HAS THE OBJECTIVE OF THE CORPORATE FIRM CHANGED OVER TIME?

Prasad Padmanabhan, St. Mary's University
Ajaya K. Swain, St. Mary's University

ABSTRACT

This paper argues that despite changes in the technological and the business environment, the objective of the public firm remains the same as it always has been – to maximize common shareholder wealth. The paper introduces the traditional objective of the firm followed by a brief review of the recent changes to the business environment. These include the presence of a new generation of stakeholders, increased stakeholder activism based on their perceived differences in social, environmental and political views, and instant social media. We next detail how firms have addressed these changes before concluding that the objective of the corporate firm remains the same. We also provide suggestions for further research.

Keywords: Corporate firm, Objectives, Balanced scorecard, Triple bottom line, Common shareholder wealth.

INTRODUCTION

We address the relevance of the old objective of the public firm[1] in the current era of shareholder activism, instant social media, a discriminating customer base that wants products that do not destroy the planet, and the advent of corporate social responsibility. We suggest that although the world has changed, the age-old mantra of the objective of the firm remains unchanged. The business environment facing public firms has changed considerably over the last few decades, and firms have to manage the process of efficiently navigating these choppy waters.

We organize the paper as follows. In the following section, we discuss the traditional objective of the firm taught in finance and other business classes followed by a discussion on the operational impact of this objective. The next section details how the world has changed from what it was eons ago: the new era of social media that disseminates good and bad news instantaneously across the globe, and the new generation of customers who demand new products created with care for the people and the planet. This section also introduces buzzwords (like people, planet and profits, the balanced scorecard, the triple bottom line, and corporate social responsibility) that form the new lexicon of business. The next section presents details related to the changes firms have made to their corporate strategies to accommodate the new rules. In addition to reports on financial performance, firms are now compelled to report their performances in other areas. Finally, we provide a brief discussion on the points raised in this paper followed by conclusions and suggestions for further research.

THE OLD OBJECTIVE OF THE FIRM

Business (especially finance) professors teach the mantra that the objective of the public firm (with common shareholders serving as owners) is to maximize common shareholders' current wealth. In most finance books, the first few chapters deal with the accounting basics followed by a list of possible objectives of the firm. This discussion then concludes by stating that the only objective that bears scrutiny is the one stated above. Maximizing common shareholders' current wealth is akin to maximizing the current market price of common stock. The chapter then usually ends with a discussion of agency theory[2] and on how managers should make decisions that reward owners. Public firm managers are agents of common shareholders and positive/negative incentives motivate managers to adopt only those projects that augment the common shareholders' current wealth. Positive incentives grant stock options to managers. These options increase in value as a function of the market price of common shares and thereby incentivize managers to make decisions that increase this price. Negative incentives can include the possibility of owners firing managers.

A logical question to ask is, how can management maximize an objective that they cannot directly control? They can control market price to a limited extent using buyback of existing common stock. The treasury stock section on the firm's balance sheet record these purchases. After the textbook introduces the "project selection criteria" in a later chapter, the discussion will focus on what this objective really means operationally to firm management. The operational impact of this objective is for management to select the best projects at least cost. This strategy requires managers to predict future expected cash flows and compute the net present value[3] of each project. Clearly, owners expect management to use their experience to predict project related cash flows/risks and select the best projects (Macke, 2012) [4].

THE NEW ENVIRONMENT: WHAT HAS CHANGED?

In this section, we present details relating to the changing marketplace for goods and services. We are in the midst of a new set of generational stakeholders who embrace strong views on how public entities should treat them (and the planet). In addition, developments such as instant social media has forced firms to manage carefully their information flow strategies. Next, many firms have resorted to political activist strategies by embracing selective societal statements in their advertisements. This in turn, can alienate customer and stakeholder groups who do not agree with the statements. Finally, the current global pandemic has forced firms to make dramatic changes to their product/service offerings, to their global supply chains, and to their advertisement to customers. We discuss each of the above developments below.

A New Generation of Stakeholders, Shareholder and Customer Activism and Differences in Political and Social Views

Arguably, there seems to be increased concern for environmental and social issues from one generation to the next. (Darnell et al. (2012) state that increasingly, consumers are becoming more knowledgeable about the environment and reflecting this knowledge in their decisions to buy green products. In another study, the authors document that there is an increase (from 47% in 2017 to 60% in 2018) in a survey sample of US based customers who make purchase decisions based on their stand on societal and environmental issues (Kapner and Chinni, 2019). Today, relatively expensive green products reside side by side with cheaper less expensive products[5]. Firms also take pride in advertising fair wages paid to workers making these products. Newly minted college students are now seeking jobs that pay well and are highly principled and have sourced on tech jobs that they perceive as falling short on ethics (Goldberg, 2020).

Not surprisingly, shareholder activism based on political and societal issues has increased manifold. For instance, pro-gun shareholders recently confronted Dick's Sporting Goods CEO over its decision to increase scrutiny for gun purchasers. Dick's gun sales dropped following thisrevised gun sales policy (Henney, 2018). Next, Hallmark Channel managed to upset almost all viewers after it removed its same-sex ads on its channels after complaints from the American Family Association. This in turn prompted backlash from the LGBTQ[6] group and led to decreased viewership (Vranica, 2019). Shareholder and customer stances on a variety of social and political issues may have adverse consequences for future expected revenues for firms. These cash flows depend in part on how firm management react to such attacks.

Instant Social Media

Today's social media instantly disseminates corporate information globally (Swain & Cao, 2017). For instance, in 2018, United Airline's CEO had to apologize for blaming the victim in reaction to a passenger's forced exodus from one of its planes after a video of the incident circulated on social media within hours of the incident (Zdanowicz & Grinberg, 2018). In addition, Adidas removed its ads and tweets congratulating Boston Marathon survivors after upset Twitter followers suggested that the ad and tweet reminded individuals of the tragedy. Both United Airlines and Adidas presumably took a financial hit from costs associated with their ads and lost future revenues due to the resulting negative publicity (Padmanabhan, 2019).

Political Activism by Firms

As the examples presented above show, firms have to navigate the slippery slope generated by shareholder/customer/political activism and instant social media to choose a path that does not generate loss of future revenues. Firms realize the need to manage information flow to outsiders very carefully. Still, some firms have managed to insert themselves into the political scene. For instance, Nike's use of a provocative ad of former San Francisco 49er Colin Kaepernick's kneeling protest during the playback of the US national anthem, garnered the company positive and negative attention. Nike's revenues may have increased immediately following the ad, but many burned Nike products and a mayor initially banned the sale of Nike products in his city before retracting it. It is unclear whether Nike will continue to reap benefits from its political activism over the long run. Unfortunately, politically motivated statements by firms may negatively influence the wealth of all of its common shareholders, with little regard for whether they approve/disapprove of these statements. Firms face a continued operational dilemma on how to maximize common shareholder wealth when shareholders harbor diverse political views. Similarly, small business and private firms may also not be immune to political activism. Red Hen may lose revenue if groups peeved with its political stance opt not to patronize the restaurant. Similar example abound (Padmanabhan (2018). A strategy favoring one political group or another may look good on paper, and it may still be an excellent strategy. The danger is that political activism by firms can alienate its customer base and impact future revenues (Padmanabhan, 2018).

Global Pandemics – COVID-19

As we are all keenly aware, the COVID-19 virus is sweeping the world. Since its advent in early-mid December, stock markets and economies have lost trillions of dollars in revenues. Not surprisingly, this resulted in a significant attack on global supply chains, even as demand increased for key products like pharmaceuticals and N95 facemasks. According to a recent Dun & Bradstreet report (Partington & Wearden, 2020), over 1100 U.S. firms have direct or indirect supply chain links to China, thereby causing severe supply chain disruptions, leading to eventual negative ripple effects in global production, revenues and employment. To preserve future revenues, many firms are changing their business models. For instance, many restaurants now offer only curbside pickups or free home delivery. They advertise the fact that food is prepared or delivered with little or no human touch, and, many firms have resorted to advertising the ways they sanitize their food processing methods (Raftlova, 2020). In addition, General Motors and Ford are now manufacturing ventilators – a critical need during these times. Other firms have offered free food and airline tickets to healthcare workers (Gitlin, 2020; Root, 2020). Firms may make these operational changes by a need to preserve future revenues but they also signal to stakeholders that they are good corporate citizens. These signals may originate from an altruistic motive, but they help to preserve, to the extent possible, future revenues. Who would want to buy products and services from firms who do not assist when the citizenry needs help?

HOW FIRMS HAVE ADDRESSED THESE ENVIRONMENTAL CHANGES

The examples presented above suggest some of the ways in which firms have practically incorporated customer desires and needs when offering products. In this section, we will present how the academic literature and the popular press have dealt with these issues. We constantly hear the phrase "planet, people and profits" in the popular press, which reminds firms to pay attention to people and the planet as they strategize on profits. Next, firms now report their performance using the "balanced scorecard" and the "triple bottom line" whereas previously, reporting only its net income would have sufficed. The former suggests that firms should pay attention to the firm's nonfinancial performance in addition to the traditional financial measures of performance. The triple bottom line (TBL) uses factors that include financial performance, social responsibility and environmental responsibility to benchmark firm performance. Increasingly, firms are self-motivated to report their performance along financial, customer relations, internal business processes and learning/growth dimensions (Swain, 2014). Presumably, stakeholders — that includes customers, investors, governments and anyone else interested in the firm — use this information to judge the firm's overall performance (Zhang et al, 2018).

Academic research on whether these alternate measures are effective abound. For instance, the balanced scorecard combines financial and nonfinancial strategic measures into one single scorecard measure of performance that include financial, customer relations, internal business processes, and learning/ growth (Norreklit, 2000; Padmanabhan, et al., 2020). Kaplan and Norton (1996) suggest a causal link between nonfinancial strategic measures and financial performance. Recent evidence (Teng, et al., 2014; Lai, et al., 2013; Cowan, et al., 2016, 2015; Swain, 2018) suggests the emergence of a strong link between current CSR and subsequent financial performance.

TBL is an alternate measure used to highlight a firm's commitment to financial performance, social responsibility and environment responsibility to benchmark firm performance

(Elkington, 1998). Firms' long-term survival increasingly depends on satisfactory performance on the TBL. Social responsibility can (and does) include environmental responsibility. Hence, firms must comply with environmental regulations in force to score well on the TBL. Some of the current environmentally related constraints facing firms are carbon credits and the adoption of costly green technologies (International Institute for Sustainable Development, 1996).

There has been an increased interest by a variety of stakeholders to motivate developed and developing country firms to invest in green technology. The established wisdom suggests that market rewards firms who invest in green technology and for utilizing pollution friendly technologies with positive reduction in the collective carbon footprint. Firms are increasingly motivated to adopt a "balanced scorecard" (the triple bottom line of people, profit, and planet) approach when communicating with owners and other stakeholders. Together with corporate social responsibility (CSR) related initiatives, managing the collective process has assumed strategic importance to the extent that firms are now assigning scarce resources for this purpose.

Clearly, firms develop new products to survive. However, they must now address all of the societal and environmental issues to preserve and extend future revenues. Hence, in addition to displaying their overall performance on the balanced scorecard and the TBL in their annual shareholder reports, many now actively advertise their focus on the people and the planet. For example, Blue Apron and Plated (two different US based food delivery service firms) provide information on their websites on how they make and market products designed to appeal to stakeholders concerned about social and environmental issues when making purchases. Plated advertises its organically grown products and its sustainably sourced seafood. Rackspace (a multi-cloud solutions firm) has pledged to use only renewable energy sources by 2026. H-E-B (a Texas grocery chain) also responsibly source their products and donate vast quantities of food to help feed the poor. As another example, Dimension Data's statement in its annual report (2020)[7] indicate its performance along People/Planet/Profit lines by indicating how their "…people are giving back to our communities, the ways we're using technology to make a positive impact on our planet, and how we're measuring our success…". Similarly, Rockwater Energy Solutions[8] reports its Balanced Scorecard and highlights its performance along the following dimensions: financial, customer, internal business, and innovation and learning perspectives. Many firms hire chief purpose and ethics officers to manage their social profiles (Forbes Insight Team, 2019).

Does taking care of the people and the planet pay off in financial terms in the long run? In a published set of studies, we found evidence that current CSR activities for a group of service firms strongly positively correlate with future revenues and profits, after controlling for other factors (Cowan et al, 2015). The global manufacturing and service firms use CSR dollars as strategic dollars spent carefully to maximize future financial benefits (Cowan et al, 2016; Swain & Cao, 2014). Another related study by other authors found that banks offer lower interest rates on new bonds to firms profiling their CSR activities over firms that do not (Kim et al, 2014). Privately, bankers may like the altruistic behavior of firms implementing good CSR practices, but they still follow the money. They offer lower interest rates to such firms since they may recognize that altruistic behavior pays off via increased future revenues and lowered business risks.

DISCUSSION

We present the overall message of this paper in point form below:

1. The traditional reporting of only financial information will not suffice in the modern

globalized, social-media-filled world. For a firm to remain profitable, it needs to take care of the people and the planet.

2. Altruistic behavior by firms today generates increased future revenues. Ultimately, firms cannot make money unless they take care of their stakeholders. The harsh limelight of social media punishes irresponsible firms because potential, and even loyal, customers will avoid its products. Decreased revenues, in turn, lead to lower profits. Lower profits can negatively affect the stakeholders of the firm. It is essentially unimaginable for any firm today to earn sustained profits while being irresponsible custodians of the planet and/or not taking care of its employees and customers. If managers opt for the best projects, then they will earn revenue because customers will buy their products.
3. Firms can only address one objective. They cannot embrace multiple objectives (Cromwell, 2019; Kim & Yoon, 2020; Shinder, 2019; Stickler, 2019). In addition, this objective continues to remain unchanged: Maximize the current stock price of common shareholders. The old objective has stood the test of time.

CONCLUSIONS AND SUGGESTIONS FOR FURTHER RESEARCH

In summary, the message conveyed in this paper is that firms should report their performance along financial and nonfinancial lines because stakeholders demand it. However, the focus should be on increasing profits by producing quality products and taking care of its stakeholders and the planet. Given the dynamic changes taking place in the globalized market and the increased concern for stakeholders other than common shareholders, the only path to maximizing shareholder wealth is to develop innovative products that are simultaneously planet and people friendly. Hence, the old objective of the firm still survives despite the tumultuous changes taking place in the marketplace. The current message to firms is that they should take care of the *people and the planet for profits*.

Obviously, taking care of the people and the planet while making financial profits is not without cost. Firms must allocate scare financial and managerial resources to manage this process. The specific added costs will depend on the nature of the products the firm offers and on its competitive landscape. However, we suggest that the costs (in terms of losses of future revenues) far outweigh the costs if firms do not develop efficient strategies to manage the process.

We offer many avenues for further academic research. While we conclude that the objective of the firm remains unchanged, the precise means by which a firm's management team operationalizes these objectives in practice remains a thorny issue. Forexample, it is possible that any project selection action along the lines suggested in this paper can find ready opposition by one group or another. There is scope for developing careful strategies to manage this thorny process.

Next, while we conclude that firms cannot maximize common shareholder profits unless they take care of the planet and the people, we do not provide precise guidance on how to allocate scare resources to each of these strategic activities. Presumably, allocation strategies are firm and/or industry concentration specific; we leave an examination of these important issues for future research.

Finally, while we suggest that the objectives remain the same, the firm environment has changed dramatically over the last few decades. An important question remains as to the best strategy to teach these changes to students in introductory finance and business courses. We leave these aspects to future research.

ENDNOTES

1. Although our discussion will focus on the objectives of the corporate public firm, it can easily apply to any firm, public or private. Sole proprietorships and partnerships arguably face different issues but can be subject to the same forces described in this paper.
2. Agency theory refers to the conflict of interest between the owners (the common shareholders of the firm) and the management (hired by the owners to manage the firm on their behalf). Managers may not necessarily chose projects that are in the best interest of the common shareholders. The "agency problem" refers to the possible conflict of interest between managers and owners.
3. Net present value (NPV) refers to a project selection criterion that represents the difference between present value of future cash inflows and the present value of current and future cash outflows. The discount rate is generally the weighted average cost of capital (WACC). Academicians and practitioners generally view the NPV criterion as being the best from several competing criteria. See, for example, Ross, Westerfield, and Jordan (2017) for details on the objective of the firm and discussions on NPV and WACC concepts.
4. Lynn Stout (in the book titled, The Shareholder Value Myth (Stout (2012)) argues that shareholders do not deserve any rights in Corporate America. Jeff Macke summarizes his point effectively in an editorial on this book. He quotes Stout "… The dogmatic pursuit of "shareholder value" is based on a flawed concept, leading to management structures and behaviors that not only limit stock market returns but actually damage the very structure of corporate America…" (Macke, 2012).
5. As an example, many chain grocery stores (like HEB in Texas) stock expensive green products or "fair trade" products and cheaper (not labelled as green) products side by side. Customers can select products based on their preferences. The link https://www.fairtradecertified.org/ offers information on how firms can seek and obtain fair trade certification.
6. LGBTQ is an acronym that stands for Lesbian, Gay, Bisexual, Transgender, and Queer. Definition from: https://acronyms.thefreedictionary.com/LGBTQ.
7. Dimension Data is a South African based global conglomerate offering global systems integration and managed care services for hybrid IT. We abstract this quote from Dimension Data's Annual Report (2020).
8. Rockwater Energy Solutions "…is a chemical and environmental solutions provider offering customized products and services to the, stimulation, fracturing, fluids, and production needs of our customers throughout the U.S…" We abstract this statement from the webpage of Rockwater (2020).

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