Introduction

Is there one best strategy in any given situation, or does it depend on whom the strategy is for? This question should be at the heart of every discussion about strategy. Consider the well-known story of Deutsche Börse's failed effort to take over the London Stock Exchange (LSE) in 2005.[1] Whereas German institutional shareholders generally supported the cross-border consolidation strategy proposed by CEO Dr. Werner Seifert and approved by the supervisory board, a group of non-German hedge funds led by TCI (The Children's Investment Fund Management) and Atticus Capital decided to actively oppose the strategic direction of the firm and campaign that the money be used instead for a share repurchase program. Over a period of three months, TCI and other opponents of the consolidation strategy were able to gain enough influence over the shareholding body to persuade management to withdraw the offer for the LSE, agree to a share repurchase, and to force the replacement of Dr. Seifert and the resignation of Dr. Rolf-E. Breuer, chairman of the supervisory board. Triggered by an attempt to raise the stakes and make Deutsche Börse a leading global player, the LSE episode in fact brought about a change in the balance of power among shareholders, resulting in a strategic about-face and a change in the leadership of the firm. Ironically, of all firms not to take the diverse interests of shareholders into account in the making of strategy, with Deutsche Börse it was a stock exchange that suffered one of recent history's most remarkable reversals at the hands of a group of shareholders determined to defend *their* view of the right strategy.

In general, researchers and practitioners work with the assumption that the choice of the right strategy does not depend on the interests of the actors involved: there is one economically best strategy for the firm.[2] If, however, shareholders differ among themselves and differ with managers in terms of their preferences as described in the case of Deutsche Börse, then what is best for one subgroup may not be good, or even acceptable, for others. Depending on which coalition emerges as dominant, strategic choices may in fact impair the long-term prospects of the firm. If strategy is not neutral – that is, not purely economic, but determined by a political process with its own rationality – then we cannot avoid asking the question, "strategy for whom?"

Background

The founder of a family firm who transfers ownership to his/her children, the partnership that welcomes new partners, and the shareholders of a firm that chooses to go public are making decisions that are not merely legal or financial, but also strategic. Conversely, a change in strategy such as a move to diversify or a decision to take on more risk in a business can make the firm more attractive to some shareholders and less attractive to others and is therefore not ownership neutral. And yet, in academic research, ownership and strategy are treated separately: finance and law deal with the roles and rights of shareholders; economics and behavioral perspectives explain a firm's strategic choices of resource allocation and competitive position. The separation between ownership and strategy is mirrored in the professional services that address these topics: investment banks and law firms for ownership, general management consultants for strategy. Business school education perpetuates the divide, presenting ownership as a stand-alone topic or as an aspect of corporate finance and only very rarely making more than a passing reference to ownership in strategy courses, *as if* ownership and strategy were entirely unrelated.

In 1932, Berle (a scholar in corporate law) and Means (an economist) wrote a very influential book about the separation of ownership and control (over strategy) in American publicly listed firms.[3] They observed that shareholdings had become more dispersed and shareholders less influential over time and that control over strategic decisions in the firm had effectively been transferred to nonshareholder managers. The work of Berle and Means marked the beginning of the separation of ownership and strategy in academic research and provided the empirical basis for the development of agency theory.[4] In agency theory, the firm is described as consisting of principals (read shareholders) who provide capital and do not get involved in strategy and their agents (read management) who make decisions for the firm. Because the interests of shareholders (maximizing return to shareholders) and managers (maximizing return to management) may lead to opposite conclusions in practice, agency theory predicts conflict between shareholders and managers and emphasizes the need to align the interests of the two groups by means of incentives.

Separating questions of ownership and strategy was undoubtedly appropriate in the heyday of the management profession. Nonshareholder management dominated strategic decision-making in many companies and in many countries for most of the twentieth century, especially in the case of publicly listed firms.[5] But what about today – is the separation between ownership and strategy still justified? Globalization and technological development have rendered competitive advantage fleeting and undermined the dominance of management; the concomitant growth of capital markets has made firms more dependent on outside capital. As a result, the shareholders of publicly listed firms have become more influential, both indirectly, through the force of expectations and the threat of sale, and directly, through activist intervention, as described in the case of Deutsche Börse above.[6] In privately held firms, shareholders never did go away: even in those private firms where nonshareholder managers were put in charge, the influence of the family or the partners always had to be reckoned with, and this is still true today.

Of course, nonshareholder management continues to play a very important role in strategic decision-making, both in publicly listed and in privately held firms. Except in those firms where a shareholder is also the chief executive, nonshareholder managers are formally responsible for formulating and implementing strategy. What has changed over the last thirty years in both the publicly listed and the private firm is not the formal role of the nonshareholder manager, but the way the role is played out: not in opposition to shareholders and their interests as propounded by agency theory, but in full recognition of the interests of ownership.

Theory

In this book, we depart from the key agency theoretic assumption of uniform interests among shareholders.[7] Based on an emerging perspective in the corporate governance and finance literatures and our own research, we posit that shareholders differ among themselves in terms of their values – that is to say the relative measures that they use to evaluate their own performance. Thus, whereas some shareholders orient themselves towards an external value such as equity market and peer group performances indices, other shareholders look to an internal value such as the continuity of the firm and what it stands for. Not only do shareholders have different values, they also have different methods, with some seeking to vocally influence decision-making, while others remain silent and primarily influence strategy by the threat of sale. This makes it doubly important to insist upon a detailed assessment of the shareholding structure in interpreting the relationship between ownership and strategy.

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Shareholders may be diverse, but what about managers – can one assume that the managers of the same executive group have the same values and operate according to the same methods?[8] As we will discuss in Chapter 2, a similar categorization as that applied to shareholders can be applied to managers, distinguishing among those who follow a value defined outside the firm (i.e., financial market expectations or professional standards) and those who adhere to a value defined inside the firm and among those whose method tends towards rupture and those whose method tends towards continuity. This book will argue that explaining how these differences among shareholders and among managers as well as between shareholders and managers play out is the key to developing an understanding of how ownership and management affect strategy.

It is critical to note that the relationships between ownership, management, and strategy are not readily apparent in a steady state; there are no simple correlations between types of ownership or types of management and types of strategy. The interpretation becomes easier if we focus on change events: in practice, changing *who directs* the firm has a definite impact on the *direction* the firm will take, and changing the *direction* of the firm has implications for the question of *who* will *direct* the firm. In the general case, diverse shareholders with different values and different methods confront diverse executives with their own values and methods.[9]

As depicted in Figure 0.1 below, conflict over strategy can occur both *between* shareholders as a group and executives as a group (as predicted by agency theory) as well as *among* shareholders and *among* executives. Strategy choices result from the emergence of dominant coalitions between diverse shareholders and diverse executives. Thus, a change in the identity of ownership just as much as a change in the identity of the chief executive and his/her team can lead to a reconsideration of strategy. A change of strategy, in turn, may well engender changes in the identity of ownership and of management, as disgruntled shareholders or executives unsuited to the new strategy

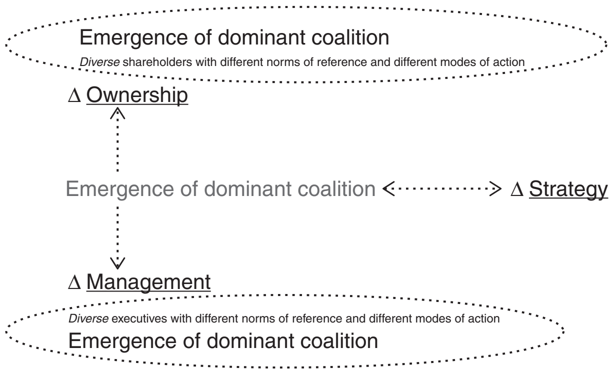

Figure 0.1 Ownership, management, and strategy.

leave the firm. The interaction of firm ownership, management, and strategy allows a dominant coalition of shareholders and managers to emerge and determines the future of the firm.

In every firm, ownership, management, and strategy are embedded in a system of corporate governance – procedures and controls that serve to ensure the accountability of the decision-makers.[10] We speak of the corporate governance of leading change to emphasize the point that significant changes in ownership, management, and (or) strategy can stretch the firm's existing system of corporate governance and be the cause of major governance failures: new shareholders can substitute short-term opportunism for long-term profit maximization; new management can divert resources for pet projects or personal gain; and new strategy can be the source of significant new risk. In practice, leading change successfully depends on adapting the firm's system of corporate governance to ensure control and maintain accountability. The board of directors, in our framing, is one of, if not the most important locations for addressing the conflicts among and between shareholders and managers. In most jurisdictions, the board of directors is called upon to act in the best long-term interest of the firm.[11] In practice, this is impossible to define precisely, and, given diverse shareholders and diverse managers with different perspectives on what constitutes the best long-term interest of the firm, the board of directors has to deal with the reality that strategy is created by the interaction of these different perspectives.

In opening the black box of agency theory to consider how shareholders and managers differ among themselves, and in exploring how decisions are made when these actors come to different conclusions about the direction of the firm, we present a political picture of strategy.[12] In our view, strategic choices are the outcome of a political process and, in turn, create a new political reality, strengthening some, weakening others, and, if the firm's ownership and management structures are open, in due course attracting new shareholders and new managers. Such a political picture of strategy goes against the received wisdom of strategy as rational choice: if strategy is the outcome of a political process, then it is the preferred solution only for a circumscribed group. In our analysis of strategic decisions, the critical question to ask is not what is the best strategy, but rather, who is the strategy for.

Outline

The arguments presented in this book build upon our collective research efforts in ownership, management, and strategy. We have observed a relationship between ownership change and strategy change in a broad range of cases: privately held firms and publicly listed firms; small firms and large firms; European, American, and Asian firms. Chapters 1 and 2 explore the effects of changes in the identity of ownership and in the identity of management. We find that changes in the identity of ownership can have significant effects on management and strategy. Changes in the identity of management, in turn, have far-reaching effects not only on strategy, but also on ownership and governance. Chapters 3 and 4 examine the special cases of changes in form: of the legal structure and of the organization. We find that any change in form has implications for strategy, whether it is brought about by sharing decision-making power with new actors, as in the case of an initial public offering (IPO), or by redistributing power among existing actors, as in the case of an internal reorganization.

Strategy change events – in corporate strategy and in business strategies – are covered in Chapter 5. Changes in strategy affect ownership and management in light of the institutional challenges and informational requirements posed by the strategy: the more important the change in strategy, the greater the potential impact. These effects are not automatic, however, and changes in strategy can be interpreted as struggles for power over the direction of the firm. Now, changes in strategy are usually also associated with changes in the fortunes of a firm; in fact, success in the marketplace is the ultimate measure of the suitability of a strategy.[13] In the context of examining changes in strategy, it is therefore also of interest to examine under what performance conditions change may be *blocked*: Chapter 6 looks at cases where no changes occur in ownership, management, and strategy – *despite failure* in the marketplace; Chapter 7 studies examples in which market *success reinforces* the existing constellation of ownership, management, and strategy. When ownership, management, and strategy are closely interlinked, for example when they are all tied to the same person or if stakeholder groups are tightly connected, adaptation can be prevented.

Chapter 8 reviews the institutions of corporate governance, with particular emphasis on the challenges of leading change and the role of the board of directors. Is there one best strategy in any given situation, or does it depend on whom the strategy is for? We return to this question in the Conclusion and outline the practical and theoretical implications of considering strategy not as neutral, but as driven by different interests.

Purpose

This book is intended for company owners, board members, and executives considering changes in firm ownership, management, or strategy, as well as the professionals in governance (lawyers, auditors, and investment bankers) and general management (consultants) who advise them. Compared to the specialist approaches of lawyers and consultants, the added value of our cross-disciplinary perspective lies in pointing out the broader consequences of apparently narrow legal or strategic actions. Our hope is that reading this book will lead more firms and their advisors to consider the interactions between ownership, management, and strategy when they devise plans for change. Inasmuch as whole industries may change ownership form and subsequently choose a different, more risky strategic emphasis, such as was the case for the great US investment banks whose governance histories are discussed in Chapter 3, policy makers may also find food for thought. Most importantly, we want to persuade the worlds of academia and business to do away with the time-honored illusion that firm ownership, management, and strategy can be considered in isolation from one another.

Background reading – Introduction

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