
AN IMPROVED PEDAGOGY OF CORPORATE FINANCE: A CONSTRAINED SHAREHOLDER WEALTH MAXIMIZATION GOAL

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ABSTRACT

The most prominent textbooks in finance literature present the goal of a firm or financial manager as “unconstrained shareholder wealth maximization (USWM)” and focus on economic efficiency and maximization of shareholder wealth, providing limited information about potential constraints. In contrast, constrained shareholder wealth maximization (CSWM) requires students to put equal emphasis on both the objective function (maximizing shareholder wealth) and the constraint (keeping natural stakeholders protected). Our survey of finance textbooks reveals an inadequate level of introduction to these topics, possibly misleading students to believe that society should define its laws in favor of firms (shareholders) at the expense of natural stakeholders. Thus, misinformed students might see stakeholder wealth expropriation as fair game in its extreme form due to our outdated finance pedagogy. In attaining the teaching goal of CSWM as an improved pedagogy, we offer specific suggestions to finance textbook authors.

INTRODUCTION

Bloom's taxonomy (1956) has guided pedagogical structure and innovation for half a century in the United States, and its focus on developmental learning remains relevant and instructive for us. The six developmental levels (knowledge, understanding, application, analysis, synthesis, and evaluation) separate basic knowledge acquisition from the critical thinking and analytical skills necessary for making ethical decisions or judgments. Answering questions about business ethics requires knowledge from multiple disciplines, including philosophy, psychology, political science, sociology, economics, finance, organizational management, and law. Analyzing such a vast body of data in ethical frameworks requires the highest levels (analysis, synthesis, and evaluation) of critical thinking as expressed in the taxonomy. Corporate governance, an interdisciplinary subject addressed in all these disciplines, explores the inter-workings of both for-profit firms and not-for-profit firms and is an area requiring business students to evaluate ethical issues when making decisions.

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CONCLUSIONS

Our survey of corporate finance textbooks reveals that students of finance are deprived of a complete education regarding a balanced approach to the firm goal, corporate governance theories, and adequate business ethics discussion. The introduction of a constrained shareholder wealth maximization perspective will enhance the business ethics curriculum since the teaching of the objective (shareholder wealth maximization) as well as the constraint (protection of natural stakeholders) exposes finance students to corporate governance and higher levels of critical thinking. The current omission of competing theories of ethics in corporate finance textbooks leaves students with an incomplete world view of corporate governance. An ethics education for MBA and undergraduate finance students that focuses only on shareholder wealth maximization goal encourages society to define its laws in favor of corporations so that other stakeholders are left unprotected. AACSB has stated unequivocally that ethical and legal responsibilities in organizations and society must inform every course in the business school curriculum; finance textbooks are failing to do their part.

We recommend that corporate finance textbooks take the responsibility to improve their current offerings by providing both sides of the story through teaching of constrained shareholder wealth maximization and competing theories in corporate governance, and by providing adequate exposure to business ethics. By doing so, students will be able to make informed managerial decisions. In the continued long-term omission of adequate ethics teaching, corporate scandals are likely to become a mainstream phenomenon rather than an anomaly.

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NOTES

- 1 Mentioning stakeholders of a firm, usually within agency theory, does not mean that stakeholder theory has been introduced.
- 2 Corporate social responsibility discussed in the context of agency theory does not mean that stakeholder theory has been introduced.
- 3 Including stakeholder definitions in the glossary does not mean that stakeholder theory has been defined or explained.
- 4 Corporate governance is not the same as corporate control, which is related to the mechanics of existing organizational structure and rules.