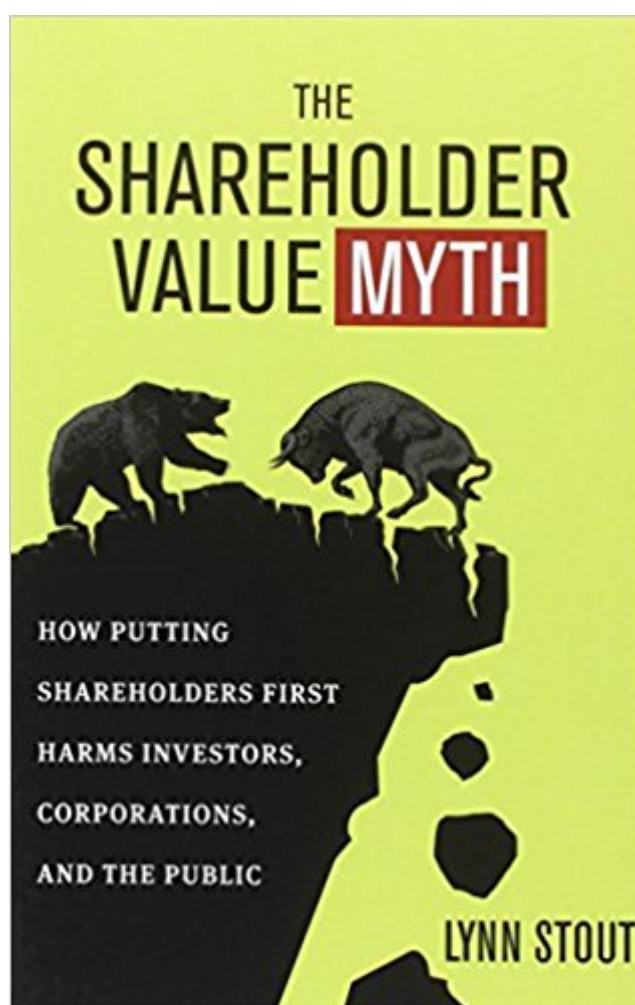


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# The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, And The Public



## Synopsis

Executives, investors, and the business press routinely chant the mantra that corporations are required to “maximize shareholder value.” In this pathbreaking book, renowned corporate expert Lynn Stout debunks the myth that corporate law mandates shareholder primacy. Stout shows how shareholder value thinking endangers not only investors but the rest of us as well, leading managers to focus myopically on short-term earnings; discouraging investment and innovation; harming employees, customers, and communities; and causing companies to indulge in reckless, sociopathic, and irresponsible behaviors. And she looks at new models of corporate purpose that better serve the needs of investors, corporations, and society.

## Book Information

Paperback: 120 pages

Publisher: Berrett-Koehler Publishers; 1 edition (May 7, 2012)

Language: English

ISBN-10: 1605098132

ISBN-13: 978-1605098135

Product Dimensions: 5.6 x 0.4 x 8.5 inches

Shipping Weight: 7.2 ounces (View shipping rates and policies)

Average Customer Review: 4.1 out of 5 stars 41 customer reviews

Best Sellers Rank: #38,997 in Books (See Top 100 in Books) #4 in Books > Business & Money > Management & Leadership > Corporate Governance #9 in Books > Business & Money > Finance > Corporate Finance > Valuation #47 in Books > Business & Money > Management & Leadership > Project Management > Business

## Customer Reviews

“A must-read for managers, directors, and policymakers interested in getting America back in the business of creating real value for the long term.”  
—Constance E. Bagley, Professor, Yale School of Management; President, Academy of Legal Studies in Business; and author of *Managers and the Legal Environment* and *Winning Legally*  
“A compelling call for radically changing the way business is done, *The Shareholder Value Myth* powerfully demonstrates both the dangers of the shareholder value rule and the falseness of its alleged legal necessity.”  
—Joel Bakan, Professor, The University of British Columbia, and author of the book and film *The Corporation*  
“Lynn Stout has a keen mind, a sharp pen, and an unbending sense of fearlessness. Her book is a must-read for anyone interested in understanding

the root causes of the current financial calamity. • Jack Willoughby, Senior Editor, Barron's  
"Lynn Stout offers a new vision of good corporate governance that serves investors, firms, and the American economy."  
• Judy Samuelson, Executive Director, Business and Society Program, The Aspen Institute

Lynn Stout is the Marc and Beth Goldberg Distinguished Visiting Professor of Law at Cornell Law School. Her work on corporate theory was cited by Supreme Court Justice John Paul Stevens in his dissent in *Citizens United*.

If you so much as skim the business pages in a newspaper, there's little doubt you've heard it said or seen it written that corporate officers and directors are required by law to maximize shareholder value and that they're subject to lawsuits if their decisions favor any other stakeholder such as employees, customers, or suppliers over profit. The well-entrenched view that shareholders are paramount is widely regarded as the cornerstone of contemporary business law -- and it's flatly untrue. In *The Shareholder Value Myth*, business law professor Lynn Stout proves this point, citing chapter and verse in court decisions going back more than a century. "So long as a board can claim its members honestly believe that what they're doing is best for the corporation in the long run, courts will not interfere with a disinterested board's decisions -- even decisions that reduce share price today." Having laid the legal groundwork, Stout then proceeds to explain how this mistaken view of shareholder primacy is bad for business. "Put bluntly," she writes, "conventional shareholder value thinking is a mistake for most firms -- and a big mistake at that. Shareholder value thinking causes corporate managers to focus myopically on short-term earnings reports at the expense of long-term performance; discourages investment and innovation; harms employees, customers, and communities; and causes companies to indulge in reckless, sociopathic, and socially irresponsible behaviors." Among the examples Stout cites is the Gulf oil spill, caused by excessive cost-cutting on the part of BP. "In trying to save \$1 million a day by skimping on safety procedures at the Macondo well, BP cost its shareholders alone a hundred thousand times more, nearly \$100 billion."

Q.E.D. Stout deftly demonstrates that this irrational focus on shareholder value has been harmful in other ways as well. For example, "[b]etween 1997 and 2008, the number of companies listed on U.S. exchanges declined from 8,823 to only 5,401." Of several factors that help explain this trend, shareholder primacy clearly stands out. Smart people know that there's more to success in business than a rising stock price. The origin of this misguided notion lies in the thinking of the so-called Chicago School of free-market economists best known through the work of the late Nobel

Prize-winner Milton Friedman. Friedman had written a book in the 1960s that highlighted the idea, but it was his essay in 1970 in the New York Times Magazine that gained wide attention. There, he "argued that because shareholders 'own' the corporation, the only 'social responsibility of business is to increase its profits.'" Stout argues that "shareholders do not, and cannot, own corporations . . . Corporations are independent legal entities that own themselves, just as human beings own themselves." Shareholders merely own shares of stock that constitute a contract with the corporation to receive certain financial benefits. They're not in charge of the show, either. Some lawyers and economists writing after Friedman contended that shareholders appoint the directors as their agents. This too, Stout contends, is mistaken. She devotes two chapters to prove that this description of shareholders as principals "mischaracterizes the actual legal and economic relationships among shareholders, directors, and executives in public companies . . . Moreover," Stout writes, this assumes "that shareholders' interests [are] purely financial," when in fact shareholders may have any one of a great many different reasons for buying and holding shares in a company. A fair portion of *The Shareholder Value Myth* is focused on analyzing the impact of several popular measures promoted by shareholder advocates, the SEC, and Congress over the past two decades: "de-staggering" boards, so that all directors may be removed at once; giving shareholders the right to circulate proxies to all other shareholders on issues of interest; and equity-based compensation. Ask yourself: How often have shareholders removed the entire membership of a corporate board with a single vote? And how often have shareholders of a public company -- other than corporate raiders or hedge funds -- successfully obtained proxies to overturn a corporate board policy? You can guess the answer to those questions. But the very worst impact of these efforts to strengthen the shareholders' hand has come from the popularity of equity-based compensation. "In 1991, just before Congress amended the tax code to encourage stock performance-based pay, the average CEO of a large public company received compensation approximately 140 times that of the average employee. By 2003, the ratio was approximately 500 times." That policy isn't the only factor to account for this dramatic rise in the ratio, but it's certainly a major one. And it only seems to work on the upside. How many times have you read about board decisions to lower a CEO's pay in proportion to the decline in its stock price the past year? You probably know the answer to that one, too. *The Shareholder Value Myth* is an important contribution to a growing body of thought that seeks to re-conceive the role of the corporation in a more expansive manner commensurate with its growing importance in contemporary society.

Seriously, read it. Then have a good debate in your ethics or finance class. It's worth it and we need

to start understanding what our other options are for valuation much better. But you can't join THAT conversation until you know why we might want to do that. The book is a bit simplistic, but it's great for those just dipping their toe into the field/topic area.

A must read for all citizens, liberal and conservative alike. A balanced exploration of the role of corporations. Not a liberal screed at all

An excellent, concise clarification of a widespread confusion.

Great book, very interesting point on the shareholder value. Valuable book as a business student

I knew, by gut feeling, something was wrong with the "everything for the share holder" dogma that I learnt from GE. Now I know it is wrong thanks to this book.

The book is well researched and supports their premise. It did seem to go a little long after they made their case.

A thorough research. Thanks to Lynn Stout for her outstanding efforts and setting the record straight. Very well written and documented.

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