

# “The CEO's Attitude Towards the Shareholder Value and the Stakeholder Model. A Comparison Between the Continental European and the Anglo-Saxon Perspective”

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| <b>AUTHORS</b>      | Christian Stadler<br>Kurt Matzler<br>Hans Hinterhuber<br>Birgit Renzl   |
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## SECTION 2 | Management in Firms and Organizations

### The CEO's attitude towards the Shareholder Value and the Stakeholder Model. A comparison between the Continental European and the Anglo-Saxon Perspectives

Christian Stadler, Kurt Matzler, Hans Hinterhuber, Birgit Renzl

#### Abstract

The debate on shareholder value versus stakeholder orientation is more than ever an issue, particularly, since the burst of the internet bubble and corporate scandals in the United States have scrutinized prevalent management practices. There are also some arguments that the shareholder model will prevail due to the globalization of capital markets and the growing power of institutional investors. This paper addresses the issue of shareholder value versus stakeholder orientation in firms. It provides new evidence of CEOs' preferred orientation across countries. The findings of our study indicate that American and British CEOs favor maximizing shareholder value and European CEOs focus on engaging with the stakeholders. In addition a case study of Shell in the 1990s is presented indicating that firms are able to achieve outstanding returns for their shareholders in the long run not despite but because of their stakeholder orientation.

**Key words:** shareholder value approach, stakeholder value, corporate governance, oil industry.

**JEL Classifications:** L2, L10, L65, L72, M10.

#### Introduction

Corporate Governance has become a hotly debated issue in the management literature since the beginning of the mid-1990s (Koen, 2005). Corporate Governance covers the way of organising ownership, management, and control of a corporation (Cadbury, 2002; Keasey *et al.*, 1997; Shleifer *et al.*, 1997; Witt, 2000). The prevailing corporate governance system influences the corporation regarding overall strategy, i.e. the recognition of stakeholder interests, especially, the interest of shareholders, customers, banks, management, and employees. It is necessary to balance the varying interests among these parties involved and the existing asymmetries in information consequently (Witt, 2000). The mechanisms of balancing these interests vary across different countries.

The literature on corporate governance distinguishes two different models: 1) the shareholder value model, *Anglo-Saxon model*, in which the maximization of shareholder value is the primary goal of the firm, and 2) the stakeholder model, *Rhineland model* (Albert, 1993), in which a variety of firm constituencies – including employees, suppliers, customers, etc. – have a say in the firm, and whose interests are to be balanced against each other in management decision-making. The fundamental distinction between the shareholder and stakeholder model is that

*“... the stakeholder theory demands that interests of all stakeholders be considered even if it reduces company profitability. In other words, under the shareholder theory, non-shareholders can be viewed as “means” to the “ends” of profitability; under the stakeholder theory, the interests of many non-shareholders are also viewed as “ends”.” (Smith, 2003)*

Table 1 summarizes the key differences between the shareholder value perspective and the stakeholder value perspective.

Shareholder value versus stakeholder value (De Wit *et al.*, 2004)

|                              | Shareholder Value Perspective                 | Stakeholder Value Perspective                                  |
|------------------------------|---|--|
| Emphasis on                  | Profitability over responsibility             | Responsibility over profitability                              |
| Organizations seen as        | Means to maximize profits                     | Socioeconomic system   |
| Organizational purpose       | To serve owners                               | To serve all parties involved                                  |
| Long-term objectives         | Maximize shareholder value                    | Sustainability/viability of long-term development and survival |
| Major difficulty             | Getting agent to pursue principal's interests | Balancing interests of various stakeholders                    |
| Corporate governance through | Independent outside directors with shares     | Stakeholder representation                                     |
| Stakeholder management       | Means   | End and means  |
| Social responsibility        | Individual, not organizational matter         | Both individual and organizational                             |
| Society best served by       | Pursuing self-interest (economic efficiency)  | Pursuing joint-interests (economic symbiosis)                  |

Starting in the 1980s American companies adopted a view that value creation and value maximization for shareholders should be their primary goal. European companies were critical of this approach, seeing it as anti-social. As Calori and Wood put it "Europeans have never fully adopted the simplistic approach of Milton Freeman, who claims that the only social responsibility of business is to make money" (Calori *et al.*, 1994). While American companies are generally perceived as being at the forefront of the shareholder value movement, European and Japanese corporations are often related to the stakeholder approach (Hinterhuber *et al.*, 2004).

There is also some empirical evidence for international differences in this respect. Hampden-Turner and Trompenaars (1993) asked managers whether they thought the majority of their fellow citizens felt that a company's goal was profit, or if they thought that companies are also responsible for the well-being of the stakeholders. They found great differences among the countries. In the USA, 40% of the managers chose the former response, versus 24% of the managers in Germany opted for the latter.

A study based on a survey of business leaders in US, Britain, Germany and Japan underlines the different orientation in the Anglo-Saxon world (Yoshimori, 1995). Yoshimori, the author of the study, sees a strong shareholder orientation in the US and Britain while Germany and Japan are much more stakeholder orientated. Given the option of either lay-off of workers or lowering the dividend, 90% of CEOs questioned in the US and Britain would rather start a redundancy round. In Germany and Japan, however, the surveyed leaders preferred to lower the dividends: 60% in Germany and even 97% in Japan. Deciding on a preference for shareholders or stakeholders the situation is similar. 75% of US CEOs give priority to the shareholders while in Germany 82% and in Japan 97% say that they prefer a stakeholder approach.

In recent literature, the shareholder value model has been strongly criticized by leading scholars (Ghoshal, 2005; Mintzberg, 2000; Mintzberg *et al.*, 2002; Porter, 1990) for its tendency to underinvest and focus on short-term results and for the fact that it does not take ethical and social values into account. Therefore, it is argued that it can not be a solid foundation for the society. In an interview with the Academy of Management Executive Henry Mintzberg puts it this way (Mintzberg, 2000):

*"We are certainly seeing some of the trend toward shareholder value in Europe. I don't know whether they'll wake up and realize what nonsense shareholder value really is, or whether they will keep pursuing it until people are out in the streets protesting. It is a phi-*

*losophy of greed, not a philosophy of large institutions serving society as well as their own particular needs. It's anti societal, and the only advantage to it sweeping through Europe and Japan is that it will decrease the damage of our own nonsense in North America. So if others are stupid enough to do it that will only help North American business".*

At present, it is generally believed that the shareholder value approach will prevail due to the globalization of capital markets and the growing pressure of institutional investors (Lazonick *et al.*, 2000) who are strongly seeking for higher returns. Germany and Japan, for example, have witnessed major changes in 1) the formal and regulatory system, 2) structure of ownership, 3) the growth of the stock market, and 4) the emergence of a market for corporate control (Koen, 2005). Some authors argue that important legal and institutional developments of the last 10 years in Germany can be seen as preparing the way for larger and more active German equity markets, together with a more "shareholder-friendly" corporate governance system (Nowak, 2001). The main question here is whether the stakeholder model of corporate governance changes towards the shareholder model as a result of globalization pressure (Koen, 2005). To answer this question, a study among CEOs of the largest firms in Europe and the USA was carried out that was aimed at measuring the CEOs attitude towards the stakeholder and the shareholder models.

## **Methodology**

Given the nature of our study we decided to split our research process into two phases. In phase I we determined the attitude of CEOs towards shareholder and stakeholder approach. In phase II we conducted a case study of Shell to gain a better understanding how a stakeholder oriented firm can generate outstanding return for its shareholders.

### ***Phase I***

To study the CEO's attitudes towards shareholder value or stakeholder value a short self-administered standardized questionnaire was developed. The items were phrased as bipolar statements using a 10-point continuous rating scale measuring the CEOs' attitudes towards shareholder and stakeholder values. The items were taken from De Wit and Meyer's table (see Table 1) distinguishing the two approaches (De Wit *et al.*, 2004). This scale measured to what extent CEOs were either shareholder or stakeholder value oriented (e.g., "The emphasis of a firm should be on maximizing shareholder value over responsibility to stakeholders (1)", "The emphasis of a firm should be on responsibility to stakeholders over maximizing shareholder value (10)"). 149 questionnaires from European and U.S. American CEOs were collected (107 Continental European and 42 U.S. American and UK CEOs).

### ***Phase II***

Phase II is based on an in-depth, inductive case study of Shell (high Total Shareholder Return and a reputation for stakeholder engagement) in the 1990s. First, all qualitative methodologies are more suitable for exploratory studies (Eisenhardt, 1989) like this one and, second, given the open-ended nature of our question we felt that this was the most appropriate method (Glaser *et al.*, 1967; Miles *et al.*, 1994; Yin, 1984).

In addition to the material which was publicly available data was gathered through interviews and active project participation (Tripsas *et al.*, 2000). The latter was intended to provide a deeper understanding of processes engaging various stakeholders. One of the researchers took the role of a social anthropologist exploring the 'unknown tribe' Shell through active participation in various projects. This approach allows a much deeper understanding of how an organisation functions than mere outside analysis or exploration via surveys as many of the crucial aspects are implicit rather than explicit (Schein, 2001; Schein, 2000).

The active participation in Shell included a number of different projects. They were chosen to gain a broad picture and to develop an understanding of how the organisation tries to create value for different stakeholders and how this enhances Total Shareholder Return. The most important en-

agements were several months which one of the researchers spent with a team responsible for Shell's Group-wide employee survey in 1999 (90.000 employees were surveyed) and 2000 (100.000 employees were surveyed) and a team which organises voluntary assignments of staff to social and environmental projects.

Finally we interviewed 5 chairmen of the Committee of Managing Directors (comparable to a CEO) of Shell. Two were active at the time of the interview (Mark Moody-Stuart, Phil Watts), one was the head of the supervisory board of Royal Dutch (Loo van Wachem) and two were retired (G.A. Wagner, Cor Herkstroeter). On average an interview lasted 45 to 60 minutes.

## Results

Our research indicates that Continental European CEOs are stakeholder oriented whereas CEOs in the USA and UK are shareholder oriented. In order to compare the attitude of Continental European CEOs towards the shareholder value approach with that of American and British CEOs a t-test between the two groups was conducted. Table 2 reports the results. As can be seen from the table, significant differences are found on eight out of nine items. Respondents from the USA/UK and Continental Europe did not differ significantly on the statement "Social responsibility is ... not an organizational matter (1) – an organizational matter (10)".

Table 2

### Results

| Statement   | USA-UK versus Europe | Mean | S.D.  | t-test Sign. |
|---|----------------------|------|-------|--------------|
| The emphasis should be on ...<br>Maximizing shareholder Value over responsibility to stakeholders (1) – Responsibility to stakeholders over maximizing shareholder value (10) | Continental Europe   | 5,19 | 2,245 | ***          |
|   | USA-UK               | 3,60 | 1,515 |              |
| Organizations are ...<br>Means to create shareholder wealth (1) – "Joint ventures" between all stakeholders (10)  | Continental Europe   | 5,32 | 2,374 | ***          |
|   | USA-UK               | 3,53 | 1,830 |              |
| An organization's primary purpose is ...<br>To serve its owner (1) – To serve all parties (stakeholders) involved (10)  | Continental Europe   | 6,19 | 2,641 | ***          |
|   | USA-UK               | 3,95 | 2,070 |              |
| Success is measured through ...<br>Share price and dividends (shareholder value) (1) – Satisfaction among all stakeholders (10)   | Continental Europe   | 4,93 | 2,435 | ***          |
|   | USA-UK               | 3,65 | 1,901 |              |
| Major difficulty of an organization is ...<br>Getting managers to pursue shareholder interest (1) – Balancing interests of various stakeholders (10)                          | Continental Europe   | 6,56 | 2,371 | **           |
|   | USA-UK               | 5,47 | 1,944 |              |
| Corporate governance should rely on ...<br>Shareholder representatives (1) – Stakeholder representatives (10)   | Continental Europe   | 4,63 | 2,535 | *            |
|   | USA-UK               | 3,72 | 2,119 |              |
| Stakeholder management is a(n) ...<br>Means to maximize shareholder value (1) – End in itself (10)  | Continental Europe   | 4,66 | 2,530 | n.s.         |
|   | USA-UK               | 3,98 | 2,395 |              |
| Social responsibility is ...<br>not an organizational matter(1) – an organizational matter (10)   | Continental Europe   | 8,34 | 1,851 | *            |
|   | USA-UK               | 7,58 | 2,538 |              |
| Society is best served if companies ...<br>Pursue their self-interest (economic efficiency) (1) – Pursue interests of all stakeholders (10)                                   | Continental Europe   | 6,19 | 2,689 | *            |
|   | USA-UK               | 5,05 | 2,478 |              |

In order to do an in-depth case study, we selected a company that displays both Stakeholder orientation and outstanding return for its shareholders (average annual TSR between 1993 and 2003 is 14%).

### **Case study: Shell**

In the 1990s – the period we focused on in our research – Shell saw stakeholder orientation not only as the right approach from an ethical point of view but even more important as a guarantee for long term success. Shell used a number of tools, e.g. the Balanced Scorecard, to ensure a stakeholder approach in its operations. The most fundamental and important guarantee of the stakeholder approach were the firm's culture, managed through the basic beliefs, the Shell General Business Principles.

Top executives in Shell have always been aware of the political nature of the oil industry and their dependence on government concessions to explore and exploit oil reserves. Consequently public opinion matters from a business perspective. An initiative from the International Chamber Commerce and two events causing public criticism led to a formulation of "Shell General Business Principles", Shell's basic values, with a clear commitment to all stakeholders in 1976. Wagner, the chairman of the Committee of Managing Directors (CMD) at the time, explains the events:

*"At the end of the 1960s business and especially multinationals were more and more criticized. Sometimes for good reasons, sometimes for bad reasons. In 1969 the International Chamber of Commerce decided to devote a study to this aspect and formed a committee. I was a member of this committee in 1974. We formulated some principles explaining why and how multinationals should behave. ... That document of the ICC was then taken under the wings of the OECD. On that basis they drew guidelines for international investment and national treatment. That document was finished in 1976. We in Shell took the initiative in September 1975 to have our own statement of business principles which go beyond guidelines for investment. ... Why did we do it? Because we are so ethical? No, it is pure business sense". [Interview Wagner, 15 June 2002]*

The importance to follow the General Business Principles and to act in the interest of all stakeholders was emphasized by two events in the mid 1990s: Brent Spar and Nigeria. Brent Spar was a North Sea installation from the 1970s which was about to be dismantled and sunk in the Atlantic when Greenpeace occupied the platform, organized consumer boycotts and put pressure on Shell's public relations department. Despite having a solution which was technically and environmentally sound and regardless of the government approval of countries bordering the North Sea, Shell lost the PR battle. Shell's technical argument was overcome by the emotional approach of the Rainbow Warriors. Shell was eventually forced to dismantle Brent Spar and use it to build a quay in Starvanger, Norway. The situation in Nigeria was even more complicated as it was set in a political struggle between the government and the Ogoni people. After a politically motivated murder trial a number of people, among them Ken Saro Wiwa (a writer and leader of the Ogoni people) were executed. In Europe the press portrayed Shell as the exploiter of both the people and the environment in this region and of being relieved that Ken Saro Wiwa was no longer a thorn in their side. These allegations were never proven. Nevertheless in Germany, the country where Greenpeace's campaign was most effective, revenues fell (Note this consumer campaign was related to Brent Spar). Shell recognized that they had to renew the effort to engage stakeholders and centered these efforts around the General Business Principles. Shell decided to introduce a process where country chairman gave a written commitment to do business according to the General Business principle in their country. At the end of each year the country chairman would discuss developments with the CMD.

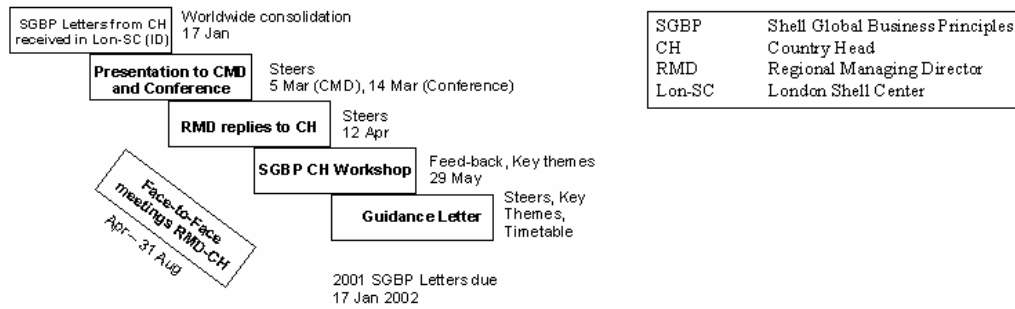


Fig. 1. The Shell General Business Principle Letter process, 2001

This approach was powerful in an organization where country organizations enjoyed great operational freedom. It ensured that Shell’s country managers were aware of the significance of the Business Principles. The emphasis was less on sanctions and more on engagement.

In 1997 the company decided to move one step further and started to publish an annual document reporting on the Group’s financial, environmental, and social (including employee indicators) performance. The publication created a more transparent approach, engaging a wider public – particularly NGOs. The mood in the company also encouraged internal initiatives. For example a group of mainly young employees approached top management with the request to receive funding and support for voluntary environmental and social projects. The CMD endorsed the team’s effort and “Project Better World” was born. A small group of volunteers organized two week environmental programs and social projects lasting between 6 months and 1 year in cooperation with Earth Watch and Voluntary Service Overseas (two established NGOs). While some line managers originally were skeptical how they would keep their business running when key people left for a voluntary assignment they soon started to see the program as a training program providing their staff with new skills, e.g. negotiation and leadership skills. By 2005 185 employees have volunteered for environmental and 12 for social programs. Project Better World is now active in 20 countries and has more than 1600 people helping to coordinate the initiative.

Another initiative built around the company’s core values was started at the end of the 1990s. In 1999 Shell conducts its first Group wide employee survey which was to be repeated every two years. While the Head of Global Employee Relations, the sponsor of this activity, was sometimes struggling to create interest from line management for the first survey, a response rate of around 70% (pushed up to 80% in 2002) made enough noise to gain the attention of top managers. Some parts of the organisation now use the survey in their tasks and target setting. In most parts of the organisation the survey is mainly a communication tool, facilitating the dialogue between employees and their managers.

The Shell story shows how a company was able to build a successful business taking a stakeholder approach. Using the company’s core values as the basic foundation a company can create an environment which encourages initiatives reflecting a stakeholder approach. The statements of top executives and the origin of this approach support the motion that it is hard nosed business sense and not purely ethical motivation driving Shell executives to engage with stakeholders. Following the introduction of a new structure in Shell in 2004 the allocation and execution of accountabilities are much clearer now providing leaders with an opportunity to take this approach to the next level.

## Discussion and Conclusion

The results of this study find significant differences in shareholder value versus stakeholder orientation between Continental Europe and the USA. Although there are some trends towards the shareholder approach in Europe, European CEOs still favor the stakeholder approach. In contrast

to the shareholder value model the stakeholder model tries to take the interest of different groups into consideration. Professor Michael Mirow (2002), the former chief strategic planner at Siemens, summarized the point of German entrepreneurs and senior executives this way: The overall objective of a company is not shareholder value. Increasing the value of the investment for the shareholder is a necessary condition for the long-term survival of the corporation as are customer satisfaction, employee engagement, and so on. The overall objective of a corporation is sustainability/viability for its long-term development and survival (Matzler *et al.*, 2005). The Shell case study demonstrates that a stakeholder approach does not hinder performance. On the contrary it can be the basis of outstanding returns for shareholders.

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