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Modern Portfolio Theory and Shareholder Primacy

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A COMMENTARY ON Gordon G. Sollars and Sorin A. Tuluca (2018), “Fiduciary Duty, Risk, and Shareholder Desert,” ***Bus Ethics Q*** 28(2): 203–218, https://doi.org/10.1017/beq.2017.47

ABSTRACT

Shareholders assume risk by investing. Sollars and Tuluca (2018) argue that while this does not justify a managerial policy of shareholder wealth maximization, it does justify compensating shareholders at the often-calculated cost of equity—the cost that investors require given the level of risk they assume. Here, I show that this can be unfair if the cost of equity is unfair. I then show how shareholder wealth maximization as a managerial imperative is better justified on other grounds.

IN NORMATIVE BUSINESS ethics, one question concerns how much of a corporation’s rents are *owed* to its shareholders. According to one popular camp, the answer is: all of it. After all, the corporation is owned by the shareholders, say the so-called shareholder primacy theorists. As the residual claimants, anything not paid out in expenses or to lenders belongs to the shareholders to either take or allow for reinvestment. They go even further. The corporation is primarily *for* the shareholders, they will say, so managers should manage the company primarily with the shareholders’ interest in mind. The corporation ought to be in the business of maximizing shareholder value.

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