Shareholders versus stakeholders: corporate mission statements and investor returns

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Introduction: the rise of shareholder value

Since the mid-1980s we have witnessed an increasing focus on shareholder value by directors of UK and US companies. Influences such as the globalization of capital markets, the rise of institutional investors, greater shareholder activism, and the increasing importance of corporate governance issues have all been cited as contributory factors (Mills 1998, Fera 1997). Those companies embracing the shareholder value philosophy must pursue appropriate strategies in order to achieve this. This means that companies should focus on high-value activities and that diverse activities should be consolidated or divested (Bughin and Copeland 1997). The increasing orientation of companies towards a shareholder value perspective has created new challenges for finance and management. This has led to a number of new financial metrics and management methods being advocated in the literature (see for example Rappaport 1986, Stewart 1991, Copeland, Koller and Murrin 1994, Mills 1998). However, perhaps the greatest challenge posed by the shareholder value approach where the interests of shareholders dominate. It seems that it is difficult for both approaches to managing a business to co-exist in harmony within a particular economy. It has been argued that in the United States the stakeholder approach has been undermined by the pursuit of shareholder value through such mechanisms as hostile takeovers, mergers, down-sizing and executive reward schemes that are linked to share prices (Beaver 1999).

The main argument of those supporting a shareholder value perspective is quite straightforward: failure by managers to recognize the primacy of the shareholder group will result in poorer returns to shareholders. The stakeholder approach is therefore rejected because it demands that managers respond to the needs of a variety of 'claimants' and so trade-offs between stakeholder groups may have to be made. However, there are counterarguments to this rather simplistic view. Some believe that unless the needs of stakeholders are properly addressed there will be an adverse effect...
on company performance and therefore on share
holder returns (Freeman 1984, Harrison and St
John 1994). Recently, John Egan (CEO of British
Airport Authority) justified his commitment to a
stakeholder approach by arguing:

… you cannot serve the long-term interest of share-
holders other than by satisfying and gaining co-
operation of all the stakeholders in the business.

The idea that satisfying the needs of all those with a
stake in the business go hand in hand with superior
returns to shareholders has obvious appeal. Unfor-
fortunately, there has been little empirical evidence
undertaken to support this view. However, a recent
study of UK companies found limited support for
the view that a stakeholder orientation is positively
associated with performance (Greenley and Foxall
1997).

One way of discovering whether a company
adopts a shareholder or stakeholder orientation is
through an examination of its mission statement.
A central theme within the strategic management
literature is that the mission statement of a
company is the first step in the development of a
strategic plan. It has often been argued that when
writing the mission statement, those who have a
claim on the business should be clearly identified
(see for example Pearce 1982). Thus, the mission
statement will often reveal whether it is the share-
holders or a wider constituency of stakeholders
whom the management regards as having a claim
on the business and to whom it is accountable.

An example of the mission statement of a
shareholder-focused business is that of the Coca-
Cola Company which states:

*We exist to create value for our share owners on a
long-term basis by building a business that enhances
the Coca-Cola company’s trademarks. This is also our
ultimate commitment.*

In contrast, an example of a mission statement
of a stakeholder business is that of Cadbury
Schweppes which states:

*Our task is to build upon our tradition of quality
and value and to provide brands, products, financial
results and management performance that meet the
interest of our shareholders, consumers, employees,
customers, suppliers and the communities in which we
operate.*

An interesting question that arises is whether
the stated orientation of the business (shareholder
value or stakeholder) has a significant effect on
the returns to shareholders. To put it another way:
can we assume that companies which publicly
embrace the shareholder value approach provide
superior returns to those which focus on the needs
of a variety of different groups with ‘claims’ on the
company? There is a paucity of empirical research
relating to this question and so this paper attempts
to redress this situation.

**Methodology**

We obtained mission statements of UK listed
companies primarily via the Internet, but also
from other sources, such as annual reports. We
reached a quota sample of 80 companies that
could be clearly identified as either stakeholder
oriented (48 companies) or shareholder value
oriented (32 companies). We wished to examine
the shareholder returns of each sample of com-
panies to see if there was a significant difference in
returns to shareholders between the two samples.
For this purpose, we used three commonly-used
measures of shareholder performance. The first
was an accounting measure, namely, return on
equity. The other measures were market-based;
one representing the company stock market return
and the other the excess return, i.e. the return in
excess of that predicted according to the capital
asset pricing model. There were four moderating
variables that were regarded as being potentially
significant in their impact upon shareholder
performance. These were:

**BETA RISK:** the rationale being that firms with
greater systematic risk should command higher
returns. There is some evidence supporting this,
although adjustments for book-to-market values,
size (see below), and price-earnings ratios have
also been suggested (e.g. Davies et al. 1999, Fama
and French 1998).

**GEARING:** since greater financial risk also
should command a higher return. Rajan and
Zingales (1995) and others demonstrate that
gearing is negatively related to profitability.
Furthermore, Jahera and Lloyd (1996) observe the importance of alternative tax shields in explaining corporate debt levels.

**TAX:** this was chosen as a further moderating variable, possibly influenced by gearing and the tax incentive of interest deductibility. Reduced corporate tax payments might enhance shareholder returns. Some UK and US multinationals consider the allocation of assets and liabilities in an overall tax minimizing configuration to be of some importance (Hooper 1994). Hooper also finds that, for some firms, tax is an important factor in multinational debt financing.

**SIZE:** since an influential strand of empirical research, particularly that of Fama and French (1998) suggests that smaller firms are more successful than larger firms. This result, however, has been strongly challenged by Ashton and Tippett (2000).

Apart from the extraction and classification of mission statements, the data source for all relevant items was DATASTREAM. In the next section we apply various statistical tests to the data and review the results.

**Analysis and results**

The industrial classifications of the samples are provided in Table 1. The shareholder oriented sample was two-thirds the size of the stakeholder group, so that in general there were more stakeholder-oriented companies than shareholder-oriented companies for particular categories. It may be worth mentioning, however, that all six real estate sector companies were shareholder focused rather than stakeholder focused. Apart from this exception, there was a reasonably good spread across industries.

In Table 2 (see Appendix) we set out the results of the statistical tests of the significance of the performance indicators and their hypothesized key determinant factors. An analysis of variance test was performed on each variable to determine whether there was a significant difference between the means of the shareholder and stakeholder samples. Tests were also conducted on their respective standard deviations, using both Cochran’s test and Bartlett’s test, to see if there were any significant differences in this regard. Consequently, greater reliance was then placed upon the difference in medians of the shareholder and stakeholder groups. For this purpose the Kruskall-Wallis median test was used.

The extent to which the mean actual return exceeded the capital asset pricing model’s derived return was evaluated for the shareholder and stakeholder samples, for both six years and three years. The capital asset pricing model of Nobel prizewinner Sharpe (1964) suggests that, for widely diversified investors, the rate of return required by shareholders of a particular company is related to the beta risk of that company. Beta risk is defined as the correlation coefficient of a particular company’s rate of return with the stock market as a whole, times the standard deviation of the share’s rate of return divided by the standard deviation of the overall stock market rate of return. In each case the ANOVA significance probability far exceeded 0.05 and so there was no statistically significant difference at the 95 per cent confidence level between the excess returns of the shareholder and stakeholder samples, whether the figures were based upon the average excess return over six years or three years. Cochran’s and Bartlett’s tests revealed no statistically significant difference between the standard deviations of the returns on equity for the shareholder and stakeholder samples. Hence, the constant variance assumption of the ANOVA test was not violated. Furthermore, the medians were not significantly different at the 5 per cent level of significance, as indicated by the Kruskall-Wallis test.

Our next focus of attention was upon the accounting-based returns on equity over six years and three years for the shareholder and stakeholder groups. Such returns measure accounting performance rather than economic performance. Nevertheless they are widely reported and may be perceived as an appropriate measure of performance by less sophisticated investors. Cochran’s and Bartlett’s tests demonstrated highly significant differences at the one per cent level between the standard deviations of the returns on equity for the shareholder and stakeholder samples. The
shareholder group experienced much wider variation in the return on equity. Since the constant variation assumption of the ANOVA tests was violated, the ANOVA result was unreliable. Hence the Kruskall-Wallis median test was more appropriate. Once again, at the five per cent level of significance, there was no statistically significant difference between the median returns on equity of the shareholder and stakeholder groups, whether the companies were based on averages of six-year returns or three-year returns on equity.

The third measure of performance was the stock return based on each individual company’s share price appreciation and dividend return. Two sets of analysis were conducted based upon performance over three years and six years. The nature of the results was not affected by the different time horizons. At the five per cent level of significance, there was no statistically significant difference between the mean stock returns of the shareholder and stakeholder samples (see ANOVA p-value), between the median stock returns of each group.
(see the Kruskall-Wallis p-value), and between their respective standard deviations (see the Cochran and Bartlett tests).

The next step was to examine the financial characteristics of the two samples. It could be argued that firms with higher levels of systematic (beta) risk should expect to generate better returns for their shareholders, particularly over a longer-time horizon. To examine the betas of the two samples is therefore important. However, it was found that, at the 95 per cent level of confidence, there were no significant differences between the means, medians and standard deviations of the shareholder and stakeholder groups. Thus, the samples were well matched in terms of systematic risk. They were not originally selected on this basis, instead they were selected by a quota sample of identifiable mission statements, but it is pertinent to know this result, since it lends more credence to the comparison tests of performance of shareholder and stakeholder oriented firms.

Returns to shareholders can also be affected by differences in gearing (the ratio of long-term debt to total long-term finance), since firms need to earn superior returns to compensate for higher levels of financial risk. Using figures based on six-year averages, there was a significant difference, at the one per cent level, between the median gearing levels of the shareholder and stakeholder groups. The stakeholder group experienced a wider variation in gearing. Unfortunately this violated the constant variance assumption of the ANOVA test, so it is not appropriate to investigate any differences between the sample means. Turning now to the three-year average gearing levels, there was no significant difference, at the five per cent level, between the standard deviations of the gearing levels of the shareholder and stakeholder samples. Since the constant variance assumption of the ANOVA test was supported, it was appropriate to examine the significance probability of the ANOVA test for the difference in the mean gearing level over three years. In this instance, the difference in sample means was not significant at the 95 per cent confidence level. However, at the five per cent level of significance, there was a significant difference between the median gearing levels of the shareholder and stakeholder groups.

The implications for the gearing differences upon returns will be reconsidered later.

Taxation can partly be regarded as an intervening variable, since higher gearing levels can reduce taxable profits through interest deductibility, and hence should increase shareholder performance. The shareholder group experienced a higher mean gearing level over six years and a lower tax ratio. The same also applied to the three-year horizon. However, this does not appear to translate in terms of higher excess returns or stock returns over six years, although the shareholder group had a higher accounting return on equity. At the moment, however, the focus is upon the tax ratio per se. There was a significant difference, at the one per cent level, between the standard deviations of the two samples. This is independent of the time horizon. The shareholder group experienced a higher variation in the tax ratio. This violates the constant variance assumption of the ANOVA test and so more emphasis needs to be given to the median test. However, the Kruskall-Wallis median tests were not significant, at the five per cent level, when applied to the six year and three year tax ratios. As an explanatory variable, tax will be reconsidered shortly.

The fourth key factor related to firm size. Fama and French (1998) have claimed that smaller firms perform better, although Ashton and Tippett (2000) have disputed the use of arithmetic instead of logarithmic returns. Nevertheless, in this research it was decided to check whether the shareholder and stakeholder groups differed significantly in size, otherwise variations in performance may be attributable to size rather than mission orientation. Tests were conducted using data averaging size, both over six years and three years. The results revealed no significant differences in medians, means and standard deviations of the shareholder and stakeholder samples.

The next stage of analysis was to evaluate the implications of possible interactions between the hypothesized key factors upon the performance indicators. The most important factor, however, is whether the mission orientation of the firm affects its performance. Performance was measured by excess return, return on equity and stock return over six years and three years, respectively. A
dummy zero-one variable was introduced into each full multiple regression model that contained four key factors, namely, beta, gearing, tax and size. From each full regression a backward step-wise regression was run to determine whether the mission dummy was still retained in the best model that predicts performance. There are thus two models for each data set, a full multiple regression model and a reduced model. Given that there were also three separate measures of performance over two time horizons, twelve regression models are reported in Table 3 (see Appendix). Taking the excess return over six years as the dependent variable, it can be seen from Table 3 that the significance probability of the mission dummy is very high (0.8556). Hence at the five per cent level of significance, the mission orientation, as specified in the full model, does not significantly contribute to explaining variation in excess returns over six years. Actually, none of the variables is significant. The step-wise reduced Model 1B includes only a constant. Hence, the mission orientation of the firm does not influence the excess return performance over a six-year horizon.

But perhaps the accounting return on equity reflects the mission of the company! A similar analysis was conducted using return on equity over six years. Once again, the mission dummy was not significant, at the five per cent level of significance, in the full model (p-value = 0.2611). But neither was the mission dummy selected in the final step-wise reduced Model 2B.

The final measure of performance over six years was the stock return as a reflection of share price appreciation and dividend return. The mission orientation of the company was not significant in the full Model 3A. The significance probability of the mission dummy was high (0.8556). In the step-wise reduced Model 3B the mission dummy was not included. Hence stock return performance over six years is not characterized by the mission orientation of the company. Instead the beta risk factor is the only explanatory variable, other than the constant.

Three-year returns were then considered. The mission dummy was not a significant factor, at the 95 per cent level of confidence, in the full Model 4A of the excess return over three years. In the reduced step-wise Model 4B the mission dummy was not a selected variable, instead gearing and size were key determinants, both significant at the one per cent level. However, the coefficient of the size variable was positive, indicating that larger firms had higher excess returns, contrary to the Fama-French (1998) inference. Furthermore, the greater the gearing level the worse the performance measured by three-year excess returns.

The accounting return on equity Model 5A did not have a significant mission dummy (p-value = 0.5176), and nor was the dummy variable included in the step-wise reduced Model 5B. Hence mission orientation has no impact on the three-year average accounting return on equity.

Finally, regressions were run on the stock return over three years. In the full Model 6A the mission dummy was not significant (p-value = 0.4364). The reduced Model 6B demonstrated that variations in gearing and size explained 15–17 per cent of the variation in three-year stock returns. The mission dummy was not selected in the final step-wise model. Hence, three-year stock returns are not a reflection of corporate mission orientation.

Conclusions

The intention in this paper was to investigate whether shareholder-oriented companies earned superior returns to those firms that embraced wider responsibilities to stakeholders. Orientation was defined by a classification of the mission statements. ANOVA and Kruskall-Wallis tests revealed that mission orientation did not affect performance. Multiple regressions were also run to test for any significant differences. Independent variables were introduced to deal with beta, gearing, size and tax, since these factors could otherwise confound the comparisons between the two mission-oriented sub-samples. By testing for mission significance, in each regression a dummy variable was introduced but not found to be significant. The overall conclusion is that there is no significant difference in shareholder returns between stakeholder-oriented and shareholder-oriented
companies. Therefore to adopt a stakeholder approach, which embraces a wider remit of corporate responsibility, does not lead to inferior returns to shareholders.

References


Fera, N. 1997. ‘Using shareholder value to evaluate strategic choices’. Management Accounting (USA), 79, 47.


Table 2: Summary analysis for whole sample

<table>
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<tr>
<th></th>
<th>Mean: Shareholders</th>
<th>Mean: Stakeholders</th>
<th>Standard Deviation: Shareholders</th>
<th>Standard Deviation: Stakeholders</th>
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Notes: * = significant at the 5 per cent level.
** = significant at the 1 per cent level.
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<td>6.B</td>
<td>Stock Return (3 years)</td>
<td>0.17 ($R^2$)</td>
<td>0.15 ($R^2$ ad.)</td>
<td>0.0007</td>
<td>Constant = 1</td>
<td>-0.03</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Beta</td>
<td>Gearing (3 yrs)</td>
<td>-0.003</td>
<td>0.0074</td>
<td>0.0018</td>
</tr>
</tbody>
</table>