Chapter 1

Firm Value

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Additional information is available at the end of the chapter

http://dx.doi.org/10.5772/intechopen.77342

Abstract

The chapter explains the meaning of firms from the perspective of economic researchers in the past to the views of current dates. Traditional model of a firm's value is linked firmly with shareholders' value. This traditional view is used in finance and in business for many years. To enhance a firms' value, we need to maximize shareholders' value. According to this view, any activities in firms can increase the value of firms if it increases the value of the Shareholders. However, traditional concept of shareholders' value as the explanation to firms' value is challenged by a group of researchers. This group believes that value of firms should not be based on just shareholders but should include all groups of stakeholders. After giving some ideas on the meaning of firm, the corporate sustainability value of firm in terms of economics and finance is explained.

Keywords: sustainability, performance, stakeholders, firms value

1. Overview of the chapter

In what follows, the author attempts to evaluate the concept of the theory of firm value as it has passed through its interpretive history. For example, the earlier stage of the concept maintained the interpretation that a firm is merely a legal device through which the private business transactions of individuals are maintained and operated. Such a concept has dominated business, finance, and economic understanding about a firm's theory for a long time. Furthermore, as we pass through time, many views emerge from business and finance academicians who compete to explain what should be the meaning of the term "firm." This chapter is designed to outline to readers the evolution of the terms *firm* and *firm value* through the lens of academic study in business and finance (or economics perhaps?) through prior literature surrounding the issues. The essential point of the chapter is simple: to provide an answer to the fundamental question of "what is the meaning of the term 'firm' and what do we know about the value of a firm?" Along with the detailed explanation, the author points to the central theme in major theories and concepts so that the reader can follow the theories and concepts when they are applied to business. Also, some important empirical papers are discussed throughout the chapter.

The structure of this chapter is as follows. First, the author discusses the relevant concepts as they are presented to us and are used from the past up until current usage. What we have learnt after using this traditional theory for half a century is that the simple focus on single stakeholders creates some important problems that require attention with regard to the drawbacks of the theories in the past. In the second part, the author illustrates the major problems arising from these traditional viewpoints of *firm value theory* and how the modern system of corporate finance can help us to solve this problem. The third part introduces the reader to a theory that challenges long-time traditional use of shareholders' maximization theory (i.e., a theory whose main focus is only on a single group of stakeholders known as *shareholders,*); the more recent theory however focuses on a multifarious-group of stakeholders and is known as *stakeholders theory*. The author shows that stakeholders' theory has been transformed into many versions of the current conceptualization-of-firm theory, such as sustainability concepts, triple bottom lines, or the CSR theory.

2. The traditional conceptualization of a "firm"

In the early part of the nineteenth century, business units were owned by individuals or small groups of individuals. In this typical business unit, a firm was managed by an individual or assigned individuals who were appointed by an individual owner [9]. The problems of such private firms included the limitation in size and wealth of firm. This typical type of firm was owned and operated by a small group of people who had limited resources to expand and to manage the firm in the century in which business was becoming bigger and better [9]. More importantly, the continuity of typical single-owners or single-family firms was constrained by the geographical area where the owners or the groups of owners existed. This constraint curbed the size and wealth of a firm in that period.

The first paradigm shift in the conceptualization of a "firm" leads to the new architecture of "corporation," through which its structure is designed to collect the wealth of individuals under a unified management and control system. This feature of corporations is known as "the separation of ownership and control" [9, 21, 53] implying the mechanism wherein owners of a firm can be replaced without disturbing the control or management of a firm. The continuity of a firm is no longer contingent on the owner, or upon the geographical area of its founder. Moreover, this type of firm can obtain a huge amount of funds from its many and various shareholders, by collecting a small amount money from them. More importantly, a new empire or a huge conglomerate business has the possibility of being created through the activities of mergers and acquisitions, through which the activities require significantly large amount of money [8].

Back in the 1960s, many researchers whose works related to the theory of firm or firm value cited the classic paper of Ronald Coase when they wrote about firm theory. Coase [21] was the Nobel Prize laureate in politics and economics and held the view that firms can be composed of many "nexus of contracts" or "nexus of parties" and, when there is a conflict of "property rights," parties within the nexus can bargain or negotiate terms that are more beneficial among them. In the nexus, the "Pareto efficient" is obtained by bargaining among the nexus. Coase's theorem is therefore known as property right theory. The concept of a firm derived from Coase's explanation is the springboard for many subsequent business and finance theories, including the classic paper, *Theory of the firm: Managerial behavior, agency costs and ownership structure,* of Jensen and Meckling [53].

Property right theory was defined as "separation of ownership and control" by Jensen and Meckling [53] and signified the separation of ownership and control that underlines the main nexus of firms into two groups. One is the group who has the property rights as the "owners" of firms. The other one is the section of the management who has the right to operate or "control" firms. The relationship between the groups is called the principal-agent relationship. Nexuses have many types of this kind of relationship, that is, the owners (principal) and management (agent), the shareholders and bondholders, or the minority shareholders and owners-managers.

In the standard contractual concept, shareholders offer money as capital to a firm in return for residual claims on returns of capital after money is paid to other groups. The attribute of the residual claim of shareholders is used to distinguish them from others. With this standard concept, it is clear that the shareholders are the group who provide capital to contribute to the overall operation of the firm. Even other groups, such as bondholders or preferred stockholders, can also provide some forms of capital to the firm, but they have no right to directly or indirectly control a firm. The standard argument holds that shareholders, with only residual claims, would bargain for corporate control in return for their residual risk bearers on the claims. Equipped with the power of corporate control, shareholders can assign control to their agents who will work in the firm so as to maximize benefit for them in returns. Clearly, this side of the theory is known as "shareholders theory" [11]. Viewed from the eyes of this separation, modern forms of firms have a lot of advantages as explained earlier, such as continuity, ample resources to expand the boundaries of a firm, and the independence of a firm's site location and owners' locations. Firm theory enjoys these advantages and applies them to the expansion of a given firm to harvest an industrial revolution. The theory also encourages owners to think in more revolutionary ways about their firms.

However, Jensen and Meckling [53] did not just describe the meaning of the term "firm" according to their own view. The great beauty of their work is in showing how we can exploit the fruitful nature of the concept of the "separation of ownership and control" as a magnifier to examine the peripheral events around a firm. They manage to fit the concepts very well with the overall business environment. Furthermore, the concepts can be used as heuristic tools for owners, managers, or any stakeholders to understand the causes and effects in relation to the value of firms and to understand the appropriate solutions for problems related to the principal-agent relationship. Problems arising from this relationship are known as agency problems (see [30, 53]). The problems propose that whenever we have this relationship in the environment (not just in business), we are surrounded by the agency problem. Smith and Zsidisin [73, 74] used the agency framework to understand the trade-off involved in the selection of various approaches of student evaluation. The agency problem further proposes that it is not beyond reasonable expectation that both parties in the relationship have their own interests and incentives in order to maximize their own interests and wealth. It is this conflict of interest which is the root of the agency problem.

Traditional views of firms and the view of Jensen and Meckling or Coase still focus on the shareholders as the prime nexus or the most important group in the firm since they have the highest bargaining power in the firms as described earlier. To maximize the value of a firm, agents or managers need to put all resources into maximizing the value of the principal for the shareholders. Theoretically and according to the expected conflict of interest that might occur, the misalignment from the maximization of the value of a firm is generally found and hence reduces a firm's value. Managers can allocate firm resources to benefit themselves in many ways such as to use a luxurious office or use expensive car(s) or other perks for their management position.

In the Enron case and in many other such cases, it was found that managers attempted to adjust financial statements for their own benefit. One important issue in accounting research is the extent to which managers alter reports to benefit themselves [7]. Empirical evidence shows that income-increasing earning management is more pervasive than income-decreasing earning management. Also, there is evidence that managers have incentives to increase income to hide any deterioration of performance [7]. Jensen and Meckling call the activities managers use to maximize their own wealth as "shirk" or "perquisite" or "perk," through which these behaviors can directly and indirectly reduce a firm's value. On the other side, (the point of view of the agent-principle relationship), any set of activities that reduce shirk or perk actually enhance the value of the firm. The demand for maximization of a firm's value or of shareholders' value calls for an effective set of activities that can be solved or can mitigate the agency problem.

2.1. Corporate governance

If the "shirk" or "perk" is not beyond the expectations or the principles of owners of the firm, they will formulate a set of mechanisms to control the deviation from shareholders' wealth maximization. These take the form of "auditing" activities and monitoring activities. The auditing method is the inspection of managers through the prism of financial management and has been used in business and accounting for a long time. However, the regular occurrence of fraudulent management in many firms demonstrates to us that the effectiveness of auditing activities alone cannot counter unethical business practices. Auditing is one set of activities designed by incumbent owners to monitor the behavior of managers. Issues of corruption, the rule of law, and legal enforcement demand a more effective set of monitoring activities, which have come to be known as corporate governance [68].

Corporate governance is defined as "a set of mechanisms through which outsider investors protect themselves against expropriation by the insiders." Governance implementation can be achieved by external mechanism (the market for corporate control) and internal mechanism. The supreme objectives of corporate governance are set to ensure that shareholders as financiers get a return on their financial investment [71]. Corporate governance involves issues of practices to solve the complex issues among contract participants (social, employees, debt holders, and minority shareholders). However, the ultimate objective of corporate governance is still to focus on the wealth of the residual claimants who possess the highest bargaining power in the firm. Empirical research on the issues of corporate governance around the word have major research questions, especially with regard to their effectiveness over firm performance, which are directly linked to shareholders [5, 59, 66, 68].

Renders and Gaeremynck [66] used a sample from 14 European countries and showed that governance within a high-quality disclosure environment leads to a higher firm value. Saona and Martin [68] used a sample from Latin American firms and assessed whether within country changes in governance and changes in ownership concentration can predict a change in the value of firms. The results are in contrast to expectations, that is in immature financial markets, (as found in Latin America), firms take advantage of both the asymmetries of information and the multiple frictions in order to produce inflated valuations. These results correlate with and confirm the expropriation of minority shareholders.

Further, as the financial system develops, firm values drop. Research in this field attempts to associate various factors with monitoring ability and test them on the relationship with firm value. Mayer [59] discussed the interaction between competition, ownership structure governance, and performance. The author shows that corporate systems across countries are different and relate to ownership and the control of a firm (these variables are explained in the next section). Ownership concentration is higher in continental Europe and Japan than it is in the United Kingdom and the United States of America [59]. The next section provides an empirical test of some essential factors that are known to affect monitoring and hence affect firm value.

One set of the data regarding the governance system can be obtained from the effective board of directors. Board characteristics are directly a proxy for monitoring capability and are associated with firm value. Whole volumes of prior literature have discussed this topic ([14, 32, 33, 50, 45, 57]). Compositions of board [1, 33, 49] studied in literature, include board size, board independence, and CEO entrenchment. The size of board or the number of directors on the board affect monitoring activities and henceforth can capture the level of corporate governance in a firm. A larger board size, it is argued, can lead to communication problems and higher agency problems. Free-rider problems from inert committees in large-sized board rooms give rise to greater CEO power. Larger-board firms are expected to have lower monitoring costs [49]. Previous empirical studies have evidenced that board size is negatively correlated with a firm's performance [1, 29, 38, 81].

Board independence and a higher percentage of independent directors tend to capture the monitoring capability of the board. Hence, it can be a proxy for the level of governance and it is used widely in literature in the area of board structure [13, 15, 23, 27, 62, 70, 78].

The diversity of board of directors also affects the capability to monitor and hence is further associated with the overall firm value. Empirical evidence has shown that diversity can improve a firm's performance [1, 47]. The gender of executives is believed to be another factor that has improved board monitoring Adams and Ferreira [1] by adding "multiple diversity facets to the oversight lens" [57].

3. Ownership structure and monitoring system

Ownership structure can be explained in many formats. In one form, it can be viewed as a concentrated and well-dispersed ownership structure. Concentrated ownership structure is the form of ownership in which large shareholders exist and are able to monitor a manager's activities in order to ensure the highest shareholder's value. Dispersed ownership structure, on the other hand, is the structure of ownership in which shareholders are not large enough to form an active monitoring group themselves. Concentrated ownership is found mostly in countries where stock markets are not yet developed. Another structural view is that the activities of the company are the criteria used to justify whether the structure is concentrated or dispersed [5, 17, 58, 60]. Ownership structure is also classified by its use of a particular legal system in La Porta et al. [56]. Countries where common law is used to enforce the governance structure (found in the US and the UK) lead to a more dispersed form of structure. On the other hand, countries where civil law (found in France, Germany, or in emerging markets) is used to protect investors may lead to a more concentrated ownership structure, since the poorer protection afforded by civil law is substituted by the internal control system derived from the larger shareholders. Berle and Means [9] proposed that ownership concentration should have a positive effect on value because it reconciles the interests of managers to shareholders. However, other researchers argue in opposite directions [25, 26].

Byun et al. [16] used data from the Korean stock market to explore the relationship between ownership structure and firm value. They found that controlling shareholders through more direct ownership moderates the relationship between intensive board monitoring and firm value. In the US, Ajinkaya et al. [3] showed that firms with higher ownership concentration and higher institutional shareholdings are associated with stronger monitoring mechanisms. Previous research also argues that for any board with an entrenched CEO, monitoring capability will decrease because entrenched managers have greater bargaining rights, through which they can use their right to deviate firm resources to benefit their group [44]. Previous literatures have measured the entrenchment power of CEOs, using the situation when the CEO is the same person as the chairman of the board [13, 44]. Also, a CEO of long tenure is more likely to become entrenched [19].

One form of controlling shareholders is known as the family firm. A firm is regarded as a family firm if the shares of the company belong to either a single or a few families. In contrast, a widely held firm is the case in which shares of the company are held by many widespread investors. Many researchers have investigated the role of family firms on the firm value. Whether family firms improve or destroy the overall value of a firm is an interesting topic for researchers. Under the agency problem, large shareholders can expropriate wealth from minority shareholders to their group. Or, they can divert resources of the firm in order to facilitate a monitoring system that is tailored to their own requirements. The former hypothesis regarding firm value is destroyed, while the latter hypothesis proposes that firm value should improve [77]. Evidence shows that owner-manager conflict in nonfamily firms is more costly than a conflict between family and nonfamily shareholders in founder-CEO firms [77].

4. Corporate social responsibility

After a long debate over the effectiveness of corporate governance, with the ultimate objective focusing on the wealth of shareholders, literatures have turned to ask questions about other stakeholders such as customers, social groups, or environmental lobbyists. Social pressures are the main driving forces of the strategic management in terms of both not only shareholders but also social issues too. The strategic management of many modern businesses includes the corporate social responsibility (CSR) of their strategic policy. CSR is also one attribute of corporate governance. However, researchers are still not clear about the benefit of CSR to shareholders.

In the context of the agency problem, managers of firms are inclined to invest for their own interests (i.e., for reputation) even in the cases of negative NPV projects. If an agency problem is manifested in the good policies (CSR in this case), the relative problem should be reduced when an efficient corporate governance mechanism is enforced.

If CSR is one attribute of corporate governance in terms of a tool to eliminate the agency problem and hence improve overall firm performance, one should observe the positive relationship between corporate governance and sustainability. Boghesi et al., [12] using the Governance Index or *G-index* as a proxy for the level of corporate governance in a firm (see [39]) find no relationship between *the G-Index* and the level of CSR. However, one may find that the level of CSR is higher for low insider firms (firms in which managers own a lower percentage of shares) and low institutional holdings. These findings suggest that investing in the CSR may not be due to the interest of shareholders but from the personal interest of managers. The theoretical implication from the agency problem is that if the CSR or other ethical policies are created in the service of a manager's private benefit, then strong governance should reduce the CSR or other goodness policies ([2, 18, 41]; and [12]) In fact, the managerial ownership or the *high institutional percentage of shares* in a firm represents institutional pressure which, in the context of this chapter, may not have much involvement in explaining the firm's investment in CSR activities. Thus, one could conclude that investment in CSR originates from *the personal motivation of managers rather than from institutional force*. Furthermore, findings about ownership structure and corporate governance are not consistent among different researchers. Barnea and Rubin [6] found a negative relationship between insider ownership and CSR, while Harjoto and Jo [41] found a positive relationship between institutional ownership and CSR activities; however, Boghesi et al. [12] found the opposite relationship—firms with larger institutional ownership are negatively related to the CSR. From the perspective of these research findings, the CSR might not be the ideal solution for the alignment of the managers' interests with the shareholders' interests.

Numerous empirical tests on the issue of the determinant factors of institutional ownership and governance structures are evidenced in many literatures that have been carried out over the last two decades. We provide some examples of the articles in the following section. Johnson and Greening [54] and Jansson [48] empirically found that companies with more pension funds representatives on the board perform better overall with the CSR. Siegel [72] showed that high-skill labor firms are associated with a higher social sustainability performance. Turban and Greening [76] and Greening and Turban [40] evidence that high-quality workers are retained in high social sustainability performance firms. Unions in the firms are tested and hypothesized to affect corporate sustainability. Strong employees' unions are found to be positively correlated with high social sustainability performance [63].

Previous sections have shown some internal control mechanisms such as the ownership of shares, the number of analyst following, or the incentive compensation program. In this section, the role of *board characteristics* is discussed to show that it is also used as an internal control mechanism in a firm ([14, 32, 33, 50, 45, 57]). The composition of the board of directors is studied by many researchers with regard to its relationship with the decision to invest in social programs (or the CSR).

Compositions of the board being studied [1, 33, 49] in literature include board size, board independence and CEO entrenchment. The size of board or the number of directors on the board affect monitoring activities and henceforth can capture the level of corporate governance in a firm. A larger board size is generally argued to have communication problems and a higher agency problem. Free-rider problems from inert committees in large-sized boards give rise to greater power to the CEO. Larger board firms are expected to have lower monitoring costs [49]. Previous empirical studies have evidenced that board size is negatively related with a firms' performance [1, 29, 38, 81].

Agency theory is the product of suspicious views over the relationship between principal and agent. The implication of this theory is that it is natural for owners and managers to foster interests in their own wealth rather than the firm's wealth (or shareholders' wealth). The agency relationship is under criticism because of the conflicting goals of the principle and the agents [24]. While agency theory views that conflicts of interests are not beyond expectation, the *Stewardship theory* offers the opposite view. Stewardship theory posits that managers are not opportunist nor commit to their duty for their own interest. Without any individual interests, board members can focus on strategic planning and on monitoring roles for the firms' overall sake. These roles are more manifest when the board of directors imposes effective communication, collaboration, personal charisma, and networking. Moreover, the gender differences literature suggests that such qualifications are to be found more in women rather than men [20, 57]. Based on this theory, gender differences may play more vivid roles in producing managerial outcomes that differ from all-male boards only.

5. New challenges for firms

In the current environment, business structure has substantially changed and firms find themselves in different terrain from previous commercial paradigms. For example, there is a more horizontal structure and firms are very close to their various stakeholders. The new structure is accelerated by the widespread fastening of social integration through information technology, as outlined brilliantly by Seidman [69].

This new circumstance changes the explanation on the theory of firms in many perspectives. Characteristics of these changes can be observed in two important concepts about the theory of firms. First, the value of firms no more concerns only the explicit relationship of various stakeholders such as shareholders and debt holders, but it incorporates the relationships which are the implicit ones to be included in the valuation function process.[1] Second, *not only a single group of stakeholders* (shareholders) will receive their value at the maximum level from the firms' operation, *but many groups of stakeholders have their claims on part of the firm's overall value* [52]. Until the introduction of agency problems, finance theories explained many financial issues away by relying on the clear separation between participants. Effects from the decisions of any one group do not have any (or small) effect on decision of others. The separation of ownership and control assumes that inside equity owners or managers maximize the value of the firm without any constraints on or without any concerns about other outside non-managerial shareholders' objectives. Furthermore, firm theory has previously had nothing to do with other stakeholders' desires. Stakeholders (customers, suppliers, community, etc.) were related to firms via the sole objective of profit maximization. In shareholders' maximization circumstance, only the cash flow to shareholders is taken into the valuation model by assuming that wealth of shareholders is created from sufficient returns without *acknowledging or mentioning various returns to other stakeholders' contributions.*

This traditional approach to firm theory is challenged by researchers in many fields. Management theorists have now asserted that stakeholder theory has become the prominent theory instead of shareholder theory. The concepts of decision management beyond shareholders' value are welcome, such as the Customer Social Responsibility (CSR), the triple bottom lines, the Economics Social Governance, or the Corporate Governance. Marketing theory has introduced the new paradigm of *Maketing-3.0*. Finance researchers have also incorporated these changes into the existing theories such as *the firm's value determination, the capital structure theory, and the theory of firms.*

5.1. From shareholders to stakeholders

Shareholders' theory and stakeholders' theory are two opposing theories that view property rights differently. Traditional shareholders' theory views shareholders as the only owners of the assets since they invest their money (capital) into the firm and they should therefore get the residual income to offset the risk from an operation. Traditional structure, therefore, assigns the right to shareholders who select the board to be their representatives. The board then selects the managerial team to operate a firm. Another perspective or stakeholders' theory views that all stakeholders have their own rights with regard to their assets in a firm. Workers invest their human capital, customers and suppliers also contribute to a firm and should have their own claims on the part of the total income. Consumer co-operatives and

[1] Implicit relationship or implicit contracts are found in the relationships between nonmonetary stakeholders (social environment or community surrounding the organization, or environmental organizations).

worker-cooperatives (or unions) are examples of organizations where consumers or workers explicitly get the shared income from an operation. Confliction in the two theories comes from the main disputed questions which turn out to be: Who should be the parties that have such "rights" on the asset or property and: Who has the authority to allocate the shared income? Jensen and Meckling [53], Ross [67], Quinn and Jones [64], Jensen [51] all argued in favor of shareholders maximization theory based upon the ideal that shareholders are essentially the principals who invest their explicit capital and delegate their managerial rights to managers or agents to operate the firm using the single objective to maximize the wealth of shareholders. By contrast, Freeman [34], Donaldson and Preston [28], Kay [55], Blair and Stout [10], and Freeman et al., [37] are researchers in favor of the stakeholders' theory. Kay [55] argued that assets of the firms are in many forms and not just monetary capital provided by shareholders. Employees provide the skills, customers and suppliers' the willingness to purchase and sell; additionally, a better understanding from societal groups around the firm is also an important asset that in terms of its returns, should be maximized. Kay explains that managers are the trustees of these assets.

Stakeholder theory is called an incomplete theory by Jensen. Jensen argues that stakeholder theory is incomplete because it does not offer a maximization of value for stakeholders. He also points out the flaw in the theory is that it does not provide a single-objective, so that the management cannot have a long-term goal under the stakeholder concept. However, he accepts that a stakeholders-oriented policy is needed to couple with the objective function and is labeled the "enlighten value maximization" policy. According to Boatright [11], stakeholder theory is not inconsistent with the nexus-of-contract view of firms, in which shareholders are held to be the only group that should be allowed to maximize their value. Boatright [11] reconciled the theory of stakeholders and nexus-of-contract views and argues that stakeholder theory has the following perceptions: (1) all stakeholders have a right to participate in corporate decisions that affect them, (2) managers have a fiduciary duty to serve the interest of all stakeholder groups, and (3) the objective of the firm ought to be the promotion of all interests and not just those of shareholders alone. These three criteria are served as the essential concepts to understand how value and stakeholders are related. It is not uncommon for all stakeholders to participate in corporate decisions in this corporate governance structure. But, it is possible for some groups (employees or creditors) in some countries to have no such right [48].

6. Sustainability of a firm

According to the traditional concept, a firm is composed of contracts among interrelated groups within. The nexus-contract meaning of firms [4, 21, 32, 33, 53] views the value of firms as the value of explicit contracts among monetary stakeholders, such as shareholders and debt holders. Such meaning of the term "firm" is challenged by the increasing importance of non-monetary and *implicit* stakeholders. From this perspective, values of firms can be increased because of the increasing value of implicit contracts [22, 75] and intangible assets [11, 51, 82]. Further, since each constituency can bargain with a firm over the effective means for protecting its interests, value of firms can be increased (or decreased), when each constituencies' individual interest is satisfied [11]. Stakeholders' theory and nexus-of-contract firms are aligned to each other because all stakeholders participate as contractors in the formation of a firm. In this view, the intrinsic value of each groups' interest is the added value to a firm. As explained earlier by the author, the main normative clause from the nexus-of-contract theory is the agency theory, which posits that agency cost or agency problem is naturally occurring in the separation of ownership and controls [53]. Under the agency base theory, the value of a firm can be increased when agency costs are minimized. Agency theory focuses on explicit contractual relationships. Hill and Jones [46] and Boatright [11] proposed a new conceptual theory of agency-cost among stakeholder groups, which is called stakeholder-agency theory. Their model contends that stakes of constituencies or the various sizes of stakes are derived from the implicit contracts of the specific assets invested by stakeholders. By definition, specific assets means assets that cannot be redeployed to an alternative use without a loss of value [11, 46, 79, 80]. In this model, the relationship between manager and each stakeholder depends on such specific assets [11] and the power of difference between managers and stakeholders [46].

Promotions in the job, a continuing production of handling quality products, or services to customers are examples of implicit contracts that can affect a firms' value. As outlined by Williamson [79, 80]), Hill and Jones [46] and Boatright [11], human capital is an example of an intangible asset *and is called on as a specific asset only if the human assets in the particular firm pose a unique skill to work within only that kind of business*. Talented staffs with specific skill are usually found in the computer business or airlines business.

7. Stakeholders and sustainability

Corporate sustainability is a broad dialectical concept that combines economic growth with environmental protection and social equity. Originally, the term was used by the World Commission for Environment and Development or WCED in 1987, which defined sustainable development as *development that met the needs of present generations without compromising the ability of future generations to meet their needs.* The concept of sustainable development was originally created to enhance the implementation of macro-economic policy against the direction of country-development, which most countries often set in tandem with policies geared toward monetary growth (such as GDP). The concept has subsequently been used by businesses, who then labeled the term as "corporate sustainability" to differentiate from the macro-concept. Despite the lack of clarity as regards a working definition, there are still common concepts used to explain this term. The common concept usually documented is from the Global Reporting Initiative (GRI), which is the nonprofit organization that works toward a sustainable global economy. From the viewpoint suggested by the GRI, corporate sustainability comprises *three pillars*: the economic performance, the environmental aspect, and the sociological performance.

The three pillars concept is very much well known in connection with the name of the *triple bottom lines* delineated by Elkington [31]. Corporate sustainability is almost identical to the triple bottom lines and many businesses use and interpret it as if they are utilizing the exact self-same meaning. However, there are some different points that should be noted. The first point is the interpretation over the term "economic performance." Triple bottom lines interpreted "economic" as accounting for the profit of firms, whereas the corporate sustainability concept describes economic performance more broadly than just accounting for the profit of firms in this limiting fashion. The second point of difference is the perception of *value.* While the triple bottom lines separate the value from the environmental and the social by implying that management has to indulge extra activities to enhance economic profit [43], the corporate sustainability theory states that value can be created when resource-suppliers (or stakeholders) are maximized [43, 61].

The resource-based concept of corporate sustainability fits very well with the overall framework of stakeholders' theory [28, 34–36, 42], which has the main focus of sharing the value created in firms between all stakeholders—not just shareholders. As a consequence of this assumption, we use the terms "corporate sustainability" and "stakeholders" theory interchangeably in this chapter. Practically, it is very difficult to separate the sustainability strategy from a policy that is focused on the triple bottom lines theory.

8. Why sustainability?

Almost all corporations in the contemporary period voice their concerns regarding stakeholder groups beyond the realm of financial stakeholders (shareholders and creditors). Customers, employees, and suppliers are all targets of concerns since they are groups who interact and have a direct influence upon a firm's operation and profitability. More extrinsic stakeholders such as social groups, community groups, or environmental activists are indirectly affected by a firm's operations—but they are also targeted. As indicated in stakeholders' theory, a business's operation in the current business climate cannot be sustained if their stakeholders are not satisfied.

Corporate sustainability is not just a new concept in management theory—but the concept has been proposed and discussed by economist for a few decades now. The questions as to why it is needed for current business strategies can be evidenced by many concrete demonstrations and by the work of many academicians. In general, corporate sustainability or stakeholder theory has become the prominent theory because the conventional theory, which emphasizes on a single group of stakeholders or stockholders, is not sufficient to explain the vagaries of the current business climate. Business in this current environment of high and effective internet communication has lowered its wall against outside influences. Their policies or practices are exposed to stakeholders who are more collective in voicing their demand against unjustified policies or unfair policies. There are many business cases which aptly demonstrate how businesses are in a situation of turmoil when stakeholders' welfare requirements are not satisfied. For example, the case of *Nike* in the middle of the 1990s where a transnational was blamed for the use of child labor in Pakistan; in addition, "KFC" has been the target of criticism for its use of trans-fat in its operations. In 2009, *W.R. Grace and Company* the Maryland-based chemical conglomerate had a case filed against if for exposing workers and residents to asbestos contamination in Libby, Troy, and Montana. The case has been the subject of a film entitled "A Civil Action." These cases are all good examples of businesses that got into trouble when their practices adversely affected various stakeholders, both extrinsic and intrinsic. In fact, their practices and standards did not meet the required ethical standards of a wide range of stakeholders.

Zingales [82] described the changing characteristics of modern firms by claiming that:

> *"The nature of the firms is changing. Large conglomerates have been broken up, and their units have been spun off as stand-alone companies. Vertically integrated manufacturers have relinquished direct control of their suppliers and moved toward looser forms of collaboration. Human capital is emerging as the most crucial asset."*

9. Conclusion

The developmental learning of firm theory through its history is akin to what Isaac Newton (1675) alluded to when he claimed *If I have seen further it is by standing on the shoulders of Giants*. If we imagine the *theory of firm value* as a ride on a long journey, we can see a lot of changes along the way. Along the journey, the view from one side of the road is clearly different from that on the other side of the road. It moves from one belief in the theory of shareholders to the other side, or the emphasis upon stakeholders. Firm theory has to address these vacillations in financial knowledge. Zingales turns the spotlight onto the future of finance, when he writes that the new theory of finance should understand the relative effects of mergers, acquisitions, spin-offs, and diversification under the aegis of these new theoretical changes. In these new and changing circumstances, the concept of corporate governance must be addressed in order for it to develop a new system to cope with these new market environments [65, 82].

Acknowledgements

I gratefully acknowledge the Thailand Research Fund (TRF) for providing the funding on the project number RSA5580020. This chapter is based on a partial study from this project.

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