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The Divorce of Ownership from Control and Stakeholders

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Abstract: It is said that within a company, shareholders are after profit making while managers are after their own interests. Also, corporations are said to have stakeholders other than shareholders and managers that are affected by the actions they take, though not owning or employed by them. It will be discussed in this essay that whether the statement is accurate.

Keywords: Ownership and Control; Stakeholders; Corporate Governance

1. Introduction

This essay is going to divide the statement into two parts to explore. First, it will argue that although there could be differences between objectives of shareholders and managers, shareholders do not always seek profit maximization, and purposes among managers vary, too. Second, it will state that stakeholders can be impacted by firms through various channels. To demonstrate this, each group of stakeholders, including which is neglected in this statement, will be investigated separately[1].

2. Main analysis

2.1 The divorce of ownership from control

The first part of the statement implies that although making a profit seems to be the sole goal of for-profit firms, managers may not make decisions from the perspective of shareholders, which is also known as the principle-agent problem. It was put forward first by Berle and Means (1932) in their book that shareholders tend to have little control over the decision-making progress of the American modern corporations. Ownership has already started to be divorced gradually from control in the early twentieth century in pioneered countries such as America, Japan and European countries as Hannah (2007) mentioned in her article, which raised debates on whether this was a positive trend. One of the reasons is the executives' responsibilities to their personal social network or the society, such as their families and conscience, other than their employers, as suggested by Friedman (1970). Therefore, the first part of the statement is partially correct about shareholders and managers having different purposes[2].

However, the hypothesis that profit making is of greatest importance to shareholders, as the traditional shareholder theory stated, may be flawed. According to Hornby's (1994) empirical research over 77 Scottish companies, firms controlled by shareholders do not necessarily tend to pursue profit maximization more than managerially controlled companies, though a minimum profit constrain is more ubiquitous in the former. Furthermore, Friedman (1970) demonstrated that owners of a company could be after serving the public welfare, like hospitals and primary schools. In such cases, shareholders do not deem profits to be their single goal, but the implementation of these services. Hence, shareholders do not merely want to make a profit[3].

What's more, there are divided targets among managers. According to Williamson (1963), managers are inclined to seek maximization in their own interests, such as high salaries and promotions, which was supported by Friedman's (1970) article and the agency theory (Bohren, 1998). However, Marris (1963) argued that managers could be devoted to maximizing the

growth of the corporation. Moreover, it is hard to distinguish shareholders and executives sometimes, for there are managers who are also owners. Hornby's (1994) article illustrated that there is hardly a common agreement on the definition of owner-controlled companies and managerially controlled companies. As a result, it is inaccurate to classify managers' goal as earning a wage[4].

2.2 Stakeholder economy

For the second part of the statement, it suggests that stakeholders who do not work for the company or own the shares of it could also be influenced by its behavior. It is true that the stockholder and stakeholder theory have long been the subject of debate, which argue that whether firms should consider interests of non-shareholders when making decisions or focus on meeting shareholders' needs (Boatright, 2002)[5]. Although there are opinions against stakeholder theorists that constituencies would protect their own interests if they participate in the process of making decisions (Boatright, 2002), stakeholders are not only those who are in the business, but also those who do not have control over the company, but are involved in consequences it caused[6].

However, there is a missing group in this statement, which is low-level employees, whose welfare depends on the firm's policies and performance. As long as the cost of their turnover is so significant that they are reluctant to switch to other corporations (O'Connell & Kung, 2007), the company's impact on them is huge. Also, employee financial participation has been viewed as an effective means to arouse motivation and efficiency (Froud, Haslam, Johal, Shaoul & Williams, 1996), which attaches employees' self-interests to the firm's state of operation. Aside from workforce, managers and shareholders, stakeholders include customers, suppliers (Sloman, Garratt, Guest & Jones, 2016) and competitors (Ambler & Wilson, 1995), which will be discussed respectively below[7].

2.2.1 customers

The relationship between customers and firms can be stated as demand and supply. Change in supply and price would result in the responsiveness of demand, though the extent depends on the market type and the price elasticity of demand. When the demand of customers for the company's products or services is elastic, which means it is easy to consume substitutions, or they do not have rigid demand for such goods, firms have little impact on customers when pursuing profit making, especially in a perfectly competitive or monopolistic competition market. The quantity of demand would reduce significantly while the company raise the price relatively slightly[8]. If they increase the output, there would hardly be a sharp rise in the amount of demand for a single company, but the market demand would go up vastly. When the demand is inelastic, the outcomes vary in different types of market. The customers would suffer from limited choices and become price takers in a monopoly market or collusive oligopoly market while the firm is a price maker. In this case, customers are affected massively by the company's actions (Sloman, Garratt, Guest & Jones, 2016)[9].

2.2.2 suppliers

A firm is a nexus of contracts with suppliers, as stated by Jensen and Meckling (1976), firms would play the role of customers when dealing with suppliers. For example, Apple demands components and parts with specific requirements to assemble the products and saves a lot because of sheer volume purchases and scale of economics in manufacturing and transportation (Satariano & Burrows, 2011)[10]. It shows that specific skills and expertise attract firms to collaborate with suppliers. If firms decide to cut production so that they can raise price, or they find that the cost control is not ideal, they might reduce demand for raw materials and labor. Enterprises always need to produce so that they can maintain daily operation, as a result, the demand is mostly inelastic in a long term[11]. In a perfectly competitive or monopolistic competition market, which means companies can find a lot of suppliers which can provide particular factors or goods they request, at the new equilibrium point, the reduce of the quantity of sales and price would lead to a loss in revenues of suppliers. However, when it is difficult for other suppliers in the market to offer such production, firms have difficulties in manipulating suppliers[12].

2.2.3 competitors

In monopoly and oligopoly markets, entry barriers could be very high to potential competitors. The company which have monopolistic market power might apply predatory pricing or other anti-competitive strategies to drive rivals out (Sloman, Garratt, Guest & Jones, 2016). Similarly, in a monopolistic competition market, firms can become monopolistic in part by creating something special that distinguish their products from other brands like high quality (Shaked & Sutton, 1982). In a perfectly competitive market, however, firms supply standardized products which are all the same and completely alternative, so that competitors will not be affected by any change made by the enterprise[13].

3. Conclusion

In conclusion, the first part of the statement is correct under certain conditions, based on the divorce of ownership and control theory. However, it can clearly be concluded that the assumption that shareholders want to get money return for their funds and managers would like a raise in their wage is not comprehensive enough. Both of them might make ethical moves rather than being egocentric. However, it is unclear that how much stock should shareholders own to make the company owner-controlled, so that the results could be biased[14].

As for the second part, it has been showed that employees are ignored in this allegation, and other stakeholders are affected by the actions of the company in different ways. This has been confirmed by the stakeholder theory and the analysis presented above[15]. It has been demonstrated that customers and suppliers will bear a loss or benefit tremendously in perfectly competitive and monopolistic competition markets. While in monopoly or oligopoly markets, customers can only be affected when their demand is inelastic, and suppliers can barely be affected. Competitors are proved to be impacted strikingly by firms' competition strategy in a monopoly or oligopoly market. Since perfectly competitive markets and monopoly markets are extreme cases which are hypothetical, the relevant analysis is theoretical, not factual.

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