



# THE QUESTION OF SHAREHOLDER PRIMACY: A REALISTIC RESPONSE TO THE MANY CALLS FOR CHANGE

DENIS KILROY

*Since the late 1990s, there has been widespread agreement that the fundamental economic objective of every listed company should be to create shareholder wealth.*

However what was never properly resolved and until now has remained something of a conceptual frontier, is the question of how that wealth should be created and what heed should be paid to the interests of other stakeholder groups along the way.

## Emerging Doubts Regarding Shareholder Primacy

In the aftermath of the GFC there have been many calls for an end to the notion of “shareholder primacy”. These sentiments are most prevalent in Europe, where there is mounting pressure for listed companies to set aside the idea that “shareholder value maximisation” should be regarded a governing corporate objective to which all other objectives must be considered subsidiary. Some of the main contributors to this thinking are groups like the Brussels-based *Purpose of the Corporation Project*, the Oslo-based *Sustainable Companies Project*, the London-based *Modern Corporation Project*, as well as the Aspen Institute’s *Business in Society Program* in the US. The Governance Institute of Australia is now involved as well, with a recent and very well-written discussion paper entitled “*Shareholder primacy: Is there a need for change?*”.

Much of the very good work being done by these and other similarly motivated groups has a legal, regulatory or governance focus. Its “outside in” approach looks closely at the rules, regulations and requirements that govern the behaviour of listed companies. It has also tended to view short-term earnings maximisation as either being synonymous with or else a path to shareholder value maximisation – which it is not. The stand-alone pursuit of short-term earnings maximisation is rarely if ever in the long-term best interest of shareholders. Nor is it in the interest of the many other stakeholders in a listed company.

In aggregate, the work of these groups clearly articulates the nature of the problem being addressed and in doing so, makes a compelling case for change. However a clear solution combined with a practical path forward has yet to be formulated. The purpose of this paper is to put forward one possible solution.

*In the aftermath of the GFC, there have been many calls for an end to the notion of shareholder primacy*

## THE LEGACY OF GOOD LEADERSHIP

*A Wealth Creation Paradigm  
for the Third Millennium*

Constructing a company that creates value  
for its customers and builds wealth for  
its shareholders while at the same time  
enhancing community wellbeing

DENIS KILROY  
with MARVIN SCHNEIDER

[www.thelegacyofgoodleadership.com](http://www.thelegacyofgoodleadership.com)

### A More Inclusive Business Paradigm

If we approach the challenge of defining a more appropriate and more socially responsible set of corporate objectives from the “inside out” rather than from the “outside in”, we can develop a meaningful response and chart a path forward that is both realistic and practical. However to do this, we need to be prepared to retain that which is correct and valuable about the current business paradigm – and not just focus on its shortcomings.

The answer could lie in making a seemingly subtle but actually quite profound change to the fundamental economic objective for all listed companies.

Leadership teams of publicly listed companies have many important responsibilities. However in our view, from a purely economic perspective, their primary responsibility is to build an organisation capable of creating wealth for shareholders on an ongoing basis. It is important to be clear about this. **The goal is not to create shareholder wealth per se**, but to build an enduring institution that has the ability to create wealth for its shareholders on an ongoing basis.

Significantly, the very nature of this more complete and appropriate goal means that the way a company journeys towards it can be just as important as eventually getting there. In fact, if pursued with integrity, the journey and the destination can become one. This is because the way a company goes about creating shareholder wealth has an enormous impact on its ability to continue to do so on an ongoing basis.

Once this is understood and accepted, it is possible to embark on the journey armed with both a philosophy and a toolkit that are completely “in sync” with each other. At each step along the way, it will be apparent just how closely they are aligned. At the same time, a number of perhaps surprising insights will become apparent.

It will quickly become evident that the way most shareholders measure company performance from an external perspective is both different to and quite difficult to align with the way management teams traditionally measure performance internally. Aligning these two perspectives is essential if a company is to understand the link between its strategic decisions and its financial performance; as well as how its performance in the market for its products and services affects the capital market outcomes experienced by its shareholders. Both linkages must be understood if company directors and executives are to act in the long-term best interest of shareholders. As is often the case with seemingly complex challenges like this, there is a relatively simple answer. In this case, all that is needed is to shift from accounting to economic measures of performance.

It will also be evident that in most cases, building an organisation that can create wealth for its shareholders on an ongoing basis requires customer value creation and shareholder wealth creation to be embraced as joint and mutually reinforcing objectives.

*The goal is to build an enduring institution that has the ability to create wealth for its shareholders on an ongoing basis*

*The way a company goes about creating shareholder wealth has an enormous impact on its ability to continue to do so on an ongoing basis*

*Customer value creation and shareholder wealth creation need to be embraced as joint and mutually reinforcing objectives*

Most opportunities to create wealth for shareholders on an ongoing basis arise at segment level – the same level at which successful companies seek to create value for their customers. This is because the key to ongoing shareholder wealth creation is more often than not the efficient delivery of additional customer value – a good proportion of which is recaptured through price.

However to make full use of this understanding, it is necessary to define segments as *groups of customers whose needs are so similar that we can serve them in a way that is value creating for them and cost effective for us*. Once defined in this way, each segment can serve as a platform for ongoing value uplift through which it is possible to establish and maintain an enduring cycle of customer value and shareholder wealth creation.

It will also be apparent that once established, working with this cycle to continually create both customer value and shareholder wealth requires a *hybrid form of thinking that draws on both creative and analytical modes of thought*. This means learning to operate in a whole brain state and deliberately making use of both the analytical left and the creative right hemispheres of the brain – not separately but at the same time. This is a deceptively easy skill to apply once developed; yet the benefits that flow from its use are enormous.

More forward thinking business leaders will come to understand that having embraced customer value creation and shareholder wealth creation as joint and mutually reinforcing objectives, they are in a position to make a conscious choice to create value for customers in ways that preserve and wherever possible enhance community wellbeing – should they consider this an appropriate course of action.

There is no obligation or externally imposed requirement for a leadership team to steer their company in this direction – at least not yet. However those that do choose this path forward will need to have a clear understanding of the nature of the value or benefit that they are setting out to create for their customers. Will it be real value stemming from the provision of useful, beneficial or healthy products or services, the consumption or use of which contributes to the long-term wellbeing of customers and end consumers? Or will it be artificial value arising in large part from the satisfaction of desires created by their company's own consumer marketing campaigns?

If sufficient companies elect to focus primarily on creating real or authentic value for customers, then there is every chance their actions could open up the possibility of a new and more socially responsible business paradigm. Under that paradigm, the goal of listed company leadership teams might well evolve into seeking to build enduring institutions that prosper through serving society: by creating real or authentic value for customers; by building significant wealth for shareholders; and by doing both in ways that quite deliberately set out to enhance the wellbeing of their employees, the wider community and the environment. However, the leadership team of each and every listed company that chooses to embrace this paradigm will need to be clear about their true underlying intentions.

*Business leaders can make a conscious choice to create value for customers in ways that also enhance community wellbeing*

*Will it be real value, from providing truly beneficial products or services, or artificial value arising from the satisfaction of a desire created by a consumer marketing campaign?*

*A focus on creating real as distinct from artificial value could open up the possibility of a new and more socially responsible business paradigm*

In reaching that point of clarity, they must be prepared to confront in an open and honest manner, the question of whether they consider being in business an opportunity to serve society, or an opportunity to exploit it.

### **A Potential Path Forward**

Unlike many who are calling for an end to the notion of shareholder primacy, KBA does not believe customers, shareholders, employees and the wider community should be regarded as having inherently competing interests. In our view, with the right mindset, the correct understanding and a long enough time horizon, the interests of all of these stakeholder groups are actually aligned.

Consistent with this, we are less concerned with devising the optimum legal or regulatory framework than we are with what we consider the more fundamental task of building an organisation that is both capable of and devoted to creating customer value, building shareholder wealth and at the same time enhancing the wellbeing of all other stakeholders.

The legal and regulatory framework is certainly important – and it does need to be adjusted to both encourage more companies to act in this way as well as to support those that have already chosen to do so. However for KBA this is a second order issue. In putting together a series of three books based on our experiences (which in combination posit a new and much more socially responsible business paradigm) we felt it made sense to us to put the discussion about the regulatory framework in the third and final book. The three books in the series are entitled:

- *The Legacy of Good Leadership*. Constructing a company that creates value for its customers and builds wealth for its shareholders while at the same time enhancing community wellbeing
- *The Choice to Serve or Exploit*. Guiding leadership teams in perhaps their most fundamental choice – whether to consider their business and opportunity to serve society, or an opportunity to exploit it
- *A Path to Social & Economic Equilibrium*. Shaping a regulatory environment that encourages the business community to create customer value, build shareholder wealth and enhance community wellbeing

The first book was released in late 2014. The other two will be released over the next 12-18 months.

*An important question for all business leaders is whether they consider being in business is an opportunity to serve society, or simply an opportunity to exploit it*



The KBA Consulting Group

The KBA Consulting Group  
Level 3, 650 Chapel Street  
South Yarra Victoria 3141  
AUSTRALIA  
Tel. +613 9024 8288  
[www.kba.com.au](http://www.kba.com.au)