Mikael Silvennoinen: THE SKILLS OF A CAPABLE OWNER

The main role of an owner is to establish conditions in which a business can operate competitively. Only a competitive business can have a future. The owner must understand how to conserve and enhance competitiveness. Understanding of this kind requires experience, knowledge and skills.

Defining an owner

By an *owner*, this article understands a person who has no specific job in the operations of a business, but who is actively involved in increasing its value. The ability of such an owner to influence value creation in the business will be expressed through the decision-making process of the shareholders' meeting, by serving on the board of the company, and by engaging in direct discussions with the board of directors and senior executives as required.

The owner is thereby able to influence the company's business strategy and ensure that the content, risk level and development trend of operations remain consistent with the owner's intentions and risk inclinations.

An owner will also be involved in the business over the long term, even in times of difficulty. This definition draws a distinction between an owner and a mere investor whose influence on the governance, strategy and operations of a company is not as active and systematic as that of an owner. An investor will also often react to changes in the value of a business by buying or selling of shares in that business, even over the short term.

What is good performance made of?

Before we can say much about the kind of expertise an owner needs, we should think about the elements that make up good performance. Owners seek to exercise influence in the hope of ensuring optimal performance by the business that they own. That performance comes about through co-operation between the board, executives and staff.

"People are the key to everything. With a good enough team, you don't even need a business idea. A good team will come up with that, too." Though true as such, this oft-quoted oversimplification should be understood in the light of two qualifications:

(1) How do we know what kind of team will be effective and work well together?
(2) Besides the expertise of teams and their members, organisations gain organisational competence over time, meaning that they develop a history, culture, practices, values, capacity to reform and ability to co-operate. Organisational competence affects the kind of strategy that can be formulated for a business and how it can be put into practice. While organisational competence evolves at a relatively slow pace, developing this competence must remain the responsibility of the senior management, board of directors and owner, and it must stay on the agenda for these specific roles.

Detailed discussion of the wide range of tools designed for building, evaluating and developing an effective and functional team lies beyond the scope of this article, but it is at least important to ensure that a team includes sufficient diversity. Examples of a team in this context include the board of directors or management team of a business. It is important for team building to seek diversity of thinking and expertise explicitly.

Such diversity may, for example, arise from a differing educational background, from differing work and life experience, and from differences in age, gender or national origin. A group that thinks in diverse and versatile ways will tend, over the longer term, to make better choices and decisions in changing circumstances, and will be more innovative than a homogeneous group. A business owner must accordingly ensure that the board of directors or management team of the business possesses the diversity of thinking and expertise that will make the business more competitive.

Four components are required to realise good performance:

(1) appropriate experience and expertise,
(2) adequate intellectual capacity,
(3) adequate and suitable competencies for management and operation, and
(4) strong motivation.

This applies to both individual and group performance, which also affect the owner as an individual. By enhancing these properties, owners can also improve their own expertise and performance. Good group performance must also make special allowances for the importance of group diversity and teamwork skills to overall performance. The capacity for teamwork can be guided through the choice of team members and by means of rewards. Diversity will also affect the team's ability to cooperate.

Evaluating competencies for management and operation

Successfully managing a business calls for good business management expertise, and may be understood under the following headings:

(1) a profound understanding of the operating environment,
(2) making strategic business and organisational decisions,
(3) managing people and stakeholders
(4) communicating, influencing and networking, and
(5) managing performance (results).

The first two of these headings are key components in the work of a board of directors. The job of a board of directors is to improve the competitiveness and performance of the business specifically by means of strategic decisions and key staff appointments, beginning with the CEO in particular. In addition to exerting a strategic impact, the board of directors will stay in contact with operations through dialogue and co-operation with the CEO and the management team. An owner may influence the effectiveness of boardroom work by serving as a member of the board of directors or by determining its composition.

Even though it is not the job of the board to interfere in daily management of the business, it needs an overall business management ability corresponding to that of the management team responsible for directing operations. Sufficiently strong managerial competence and industry expertise are a basic requirement of a board that engages in strategic development of the business and value-adding dialogue with its executive management. The board is nevertheless precluded by its role from interfering in daily management. It also has the special function of ensuring that the business strategy of the enterprise is consistent with the understanding reached with the owners.

Psychometric tests are often used when appointing and developing the executive management of a business with a view to clarifying the functional profiles of management team members. The aim is to ensure that the management team has enough diversity in functional and behavioural styles. In addition to the diverse expertise and work experience of management team members, it is important for them to complement one another in styles of thinking and working, attitudes to stress and surprise, capacity for reform and willingness to change, interaction styles and social tendencies.

Psychometric tools are not generally used when building a board of directors, as the board has no executive role in leading the business organisation, and its members do not interact with one another on a daily basis. The diversity requirements of a board of directors highlight work experience, expertise, interaction, self-expression and intellectual engagement.

The strategic effectiveness, efficiency and development of boardroom work are nowadays evaluated through annual appraisal processes that are increasingly outsourced at regular intervals to outside consultants. Boardroom appraisals have two key objectives: to help a board of directors improve its own operations and to help owners appreciate the need to change or develop the board. These two objectives mean that the owner and chairman should initiate the appraisal and determine its content jointly.

Owners increasingly communicate their views and wishes to the board of directors of a listed company over the year through a nominations committee representing the largest shareholders. One key element of boardroom work appraisal is to form an impression of how the board of directors has fared in its mission of formulating a strategy for the business and developing its competitiveness, how effective boardroom work has been, and what kind of expertise the board of directors will require, having regard to future operating and competitive conditions.

Owners must apply their expertise to assess how the board is discharging its functions and to determine any changes that must be made to the board in order to maintain business competitiveness. If the owner is also a member of the board of directors, then a corresponding evaluation challenge will arise with respect to the management team.

Education, traditions and culture

Particularly in family businesses, education, traditions and culture play a major role in developing expertise. The succeeding generation of owners often has an opportunity to learn about the business, to work in it, to network with other similarly owned businesses at home and abroad, and to acquire training related to business enterprise and ownership.
Many family businesses have established organisational formats and structures to enable ownership development and continuity. While these owner organisations remain separate from the business operation, the chairman of the board and the CEO usually submit periodical reviews to them.

Importance of the owner to the reputation of a business

The advent of global electronic media and the strong emerging emphasis on social and environmental accountability in business have increased the importance of reputation as an enabling factor in operations. A good reputation helps a business break into new markets, assisting sales, recruitment, stakeholder relationships and publicity management in general. Factors affecting reputation and corporate image include the internal and external image of the business as an employer, its customer image, its financial position, and accountability in the broadest sense.

An owner may influence the reputation of a business through dialogue with its board of directors, appointments of key individuals, appropriate public appearances, and attention to personal reputation. The principal business partners of an enterprise will want to know who owns the enterprise and what kind of people they are. So will key prospective members of the enterprise's administration or staff.

A good reputation also secures the commitment of staff, who will tend to respect and value a reputable employer. Many employees regard this as more important than maximising financial remuneration from their work.

The owner's role in appointments and remuneration

The main instruments for influencing business success that are available to an owner with no executive role in management are appointments and ensuring that the aims and motives of management conform to the goals of the owner.

Appointments

The members of the board of directors, particularly the chairman, and the CEO are the most important appointments that an owner can influence. The most effective and natural way for an owner to influence the appointment of the CEO is by serving in person on the board of directors.

Co-operation between the chairman and the CEO is the most important form of co-operation in a company, so irrespective of the ownership structure of the business, it is important to both the board and the CEO to ensure that the board genuinely selects the CEO. This is not how things are done in all companies. The CEO must enjoy the confidence of the board, but for co-operation to be functional and efficient, the CEO must also have confidence in the ability and integrity of the board.

The role of the chairman is of prime importance for three reasons:

(1) The chairman must be capable of professionally managing, developing and, where necessary, reforming the board to ensure that its strategic impact on company operations remains continually relevant.
(2) The chairman serves as a close confidante of the CEO, preparing board meetings and the longer-term agenda in partnership with the CEO.
(3) The chairman is an important channel of communication with the owners.

The process of appointing a chairman will accordingly focus not only on suitable work experience and expertise, but also on leadership, communication and interpersonal skills. A recently rising trend in corporate governance is to let the shareholders' meeting elect the chairman of the company. This appointment must be carefully prepared in advance of the shareholders' meeting, with the largest shareholders playing a leading role in these preparations.

Remuneration

Deciding the management and staff remuneration system is one of the main functions of a board of directors. If the board has organised itself into select committees, then preparing the remuneration system for a final decision of the board will be a key function of the remuneration and human resources committee.

As of no later than 2020, the new Shareholder Rights Directive (2017/828/EU) will require the remuneration policy, senior management pay and remuneration system of listed companies to be submitted to a shareholders’ meeting for confirmation. The Finnish Limited Liability Companies Act (624/2006) already assigns the decision on emoluments payable to directors for decision by the owners at the shareholders' meeting.

The principal consideration in remunerating executive management is to ensure that remuneration provides an incentive for management to comply with the strategy of the enterprise and with the goals of the owners.

Good practice in appointments and remuneration

Appointments

The principal appointments made by an owner are of the members of the board of directors. When reforming a board, the owner must decide what kind of people to look for and how to find them. This decision should be considered in partnership with the chairman. The conclusions of a boardroom work appraisal and the anticipated changes in the competitive conditions and operating environment of the business will indicate the kind of expertise that the board will require.

While it is natural to rely on the contacts of the owner and the board when considering new people, there is often good reason to use an executive search organisation that specialises in recruiting directors. Using an outside advisor for recruitment informs the process of selecting and appointing candidates with professionalism, diversity, and any required international character, and it makes candidate evaluations more objective and systematic. An external consultant is often also more naturally placed to notify refusals to unsuccessful candidates.

Remuneration

The recommended approach is for the total compensation of executive management to derive from a fixed annual salary, an annual incentive system (short-term incentive, STI), and an incentive scheme covering the longer term (long-term incentive, LTI).

The LTI is the most natural vehicle for ensuring that compensation is consistent with the owner’s objectives, and care should be taken to ensure that the structure of an LTI:

- supports and rewards the development of business strategy and rising shareholder value,
- encourages commitment and brings competitiveness to recruiting,
- is of reasonable cost in relation to the results achieved,
- is structured and dimensioned on the terms of the open market
- is transparent, clear and equitable from the point of view of both management and owners
- is functional and flexible under various conditions, for example when the business restructures or changes its strategy.

When determining the emoluments of the board of directors, an owner should take care to ensure that the criteria governing those emoluments and executive remuneration do not result in any dependency that is undesirable from the point of view of the supervisory function of the board. The emoluments payable to the members of the board will therefore usually be fixed fees determined annually. It’s a good idea to pay the emoluments of board members in company shares where possible to ensure that this remuneration is also tied to the change in company and shareholder value.

An owner and a board of directors can turn to businesses that specialise in formulating remuneration systems for worthwhile professional help in this field. These professionals can not only provide in-depth expertise on remuneration structures and options, but also advise on the state of the market with respect to the remuneration systems used by other enterprises.

Summary

Owners engaged in establishing conditions for business competitiveness require expertise particularly in two important fields: appointing the board of directors and CEO, and adequately understanding the operations of the enterprise.

The importance to the owner of making appointments successfully is evident when reviewing the main functions of a company board, which must be competent to make decisions on all of the following:

- the strategic position and competitive edge of the business,
- strategically important questions such as investments and corporate acquisitions,
- financial targets and benchmarks of success,
- the normative operating framework (mission, vision, values and key policies), and
- appointing, instructing and remunerating the CEO and planning for a successor.

Every member of the board must understand all relevant aspects of the enterprise if the board is to function as a team that can generate added value.

A capable owner will understand the operations and strategic position of a business, be able to make appointments that support and develop its competitiveness, and ensure that the remuneration of senior management supports increasing enterprise and shareholder value. A capable owner will also know how to call on outside expertise when discharging the duties of ownership.

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__IMS Talent__ is a Finnish executive search partnership established in 1986. The services of the partnership also include finding company directors, and evaluating and enhancing the work of company boards and management teams. IMS Talent is affiliated to the IMD International Search Group representing more than 40 offices in 25 countries.