

# Understanding Economics: Shareholder value

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Should companies exist solely to make their shareholders richer? For decades, the idea of shareholder value has dominated corporate management, but I argue that this approach has fundamentally misunderstood what makes businesses successful.

In this *Understanding Economics* video, I explain what shareholder value means, where the idea came from, and why putting shareholders first can damage businesses, workers and society.

In 1970, economist Milton Friedman argued that companies should prioritise making profits for their shareholders. This idea became central to neoliberal economic thinking and helped transform how major corporations were managed.

Around the same time, economist Eugene Fama developed the efficient market hypothesis, encouraging the belief that share prices accurately reflect the value of companies. Together, these ideas helped make profits and rising share prices the dominant measures of corporate success.

But does a rising share price really mean a company is doing well?

I examine how the pursuit of shareholder value can encourage businesses to cut jobs, suppress wages, reduce investment and buy back their own shares to boost financial returns. These decisions may benefit shareholders in the short term while weakening the businesses they own.

I also explain why shareholders are not the only people responsible for creating a company's wealth. Workers, customers, suppliers, governments and communities all contribute to business success, yet shareholders are often given priority when the rewards are distributed.

UK company law recognises some of these wider responsibilities. Section 172 of the Companies Act 2006 requires directors to consider employees, suppliers, customers, communities and the environment, although shareholder interests remain central.

Drawing on my experience as a chartered accountant who has advised hundreds of businesses, I argue that successful companies prioritise providing useful products and services, treating workers fairly, maintaining good supplier relationships and respecting the environment.

Profit matters, but it should be the consequence of running a successful business rather than its sole purpose.

Companies should exist to meet people’s needs and contribute to society. Shareholders deserve fair treatment, but so does everyone else who makes business success possible.

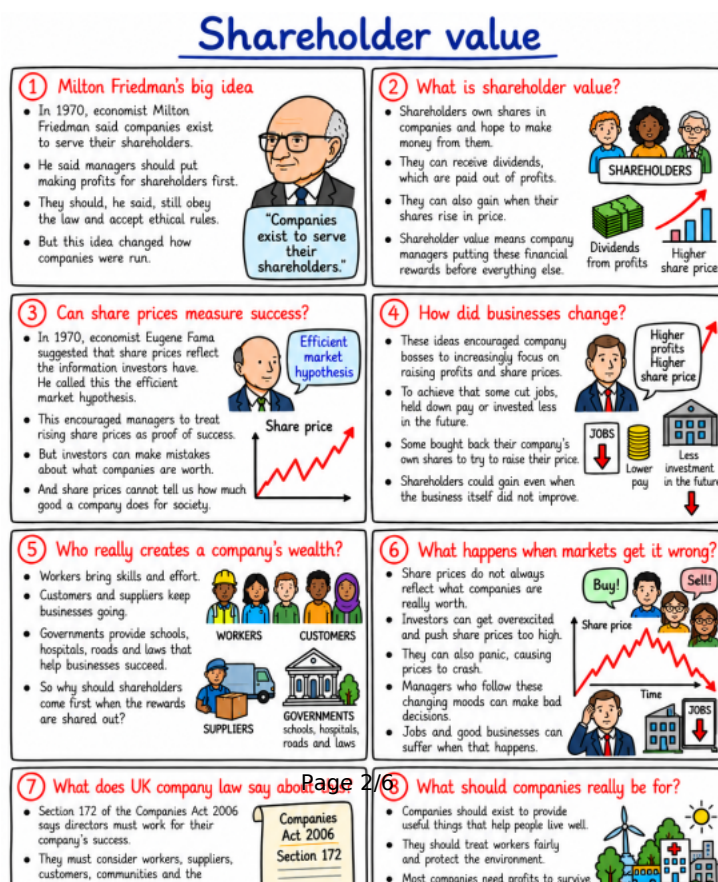
It’s time to rethink shareholder value and ask what companies should really be for.

<https://www.youtube.com/watch?v=15r28WaimP8?si=ScwjvLxaPb26OIWI>

This is the audio version:

[https://www.podbean.com/player-v2/?i=dmd6r-1b93df8-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=f6f6f6&font-color=auto&logo\\_link=episode\\_page&btn-skin=c73a3a](https://www.podbean.com/player-v2/?i=dmd6r-1b93df8-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=f6f6f6&font-color=auto&logo_link=episode_page&btn-skin=c73a3a)

This infographic supports this video:



This is the transcript:

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Hello, I'm Richard Murphy, and this is *Understanding Economics*. That's the series of videos that I'm making that explains economics in the way that I see it. Now, I stress this is the way in which I see it, and I do not see it as most economists do because I am a heterodox economist. That means I'm outside the economic mainstream. But I think that's appropriate. Economics as it is being taught in universities, as most economists talk about it, and as most commentators talk about it, has clearly failed us.

So this view of economics is about an alternative view of an economics that could work for you, does work for me, and which explains the world as it is based upon my experience of working within that world as a chartered accountant, as a campaigner, and as a university professor.

Today I want to talk about something which is important because it is fundamentally linked to the concept of neoliberalism, about which we made a video recently, and that is the concept of shareholder value, which has totally changed the way in which the world's largest companies have been managed over the last 30 or 40 years.

This concept was created by the economist Milton Friedman in 1970 when he wrote an article which said that large companies should exist solely to serve the interests of their shareholders. He said the world's corporate managers should put making profits for shareholders at the top of their list of priorities, and everything else should be a long way down. He did admittedly say that companies should obey the law, but beyond that, shareholders came first. And this idea of Milton Friedman's changed how the world's largest companies have been run. Shareholder value is the concept which now dominates corporate thinking.

And shareholders own shares in companies and hope to make money from them.

Let's be clear, shareholders don't work in companies. Shareholders do not participate in the management of companies. They just own a share in the ownership of the company, which gives them a right to receive dividends if the managers agree that that is appropriate, and these are paid out of corporate profits.

They can also gain when their shares rise in value if they're quoted on stock exchanges. And shareholder value means that company managers are meant to put these two types of financial reward at the top of their list of priorities before everything else.

So, can share price measure success? By coincidence. In 1970, the economist Eugene Fama, who went on, like Milton Friedman, to win the Nobel Prize in economics, suggested that share prices reflect the information investors have. He called this the Efficient Market Hypothesis (EMH). I will be honest, the concept is a little more

complicated than that, but this idea encouraged managers to treat rising share prices as proof of success.

But investors can make mistakes about what companies are worth, and share prices cannot tell us how much good a company does for society. So how did business change as a result?

These ideas encouraged company bosses to increasingly focus on these two issues, raising profits and increasing share prices. Their own rewards were often aligned with these goals, and as a consequence, many of them set out to cut jobs, hold down pay or cut investment in the activity in the company because that would release money for current dividends rather than hold it back to generate future well-being.

Some also authorised the buyback of their company's own shares from stock markets, and that raised their prices, often, in my opinion, artificially. Shareholders could gain as a result even when the businesses that they owned did not improve.

So who really creates a company's wealth? That's the ultimate question to ask when it comes to this concept of shareholder value and putting that first amongst all other things. In my opinion, shareholders do not, of course, create a company's wealth.

Workers bring skills and effort.

Customers and suppliers keep businesses going.

Governments provide schools, hospitals, roads and laws that help underpin business success.

And so the obvious question to ask is: why should shareholders come first when the rewards come to be shared?

Why do they have priority when everybody else seems to have done more to create the success which they are meant to have priority upon?

And what happens when markets get share pricing and other issues wrong? Share prices do not always reflect what companies are really worth. Investors can get overexcited and push share prices too high. I think they're doing that with regard to AI shares at present. They can also panic, causing share prices to crash. They did that, for example, in the dot-com bubble in 2000 when it burst, and there were real companies subject to a crash at that time, which had lasting value.

So managers who follow these changing moods could make very bad decisions, and the evidence is that they do. Jobs and good businesses can, however, suffer when those bad decisions are made.

So what does UK company law say about all this? And I stress the point: I am talking

about UK company law here, and not that in every country around the world, where this will differ.

UK company law on the purpose of companies is determined by Section 172 of the Companies Act 2006, and this says that the directors of the company must work for the overall success of the enterprise. They must, in the process, consider the interests of workers, suppliers, customers, communities, and the environment, and indeed the standing of their business in that community.

But the law still puts the interests of shareholders first for most companies, and I stress one point. It treats all shareholders as equal. The company cannot prioritise one shareholder over another. But that being said, the law recognises wider responsibilities without giving them equal importance, and that matters. Shareholders do come first in UK company law.

But what should companies really be for? That's the key question here. Companies should exist to provide useful things that help people live well. I've run many companies in my career. I've started quite a number. And what I know is that a company that does not produce something that somebody wants to buy is going nowhere.

And what I also know is that a company that does not treat workers fairly and protect the environment is likewise going to have a very short life indeed. People will walk out on it. The company will fail. And therefore prioritising profit before the interests of customers, workers, and the environment makes no sense at all. I would also add to that list suppliers, because they have to be treated fairly as well.

Companies need profits to survive in most cases, and they need that because they might need to pay a return to shareholders, but more importantly, they need to fund future investment in their activity as well.

Making shareholders richer is what I call an epiphenomenon of a successful company. It's the consequence of doing something really well. And the thing that a company has to do well is treat its customers by supplying them with good products, caring for its workers, caring for the environment, caring for its suppliers, and paying its tax on time. When it's done all of those things, and if it does them well, shareholders will benefit.

A company succeeds by helping people in society thrive and not just by making shareholders rich. And I cannot stress that point enough. In my experience as a practising accountant who has advised hundreds of companies in my career, and I'm not exaggerating when I say that, I have never seen a company that prioritised profit succeed as well, if at all, as one that prioritised providing good products, treating people well, managing supplier relationships so that everyone was happy and respecting the environment.

Companies that succeed do so because they're good at what they do and not because they only think about their shareholders.

So, companies should exist to meet people's needs and help society thrive. Shareholders deserve fair treatment, but no more than anyone else whose contribution makes the business possible. It's time for companies to value everyone and not just shareholders.

Now that's what I think, but in this series on Understanding Economics, there is, of course, room for you to disagree. That's what Understanding Economics is all about. We form our opinions by disagreement. Let us have your comments below. I'd be delighted to read them.

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Poll

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