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978-1-107-04420-3 - Strong Managers, Strong Owners: Corporate Governance and Strategy
Harry Korine and Pierre-Yves Gomez
Frontmatter
More information

Strong Managers, Strong Owners

The family firm preparing generational change, the partnership that welcomes new partners, and the shareholders of a firm that chooses to go public are making decisions that will have an impact on strategy and management. 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. Opening the black box of agency theory, Korine and Gomez show how management and ownership interact to shape the strategy of the firm. In their view, the critical question to ask is not what is the best strategy, but rather, who is the strategy for? With numerous detailed examples, *Strong Managers, Strong Owners* is an invaluable resource for company owners, board members, and executives, as well as their advisors in strategy and governance.

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Corporate Governance and Strategy

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Contents

Cambridge University Press
978-1-107-04420-3 - Strong Managers, Strong Owners: Corporate Governance and Strategy
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Frontmatter
More information

Figures

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978-1-107-04420-3 - Strong Managers, Strong Owners: Corporate Governance and Strategy
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Frontmatter
More information

Tables

Foreword

The interrelationships among shareholders, directors, and senior executives have come under the microscope only fairly recently. Having been personally involved in various capacities through the last two decades both on the public and private sides, I have seen first hand how the roles have evolved over time. Shareholders' awareness of their interests and rights, and their expectations of the people they have put in place to act in, if not protect their interests, have heightened over time, no doubt thanks to the numerous episodes of wide-scale frauds by executives or failure to discharge fiduciary duty by directors. To a similar extent, directors are now acutely aware of the onerous liabilities they assume when consenting to sit on boards. Heavier emphasis is being placed on appointing a rising proportion of nonexecutive or even independent directors, thereby subjecting the board-management relationship to even more tension. In short, the distinction between roles is being sharpened, and the lines of responsibility are more clearly drawn.

More critically, I am convinced that strategy formulation is never accidental; it is in fact the direct consequence of the interplay of the different interests among shareholders, directors, and management. This implies that any change in the composition of ownership or management can potentially have an impact on strategy. By the same token, if the strategy were refined or radically revamped, particularly with outside help, the dynamics between the shareholders and management would undoubtedly be affected.

We are all familiar with the experiences of a redefinition of strategy around a change in ownership, resulting from a merger or acquisition. I have witnessed first hand and twice over, as a senior executive in financial services, how the new owners reshaped strategy – defining what was core business, which strong market position to build on – and essentially restructuring the management teams along with the new priorities. Likewise, when a new investor such as a private equity fund takes on a significant shareholder role, the revised strategy will be consistent with and reflect the basis for investment, for example to realize value-add through operational enhancements or organic growth. In such circumstances, new chemistry and new working relationships have to be fostered. When managed carefully and sensitively, a stronger entity with a clearly defined business focus, executed by competent executives, should emerge.

This should hypothetically be no different even if the owner were a sovereign wealth fund. In reality, however, for businesses with a political or strategic element, say in the provision of public goods or essential services, more often than not, any shift in strategy may entail or even arise from noncommercial considerations. The more ambiguous the objectives for strategy review are, the greater the tension between owners and management will be.

It gets more complicated when government is a direct shareholder. I have come to realize that a deep appreciation of the multiple roles that a government can play is essential to understanding the impact of any strategy change on management. What are the factors giving rise to the typical confusion over the capacity that a government is acting in?

There is often more than meets the eye; this describes the unique situation where the government is both an owner and regulator and, in some cases, a customer as well! The arena of public goods is replete with illustrations of the tightrope that many governments walk on. Say in the area of public transportation or education or healthcare. The harsh reality is that these multiple roles have conflicting interests from time to time. As a regulator, the government may elect to have a more liberal competition framework for pay TV but the operator that it owns may well wish that competitive pressures are limited. Or that public policy may be leaning towards higher co-payments for nonessential healthcare services but competitive pressure limits what people pay. Whither the strategy in such circumstances?

Any public policy shift will necessarily lead to a corresponding redefinition of strategy of the state-owned business that plays in that space. This in turn requires a slew of changes that management will have to conceive, embrace, and execute, sometimes to better outcomes and, other times, with disastrous results. Occasionally, it's the opposite – where government assumes a doctrinaire position as a shareholder but the underlying market transformation warrants a new strategy. Something has to give; if the government insists on no change in stance despite market indications to the contrary, then management will be saddled with the burden of treading carefully between pleasing the owner and staying relevant. Overall, I have observed that it will serve governments well to adopt a dynamic stance towards its participation in business.

Where government is a shareholder, many relevant questions are posed – should it remain involved in business? If not, when should the exit be? What form should its involvement take – active or purely financial? This is a topic of immense interest to many, including myself, and especially those who have to deal with either the state bureaucracy or state-owned enterprises.

It will be futile to push for a convergence of interests across owners, board members, and management because such an outcome does not always exist. Instead, I have learnt that it would be more pragmatic to understand the differences, some of which are inherent in the definition of roles, and to accept that the desired outcome has necessarily to be multidimensional. There would be competing and conflicting demands on resources or simply a difference in expectations. But ultimately, the long-term, sustainable well-being of the firm must reign supreme. In any course of action or revision to strategy, we must always bear in mind that making tradeoffs and minimizing tension and power play should be part and parcel of such an exercise.

Strong Managers, Strong Owners, by Korine and Gomez, reflects a deep understanding of how the potential differences among the various stakeholders' interests can influence the shaping of strategy. It offers simple but sound advice on how to take these multiple interests into consideration when formulating strategy.

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This book has been three years in the making and draws on over ten years of joint research. Over such a long period of time, we have benefitted from the ideas and support of many.

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We appreciate the steadfast support of our editor, Paula Parish, of Cambridge University Press. In many ways, this new book represents a further development and a systematic application of the theoretical framework we first presented in *Entrepreneurs and Democracy* in 2008. This is why it is especially nice to have been able to work again with the same publisher and the same editor.