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What is the Objective of a Firm? Overview of Theoretical Perspectives

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Abstract: The paper studies theoretical views on corporate governance models from the perspective of perceived primary firm's objective. We find that there are two main theories on the primary firm's objective: shareholder theory and stakeholder theory. The first defines the primary firm's objective as value maximization for shareholders, whereas the second takes into account also other firm's stakeholders and therefore defines the firm's objective more broadly. We believe that the answer to the question of the firm's objective lies in between the two theories: firm should follow the principle of shareholder value maximization in the long run, however at the same time take into account also the stakeholders' interests, which should be subordinated to the shareholder value maximization objective.

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Introduction

What is the objective of a firm? In whose interests is it governed? Is the primary objective or purpose[1] of the firm's existence subordinated only to the shareholders or to all stakeholders, among which shareholders are just one of the interest groups without special status? All of these questions, despite voluminous literature, remain unsolved, both from theoretical and empirical perspective.

According to the shareholder theory, the primary purpose of a firm is usually defined as value maximization (for shareholders).[2] By this we refer to maximization of a firm's equity, which is in fact the present value of expected benefits (cash flows) that shareholders can expect from the firm.[3] According to this definition, a firm's value can be maximized only when expected benefits are maximized in the long-run. By this we should keep in mind that value maximization (of equity) is not equivalent to profit maximization. Expected profits can only

[1] In the literature, terms "purpose" and "objective" are often used as synonyms and there is no appropriate differentiation between them. In this paper we use these terms in accordance with the original literature. Therefore, we understand "purpose" as an answer to the question, why we have started with certain activity, why something exists (for example, why we started the firm). On the other hand, "objective" or "objectives" are defined as means to reach the purpose.

[2] By value maximization we refer to the market value of equity. Therefore, in the case of a public limited company, we define value maximization as the maximization of the market value of stock price.

[3] We can refer to this value also as the internal value of a firm.

to a certain extent explain the market value of the equity (see Stubelj 2010a). Namely, profits are an accounting category and represent the historical performance of a firm; however, they are not the best proxy of what investors can benefit from a firm. Thus, from the perspective of the shareholder value maximization, expected future (free) cash flows are a far more important measure of a firm's performance.[4]

On the other hand, if we define the primary objective of a firm from the perspective of all its stakeholders (i.e., shareholders, employees, customers, suppliers, creditors, local community, state and others), the primary objective would be defined more broadly, as the interests of stakeholders differ and cannot be expressed using a unique measure.

The question of a firm's primary objective relates to the question in whose interests is a firm governed. If a firm is governed (predominantly or exclusively) in the shareholders' interests, then its governance aims at the shareholder value maximization. In this vein, the shareholder theory explains the rationale of the value maximization for shareholders.[5] On the other hand, the stakeholder theory explains the rationale of firm's governance in the interest of all firm's stakeholders.[6]

The purpose of this paper is to study the corporate governance models from the perspective of perceived primary objective of a firm. In the first part of the study we provide an overview of the theory and relevant researches on the corporate governance models. Based on a synthesis of the existing theories and studies, we present our own view on raised questions.

The whole study continues with empirical analysis, which is – however due to the fact, that it is not yet finished - not included in this paper. Thus we provide here only the research framework. In the empirical part we will study the corporate governance model in Slovenia in order to find the most common corporate governance practice and find answers that relate to primary objective of firms in Slovenia. We will conduct our empirical research in two stages. Firstly we will conduct semi-structured interviews in five firms that differ in ownership structure (state ownership, private ownership, foreign ownership, family ownership, workers ownership). Taking into account the interview results we will form a questionnaire addressed to the management. The survey will be sent to 1400 Slovenian middle-sized and large firms. The results will then be adequately analysed and research questions will be properly addressed.

The paper is structured as follows. We continue with an overview of the theoretical framework and empirical studies, with special attention being put both on shareholder and stakeholder models. In section 3 we give our view on the corporate governance model and try to answer the question which model is more appropriate and would result in a sustainable growth and welfare in economies.

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[4] Cash flow that belongs to the shareholders in a given period can be calculated as net income plus depreciation minus gross investments in (long- and short-term) assets used to support firm's operations, plus change in firm's obligations.

[5] "Shareholder" is an English expression for an individual or institution (i.e., legal entity), who/which is a (legal) owner of the share of a firm (Fama 1980).

[6] The term "stakeholder" is an American version of the term "shareholder" (Fama 1980), however it is used also to refer to the firm stakeholders, i.e., "interested parties" (e.g., employees, other firms and institutions, creditors, local community, the state, etc.) that affect the firm and are at the same time affected by the firm's business. In terms of the stakeholder theory, a stakeholder is understood as a participant of the firm and not just as the (partial) owner of the firm.

Overview of Theoretical Framework and Empirical Studies

Several researches have addressed the diversity of corporate governance models, among others Boyd *et al*. (1996), Bradley *et al*. (1999) and Guillen (2000). An important element of these studies is the comparative analysis of how different countries view public limited companies. Do they perceive them as economic entities, aimed at increasing shareholder value, or as social institutions, aimed to promote the interests of the firm and its stakeholders (i.e., shareholders, employees, creditors, suppliers, customers, local and broader community). We can define the first view, in general, as an Anglo-American model of governance, whereas the second model is more common in other parts of Europe and in Asia (Fiss and Zajac 2004).

Corporate governance models differ significantly across European countries. For example, Germany has a system of co-determination in which employees and shareholders in large firms have an equal number of members in a firm's supervisory board. This means that the interests of both parties are equally represented (Allen *et al*. 2009).[7] Wymeersh (1999) documented the characteristics of different corporate governance practices in several other countries. He noted that Austria has a similar system of co-determination as Germany. In the Netherlands, corporate governance system is characterised with indirect workers representation – the representation is indirect in a sense that directors must enjoy the confidence of workers.[8] Denmark, Sweden and Luxembourg have one-tier board system, where also workers are members of the board. The number of workers' representatives differs between countries and between firms' sizes. In France, workers' representatives are observes in the boards. In Finland, firms can voluntarily decide on the workers' representation in the boards. In Japan, managers do not have a direct responsibility to shareholders. However, they may be liable for gross negligence in the performance of their duties, including the duty to supervise (Scott 1998). In fact, it is generally accepted in practice that Japanese managers represent all stakeholders (Allen *et al*. 2009).

Although corporate governance systems differ significantly among countries, it is obvious that in many countries both shareholders and other stakeholders are included in the decision-making processes. Moreover, in several countries workers have an important role in these processes and are therefore treated as an important stakeholder of a firm (Allen *et al*. 2009).

The shareholder approach, which states that managers are required to manage a firm in the interests of its shareholders, on the other hand, has always been the ruling concept in the Anglo-American corporate governance. However, several authors question why shareholders, as one of the firm's interest groups, should be treated as privileged. According to Easterbrook and Fischel (1996), this is because the shareholders take the majority of firm's risk. Namely, they are entitled to the residual after all other firm's obligations are paid. Their "claims" are subordinated to all other claims and are therefore entitled to the net cash flow of the firm. Consequently, a firm has to be managed in accordance with their interests. Therefore, the shareholder value maximization has to pursue two purposes: responsibility and efficiency. This ensures that managers are fully accountable to shareholders for their stewardship of the firm's assets, making managers focused on a single clear objective, which ensures the most efficient outcomes (Gamble and Kelly 2001).

With regard to the above interpretation, we may conclude that the shareholder theory is simple and raises no contradictions. However, this is not true in practice, mostly because of

[7] For more details see also Rieckers and Spindler (2004) and Schmidt (2004).
[8] This system holds for all larger firms.

different ways in which the firm is conceived, its purpose, legal foundation, and political environment. Like parliamentary sovereignty, shareholder value is a doctrine that arises in a specific institutional context and sharply contrasts with the operating doctrines in other systems of corporate governance, such as in Germany and Japan. Therefore, one cannot argue that that the shareholder value is the most appropriate objective a modern firm should follow. It is adopted for specific purposes and depends on the definition what the firm is and to whose interests it serves (Gamble and Kelly 2001). The need for a shareholder value doctrine arose from the separation of ownership and control, described as the ownership fragmentation (Berle and Means 1991). The separation of different functions of ownership among different agents is one of the defining features of a modern public firm, resulting in the creation of legal entities with legal personalities isolated from their shareholders (Ireland 1996). The legal and political revolution in the 19th century allowed the rise of corporate economy. However, it was not inevitable that the principle of shareholder value was interpreted in accordance with the managerial autonomy rather than with shareholder democracy (Hannah 2006). For instance, in the United Kingdom the corporate ownership became fragmented and the shareholding became dispersed, which gave to the new class of managers a high degree of managerial autonomy (Gamble and Kelly 2001).

According to Rose and Mejer (2003), several regulators and consultants have in recent years emphasized that it is necessary to provide an increase of the shareholder value, while some others have, at the same time, emphasized the importance of other stakeholders' interests. For example, OECD, which advocates the protection of the shareholders' rights, encouraged the active co-operation between corporations and other stakeholders in order to create wealth, jobs and sustainability of financially stable firms (OECD 1999). Rose and Mejer (2003) believe that the stakeholder orientation implies that a firm should be managed in the interest of all its stakeholders, not just in the interests of shareholders. With this regard they pointed on the issue of firms' social responsibility. However, there is no universal view on the definition of the stakeholder theory, although the term is widely recognized as the obligation of the management to take into account the interests of anyone who has a significant "stake" in a firm. .

According to Rose and Mejer (2003), advocates of the shareholder theory argue that the stakeholder orientation undermines shareholder's rights on the private property and that the definition of stakeholders is so broad that the responsibility is diluted.[9] On the contrary, proponents of the stakeholder approach argue that not only shareholders should be entitled to a firm's residual.[10] According to the authors, this is important (at least) in a situation when workers engage in firm-specific investments in human capital, for example, in technology-intensive production. In such firms, most of the added value comes from innovations, specialised products and specialised services. Such activities often demand investments in human capital, which make workers involved in the risk of a firm. In countries with strong trade unions, as for example in Denmark, workers are protected from dismissal at short notice and are in case of dismissal entitled to appropriate compensation.

In their in-depth study of the Danish system, Rose and Mejer (2003) showed that the Danish system of corporate governance has traditionally been oriented towards protecting interests of all stakeholders, not only shareholders. Nevertheless, in the last years the pressure of financial markets integration caused that the Danish system of corporate governance became more (market- or) shareholder-oriented. The increased proportion of contracts of Danish managers

[9] See, for example, Easterbrook and Fischel (1989), Romano (1996) and Jensen (1986).
[10] See Freeman (1984a), Blair (1995), Turnbull (1997), Blair and Roe (1999), Tirole (2006) and Vinten (2001).

in recent years, according to which managerial compensation is based on the firm's financial performance, confirms the trend towards the shareholder-oriented corporate governance.

Goodpaster (1991) pointed on the obvious paradox of the stakeholder approach: management has a contractual obligation to run the firm in the interest of shareholders and, at the same time, also a moral obligation to take into account the interests of all stakeholders (on this issue see also Boatright (1994), Goodpaster and Holloran (1994), and Maren and Wicks (1999)). There were also some other attempts to extend the stakeholder theory into, what Jones (1995b) defined as a central paradigm, which links agent theory, transaction costs theory and contract theory. Jones and Wicks (1999) explicitly tried to combine the divergent studies in the paper titled "Convergence stakeholder theory" (Freeman 2004).

La Porta *et al*. (1997) stressed the issue of legal protection of shareholders. They argued that protection of shareholders plays a key role in functioning of the financial markets, as it tries to ensure that management does not act in a way that harms shareholder's interests. This is important because shareholders provide capital in exchange for firm's control.

Yoshimori (1995) examined the views of managers in Japan, Germany, France, in the United States and in the United Kingdom. He found that managers in Japan, Germany and France believe that the firm exists for the interests of all its stakeholders. On the other hand, most of the American and English managers argue that a firm should give first priority to shareholders' interests.

Support to the Shareholder Theory

Williamson (1985) showed that shareholders should be entitled to special treatment, because the value of their investment in a firm (i.e., value of equity) is related to the firm's performance. This implies that they can lose everything in case a firm goes bankrupt. This, however, does not hold for other firm's stakeholders.

Rubach and Sebora (1998), Coffee (1998), Bradley *et al*. (1999), Useem (1999), Hansmann and Kraakman (2000) and Hopner (2001) focused their research on the estimation of the Anglo-American corporate governance model. According to their findings, Anglo-American shareholder-oriented governance model will soon prevail over other models, especially because of globalization and increased competition on the international capital markets. Namely, firms with shareholder-oriented corporate governance have access to cheaper capital sources, providing them with a competitive advantage over firms with other corporate governance models (Fiss and Zajac 2004).

In similar vein, Hansman and Kraakman (2000) showed that firms with shareholder-oriented governance enjoy competitive advantages on the market, as their corporate governance is more flexible and allows fast adaption to market changes. As these firms are not burdened with the interests of other stakeholders, they can adapt their management structures, enter the market more aggressively, and exit from inefficient investments more rapidly. Product-market competition gives a firm also an opportunity of social learning, because competition makes possible for firms to come in contact with other shareholder-oriented governance firms and to learn from them (Fiss and Zajac 2004).

Jensen (2001) studied the role of the corporate objective function in the corporate productivity and efficiency, social welfare and the accountability of management. Author claimed that since a firm cannot maximize more than one dimension, it needs a single objective function. However, a single objective function does not imply that only one aspect is important for a firm. On the contrary, single objective function is a complicated function of many different "goods and bads". Two hundred years of work in the economy and finance showed that in the absence of externalities (i.e., situations in which decision maker is not entitled to all benefits and does not bear costs of his/her decisions) and monopoly (and when prices for goods are formed on the market) value maximization within a firm can lead to social welfare maximization. Social welfare is created when a firm produces outputs that are valued by its customers at more than is the value of inputs for their production. Firm value therefore equals the present value of the difference between the expected prices of inputs and outputs. As long as the firm is capable of selling its outputs at higher market price than is the cost of its inputs, it should increase the supply of inputs for production of outputs. Given that the prices of inputs and outputs are set in a manner that all gain the highest benefits (in case of absence of externalities and monopoly), profit maximization (i.e., difference between costs of inputs and prices of outputs) would lead to social welfare maximization.

Stakeholder theory, on the contrary, does not offer managers a clear managerial objective, as it does not explain how managers could choose between competing interests of stakeholders. If a manager has to simultaneously maximize profits, market share, growth in profits and everything else, this will hinder his decisions and cause confusion. It is impossible to maximize more than one dimension at the same time if dimensions are not monotone transformations of one another. Furthermore, this theory can be ideal for managers who will try to follow their own (short-term) interests. As a consequence, stakeholder theory increases agency costs and economic inefficiency. So, firms that adopt stakeholder theory are limited in their competition for survival.

According to Jensen (2001), value maximization objective is more than just creation of a firm value. Sole value maximization does not boost energy and enthusiasm of workers and managers to create value; it serves only as a criterion for evaluating the firm's performance. Hence, the value maximization as a business objective has to be supported with the vision of a firm, strategy and tactics, which pull all firm's driving forces (i.e., managers and workers) in their eagerness for domination at the competitive market.

The stakeholder theory, as defined by Freeman (1984b, 2010) and the Clarkson centre (1999), does not provide an answer on how to make a trade-off between different interests of all stakeholders. This theory is harmful both for a firm and for social welfare. Based on a case of a small non-profit firm, Wruck *et al*. (1991) showed the consequences of following more objectives at the same time. According to the authors, maximization of several objectives at the same time almost destroyed the firm. Likewise, Cools and van Praag (2000) found that pursuing several objectives at the same time hinders firm's competition. Based on the analysis of 80 Danish firms between 1993 and 1997, authors demonstrated how important it is that a firm sets one objective in value creation process.

Senge (2000) presented an interesting definition of a firm as a living organism and not as money making machine. As it follows from the history, nature itself makes a selection among organisms that have to pass a natural test of creating value. He believed that firms and economic systems are like living organisms, yet their test of survival operates with a long time lag. Following this reasoning, Senge (2000) claimed that firms could follow also other objectives than only an increase of shareholder value. Jensen (2001) opposed Senge and stated that setting the value-creation score front in every organization could stimulate and not hinder progress. Based on firms' examples, he showed that many firms have gone bankrupt because they did not devote enough attention to the value creation/destruction score.

Sundaram and Inkpen (2004) promoted shareholder value maximization as a decision-making rule that brings benefits to all stakeholders. Their recommendation is as follows: "maximize the long-run value for shareholders and you will maximize the value for firms on the long run." Discussions on stakeholders and their link to managerial decisions, on the role of firms in the society, and on the efficiency of ownership have played a crucial role in the evolution of legislation, social and political norms on corporate governance and significantly influenced managerial practice.

Sundaram and Inkpen (2004) presented an example of Merck, which was identified by Freeman *et al*. (2004) as a practical example of a successful stakeholders' approach governed company. They specified the following rule of Merck: "Our ability to meet our responsibilities depends on maintaining a financial position that invites investment in leading-edge research and that makes possible effective delivery of research results" (Merck 2004). In other words, firms such as Merck need to achieve the required return for shareholders to fund investments that will in turn be beneficial for all its stakeholders (Sundaram and Inkpen 2004).

Modern theory of finance offers a solid basis for controlling the firm's management. According to Tirole (2006), there is a concern that not the best managers will be chosen to run a firm, and, when they will be chosen, they will not be responsible. The financial view on the corporate governance is based on the following premises: 1) in order to obtain adequate financial resources, a firm has to provide investors (i.e., owners and creditors) an appropriate/required return on investment; 2) managers have their own interests, thus they might not run the firm in the investors' interests; they might rather exploit their experiences and superior information, and redirect these resources for their own benefits; 3) consequently, in corporate governance several issues depend on limitations set by managers (for themselves) or by investors in order to hinder the ex-post wrong allocation of resources, which will demand greater ex-ante need for assets (Shleifer in Vishny 1996).

Support to the Stakeholder Theory

Freeman and Evan (1990) argued that interests of other stakeholders can be highly associated with a firm's performance as well, implying that they too can face losses. On the contrary, shareholders are more secured as they can (usually) sell their stocks on a liquid market. Thus, managers should not be more devoted or responsible to owners, especially not on the expense of other stakeholders (Freeman 2004).

Wallace (2003) studied the issue of the long-term value for shareholders in the context of broader objectives of stakeholders. Using various measures of business performance (he focused on broader definition of business performance, not only shareholders' focus), he analyzed whether a broader focus on a firm's objective is inconsistent with pursuit of long-term value for shareholders. He found that long-term value creation is a necessary condition for maintaining corporate investment in stakeholder relationships. Namely, firms with higher levels of shareholder value creation have stronger reputation for treating shareholders well.

On the other hand, firms that create little value for shareholders end up short-changing their shareholders and also all their constituencies. Wallace therefore claims that investing in stakeholders can add value – additional dollar spent for relationship with stakeholders pays off as long as the present value of the expected (long-run) return is at least one dollar.

Allen *et al*. (2009) developed a model of stakeholder capitalism. According to the authors, most of the literature deals with a question whether firms are governed in accordance with the interests of shareholders. Nevertheless, in several countries firms do not focus only on the interests of shareholders, but also on other stakeholders. Using a simple model, authors showed that a firm and (almost) all stakeholders are better-off if a firm concentrates on the interests of all stakeholders. Namely, their findings showed that in cases when firms take into account also interests of other stakeholders (also if this is not required by the law), this increases the firm's value in comparison to firms focusing on shareholders alone. Some firms even consider interests of other stakeholders also if this is not directly associated with the value of a firm. However, this can result in increased prices of firm's goods and services, making consumers worse off. One of the limitations of their study is that they treat shareholders, stakeholders and consumers as different groups, although they in practice overlap (Allen *et al*., 2009).

An important issue in the context of globalization is also the entry of new firms in the market. By this we are referring to the situation in which firms that are stakeholder-oriented enter on the market with shareholder-oriented firms and vice versa. Allen *et al*. (2009) showed that regardless the prevailing type of firm governance in the market, existing firms in the market prefer an entry of a stakeholder-oriented firm. From our viewpoint, this is also in line with the shareholder theory view. The latter believes that in a stakeholder-oriented market the prices will be higher and competition will be lower.

Hilman and Keim (2001) analysed a sample of 500 American S&P firms and found that investing in stakeholder management may be complementary to shareholder value creation and may provide a basis for competitive advantage, as it enables a firm to develop capabilities and resources that differentiate a firm from its competitors. As regards firm's participation in social issues, it may be understood as a transactional investment that can be easily copied by competitors. Their findings tend to help the managers to clarify the dilemma they face when called up to serve an expanded role in the society. Authors suggest that if the activity is directly tied to primary stakeholders, investments might not only bring benefits to stakeholders but also result in an increased shareholders' value. Participating in social issues that go beyond the direct stakeholders interests, however, may have a negative impact on the firm's ability to create shareholders' value. In the decision-making process firms can rely on the reasoning of Moran and Ghoshal (1997), who claimed that things that are beneficial for society are not necessary bad for the firm, and what is good for the firm is not necessary a cost to society.

Based on the historical analysis of the development of shareholder value principle, Lazonick and O'Sullivan (2000) showed why the model of shareholder value maximization dominated in the corporate governance. They studied reasons for transformations from the strategy of retained profits and reinvestment, which prevailed during the 1970s in the United States, to the strategy of downsizing of corporate labour forces and distribution of earnings to shareholders during the 1980s and 1990s. In their opinion, these transformations were a consequence of the focus on maximizing the value of a stock. The latter resulted in immediate benefits for shareholders and managers, who were rewarded with stock options. Nevertheless, this was done on the costs of workers – during this period the number of workers and also the incomes[11] significantly decreased, especially in the manufacturing sector. By reducing the proportion of retained profits and buy-outs of stocks, the short-term return on equity increased, while investments in research and development decreased, leading to lower perspectives for firms' growth. This was supported also with the financial deregulation, as the stock prices were shaped by financial speculations and not by the internal value of the company. In such cases managers have harmonised their interests with the interests of external financial institutions, and have not focused on the development and long-term perspective of the firms. As a result, American firms lost the competitiveness on international markets that they had for decades after the Second World War.

The US financial economists, who advocate shareholder value maximization as an optimal model of corporate governance, believe that when following the principle of shareholder value maximization also other firm's stakeholders benefit and, consequently, the entire economy. This strategy enabled reallocation of labour force to most perspective industry sectors with new technologies. They point to example of successful firms in the Silicon Valley. However, Lazonick and O'Sullivan (2000) disagree with these arguments and state that the success of firms in the Silicon Valley was a result of a long process of reinvestments of retained profits. Shareholders and upper management definitely benefited from the strategy of cutting jobs and great sell-out of profits, which occurred in the second half of previous century. But experiences in the United States showed that adoption of a shareholder value maximization strategy resulted in a contraction of firms and consequently the entire economy. Authors concluded that the economy needs a new corporate management strategy, which will boost the creation of new businesses and increase the economic activity.

Koslowski (2000) showed that the shareholder value can be used as a principle of management control, but not as the firm's objective. According to the author, the idea that the shareholder value maximization is the only firm's objective is a mistaken transfer from the financial to industrial firm. Namely, concentration on the shareholder value works as means to increase the allocation efficiency of investments, which is a desired effect. The shareholder value is also an instrument to prevent the shirking of managers and the shirking of whole firms.

Among all stakeholders of a firm, an increase of firm's value is an objective only for shareholders. For other groups, this objective is just a precondition that enables the success of the firm as a whole. Following this, Koslowski (2000) suggested that the main purpose why a company has been established should be the production of goods and services, and not the production of profits or shareholder wealth. However, this may only be accomplished if adequate return on investments is realized. From this perspective, the creation of shareholder value is only a precondition for achieving the main purpose of a firm; however it is not the most important. Accomplishment of this condition enables a firm's existence. The means of securing the purpose of the firm are, however, not the primary purpose of a firm.

The motivation of the entrepreneur and manager can be described with a concept of the »over-determination of action«, introduced by Sigmund Freud. The concept of over-determination of action and of overlapping determinants of economic action states that our economic behaviour is overdeterminated by several motives. In accordance with this concept, good shareholder value should be the side-effect of a good product and a good firm, rather than a

[11] In fact, the difference between managers' compensation and average wages increased.

good product and a good firm being the side-effect of shareholder value maximization (Koslowski 2000).

Using the case of Eurotunnel project, Vilanova (2007) explored the relationship between managers and shareholders, which is in the core of debate on corporate governance. This debate usually refers and defines two ideal models of corporate governance. On one side, we have a firm which is managed according to value maximization concept. Such firms are characterized with the concentration of power in the hands of shareholders and little autonomy of managers in decision-making or conflict resolution. On the other side, we have a firm, managed according to stakeholders approach, where managers have more discretion and act as mediators between different stakeholders and interests. Author found that: i) the traditional mechanism for resolving conflicts can be counter-productive and may result in increased conflicts; and ii) managers do not follow only the interests of shareholders or other stakeholders, but prefer the most powerful interest groups, so called "short-term salient stakeholders". Vilanova (2007) proposed a new descriptive and instrumental stakeholder theory, which adapts the concept of asymmetrical information and takes into account differences in bargaining positions of different stakeholders. Under these two assumptions the theory states that: i) firms are governed in the interests of one unique interest group; ii) management is prone to make the agreement with the most powerful group; iii) this autocratic type of governance is unstable in the long-term, as the legitimate stakeholders, who are not taken into account in one period, use influence strategy to gain power in the next period. According to this instrumental view, Vilanova's theory finds that chronic conflicts related to the short-term theory of main stakeholder management can lead to poor performance (Vilanova 2007).

Conclusion

Today firms operate in an environment where capital is a scarce resource. A firm is usually established with goals and entrepreneurial motives that are defined with psychological factors such as independence, need of achievement, sensation of control and risk. Nevertheless, a firm cannot survive in a long-run if it does not follow the financial objective of shareholder value maximization, which enables a firm to gather the necessary capital resources on the market.

When defining the shareholders' interests, we could start from the short-term aspect of the shareholders benefits. In this case, shareholders' interest would be focused on reaching the highest profit. However, it is clear that this is only the short-term perspective and may not work on long-run, because a firm may in a future fail to generate enough profits or even end-up in losses. Because equity is a long-term financial resource of a firm, we should, according to the definition, proceed out of the premise that the shareholders' interests can only be defined in the long-run. However, this can only be attained, if the firm can provide the highest possible profits (actually, cash flows) in the long-run and therefore maximize its present value. In a competitive market, a firm must build its competitive advantage using all the available resources and the best services (see Radosavljević *et al.* 2012). In order to achieve this, a firm must consider the interests of all the stakeholders involved with the firm.

We assume that a firm in a competitive environment by its operation satisfies the interests of all direct stakeholders (i.e., shareholders, creditors, workers, state, etc.), taking into consideration also the added value of different stakeholders to the performance of a firm (for example, productivity, etc.). For instance, creditor's interest is that a firm will pay back its debt and make relevant compensation for the resources they invested (i.e., interests). The main interest of workers is an appropriate payment for their performed work. Moreover, state is interested that firm pays all its legal obligation (taxes, contributions, etc.) and eventual costs of negative externalities (for example, pollution of water, air, exceeded use of roads, etc.). And finally, shareholders or owners demand an appropriate compensation for the funds invested, i.e., required rate of return subjected to the risk they take.

If a firm does not follow the principle of value maximization in a long-run, it may be found in a situation, when it could not gather adequate financial resources for its investments. Yet, investments present a precondition for growth and development of a firm and as such enable satisfaction of interests of both stakeholders and shareholders.

Of course, we cannot go beyond the fact that regulators and supervisory bodies should assure that the firm's objectives of shareholder value maximization are not detrimental for the interests of other stakeholders, which are also influenced by the firm's decisions (for example, workers, environment and society).

We believe that the firm's management should follow also objectives of other stakeholders, however, these objectives should be subordinated to the long-term shareholder value maximization. Such objectives are, for instance, satisfaction of employees, customers, suppliers, local population, responsibility towards environment, respect of ethical norms, etc. We believe that the failure of achieving these objectives could have a negative impact on the shareholder value as a primary objective.

However, this holds only under the condition that the financial markets are more or less perfect, which assures that the value of a firm (i.e., the shareholder value) reflects the internal or basic value of a firm. The latter is defined as the present value of all future expected cash flows, implying that the value of a firm is subject to firm's long-term performance. However, in practice, financial markets are imperfect, some more and some less. In such a case, pursue of shareholder value maximization approach can imply only short-term increase in value and fails to comply with the long-term benefits for either shareholders or stakeholders. Therefore, firm's financial environment should be taken into consideration when deciding on potential deviation from the value maximization approach.

However, it should be noted that shareholder value maximization approach is quite fuzzy when refereeing to firms that are not public limited companies (either their shares are not in the stock market or they are, for example, a private limited company). In such a case, it is hard or even impossible to assess if the management really follows the value maximization principle (or at least increases the shareholder value). This could be estimated (for example, for the purpose of management control) if periodical independent evaluation of the firm is performed, but this is a costly and time consuming operation. As a result the operational objective of a firm (or the criterion for measuring management performance) often shrinks in practice to (accounting) parameters of business performance: profit, return on equity or similar.

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