Shareholder Value Culture

Prompt: A rational adaptation perspective, for present purposes, predicts that organizations and other social groups act out of rational self-interest. Consider the emergence of the culture of shareholder value in the U.S. in the 1980s, as explained in the Heilbron/Verheul/Quak article.

a) Explain whom a rational adaptation perspective would have predicted would have been the initial advocates of shareholder value culture, and why.

b) Explain why the group you identify in part a) was not the initial advocate of shareholder value culture in the U.S., but only began supporting it later.

a) The emergence of the culture of shareholder value in the 1980's American business sector was a stark transition in business strategy from the previous emphasis on company growth and preserving and reinvesting profits. Following the rational adaptation perspective understanding that organizations and social groups act out of rational self-interest, one would conclude the initial advocates of shareholder value culture would be the shareholders themselves or the institutional investors who are the most powerful and organized owners of said shares. Institutional investors have a vested interest in shareholder value (being the main owners) and thus would rationally be the first to promote a culture that supports their interests.

b) In the analysis by Heilbron, Verheul, and Quak on shareholder value in published discourses, they discovered that despite a rational reason to support shareholder value culture, institutional investors were not the *initial* advocates of it. Moreover, the authors indicate that corporate raiders were more integral in the first emergence of shareholder value culture in the early years of 1980-1982. This was because corporate raiders acted aggressively through methods such as hostile takeovers, or threats thereof, wherein the raiders buy a large enough stake in a corporation to obtain enough shareholder voting rights to increase shareholder value. Corporate raiders were further aided by government policy of the Reagan administration that reduced antitrust enforcement, broke labor unions, and effectively enabled corporate takeovers.

Institutional investors, on the other hand, were not accustomed to meddling in corporate affairs and thus didn't adopt shareholder value culture as widely as corporate raiders until the period of 1983-1986. Although later to adopt, by 1985 institutional investors had created the Establishment of Council of Institutional Investors and had published articles applauding corporate raiders for their push toward shareholder value culture such as the actions of corporate raider Carl Icahn.

Prompt: One of the implications of a culture of shareholder value is that it elevates the importance of *share price* as a metric, relative to *profit*, per se. Explain how the specific case of Enron Oil—the "canary in the coal mine" episode within Enron—demonstrates behavior driven by a prioritization of share price over profit.

Profit is gained when companies provide tangible goods or services such that their revenues are greater than their costs. In a market where shareholder value culture takes precedence, however, profit becomes a means to an end wherein the end goal is instead an increase in share prices. The case of Enron's prioritization of shareholder value has been considered an example of a "canary in the coal mine" or a warning of danger to other corporations of the long-term effects on profit when strategies are solely oriented toward assuring short-term share price. Enron's emphasis on shareholder value as opposed to actual profit is evident by the many accounting measures the company took in order to create an illusion of high-growth throughout the 1980's and 1990's. One tactic Enron implemented was market-to-market accounting strategy wherein they reported long-term contracts as up-front earnings (despite the actual accounting period the funds would be received) to give the impression Enron was a reliable, high-revenue company. These deals were also made as often and as quickly as possible often times regardless if they were lucrative or not by traders or "deal-makers" of the company who constituted an entire third of Enron's employees. Other accounting methods Enron used were reporting fictitious losses to later pay the money back to themselves in a different earnings period and failing to report earnings shortfalls or "holes" to Wall Street in order to exaggerate earnings. Enron also delayed recording losses and reported overly optimistic earnings projections all in the pursuit of maintaining high shareholder value regardless of the more realistic future share prices of the company. Finally, the epitome of said emphasis on share price can be seen by how Enron took out loans from Citigroup, the opposite of making a profit, and maneuvered the loans on their records to make it look like revenue further skewing share price of the company. These strategies, however, were ultimately unsustainable and eventually ended in Enron’s financial demise.