# THE VALUE OF THE LONG-TERM VIEW

## Balancing the shareholders and stakeholders' priorities

By Professor Nuno Fernandes - November 2009

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Who should come first in managers' minds: shareholders or stakeholders?

According to one fundamental principle, the answer is clear – executives' primary objective should always be to create value for their firm's owners. Under the "shareholder view" approach, maximizing profits takes priority over all other possibilities.

Opponents of this view, however, argue just as strongly that firms have a responsibility take the interests of all their stakeholders – employees, customers, suppliers and society more generally – into account when shaping their governing objective.

But these competing approaches need not be mutually exclusive. Research at IMD has shown that the firms most admired for their treatment of stakeholders are also significantly more successful than their competitors.

Each year since 1983, *Fortune* has published a survey of the world's 50 most admired companies. This year's list is topped by Apple, which was also ranked number one last year. Others in the top 10 include Berkshire Hathaway, Toyota Motor, Google, and Southwest Airlines. AT&T, Accenture and Samsung Electronics make up the bottom three.

The magazine prepares the list by asking more than 10,000 business executives, outside directors, and analysts, to vote for the companies that they admire most. They are asked to consider factors such as innovation, people management, use of assets, social responsibility, management quality, financial soundness, long-term investment and product quality.

The results show that the most admired corporations are certainly doing their job when it comes to stakeholders such as employees, customers and local communities. What is less immediately obvious is whether or not they are also worthy of investors' money.

However, upon analysis of the stock market performance of the most and least admired corporations in the survey, it became clear that the firms that took better care of their stakeholders also outperformed their rivals in both good and bad years. For example, between 2000 and 2007, the firms ranked in the top 10 did nearly 17 percent better than those ranked in the bottom 10. In other words, maximizing shareholder value correlates with taking better care of stakeholders, rather than competing with it.

| | Best | Worst | Difference |
|---|---|---|---|
| Financial soundness | 17% | -10% | +27.1% |
| Innovation | 8% | -3% | +10.5% |
| Long-term investment | 22% | -10% | +32.5% |
| Management quality | 15% | -7% | +21.2% |
| People management | 11% | -10% | +21.4% |
| Quality of products/services | 6% | -6% | +12.0% |
| Social responsibility | 7% | 0% | +6.2% |
| Use of corporate assets | 16% | -9% | +25.2% |
| Overall Average | 13% | -4% | +16.9% |

This relationship also holds true in bad years such as 2008, when firms lacked the cash to fulfill all their goals and had to go through painful cost-cutting measures, layoffs and discontinuation of products. It comes as no surprise to see that most firms in *Fortune*'s list had negative returns in 2008. However, the most admired firms were also the firms that weathered the crisis better. Overall, those in the top 10 performed 29 percent better than those in the bottom 10. Some of the most striking differences by category included the top 10 companies for people management doing 37 percent better, the top 10 for corporate assets doing 42 percent better and the top 10 for long-term investment doing 57 percent better.

| | Best | Worst | Difference |
|---|---|---|---|
| Financial soundness | -28% | -71% | +43.5% |
| Innovation | -40% | -56% | +15.5% |
| Long-term investment | -19% | -77% | +57.1% |
| Management quality | -30% | -72% | +41.4% |
| People management | -36% | -73% | +37.2% |
| Quality of products/services | -41% | -48% | +7.0% |
| Social responsibility | -32% | -39% | +6.6% |
| Use of corporate assets | -30% | -72% | +41.7% |
| Overall Average | -32% | -62% | +29.4% |

Our evidence shows that firms that take care of their employees, customers and other stakeholders also deliver value to their shareholders. The top companies in each category are also the best stock market performers in good times and bad.

Ultimately, maximizing shareholder value is much more than optimizing current share price or this quarter's earnings per share. Short-term goals like this ignore the strategic view of the firm, which focuses on sustainable value creation. In the long run – through boom times, and through recessions – firms that focus on long-term shareholder value creation are also able to respect and gain the support of other stakeholders.

Great companies have happy shareholders that earn an appropriate return on their capital. But in order to do this, they also recognize the need to have loyal employees, satisfied costumers, reliable suppliers and agreement from the community in which they operate.

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