# HOW STRATEGY SUFFERS WHEN CORPORATE GOVERNANCE TAKES A BACK SEAT: CASE STUDY FROM PAKISTAN

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**ABSTRACT**

This paper uses strategy theory and relates this with corporate governance practices to examine the influence of ownership structure on the long term strategy of a family-owned non-listed company using a case study of a Pakistani manufacturing firm. The general definition of "non-listed companies" used in OECD discussions is: closely held companies whose shares, unlike those of publicly held companies, do not trade freely in public equity markets, either because the shares are held by a small number of persons or because they are subject to restrictions that limit their transferability. The case study presented draws on two internal mechanisms of corporate governance, namely the ownership structure and the board of directors, to show how corporate governance mechanisms affect the long term strategy of companies with concentrated ownership structure.

## RESEARCH OBJECTIVES

This case study has originated from the need to take a strategic look at family business research in Pakistan, and PICG's aim to produce a library of academic resources on the governance of family owned firms. The vast intergenerational transfer of assets and a strong capacity to build sustainable businesses present family firms with the possibility of unconventionality in strategic decision making. This offers intrinsically interesting grounds for further research.

Another aspiration is that this preliminary case study would make way for more nuanced research methodologies to explore the complex nature of family firms, encompassing a more diverse set of topics and contexts.

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## INTRODUCTION

The International Finance Corporation (IFC) Corporate Governance Methodology classifies companies in to five types called paradigms: listed companies; family companies; financial institutions; privatized transition economy companies; and state owned enterprises. The primary focus of IFC's family company paradigm is on unlisted family companies. As a group denominated by conflicts over economic versus social investment, family owners present a particularly interesting case (Fiss, 2008).

In their book *Corporate Governance Matters*, Stanford Graduate School of Business Professor David Larcker and his coauthor Brian Tayan observe that popular governance issues such as excessive risk taking and CEO compensation get a lot of attention while issues such as corporate strategy and succession planning are left out (Larcker & Tayan, 2011).

The aim of this paper is to highlight the link between strategy and corporate governance in Pakistani family-owned companies. Evidence on Pakistan's corporate structure strongly suggests ubiquity of firms which have a controlling shareholder, often in the form of the family. Family-business groups are structured as pyramids, with a controlling shareholder who maintains control through cross-shareholding and interlocked directorships (Ashraf & Ghani, 2004; Cheema, 2003).

The problems of long run sustainability are characteristic of family businesses. According to the IFC, about two-thirds to three-quarters of family businesses either collapse or are sold by the founder-owner during their own tenure owing to complexity in terms of governance (*IFC Family Business Governance Handbook*). The board of directors often plays a substantive role in firm-level strategic decision-making (Judge & Zeithaml, 1992). Based on insights from strategy process literature, the paper suggests that boards could fulfill a meaningful role in strategy implementation in family-owned companies provided there is consistency between corporate governance processes and the firm's intended strategy.

Section 1 describes the research methodology for the paper with a critique of the case study methodology.

Section 2 engages with a literature review based on the theory of the firm, theories of strategy, and the theoretical foundations of corporate governance.

Section 3 presents the case of New Ltd., a family-owned public unlisted company, with a brief note on the governance model of Japanese firms.

Section 4 concludes the case study with a discussion of the case, and lists the limitations of the research.

Section 5 summarizes the main research questions based on the International Finance Corporation's (IFC) Corporate Governance Progression Matrix For Founder/Family – Owned (Unlisted) Companies, and case participants' responses to a structured interview question guide.

## METHODOLOGY

This paper offers a narrative case study following a qualitative case study research methodology. The narrative has been deliberately employed as it acts as a depository of information. The effort in this paper is to state a clear research question and a clear unit of analysis. Case and participant selection criteria and data collection method have been discussed in an attempt to provide a chain of evidence. Adequate references have been made to the literature on case study research methodology.

### Unit of Analysis

The unit of analysis is a single family-owned public unlisted company. This unit was selected for two reasons:

i)in Pakistan, family-owned firms with a controlling shareholder, often in the form of the family, are ubiquitous (Ashraf & Ghani, 2004;Cheema, 2003); and

ii) the commonality in these firms of the separation of ownership and control

### Case and Participant Selection Criteria

Since research participant selection affects external validity, participant pool was kept small and selective. Considering that the number of participants relates to the question or to the type of qualitative approach used such as narrative, phenomenology, grounded theory, ethnography, or case study research, questions were targeted to a limited number of participants and events (Creswell, 1998).

Participant selection was through both self selection where one participant volunteered for the case study, as well as through researcher selection where the researcher determined the eligibility of the participant according to the requirement of the research questions. Therefore, randomization of participants did not occur. The anonymity of the participants has been preserved.

**Data Collection and Verification Method**

Qualitative case study research typically involves interviews, observations and documentary analysis. However, case studies can also involve more quantitative survey instruments such as questionnaires and other forms of assessment and measurement.[1] This case study is built upon information gathered through a hand collected data set. Data was collected mainly through interviews, documentation review and questionnaires.

Patton (1980) suggests the use of the interview guide strategy to give structure to unstructured interviews, yet maintain flexibility. Since interviews were open-ended, and hence conversational, an interview protocol was devised to give form to the interviews. Interview protocol included two questionnaires which are appended. Maximal variation (purposive) sampling was employed in order to get different perspectives on the central question in the study. The firm allowed a broad sketch of answers to the questionnaire.

Some aspects of the interviews were deliberately kept flexible. Unresolved queries were followed-up with respondents through email. Archival research was conducted through both hardcopy and electronic issues of articles in corporate governance and strategic management journals and periodicals as well as the business press.

By making use of multiple sources of data, the researcher uses the process of triangulation which involves corroborating evidence from different sources to shed light on a theme or a perspective (Creswell, 1998). To maintain internal validity the researcher solicits the research subject's view of the credibility of the findings and interpretations (Miles &Huberman, 1994).

Therefore, data, analyses, interpretations, and conclusions for this particular case study were taken back to the research subjects so that they could judge the accuracy and credibility of the account.

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[1] Labuschagne (2003) considered qualitative research doubtful. By aggregating the responses of a large number of respondents to a limited number of questions, quantitative research provided for comparison of data which lead to findings that could be generalized. Qualitative methods, on the other hand, typically produced detailed data about a much smaller number of respondents. In fact, the philosophy behind selecting a particular research methodology is to decide what methods are appropriate in a given analytical situation. Both quantitative and qualitative methods are essential and complementary. Even Labuschagne (2003) admitted that "Qualitative analysis seeks to capture the richness of people's experience in their own terms."

Labuschagne, A. (2003) *Qualitative Research – Airy Fairy or Fundamental?,* The Qualitative Report, 8 (1) Available online at: **http://www.nova.edu/ssss/QR/QR8-1/labuschagne.html**

**Case Study Research**

Yin (1984) defines case study research as an empirical inquiry that investigates a contemporary phenomenon within its real-life context, using multiple sources of evidence, particularly when the boundaries between phenomenon and context are not clearly evident.

According to Yin (1994) case study must be used:

- to answer questions like 'how' or 'why';
- when an investigator has no control over the events;
- to study contemporary phenomenon in a real-life context

Dul and Hak (2008) distinguish two main types of case study:

- the single case study in which data from one instance is enough to achieve the research objective; and
- the comparative case study which requires data from two or more instances to achieve the research objective

The case study has its fair share of critics. A general grievance against the case study is that it is subjective, giving too much scope for the researcher's own interpretations (Flyvbjerg, 2006). This paper employs case study research since it is also possible to generalize from only one case (Gummesson, 2003; Stuart et al., 2002). The aim of this paper is not to close the case decisively, but to keep it open in all its complexity and diversity.

Creswell (1998) maintains that a case study may have a narrative form of representation. One of the main characteristics of narrative research is the process of collaboration between the researcher and her research subjects. The research subject is regarded as a collaborator rather than an informant guided by the agenda of the researcher (Altork, 1998). Faber (1998), Boje (1991) and Beech (2000) apply the narrative to gain insight into organizational change. Finally, as Dul and Hak say, "Case study research enriches not only theory, but also the researchers themselves."

## LITERATURE REVIEW

### Theory of the Firm

*Islands of conscious power in this ocean of unconscious co-operation like lumps of butter coagulating in a pail of buttermilk*
D.H. Robertson (1923), as quoted by Ronald Coase

In *The Nature of the Firm* Ronald Coase (1937) posed the question why firms and markets coexist. Coase argued that organizing economic activity either through firms or through the market is costly. Using the market is costly because of the need to bargain since bargaining entails discovering what the market prices are, and then negotiating a contract for each exchange transaction. Within the firm, bargaining is replaced by authority. Authority is costly because as the firm gets bigger: a) the entrepreneur/in charge, given their limited intellectual capacity, will be increasingly burdened by the firm's activities; and b) the entrepreneur/in charge will make mistakes (Coase as quoted in Hart, 2008). Herein comes bounded rationality which refers to limits on individuals' capacity to process information and deal with complexity (Simon, 1976, 1978, 1979; March &Simon, 1958; Cyert & March, 1963; Williamson 1985, 1996).

Demsetz (1988) opines that the only two perspective altering theories of the firm in the last 200 years have been Knight's (1921) and Coase's (1937). Coase's work must be understood as an extension of Knight's theory of the entrepreneur. Both Coase and Knight identify the entrepreneur as the central economic actor who consciously allocates resources within the firm by command, to those who have agreed to act as directed by the entrepreneur (O'Kelley, 2012).

Alchian and Demsetz (1972) disagreed with the Coasian idea that activities within the firm were governed by authority. They emphasized the role of contracts as a vehicle for implicit negotiation between employer and employee. They are supported by Jensen and Meckling (1976) who consider contractual relations as the essence of the firm.

Oliver Williamson agreed with Barnard (1938), Coase (1937) and Simon (1951) in identifying the employment contract as the source of authority within the firm. According to Williamson (1991) and Jensen (2001) the goal of the firm is to maximize by furthering shareholders' interests or to economize by lowering transaction costs, respectively. Williamson (1996) regards the firm as a governance structure in which the firm's legal status proffers the right to avoid conflicts through the decision-making authority of the chief executive.

The stewardship perspective suggests that as stewards of the business, executives and directors are motivated by the attainment of organizational success (Donaldson & Davis, 1991) since maximizing the firm's financial performance, as well as the shareholders' profits, directly impacts perceptions of their individual performances (Daily et al., 2003). Shleifer and Vishny (1997) insist that managers return finance to investors with the objective of re-entering the market for future finance.

Fama (1980) and Fama and Jensen (1983) are both essentially critiques and extensions of the Jensen and Meckling paper (Foss, 1998). Fama (1980) highlights the role of the managerial labor markets, that is executives and directors, in disciplining firm management through managing their careers in order to be viewed as effective stewards of their organization. Fama and Jensen explore the separation of decision management and decision control similar to Stettler's (1977) separation of operational and accounting duties in auditing.

Fama and Jensen (1983) enumerate four steps of the decision making process: initiation, ratification, implementation and monitoring. According to them, the organization's decision making process is split up in to a combination of initiation and implementation to form decision management while ratification and monitoring combine to form decision control.

Holmstrom and Milgrom (1994) view the firm as a system of incentives that ought to be evaluated as part of a coherent system for inspiring cooperation and coordination within the organization. Penrose (1955, 1959) argued that in order to understand the growth processes and diversification activities of firms, it was necessary to understand firms as collections of resources and services, derived from these resources, all organized under an administrative framework. Demsetz (1988) points to the lack of focus on information cost as an important component of transaction cost to construct a more complete theory of the firm.

The knowledge-based view of the modern firm suggests that it is the firm's cumulative knowledge, not its transaction costs, that holds it together. The most valuable firm asset in the knowledge economy is the knowledge worker who drives the creation of wealth (Chandler, 1992; Brown &Duguid, 1998; Drucker, 1999).

In conclusion, to the question why firms exist, Conner and Prahalad (1996) assume limited bounded rationality on the part of individuals and assume that opportunistic behavior will not occur. Their answer is that knowledge-based considerations can outweigh opportunism in business activity. Foss, Foss and Klein (2007) state that firms exist not only to economize on transaction costs, but also as a means for the entrepreneur to delegate particular decision rights to subordinates who exercise a form of 'derived' judgment on his behalf.

## Theories of Strategy

Rumelt (1984) argued that the study of business strategy is founded on the economic model of the firm. Firm strategy is defined as a set of choices a firm must make in order to survive --- the choice between business goals, the choice between products and services to offer, determining how the firm positions itself to compete in product markets, and the design of organization structure and policies (Rumelt et al., 1994). Owing to the diverse nature of strategy research, it is difficult to construct an all encompassing theory of the firm, or to select a single theory to the exclusion of others (Seth &Thomas, 1994).

Resource based, or core competence, theories of strategy proposed in the late 1980s and the 1990s (Barney, 1986; Hamel & Prahalad, 1990) explored the strategic reasons behind the success of companies with a small share of the market that managed to gain a significant share of an industry --- Canon challenging the dominance of Xerox, Airbus Industrie snatching market share from Boeing. [2]

Hamel and Prahalad (1990) coined the term 'core competences' to distinguish those distinctive capabilities that drive a firm's strategy and performance from the limited range of productive knowledge firms possess (Richardson, 1972). They view strategy as comprising both operational effectiveness and innovation. Core competences are defined as the 'collective learning in the organization, especially how to coordinate diverse production skills and integrate multiple streams of technologies' (Hamel & Prahalad, 1990). The capabilities or competences perspective is a considerable influence on organizational economics (Foss, 1998). According to Porter (1996) the main components of strategy are performing unique activities, choosing a strategic position, making trade-offs that underlie sustainability, and optimizing the fit of an entire system of activities.

Aghion and Tirole (1995) address the issue of core competence by means of an incomplete contract set-up. Grossman and Hart (1986) emphasize asset specificity as a key determinant of the scope of the firm. According to Teece (2000) the firm's knowledge base includes its technological competences as well as its knowledge of customer needs and supplier capabilities that provide the foundation for the firm's competitive advantage.

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[2] According to the resource based view, firms achieve above average performance:
i) through the acquisition of resources at a cost below their potential to create financial returns; and
ii) by deploying and configuring these resources into capabilities that create higher than average benefits for customers, and also allow owners to capture part of that value (Sirmon et al., 2007).

Sirmon, D. G., Hitt, M. A., Ireland, R. D. (2007) *Managing Firm Resources in Dynamic Environments to Create Value: Looking Inside the Black Box*, Academy of Management Review 32(1), 273-92

Nonaka (1988) viewed strategy making as both top-down and bottom-up. In his view, top-down deductive management entails high levels of central planning and analysis; bottom-up, inductive management is driven by individual or group initiative to sponsor projects and make sense of decentralized activity. Compressive management is a combination of deductive and inductive modes entailing high levels of activity for both senior management and employees.

According to Porter (1980) strategy suggests systematic environmental analysis, assessment of internal strengths and weaknesses, explicit goal setting, evaluation of alternative courses of action, and the development of a comprehensive strategic course of action. Porter (1996) argues that strategy consists of neither operational effectiveness nor focusing on a few core competences.

A firm may have great skill in making a product for which there is little demand and core competences can be duplicated. Successful companies strive for 'strategic fit', the idea that the strategy should fit the organizational context, by exploiting new market opportunities and making tough choices in cost structure.[3]

**Theoretical Foundations of Corporate Governance**

As a public policy issue, corporate governance has been highlighted through the Berle and Means (1932) corporation.

Berle and Means (1932) and Jensen and Meckling (1976) play an important role in the understanding of corporate governance systems. Corporate governance mechanisms reduce the agency costs resulting from a divergence of interest between the owners and managers of the firm. A large body of literature has generally found that better governance is linked to better performing and better valued firms in emerging markets (Klapper & Love, 2004; Durnev & Kim, 2005; Doidge et al., 2007).

[3] Porter's Five Forces present a convenient framework for analyzing the economic factors that affect the profits of an industry. Porter's main innovation is to classify these factors into 5 major forces that encompass the vertical chain and market competition. The five forces are: internal rivalry; entry; substitute and complementary products; supplier power; and buyer power. The underlying idea of the model is that every business operates within a framework of suppliers, buyers, new entrants, substitutes and complements. A firm that understands fully the nature of these five forces and exploits them to its advantage will be in a stronger position to develop its strategy.

Porter, M.E. (1979) *How Competitive Forces Shape Strategy*, Harvard Business Review

Zingales (1998) defines corporate governance as ‘the complex set of constraints that shape the ex-post bargaining over the quasi-rents generated by a firm.’ Shleifer and Vishny (1997) define corporate governance as dealing ‘with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment’ through a concerted strategy of ownership concentration.

A firm’s ownership structure can play a strong role in determining the firm’s corporate governance practices (Lemmon & Lins, 2003). In the Asian context ownership is massively concentrated (La Porta et al., 1999; Claessens et al., 2000). Steger and Amann (2008) enumerate four factors that shape corporate governance systems all over the world: personalities, ownership, core business model, and legal and cultural framework.[4]

[4] i) Personalities — for example, the founder or long-time and successful CEO and his experiences, values, and leadership style
ii) Ownership — for example, family business or concentrated vs. fragmented shareholding structures
iii) Core business model — shaped by the industry as well as the company’s lifetime, global exposure, and competitive focus
iv) Legal and cultural framework

Steger, U., Amann, W. (2008) *Corporate Governance: How to Add Value*, Oxford: Elsevier

**CASE STUDY: NEW LTD., A UNIT OF PAK TWO GROUP OF COMPANIES**

Pak Two Group of Companies is a family owned business set up and formed during the last 20 years. The Group comprises two industrial manufacturing units, one a public unlisted company and the other a public listed company quoted on all three stock exchanges in Pakistan, three private trading companies, and two private services companies. Sixty percent of the board of directors seats are held by family members and forty percent by other directors who are company executives. The founder-entrepreneur is Group Chairman while the Chief Executive position is separate. Majority shareholding of Pak Two Group is with family members but the controlling shareholder is Chairman.

Of the two manufacturing units, one was New Ltd., an unlisted public company, with a state of the art production facility engaged in the manufacturing and sale of a range of good quality household and commercial ceramic tiles. In addition to the domestic market the company's target export markets were Middle East and North Africa (MENA), Central Asia and European Union (EU).

The New Ltd. plant had been in production for over 20 years. Initially, global sales had soared with ceramic tiles mainly driving sales in terms of volume backed by high product quality and brand name. New Ltd. had been enjoying its monopolistic status for over a decade when it gradually began suffering from overproduction that resulted in high storage costs and excessive lead times leaving stockpiles of inventory in its wake. Unable to keep pace with technological innovation in the global ceramic industry, New Ltd. was quickly losing its share of the export market.[5]

**Pak Two Group had acquired New Ltd. 10 years ago when the plant was breaking even.**

There were other major factors responsible for low sales. The plant was running under capacity due to tough competition from a high flow of Chinese finished products at comparatively very low prices causing low market penetration for New Ltd.'s products. Cost of production at the

[5] It is easy for firms in a monopolistic competitive market to raise price above marginal cost since sellers enjoy customer loyalty based on product differentiation. That had been New Ltd.'s strategy for over a decade. But even a monopolist cannot go on charging the highest possible price. Like any profit maximizing firm, the monopolist will price where marginal revenue equals marginal cost. Since the monopolist is a price setter and faces a downward sloping demand curve, its price will be greater than its marginal revenue. At this point profits will be maximized. By charging very high prices, the monopolist will not be able to attract customers losing them instead to fringe firms.

plant was increasing due to high materials and energy costs, high rupee dollar parity, and import duties and tariffs on raw material.[6]

The New Ltd. board had evaluated long ago that the monopolistic conditions under which the company had previously been operating would not last forever. There were 10 members on the board of whom 6 were family and 4 were non-family members. The 4 were New Ltd.'s CEO, one Group associate finance director and two executive directors. One director had a ceramic industry background with over 15 years of experience in production and logistics.

**New Ltd. CEO's philosophy was simple. A fall in underlying quarterly sales could be offset by rising profit margins** through:

a) deleveraging the balance sheet; and
b) lowering of interest charge from refinancing of debt facilities

The company was heavily dependent on financial arrangements with banks and the payment of hefty financial charges was eroding profits. With banks raising their lending rates, New Ltd.'s borrowing costs remained high. New Ltd.'s gearing ratios were unacceptably high so that major lenders were restricting financing. Gearing can be used to increase the returns to owners/shareholders provided the returns generated from borrowed funds exceed the cost of paying interest.[7]

New Ltd. was nearing a net operating loss which was increasing year on year resulting in a negative return on capital employed (ROCE). Since ROCE is the result of a complex mix of product market conditions, the internal and variable operating structure of the business combined with balance sheet capitalization, therefore, a firm or sector return on capital is also

[6] As markets become increasingly mature and competitor interaction intensifies, it becomes more difficult to recover product costs. The demand for products undergoes what is described as trajectory. When a firm shifts off a growth trajectory it will exhibit loss of gross sales income and lower value added generated to cover internal costs. Even where a firm is able to generate strong sales growth, it may not be able to translate it in to profit and cash. This is because internal operating ratios deteriorate, and increased costs undermine overall profit margins.

[7] The underperformance of family-controlled firms is concentrated in only those firms that have financial slack, where the controlling family may enjoy a larger degree of discretion (Lins et al., 2011).

Lins, K.V., Volpin, P.F., Wagner, H.F. (2011) *Does Family Control Matter? International Evidence from the 2008-2009 Financial Crisis,* Available at SSRN: http://ssrn.com/abstract=1964764 affected by this combination. Many of these variables may be outside the control of management. [8]

To avoid losing control of the company the board considered infusing Rs200 million in to New Ltd. by way of an equity injection through two Group associate companies, one of them being Old Industries Limited, the public listed entity. The equity would not only balance out New Ltd.'s gearing ratios but would also give the company an opportunity to capture better market share. The return on equity (ROE) for the associated companies was higher than what they were getting on their surplus funds from banks.

Given New Ltd.'s weakening competitive position and slow market growth, board discussions focused on where to find new money to upgrade New Ltd.'s manufacturing capacity in order to reduce operating costs and add quality.

The Management Committee of the board submitted its proposal to the board. This proposal had been reviewed by an outside technical and engineering consulting firm for ceramic manufacturing industries that provided a wide range of solutions for new plant installation and existing plant process improvement.

The consultant's report concluded that New Ltd. must upgrade and modernize its plant and facilities for maximum capacity utilization. The company also needed to diversify in to sanitaryware as a strong component of its business. The Committee's proposal was endorsed by the board.

Concentric diversification made more sense given New Ltd.'s existing resources and capabilities in terms of plant and machinery, material and labor, sales and distribution capacity, economies of scope, and brand name to help diversify new product concentration from dwindling export markets to the domestic market. The strategy was aimed at helping New Ltd. penetrate the niche market.[9]

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[8] Levitt (2004) argues that the cycle of expansion and decline occurs because managers believe that growth can be sustained by an increasingly affluent population, that there will be no competitive substitutes, and that mass production will reduce unit costs. Therefore, the market will continue to expand. The problem is that in mature and cyclical markets, sales volumes combine with aggressive price wars to undermine the total revenue base of the market. The net result is that revenue is limited for one particular organization.

Levitt, P. (2004) *Marketing Myopia*, Harvard Business Review, 139-149

[9] There are two major types of diversification: concentric and conglomerate. Concentric diversification means the new venture is strategically related to the existing lines of business, while conglomerate diversification occurs when there is no strategic fit or relationship between the new and old lines of business. In concentric or related

New Ltd. estimated its future earnings depending on the projected sales volume, trends in material and labor costs and productivity from the diversification strategy. The profit projections for the modernization of the New Ltd. plant and the market absorption of its diversified product range were so encouraging that the Old Industries Ltd. board agreed to take the investment plan to their shareholders. New Ltd. had a strategic fit with the proposed venture. To make this strategy work, New Ltd. had only to capitalize on the competitive advantage it had already established.

**The board's proposal for funding New Ltd. through equity was rejected by Chairman who looked at it as subsidizing New Ltd. at the cost of Old Industries.**

Chairman advised the CEO to restructure New Ltd.'s debt and obtain bank funding of PKR 200 million. Chairman's dismissal of the board's proposal sprung from his reluctance to invest Old Industries' surplus to revive what he considered a sick unit. Chairman was also opposed to the diversification plan. His reason: diversification destroys value.

**Chairman's philosophy was to survive on borrowed capital.[10]**

**Chairman was of the opinion that the board was risk averse while he had the entrepreneur's appetite for risk.**

Nguyen (2010) finds that corporate risk taking is associated with specific corporate governance structures. Family controlled firms are associated with significantly higher idiosyncratic risk. In contrast, bank controlled firms are associated with significantly lower idiosyncratic risk.

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diversification, companies have a strategic fit with the new venture. To make this strategy work the firm must capitalize on the strengths or competitive advantage it has already established.

[10] Modigliani-Miller's (1958) net income approach shows that, assuming there are no taxes, a company does not have an optimal structure. Irrespective of its gearing level the overall value of the firm remains unchanged by altering its debt to equity ratio. Unlike MM, the trade-off theory rationalizes moderate debt ratios so that high profitability companies can use relatively more debt. Actual capital structures demonstrate, though, that the most profitable companies borrow the least.

Modigliani, F. and Miller, M.H. (1958) *The Cost of Capital, Corporation Finance and the Theory of Investment*, American Economic Review, 48, 261-297

New Ltd.'s dilemma was that it was a family controlled firm that was controlled by banks. When banks are in control, the firm's investment policy is naturally shifted towards low risk projects. In fact, increasing corporate risk taking in the absence of genuine growth opportunities may not be an economically rational strategy for smaller firms. Larger firms with greater asset bases are more inclined toward risk taking irrespective of market valuations of their investment opportunities (Wright et al., 1996).

In spite of the limitations imposed on its strategic management, the board was considering the circumstances under which New Ltd. could take risks. As corporate insiders, senior executives and board members were highly aware that New Ltd. was located in a fast changing industry that presented profitable alternatives provided the company was ready for a transformation in line with global trends. The ceramics industry is turning in to a niche industry. For the up market consumer the value added product has gained significance. In essence, New Ltd. could be looking to have a bigger slice of a shrinking pie.

Strategic planning involves analyzing the external environment and predicting what impact this environment could have on the organization over the next few years. The competitive forces at work in an industry determine much of a firm's performance. These forces are beyond the control of the firm and its managers.

**The market had become too competitive. New Ltd. needed to go in a new direction.**

When Henry Mintzberg (1992) explored strategic planning processes among large multinational companies, he concluded that he was unable to identify a single process that could be called strategic planning. Instead, Mintzberg conceived five strategy types which he termed the 5 Ps of Strategy: Plan; Ploy; Pattern; Position; Perspective. The fifth, Perspective, is a strategy determined primarily by a master strategist.

Chairman believed that the remarkable strategic insights of Japanese companies resided in one founding father. These men steered the company not through statistical analysis and boardroom deliberation, but through their intuitive understanding of how the market worked and how the business positioned itself. Chairman lamented that the visionary leader had been usurped by pragmatic number crunchers.

Chairman was highly skeptical of the evidence on the effects of corporate governance reforms in Pakistan. In private conversations with business compatriots, he would argue that in their eagerness to adopt western corporate governance models, Asian conglomerates were losing their corporate identities.

Chairman’s vision was to expand Pak Two Group beyond imagination. He was motivated to buy anything that he thought a competitor might be looking to buy. New Ltd. had been acquired under intense scrutiny from the Board. Initially, the Board had not ratified the purchase. The board, after due diligence, had shown serious concern on the grounds that the plant was inefficient and had high inventory and blocked working capital. One board member in particular fell in to Chairman’s disfavor for vocally opposing the deal and was sidelined.

Chairman’s interest in acquiring New Ltd. was also because of its assessed accumulated losses which would give a tax benefit to the acquiring services company of Pak Two Group.

## THE JAPANESE GOVERNANCE MODEL

According to Khanna and Yafeh (2005) Japan has become a testing ground for theory and evidence on business groups in Asia ever since Japanese economist Kaname Akamatsu (1935) developed the 'flying geese' model to illustrate how industrialization spreads from the developed countries to the developing countries. This model views Japan as the 'lead goose' leading the second-tier geese (less developed countries) which in turn were followed by the third-tier geese (least developed countries).

There is no formal documentation of the types of discernable strategies Pakistani family-owned companies employ, but an interesting comparison may be drawn with Japanese group decision making structures. Several studies of the strategic challenges facing Japanese companies cite the entrenched nature of group decision-making as the main reason for these companies' inability to respond to changing market dynamics (Ishikawa, 1988; Porter &Takeuchi, 1999; Allen et al., 2007).

Institutionalized practices like *nemawashi* and *ringi*, for instance, result in long decision-making times and resistance to short-term change. *Nemawashi* is the process of preparing others through persuasion and sharing information for decision-making. *Ringi* is group decision-making through memos, meetings and formalized information and authorization gathering which results in a consensus decision (Allen et al., 2007).

According to Gedajlovic and Shapiro (2002) Japanese firms present an interesting case of governance since they are characterized by a clear separation of ownership and control, yet they are embedded in dense intercorporate networks. Japan's corporate governance system is intimately tied to these formal networks often referred to as *keiretsus*. Industrial or vertical *keiretsus* typically comprise a large manufacturer and its major suppliers and are characterized by cross ownership of equity (Dyer, 1996). Financial or horizontal *keiretsus* link firms in different industries through a common main bank which provides loans and has ownership stake in a network's firms (Hoshi et al., 1990).

The control-based governance system prevalent in Japan, continental Europe and emerging economies differs from the market-based governance system of the US and UK. The market-based model relies on independent corporate boards, dispersed share ownership, transparent information disclosure, and active take-over markets while the control based system relies on concentrated share ownership structure, insider corporate boards, limited disclosure, and reliance on family finance and the banking system.

Nakamura (2011) highlights how lacking the traditional source of bank financing and facing severe competition from abroad, Japanese firms lost their global competitiveness. A strategy of exploiting structural sources of advantage such as exchange rate movements or cheaper labor limited the capacity of Japanese businesses for productive intervention or innovation. An interesting example is Sony Corp.'s structural decline over the years as its ROCE has steadily dropped as a result of lower profits (return on sales) and increased capital intensity.

**Since its acquisition, New Ltd. had seen three CEOs come and go.**

All three chief executives had been handpicked by Chairman and the board could never bring itself to wholeheartedly align with their strategies. The board had little confidence in incumbent CEOs' ability to run New Ltd.

The board made it known that it should be involved in CEO selection and succession. Directors argued that as a fundamental decision, the board should be able to identify what skills the CEO should possess. Chairman was unimpressed. While the board struggled to recruit suitable replacements for outgoing CEOs, it was widely rumored that their hasty departures were engineered by Chairman himself with the backing of the board.

On their part, the CEOs maintained that they should be the ones driving the company's corporate strategy, working closely with the board. The board must strictly serve in an oversight and monitoring role rather than a developmental role.

New Ltd. had experienced, capable directors on its board who demonstrated a deep understanding of the business, including the marketplace and the competitive landscape. The internal dynamics of the New Ltd. board were strong. Directors regularly talked and updated each other on company affairs. Aside from company meetings, the directors met for informal dinners and after office smokes and chats. Inside board meetings, the atmosphere was one of professional camaraderie. But confronted with Chairman's command-and-control personality, none would challenge his decisions.

Chairman considered himself a consensus builder. He did not have much liking for independent viewpoints. It was clear that Chairman was deterring the board from effectively challenging his decisions. Board members had become active participants in furthering the interest of the controlling shareholder (OECD's *Experiences from the Regional Corporate Governance Roundtables*). [11]

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[11] Within the organizational strategy literature, the practice of consensus is regarded as one of the factors affecting strategy implementation. Floyd and Wooldridge (1992a) define four levels of strategic consensus: strong consensus, blind devotion, informed skepticism and weak consensus. Strong consensus exists when managers possess a common understanding as well as a shared commitment to their strategy. Weak consensus exists when there is neither common understanding nor shared commitment. Blind devotion is when managers are committed to the cause without knowing what the cause is, that is, they are well-intentioned but ill-informed. And finally, when managers are aware of their strategy, but are not really committed to it, that is, they are well-informed yet unwilling to act, they are, according to Floyd and Wooldridge, suffering from informed skepticism.

Floyd, S.W. and Wooldridge, B. (1992a) *Managing Strategic Consensus: The Foundation of Effective Implementation*, Academy of Management Executive, 6, 27-39

In 2011, with the market for initial public offerings slumping, New Ltd. looked to go public to raise equity for additional funds. The plan was to start exploring an Initial Public Offering (IPO) to claim working capital financing as well as off-loading of financial obligations, and upgrading of the manufacturing plant.New Ltd.'s valuation was based on asset appraisal.[12]

The board knew New Ltd.'s offering would be regarded with skepticism in the market since the company had been reporting annual losses for the last four fiscal years. Other upcoming IPOs would diminish the possibility of subscription in New Ltd. The response from underwriters was at best lukewarm. Offering the IPO at discount was not viable.

In order to facilitate a successful IPO, the board suggested a structuring with major shareholders' equity in the pre-IPO process. Adding equity this way would raise New Ltd.'s profitability and enhance general public and investor confidence in the company. As always, Chairman was unmoved.

**New Ltd. dropped its IPO plans.**

For any privately owned company, the decision to enlist provides it with the opportunity to benefit from improved access to capital, increased business profile and access to liquidity. However, every company wishing to enlist must also have a clear strategy and business plan, a robust board structure, and operational, financial and management information systems appropriate for a publicly traded company. The business must be prepared for the greater disclosure, openness and accountability that investors and the market require following flotation, and the business must be ready to adhere to best practices on corporate governance.

**Eventually, New Ltd. was put up for sale.**

New Ltd. was acquired by a cash rich company that said New Ltd. had intrinsic value that would help them create efficiencies in the company and reinvest the profits back in to product innovation.

[12] Companies with heavy fixed assets, such as manufacturing plants or refineries apply asset valuation so that the assets are valued independently from the firm. An asset appraisal will yield a more accurate valuation than a discounted cash flow (DCF) analysis in private companies. In asset appraisal, the fair market value of fixed assets and equipment (FMV/FA) is calculated as a means of evaluating the business.

Ironically, the new management adopted the same proposal for equity financing and plant expansion through group associates that the New Ltd. board had put forward. As part of a cost cutting effort, they decided to shed staff. The restructuring was expected to bring in yearly savings.

**It's telling what this transaction meant for the several hundred employees of New Ltd.**

## DISCUSSION AND ANALYSIS

*I believe that many companies undermine their own strategies. Nobody does it to them. They do it themselves. Their strategies fail from within.*
**Michael E. Porter**

Why did New Ltd.'s strategy fail? The answer: partial commitment to the strategic plan, and failure to execute.

The most important component of strategy is to make people aware of the key variables. The most important reason good strategies fail is execution and the basic reason execution can go wrong is allowing the focus of the strategy to shift over time. Wharton management professor Lawrence G. Hrebiniak, author of *Making Strategy Work,* says strategies also fail because individuals resist the change. The cost-benefit can be achieved only through agreement on the actual execution of strategy (Hrebiniak, 2005).

Previous studies have endorsed the superior monitoring abilities of family owners and their motivation to make longer term strategic decisions (Becht & Roel, 1999; Dhnadirek & Tang, 2003).

According to Becht and Roel (1999) and Dhnadirek and Tang (2003) family members represent a special class of large shareholders that have a powerful incentive to make longer term strategic decisions. Agency theorists such as Jensen and Meckling (1976) have asserted that since there is so little managerial opportunism in family firms, these firms do not have a need for internal governance mechanisms like a board of directors.

Recent theory, however, suggests that the board of directors is not merely a monitoring or governance mechanism, but a resource to be used by family owners (Johnson et al., 1996). The two main functions of the board of directors are monitoring and providing resources (Hillman & Dalziel, 2003; Zahra &Pearce, 1989).Zahra and Pearce (1989) argue that the board has an active role in strategy that involves counseling and advising the chief executive officer, initiating strategic analysis, and suggesting strategic alternatives.

Might Chairman's belief, that he did not need the board to ratify his business decisions, have been ill founded?

Though they do not provide a very strong empirical base to test their findings, several studies have considered the critical role top management plays in strategy implementation. Schmidt and Brauer (2006) consider the board as one of the key drivers of strategy implementation. An indispensable part of the board's duties is to ensure that a strategy is in place.

Was it wrong for the New Ltd. board to propose strategic action for the company like the CEOs alleged?

As part of its oversight role, the board should also assess senior leadership, including the CEO, and their decisions in relation to strategy. Though it is the board's role to approve management's strategies, according to Scott Carson, professor of strategy at Queen's School of Business not all companies are strategic and performing well. In tough situations, the board must force management to do the planning.

Were the CEOs' regular ousters affecting New Ltd.'s strategy?

Yes, they were. According to Fiss (2008) strategy implementation is not only a technical but also a political and cultural process. Kotter (1995) maintains that changes in key personnel, particularly the chief executive officer, can trigger widespread organizational change associated with profound change in the strategic direction of the organization.

Was the board directly responsible for the CEOs' ouster?

Dimopoulos and Wagner (2012) find that the likelihood of CEO turnover increases in firms that have a controlling blockholder, have high financial leverage, or are subject to takeover pressure. Firm level governance is highly relevant for CEO changes. The board, though, plays a very limited role in CEO turnover.

What was the reason for the CEO turnover?

The underlying cause was Chairman's obsession with short term results as opposed to the long term longevity of New Ltd. The CEOs grappled with meeting revenue targets while strategy languished.

Graham and Harvey (2002) report that the pressure on CEOs to generate short term earnings is very real. The most surprising finding in the study conducted by Graham, Harvey and Rajgopal (2005) is that most earnings management is not done through accounting manipulations, but through real economic actions such as giving up positive NPV projects.

Demsetz and Lehn (1985) have showed that there is little clear indication that ownership concentration affects firm performance. One significant finding is that ROI is a performance measure that is affected by ownership concentration levels.

However, the ability of individual leaders to systematically impact the return on investment (ROI) of large, complex, formal organizations may be limited. Gadhoum et al. (2005) show that ROI is positively affected by ownership concentration in Canadian companies where ownership is concentrated in the hands of one or a few institutional shareholders.

ROI is boosted through a comparison of variables such as fixed capital, market concentration, and industry growth of competing businesses with structural characteristics similar to one's own business, and then identifying and manipulating those variables that would enhance the ROI of your business (Cvar & Quelch, 2007). The ownership structure of the firm is also critical in analyzing return on investment. While a publicly owned firm should focus on market risk, a privately held firm should choose the optimal strategy based on the owner's tolerance for risk and return.

In a highly levered business, the cost of capital reduces net income. High debt levels make the returns to shareholders much more volatile. When ROI equals the cost of capital, net return is zero (Brealy et al., 2008).

New Ltd.'s diversification strategy was well rounded. Though insider owners view corporate diversification as value destroying, it has been empirically proved that related diversification is more value creating than unrelated diversification.

Berger and Ofek (1995), Lang and Stulz (1994) and Servaes (1996) show that firms operating in multiple lines of business tend to have lower values than portfolios of similar focused firms. Schoar (1999) finds that firms that acquire plants in unrelated industries experience a subsequent decrease in total firm productivity. In contrast, when firms optimally choose to diversify, diversification has a positive effect (Fluck & Lynch, 1999).

Each diversification move is characterized by a transition period during which the company readjusts to new operating conditions. Thus, a sufficient length of time is required for the effects of diversification to be realized fully. Perhaps, Chairman was unwilling to allow the extra length of time required to fully realize the benefits of the diversification move.

New Ltd.’s IPO plans were foiled because IPOs require long standing planning. Before a company can sell itself to outside investors, it must put its affairs in order. Earnings should show a systematic up-trend. Chemmanur and Liu (2002) develop a model which predicts that in equilibrium, higher quality firms that is, firms of higher intrinsic value, choose bookbuilding to go public since they are willing to generate production of information in the IPO process in order to maximize the long term value of their stock.

In this model, company insiders are informed while outsiders who are uninformed can acquire company information at a cost. Therefore, according to this model, bookbuilding generates higher information production about the company which leads to a higher long term valuation (Chemmanur & Liu, 2002). Since New Ltd.’s information production was less abundant, it naturally preferred lower visibility.

Lastly, New Ltd. was unaware of the human toll of its sale. How many families were affected by New Ltd.’s acquisition and resultant restructuring. Business has a social purpose beyond maximizing shareholder value --- to create jobs and sustain people’s livelihoods. It must be protective of its capacity to operate sustainably in to the future.

The OECD Principles of Corporate Governance maintain that good corporate governance requires that whatever the structure of the board, its focus should be on long-term issues such as assessing corporate strategy, and activities that might involve a change in the nature and direction of the company.

A company’s governance revolves around the key areas of risk management, contingency planning, financial reporting and compliance, strategic planning and execution, and board oversight. The board of directors represents a collective wisdom which is essential to guide the corporation’s strategic course of action. If Chandler (1977), Brown and Duguid (1998), Drucker (1999) and their fellow theorists are to be believed, then the board is a value network that turns expertise in to capital.

The corporate governance of firms in emerging economies is work-in-progress. Jiang and Peng (2011) find that there is no concrete evidence documenting that family ownership and control are always ‘good’, ‘bad’, or ‘irrelevant’ for firm performance. They could be any or all of the above. According to the authors, governance reforms need to be embraced with a deep understanding of the enigma surrounding family ownership and control of large firms.

A large body of corporate governance research has shown how controlling shareholders themselves pay the costs of poor corporate governance in the form of lower valuations and restricted access to equity finance. Family-owned businesses will have to realize that mere compliance will not impact strategy. Corporate governance will have to be embraced in spirit.

The entrepreneur's ability to grant, deny, or terminate access to the firm's productive assets gives the entrepreneur power and makes internal governance structure critically important (Rajan & Zingales, 1998). Companies like New Ltd. must learn to cope with market changes by avoiding dependence on specific investment strategies, and through diversifying their portfolios with new activities.

In its current evolutionary state, non-compliance with corporate governance may be unable to explain all the deviations from strategic efficiency. But if we acknowledge the fact that strategic decisions are made by self-attributing individuals, then corporate governance may have major implications for these individuals' decision making in the corporations they run.

## LIMITATIONS OF THE RESEARCH

The paper is based on the study of a single unlisted company in a single country which was a limitation in itself. To offset this, comparative literature on regional studies was pulled out from other sources. The research question was daunting as was the main research method employed. Conducting case study interviews is time consuming, as is identifying respondents with an inclination to assist with an academic project. The reason for using qualitative interviews was to compile information based on the direct observations and experiences of respondents.

Limitations of this research paper include respondents' biases. For instance, respondents may have refrained from stating certain facts relating to the unlisted company in question due to the nature or extent of information they thought should be divulged to the researcher. As Sandelowski (1986) puts it, every research study is a potential carrier of confirmation bias as well as a lack of trustworthiness.

The greatest difficulty was in gathering industry information and secondary data on public unlisted companies in the ceramic manufacturing business. Given limited data access and sources, we were unable to conduct regressions to determine causality.

## BRIEF EVALUATION OF NEW LTD.'S CORPORATE GOVERNANCE AND STRATEGY

**I. Ranking on IFC Corporate Governance Progression Matrix For Founder/Family – Owned (Unlisted) Companies**
**(Appendix A)**

Given the important economic role of unlisted and founder/family – owned companies it is critical to examine these companies' specific governance problems. In this regard the IFC has established a corporate governance methodology for family-owned or founder-owned unlisted companies.

The IFC Corporate Governance Progression Matrix For Founder/Family – Owned (Unlisted) Companies is one of seven key Corporate Governance Tools used to analyze the governance of family-owned companies and has been adapted for the Family Company paradigm.

The Progression Matrix is basically a communications tool with four levels of evolution and four areas of analysis for family-founder firms.

The Progression Matrix relates the five areas of governance namely, Commitment to Corporate Governance, Structure and Functioning of the Board of Directors, Control Environment and Process, Transparency and Disclosure, and Shareholders to four levels of achievement.

The Progression Matrix is used here to assess the corporate governance of New Ltd.

## NEW LTD.'S RANKING ON THE IFC PROGRESSION MATRIX

| **Attributes** | **Levels** |
|---|---|
| **A.** Commitment to Corporate Governance | **Level 2** First concrete steps toward best practices |
| **B.** Structure and Functioning of the Board of Directors | **Level 2** First concrete steps toward best practices |
| **C.** Control Environment and Processes | **Level 3** Implementation of best practices |
| **D.** Transparency and Disclosure | **Level 3** Implementation of best practices |
| **E.** Shareholders | **Level 2** First concrete steps toward best practices |

**II. Governance and Strategy According To Interview Participants' Responses to Questionnaire (Appendix B)**

The Chairman and CEO positions were separate. There were 10 directors on the board.[13] There were board committees on finance and human resources. No formal board evaluation process was in place.

There were 6 non-executive directors, but no independent directors on the board. The presence of independent directors is intended to encourage independent thinking in strategy formulation, decision making and overseeing of financial performance of results etc. [14]

The company had limited decentralized decision making for the firm's day to day activities with centralized long-term strategic planning. Operational decisions were made at the divisional level. The head office allocated resources to the divisions. When operational decisions are made at the divisional level, the central headquarters of the firm can focus on the allocation and governance of resources among the divisions.

The board was effectively both a 'strategy' board as well as an 'operational' board. Board members brought technical and industry experience with them, and assessed whether there were new risks and what competitors were doing. Since the CEO was selected by the Chairman, and not the board, he had no independent decision making powers. Consequently, the board had no role in evaluating the CEO's performance. Efforts to develop a concerted strategy, more often, did not succeed.

[13] According to IFC Family Business Governance Handbook, best practice recommends a manageable board size of 5 to 9 members.

[14] One widespread response from participants of the OECD *Regional Corporate Governance Roundtables* is mandating greater use of 'independent' board members who are defined as being independent from the controlling shareholders.

# Appendix A

**CORPORATE GOVERNANCE PROGRESSION MATRIX FOR FOUNDER/FAMILY – OWNED (UNLISTED) COMPANIES**



| ATTRIBUTES | LEVEL 1<br>*Understanding the need to professionalize the Company* | LEVEL 2<br>*First concrete steps toward best practices* | LEVEL 3<br>*Implementation of best practices* | LEVEL 4<br>*Leadership* |
|---|---|---|---|---|
| **A.<br>COMMITMENT TO CORPORATE GOVERNANCE** | - The basic formalities of corporate governance are in place including:<br>- Board of Directors;<br>- Annual Shareholders' meeting;<br>- Shareholders and shareowners identified and recorded.<br><br>- Board member or high-level company executive explicitly charged with responsibility for improving corporate governance practices. | - Written policies established addressing key elements in family firm governance:<br>- Succession planning;<br>- Human resources and family-member employment;<br>- Non-family-member share ownership.<br><br>- Management/Board approves annual calendar of corporate events. | - Corporate Governance policy covers:<br>- Role of Board vis-à-vis management;<br>- Long-term planning for corporate governance of company commensurate with business plan. | - Applicable corporate governance, accounting, auditing and internal controls, and shareholder information practices are equivalent to those in place at best practice public companies (i.e., little would need to be done to qualify to make a public offering).<br>- Company fully complies or explains any deviations from all applicable provisions of voluntary code of best practices of the country (some elements of which may be applicable only to public companies). |
| **B.<br>STRUCTURE AND FUNCTIONING OF THE BOARD OF DIRECTORS** | - Board of Directors constituted and meets periodically. | - Board Meetings held according to a regular schedule, agenda prepared in advance, minutes prepared and approved.<br>- Non-family members (probably company executives or ex-executives) appointed to the Board and core competency (skill mix) review of Board conducted, or advisory Board of independent professionals established and consulted on a regular basis. | - Board composition (competencies/skill mix) adequate to oversight duties.<br>- Annual evaluation conducted.<br>- Audit Committee of non-Executive Directors established.<br>- Directors independent of management and owners appointed to the Board (perhaps "graduated" from the advisory Board). | - Audit committee composed entirely of independent directors.<br>- Nominating Committee established.<br>- Compensation Committee established. |
| **C.<br>CONTROL ENVIRONMENT AND PROCESSES** | - Adequate internal control systems are in place and are periodically reviewed by independent external auditors. | - Internal audit and internal control systems are in accordance with <u>highest national standards</u>. | - Internal audit and internal control systems are consistent with highest <u>international</u> standards. | |
| **D.<br>TRANSPARENCY AND DISCLOSURE** | - Adequate accounting and auditing systems in place including:<br>- Quarterly financial reports prepared by internal accounting and approved by the Board;<br>- Annual financial statements audited by independent external auditors and approved by Shareholders' Meeting. | - Accounting and reporting are performed in accordance with the <u>highest national standards</u>.<br>- The annual audit is performed by a recognized accounting firm in accordance with the <u>highest national standards.</u> | - Accounting, reporting and auditing systems meet the highest <u>international</u> standards. | |
| **E. SHAREHOLDERS** | - <u>All</u> shareholders kept informed of company policy, strategy and results of operations.<br>- Annual shareholders' meetings held. | - Shareholders provided with all material information and detailed agenda in advance of shareholders' meetings. | - Family council established (if number of family members large or substantial portion are not working in the business). | - Company in position to quickly implement all aspects of best practice code with respect to shareholders when company to go public. |

# Appendix B

**STRUCTURED INTERVIEW QUESTION GUIDE**

**Governance**

1. Are the CEO and Chairman positions separate?
2. Is the CEO independent in making business decisions?
3. What is the size of the board?
4. How many Board Committees are there?
5. How many Independent Directors?
6. How many Non Executive Directors?
7. Is there a Nominating Committee to nominate directors, set their remuneration and evaluate their performance?
8. Is there a Board Evaluation process in place?
9. Are operational decisions made at the divisional level?
10. Does the Head Office focus on the allocation and governance of resources among the divisions?

**Strategy**

1. Does the Company have decentralized decision making for the firm's day to day activities with centralized, long-term strategic planning?
2. Is the board involved in setting the strategic direction of the business?
3. Is your board essentially a 'guidance' board, or an 'operational' board?
4. Does the delineation of responsibility follow convention, that is, does the executive team develop strategy, the board fine tunes it, and then oversees its execution by management?
5. Does the board measure the CEO's performance against a set of agreed upon objectives?
6. Is the development of strategy a collective effort between management and the board?

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