**THEORY OF THE FIRM**

PREP 2 – The Role of the Shareholder

**INSTRUCTIONS**

Read the articles in the folder ‘PREP HWK’ on GOL and construct a mind map to answer the following questions below using the titles of the question for each branch of your mind map. All the questions can be answered as long as you read the articles. There is NO NEED for further internet research….

**Quick Introduction to the Shareholder**

Shareholders are owners of firms – both private (Ltd) and public (PLC). Most share buying and selling though happens with ‘public share’s’; that is shares traded and issued through stock markets like the London Stock Exchange (LSE) in the UK and the NASDAQ in the USA. Shareholders can be individuals, so wealthier individuals who wish to get a return on their savings. Or they can be large ‘investment funds’ which consist of ‘fund managers’ managing a portfolio of stocks/shares for a collection of individuals. Often, a private pension will be part of one of these larger ‘investment funds’.

**QUESTION 1: Short-Termism (3 articles)**

Short-termism is a phrased coined by the author and economist ‘Will Hutton’. It is a derogatory term to describe the behavior of ‘public’ shareholders who are often detached from the companies they are buying shares in and only want a quick return on their investments rather than believing in the ethos and direction of the company. A ‘short-termist’ shareholder is not interested in long term investment plans and the state of the firm in even two years. They are obsessed with ‘quarterly profits’ (these are profits earned each quarter of a year) being maximized so that their share price increases and dividends are as high as possible. The opposite to ‘short-termism’ is ‘long-termism’ which is often found in European and Japanese economies. Germany for example puts a lot more emphasis on ‘stakeholder capitalism’, preventing shareholders having all the power in a firm and recognizing there are other stakeholders in the firm.

* Why does Will Hutton claim that shareholders power is leading to a ‘dysfunctional’ form of capitalism?
* What is ‘stakeholder capitalism’ according to Will Hutton and why is ‘short-termism’ the opposite of this?
* What does Duncan Weldon suggest is another problem (apart from short-termism) with your average ‘public shareholder’ today which has led to a lack of investment?
* Why might ‘short-termism’ be bad for the entire economy (both Hutton and Weldon hint at what this might be)?
* How does the ‘Economist’ article defend against the criticism of short-termism leading to a lack of investment?
* What does the ‘Economist’ article think is the problem with our current state of business and capitalism?

**QUESTION 2: Divorce of Ownership and Control and Executive Pay (1 article)**

In larger firms (often PLC’s), there is often a ‘divorce of ownership and control’ which means the owners (or shareholders) of the company do not run it directly. For that, they employ specialist managers, headed by a Chief Executive Officer (CEO) in a ‘boardroom’ with other executives. These executives then have to report to the shareholders (owners) in a yearly meeting called the ‘AGM’ (Annual General Meeting). They have to justify their positions, explain their strategy for the business and reassure shareholders about how they will boost their shareholder wealth and increase dividends to the shareholders. In recent years, this process has been criticized and there has been evidence of ‘managers’ just ‘feathering their own nest’ and not worrying about the needs of the shareholder.

1. Why is the recent pay issues with BP, a good example of managers just looking out for themselves?
2. Why is maybe this assertion incorrect however, according to the articles

**QUESTION 3: The Shareholder Spring of 2012 and 2017? (2 articles)**

1. Explain what the ‘shareholder spring’ refers to.
2. Come to a judgement after reading the articles as to whether you think it is a positive force for the economy in the UK or not? Be prepared to justify your answer. There is no right or wrong answer! But an ability to have a justified opinion shows your understanding of the area.

**QUESTION 4: Why are Private Firms (LtD) better, according to some? (1 article)**

The size of PLC’s often means there is a divorce of ownership and control. This can have positive impacts. Specialist managers are more likely to gain good efficiency savings and boost profits as they will be able to get the best out of employees and be trained to get the right strategy. Whereas owners might not have this skill set. However, certain business leaders think that private firms (Ltd) are best.

1. Why does Michael Dell (founder of Dell Technologies) believe that private companies are best?