mean that a group of workers with the lowest transfer earnings got the lowest wage, a middle group got mid-level wages and only the marginal group of employees got the wage shown in figure 1. In this way the owner can transfer part of the employee-benefits to the surplus.

A decrease in the price of medicine for developing countries can be understood as an example of a social responsibility fulfilling the stakeholder interest of the populations in poor countries. However it can also be taken as a price-discrimination strategy to exploit the segments of the market with low purchasing power and still making a profit for the company⁸. On top of this the company can use the gift-element in the promotion to improve its reputation.

It can be argued that the zero sum game is just a matter of the distribution of the cake, and still the total cake and thus the total return to all stakeholders is maximized. However, because of the problem of multi-dimensionality the benefits to specific stakeholder cannot be compared, so we cannot say that one stakeholder's appropriation of benefits from another stakeholder is neutral.

Often the game between different stakeholder groups does not only lead to a change in the distribution of rents. The result can be a minus game, where the redistribution leads to a decrease in the size of the cake. A monopoly situation is a classical example where profit-maximization means that the monopoly restricts production and increases prices, so that there will be a loss of the consumer surplus and in general a deadweight loss for the society. Similarly in figure 1 the firm could get a higher profit by lowering wages and restrict production. The surplus would increase, but the benefits to employees would fall even further. There is again a deadweight loss to society, and no straight forward path of negotiations to reach the optimal production level.

In relation to externalities the profit-maximizing company has an interest in hiding the negative effects and seeking compensation for the positive effects⁹. High transaction costs often mean that it is not possible to make mutual improvements for the involved stakeholders. This situation calls for state regulation to strengthen the positive and limit the negative externalities.

There are cases where narrow owner maximization is in line with satisfaction of the

needs of other stakeholders e.g. consumers, but there will also be cases with conflicting interests with trade-offs between different stakeholders' benefits. Even within a stakeholder group, such as the group affected by different externalities from a company there will be high variation in the valuation of the effects e.g. the uncertainty connected to possible negative effects on the environment and positive effects of future employment possibilities caused by the company.

Who shall decide the exact trade-off function to assign the weights to these diverging interests? In most cases the owner in control of the company will make these choices combined with some state regulations. The maximization problem may be solved by the owner maximizing his own utility function given a vector of restrictions determined by the owners' relation to these other stakeholders and state regulation. These constraints can be assumed to vary between different types of stakeholder-owners: A large well known multinational company with a strong established brand can be expected to be very sensitive to the reputation in relation to negative information about pollution, mistreatment of the labor-force, negative health impact of the products or production processes etc. The sensitivity depends e.g. on the degree of information and reactions by "political consumers". Compare with a small focused firm, which does not have much reputational capital to lose. Such a company will pay less attention to stakeholder interests compared to the high profile MNC. An analytical stakeholder approach must, therefore, in the analysis include the specific stakeholder-owner objectives and the stakeholder-owners relation to other stakeholders. This means that not only the stakeholder owners' objective function will vary. The restrictions on this maximization in relation to other stakeholders will vary too.

On top of the share-value and the benefits for the stakeholder-owner, broad stakeholder maximization includes all the benefits of the other stakeholders. If we have owner maximization we can assume that the owners have already contracted all the contractible benefits and turned them into value for the owners. The restrictions made by legislation, codes and standards and pressure from organized groups, which can affect the reputation and thus the returns to the company may turn the company away

from some of the activities, which diminish the returns to other stakeholders. An activity which is not profitable from a narrow profit-maximization point of view, but which is profitable from a broader point including benefits for other stakeholders, may turn out to be profitable for the company when it considers its reputational value. In this way legislation and pressure from organized groups can imply an increase in the area for win-win situations where both owners' value and other stakeholders' value move in the same direction.

To increase the area for win-win situations it is important that the company gets credits for the activities with positive impact for the stakeholders, but to develop long run credibility the company shall also be transparent about the possible negative stakeholder effects. The company shall strive for transparency and give timely, detailed and accurate information about the company's activities and the estimated effects of these activities on different groups. This means that in addition to the normal shareholder-oriented financial information, the company should make estimates for the effects for the employees (wage, employment, training, safety etc), the effects on consumers and society (pollution, carbondioxide-balance, health implications, tax etc.). At the same time the company shall open up for stakeholder inputs by including different stakeholder groups in the discussion about the company's activities.

Conclusion

In the 1990'es the tendency has been to focus on quite narrow shareholder maximization, but with the recent introduction of Corporate Social Responsibility broad stakeholder maximization has again been an important part of the agenda. In this content it is relevant more precisely to define shareholder and stakeholder values.

In the discussion on maximization the neoliberal camp argues that profit-maximization in the companies lead to the best results and market contracting also fulfills the needs of other stakeholders. On the other side we have the normative stakeholder approach stating that all stakeholders shall be involved in the governance of the companies without stating more exact procedures for how this should be done. In this paper the

starting point is the analytical stakeholder approach emphasizing that the analysis of governance of companies must include the distribution on different stakeholders of different interests, resources and rights in relation to the company. This approach is the analytical tool for understanding the governance structure and the background for the different maximization strategies.

The stakeholder-identity of the dominating owner is crucial. We distinguish between two types of owner-maximization: pure shareholder-maximization and stakeholder-owner maximization. The latter includes stakeholder benefits defined from the principles of economic rent. If in a certain transaction the stakeholder supplier (buyer) gets a price that is higher (lower) than what is necessary for the stakeholder to go into the transaction there will be a net-benefit left for the stakeholders. The net benefits of externalities are simply the sum of the benefits minus the costs estimated by all the persons affected by the externalities.

The stakeholder-owner has specific resources and interests, which is important both for the economic performance of the enterprise and for the distribution of stakeholder benefits. Through ownership the stakeholder-owners can secure their company specific stakeholder benefits. They can also get a higher share of the benefits in the distribution-game with other stakeholders including minority shareholders. The stakeholder-owner who has the greatest advantage of ownership compared to ordinary market exchange will pay the highest price for ownership and control the stakeholder-owner maximization of the company.

Pure shareholder-maximization is a special case of owner-maximization where only the pure owner interest as supplier of risk-capital is behind the maximization. Other stakeholder-owners include on top of the interest as supplier of capital also specific stakeholder-interests as supplier, buyer, resident in the area etc. The value seen from the point of view of the pure shareholder owner will be the highest when market imperfections, relation specific investments and transaction costs are so low that the potential stakeholder-owners satisfy their interests best through ordinary market transac-

tions. In this case the stakeholder-owner benefits are quite low, and cannot cover the fall in shareholder value, which is often following a takeover, which implies a change from pure-shareholder maximization to stakeholder-owner maximization.

Broad stakeholder maximization includes the benefits for all groups – pure shareholders as well as all other stakeholders. This covers the shareholder value, the value for the stakeholder owner, and the value for other stakeholders. There is a precise measure for broad stakeholder maximization only under the restrictive condition that there are no trade-offs between the benefits of the different stakeholders. When there are trade-offs it is necessary with a measure stick to transfer the different benefits to one dimension.

Under perfect market conditions the maximization of owners' value coincides with broad stakeholder maximization because the different stakeholders go into transactions with the company only when they are mutually beneficial. However, in case of imperfect competition, externalities, and high transaction costs, the interests of the dominant owner to a high degree determine the distribution of benefits on the different groups. In case of trade-offs the objective function will be determined by the dominant owner. This happens in interaction with the market and the other stakeholders. Thus, in practice even in companies influenced by Corporate Social Responsibility, we will not find broad stakeholder maximization. Instead we will have stakeholder-owner maximization (with shareholder maximization as a special case) with constraints given by the interests of different stakeholder groups including the public interest represented by the state and enforced through different types of regulation.

The tighter these constraints, the more the dominant owner will have to consider other stakeholder interests, and the larger the outcome area where owner-maximization and stakeholder maximization are following each other. State legislation, new standards for Corporate Social Responsibility and active “political consumers” can strengthen these constraints. Legislation only covering one country can undermine the competitiveness of local companies. Therefore, it must be implemented within regional trading-areas or

even better globally. In fact, globalization and building up global brand-names make MNCs accountable all over the world and more sensitive to strong movements of political consumers. The development of international standards for treatment of workers, environment, human rights etc. both through legislation, international cooperation, and globally organized pressure groups makes it possible that market based decision-making based on owners' maximization also includes strong considerations for other stakeholders by including their interests as constraints to the maximization procedures.

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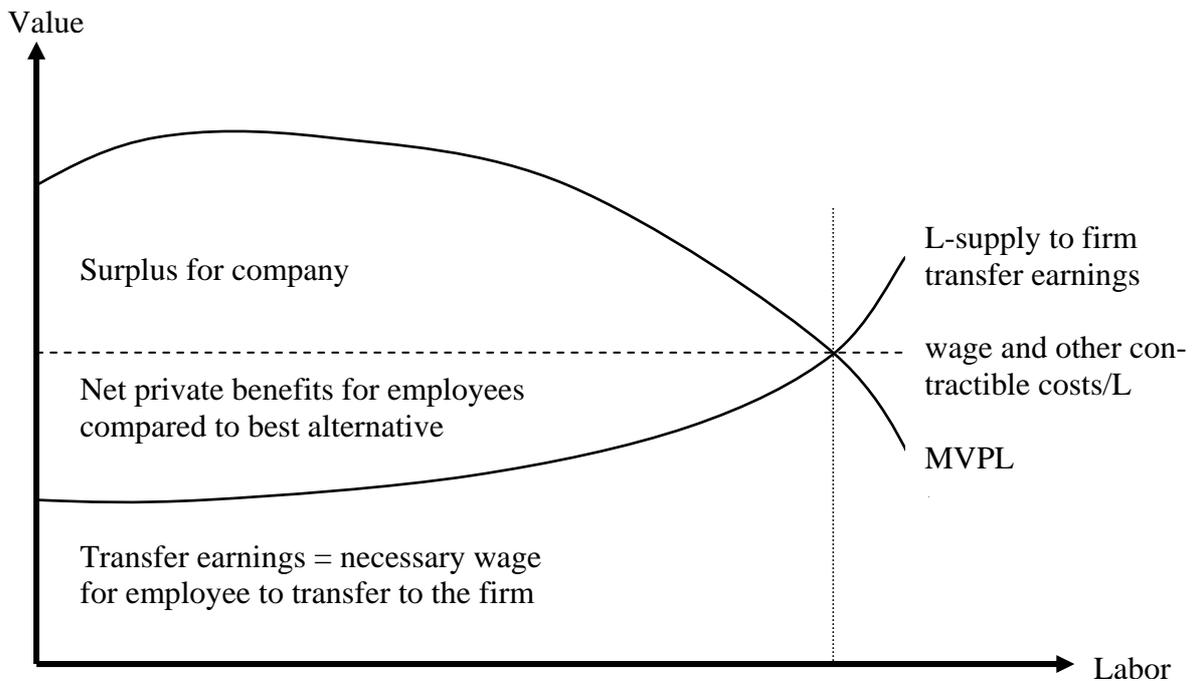
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Figure 1 Net stakeholder benefits for employee stakeholders, firm-level.



Endnotes

¹ In their distinction between normative, instrumental and descriptive Donaldson and Preston (1995) would probably categorize the analytical approach in their last category.

² How the identity of the stakeholders determine the objective functions of the company is an important topic in the governance literature (see Fama and Jensen 1985 and Shleifer and Vishny 1997), and especially the role of the manager as agent for several stakeholder principals have been discussed in the stakeholder literature (Hill and Jones 1992 and Mitchell et al 1997).

³ The company does not need to be listed on the stock-exchange. The idea is that the share value on the stock exchange reflects the expected returns for the pure shareholders, or alternatively that the market for control of unlisted companies reflects the value seen from the point of view of the pure owner.

⁴ The value is the present value of the expected future net-benefits, so we do not distinguish between flows and stocks.

⁵ Special credit constraints for employees on imperfect capital markets may mean that the employees cannot implement even a value-creating takeover.

⁶ Special quite specified leasing contracts modify this conclusion, but usually such contracts are long-term and come close to de facto ownership.

⁷ Empirical evidence shows that most often the shareholders of the target company gets most of the benefits (Jensen and Ruback 1983), but the actual distribution of the shareholder value is not important in this content.

⁸ This is possible if the starting point is monopoly where the price is higher than the marginal costs. It means that production will increase and part of the deadweight loss will be transformed to profit and consumer surplus. We assume, it is possible to make price-discrimination, and therefore the price and profit on the existing market is not lowered.

⁹ Jensen 2001 stresses that short run profit maximization may hamper the long run cooperation with the stakeholders and therefore it will not be in accordance with value maximization. With his “enlightened maximization” Jensen therefore emphasizes long run considerations in the relations with the different stakeholders. At the same time he recognizes that externalities and monopoly can break the connection between owner-maximization and maximization of the stakeholders interests. Therefore, state-regulation has an important role to adjust for these imperfections.