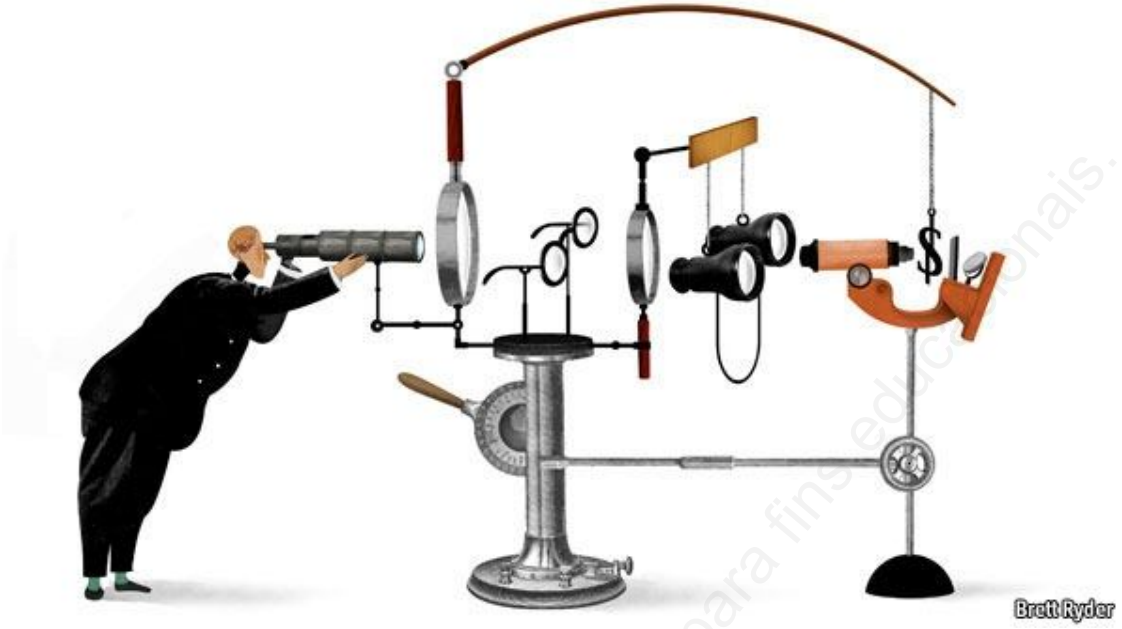
Taking the long view

The pursuit of shareholder value is attracting criticism—not all of it foolish



He Is the chief executive of a multinational corporation, but Paul Polman sometimes sounds more like a spokesman for Occupy Wall Street. The boss of Unilever (an Anglo-Dutch consumer-goods firm with brands ranging from Timotei shampoo to Ben & Jerry's ice cream) agonises about unemployment, global warming and baby-boomer greed. He puts some of the blame for these ills on the most influential management theory of the past three decades: the idea that companies should aim above all else to maximise returns to shareholders.

He appears to mean it. Since taking charge in 2009, Mr Polman has stopped Unilever from publishing full financial results every quarter. He refuses to offer earnings guidance to equity analysts. He has introduced a lengthy "sustainable living plan" and attracted a new cadre of long-term investors, particularly in emerging markets. He even told an audience in Davos that hedge-fund managers would sell their own grandmothers to make a profit.

Mr Polman was one of several titans to decry the cult of shareholder value at the Peter Drucker Forum (an annual gathering of admirers of the late Austrian-born management guru) in Vienna on November 15th and 16th. Roger Martin, the dean of the Rotman School of Management at the University of Toronto, called it a "crummy principle that is undermining American capitalism". Georg Kapsch of the Federation of Austrian Industries urged the world to abandon it. Rick Wartzman, the director of the Drucker Institute, said its critics were gaining momentum.

The cult has certainly yielded perverse results. The fashion for linking pay to share prices has spurred some bosses to manipulate those prices. For example, a manager with share options gets nothing if the share price misses its target, so he may take unwise risks to hit it. Short-termism is rife on Wall Street: the average time that people hold a stock on the New York Stock Exchange has tumbled from eight years in 1960 to four months in 2010. The emphasis on short-term results has tempted some firms to skimp on research and innovation, robbing the future to flatter this year's profits. "Long-term results cannot be achieved by piling short-term results on short-term results," Drucker once remarked.

One study shows that listed companies have invested only 4% of their total assets, compared with 10% for "observably similar" privately held companies. A second shows that 80% of managers are willing to reduce spending on R&D or advertising to hit the numbers. John Kay, a British economist (and author of a government report on short-termism) argues that the

pursuit of short-term profit may have undermined two of Britain's greatest companies, ICI and GEC.

But hang on a second. Are the critics really right to argue that modern capital markets invariably put short-term results before long-term ones? Amazon has never found it hard to attract investors, despite the way it ploughs its profits into long-term plans for world domination. Plenty of other tech stocks are wildly popular despite negligible short-term returns. And are companies always foolish to react sharply to short-term warning signs? Nokia, a Finnish telecoms firm, would be much healthier today if it had reacted more swiftly to market warnings, rather than keeping a second-rate boss in place while Apple destroyed its business.

The critics make a distinction between long-term value (good) and short-term value (bad). But what is long-term value if not short-term results piled upon each other? And what is wrong with making regular checks on your performance? A company's quarterly results will probably tell you something about its long-term health as well as its performance over the previous quarter.

The critics have also failed to produce a viable alternative measure of success. One idea is to look at "customer satisfaction". But isn't the best way to please customers to give everything away for nothing? Another idea is to rely purely on the judgment of managers, but isn't this like allowing children to mark their own homework? Many critics of the shareholder model embrace a "stakeholder" model instead, but this is too vague to be much of a guide. Who are a company's stakeholders, and how should their competing interests be weighed against each other? No one knows. The great virtue of a share price is that it provides a clear external measure by which managers can be judged.

The stockmarket is not as short-sighted as some people think. Amazon is not the only firm it has rewarded for taking the long view, notes Baruch Lev of New York University's Stern School of Business. Others include Toyota, IBM and John Deere. Mr Lev also argues that most managers who manipulate their results to "hit the numbers" are caught. The problem is not that investors are fools, but that some managers think they are.

Mend it; don't end it

Rather than junking shareholder value, companies should tweak it. Some are getting better at this. Warren Buffett, like Mr Polman, adamantly refuses to provide earnings guidance to investors. IBM has produced a "2015 roadmap" to persuade investors that its big investments today will make money in the future. L'Oréal and Air Liquide have offered shareholders bonuses for holding shares longer than a certain period of time. Google, LinkedIn, Zynga and other tech companies have adopted dual-class voting structures that allow the founders to resist the pressure to produce short-term results.

Several companies allow their chief executives to exercise their share options only after retirement, to encourage long-term thinking. Giving managers ordinary shares (rather than options) which they cannot sell for several years aligns their interests even more closely with those of ordinary shareholders. As Bill Clinton once said of affirmative action, the best way to deal with the shortcomings of shareholder value is to "Mend it; don't end it."

Fonte: The Economist, London, v. 405, n. 8812, p. 75, 24 a 30 Nov. 2012.