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Buddhist Economics
What went wrong with shareholder value?

The Shareholder Value Revolution announced it success with the slaying of some obvious villains. Walking boardroom excesses such as Ross Johnson, the RJR Nabisco chief executive whose anti-heroism book and film Barbarians at the Gate, who drained the company cashflow into corporate jets and cranky research projects and then tried buying it out at an absurdly flattened share price. Asil Nadir, who turned Polly Peck into an apples-to-electronics glamour stock before fleeing to North Cyprus with the only remaining capital. And Liam Strong, who sank with the UK retail group Sears despite having money-spinning Selfridges at the heart of its collection. But it soon became clear that some of the movement's new champions weren't really such good value. Some, like Jeffrey Skilling of Enron, had cooked the books to make the profits rise, in ways that eventually brought the company down and wiped the shareholders out. Others, like George Simpson of Marconi and Allen Yurko of Invensys, had claimed to be re-focusing and reviving old conglomerates, but were actually taking them down a narrow-track road to ruin. Shareholder value knew no shinier examples than the dot-com entrepreneurs of the late 1990s. They saw their value peak at astronomical levels - and then plunge to earth before they could even get a viable product to market. Most, it turned out, never had a viable product to market. And share prices didn't, as expected, move to a permanently higher level. As well as the dot-com crash and the earlier Black Monday crash of 1987, the world's stock markets suffered mini-crashes in 1989, 1997and 2001, and an enormous crash that began in 2007. Pursuit of shareholder value seemed to have made prices more volatile, without lifting them so high that they didn't hit the ground when the next correction came. Shareholder value was meant to benefit customers, by helping businesses invest in their satisfaction and making them compete for their loyalty. But users of demutualised financial institutions often found life tougher after their one-off flotation bonus. Many who stayed loyal to a public limited company – a PLC brand – found the brand stamped on outsourced products and local service replaced by a call centre. Shareholder value was meant to benefit employees, by forcing managers to pay and train them better to retain the best. But those who boosted shareholder value most successfully were generally those who downsized, and held down pay while increasing productivity. Training, workplace improvement, research and development were all costs, whose reduction boosted profits and share prices. The best way to reduce cost was often to shift production somewhere cheaper. So, for example, a shareholder-driven Marks and Spencer abandoned its policy of local sourcing, pulling the remaining rug from under the UK textile industry. The shareholderdriven Big Four supermarkets cut ever tougher deals with small farmers and foodmakers. Lord Browne, the shareholders' champion who turned BP into a global oil giant, admits that the by-products were a devastating oil refinery explosion and maritime spillage – due to chronic neglect of basic safety measures, because strengthening the bottom of an oil tanker does nothing immediately to strengthen the bottom line. Above all, shareholder value was meant to benefit shareholders. But all too often, the share price boost lasted just long enough for accolades and knighthoods to be showered on the new chief executive, only to collapse shortly after they'd handed over the suddenly shaky reins. The costs that they'd cut – training, product development, preemptive maintenance, brand-building, health & safety – had actually been investments. They would have paid back in future innovation, reputation and profit - if they hadn't been cut out by managers whose only interest was the next quarter's earnings per share. And what about the promise that shareholder value would mean better allocation of resources, more investment, more innovation, and a richer, more dynamic economy? Well, because companies now wanted higher rates of return on investment, there were fewer investments that could yield the necessary profit. So companies became less inclined to spend on new products, or machinery, or skills, and more inclined to return the cash to shareholders. In fact, buying back shares became a favoured way of boosting their price, and raising shareholder value. So big business moved from investing in future production to handing out the proceeds of past production. Downsize and distribute took over from invest and expand. So who gained from the shareholder value revolution? Ironically, the biggest

winners were often the managers who were supposed to be dethroned. To bind them more closely to shareholders’ interests , managers had been turned into shareholders – through profit-linked pay, and share options that were only worth cashing if the share price rose. Managers who’d once enriched themselves by letting profits and share prices erode proved equally adept at enriching themselves by boosting profits and share prices - at least until their share options became cashable. Whether it was by axing the product renewal programme or being creative with the accounting, those profit targets were hit with unerring accuracy. Until the day after the golden handshake. And even if the share price fell again before the executive moved on, there was usually a golden parachute. The revolution ended with executive pay going through the roof, even as shareholder value fell back through the floor.