VALUE CREATION FOR OWNERS AND DIRECTORS

A Practical Guide on How to Lead your Business

Massimo Massa
Kai Taraporevala
Ludo Van der Heyden

palgrave macmillan

Value Creation for Owners and Directors

Massimo Massa • Kai Taraporevala
Ludo Van der Heyden

Value Creation for Owners and Directors

A Practical Guide on How to Lead your Business

palgrave
macmillan

Massimo Massa
INSEAD
Singapore, Singapore

Kai Taraporevala
Mumbai, India

Ludo Van der Heyden
Flendruz, Switzerland

ISBN 978-3-031-19725-3   ISBN 978-3-031-19726-0 (eBook)
https://doi.org/10.1007/978-3-031-19726-0

© The Editor(s) (if applicable) and The Author(s), under exclusive licence to Springer Nature Switzerland AG 2023
This work is subject to copyright. All rights are solely and exclusively licensed by the Publisher, whether the whole or part of the material is concerned, specifically the rights of translation, reprinting, reuse of illustrations, recitation, broadcasting, reproduction on microfilms or in any other physical way, and transmission or information storage and retrieval, electronic adaptation, computer software, or by similar or dissimilar methodology now known or hereafter developed.
The use of general descriptive names, registered names, trademarks, service marks, etc. in this publication does not imply, even in the absence of a specific statement, that such names are exempt from the relevant protective laws and regulations and therefore free for general use.
The publisher, the authors, and the editors are safe to assume that the advice and information in this book are believed to be true and accurate at the date of publication. Neither the publisher nor the authors or the editors give a warranty, expressed or implied, with respect to the material contained herein or for any errors or omissions that may have been made. The publisher remains neutral with regard to jurisdictional claims in published maps and institutional affiliations.

This Palgrave Macmillan imprint is published by the registered company Springer Nature Switzerland AG.
The registered company address is: Gewerbestrasse 11, 6330 Cham, Switzerland

To our Families and our Students

Preface

This book discusses key aspects of business, ownership, and governance, and their deep connections to value creation. And to its opposite, value destruction. The interplay between ownership and governance is rarely addressed in the academic and professional literatures, which remain centered on publicly listed firms. Though shareholders of such firms are often referred to as "owners," their number typically reduces their power to that of voting in public elections. Indeed, their interactions with boards of directors and corporate executives are often reduced to listening to presentations at the Annual General Meeting and then voting on the proposals submitted by the board. These are limited, often contentious, and can barely be called conversations.

The situation is completely different when owners are few and identifiable. This is the case for founder and entrepreneurial firms, and for firms owned by private equity, families, or a state. These are cases where ownership manifests its wider dimensions and where ownership truly matters. Yet this subject is rarely addressed from a value creation perspective, governance typically discussing the relationship between corporate boards and executives and, particularly after the 2007–08 financial crisis, between boards and regulatory or government authorities. Yet ownership is critical not just for short-term performance but also for the longer-term sustainability and success of enterprises.

The distinct nature of such identifiable ownership is the focus of this book. We aim to draw a sharp line between the governance of owner-led and owner-governed firms and that of so-called market-led firms, which as we will explain shortly tend to be or become "executive-led" firms. The importance and complexity of the ownership task is largely underestimated. This is the topic our book explores: ownership as an integral and foundational part of governance, with a particular angle on value creation.

The complexity of the ownership task is further amplified by the natural biases that permeate all personal and group interactions. Owners of companies and directors on their boards are particularly prone to these biases. The professional and academic literature rarely details these topics together, nor do they handle them with sufficient clarity. They often indulge in "best practice governance" or in the legal and regulatory aspects of governance. This book aims at starting to fill this gap. Our treatment of these issues characterizes the competencies owners and directors must possess for governance to be effectively exercised in the firms they own and govern, and for value creation to occur in a sustainable way.

The efficient market hypothesis that has prevailed for decades has too often equated value creation with stock price performance. It has left relatively little space for the role of ownership beyond the stock market valuation, engulfing governance in the study of stock market dynamics. Real ownership is typically absent from these debates, as there is no need for it, the market taking care of all matters in an efficient way.

The 2007–08 financial crisis and its global consequences have shown how failures in governance can be disastrous. The roots of the crisis have been well described by Nobel laureate Joseph Stiglitz[1] as a failure of governance at multiple levels (executives, boards, regulators, and governments). Some of its still ongoing effects are being exacerbated in the current COVID-19 crisis: a regime of low-interest rates, large government indebtedness, a growing disconnect between leading value creating businesses, and value appreciation in the financial markets. Again, ownership has hardly been addressed in such discussions, except for the benefits to owners of the appreciation of their shares, or of their challenges in the face of falling equity values.

Following the 2007–08 financial crisis, and again in the COVID-19 pandemic, citizens had to rescue many corporations. They collectively became the ultimate owners of iconic companies like AIG, GM, Royal Bank of Scotland, and UBS. Governments acted on their behalf as proxy owners. The expense was massive and government ownership expanded as a result. Paradoxically, governments, as owners, have often done well in such rescue operations, which is remarkable given the unpreparedness of governments for such ownership.

Another major change in liberal capitalism is the growing size and importance of institutional investors representing end-retail investors (e.g., pension funds, insurance companies, mutual funds). If ownership by the state and ownership by the people—the end-retail investors—are on the rise, surely ownership effectiveness must and will become a subject of greater importance. The impact of state versus private ownership in these funds should also become increasingly clear for all to see, with clear consequences should differences indeed emerge from this comparison.

Changes and crises always have consequences, often unintended. They also have one virtue: they concentrate the mind on the essential factors driving value creation and the key role that effective governance plays in such instances.

The practice of governance has been excessively shaped by what boards of listed firms do, and then particularly in the US, whose firms are the most studied. The US is the biggest economy in the world and has been the Athens of the study of business. US firms have also provided by far the largest amount of high-quality data for academics and governance professionals to examine and research. US listed firms are the most written about in the Anglophone global business media. As beautifully described by Alfred Chandler,[2] they have given a picture of firms as managed and ultimately governed by their executives. And indeed, CEOs often double up as Board Chairs, focusing business scholars on the executive leadership of these firms, or on their stock market performance. We refer to this situation as *executive-led governance*. This is paradoxical as this reality is often referred to as *(stock) market-led governance*. It is far from being solely a US reality; it is equally present in countries such as the UK, France, and Japan.

Our book takes a contrarian view, namely of firms led and governed by their owners, who may or may not be Chairs and/or CEOs of their firms. This starting point is unique and leads to the main contribution of the book: regardless of national and legal aspects, it is crucial, for a thorough knowledge of value creation and governance, to understand that the governance practices of owner-led firms or firms with identifiable owners differ substantially from those Chandlerian firms with many shareholders. Shareholders in listed companies may be labeled as "owners" but de facto enjoy little if any power in the exercise of their ownership beyond a vote at the Annual General Meeting.

Let us add too that stock listed firms are a small minority in the ecology of firms: the World Bank estimates that there are about 43,000 listed companies in the world,[3] approximately 10% of which are listed in the US, while the number of companies in the world is estimated to be above 213 million.[4] Of course, most of these companies are small, if not exceedingly small. But these numbers confirm our point that the world of listed firms is a small and biased sample in the galaxy of companies. The second aim of our book follows from this: to draw what is distinct in the governance of owner-led firms, to detail it, and to guide corporate owners on the trajectory of value creating ownership. The ownership task does not necessarily become more complex as the business grows, for with growth comes the access to greater talent, intelligence, and experience. In comparison, the task of the small business owner appears more herculean.

Ours thus stands at odds with the Chandlerian view of corporate leadership, still shared by many CEOs and Executive Chairmen. This view holds that the crux of business life and value creation rests with executives. Our approach immediately imposes greater precision in the language of governance. In our treatment, a board is a generic term: it is the adjective that precedes it that fully defines and operationalizes the term. We will explain that there are "Owners' Boards," "Corporate Boards," and "Business (Unit or Management) Boards" and we will argue that the roles and responsibilities of each of these boards differ. As each of these three boards impact an organization's purpose and the execution of that purpose, one key question for us will be to examine how to align these boards on value creation. Decisions on growth, risk, and financing are instances of how each board impacts value creation, and how poor alignment may result in the destruction of value. Separate chapters will be devoted to examining these facets of value creation.

Another distinction we draw in this book pertains to executives and directors of a multi-business corporate entity as compared with those of a single business. The board members of a banking group, for example, may consider that they are governing a single business, defined as banking. The reality is much more complex: a banking group typically hosts multiple businesses, such as retail banking, corporate and investment banking, consumer finance, and asset management, to cite only a few. Each of these corporate units, sometimes called "divisions," is a business, with a distinct value proposition and specific competitors, delivering and creating value in its own way, and driven by its own strategy. Ignorance of this multiplicity of businesses inside a banking group might lead the board of such a group to think of formulating a single strategy aiming for specific "business" goals. Value destruction will invariably result as each business in such a banking group requires distinct leadership, goals, and strategies, which cannot be simply "averaged" away or reduced to group statements and decisions uniformly applied to the separate business units. This observation has a second corollary: the roles of corporate (or group) executives are more related to those of board members governing the multi-business corporation than they are to the executives of the group's business units. The latter aim to make a difference in their respective and distinct competitive business contexts. Corporate executives do not run these businesses but rather oversee the group's multiple businesses. These observations invite corporate executives, as well as their board members, to take an interest in this book.

Many owners behave as if they were the Board of Directors, demanding that their boards formally approve what they as "owners" decide. They state that this is their right as the masters and owners of "their corporation." Regretfully for them, and fortunately for the other stakeholders of the business, this is not the way liberal or democratic capitalism functions, which assumes that owners and their corporations are distinct legal "persons" whose interests may align but may also diverge. This is precisely why liberal capitalism puts the responsibility for the corporation with its Board of Directors. When the latter board is "captured" by owners and becomes excessively subservient to them, the board may provide legal protection for the owner (which some devious owners indeed enjoy and need). But such boards will not protect their owners from value destruction. Such situations occur when owners force decisions that lack the necessary operational understanding of the business or when owner decisions are based on erroneous hypotheses regarding the business context or the functioning and capabilities of the owned organization.

An understanding of the differential and complementary roles of owner, corporate, and business boards is fundamental to effective ownership and governance of owner-led firms. This understanding is particularly important for family enterprises which are vital drivers of the economies and societies in which they operate. Detailing the interplay and in particular the value creating roles of owners and owners' boards in such contexts will be the third goal of our book.

Our broadest aim is to underline that governance actors, if they are indeed aiming for value creation and eager to be responsible and effective actors, must possess standard governance competences, as well as basic business and industry knowledge. They must also be able to think through and follow effective board- and group-level deliberative and decision-making processes. They must learn to address the value creation conflicts that invariably characterize interactions between different stakeholder groups. The lessons from the Macondo (BP/Deepwater Horizon) and Fukushima (TepCo) disasters, as well from the many financial and now pandemic crises we have faced, should not be forgotten. These point to major risks and massive costs when governance, ownership drivers, and stakeholder needs are not sufficiently understood, or managed effectively. In sum, there is a mantra that boards ought to take to heart: "*Organizations – just like people - inevitably die; all wish to die well, as healthy and as old as is possible; let foolishness, stupidity or ignorance not detract us from this wish.*" In fact, this mantra is applicable to all of us, including in our personal governance and in that of our families.

Our treatment is divided into three parts, each representing one of the legs of a "tripod" on which ownership effectiveness rests. As is the case for any tripod, all three legs matter: the structural elements (referred to as the owner's **hardware**), the relational elements (the **software**) that allow owners to manage the social and emotional dynamics of ownership, and the fact that owners are people, subject to emotions and egos. Owners have histories, defining experiences, memories, and talents. No owner is perfect. All owners have shortcomings and biases. We will refer to these defining personal and idiosyncratic aspects as the **humanware** of ownership. A single missing or even ill-functioning leg of the tripod risks rendering ownership ineffective. We end this Preface by detailing the main elements of the hardware, software, and humanware of ownership.

Part I describes the **"hardware"** of value creation in owner-led firms. It presents the key structural requirements for value creation. This part deals with the **"WHAT,"** the **"Mission"** of the enterprise, which provides its foundational structure. The literature often refers to this as the purpose of an enterprise, but we will provide a more precise meaning for the notion of Mission and include values and governance arrangements as well. Two frameworks are presented that are key to implementing the Mission inside an enterprise. These frameworks form the backbone of the ideas developed in this first part. One is our **MGSF** framework, which requires the need to align the **G**oals, **S**trategy, and **F**undamentals governing the enterprise, and project it into the future with its **M**ission if value creation is to result. The second is the **Three Boards** framework consisting of the **Owners', Corporate, and Business Boards.** These represent the three governance levels typically encountered in privately owned firms. They provide the main backbone on which governance rests. These three boards are rarely addressed together and distinctly as we will do in this book. This is necessary to avoid the risk of confusion or loss of alignment, and eventually value destruction. No matter how noble one's dreams, no matter how valuable one's insights, our thesis is that businesses require a clear-sighted and disciplined view on what precisely constitutes value creation and how the subject is approached within a corporate and ownership structure. Obtaining clarity and disciplined alignment on these issues is the primary mission of owners. This specification fundamentally distinguishes owner-led firms from publicly listed ones. In the latter this alignment is a rather haphazard outcome of forces applied by shareholders, board members, and other stakeholders, including, of course, executives, but also suppliers and partners, and, increasingly so during the last few years, regulators.

Part II deals with the **"software"** required to sustainably guide and adapt value creation in changing contexts. This part addresses the relational aspects of corporate governance and the omnipresent and dangerous behavioral biases, at individual or group level, that pose serious challenges to effective board work. This part highlights the **"HOW"** of ownership and governance, which concerns the "Process" of decision making that is the heart of board work. The HOW is critically affected by interactions among the members of the three foundational boards. Of concern are the corporate board's interactions with owners on the one hand, and with executives and managers on the other, as well as regulators and other stakeholders. We here follow the path-breaking work of Kahneman and Tversky, who created the subfield of **behavioral economics.**[5] The novelty in their scientific examination of how people make decisions lies in their descriptive viewpoint, which contrasts with the prior normative treatment premised on hyper-rational actors. Their more realistic models allowed substantial progress in our knowledge about human decision making, as we will explain in this second part of the book.

Having convinced our readers of the seminal findings of Tversky and Kahneman and their followers, we present our **FPL** (**F**air **P**rocess **L**eadership) methodology that counters these biases. FPL provides the different governance actors, owners, directors, and managers with a better chance of remaining on the positive side of risk and of traveling the path of effective decision making and implementation for real value creation. FPL also identifies the factors that cause individuals or groups of individuals to enter the path of value destruction. The methodology favors involvement of stakeholders and their commitment to the decisions made. In sum, FPL provides the software to both engage and align owners, boards, executives, and stakeholders in decision making.

Part III presents the **"humanware"** underlying the complex and often surprising human aspects of ownership and corporate governance that Tversky and Kahneman brought to light. They were not the first, as the Greek poet Homer, in both the *Iliad* and the *Odyssey*, beautifully narrated how humans can, tragically, lose their way in matters of ownership, family, and, above all, personal ambition. Anaïs Nin wrote, "*We do not see things as they are, we see them as we are.*" Nin describes how our identity is the principal root of the many biases that cloud individual and collective decision making.[6] Sydney Smith, cleric at the University of Oxford, similarly noted these origins of our biases: "*It is, then, a matter of sovereign necessity, before we decide on great … questions to … review, with an honest severity,* ***those peculiarities of disposition, situation, and education****, which may communicate an unfair bias to the mind, and induce us to decide, not as the truth of things, but as we are ourselves.*"[7] Character, context (parents, family, position in society, the city and country where we came from), and education (by our parents, family members, teachers, and mentors) all shape our biases and, in turn, our contributions to group decision making and dynamics. In short, our third part thus concerns the **"WHOM."** It reviews the different leadership styles and patterns of owners, as well as the critical transitions that they make in their quest and that act as milestones marking their developmental road.

Our treatment of ownership and governance takes distance from the standard treatment in the economic theory on the governance of the firm, where the key model is the *principal-agent model,* generally associated with Jensen and Meckling.[8] The setting of this model concerns the definition of an agreement or contract between the owner (the *principal* in the model) and the business manager (the *agent*). The principal and agent have different attitudes toward risk. The agency problem is cast as defining the contract for the agent that most benefits the principal. The model sits at quite a distance from normal governance contexts: it relies on a single principal (when shareholders are numerous and far from uniform) who owns a company as the sole shareholder. Any application of the agency model to governance immediately hits upon the question as to whether the board should be considered the principal, with management as the agent, or whether the principal is the owner, and the board the agent. The necessary introduction of a Board of Directors sitting between shareholders and management suggests either a doubly layered principal-agent model, or the introduction of three layers of principals and agents (owners, directors, and managers), which is not the model's setting. Viewing the application of the agency model to governance as rather complex and unsettled, our book focuses on the substance and structural complexities of governance, including the dynamic interaction of the three boards (owners, corporate, and business boards) searching for alignment as described by the MGSF framework and supported by a number of other frameworks, where FPL takes a prominent role in supporting positive relationships by the owner with the Board of Directors and the firm's stakeholders.

In developing our ideas, we recognize that much of management and economic teaching and research is still viewed to be "*as clear as mud*."[9] To escape the curse, we have aimed for transparency and clarity in the formulation of our hypotheses, and in the arguments and foundations on which these hypotheses are built. Our aim throughout is to present a practical book for guiding owners, directors, and business leaders, with a particular focus on business families. Entrepreneurial founder-owned firms, as well as state and private equity-owned entities, are in our purview as well.

Corporate governance is the domain of well-written policy and regulatory manuals, of which there are plenty. These writings are usually normative, abounding in the "should" and the "will." They emphasize the responsibilities of board members and the many tensions a professional practice of governance generates. They typically do not present the academic knowledge in a practical manner that helps board members, their owners, and their executives manage these tensions and exercise their responsibilities more effectively. This is what we aim for.

This book is based on the popular INSEAD education course Value Creation for Owners and Directors. The course has its origins in a long and very early morning car ride in 2007 from Fontainebleau to Brussels, where two of the authors debated how to help the owners of a large Belgian family business group become more effective in addressing their challenges. The authors, who had been invited to help this business family, asked the family leaders to first reflect on the mission pursued by their family business, and on the risks entailed in their enterprise, before structuring the leadership succession they faced. They had been asked to present "helpful academic knowledge relevant to the issues at hand." The family did find the authors' presentation insightful and their intervention helpful in addressing their challenges.

This positive engagement encouraged the authors to launch the course for business owners and directors mentioned earlier. Every iteration of the course furthered insights, validating some of the authors' main views while sharpening others. The book that follows presents these insights and views, refined by the now ten iterations of the course. The course and this book are immeasurably better for the many insights and comments gained from our participants. Every group left behind thoughts, histories, experiences, and wisdom. All of them have and deserve our heartfelt thanks. Having tested our ideas on many cohorts, the time had come to write things down for greater diffusion. It generated further reflection. While writing the various chapters, we regularly experienced Oscar Wilde's saying: "*Thought arises between the tip of the pencil and the paper.*"

The third author, and INSEAD MBA, joined the first two after writing a case on governance and succession in the Tata Group. The collaboration was so positive that the original two authors asked him to join in writing this book. His experience in governance as executive, independent director, and investor added a wealth of contextual and conceptual knowledge to the book. The engagement has undoubtedly resulted in a higher-quality book.

Singapore, Singapore — Massimo Massa
Mumbai, India — Kai Taraporevala
Flendruz, Switzerland — Ludo Van der Heyden

Notes

1. Nobel Laureate Joseph Stiglitz has provided one of the best diagnoses of the root causes of the crisis in *Vanity Fair* (January 2009) entitled "Capitalist Fools." One of the authors has also written on the subject in *The European Financial Review* (June–July 2011) under the title "Public and Corporate Governance After the Crisis."
2. *The Visible Hand: The Managerial Revolution in American Business*, by Alfred D. Chandler Jr., Belknap Press (1977).
3. https://data.worldbank.org/indicator/CM.MKT.LDOM.NO?end=2020&start=2000&view=chart.
4. https://www.statista.com/statistics/1260686/global-companies.
5. The seminal book reference for this area of research is *Judgement under Uncertainty: Heuristics and Biases*, by Daniel Khaneman, Paul Slovic and Amos Tversky, Cambridge University Press (1982). Khaneman's latest book, *Thinking, Fast and Slow,* Farrar, Strauss and Giroux (2011), became an all-time bestseller detailing the intricacies of how our brains function and lead to a host of conscious and unconscious biases.
6. Anaïs Nin, *The Seduction of the Minotaur,* The Swallow Press, 1961, p. 124.
7. "On the Predisposing Causes to the Reception of Republican Opinions," in: *Sermons by the Reverend Sydney Smith (Late Fellow of New College, Oxford),* Vol. 1, 1801.
8. Michael C. Jensen, William H. Meckling, "Theory of the firm: Managerial behavior, agency costs and ownership structure," *Journal of Financial Economics* Volume 3, Issue 4, October 1976, pp. 305–360.
9. Title of a review published in *The Economist* of Tourish's 2019 book *Management Studies in Crisis: Fraud, Deception, and Meaningless Research*.

Chapter Outlines

This book discusses the hardware, software, and "humanware" required by effective owners and directors aiming for value creation. Each element of this tripod is exposited in a separate part of the book. Key ideas are presented in a linear, chapter by chapter manner. Our suggestion to readers is to follow the advice to the Rabbit in *Alice's Adventures in Wonderland*: '"*Begin at the beginning,*' *the King said gravely,* '*and go on till you come to the end.*'"

The key concepts developed in the book are presented here, in brief fashion. This should help all readers, particularly those readers that do not wish to follow the advice given to the Rabbit, preferring to read chapters out of order.

Throughout the book, case studies, real-life examples, as well as interviews of owners and directors provide illustrations and context for the arguments presented. Many examples are given, each presenting facets we can learn from. These examples teach us in two ways:

- Positive examples or good practices where owners, boards, and top management got it right. They obey the Anna Karenina Principle, based on Leo Tolstoy's book, where he writes: "*All happy families are alike; each unhappy family is unhappy in its own way*."[1] In these positive instances, success is achieved when a set of principles are all validated. Such examples also demonstrate that success is a systemic property, and not the result of a single "silver bullet," or of a subset of factors. They attest to the systemic complexity of achieving success when all principles must be validated.[2] As we stated earlier, these principles fall into three macro-characteristics, referred to in this book as hardware, software, and humanware.
- Negative examples or bad practices, showing case studies of enterprises that failed. These follow what we might call the Charles Munger Principle, after

the business partner of Warren Buffett. Munger explained this method of learning in his 1986 Harvard School Commencement Speech: "*What [Johnny] Carson said was that he couldn't tell the graduating class how to be happy, but he could tell them from personal experience how to guarantee misery. What Carson did was to approach the study of how to create X by turning the question backwards, that is by studying how to create non-X.*"[3] Case studies here explain why success proved elusive.

An outline of the book, with brief chapter summaries, is presented next.

Chapter 1. Introduction: Corporate Ownership

The introduction illustrates the main characteristics of the exercise of effective ownership. It also presents an ownership typology. We qualify ownership types according to the other roles owners may also assume: founder, Chair, CEO/General Manager, board director, shareholder, or a combination of these. This categorization distinguishes ours from more usual explanations based on ownership structures and looking at ownership mostly as exerting "control" over a business. The typology allows a clearer discussion of the interaction between ownership and governance.

Part I. Hardware: A Value Creation Framework

Value creation is defined by an anteceding requirement: the need to define value by a proper definition of the **mission** of the firm. This underlines that the definition of mission[4] is the essence of the owner's role, from which all else derives. This observation leads us to present our **MGSF** (**M**ission, **G**oals, **S**trategy, and **F**undamentals) framework that we regard as critical for the effective governance of high-performance companies. Our **Three Boards** framework (Owners, Corporate, and Business) provides an integrative governance architecture, which along with the MGSF framework structures the firm's governance for effective value creation.

Chapter 2. The Primacy of an Owner's Mission

The **owner's mission** sets the purpose of a company and gives it a clear direction. Critically, a mission thus determines the value to be created by corporate ownership as progress on this mission.

The ability of owners to determine the mission of the corporation they own is one of the fundamental characteristics distinguishing owner-led firms from publicly listed ones. In the latter, after the mission is set by owning founders, subsequent changes in mission are typically set by the Board of Directors, if not by the management, and then approved at the General Shareholders Meeting. Owners generally know why they own a business and what they seek from it. Well-set out missions provide companies with a clear focus and greatly enhance the chances of longer-term success.

A mission statement thus frames value creation for an owner-led company as making progress on the mission. This cannot be repeated enough. Companies whose missions are not well set out inevitably lead to value destruction, a consequence of wrong and in effect value destroying mission statements. Disagreements or compromises among owners about the mission, or a persistent lack of alignment among owners, boards, and management and continued disagreements on what the mission ought to be, unavoidably follow this state of affairs. They set the firm up for failure.

The first task of an effective **Owners' Board** (OB) is to craft a mission and then anchor this mission in shareholder agreements and in the corporate charter. Missions may be changed when contextual factors force a change, or when owners change.

Owner-led companies consequently benefit from another characteristic relative to their publicly listed counterparts: they are able to change the mission more swiftly. Changing the mission of publicly listed firms invariably leads to shareholder contests about the opportunity or desirability of such a change.

Chapter 3. The Board of Directors: Governing the Mission

The **Board of Directors** (BoD, though throughout the book we will also use the unqualified term board when referring to a BoD) lies in the middle of the transmission chain linking owners with the management. In liberal capitalism, boards are legally responsible for the organization they supervise. Hence, in the legal view of the firm the board <u>is</u> the organization, while the owners are not. This is why it is so important, in owner-led firms, to anchor value creation in the preferences of the owners. It also follows that in such firms it is important for boards to regularly provide feedback to owners and managers regarding value creation, and also to ask for guidance from both.

One of the key tasks of the value creating BoDs is to maintain alignment with the owners. This is done by ensuring that owners indeed see the company to be delivering value, by showing the progress realized by the company in pursuit of the owners' mission. This requires the Board to see to it that its decisions and those made by executives are aligned with the mission. Using an analogy from how a country is governed, the mission acts like a constitution, goals might be considered laws governing the country, and the Board acts like a supreme court ensuring that the laws are aligned with the constitution.

The alignment exercised by the BoD takes many forms: selecting CEOs and other members of the senior leadership team that are aligned with the mission, crafting jointly with these executives the company's goals, in line with the mission, and monitoring their implementation. Indeed, when CEOs and executive teams pursue actions at variance with the mission, they inevitably lead to a clash with owners who will consider value creation to be denied. Boards must then intervene to restore alignment and return harmony to the organization.

One of the outcomes of the BoD's discussion with the executive team may be that it reveals the mission to be impossible or too costly to deliver; in that case it is up to the board to engage the owners in a discussion of a needed modification of the mission, realizing that is not the BoD's purview, but that of the Owners' Board. In crisis times, the BoD often becomes front-line as the crisis typically results from ineffectiveness in the senior leadership team.

Effective boards regularly review progress and check that the goals pursued remain aligned with the mission. In fulfilling their responsibilities, boards of privately owned firms lie at the center of the "duality" between ownership and the management of the owned corporation, ensuring continued alignment so that the business continuously delivers the value expected by the owners, and also the other stakeholders who must be informed of owners' preferences as revealed by the mission.

Chapter 4. The CEO and the Executive Team: Responsible for Executing the Mission

CEOs and their executive team are responsible for turning the mission, defined by the owners, into reality. They operationalize the mission by aligning business activities with the owner's mission by crafting the goals. They also provide feedback to the BoD on progress in value creation, and warn the BoD on challenges in execution. Good governance is defined by the absence of surprises. But surprises do happen; what should not happen is that surprises known to executives are not known by the BoD, or the owners. This is where strategic planning and risk management become essential.

Chapter 5. Goals, Strategies, and Fundamentals

Missions are generally **long term** in nature. **Goals** translate missions into practical, quantifiable **medium-term** objectives that then trigger the search for **short-term action plans**. Goals can be broadly quantified around three main dimensions: **profitability, growth, and sustainability**. It is important that boards and executive teams understand the interactions and especially the trade-offs between these three dimensions. It is impossible to pursue all three goals simultaneously, at least in the short term. Boards need to address this major challenge with executives, as, at least in the short term and possibly also in the medium term, these three goals cannot be pursued simultaneously. Executive teams thus face clear trade-offs which they need to recognize and manage. Boards are there to support executives with necessary clarifications on the goals that need to be pursued.

Strategies are the action plans that executives deploy following the choice of mission by owners and the selection of goals by the board, in collaboration with the executive team. In case growth is chosen as the goal, for example, typical strategic choices are: **build, buy, or ally strategies**.[5] The selection of a strategy does not depend solely on goals, it also depends on company **fundamentals**: the type of industry the firm operates in, the client's ecosystem, suppliers, competitors, regulators, where and how the company generates cash flows, the types of risks the company faces and needs to mitigate against, as well as the company's ability to raise financing. Examples are presented illustrating how strategies are selected by examining cash flow generating opportunities.

Chapter 6. Fundamentals: Financing and Risk

Owners must understand how company fundamentals affect the selection and success of the strategies, and hence of risk, and how they may alter the results expected from good strategy execution. These interactions naturally have a bearing on financing opportunities. This point deserves to be fully recognized, as growth requires financing. Location of a company, for example, has a great influence on cash generation potential, both in supply of investors and demand for investments. These interactions too must not be ignored.

In our discussion of a company's financing needs, we follow the risk-return paradigm of modern finance. This paradigm identifies risk as the fundamental factor in financing. Deviating from the classical Modigliani-Miller treatment, which asserted that financing had no bearing on the value of the firm, equity financing through IPOs enables and influences strategies, as it changes the nature of ownership. The chapter concludes with a discussion of the impact of financing on overall value creation.

This book classifies risk in three types: **volatility, Black Swan, and obsolescence**. Two of these risks, volatility and Black Swan, are investigated in this chapter. The third risk, obsolescence, is dealt with separately in Chap. 7. Obsolescence acts like a cancer, though treatment and recovery are possible. Examples again illustrate the impact of these risks on strategic choices.

Chapter 7. Control and the Corporate Board

Language being central in governance, this chapter begins with a definition of control. Owners, directors, and executives must align on control, and agree on the what, the why, and the how. We illustrate how control is typically achieved through a variety of structural mechanisms. This is our entry point for distinguishing, in a multi-business setting, the responsibilities at the corporate level (Board of Directors) from those at the business level (CEO and executive management of the business units). A clear and complementary differentiation of the role and function of the corporate board as distinct from that of the business unit boards is thus obtained.

Chapter 8. Obsolescence and Counterfactual Thinking

Obsolescence is the silent killer of companies. It often operates insidiously. Through several examples, we illustrate how boards usually do not spend sufficient time appreciating a company's obsolescence risks, understanding when these arise, when they grow, and what they consist of. In this context, we also present **counterfactual thinking** as a key competence for owners and boards to possess. Our recommendation to boards and owners is for these obsolescence risks to be made more visible as a pre-condition for an effective treatment of this corporate cancer, and to apply counterfactual thinking more rigorously as a way of examining what treatments will be more value creating and contribute to greater sustainability. Our formal discussion of obsolescence and counterfactual thinking is another distinguishing feature of our book.

Chapter 9. MGSF and the Three Boards

This chapter closes Part I of the book by reviewing the entire **Mission, Goals, Strategies, Fundamentals** framework (MGSF), underlining again its central importance as a foundational tool for the alignment required for a firm's value creation across the **three boards**: owners' board, corporate board, and business board. The distinction between the three boards is often too foggy, leading to overlap and confusion as to their distinct roles, as opposed to synergy and complementarity. This lack of clarity lies at the root of a great number of governance inadequacies and pathologies and turns a potential synergy into a needless and soon emotional confrontation of power and authority. The resulting deficit of firm performance may ultimately threaten the survival of the enterprise. A good understanding of the proper hardware of governance is vital.

Part II. Software: Effective Collaborative Processes and the Need to Manage Self

This part begins by building proper awareness of the many biases prevailing among governance actors and of the need to understand how these biases affect decision making at individual and group level. Our proposition is that good software is central to decision making in such a context, which is the essence of what boards do.

This chapter shows how good governance software supports and drives proper collaboration between the various actors and organizational units involved in decision making. Board decision making is complex because several groups or individuals (which metaphorically can be regarded as the software modules) must interact synergistically. The use of good protocols and processes (the software macros) is vital to produce good decisions by our three boards, and for the successful implementation of these decisions. Individual and group biases are akin to programming errors in IT software, leading to errors when the corresponding software is invoked. The prevalence of such biases must not be ignored; unfortunately, many of these biases arise unconsciously. Only through an open, collective, and confrontational treatment can these biases be addressed. This is where **F**air **P**rocess **L**eadership (**FPL**) proves invaluable. It is a powerful antidote, if correctly applied, for the ever-prevalent biases that cloud organizational and corporate decision making and action.

The chapter lays out the benefits obtained through the proper application of the FPL framework and explains why its effective use indeed counters the many biases that affect the quality of communications and exchanges between corporate governance actors, and organizational actors more broadly. Effective FPL leads to higher board and corporate performance; conversely, FPL violations reduce board and corporate effectiveness. In one form or the other, be it explicit or implicit, FPL is not just an option, or as we have stated before, a necessary foundational tool for value creation. What is also interesting about FPL is that it introduces fairness in the governance and corporate scene, not as the fair share that is so dear to shareholders and stakeholders, but as fair play among them.

We do believe that the critical role of FPL will increasingly become recognized as a foundation for effective corporate governance. The promise that family-owned and family-controlled enterprises hold in this regard is clear to us. FPL must be rooted at the ownership level to durably impact the enterprise going forward, and become an integral and durable part of it. The absence of the ownership anchor is a risk for listed firms, the market on its own showing no clear proclivity for FPL due to its shorter-term focus. Most conflicts affecting family firms can be seen to result from FPL violations.[6]

Chairs and CEOs may not commit to FPL, possibly out of ignorance. But even when committed, our experience shows that the quality of Fair Process changes as the leader changes. The presence of the “L” in the acronym FPL reminds us of this fact, which may cause a disruption in fair process when chairs and CEOs change.

Chapter 10. Delusions, Confusion, and Biases

Individual and group biases corrupt a rational and fact-based approach to governance. This chapter lays out problems that affect CEOs and their executive teams, as well as owners and their Boards of Directors. A lack of awareness of these biases in companies is akin to flying blind or with only a partial view. Understanding these biases is the first necessary step toward building a more accurate view of reality. The second one is effective treatment of the biases.

This chapter also shows that substantial alignment and durable commitment are required for value creation. At the same time, it is now well accepted that heterogeneity is an essential ingredient for effective decision making, including for correctly framing the challenges facing the enterprise, its governance, and its ownership. Heterogeneity is also fundamental for the effective generation of options and for thoroughly exploring the alternatives available. Yet, heterogeneity may also render board work unmanageable. Heterogeneity thus needs to be managed; left unmanaged it may become destructive.

This makes board composition a crucial decision, often paid insufficient attention to by owners and excessively subjected to owners' biases and preferences. We all know how strategies and tactics in sports teams are highly dependent on the selection of players and coaches. The same holds for owners and their boards. Examples are presented to illustrate this key point, and to highlight the ways boards succeed in conquering this challenge, and go astray when they do not.

Chapter 11. Biases in Action and How High-Performance Teams Address Them

Boards are teams, sharing the common goal of value creation and being collectively responsible for the company they supervise. This chapter explores what it takes for teams to become performing, or, on the contrary, how they lose their performance edge. To make the point vividly and grasp it better, this chapter provides a detailed account of a tragedy that occurred on Everest in 1996 that involved three mountaineering teams led by business owners that were running businesses, albeit small ones. The Everest metaphor works well as boards also are small teams, pursuing a challenging and difficult mission, and regularly submitted to major "storms" and turbulence. Getting out of distress often feels like having to conquer Everest. "Going to the top" is an ambition that fuels any group or board aiming for high performance.

The individual and team biases affecting the performance of the two climbing teams are described in detail. The tragic impact of these biases on the effectiveness of two of the teams is explained, making horrific outcomes easier to understand and appraise. These stories will help the reader spot similar issues on their boards, thus preventing their boards from meeting similarly tragic ends.

Ways to combat these biases are explored, repeating the argument that good processes engender and support effective teamwork, and also why. The translation to effective board work is straightforward. Indeed, we have seen that these Everest stories are very engaging for boards we have presented them to, leading them into a fruitful—and sometimes passionate—discussion of their own effectiveness and their ability to avoid crises and catastrophe.

Chapter 12. Fair Process Leadership: The Path to Positive and Collaborative Dynamics for Owners and Their Directors

Fair Process Leadership (FPL) is an integrative and inclusive approach to leadership that emphasizes high levels of engagement and transparency with stakeholders, as well as objective evaluation of both outcomes and process, driven by an unabating commitment to continuously improving the leadership process. FPL confronts human biases head-on and leads to more effective decision making.

Here we explain FPL as a dynamic framework consisting of a cycle of five stages, identified as Engaging, Exploring, Explaining, Executing, and Evaluating. The disciplined and thorough application of this cycle results in critical voices being heard and addressed, and value creating actions being taken and implemented with strong commitment. Our experience is that the cycle is often not followed in a disciplined way, or when it is followed, it is done so too superficially and with insufficient thoroughness.

A historical example, that of Napoleon Bonaparte and the French Empire that resulted from his forceful actions after the French Revolution, is a strong example of the power of FPL. Details on this period of France history when its power and impact on the world stage were unequaled are provided in Appendix B as not all readers may wish to know the specifics of this mythical leadership figure, who starts out as an executive, then becomes CEO and later Chairman, and eventually owner. The example is interesting for it illustrates the power of FPL in the rise of Bonaparte, the young military officer, who perfectly executes the missions that he is given. But FPL is also useful to pinpoint the enormous destructive power unleashed by the multiple FPL violations that emerged when the general took on his imperial clothes. Having become the nearly sole "owner" of the French Empire, and having transformed it into a family business, Napoleon, the Emperor, destroyed most of what he had contributed to during his ascent to power. Beyond its historical significance, the example attests to the immense destructive powers of ownership when FPL norms are violated.

Chapter 13. Fair Process Leadership Illustrated: Applications to Owners, Board Members, and Executives

This chapter deepens our FPL discourse in the world of owners, board members, and managers. We examine the story of Carlos Ghosn, which in many ways is a modern-day replica of the Napoleonic story. Both Napoleon and Ghosn are uniquely talented leaders, who both had plenty of victories to celebrate in the ascending part of their reign and created empires, Ghosn's consisting of two companies, Nissan and Renault, committing to a formidable alliance challenging large rivals such as Toyota, GM, and VW.

But their ownership was ultimately neither wise nor fair. The ends of these two remarkable leaders are similar: both men end up in prison, on a distant island, Longwood House for Napoleon, a Japanese prison then a Lebanese one for Carlos Ghosn. Both were betrayed by some of their closest associates. Both acted—at least psychologically—as if they were the owners of the organizations they led. Their boards did not stop their destructive behaviors. Their stories illustrate vividly the immensely negative impacts repeated and prolonged violations of FPL have on individuals, leadership teams, boards, organizations, and their multiple stakeholders. As one corollary, these stories also plead for a clear separation of chair and CEO roles.

Part III Humanware: Owners as Leaders and Value Creators

The third leg of our governance tripod is denoted **Humanware.** It connotes the intrinsic and pervasive human dimensions of ownership, governance, and value creation. People come to ownership and boards with their character and personality, shaped by their histories and memories, with their myths and ideologies, anxieties and dreams.

This makes governance an intricate and profoundly human affair. Hardware and software are ultimately activated and deployed by people. We all know from experience that humanware must be compatible with hardware and software for computers and smart phones to be of value to users. When this is the case, value creation results, with a much greater likelihood of sustainability. What is true for computers and smart phones also holds for ownership.

We also know that humanware often interferes with the proper or intended functioning of hardware and software. We close this book by addressing the human facets of ownership and governance. We do this through sharing a set of profiles that show us how, in the end, humanware is critical to driving outcomes. This of course is the case in management and government as well. Good if not great humanware is thus the third part of the governance tripod on which ownership effectiveness rests.

Chapter 14. Profiles in Ownership

Thorough interviews with owners conducted during the writing of this book we present the diversity of ownership types and describe the many challenges founders and owners face when their businesses grow. A principal challenge is the need for founders to manage their own transitions, first becoming effective business leaders, then transitioning again to become effective governors and owners of their businesses.

The profiles show that ownership is a journey, with bright as well as dark days, regularly facing storms of various levels of severity. For all, it consists of repeated journeys, with plenty of learning along the road traveled. Indeed, what we have observed is that successful owners are fantastic learners. They pick up many tools and insights and are not deterred by failure, which often fills them with renewed energies for the next journey. This is one of the lessons of the book: ownership rests both on personal talents and motivations, but also on learning many lessons, including from other owners. There lies one of the advantages of a family business, where ownership examples and experiences—including negative and challenging ones - are at hand for the next generation from an early age.

Chapter 15. Transitioning to Ownership and Developing as Owner

We use the profiles in Chap. 14 to glean key lessons for founders and owners. We illustrate how successful founders are driven by a mission, which they transmit to their enterprise. With time, founders having been CEOs and Chairs return to being "just" owners, where they may continue to support a possibly modified mission of the succeeding generation. This provides them with a final and very meaningful opportunity to continue to provide sense and pride to those involved with the enterprise, even if at that time others carry the torch. At this later stage, ownership effectiveness relies on their ability to inspire and leverage their skills, talents, and energies in others, so that these others can sustain and grow the businesses, like they did in earlier times.

Ownership types are described using a leadership model built around four archetypical leadership types. The profiles from the previous chapter show that it is impossible for one person to have all the talents required for a given venture or enterprise. Missing talents must be compensated by owners acquiring and developing competences, which, however, will not be a complete match for the missing talents. Hence, they must rely on trusted advisors and allies endowed with those talents. Acquiring at least minimal competencies to beneficially interact with these talented advisors then allows a fruitful collaboration. In any case, our view is that business and ownership in the digital age call for greater doses of collaboration, solo players—like solo climbers on Everest—ending up astray, lost on merciless mountains. Value creation is unquestionably a collaborative act.

Chapter 16. Ownership in the Twenty-First Century: Closing Thoughts

The world keeps changing. Businesses are in transition. It is commonly though that the post-COVID world will differ from the world we knew when we entered the global pandemic. Just like the 2007–08 financial crisis forever changed governance, and had major impacts on ownership, it is likely that COVID-19 will leave its trace as well.

Hopefully, the global COVID crisis will help convince boards that they need to prepare for the greatest challenge of this century, which concerns the survival of our planet. Climate change will accentuate the tensions on ownership, including more charged confrontations with the weather and with multiple stakeholders. In this context, we discuss ESG and Sustainability using the models and frameworks presented earlier in the book, further illustrating their relevance.

Looking to the future, we venture to state that companies with clearly defined ownership should be better able to look toward and prepare for the future as compared with publicly listed firms. If they equip themselves with the proper hardware, software, and humanware, as this book argues.

Concretely, and as a final summary, the Appendix defines ten challenges that owners and their boards need to address. We might call them the ten invariants defining effective governance and board work. The list will hopefully be seen as a useful final checklist for owners and board members eager to take specific steps toward achieving greater effectiveness, sustaining their ambition of excellence in meeting the increasing responsibilities with which life on this planet is confronting all of us.

Notes

1. *Anna Karenina* by Leo Tolstoy, Penguin Classics, Penguin; UK ed. edition (30 January 2003).
2. Most of the models in the book have a multiplicative property and are non-compensating: failure to verify one dimension cannot be compensated by the other dimensions.
3. *Poor Charlie's Almanack: The Wit and Wisdom of Charles T. Munger*, by Charles T. Munger, Walsworth Publishing Company; Expanded Third edition (2005).
4. We will use the term mission in this book, which we find more precise and directional than purpose.
5. One now classical treatment is the book *Build, Borrow or Buy,* by L. Capron and W. Mitchell, Harvard Business School Press (2012).
6. Ludo Van der Heyden, Christine Blondel, and Randel S. Carlock, "Striving for Justice in Family Business," *Family Business Review* (March 2005).

Acknowledgments

We gratefully acknowledge our families, for their unwavering support during the endless hours invested in writing this book. We hope they might find some value in reading this book, as many of the ideas are readily applicable to a value-creating family.

We also acknowledge INSEAD. It is a wonderful place to offer educational courses to a multi-national audience. It also allows and encourages the academic entrepreneurship it takes to design and keep offering the course whose content this book summarizes.

The participants of our *Value Creation for Owners and Directors* were invaluable. Their encouragements, contributions, and insights led us on the journey of writing this book.

Finally, we are most grateful to Liz Barlow, the Head of Scholarly Publishing at Palgrave, and her excellent team—Lauren Dooley, Ulrike Stricker-Komba and Antony Sami—for welcoming, guiding, and supporting us throughout the writing.

Contents