Directors versus owners – when views collide

Good governance requires directors to act in the interests of owners. They must support and oversee – but also sometimes challenge or overrule – the strategic initiatives and risk management frameworks that managers operate. Aligning strategy, governance and ownership considerations is a key part of the value directors add to an enterprise. But what happens when directors and owners see alignment differently?
By John Mendzela

Laws and codes outline requirements for widely-held public companies where no single owner holds control and directors are experienced professionals. Professional advice and precedent is available.

But most enterprises aren't like that. Personal history and circumstances may add subjective and emotive elements to discussions of strategy. Controlling owners may have fixed or biased ideas about enterprise value. Owners may want to play roles they lack capability for. Restrictive agreements or contracts may make strategy easy to veto and hard to follow.

When views collide, good governance gets difficult! Every situation will have unique characteristics and demand creative blending of principles and pragmatism.

STRATEGY AND OWNERSHIP

Volumes have been written on strategic thinking and planning. But from a governance perspective, those processes can be expressed in one equation: 'strategy = choice + focus'. To act strategically, an enterprise must first choose between alternatives and act to further what that alternative requires.

But too often enterprises decide on a business strategy without first looking at all alternatives. Clever new themes or innate preferences may predispose directors and owners towards some strategies and away from others. Poor strategic choices readily result, often unconsciously.

A full range of strategies should be outlined – from 'wind down the business' to 'do nothing new' and 'now for something completely different'. Requirements, risk and return for each strategy should be debated. The process should challenge preconceptions and the result may deliver insights that surprise everyone.

Strategic thinking should explicitly consider owners' intangible goals and risk appetite. The frequently denigrated choice to 'settle for the Beamer, boat and bach' may make perfect sense for the current owners. But if it does not make good sense for enterprise value, then options for ownership change should be discussed.

Enterprise value need not be vague. Any business can apply historic and forecast financial data to calculate a range. That calculation can be updated annually, and adjusted for changing circumstances and special scenarios. Directors and owners then have a more objective basis for evaluating strategic options. Yet surprisingly few private companies bother to routinely calculate enterprise value.

Focus means just that – concentrate the beam of governance attention on what matters most for the chosen strategy to succeed. Construction and application of meeting agendas and papers can facilitate or obstruct. Directors may need to get outside their comfort zones of expertly studying things they know a lot about already, and venture thoughtfully into areas where they are novices.

A CONTROLLING OWNER

Directors are appointed by owners. A controlling owner can ultimately impose its preferred view, and replace directors who will not support that. But directors retain responsibility to formulate and communicate their view on enterprise value, and not just be passive agents of shareholders.

After one strategic workshop, the board agreed the best strategic path to increase share value was to approach a competing enterprise, seek operational synergies, and perhaps even combine in some way. Minority owners would support that.

But the majority owner was implacably hostile to such ideas. That entity did not see share value as its prime objective and would readily remove directors who saw priorities differently.

A fascinating discussion developed. One director argued strenuously that his responsibility was to represent the majority owner's view. He preferred to ignore the best strategic path and avoid annoying that owner. Fortunately, the majority stuck to their guns. Directors resolved to approach the competing enterprise, and informally advise the controlling owner that they would bring back to owners any resulting proposals and recommendations.

On that occasion – with independent facilitation and capable chairmanship – good governance prevailed. But anecdotal evidence suggests different outcomes readily occur. Responding to a case study like that above, boards of aspiring Crown directors almost every time decided not to approach the competing enterprise. And in private companies with a dominant shareholder, minority interests may not receive due regard even though a board is in place.

COMPROMISED GOVERNANCE

'I'm a substantial shareholder. I should have a seat on the board to represent my interests.'

Is that right, or wrong? The answer is not simple.

Theory is known and clear. Every director owes obligations to the company as a whole, and no director should see his or her role as representing one shareholder.

But in practice, some owners and directors struggle with that concept. And many entities face complicated ownership histories, governance structures, constitutions or shareholder agreements. Directors may feel they are expected to wear more than one hat. Governance readily becomes compromised.

Boards can pragmatically marry theory and practice. First, all members should acknowledge and apply their primary duty to the enterprise. Then, individual board members can bring to the table – explicitly and openly – any particular shareholder concerns. Disciplined professional discussion that recognises all viewpoints will often achieve optimal outcomes. Intractable differences can at least be stated objectively for future consideration.

To plan and evaluate governance, apply depersonalisation. Agree simple job descriptions that define required roles and capabilities: for the board collectively, for all directors in common and for individual directors in particular. The reality that one director especially contributes strategic management skills while another contributes owner perspectives then becomes complementing, not contentious.

Take one step at a time. In a private company that needed succession, board members agreed on definitions of board capability and a timed succession plan. They deferred the harder decisions about who the departing members 'X' and 'Y' would be – but a start had been made!

And those compromising constitutions, agreements and contracts? Anticipation and action to keep documentation relevant may have been inadequate. Often the old joke applies: 'if you want to reach good governance, I wouldn't start from here'. But disciplined and patient application of governance principles, enterprise value concepts and role clarity can find a practical forward route.

OWNERSHIP CHANGE

Owner is a true enterprise role, not just a word. Like any role, it should add value.

Positive value elements that a particular owner can bring to an enterprise include:

- historic imagery
- brand associations
- personal interest, inspiration and drive
- values and culture
- particular processes, systems, experience, skills and relationships
- ability and willingness to fund growth and development
- synergy with other owner or industry interests.

The shorthand phrase 'strategic shareholder' commonly expresses such concepts. But directors should apply rigour to that concept. Ownership value elements can be specified and evaluated as a key part of strategic processes.

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Ownership value is not always positive. Many readers will have experienced situations where owners seem bent on destroying value, not creating it. Keeping ownership value elements visible can help prevent that sad outcome.

Sometimes there is no easy path forward. Current ownership might not match future demands. Directors then face a challenge – to develop ownership succession paths that optimise value for current and future owners.

WHAT'S THE LESSON?

- just as governance is distinct from management, ownership is distinct from governance
- there is no one right strategy or risk profile. A customised and optimum strategic path should be established through challenging processes that may require fresh thinking about ownership
- directors must be more than passive representatives of owners. They should form and advocate their own 'enterprise value' perspective. Frank communication of unwelcome facts or opinions to owners is a positive duty.
- all directors should play value-adding roles within the board. Responsibilities are common and collective, but individual contributions can constructively differ.
- independent of other considerations, ownership should add to enterprise value. When that isn't true, directors should explicitly recognise gaps and act to close them.

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