



An Empirical Examination of the Effect of Shareholder Value on Firm Performance in Nigeria

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This research work examined empirically the effect of shareholder value on firm performance. The first bank of Nigeria is used as a case study where data was obtained and subjected under empirical tests using the Ordinary Least Squares (OLS) regression method. Findings show that shareholder value has a significant effect on firm profitability and that shareholder value has no significant influence on financial efficiency. The study recommends that firms hire managers with not only a great marketing strategy, but one that also has good knowledge of the stock market and its operations, this is the only way to ensure a win-win situation between shareholders and other stakeholders.



ABSTRACT

Keywords: Financial Efficiency, Firm Performance, Firm Profitability, Stock Market

1. Introduction

In today's competitive world, value and wealth creation for shareholders are among the most important goals of businesses. To achieve these goals, the investor needs some instruments to measure the potential value of each investment opportunity. Mahmoud, Kaviani, & Abdollahpour (2012) stated that these instruments are not capable of predicting the exact future, they just provide some piece of information and advice that help the investor in the decisions he makes. Among these criteria, the most common types are Return on Investment (ROI) and Earnings per Share (EPS). Despite the numerous applications of these instruments, theoretically, they are not related to shareholders' value or wealth creation. Shareholder value has been recently seen to be the value delivered to shareholders because of management's ability to grow sales, earnings, and free cash flow over time. A company's shareholder value depends on strategic decisions made by senior management, including the ability to make wise investments and generate a healthy return on invested capital. If this value is created over the long term, the share price increases and the company can pay larger cash dividends to shareholders. If management makes decisions that increase net income each year, the company can either pay a larger cash dividend or retain earnings for use in the business. A company's earnings per share (EPS) refers to earnings available to common shareholders divided by common stock shares outstanding, and the ratio is a key indicator of a firm's *shareholder value*. As a company increases earnings, the ratio increases, and investors see the company as more valuable.

From the economist's viewpoint, value is created when management generates revenues over and above the economic costs to generate these revenues. Costs according to Pandya (2005), come from four sources:

1. employee wages and benefits;
2. material, supplies, and economic depreciation of physical assets;
3. taxes;
4. and the opportunity cost of using the capital.

Under this value-based view, value is only created when revenues exceed all costs including a capital charge. This value accrues mostly to shareholders because they are the residual owners of the firm.

Shareholders expect management to generate value over and above the costs of resources consumed, including the cost of using capital. If suppliers of capital do not receive a fair return to compensate them for the risk they are taking, they will withdraw their capital in search of better returns since the value will be lost. A company that is destroying value will always struggle to attract further capital to finance expansion since it will be constrained by a share price that stands at a discount to the underlying value of its assets and by higher interest rates on debt or bank loans demanded by creditors.

Public corporations are businesses that choose to sell shares of stock to the public to raise money and finance growth. The executive board members and high-level managers that run corporations often focus on increasing "shareholder value," which describes the return shareholders derive from their investment. Maximizing shareholder value is achieved by increasing a stock's price over time and by increasing dividends. The focus of corporations on maximizing shareholder value is often criticized because it potentially can have several negative consequences.

Hamel (2017) stated that one potential drawback of the tendency of corporations to focus on maximizing shareholder value/wealth is that it can lead to poor or unsustainable business practices. For example, leading up to the global recession that began in the late 2000s, many financial institutions in Nigeria gave out loans to borrowers in the hopes of making as much profit as possible. While such practices may have led to short-term gains, the resulting mass defaults and foreclosures eventually forced banks to absorb huge losses. In some cases, businesses partake in illegal or unethical activities, such as falsifying financial information, to boost shareholder value. Excessive focus on shareholder value is commonly mentioned as a factor that contributed to the recession that began in late 2007, which some have called the "Great Recession."

Hamel (2017) further emphasized that corporations that concentrate on maximizing shareholder value might lose focus on what customers want, or might do things that are not optimal for consumers. For instance, a corporation

might choose to cut production costs by using lower-quality parts in its products. While this might boost profits and the price of its stock, it is bad for consumers. Over time, this can tarnish the reputation of the company and its products, resulting in the opposite of the intended effect by lowering the value of its stock. The problem is that few greedy people are ascribed as 'shareholders' who mostly are not interested in the continuity of the business, the only thing they are after is good returns on their investment quota. A corporation trying to satisfy shareholders is the fastest way to force business closure because such an objective is not in tangent with the primary purpose for the existence of a business – expanding customer base and making a profit. There should be a balance between management's desire to satisfy customers and shareholders at the same time.

Whichever side it is taken from; shareholder value/wealth maximization shouldn't be a major objective of a corporate firm, rather pursuing sustained company reputation by satisfying customers in the real market should be which in the long run improves shareholders' value and wealth.

Statement of Problem

Firms today are faced with the dilemma of choosing between focusing on long-term cash flow or short-term cash flow. The long-term cash flow is the root principle of shareholder value but over time, misinformed or uninformed managers started cutting corners, pursuing short-term objectives to increase profits and curtail pressures from shareholders. This was identified to be a contributory factor to the 2007 global financial crisis. Theoretically, it is known that pursuing shareholder value maximization boosts organizational profit in the short run. This research work pulls an attempt to test empirically if pursuing shareholders' value could improve firm performance.

Objectives of the Study

1. To determine if shareholder value has any significant effect on firm profitability
2. To determine if shareholder value has any significant influence on financial efficiency.

Research Questions

1. To what extent does shareholder value affect firm profitability?
2. To what extent does shareholder value influence financial efficiency?

Research Hypotheses

1. Shareholder Value has no significant effect on firm profitability
2. Shareholder value has no significant influence on financial efficiency

Scope of the Study

Data for this study covers 10 years (2007 to 2016) and First Bank of Nigeria Plc. is the case study.

2. Literature Review

Conceptual Framework

Shareholder value is a business term, sometimes phrased as shareholder value maximization or as the shareholder value model, its concept implies that the ultimate measure of a company's success is the extent to which it enriches shareholders. Shareholder value added is the term used for the difference between the wealth held by the shareholders at the end of a given year and the wealth they held the previous year. The increase of equity market value is not the shareholder value-added. A company creates value for the shareholders when the shareholder's return exceeds the share cost (the required return to equity). In other words, a company creates value in one year when it outperforms expectations.

The created shareholder value is quantified as follows:

Created shareholder value = Equity market value x (Shareholder return – Required Return to Equity)

OR

Created shareholder value = Shareholder value added - (Equity market value X Required Return to Equity)

Theoretical Review

Academic and business leaders have tried for a long time to define the purpose of a corporation. This pursuit has provoked a fierce debate that pits advocates of the “shareholder theory” against supporters of the “stakeholder theory” of corporate governance.

The shareholder theory asserts that corporate boards have a primary duty to maximize the financial interests of shareholders. However, under the stakeholder theory, managers must balance the interests of all the stakeholders, which include not only shareholders, but also customers and employees, and in some versions of the theory, the community, the environment, and even creditors and competitors.

Shareholder Theory

The shareholder theory was firstly proposed by Milton Friedman and it states that the ultimate responsibility of business is to increase profits. It is based on this premise that management is hired as the agent of the shareholders to run the company for their benefit, and therefore they are legally and morally obligated to serve their interests. The only qualification on the rule to make as much money as possible is “conformity to the basic rules of the society, both those embodied in law and those embodied in ethical custom.”

The shareholder theory is now seen as the historic way of doing business with companies realizing that there are disadvantages to concentrating solely on the interests of shareholders. A focus on short-term strategy and greater risk-taking are just two of the integral dangers involved. The role of shareholder theory can be seen in the demise of corporations such as Enron and Worldcom where continuous pressure on managers to increase returns to shareholders led them to manipulate the company accounts (Corplaw, 2013). Shareholder theory has also been traced to be the major cause of the 2007/2008 global financial crisis.

Stakeholder Theory

Stakeholder theory, on the other hand, states that a company owes a responsibility to a wider group of stakeholders, other than just shareholders. A stakeholder is defined as any person/group which can affect/be affected by the actions of a business. It includes employees, customers, suppliers, creditors, and even the wider community and competitors.

Edward Freeman, the original proposer of the stakeholder theory, recognized it as an important element of Corporate Social Responsibility (CSR), a concept that recognizes the responsibilities of corporations in the world today, whether they be economic, legal, ethical, or even philanthropic. Nowadays, some of the world’s largest corporations claim to have CSR at the center of their corporate strategy. Whilst there are many genuine cases of companies with a “conscience”, many others exploit CSR as a good means of Public Reputation to improve their image and reputation but ultimately fail to put their words into action.

Enlightened Shareholder Value - A Balance

Enlightened shareholder value (ESV) states that “corporations should pursue shareholder wealth with a long-run orientation that seeks sustainable growth and profits based on responsible attention to the full range of relevant stakeholder interests”. Essentially, it focuses on generating shareholder value, whilst having regard to the long-term external impacts of the wealth generation.

Empirical Review

Ramezani, Soenen, and Jung (2001) examined the relationship between growth (earnings or sales) and profitability and between profitability and shareholder value. Jensen's alpha was employed as a measure of shareholder value and after hypothetical testing found that beyond a point, growth adversely affects profitability and destroys shareholder value.

Constantinou & Constantinou (2003) researched, ‘the effect of board structure on bidder shareholders wealth: further evidence from the UK bidding firms’, their research revealed that there is evidence of cross-sectional dependence of bidder-shareholder wealth and target’s board characteristics. More specific evidence provides that the percentage of non-executives, the board size, the stockholdings of executives, and the other directorships held by non-executives serving the target board are imperative in assessing the declaration of the bid, whereas in the

bidder's board only the percentage of non-executive directors is vital for bidder-shareholders. Also, they provide evidence that some of these relationships are not monotonic in nature.

Atiyet (2012) explored the impact of financing decisions on shareholder value creation. He however focused on exploring an optimal capital structure to maximize shareholder wealth, he also tried to determine the most significant determinants for creating shareholder value. Using a sample of French firms introduced on the stock exchange and belonging to the SBF 250 index over a period from 1999 to 2005. Panel data was employed which provides the researcher a large number of data points – increasing the degrees of freedom and reducing the colinearity among explanatory variables, hence improving the efficiency of econometric estimates. The result shows that the estimation of both empirical models explains the shareholder value, the result of the findings showed that self-financing explains positively and significantly the shareholder value creation for both measures (EVA and MVA). The equity issue supply's to explain negatively and significantly the shareholder value for both measures. The financial debt contributes to explain positively and significantly the EVA, but it's negatively related to MVA. The impact of financial factors on shareholder value depends on measures taken and the financial structure added to the model. Several authors have investigated how shareholder value creation can be increased, Rappaport (1987) defined the value drivers as financial factors. The relationship between capital structure and firm value has been the subject of considerable debate. Indeed, the Pecking Order Theory and the Static Trade-off Theory found contradictory predictions in terms of the impact of the financial structure on shareholder value creation.

Cunat, Gine, & Guadalupe (2012) conducted investigative research to find whether improvements in the firm's internal corporate governance create value for shareholders. They analyzed the market reaction to governance proposals that pass or fail by a small margin of votes in annual meetings. This provides a clean causal estimate that deals with the endogeneity of internal governance rules. Their findings revealed however that passing a proposal leads to significant positive abnormal returns. Adopting one governance proposal increases shareholder value by 2.8%. Market reaction was found to be larger in firms with more anti-takeover provisions, higher institutional ownership, and stronger investor activism for proposals sponsored by institutions. They additionally found that acquisitions and capital expenditures were declining as long-term performance improved.

Cunat, Gine, & Guadalupe (2013) summarized the findings of their recent study of the effects of specific corporate governance provisions on firm value. Using a sample of governance provisions that were subjected to shareholder votes during the period 1997–2011, their study analyzed cases in which shareholder-sponsored corporate governance proposals were either rejected or passed by a small margin (no more than 5% of the vote). By so doing, this study helped correct two limitations of the existing governance literature: (1) that the effects of expected governance changes are already incorporated in share prices (the “expectations” problem); and (2) that government policies are often a consequence rather than a cause of other variables such as corporate performance and are thus correlated with many other firm characteristics (the “endogeneity” problem). Their findings however show that expected improvements in corporate governance through the adoption of particular corporate governance provisions—particularly the removal of anti-takeover provisions—are associated with both positive abnormal stock returns and improvements in long-term firm operating performance. The study estimated that the adoption of such corporate governance proposals increases shareholder value by 2.6%, on average. They further stressed that these returns are consistent, and thus accurate predictors of, future changes in corporate investment (reductions of capital spending, in most cases) and improvements in operating performance.

Cohen & Wang (2013) undertook a study on ‘How Do Staggered Boards Affect Shareholder Value? Evidence from a Natural Experiment’. They analyzed this causal question using a natural experiment involving two Delaware court rulings separated by several weeks and going in opposite directions that affected the antitakeover force of Staggered Boards. They found a well-established negative correlation between staggered boards (SBs) and shareholder's value which they stated could be due to SBs leading to a lower value or a reaction of low-value firms' greater propensity to maintain SBs.

Cremers & Ferrel (2014) conducted research that introduced a new hand-collected data set that tracks restrictions on shareholder rights at approximately 1,000 firms from 1978 to 1989. In conjunction with the 1990 to 2006 IRRC data, they tracked shareholder rights for a period of more than 30 years. Most governance changes occurred during the 1980s. They found a robustly negative association between restrictions on shareholder rights (using G-Index as

a proxy) and Tobin's Q. The negative association only appears after judicial approval of antitakeover defenses in the 1985 landmark Delaware Supreme Court decision of Moran v. Household. The decision of the court according to them was an unanticipated exogenous shock that increased the importance of shareholder rights.

Knowledge Gap

There has been much research on shareholder value, but none has been able to research the effect of shareholder value on firm performance in Nigeria and the world at large. This work is the first attempt to empirically test the implication of a firm focusing on improving shareholder value against all odds.

3. Research Methodology

The nature of data for the analysis of this study is secondary, accessed from First Bank Ltd. Annual Report from 2007 to 2016. A regression model has been employed, the essence of regression is to use a mathematical equation to express the nature of the relationship existing between variables and ultimately to use this equation to predict the value of one variable given a specific value of the other variable.

The following is a multiple regression model adopted

$Y = b_0 + b_1X_1 + b_2X_2 + \dots + \mu$. Where: Y = the variable we are trying to predict; b_0 = the intercept; b_1 = the slope; X = the variable we are using to predict Y; μ = the error term.

The intercept (b_0) is the value of the dependent variable when the independent variable is equal to zero while the slope of the regression line (b_1) represents the rate of change in Y as X changes. Because Y is dependent on X, the slope describes the predicted values of Y given X.

The above model can thus be applied in this study as:

$$ROE = b_0 + b_1EPS + b_2SER + \alpha \dots \dots \dots \text{Eqn. (1)}$$

$$CTI = b_0 + b_1EPS + b_2SER + \alpha \dots \dots \dots \text{Eqn. (2)}$$

Where

ROA – Return on Equity

EPS – Earnings Per Share

SER – Shareholder Equity Ratio

Proxies for Shareholder Value

CTR – Cost to Income Ratio

Workings:

$$ROE = \frac{\text{Net Income}}{\text{Total Equity}}$$

$$SER = \frac{\text{Total Equity}}{\text{Total Assets}} \times 100$$

$$CTI = \frac{\text{Operating Cost}}{\text{Operating Income}} \times 100$$

Techniques or Methods of Data Analysis

The method of data analysis used in this research work is the OLS (Ordinary Least Squares) method using SPSS (Statistical Package for Social Sciences) version 25.0. The aim of using this method is to curtail the inaccuracy in our prediction of the dependent variable, and by lessening the residuals, the error will be curtailed. By using the "squares" the researcher is precluding the problem of signs thereby giving the same importance to positive and negative prediction errors.

4. Data Presentation and Empirical Results

Table 4.1: Necessary Data for Analyses from 2007 to 2016

Year	ROE	EPS	SER	CTI
2007	23.73	156	10.13933	-33.6524
2008	30.89	95	5.232264	-27.2133
2009	9.99	141	21.0537	-56.0822
2010	9.47	98	16.65048	-65.8273
2011	12.99	145	14.78835	-60.4279
2012	17.87	218	14.36835	-65.3279
2013	15.49	182	11.80165	-62.2466
2014	18.76	243	12.11867	-66.2885
2015	0.01	0.11	13.79638	-59.3024
2016	10.30	153.44	13.66264	-44.8663

Source: First Bank Nigeria Ltd. Annual Report from 2007 to 2016

Descriptive Statistics of the Variables

Table 4.2: Descriptive Statistics of the Variables

Variable	Mean	Std. Dev.	Min	Max	Skewness	Kurtosis
ROE	14.95	8.549242	.01	30.89	0.456823	3.340602
EPS	143.155	68.45786	.11	243	-0.51472	2.818682
SER	13.36118	4.133352	5.232264	21.0537	-0.35584	3.63818
CTI	-54.12348	14.0468	-66.2885	-27.2133	-1.067	3.550118

Source: Authors' computation

The table shows that the variables diverged significantly from their means, as evidenced by the high standard deviations. The standard deviations also show that the variables are subject to some volatility. Table 2 showed that return on equity (ROE) varied significantly during the study period, with a mean of 14.95 and a high standard deviation of 8.549242, as well as a positive skewness value of 0.456823 units to the right and a moderate kurtosis value of 3.340602, which is more than compulsory 3 units. Earnings per share (EPS) has a mean of 143.155, a high standard deviation of 68.45786 units, negative skewness of -0.51472, and a kurtosis value of 2.818682, which is less than the benchmark of 3 units implying that the EPS fluctuated a lot during the research period. The shareholder equity ratio (SER) has a mean of 13.36118 and a standard deviation of 4.133352, with a negative skewness of -0.35584 units and a moderate kurtosis of 3.63818 units, indicating that the shareholder equity ratio values are less extreme. The cost-to-income ratio (CTR) variable has a mean value of -54.12348, with values ranging from -66.2885 to -27.2133. Furthermore, the kurtosis of all variables in the table, excluding earnings per share, is greater than three (3), implying that their probability distributions are all significantly peaked.

Unit Root Test

Table 4.3: Augmented Dickey-Fuller Test Results

Variables	Adf stat at levels	5% critical value	Adf stat at first difference	5% critical value	Order of Integration
Roe	-2.326492	-3.259808	-4.327290	-3.320969	I(1)
Eps	-3.319211	-3.259808			I(0)
Ser	-2.838203	-3.259808	-7.055103	-3.403313	I(1)

Cti	-2.218960	-3.320969	-3.586780	-3.519595	I(1)
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Source: Authors' computation

Table 4.3 above gives information about the stationarity of the variables used in this study. It is conducted using the Augmented Dickey-Fuller procedure, taking into consideration trend and intercept. The results on the table show that all the variables except EPS are stationary at first difference. EPS is stationary at level. The results suggest that the variables may be cointegrated.

Correlation Matrix

The correlation matrix displays the relationship between all of the variables in the study. If the coefficient of a correlation is 0.8 or higher, it is considered problematic. A significant degree of positive or negative correlation among the explanatory variables indicates an issue with multicollinearity in the model. It's unfavorable because it makes determining the individual influence of correlated explanatory variables on dependent variables harder. A high correlation between dependent and explanatory variables, on the other hand, is desired.

Table 4.4: Multicollinearity Test

	MODEL 1				MODEL 2		
	ROE	EPS	SER		DCTI	EPS	SER
ROE	1.000000	0.438343	-0.714954	DCTI	1.000000	-0.178563	-0.681339
EPS	0.438343	1.000000	0.007532	EPS	-0.178563	1.000000	0.026664
SER	-0.714954	0.007532	1.000000	SER	-0.681339	0.026664	1.000000

Source: Authors' computation

From the table above, All the correlation coefficients of the variables are considered healthy as they are below 0.8.

Presentation And Analysis of Ordinary Least Square (OLS) Regression Results

Model I: $ROE = b_0 + b_1EPS + b_2SER + \alpha$

Table 4.5: Model Summary

Equation 1	Multiple R	.841
	R Square	.708
	Adjusted R Square	.625
	Std. Error of the Estimate	5.237

Table 4.6: ANOVA

		Sum of Squares	df	Mean Square	F	Sig.
Equation 1	Regression	465.730	2	232.865	8.489	.013
	Residual	192.016	7	27.431		
	Total	657.746	9			

Table 4.7: Coefficients

		Unstandardized Coefficients		Beta	t	Sig.
		B	Std. Error			
Equation 1	(Constant)	26.864	6.900		3.893	.006
	EPS	.055	.026	.444	2.173	.066
	SER	-1.486	.422	-.718	-3.517	.010

The Multiple R of .841 shows that a strong positive relationship exists between the dependent variable (ROE) and the independent variables (EPS, SER). The R-Square of .708 shows that only about 70.8% of the variation in the dependent variable can be explained by the independent variables. The ANOVA table shows that the model fit is good and significant (p-value = .013). The intercept of 26.864 shows the value of the dependent variable when the independent variables are equal to zero. The slope of .055 shows that at every percentage increase in EPS, ROE will

increase by 5.5% while the slope of -1.486 shows that a unit increase in SER, ROE will decrease by 1.486 units. Our regression model will take the following shape: $ROE = 26.864 + .055EPS - 1.468SER + 5.237$

Decision

The P-value on which basis we can reject the null hypothesis that shareholder value has no significant effect on firm profitability is 0.013. Since the P-value < .05, we reject the null hypothesis and conclude that shareholder value has a significant effect on firm profitability.

Model II: $CTI = b_0 + b_1EPS + b_2SER + \alpha$

Table 4.8: Model Summary

Equation 1	Multiple R	.673
	R Square	.453
	Adjusted R Square	.297
	Std. Error of the Estimate	11.780

Table 4.9: ANOVA

		Sum of Squares	df	Mean Square	F	Sig.
Equation 1	Regression	804.397	2	402.199	2.898	.121
	Residual	971.412	7	138.773		
	Total	1775.810	9			

Table 4.10: Coefficients

		Unstandardized Coefficients		Beta	t	Sig.
		B	Std. Error			
Equation 1	(Constant)	-18.707	15.520		-1.205	.267
	EPS	-.048	.057	-.231	-.828	.435
	SER	-2.142	.950	-.630	-2.254	.059

The Multiple R of .673 shows that a fairly positive relationship exists between the dependent variable (CTI) and the independent variables (EPS, SER). The R-Square of .453 shows that only about 45.3% of the variation in the dependent variable can be explained by the independent variables. The ANOVA table shows that the model fit is non-significant (p-value = .121). The intercept of -18.707 shows the value of the dependent variable when the independent variables are equal to zero. The slope of -.048 shows that at every percentage increase in EPS, CTI will decrease by 4.8% while the slope of -2.142 shows that a unit increase in SER, CTI will decrease by 2.142 units. After substituting the model with values from SPSS Output, we will have $CTI = -18.707 - .048EPS - 2.142SER + 11.780$

Decision

The P-value on which basis we can reject the null hypothesis that shareholder value has no significant influence on financial efficiency is 0.121. Since the P-value is > .05, the researcher cannot reject the null hypothesis and conclude that shareholder value has no significant influence on financial efficiency.

Discussion of Finding

Having subjected stated hypotheses under tests, it was discovered that shareholder value has a significant effect on firm profitability and that shareholder value has no significant influence on financial efficiency. The findings in this study suggest that pursuing shareholder value maximization can only cause immediate increased profit, but this leaves the company at a very low financial state as depicted by the slopes [-.048, -2.142] in the second model which suggests that pursuing shareholder value maximization over time could lead to a decline in financial performance. This finding supports ESV (Enlightened Shareholders' Value) which suggests that corporations should pursue shareholder wealth with a long-run orientation that seeks sustainable growth and profits based on responsible attention to the full range of relevant stakeholder interests.

5. Conclusion and Recommendation

It is an established fact that the sole purpose of a business is to make profits, but not at the expense of other stakeholders in an organization. There should be a balance in business operations as pursuing a balanced goal has been seen to cause sustained business profitability in the long run.

It is recommended however that

1. Firms hire managers with not only a great marketing strategy, but one that also has good knowledge of the stock market and its operations, this is the only way to ensure a win-win situation between shareholders and other stakeholders.
2. Firms pursue long-term goals as it has been proven to payoff over time and appears to be less risky.

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