The Case for Two-Board Governance

By Ludo Van der Heyden , INSEAD

As private shareholdings grow, is it time to consider a separate "shareholders" or "owners" board to give corporate boards and directors the space and the framing to do their jobs effectively?

The life of private businesses rarely runs smoothly, but as issues and ownership structures become increasingly complex, executives and boards find themselves under increasing pressure to respond to and find consensus amongst diverging interests.

Over and over, cases of strong value creation – Warren Buffett in Omaha, Nebraska; the Desmarais in Canada; the AB InBev owners in Belgium and Brazil; or the Mittal family in India – correspond to owners having a clear and strong longer-term vision for the firm they "owned".   Their boards of directors – made up of shareholder nominees and independents - is then firstly responsible for setting their company's medium-term vision. If the firms' owners can't agree on long-term goals, boards and management can't do their work – due to a lack of goal congruence – and the business is bound to suffer.

Whether it’s a family business moving into the third or fourth generation; a state owned enterprise run by two or more ministries; or – even more complicated - a joint venture formed between partners with evolving ideas about the shared company’s future; when owners disagree the board of directors typically find themselves the “squeezed” meat in an increasingly unpalatable sandwich.

Sometimes tiffs between owners can be solved amicably through a particularly benevolent and competent board member, but at many other times they turn into out and out rows. Either way, like parents discussing a child’s future, no good can come from making decisions or settling disputes in front of the child.

‘We want owners to commit to a long-term vision – and then trust us to do the work’

An executive’s job can be stressful enough without having to please opposing masters – which is an impossibility anyway. At a recent INSEAD Governance Meeting in Abu Dhabi on ‘Value Creation and Growth in Private Businesses’, held in preparation for the development of an open enrolment executive programme, owners and executives agreed that one of the biggest challenges ahead was navigating the rocky road paved by multiple shareholders with differing visions for the company’s future.

The message was clear. Executives want a long–term picture from the owners. “We don’t want owners to interfere with short-term decisions, we want owners to commit to where they want the company to be five or ten years from now. We don’t mind pressure but what really works negatively, for both the owners and [board] executives alike, are sudden unannounced or unanticipated and unreasonable pressures, or sudden changes in direction that destroy a lot of work that went into preparing and following another direction.”

Owners who were present at the meeting basically agreed, admitting, “It’s true we don’t have enough discussion about our own strategies and how we implement those strategies, possibly because we don’t have enough discussions on where we wish to go. And the former can be a mess without a clear structuring on long-term vision, and some basic parameters that frame the box within which we can debate various strategic options.”

Firms with two or three major owners – or even more of them - should have a place to discuss long-term mission and basic terms about how to get there. This so-called “owners board” is also the place where things like ownership agreements and strategies, dividend pay-outs, succession plans, and new partners are discussed. A private place where owners can debate openly, without management and board members necessarily hearing all the ins and outs – many of them not being relevant to the business - and reach an agreement that they can then present to the board of directors and the management, with a united front.

A Family Shareholders Board, distinct from Family Councils

Some firms have started working in this direction, setting up committees or boards comprising the major family shareholders (or groups thereof). Such a board is separate from the board of directors, and helps the company, overseen by its board of directors, to pursue the chosen long-term strategy. One of the essential decisions is to nominate shareholder representatives to the corporate board. Another is to discuss investment strategy: shall we continue to invest, shall we ally with other investment partners, shall we sell? These decisions are truly owner decisions, and provide the “frame” within which corporate boards fulfill their mandate. Of course, there will be members that are on both, for reasons of transparency (hence trust building and control) and coordination. Such a formalised and more structured board made up of owners, or their representatives, and some close advisors are necessary to discuss complex issues of further investment or, alternatively, divestment – these owner boards truly take the owner’s perspective, whereas the corporate boards are typically obliged to take the organisation’s perspective. Clearly, these two bodies are complementary, and their respective roles well defined so everyone understands what their responsibilities are, and where their interests lie for the company, and the investors respectively.

In companies where there is no family council these decisions are often made at the board of directors level. This is not the correct place, nor are directors appointed for that. There’s a fine line between company problems and ownership problems and business strategies differ from ownership strategies.

At the same time, an owners board is distinct from a family council, whose function is to contribute to the governance of the family. Family members appointed to the family council are appointed for their family wisdom and respectability, not necessarily for their investment IQ. Family councils contribute to the harmony of the family, owners boards contribute to the harmony of the investments.

Complementary roles in a sort of Russian Doll construction

It's the job of directors to provide a short to medium-term vision, to hire a competent executive team and to formulate and oversee the long-term vision of the firm.

It is the owners' role to set out a steady, long-term vision – identify where they want the firm to be in the next 10-15 years - and ensure they maintain a set of shared values. This role may include setting policies that balance family and business and guide important business decisions such as those mentioned above. They should put these ideas to the board and then step aside and let the board and executive team carry out the mission.

The two boards have to be complementary – and in a family business, the family council will be a third board to work with, along with the corporate and owners' boards - they have to work together with the chairman of each forming the "threesome team at the top" of the family business.

Think of the biggest owner today, Warren Buffett. He has a strategy. He knows why he's investing in Goldman Sachs but he doesn't tell the Goldman Sachs executives what to do, he doesn't even have a seat on the board of directors. In this case Warren Buffett is the owner board. His close advisors in Omaha form his owners' board.

To work efficiently, an owners' board should in normal conditions meet two or three times a year and ensure that all members are on track and are evolving in a common direction. It should be somewhere separate such as a weekend retreat. Or, depending on conditions, on the sites of one of the assets it has invested in. What is sure is that it's impossible to assess and reach agreement on many of these issues in a quick discussion over lunch.

Right now many family companies are undergoing a seismic shift. They are moving away from the business they know and branching out into new industries. As this happens and as economies and large companies develop, it is increasingly important for owners to display investment competences. The need for two separate boards responsible for two separate interests – corporate and owners – becomes increasingly crucial. It is out of that healthy tension that wisdom and commitment will emerge.

Find article at

https://knowledge.insead.edu/leadership-organisations/case-two-board-governance

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