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The Modern Corporation

Statement on Management

— BACKGROUND

The rise of modern corporations has been accompanied by an expansion of salaried executives who have replaced owner-managers. With this expansion, the new class of managers/executives came to regard themselves as stewards of large and complex corporations, and not principally or exclusively as agents for the owners. Emerging as a self-styled 'profession', there was a continuous debate around the necessity for the corporation to be responsible to the collective and to its stakeholders. During long parts of the twentieth century the professed intent was to balance and synthesize a plurality of interests in order to ensure the long term survival and success of the corporation, pursue national strategic interests, create employment, support networks of suppliers, develop new technology as well as create an adequate or satisfactory return for shareholders (Marens, 2012; O Sullivan, 2001).

The rise of agency theory in the late 1970s and early 1980s challenged this understanding of management. Arguing that markets rather than managers provide an efficient allocation of scarce resources, it pushed an agenda in which the corporation had to pursue one single goal – the maximization of shareholder value (MSV) and that managers should be incentivised to respond to (financial) market forces. This idea gradually gained traction through teaching in US economics departments and business schools and has today become a highly influential doctrine which infuses senior executive thinking, investors thinking, corporate governance theory and public policy and regulatory decision making (Khurana, 2007; Harvey, 2009).

— IMPACTS OF MSV

- 1. Shareholders without commitment.** The distancing of shareholders from the long-term prospects of the firm is enhanced through limited liability, the liquidity of their investment, and, more recently, high velocity trading. This means that the commitment of shareholders is no longer to firms, but to short-term profits only (Davis, 2009; Muzrichi, 2010; Mayer, 2013).
- 2. Senior management without commitment.** The rise of MSV means CEOs find themselves in increasingly precarious positions with shorter tenure. As a result, senior executives rapidly move between firms which means that they have a shorter term decision making horizon, and rarely stay in a position long enough to deal with the problems that their initiatives aimed at increasing shareholder value creates (Useem, 1993, 1996; Dobbin and Zorn, 2005).
- 3. Poor quality management.** The focus on MSV has led many companies to adopt generic management practices. The most obvious example of this is firms chasing so-called celebrity CEOs who tend to be highly paid but tend to fail in their assignments. Research suggests that firms tend to be more successful when they rely on firm or industry specific management rather than generic management practices (Khurana, 2004; Ghoshal, 2005).
- 4. Race to the bottom in employment conditions.** Firms with a strong focus on maximizing shareholder value tend to concentrate upon squeezing costs to produce immediate returns, and so reduce the quality of employment (e.g. wages, pensions provision, and job security) when it is not outsourced, offshored, etc. This has a tendency to encourage regulatory dumping as different countries tend to create the conditions that will allow particular corporations to do this (Davis, 2009).
- 5. Increasing inequality within the firm.** The focus on MSV has led to a rapid divergence between the rewards received by those at the top and those at the middle and the bottom of firms. As a result, the rewards from productivity gains during the past two decades have gone to top management and shareholders rather than to employees in the form of wages and benefits. This is reflected at the macro

(societal) level with well documented increases in within-country inequalities in almost all Western countries over the past thirty years or so leading to a return towards increasingly rigidified class structures allowing for less and less mobility in many of those countries (McFall and Percheski, 2010).

6. Declining innovation. The focus on maximizing shareholder value has led many firms neglecting investing in areas like research and development in favour of ploughing money into measures which create immediate increases in shareholder value (such as paying dividends and share buy backs). The result is that future performance which comes from spending on innovation is effectively undermined (Lazonick and O Sullivan, 2000).

7. Restructuring efforts. An emphasis on narrow financial performance encourages the use of corporate restructuring efforts, such as mergers, acquisitions, buyouts and demergers in order to impress financial markets (Krippner, 2010). The vast majority of organizational change efforts are motivated by the imperative to create value for shareholders and fail to deliver long term productive capability. Such restructuring efforts tend to divert attention from the core business without receiving the benefits and result in lay offs and plant closures which have devastating effects on relations with stakeholders and thus destroy shareholder value in the longer term (Davis, 2009).

8. Increased systemic risks. The combination of MSV with limited liability leads to systemic moral hazard. the shareholders of corporations benefit from the short term value created by inconsiderate risk taking while being shielded from the medium/long term losses for the corporation and for society that may come from this kind of inconsiderate risk taking: privatization of profits and socialization of costs (Djelic, 2013). Some examples include banks which create toxic financial products in order to maximize returns to shareholders in the short term, but created huge problems for the wider financial system in the longer term. The cost of the failure has been born by other groups in society, particularly ordinary savers and public service and benefit recipients (Crouch, 2011).

■ RETHINKING MANAGEMENT PRACTICES

Backed by questionable notions of law and economics which have become embedded in corporate governance and accounting regulations, many managers now act on the basis of a folk wisdom that shareholders are the only important constituency, which leads them to deliver short-term strategic decisions, high executive remuneration, and offshoring strategies with regard to manufacturing and finance. This comes at the detriment of broader and longer- term perspectives on the purpose of the firm in modern societies and has created worse management and less competitive companies. It is ironic that the obsession with MSV has actually destroyed long-term shareholder value and that it has significantly decreased the average life span of corporations during the past 30 years (Davis, 2009).

The time has come to rethink the over-riding commitment to MSV. This involves revitalising a model in which companies are understood to have multiple and often competing goals – with producing returns to shareholders as only one of them.

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■ Signatories

Hugh Willmott, Research Professor in Organisational Studies, Cardiff business School

Marie-Laure Djelic, Professor, ESSEC Business School

Andre Spicer, Professor of Organisational Behaviour, CASS Business School

Martin Parker, Professor of Organisation and Culture, University of Leicester

Charles Perrow, Emeritus Professor of Sociology, Yale University

Derek S. Pugh AcSS, Emeritus Professor of International Management, Open University Business School

John-Christopher Spender, Visiting Professor ESADE, Visiting Professor Lund University School of Economics & Management

Jean-Pascal Gond, Professor of Corporate Social Responsibility, Cass Business School, City University London

René ten Bos, Professor, Department of Management Sciences, Nijmegen School of Management

Armin Beverungen, Junior Director at the Digital Cultures Research Lab, Leuphana University Lüneburg

Marta B. Calás, Professor of Organization Studies and International Management, Isenberg School of Management, University of Massachusetts – Amherst

Grahame F. Thompson, Professor, Department of Business and Politics, Copenhagen Business School, Denmark

Glenn Morgan, Professor, Cardiff Business School

Stewart Clegg, Professor and Research Director Centre for Management and Organization Studies, University of Technology Sydney (UTS)

Brendan McSweeney, Professor of Management, Royal Holloway, University of London

Pasi Ahonen, Lecturer in Organisation Studies, Swansea University school of Management

Philip Hancock, Professor, Essex Business School, University of Essex

Barbara Czarniawska, Professor of Management Studies, Gothenburg Research Institute, University of Gothenburg

Howard Gospel, Professor, Department of Management, King's College, University of London, and Associate Fellow, Saïd Business School, University of Oxford

Tyrone S Pitsis, Reader in Strategic Design, Newcastle University

Scott Taylor, Reader in Leadership & Organization Studies, Birmingham Business School, University of Birmingham

Christopher Land, Reader in Work and Organization, Essex Business School

Stephen Shukaitis, Lecturer in Work & Organization, Essex Business School, University of Essex

Ace Simpson, Lecturer in Organisational Behaviour, UTS Business School, Sydney

Tom Keenoy, Emeritus Professor, Cardiff Business School

Sheena Vachhani, Lecturer, University of Bristol

Laurent Taskin, Professor of Organization and human resource studies, Louvain School of Management, Belgium

George Cheney, Professor of Communication Studies, Kent State University, Kent, Ohio

Nicolas Bencherki, Assistant Professor of Organizational Communication, State University of New York

Véronique Perret, Professor of Strategic Management, Dauphine University, Paris

Florence Allard-Poesi, Professor of Management, IRG, University of Paris-East Créteil, France

Florence Palpacuer, Professor in Management Studies, University of Montpellier, France

Juan Espinosa, Lecturer, School of Commerce, Pontificia Universidad Católica de Valparaíso, Chile

David Jacobs, Associate Professor of Labor and Sustainability, Graves School of Business and Management
Morgan State University, Baltimore, Maryland

Jo Brewis, Professor of Organization and Consumption, University of Leicester School of Management

Daniel King, Senior Lecturer, Nottingham Trent University Prem Sikka, Professor of Accounting, Essex
Business School

Thomas Wainwright, Lecturer in Strategy & Innovation, Programme Director for Management with
Entrepreneurship, Southampton Management School

Torkild Thanem, Professor of Management & Organization Studies, Stockholm University School of Business

Walter Jarvis, Lecturer in Management & Organisations, University of Technology, Sydney (UTS)

Casper Hoedemaekers, Lecturer in Work and Organisation, University of Essex

Jason Glynos, Political Theory Division, Department of Government, University of Essex

Ian Towers, Professor, SRH Hochschule Berlin

Samuel Mansell, Lecturer in Business Ethics, University of St Andrews

Laure Cabantous, Professor of Strategy and Organization, Cass Business School, City University London

Bill Cooke, Professor of Management and Society, Department of Organization, Work and Technology,
Lancaster University Management School; Vice Chair Research and Publications, British Academy of
Management

Richard Marens, Professor, Sacramento State University

Iain Munro, Professor of Leadership & Organizational Change, Newcastle University Business School

Oleg Komlik, Lecturer, Ben-Gurion University

Ken Weir, Lecturer, University of Leicester

Simon Lilley, Professor and Head of the School of Management, University of Leicester

Ludovic Cailluet, Professor of Strategy and Business History, EDHEC Business School

Nihel Chabrak, Associate Professor, College of Business, United Arab Emirates University

Tony Huzzard, Professor, Department of Business Administration, Lund University School of Economics and
Management

Ozan Nadir Alakavuklar, Lecturer, Massey University School of Management

Chris Mowles, Professor of Complexity and Management, Hertfordshire Business School

Jonathan Murphy, Senior Lecturer, International Management, Cardiff Business School

Joan Le Goff, Professor, Vallorem, Tours School of Management (IAE), Tours

Ruth Slater, Lecturer, School of Management, University of Central Lancashire

Maria-Carolina Cambre, Assistant Professor of Sociology, King's University College, London ON Canada

Susana Velez-Castrillon, Assistant Professor of Management, University of West Georgia, GA United States

Djamel Eddine Laouisset, Professor, Alhosn University, Abu Dhabi, UAE

Stuart M Schmidt, Professor, Fox School of Business, Temple University

Ismail Ertürk, Senior Lecturer in Banking, Manchester Business School, University of Manchester

Alan Meyer, Emeritus Professor of Management, University of Oregon

Timothy Kuhn, Associate Professor, University of Colorado Boulder

Isabelle Huault, Professor of Organization Studies, Université Paris Dauphine

Hovig Tchalian, Visiting Assistant Professor of Management and Executive Director, Institute for the Practice of Management, Claremont Graduate University, Drucker-Ito School of Management

Thomas Clarke, Professor of Management and Director of the Centre for Corporate Governance, UTS Sydney

Isabelle Cassiers, Professor, Senior Research Associate FNRS

Jean-Pierre Chanteau, Maître de Conférences HDR, Université Grenoble-Alpes

Julien Malaurent, Assistant Professor of Information Systems, ESSEC Business School

David J. Cooper, Professor of Accounting, University of Alberta

Dermot O Reilly, Lecturer, Lancaster University

Michael Pirson, Associate Professor, Fordham University

Nidhi Srinivas, Associate Professor, The New School University

Duarte de Souza Rosa Filho, Adjunct Professor, Universidade Federal do Espírito Santo, Brazil

Alex Faria, Associate Professor, EBAPE/FGV

Raza Mir, Professor, William Paterson University, USA

Carolina Serrano Archimi, Associate Professor of OB, Aix-Marseille Graduate School of Management-IAE, Aix-Marseille Université

George Cairns, Professor, RMIT University

Kevin Tennent, Lecturer in Management, University of York

Daniel Doherty, Senior Lecturer, Leadership, Work and Organisation, Middlesex University Business School

Rick Wartzman, Executive Director, Drucker Institute, Claremont Graduate University

Pik Liew, Lecturer, University of Essex

Vlatka Hlupic, Professor, University of Westminster

Annick Ancelin-Bourguignon, Professor, ESSEC Business School

Joe O'Mahoney, Reader, University of Cardiff

Suhaib Riaz, Assistant Professor of Strategic Management, University of Massachusetts-Boston

Ismael Al-Amoudi, Senior Lecturer, University of Cardiff

Oscar Montiel, Professor of Management and Entrepreneurship, Universidad Autonoma de Ciudad Juarez, Mexico

Steve McKenna, Professor, York University, Toronto

Herman van den Bosch, Professor, Open Universiteit

Chris Rees, Professor of Employment Relations, Royal Holloway, University of London

Emma Bell, Professor of Management and Organisation Studies, Keele University

Olivia Kyriakidou, Assistant Professor, Athens University of Economics and Business

Abby Cathcart, Associate Professor, Queensland University of Technology, Australia

Rory Ridley-Duff, Reader in Co-operative and Social Enterprise, Sheffield Hallam University

Lorna Stevenson, Reader in Accounting, University of St Andrews

Andreas Kornelakis, Senior Lecturer in International Management, King's College London

Jeroen Veldman, Senior Research Fellow, Cass Business School, City University London