# 3. Testing Shareholder Homogeneity

## 3.1 Methodology

### 3.1.1 Research Design

This research maintains that in order to justify an organisation's existence and its owners' investment, corporate goals must be aligned with owner goals. To establish such an alignment, boards and management must understand what their owners want, i.e. what are their real and quantifiable objectives, not just some well-meaning generic set of outcomes. These quantified objectives form the basis for moulding the corporation's vision and its specific corporate goals, strategies and actions. This is radically different from existing practices which largely rely on the interpretations of management and directors to shape a corporation's destiny and outcomes.

The research argues that shareholders have varying objectives, and such varying objectives drive their behaviour. The research is intended to provide statistical support for the contention that shareholders' objectives vary.

### 3.1.2 Data Collection Techniques

Any discussion with institutional investors will confirm that their investment strategies involve both portfolio and risk management techniques. They vary their exposure to any investment based largely on their own interpretation of need, circumstance, opportunity and requirements related to value, benefit, growth and risk issues.

Although most business people will acknowledge this, it is difficult to establish quantified objectives from corporate shareholders in order to undertake reliable cross organisational analyses based on such objectives. Adoption of the postulated research in this study would actually see such information being made available. Accordingly, it has been necessary to establish a suitable proxy for such objectives.

This study uses the concentration of ownership (percentage ownership by the Top-20 shareholders) in the sample corporations as a proxy for their behaviour, and this represents the dependent variable in this study. The hypothesis is that Top-20 shareholders will act in a way that helps them satisfy their objectives in response to a range of stimuli - the independent variables.

It is because large shareholders have the potential to be different from the entire shareholder body in terms of objectives and behaviour, that they enable us to examine shareholder behaviour for the remaining shareholder community. Where Top-20 shareholders divest their shareholding, the degree of concentration will change according to whom they sell to or buy from. Where a Top-20 shareholder divests to another Top-20 shareholder in the same corporation, then the degree of concentration will remain unaltered. However, where a Top-20 shareholder sells to a non-Top-20 shareholder, then the degree of concentration will alter. Assuming the market is not in free fall, when someone sells shares, then someone else will buy them. The mere fact that a buyer and seller can agree in the same transaction illustrates the reality that some see value when the other does not.

The reason that concentration acts as an effective proxy is because the only way the level of concentration can change is for one category of shareholder to buy what another category of shareholder is selling. In this case, the categories are Top-20 shareholders and non-Top-20 shareholders. The transaction is evidence of different motivations in two types of shareholder in the same corporation.

The independent variables examined were:

- dividend paid per share expressed in dollars;
- debt/equity ratio expressed as a percentage;
- market capitalisation expressed in dollars;
- earnings on shareholders' funds expressed in dollars;
- dividend yield expressed as a percentage;
- net tangible assets per share expressed in dollars; and
- earnings per share expressed in dollars.

It is postulated that the relationship between these independent variables and the degree of stock held by the Top-20 shareholders of each of the sample corporations will vary between those sample corporations in both the pattern of the relationship and closeness between the dependent and independent variables. Was one to argue that all shareholders had common or the same objectives, then no variation between behaviour in Top-20 shareholders (and by implication non-Top-20 shareholders), would be identified between the sample institutions examined. Variation in Top-20 concentration between institutions in response to the independent variables suggests differing behaviour between Top-20 shareholders and non-Top-20 shareholders, and therefore differing objectives.

Multiple regression analysis will be used to establish the pattern of the existing relationship while correlation analysis will be used to determine closeness of the relationship.

### 3.1.3 Categories of Information Collected

Data was collected from published Stock Exchange Financial & Profitability Studies in the Stock Exchange Journal for the period 1983 to 1993 inclusive.

Data was collected for dividend paid, debt/equity ratio, market capitalisation, dividend yield, earnings on shareholders' funds, net tangible assets per share and earnings per share. Stock holding was determined at year end as published in the corporations' annual reports. The percentage shareholding was calculated as the total shares and options sold in the period as a percentage of fully paid shares and options of all share and option categories for the period.

It was decided to select a sample based on the banking industry, regarded as homogeneous by some banking industry players. It was felt that identification of shareholder differences within a homogeneous sector would provide stronger support for the research than such differences found in heterogeneous sectors. The banks chosen for examination were the National Bank, Westpac Banking Corporations, the ANZ Banking Corporation, Advance Bank and the Bank of Melbourne.

## 3.2 Limitations of the Approach

### 3.2.1 Lag Effects

The research method did not attempt to estimate or account for any lag effects between the dependent and independent variables, although it is acknowledged that intuition would suggest they exist. The non-consideration of lags is argued on the basis that the five banks under study would probably be impacted in a similar manner by a lag effect. Therefore it is likely that given the same definition of data from the same source over the same time period, the impact of the lag effect on the data would be minimised.

Further research may determine the existence of a lag effect for one or more of the companies in question. Should this be found at some future date, then this will only reinforce the contention that different shareholders behave in different ways. If for example, the lag in a certain bank is caused by the shareholders in that bank waiting longer to act or react to a stimulus, then the motivation to wait may be caused by a desire for higher return or greater desire/preparedness to accept risk, etc. This reinforces the differences between those waiting compared to those not waiting to react.

#### 3.2.2 Use of Proxy Measures

The research is certainly limited by the use of proxy measures rather than the raw measure intended. This is difficult in the context of this hypothetico-deductive approach as the collection of quantified shareholder objective data is the practical outcome from the adopted hypothesis postulated in this part of the research.

The technique of quantifying owner objectives has already been applied in some existing organisations. Unfortunately, these organisations represent a diverse range of industries and sectors. Comparisons between them would, in all likelihood, be proven to be spurious due to a wide range of impacting influences relating to the period of data collection and influences (economic and other) related to different periods, diversity of types of objectives, character of ownership, etc.

Currently an insufficient critical mass of publicly accessible raw data exists to allow for meaningful analysis using non-proxied data. However, should the implications and findings from this research stimulate sufficient companies to commence quantifying shareholder objectives, and making such data accessible, then in time it will be possible to replicate the analysis with more closely linked data instead of with proxies.

### 3.2.3 Period of analysis

The eleven year period examined spans a very severe recession in Australia. It was felt that the major economic factors impacting shareholders over this period would impact the sample companies and their shareholders in largely the same way and therefore the data period was not of great concern.

A criticism can be made however, that the reaction by company shareholders within the sample might differ from the 'normal' reaction due to the circumstances of the period which would skew or bias the data. The response to this is that if individual shareholders reacted differently to the recessionary stimulus compared to their 'normal' behaviour, as they do to a range of other stimuli, then this reinforced the hypothesis that they would so behave.

Irrespective of the period of study, for the hypothesis to be invalidated it would be necessary to have a finding where the behaviour of the top 20 shareholders of all five Banks was identical. In other words, where correlations and regression outcomes were the same, or where differences could be accounted for by chance.

The recessionary period would certainly account for the strength or weakness of some of the values of correlations found. The issue is not of the strength of the correlation between dependent and independent variable, but whether they differ by an amount greater than that attributable to chance.

### 3.2.4 Year End Shareholding

The percentage shareholding of the top 20 shareholders was not available to the researcher progressively throughout the year. Even if it were, it would have been exceedingly difficult to match timing of the shareholding exactly to the independent variables. It was decided to use a procedure common to listed companies: that of declaring the top twenty shareholder percentage within their annual reports at year's end. The rise and fall of the percentage owned by the top 20 shareholders was used to correlate and regress against the ratios of the preceding year.

This has two effects. Firstly it would ignore the impact of often significant shareholding changes mid-term.

Secondly, since the Top-twenty shareholding occurs after the publication of the independent variable information, it may imply a causal relationship between publication of the independent variable information and shareholding. This implication of causality is not intended since the hypothesis does not rely on *why* shareholders behave differently, but *that* shareholders behave differently.

Issues of causality are fruitful areas of examination for later research.

### 3.2.5 Ignores trends and cycles within the time period

Since the data spanned a severe recession, it might be reasonably argued that were the analysis to be undertaken in two five-year periods instead of just one period, then the strength of the relationships would be different. That is, the relationship between the dependent and independent variables going in to a recession might/would be different to the relationship coming out of recession.

This is probably a reasonable argument. However, an analysis of two five year periods or five two-year periods, or any other combination, would certainly yield different relationship values, but as discussed earlier, the existence of different values for each bank in the sample for the relationship between independent and dependent variables is the issue, and not the size of the values.

### 3.2.6 New Share Issues

New shares issues (or buy backs) during any one year under examination were not factored into the analysis. The amended share totals were recognised at the end of each period. This is a limitation of the data because the purchase of newly issued shares does come with the on-market counter-behaviour of sale of shares by existing shareholders.

### 3.2.7 Share Movement Data

Monthly published sales of shares and options were totalled and averaged for the year for each bank.

### 3.2.8 Part Periods

Data for the Advance Bank was only available for the period from 1985 while the Bank of Melbourne data was only available from 1990.

### 3.2.9 Sample Size

A key limitation of the data is the relatively small sample size of 11 years. Data beyond this period was difficult to obtain due largely to the restructuring of the banking industry prior to this period and the inability to compare like-with-like.

### 3.2.10 Multiple Regression analysis

Multiple regression analyses were undertaken on the data with the top 20 shareholding as the independent variables.

*Table 1* represents a summary of the findings. It shows that different combinations of variables appear to be significant in each bank, possibly reinforcing the suggestion that each bank is quite idiosyncratic and that one is unable to make global assumptions about key drivers of shareholder behaviour for all banks.

Based on the $R^2$, there appears to be an exceptionally strong relationship between top 20 shareholding and the accumulated effect of the independent variables. Although it must be noted that small data sets will give this result.

Unfortunately, the multiple regression analysis fails to satisfy a number of key criteria associated with the use of the multiple regression technique – notably there are severe problems of multicollinearity and autocorrelation. The sample size is too small to pursue this analysis.

*Table 1: Multiple Regression Analysis of top 20 Shareholding on Nominated Variables by Bank*

| ***Variable*** | **NAB** | **ANZ** | **Westpac** |
|---|---|---|---|
| Multiple R | 0.94740 | 0.98858 | 0.96527 |
| R square | 0.89757 | 0.97730 | 0.93174 |
| Adjusted R square | 0.65858 | 0.92432 | 0.77247 |
| Standard Error | 1.70682 | 1.35231 | 3.11434 |
| Degrees of Freedom | 7 | 7 | 7 |
| Sum of Squares | 76.58721 | 236.1610 | 397.1871 |
| Mean Square | 10.94103 | 33.73729 | 56.74102 |
| Residual | 3 | 3 | 3 |
| Sum of Squares | 8.73975 | 5.48624 | 29.09728 |
| Mean Square | 2.91325 | 1.82875 | 9.69909 |
| F | 3.75561 | 18.44830 | 5.85014 |
| Signif F | 0.1522 | 0.0180 | 0.0873 |

## 3.3 Results & Conclusion

The correlations in Table 2 between the top 20 shareholding and the nominated variables were calculated as follows:

*Table 2: Correlations between Top 20 Shareholding and Independent Variables*

| *Variable* | NAB | ANZ | Westpac | Melb. | Advance |
|---|---|---|---|---|---|
| Dividend | 0.4126 | -0.8558 | -0.4369 | -0.6631 | -0.9122 |
| Debt/equity ratio | -0.5853 | 0.6218 | -0.4453 | -0.8583 | -0.6170 |
| Market capitalisation | 0.4333 | 0.5087 | 0.7955 | -0.2472 | -0.9851 |
| Earnings on s./funds | -0.3267 | -0.8957 | -0.4790 | -0.9051 | -0.8941 |
| Dividend yield | -0.0293 | -0.2435 | -0.7154 | 0.7365 | 0.7615 |
| Net tangible assets/share | 0.8091 | -0.3140 | -0.2182 | 0.0603 | 0.2420 |
| Earnings per share | 0.4480 | -0.2123 | -0.4469 | -0.8658 | -0.9245 |

Based on the above, there appears to be support for the contention that the top 20 shareholdings in the sample companies correlate differently with the variables nominated. Due to the small sample size, particularly in the two smaller banks (Melbourne and Advance with only four years data) it is necessary to apply significance test criteria.

*Table 3* identifies the correlations significant at the 10 percent confidence level:

*Table 3: Correlations between Top 20 Shareholding and Independent Variables Significant at the 10% Confidence Level*

| *Variable* | NAB | ANZ | Westpac | Melb. | Advance |
|---|---|---|---|---|---|
| Dividend | | -0.8558 | | | -0.9122 |
| Debt/equity ratio | -0.5853 | 0.6218 | | | |
| Market capitalisation | | | 0.7955 | | -0.9851 |
| Earnings on s./funds | | -0.8957 | | -0.9051 | |
| Dividend yield | | | -0.7154 | | |
| Net tangible assets/share | 0.8091 | | | | |
| Earnings per share | | | | | -0.9245 |

At the 10 percent confidence level we have stronger support for the contention that Top-20 shareholding correlates differently with different stimuli. Although the Top-20 shareholdings in the

ANZ and Advance Banks have strong negative correlations with Dividends per share, they differ in terms of their strength.

Debt/equity correlates positively with top 20 shareholding in the ANZ while it correlates negatively for the NAB, strongly suggesting that Top-20 shareholder motivation and behaviour is markedly different in the two banks.

The same opposite correlations was found for the response to Market Capitalisation where it correlated strongly positive for Westpac while for the Advance Bank it correlated strongly negative. It would be reasonable to again suggest that Top-20 shareholder motivation and behaviour are different in the two banks.

Earnings on Shareholders' Funds appear to correlate strongly negative for both the ANZ and the Bank of Melbourne. Other variables appear to significantly correlate for one bank and not another, suggesting that what is a stimulus for one group of shareholders may not be a stimulus (objective?) for another, thus tentatively supporting the principal contention of this paper. Similarly the same shareholders may have differing reactions to the same stimuli from different banks, thus also supporting the principal contention of the paper.

*Table 4* identifies those correlations that are significant at the more stringent 5 percent confidence level.

*Table 4: Correlations between Top 20 Shareholding and Independent Variables Significant at the 5% Confidence Level*

| *Variable* | NAB | ANZ | Westpac | Melb. | Advance |
|---|---|---|---|---|---|
| Dividend | | -0.8558 | | | |
| Debt/equity ratio | | 0.6218 | | | |
| Market capitalisation | | | 0.7955 | | -0.9851 |
| Earnings on s./funds | | -0.8957 | | | |
| Dividend yield | | | -0.7154 | | |
| Net tangible assets/share | 0.8091 | | | | |
| Earnings per share | | | | | |

Although at this level of confidence, some of the earlier relationships are lost, it seems reasonably clear from the more stringent test that the following can be suggested:

- That the Top-20 shareholders of the Westpac and Advance Banks have significantly different reactions to the independent variable of Market Capitalisation. These two correlations strongly support the contention that the shareholders in general and top 20 shareholders in particular, at least in these two banks, have different responses to the same stimulus.

- That the top 20 shareholders of banks in the sample appear to react differently to differing stimuli. Changes in the NAB Top-20 shareholding, for example, correlate strongly and positively with changes in Net Tangible Assets. Changes in the ANZ Top-20 shareholding on the other hand, correlate strongly with changes in Dividend, Debt/Equity Ratio and Earnings on Shareholders Funds. Changes in the Westpac Top-20 shareholding correlate strongly with changes in Market Capitalisation and Dividend Yield.

The significant correlations found in this analysis provide encouragement for a more comprehensive research study based on more comprehensive data than those used here.

# 4. An Alternate Model of Owner and Corporate Congruence

People who run organisations often assert that organisations are only after profit, asset growth or dividends. Similarly, many business leaders cite contemporary managerial themes - such as quality improvement, customer satisfaction, process re-engineering, team building, quality circles, sustainable competitive advantage, world's best practice and benchmarking, among many other topical managerial fads - as the drivers of organisational performance (LEK 1997.).

These themes appear in the mission statements of many of the world's major corporations. 'We will become the biggest', or the 'best', or have the 'largest market share', or 'we adopt TQM principles', or 'we are here to maximise customer satisfaction', and so on. These are all admirable pursuits, but only when they are in context, and then only when they are seen as enablers to achievement rather than the purpose for striving.

In other words, they are the tools used to get to where you want to go. It is difficult to identify owners who invest in a corporation because it is, for example, customer-focused. Rather, the owner invests because of the benefit that the organisation's customer focus delivers. Even ethical investments, rather than being a tool are an outcome and are desired for that outcome.

It is a truism that not all organisations are alike; they have different needs and aspirations and similarly, the expectations of their owners are also different. Therefore management has strategic and operational choices (Rumelt 1991, 6), and the adoption of any given management theme or tool-set is not equally appropriate for all organisations.

The key dilemma facing owners and managers is when strategies and objectives chosen by management conflict directly with owner objectives. When management chooses to adopt TQM, for example, it usually does so at a considerable cost. If owners have specific short-term optimal dividend objectives, then the investment in TQM, as legitimate as it may be to the longer-term benefit of the organisation, is clearly to the short-term disadvantage of the owners. What is the correct path? Satisfy the owners at the expense of the longer-term health of the corporation, or satisfy the organisation's needs at the expense of owner objectives? What therefore becomes the corporation's mission and its key corporate goals for which it strives, who determines it and how is it determined? According to Rumelt, et al. (1991, 6), it is these types of decisions around such choices that have a critical influence on the success or failure of the enterprise.

To reconcile this dilemma, it is helpful to deal with the issues of causality in organisations. What within an organisation causes other things to happen and where does this chain of events start?

What is the principal stimulus for the decision to re-engineer a major process in an organisation? Is it the desire or need to establish or maintain competitive advantage? Is it a need for lower costs? Is it a need to be more competitive? Is it the need to lower costs in order for management's performance criteria to be satisfied despite the non-alignment of performance criteria and shareholder objectives? Where does the organisation get its bearings from?

Many would argue that these decisions are based on being able to fulfil the organisation's objectives. Indeed all corporate behaviour should be rationalised by a desire to fulfil corporate objectives. In practice, however, there are many examples of business decisions made in spite of, and in conflict with, corporate objectives.

A recent client of the author is a case in point. A major well known membership-based mutual corporation which has existed for most of this century asked to workshop its vision, mission and strategies in order to ratify its strategic agenda for the ensuing year. The first question asked of the 40 or so senior executives was 'what specifically do your owners want you to deliver for them?'. Their responses were evenly split between the delivery of service and the maximisation of profit. In the context of this organisation, these two objectives were not complimentary. To a large extent this explained the organisation's decision-making paralysis.

They were then asked who their owners were. The responses were evenly split between two categories of 'owners'. Each type of owner had a very distinct set of objectives and each of these objectives fundamentally impacted on the organisation's operational and investment strategies. The objectives of each category of owner competed with the other rather than complementing it. The organisation had great difficulty in developing strategies and product policies since it was caught in the dilemma, in this instance, between service and profit. Management couldn't define the outcomes that they were being held accountable for because they couldn't identify who owned them and what those owners wanted. The logical outcome of the session was a clear recognition that no strategy (with its resource, technology and distribution implications) could be resolved until the ownership and the owners' objectives could be resolved.

Another example involved a new CEO appointment to a major half billion dollar per year revenue Australian corporation. In discussions with the new appointee, he was asked whether in interviews with his parent organisation he was advised of the key outcomes he was expected to deliver. He said 'no, no one had mentioned any.' He was then asked how he would be able to decide on the scope and degree of change that he was expected to bring about if he had not been told the outcomes expected. 'I don't know' was his response.

Similarly, many other organisations have based their corporate planning on existing structures, as givens, because it was 'always done that way' or because of internal political expediency. When the structure pre-empts all else, objectives are distorted and optimal results rarely achieved. Structure is a means by which organisations can mould their people, reporting and communications strategies and organisational form in order to enable a desired outcome. Structure is not sacrosanct nor is it fixed and unchangeable. As we shall see later, structure should also never be the first place an organisation starts its planning activity.

Ultimately, an organisation's bearings and orientation must start somewhere. Many under-optimised organisations derive their corporate objectives from their mission and vision statements. That is, the objectives are constructed and determined in order to enable the vision and mission to be fulfilled. The problem with this is that it is management who inevitably define both vision and mission, thereby determining corporate strivings, decisions and directions. Here the relationship starts with managers defining direction and then determining the outcomes needed to satisfy that direction. Where do owner objectives fit in?

In interviews with a number of Australian corporate 'Top-100' chairmen, board members and CEOs, it was common to hear them state that they knew what shareholders wanted and they were the best placed to determine what was 'good for the shareholders'.

Almost in the same breath, they admit that the scope of their detailed knowledge of shareholder requirements was limited to the top 15 to 25 institutional shareholders, together with close relationships with analysts and brokers. And yet the 'knowledge' they did have from these sources was not quantified in any consistent or rigorous manner. They knew next to nothing about their own small investor objectives apart from the assumptions drawn from generic shareholder surveys. What was probably more concerning however, was their insistence that such knowledge was of no value to them.

These senior corporate executives also consistently confirmed their belief that 'all shareholders want the same things: dividends and growth'. The research undertaken in this study supports the view that these executives were misguided in such assumptions. However, and more importantly, such erroneous assumptions form the foundation of the assumptions made by these executives as to what their organisations will delivery and form the principles underpinning all strategies, plans, investments and resources decisions.

The alternate and preferred relationship dictates that satisfaction of owner objectives is the necessary beginning and end of corporate effort, and the vision and mission statements determine how those objectives will be fulfilled within a given environment or context. Here the relationship starts with the owners, who establish the minimum acceptable corporate outcomes (i.e. their objectives), and ends with managers making it happen. The model spelled out below details the separate steps and the decision hierarchy that combine to enable this relationship to guide organisational performance and outcomes.

The writer's experience strongly supports the view that an organisation's initial reason for existence extends outside of the organisation itself, and that it rests with the owners and their reasons for establishing, or investing in the organisation. Owner objectives ultimately are, and should be recognised as, the force which should mould and shape organisations.

## 4.1 Functional interdependence and its relationship to shareholder objectives

Drawing on experience with scores of organisations, their owners, operating environments, cultures, planning systems, performance, internal structures and operating styles, a model has been formulated which helps establish relationships and dependencies in a rational organisation between owners, managers and corporate activity.

1. *The organisation exists to fulfil owner objectives.* The fundamental characteristic of the model is the recognition that the initial stimulus of all organisations is the satisfaction of owner needs. This is argued to be equally true of public and private, large and small organisations.

This research contends that the organisation is established to fulfil the specific goals and objectives set for it. In the public arena, governments on behalf of the people they represent, establish and operate agencies, organisations and corporations to fulfil specific objectives. That some of these objectives are politically driven or non-financial, or not directly wealth generating is irrelevant.

In the private domain, the relationship between owner and shareholder is clearer, notwithstanding the discussion relating to the entity and the property views of ownership. Corporate objectives must reflect owner objectives. This view is fundamental to this model and supports the 'property' perspective against the 'social entity' perspective of the firm.

This raises the question of the role of stakeholders other than owners in this context. It is the writer's experience that no organisation exists to satisfy stakeholders, per se. However, organisations must satisfy stakeholders in order to enable owner objectives to be fulfilled. Stakeholders therefore, are enablers, barriers or neutral to corporate outcomes - but they certainly are not why the organisation exists, despite the protestations of proponents of the 'social entity' perspective.

Yet it is understandable why the advocates of 'social entity' elevate stakeholder wants ahead of, or to the same level as, that of shareholders. It is largely because the stakeholders are the elements with which the corporation must contend on a daily basis and from where many daily challenges and pressures emanate. It is not politically acceptable to tell non-owner stakeholders that they are 'merely' enablers for the achievement of owner objectives. This smacks too much of a Marxist interpretation of the relationship between the parties. It is much easier to state one's concern for the stakeholder/s and promise that the corporation is determined to maximise their objectives. This is easier and less confrontationist than being honest. The irony is that although many organisations give politically correct lip service to the importance of stakeholders, in their performance they have found it exceeding difficult to satisfy all stakeholders simultaneously.

2. The organisation chooses to operate within specific economic, social, cultural, regulatory and economic parameters within which it must be active in order to fulfil its owners' objectives and extract the benefits sought by them.

3. Within this market, the organisation must choose what it will offer (i.e. its products and services) so that a benefit can be extracted from the chosen market in order to satisfy owner objectives.

4. Once an organisation's products and services have been identified, it must choose the methods by which the market will become aware of its offerings and how these offerings will reach their market. These are the classical four 'Ps' of marketing[8]. The market and product/service decisions will open up a number of distribution, support and delivery options. How does the organisation get the products and services into the market while still satisfying core objectives? What channels of distribution, service delivery systems and marketing communication strategies are available and which ones deliver the desired benefit? Answers to these questions are impossible without knowing what outcome is desired. And yet companies frequently resolve the middle level decisions without binding the outcomes to core objectives.

5. Once the market and product mix strategies have been determined, it is then necessary to assess their impact on the organisation's product and service delivery capability, particularly human resources, information technology and financial resources. The higher level decisions will significantly determine decisions on human resources, information technology and processes required to make it happen. A decision to manufacture versus a decision to retail will entail significant differences in Human Resources, Information Technology, organisational structure and process strategies. The higher-level decisions determine the mechanistic needs of the organisation.

6. Only when these tasks have been effectively completed, can an organisation pull together these divergent (and often conflicting) elements and call it a business, corporate or strategic plan. After the higher level decisions have been made, an organisation can develop a holistic financial picture. Only then can an organisation determine whether it will satisfy owner objectives. If after progressing through this planning process, the financial (and other) analyses reveal that the probable benefits do not match desired benefits, then some of the assumptions and decisions made during the process need to be questioned and the plan needs to be reworked.

This model reflects the internal mechanics of organisational and inter-functional dependence. It establishes the relationships between events in the decision-making process and allows planners to ensure an appropriate and logical flow of managerial decision-making. More importantly however, it clearly establishes the pre-eminence of owner objectives as the fundamental first step in determining corporate objectives and vision.

Figure 3 illustrates the logical flow of the key elements within the planning process, which supports the decision-making dependencies implicit in the model. Looking at it, it is easy to see the inappropriateness of, say, organisational or I.T. structures as the principal determinants of an

[8] Product, position, price and promotion

organisation's planning process. Structure and I.T. are determined by what needs to be done and how it is to be done - they are corporate enablers.

Entrepreneurial organisations often provide good examples of how it should work. They have driving ambitions which are realised with the aid of a range of additional enablers. If resources are not available, the entrepreneur finds them through flexible strategies such as franchising, licensing, out-sourcing, sub-contracting, virtual corporations or other initiatives. The effective entrepreneurs are driven by their fundamental objectives, and see the others elements as contributing to that overall outcome, but not replacing it.

Organisations must always be prepared to question the basic fundamentals of what they do and why they do it in order to provide on-going compatibility between what the owners of the corporation want and what the organisation is doing.

For example, computer mainframe manufacturers historically assumed that their organisational structure, culture, size and skill base provided them with the competitive advantage they needed to remain dominant and profitable. For a long time they did. However, changing market conditions caused shareholder benefit to evaporate. Owner dissatisfaction forced a model shift within their corporation which caused them to radically change the corporate icons of size, culture, skill base and structure in order to continue to satisfy their shareholders.

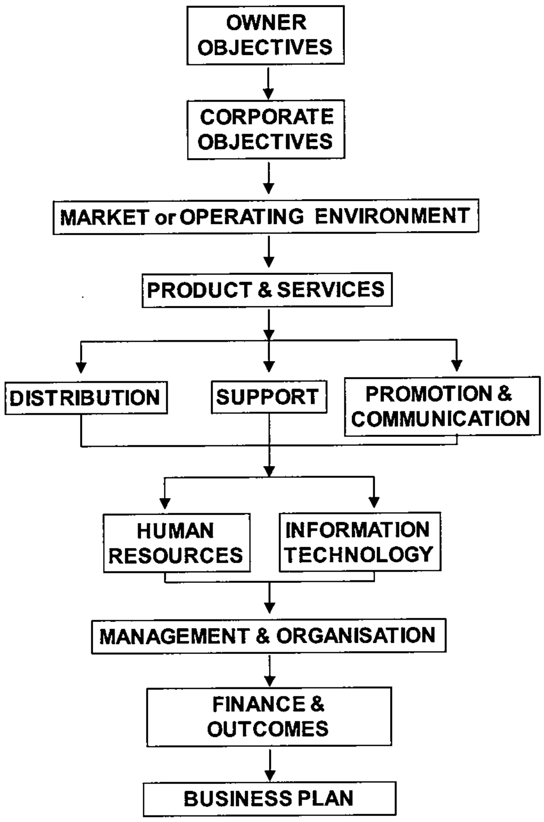


*Figure 3: The Corporation-Shareholder Congruent Planning Model*

Organisations which recognise that they exist solely as an enabler of their owners' aspirations generally remain flexible, dynamic and able to cope with the challenges brought by changing owner expectations - certainly more so than internally legitimised organisations. The reasons for this are three-fold:

Firstly, an organisation which takes its bearing solely from the subjective interpretations of its own people has no, few or blurred yardsticks to measure the suitability of its mission, operations and progress. The drivers of change within an organisation often have the same mindset as those who formulated the structure or culture that needs to be changed. The writer's experience supports the view that successfully undertaking change in such an environment is a very hard thing to do - particularly in large organisations.

Secondly, a radical change needed to an organisation with internalised legitimacy threatens the foundation of the organisation and the way its people and other stakeholders relate to it. Some of this threat comes from the organisation's need to keep refining and redefining itself in order to get its outputs to match its rhetoric. This sees effort directed to moulding corporate activity to be consistent with corporate rhetoric, and diverted from delivering corporate outcomes.

An example of this is the 'quality' movement. Companies determine for themselves that they are or desire to be 'quality' organisations and spend substantial time, money and effort in developing, enhancing and maximising quality. Internal processes, systems and products are refined and sometimes radically changed. When the organisation determines for itself that it is a quality organisation, then these flow-on organisational implications are understandable.

But when an organisation has external legitimacy, it would firstly ask the question 'does quality enhance the achievement of owner objectives?' If it is deemed to do so, then 'what is the least amount of corporate effort that needs to be expended on quality in order to deliver the specified outcomes shareholders want?' Here the focus is on doing just enough to deliver the outcome, rather than on maximisation.

With external legitimacy, it is easier to determine what and how much of a resource is needed to achieve a particular outcome. The writer has found that with internalised organisations, there is much focus on maximisation at the expense of optimisation.

## 4.2 Quantification of Shareholder Objectives

The process of quantifying shareholder objectives enables the organisation to ensure that it is aligned toward the achievement of the shareholders' collective objectives. The metrics that stem from the process relate to owner expectations relating to benefit, value, growth and risk. Quantification of shareholder objectives stems from the current exhortations for shareholders to take the initiative and actions to look after their own best interest. Cameron noted that

> Shareholders cannot simply look to the regulators to take action on their behalf, which is properly action that the shareholders themselves should take...Shareholders must look after their own interests... (Cameron 1995, 7)

Nor is reliance on increasingly stringent governance requirements a solution. Millstein noted that

> Corporate governance is nothing more, nor less, than the system each country, or culture ... develops to balance the need for managerial risk-taking, entrepreneurial energy, and high capability, with the need for some form of monitoring, so that management's direction is aligned with the interests of those who have entrusted their capital to the enterprise,... (Millstein 1995b, 2).

The question that arises from this view is how does the corporation (regulators, analysts, investors, or others) determine when the corporation has 'aligned with the interests' of the shareholders? This research proposes that the corporation asks the shareholder of their objectives, quantifies those objectives for all shareholders of the corporation, and in so doing, establishes a guideline or benchmark against which the corporation and others can assess the success of the corporation's and management's performance.

The concern for performance also extends to institutional investors, but the dilemma still exists. Matheson noted that

> Institutional investors will be continuing to seek closer, continuing relationships with management and boards. Shareholders are interested in performance, and management and boards need to acknowledge the interests and powers of ownership (Matheson 1995, 8).

The close relationships and the shareholder interest in performance referred to by Matheson remain dependent on the subjective interpretation of management unless it is possible to effectively and efficiently establish a reliable and rigorous method of defining what the shareholder interest is (institutional and otherwise). This research contends that such metrication is possible and the principal method by which performance or 'interest' can be determined to have been satisfied.

The purpose of quantifying shareholder objectives is to provide the method by which existing and potential shareholders of corporations can:

- Make more informed investment decisions through the provision of quantified representation of shareholder objectives.
- Make more effective investment choices by identifying and thus enhancing the probability of satisfying each individual investor's objectives.
- Diminish investment risk for investors by matching an investor's personal objectives with those corporations who have investors who share similar objectives. Corporations which adopt shareholder objectives as their mission have a higher chance of satisfying their shareholders than those organisations who regard shareholder objectives as incidental to their activities.

- Provide a reliable and objective method for measuring the performance and competence of a corporation and its CEO in their ability to fulfil shareholder objectives.

The purpose of quantifying shareholder objectives is also to provide the method by which the directors and management of corporations can:

- Identify legitimate, recognised, owner-approved and quantified objectives which form the *raison d'etre* for a corporation's existence and which define its objectives and form the context for its mission, vision, strategies and actions.
- Provide directors with the information against which management and board decisions and actions can be made and against which their outcomes can be assessed.
- Provide directors with the information needed to assess corporate, CEO and management performance.
- Provide clear and unambiguous expectations against which directors and management are held accountable.

## 4.3 Benefits of the Shareholder Congruence Model

The anticipated benefits that will flow from the adoption of the alternate model proposed include:

- Decreased investment risk for shareholders, who will match their individual objectives with the objectives-profile of all shareholders in a corporation.
- More effective corporate governance through the identification of legitimate, recognised, owner-approved and quantified objectives which form the *raison d'etre* for a corporation's existence and which define its objectives and form the context for its mission, vision, strategies and actions.
- Improved evaluation of the efficacy and appropriateness of management and board decisions and actions.
- Better monitoring and assessment of the outcomes of management and board decisions and actions.
- Better assessment of corporate, CEO and management performance.
- Clearer and less ambiguous expectations against which directors and management are held accountable.
- Better matching of shareholder objectives with management objectives and strategies, therefore better meeting of shareholder expectations.
- The ability to communicate and individually report to each shareholder based on that shareholder's personal objectives.

## 4.4 Method for Establishing Shareholder Metrics

A method by which a corporation can quantify shareholder objectives is quite straight- forward. Shareholder objectives can be ascertained primarily through personal interview of the top 50 shareholders and questionnaire to all remaining shareholders.

The key objective of the interview/survey program is to ascertain at what levels of performance will the shareholder be satisfied, seek to purchase more shares, or seek to relinquish ownership. Knowing these quantified objectives for each individual shareholder will enable the organisation to establish a view, based on the shareholder's own responses, of the objectives of their shareholder community. On the basis of these 'shareholder community' objectives, the board and management can formulate policies and strategies that are more responsive and sensitive to the needs and desires of their shareholder constituency.

| | |
|---|---|
| *Benefit* | • *What benefits does the investor seek from the investment?* |
| *Investment Criteria* | • *What importance (ranked) has each of the following for the investor: dividend, asset growth, capitalisation, security, share price, etc.*<br>• *When the investor assesses investments, what criteria does he/she use to make the assessment?*<br>• *Which ratios, if any, does the investor use to assess an acquisition opportunity?*<br>• *Which ratios, if any, does the investor use to assess the performance of the investment?*<br>• *How important are each of these ratios to the investor?*<br>• *If the corporation satisfies the investor's objectives, what, if anything, would motivate the investor to quit the investment or buy more stock? Issues such as environmental and ethical issues could/would be examined here.*<br>• *Against what alternative investment options does the maintenance of equity in this corporation need to compete for the investor?* |
| *For each of Dividend, Asset Growth, Capitalis-ation* | • *How important is dividend to the investor?*<br>• *What dividend would the investor regard as satisfactory?*<br>• *What dividend would the investor regard as poor?*<br>• *What dividend would the investor regard as exceptional?*<br>• *Over what time does the investor want to achieve the desired dividend outcome?*<br>• *What dividend result would motivate the investor to sell his investment?*<br>• *What dividend result would motivate the investor to buy more equity?* |
| *Risk* | • *How important is risk to the investor?*<br>• *Is gearing seen by the investor as a risk element?*<br>• *Is diversification seen as a risk element?*<br>• *Are there other issues that are perceived as risk issues by the investor?*<br>• *For each type of risk, what level of risk would the investor regard as satisfactory?*<br>• *For each type of risk, over what level of risk would the investor regard as excessive?*<br>• *For each type of risk, what risk level would motivate the investor to sell?*<br>• *For each type of risk, what risk level would motivate the investor to buy more equity?* |

*Chart 3: Examples of Questions That Could Be Posed To Shareholders.*

The interview/survey process does not need to determine a shareholder view on corporate strategy or direction, except where environmental or ethical issues are a shareholder objective, since it is the board's and management's role to determine those. The purpose of the interview/survey process is to definitively determine the outcomes that the organisation is being required to deliver to its owners, and not how that outcome is to be achieved.

Chart 3 above is indicative of the types of issues that might be surveyed within the interview and questionnaire process in order to establish and define the shareholders' desired outcomes from the organisation.

## 4.5 Likely Objections and Clarifications

The sorts of issues that might typically arise from those interested in adopting the proposed model are responded to below. A format of question and response is used to structure this discussion in an easy to follow way.

***How often (and in what manner) would shareholders be consulted to ascertain changes in objectives? (e.g. many companies change quite considerably over time leading to rapid changes in shareholder expectations?)***

This is an issue that requires considerable care as the identification of changing owner objectives *(and doing something about it)* must be counter- balanced by the need for management to have a relatively 'stable' environment over which to manage corporate issues. The issue is not how frequently one gathers the information; but rather, the frequency that the information of changing needs is *used to change the focus of the corporation.*

The reality is that at the moment, management is generally only aware of trends in the top echelon of institutional shareholders (if at all), and then not necessarily in quantifiable terms. This suggests that management currently assumes, infers, implies, deduces or guesses the objectives of the lower echelons of shareholders. It is quite accurate to suggest that the shareholding community is dynamic and is prone to considerable change. It is exactly for this reason that constant monitoring ensures congruence between the corporation and its owners.

It is envisaged that the entire shareholding population would be surveyed every two years. However this may be varied with the differing character of certain industries. Corporations in industries with demonstrably stable share registries and long term planning horizons may require re-survey only every, say, five years, while those corporations in more volatile industries may require more frequent re-surveys. It is further envisaged that new entrants into a company's share registry would receive a questionnaire, possibly with their share scrip, but at least at an early stage of their association with their new investment (possibly within three months of entry).

Over and above this level of contact would be entirely at the discretion of the board and management. Should they desire to communicate more regularly with their shareholders for other purposes or to keep them closer informed of corporate activity, then nothing in this proposal would hinder them from doing so.

The manner in which shareholders would be consulted would be one of two ways: for top 50 shareholders, each would be interviewed on a face-to-face basis. For all other shareholders, a pre-coded questionnaire would be used. New entrants into the registry would be sent a questionnaire irrespective of the size of their holding. This data would be immediately added to the existing shareholder data-base which would enable ongoing monitoring of the changing character of owner objectives (if any) by the management and/or board.

***Are the objectives of other stakeholders to be ascertained and if so, how?***

The model and process rest on the premise that organisations exist to satisfy their owners' objectives. As such, the process is intended to provide a tool/technique for making organisations more accountable to their owners and more likely to satisfy owner objectives. The model upon which owner accreditation rests suggests that non-owner stakeholders are enablers (or barriers) that impact on the owners' ability to secure the desired benefit from their organisations.

The model maintains that no organisations exist expressly to satisfy non-owner stakeholders *per se*, but non-owner stakeholder satisfaction is critical to ensure owner satisfaction. Owners invest in corporations because of the benefit that they will derive from it and are not concerned, per se, with the management of stakeholders needed to achieve that objective. The effective management and satisfaction of stakeholder objectives is the domain of the board and of management.

***Do individual shareholders have the expertise to make sense of their own objectives and might these necessarily be right for the company as a whole?***

It is certainly accepted that owners do not function with 'full knowledge', but the notion that owners' objectives are 'invalid' due to such 'partial knowledge' has been rejected on the basis of the logic and argument underpinning the proposed model.

The process will achieve a number of outcomes relevant to this issue:

- It will provide more information to owners and prospective owners of what the likely outcome may be from their investment. This is due to the mechanism which will better enable the company's stated and declared outcomes (i.e. its shareholder objectives or 'Investor Profile') to come to fruition.
- The owner and prospective owner will be able to choose the 'Investor Profile' that most closely matches their own needs, rather than rely on other criteria which do not necessarily represent the outcomes desired by that owner (such as industry generic ratios and media reports).
- The process of asking the shareholder to respond to questions regarding his/her desires relating to benefit, risk, security, growth, etc, will 'force' them to think about the issues, and in so doing, lift their consciousness of the issues. Consumer and behavioural research supports the contention that heightened consciousness irrevocably leads to the desire to

seek more information on the issue and therefore become more knowledgeable in the process.

- Where a shareholder has an investment in more than one company, and where one of those investments is one that adopts the proposed model, then the shareholder will inevitably experience and compare the different relationships between him/her and the two types of organisations. Currently, where shareholders are never asked to state their objectives, it is easy to become cynical in the belief that the small shareholder is 'irrelevant' to the functions and destiny of its investment. Adoption of this process will bind the desires of the owners more closely with the functions and destiny of the corporation than ever before.

As the concept rests on the premise that organisations exist to satisfy their owners' objectives, the concept of owners' objectives not 'being right for the company' is rejected.

Certainly there will be some shareholders whose objectives differ from those of the vast majority of shareholders (i.e. from the company's Investor Profile) and from whom the company takes its bearing and direction. In such a case, their objectives will not be fulfilled, which will logically motivate them to look at alternate investments which will better enable them to satisfy their objectives. This happens now when shareholders quit the registry when they no longer feel confident that their objectives have a high probability of satisfaction.

***Given that it is likely there would be a wide range of shareholder objectives how would these be melded into a cohesive set of objectives for the company?***

It is certainly inevitable that there will be a range of shareholder objectives. However, it is to be expected that the range prior to or at adoption of the process will be wider than after its adoption, as the process over time will enable a much better match between corporate aspirations and owner aspirations.

It is anticipated that an Investor Profile for a corporation for one criterion, say one aspect of risk, might look something like the following:

*Table 5: Hypothetical Distribution of Shareholder Responses*

| ***The debt/equity range where shareholders regard the gearing ratio as an unacceptably high risk*** | **Wiggitt Limited Shareholders** as at 30 June 20XX | |
|---|---|---|
| | **Number** | **Percentage** |
| No long term debt | Nil | |
| 20% or lower | 128 | 0.15 |
| 21% to 50% | 1,356 | 1.69 |
| 51% to 70% | 15,679 | 19.57 |
| 71% to 90% | 45,674 | 57.01 |
| Over 90% | 13,457 | 16.79 |
| Don't Know | 2,056 | 2.56 |
| No response | 1,765 | 2.20 |
| **Total** | **80,115** | **99.97** |

*Table 6: Hypothetical Distribution of Responses by Shareholding*

| **Wiggitt Limited Shareholders by value of Shareholding ($'000) as at 30 June 20XX** | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| ***The debt/equity range where shareholders regard the gearing ratio as an unacceptably high risk*** | <5 | 5 to 50 | 50 to 250 | 250 to 1,000 | 1,000 to 10,000 | 10,000 to 50,000 | > 50,000 | **Total** |
| No long term debt | Nil | Nil | Nil | Nil | Nil | Nil | Nil | **Nil** |
| 20% or lower | 59 | 45 | 12 | 8 | 4 | Nil | Nil | **128** |
| 21% to 50% | 697 | 345 | 215 | 62 | 25 | 12 | Nil | **1,356** |
| 51% to 70% | 8,204 | 6,366 | 765 | 246 | 76 | 21 | 1 | **15,679** |
| 71% to 90% | 24,783 | 19,006 | 1,152 | 541 | 132 | 54 | 6 | **45,674** |
| Over 90% | 6,904 | 5,735 | 543 | 186 | 69 | 18 | 2 | **13,457** |
| Don't Know | 1,310 | 632 | 75 | 27 | 12 | Nil | Nil | **2,056** |
| No response | 1,111 | 486 | 109 | 37 | 18 | 3 | 1 | **1,765** |
| **Total** | **43,068** | **32,615** | **2,871** | **1,107** | **336** | **108** | **10** | **80,115** |

*Table 7: Hypothetical Corporate Response to Shareholder Distribution*

<table>
<tr><th>Issue</th><th>Wiggitt Limited Policy and Objectives</th></tr>
<tr><td>Debt/equity ratio</td><td>It is the objective of Wiggitt Limited to reduce its gearing ratio to below 50%. This will satisfy 93.37% (as at 30/6/XX) of shareholders by number who regard gearing in excess of 50% as representing extreme risk.<br><br>A gearing level of 50% or lower will ensure that extreme risk will be avoided for the following shareholders by value of their shareholdings:<br><br><table>
<tr><th>Share Holdings<br>($'000)</th><th>Percentage</th></tr>
<tr><td>Less than 5</td><td>98.38%</td></tr>
<tr><td>5 - 50</td><td>98.76%</td></tr>
<tr><td>50 - 250</td><td>91.55%</td></tr>
<tr><td>250 - 1,000</td><td>93.28%</td></tr>
<tr><td>1,000 - 10,000</td><td>90.52%</td></tr>
<tr><td>10,000 - 50,000</td><td>88.57%</td></tr>
<tr><td>Greater than 50,000</td><td>100.00%</td></tr>
</table><br>The <u>strategies</u> it will use to decrease gearing to 50% are:<br><br>Strategy A, Strategy B, Strategy C</td></tr>
</table>

Currently managers and board determine policy and strategy without meaningful shareholder intelligence. This can be depicted in Figure 4.

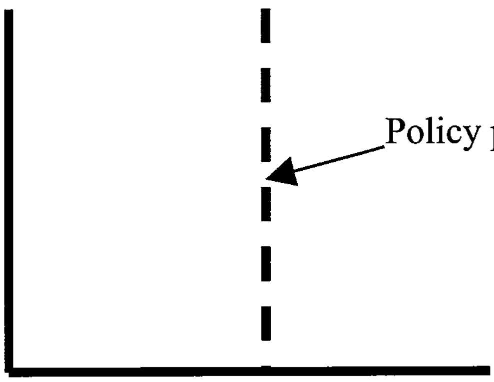


*Figure 4: Board and Management Decision in Shareholder Intelligence Vacuum.*

Where such intelligence is made available through the objective quantification process, the policy position is established in the context of shareholder objectives. Figure 5 shows the same policy position depicted in Figure 4 applied in a way that satisfies most shareholders while Figure 6 depicts policy which would satisfy only a minority of shareholders.

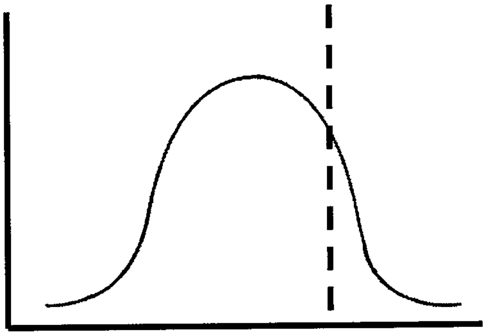

*Figure 5: Board and Management Decision with Shareholder Intelligence: satisfying the majority of shareholders*

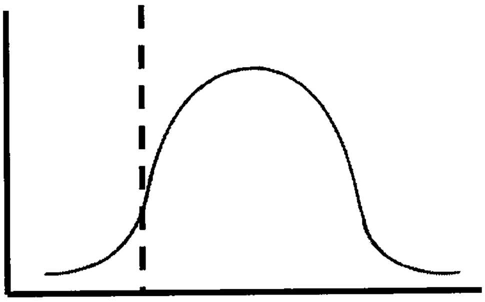

*Figure 6: Board and Management Decision with Shareholder Intelligence: not satisfying the majority of shareholders*

The implications from this are clear. Knowing a corporation's shareholder objectives in a quantifiable form enables directors and managers to determine policy and strategy with the knowledge of the likely impact that such decisions will have on shareholder satisfaction.

It is not the intention of the process to usurp the responsibility of either the board or of management as to how it should interpret the above owner profile. The challenge for both the board and management is to resolve the dilemma of different objectives and perceptions in a way that satisfies the owners. Currently, both board and management establish a policy and a direction for their company without knowledge of their shareholders' objectives. The process provides them with better information but does not absolve them of their responsibility or accountability.

Where they perform the task well, and satisfy many/most shareholders, then those shareholders will value that stock more highly and are less likely to quit the registry. Conversely, where board and management fail to satisfy shareholders then they will quit the registry, change the board, or change management. These three options are currently available to shareholders (albeit some more easily achieved than others).

Over time however, it is anticipated that it will become easier for the board and management of a company adopting the process to solve the above dilemma, as the Investor Profile will ensure that extreme mismatches between differing owner objectives will occur less frequently. Shareholders driven by personal benefit will be attracted to those companies that provide them with the highest probability of satisfaction.

***Which shareholders would the company listen to or would the majority view prevail?***

Generally speaking, the company should 'listen' to all shareholders, but that does not mean that all shareholders will be satisfied in terms of their own objectives.

In the illustration above, it is clear that Wiggitt Limited's decision to set its gearing at 50% will satisfy the vast majority of its shareholders. That does not mean that it ignored the very small minority, but rather that the interests of the vast majority were better satisfied at the 50% gearing level than at the zero gearing level. For the minority shareholders who desire zero gearing, and for whom gearing is a vital issue, then they can seek out a company with an Investor Profile where its board has determined that a zero gearing is the best way to satisfy its shareholders.

Currently, the absence of this type of information means that satisfying minority shareholders is very much based on subjective assessment and judgement. The process provides the information against which boards and managements can make informed decisions.

***Might a handful of large shareholders (with their own agenda) combine to influence the setting of objectives and the direction of the company? (e.g. reduce R&D and go for short term profits)***

In fact it is suspected that intuitively, the reverse would occur. At present such influences are largely 'hidden' from the scrutiny of the general shareholder population. The accreditation process, due to its objectivity and independence, identifies all shareholders' objectives. Under the proposed process, boards and management will need to set policies in the context of their overall shareholders' objectives. They will also have to justify those policies in the context of overall shareholders' objectives and will be held accountable for their achievement in the context of what, overall, their shareholders want.

The suggestion that large shareholders might combine to influence the setting of objectives and the direction of the company suggests that they would influence the company to adopt a course other than in the best interests of the quantified objectives of its shareholders. It is suspected that boards and managements will find such a course harder to justify under the process in light of the published quantified objectives of owners. This is because the data upon which the policy is developed may be in the public domain and open to scrutiny, not only by shareholders but also by the media, analysts and others.

Best case scenario, the process will minimise both the frequency and degree of biasing corporate direction by self-interested shareholders. Worst case scenario, there will be no difference to the current experience.

***Directors must ultimately concur that the objectives are appropriate - is this likely to mean that directors will adopt only those objectives acceptable to them, thereby diminishing the efficacy of the whole process?***

Under the proposed process, shareholder objectives will be quantified and described. The task for directors will be to interpret and translate these shareholder objectives into a delivered benefit. This question is no different to asking whether it's possible for directors to make poor decisions. Directors currently make decisions which supposedly are in the shareholders' best interests, but make these decisions without the information which is fundamental to making the decision. Mistakes or mismatches between desire and action are therefore frequent.

The process provides the extra information to enhance the decision-making process and therefore minimise poor decisions caused by incomplete or unavailable shareholder data.

Where directors have been unable to make, or have been unwilling to make appropriate decisions which effectively match shareholder objectives with corporate objectives, then they will be deemed to have failed in their responsibility. Shareholders will, as at present, resort to existing remedies of removal and replacement of directors. Conversely, shareholders might quit the registry and seek other investments which are better able to satisfy their objectives.

***Is the perception that directors are taking account of shareholder objectives more important than the reality?***

Perception is important and the process is the means by which such perception will be generated. However, at the end of the day, shareholders want the tangible benefit, and not only the feeling that they are going to get the benefit. Perception without performance will be unsatisfying to a shareholder.

The process certainly enhances a favourable perception of a company adopting the model proposed in the eyes of shareholders or intending shareholders. It also, in more tangible ways, ensures a much greater probability of the company actually delivering the promise.

***Would there be any verifiable track between the expressions of shareholder objectives and the objectives finally adopted by the company?***

Expressions of shareholder objectives would be tracked at the time of survey, and then at re-survey. The dynamic tracking of changes to those objectives would be possible at any time through the questionnaire issued to new entrants to the registry.

The Investor Profile may include a tracking section that might appear something like that depicted in *Table 8*.

*Table 8: Hypothetical Performance Report based on Quantified Shareholder Responses*

| Last Year's Shareholder Objective | Last Year's Wiggitt Limited Corporate Objective | Last Year's Actions/Strategies to Achieve Objectives | Last Year's Performance |
|---|---|---|---|
| Objective # S1 | Objective # C1 | Action # 1 | Achieved |
| Objective # S2 | Objective # C2 | Action # 2 | 10.56% short of objective |
| Objective # S3 | Objective # C3 | Action # 3 | 14.34% over objective |
| Objective # S4 | Objective # C4 | Action # 4 | Achieved |

***Would shareholders be responded to on a personal basis and if so how and how often?***

Shareholders would each receive either an interview request or a questionnaire at survey and re-survey. This will enable the company to hold shareholder data on its files as well as details of each shareholder's objectives.

The company will therefore have the ability to communicate as and when it sees fit to its shareholders on either a collective basis (which it is able to do now), or more importantly, on an individual basis. Such an individual communication can be used by corporations to report company performance and directions to each shareholder against his/her own objectives as captured in their most recent survey. Where a shareholder has expressed a low risk tolerance for example, it will be possible to write to him/her explaining (and educating them about) a proposed project and discussing in detail its risk elements thereby diminishing the perception of risk associated with that project by that shareholder. Modern information technology makes such personalisation easy.

It is believed that those corporations which are shareholder-focused will use this new capability to build and personalise the relationship between company and owner. The ability for such personalised communications has been made possible through the shareholder information collected by the process. It is likely that this new capability will be quickly seen as a major competitive edge in attracting investors and enhancing perceptions of corporate 'value'.

***How would the shareholder wanting big dividends be responded to if overall shareholder objectives indicated otherwise?***

What happens now? More often than not, a shareholder only finds out after the company has failed to perform to their expectations. They may then express their disappointment at the AGM, the media or by quitting the registry.

Under the process, a shareholder is able to establish, from the Investor Profile, their 'position' relative to other shareholder objectives before investing. If they have extreme objectives, then it is quite likely that they would have a low probability for satisfaction and be better served by looking for an Investor

Profile better matching their objectives. If on the other hand the objective falls within a reasonable range, then the probability of satisfaction increases.

Where an existing shareholder has extreme or uncommon objectives such as very high dividends, zero risk, etc., then the company has a few options. Of course, it may choose not to communicate with the shareholder and allow the shareholder to determine their own 'destiny'. (This is basically what happens now.)

The company may choose to suggest that although the company's objectives are based on shareholders with more modest dividend objectives, the company has a history of extraordinary performances (assuming of course that this is true) and the shareholder's chance of satisfaction is not as remote as it may appear to be based on the Investor Profile.

It may suggest to the shareholder, (again assuming that this is true) that a number of ventures that the company is involved in have a greater ability to satisfy the shareholder's dividend objectives, and perhaps the shareholder might consider investing directly in those opportunities.

The company may also explain to the shareholder that in the company's industry, a high dividend often means compromising other areas of necessary expenditure, such as R & D or equipment refurbishment etc., and is not in the long-term best interest of the company and therefore the shareholders of that company. In this way, the company may be able to legitimately re-align a shareholder's expectations with what is achievable. Such a strategy would help diminish disenfranchised shareholders quitting the registry. In so doing, the company's registry would be more stable, possibly causing share prices to rise.

***Would the agreed objectives be communicated to all shareholders?***

The company would use the same methods it does now to communicate its corporate objectives to shareholders, the investment market, suppliers, customers, analysts, regulators, etc. It is envisaged that an Investor Profile would become an integral part of a company's annual report. The Investor Profile would therefore reinforce the statements of vision, mission and objectives which are now commonly found in these documents. The company may also, at its own discretion, augment these conventional communication channels with additional shareholder communications which discuss or elaborate upon objectives.

For example, it might be a valuable exercise for a company to send copies of the Investor Profile to each investor, with a detailed analysis of the implications of various options before a company, in terms of the satisfaction of shareholder objectives. An analysis of the trade-off implications of a high-dividend shareholder profile and a risk-averse shareholder profile would be a very valuable discussion for shareholders.

***Would management disclose any disparity between shareholder objectives and final corporate objectives?***

It is suspected that management would not say 'our policy is not to satisfy group X within our shareholder population'. Rather, the 'disclosure' or 'identification of disparity' will come from two sources.

Firstly, shareholders will be able to match stated corporate objectives, their justification as provided by the company, and the Investor Profile, and so identify those shareholder objectives not satisfied or addressed by the corporation. Secondly, the analysts and others who assess the corporation would comment on the degree of fit or disparity between shareholder objectives and corporate objectives.

***Would shareholders be able to take any action where directors clearly failed to accept a shareholder objective?***

The same remedies available to shareholders today would be available to shareholders under the process. However, under the process, it will be easier for shareholders to gauge the degree of probable dissatisfaction or disparity between shareholder objectives and company performance and the probable level of support they may gain in a motion to replace board members or management. The process proposed is as follows:

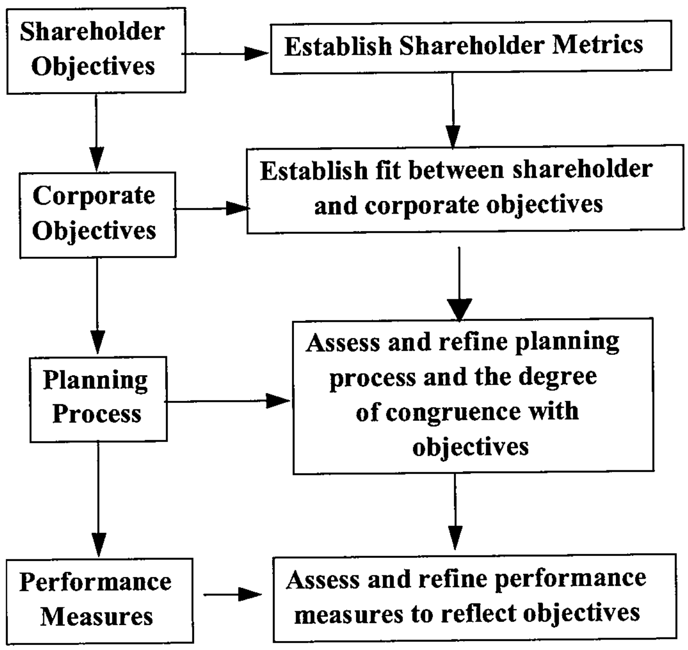


*Figure 7: The Congruence Establishment Process*

# 5. Discussion and Implications

## 5.1 Analysis of Results

The analysis of the results of this study will be considered in terms of research questions raised in section 1.3.

***How can management reconcile differing shareholder objectives within the context of their own corporation's objectives?***

The study has supported the contention that the shareholders in the sample companies correlate differently with the variables nominated. The industry chosen for analysis was the banking industry which, compared to most other industries, could be considered relatively homogeneous in terms of company activity, market definition and performance criteria. As shareholder behaviour and hence objectives vary in a homogeneous industry, it might be reasonably deduced that the differences in shareholder objectives would be greater in those industries that were less homogeneous than that studied here.

The study further implies that individual shareholders may have different objectives for each of their investments. Generic assumptions made about specific motivations by specific shareholders in specific investments are high risk assumptions. Corporate strategies based on such assumptions risk being misdirected, with funds and resources applied to them being under-optimised at best, and wasted at worst.

Managerial and board assumptions regarding shareholder objectives which are based on generic, industry or competitor characteristics are high risk assumptions. Furthermore, directors who accept such assumptions probably risk accusation of breach of duty based on the statutory responsibility of directors to represent and protect the interests of all shareholders.

Management and directors can minimise corporate risk, decrease transaction costs and enhance shareholder satisfaction by ensuring that:

- they determine shareholder objectives in quantified and measurable terms;
- they ensure that the metrics that drive shareholder objectives become the corporation's mission objectives;
- all strategies, projects, initiatives, activities and performance criteria are driven by their relationship and contribution to at least one of the quantified mission objectives;
- the success of the CEO, management and the corporation as a whole is determined against the shareholder-based mission objectives.

***To what extent are commonly used industry-wide performance ratios inappropriate as a means for assessing corporate and CEO performance? To the extent that industry-wide performance ratios are inappropriate, then what are more appropriate measures for assessing corporate and CEO performance?***

If based on this study's findings and argument we accept that shareholder objectives vary, and these objectives mould the corporation's mission as suggested by the proposed model, then it can be deduced that different corporations, even within the same industry, will have differing corporate drivers and objectives. These differences vary from a mere nuance to a significant and substantial difference. These differences may be represented by differences in fundamental outcomes (e.g. ROI versus asset growth versus low risk) to differences in the degree or extent of outcome (e.g. a 12% ROI versus a 35% ROI).

A corporation chasing ROI will adopt strategies, initiatives and resource allocations that will probably differ from one which chases asset growth as a driving objective. Similarly, a corporation which seeks a 12% ROI in an environment that sees other players achieving around 12% will adopt strategies, initiatives and resource allocations that will probably differ from one which chases a 35% ROI in the same environment.

To measure all of these companies by a single industry-generic measure does nothing to illuminate for shareholders and others the ability of that corporation or their success or failure. A company may provide the 'best' generic ratio or outcome but still not satisfy shareholders, while another company may deliver the 'worst' ratio in the industry but still satisfy shareholders.

The use of generic industry ratios distracts corporations, their managers and directors from their real task - delivering shareholder satisfaction. The study therefore supports the view that the optimal method of assessing the performance of CEOs, management or the corporation is against the shareholder-based mission objectives that apply to that corporation.

***How can the organisation undertake quantification of shareholder objectives in an efficient and effective manner?***

The method by which a corporation would quantify shareholder objectives is outlined in Section 4.2.

The basic tool is a survey of shareholders used to quantify individual shareholder objectives. Individual shareholder objectives would be aggregated to form a measurable perspective of all shareholder desires.

The quantified objectives of shareholders, followed by qualification by directors, represent the quantified mission of the organisation.

***To what extent do executive remuneration structures based on management incentives threaten the enhancement of shareholder wealth that such incentives are meant to engender?***

Without exploring the multiple dimensions of executive remuneration, the issue of interest here is that the performance measures used to provide executive incentive should be those that are congruent with shareholder objectives.

The choice of inappropriate executive incentives upon which to base executive remuneration is no different to choosing inappropriate organisational objectives, except that the management incentives will reinforce and enhance the errors, incongruence and misalignment.

## 5.2 Implications of Findings

This study provides a number of valuable guidelines to those who own and operate their own companies (i.e. are simultaneously manager, director and owner), investors, directors and managers.

1. ***Owner operators*** should be honest with themselves about what they want their organisations to do for them - what benefit they want and when do they want to achieve it? Many people, who are owners, directors and managers simultaneously, lose sight of their own personal objectives because of short-term operational imperatives. They should not forget to place a value on the degree of satisfaction they are getting from their association with their organisation.

   They shouldn't unquestioningly accept at face value and adopt competitor performance or industry ratios as their own objectives. The implications and cost of being the biggest, best, fastest or cheapest may not be the outcome that they, as owners, really want.

   If they are getting the outcomes they want then that is a good outcome. But if not, then why not? What is the root cause of their dissatisfaction? They need to deal with the root cause and not with the symptoms. Can they honestly say that based on reasonable probability and their management ability, they are likely to satisfy their objectives through their organisation? If not, they should seriously consider alternatives. If so, then what do they have to do as an owner (not as a manager) to ensure the fulfilment of their objectives? This may even involve them in 'firing' themselves as manager and appointing one better able to deliver the outcomes desired by the owner.

2. ***Investors/shareholders*** need to match the organisation's historical performance with the core benefits the investor wishes to extract from their association with it. Has the investor been satisfied in the past? They need to look at the strategies and direction the organisation is adopting and the likelihood that these strategies and direction will deliver their objectives. They can ask themselves the same questions as the owner operator. If they are not getting what they want, they should look for another investment where their objectives are better served and where they have a greater probability for satisfaction. If they are in a position to

take control, they need to ask themselves whether it is worth it. What do they have to do to the organisation to achieve what they want? Are they capable of doing it? Control does not mean success: they also need ability, judgement, drive and credibility. After all, one doesn't want to take control only to find one's suppliers, customers, backers and staff desert you.

3. ***Directors'*** needs to make sure they understand what the owners want. They must get to know the investors/owners and maintain regular communications. *They should not assume that owner objectives remain fixed or that all owners share generic and common objectives.* This study indicates they don't. They should not assume that management will always have the owner's best interest at heart - that is the directors' role and responsibility. They should not accept management plans and strategies at face value. They should always question their assumptions and assess the strategies and actions against their ability to satisfy core owner objectives. Directors should only approve initiatives that enhance owner objectives. Directors should become involved in the planning process so that they are aware of all the key assumptions under-pinning those strategies.

   Directors should not solely measure the performance of the corporation against competitors, except where one *knows* (not assumes or guesses) that their corporation's owners and the competitor's owners have the same objectives. A more viable measure of CEO and corporation performance is their ability to satisfy specific and quantified owner objectives and goals.

4. ***Managers*** should learn what makes owners happy and unhappy and learn to manage to satisfy their needs. They need to become ruthless in assessing opportunities and initiatives against owner needs. They need to get board/owner buy-in to the corporation's planning processes and assumptions.

# 6. Conclusions

The results of the study, the review of literature and of current practices indicates a range of conclusions regarding the corporation, its relationship to shareholders and the way it manages itself in determining its activities, outcomes and accountabilities.

**Contemporary and guru theory**

Classical and contemporary management and organisational theory generally takes an introverted view of the corporation, with the principal emphasis being on the maximisation of corporate outcomes. Although many management and corporate theories, remedies or techniques have positive outcomes, none provides a perspective that will enhance shareholder benefit in all circumstances or contexts. Little discussion revolves around the concept of *optimisation* of outcomes within a context of competing objectives versus the maximisation of an outcome, often at the cost of all else.

The bulk of contemporary business and academic thought revolves around the 'independence' of the corporation from the shareholder, particularly the role of management and directors to deliver outcomes that they consider appropriate. Similarly, managers appear to have the imprimatur of directors to mould and shape a corporation's destiny based on management's view of the world, the corporation's industry and the general environment and context. On occasion, these views are incorrect or biased and impact shareholder benefit and satisfaction.

The conclusion one draws from this is that classic and contemporary views of the relationship between shareholders and the corporation do not enhance, and in many cases they hinder, the ability of shareholders to secure satisfaction from their association with the corporation.

The proposed model enables the corporation to be focused on shareholder satisfaction and ensures that all activities, initiatives, projects and investments undertaken by the corporation are determined on the basis of their contribution to such satisfaction.

**Management and director subjectivity**

Although recent writers have acknowledged the biases of managers (and by extension, directors), few if any ask the hard questions that come from their conclusions. The natural and human biases of managers and directors affect their decisions and therefore their behaviour both as individuals and as corporate members.

The proposed model helps the corporation minimise the negative effects of the natural subjectivity of managers and directors by providing a quantified and measurable set of deliverables against which all activities, initiatives, projects and investments undertaken by the corporation are determined. This helps insulate the corporation from the natural foibles, machinations and subjective decisions of management and directors. Although the model will not eliminate altogether such natural behaviour, it will ensure that its impacts will be minimised and largely restricted to lower level, and less harmful decisions.

**Modern management practice and performance measurement**

Contemporary management practices clearly support the contention that it is management, and not the board, which develops and formulates high-level strategy and direction. It is further clear that the performance measures against which the CEO and the corporation's performance are assessed are determined in part by management and directors, and in part by industry performance measures, neither of which ensure the satisfaction of shareholder objectives.

The prevalent contemporary view appears to be that managers and directors formulate those outcomes that shareholders will benefit from by determining what is in the shareholders' best interest. In that context, managers and directors are 'boss' *instead of "servant"*. Management (and directors) as servants of shareholders is not a prevalent view nor is it practised on a wide scale in listed companies despite its recognition at the intellectual level.

The proposed model provides the corporation with a method by which its mission is determined by quantified criteria based on clear shareholder objectives. This removes entirely the prevalent practice where management and corporations are assessed against inappropriate, management or board-determined criteria.

**Shareholder objectives vary**

Current management thinking largely adopts a view which sees shareholder benefit as a generic outcome with which most shareholders will be content. Although there is recognition at the intellectual level that shareholder objectives vary, no attempt is made by corporations to dimension such differences and reconcile the corporation's efforts against those differing shareholder objectives.

The research undertaken examined the on-market behaviour of shareholders across five banks to discover whether shareholders have generic and common objectives or have differing objectives despite a high degree of ownership overlap between the five banks studied. The research maintains that these issues, coupled with the subjective nature of decision-making, raise serious questions about management and board ability, and motivation to satisfy owners.

The research presents a case for a new relationship between management and owners that enables the corporation's efforts to ensure more effectively the optimisation of shareholder objectives - whatever they may be. From a managerial perspective, the proposed model ensures that management decisions, and corporate outcomes, are aligned with owner objectives by involving the board's directors at critical ratification milestones in an organisation's planning process. From a board perspective, the proposed model establishes the need for, and method to, quantify owner objectives. Such quantified objectives are then interpreted by the board using their knowledge of the organisation, the industry and the context, to ensure that corporate goals and objectives are such that they optimise owner objectives.

The relationship model proposed establishes the primacy of owner objectives as the definer of corporate outcomes. Boards and management are entrusted with the responsibility of navigating the corporation through a course that delivers those outcomes - not the outcomes that management has determined through its own subjectivity. Owner objectives and corporate mission are thus one and the same, save for the interpretive role of the board who must adjudicate optimal outcomes when confronted with a desired range of quantified outcomes from a diversified shareholder population.

The quantified outcomes derived directly from owners are used to drive and assess all that is undertaken by the corporation. Initiatives, program and investments are assessed against this benchmark in order to ensure that all corporate activity, one way or another, contributes to the attainment of the deliverables. Optimisation of funds and resources applied is therefore easier, as that activity which has the greatest impact on the desired deliverables is adopted over those initiatives with lesser outcomes.

The model also establishes a clear decision-making hierarchy within corporations. It asserts that owner objectives determine corporate objectives and deliverables - which help determine the markets from which those deliverables must be secured - which help define the product and service options used in those markets to extract the deliverables - which help define the methods and channels used to bring the product and services to the market - which help define the resources (human, technological and knowledge) needed to achieve these outcomes - which help define and structure the organisation needed to operationalise these decisions. These decisions mould the financial and other outcomes of the corporation. These outcomes must deliver the outcomes sought by owners.

The implications of this study call into question some of the fundamental models used by management and boards. They also force corporations to question the way that they manage the interdependencies between elements of their organisation and the decision processes used by it. Adoption of the model instigates a rigorous assessment of all strategies, techniques and tools used by corporations against quantified shareholder-based outcomes. The potential for radical realignment of focus, rationalisation of non-value adding (to shareholders) activities and substantial cost and investment savings is profound.

Probably the most innovative and potentially most powerful implication of the proposed model, is its impact on Corporate Governance. Adoption of the model implies the identification of quantified owner objectives. These metrics and the ability of corporations and their CEOs to deliver them, provide the baseline against which corporations can be assessed by shareholders, managers, analysts, regulators and investors.

The conclusion that one draws from the study is that shareholder objectives differ and that corporations must, in order to establish relevant and focused strategies, be aware of the objectives of their own shareholders in order to establish congruence between them and the corporation's objectives.

**Shareholder objectives in different investments vary**

Management and boards appear to assume that shareholders share consistent objectives across their individual shareholding portfolios. All shareholders in the banking sector, for example, are assumed by some banking chairmen, CEOs and senior managers to have the same objectives.

The conclusions from this study contradict these apparently widely-held views. Shareholders can have differing objectives for each of their investments even when those investments are in the same industry. These differing objectives will cause shareholders to behave differently to the same stimulus across their portfolio. As corporations set their strategies to deliver certain outcomes, it is imperative for them to identify the extent, degree and diversity of shareholder objectives in order to ensure the adoption of suitable and targeted strategies, practices and policies.

## 6.1 Recommendations

The recommendations that emerge from this study are relatively simple and straight- forward and can be summarised as follows:

- That Australian regulators adopt the "Property" view of the corporation.
- Corporations should no longer assume that the shareholders who constitute their share registries necessarily share common objectives and aspirations.
- Corporations should survey their shareholders in order to establish their quantified objectives.
- Corporations should adopt a corporate/strategic planning process which adopts shareholder objectives as the corporate mission and reason for existence, and use those metrics to assess the viability, suitability and applicability of all initiatives, projects and opportunities undertaken by the corporation.
- Corporations should recognise the humanity of management and their resultant subjectivity. Adoption of the proposed model helps minimise the effects of the dysfunctional and deleterious effects of such subjectivity.
- Corporations who survey all their shareholders and thus develop a detailed Investor Profile, should use the Investor Profile to attract new shareholders who share common attributes and objectives, and to explain to existing shareholders, analysts and brokers the core

objectives that drive the organisation. The Investor Profile should be published and included in the corporation's annual report.

- Corporations, their directors, shareholders, analysts and other interested entities should assess the performance of corporations, CEOs and managers against their ability to deliver the shareholder-based corporate objectives, rather than against generic industry or competitor-based metrics and ratios.
- That the Australian Government should facilitate the establishment of an independent Owner Accreditation body that certifies corporations for the compliance with the shareholder-centric model proposed.

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