Dear Sir/s

In February 2008, I wrote to the Prime Minister regarding the concept termed "Owner Accreditation". The letter was referred to Senator the Hon Nick Sherry.

Senator Sherry recommended on the 26 March 2008, that I submit the concept to the Parliamentary Joint Committee on Corporations and Financial Services, even though submissions for this inquiry have officially closed.

The communications dealt with a proposal to establish an independent body to establish, promote and administer Owner Accreditation – an innovative breakthrough in Corporate Governance.

I recently completed groundbreaking research into the relationship between corporations, their managers and directors, and their shareholders that indicates a unique opportunity for the Federal Government to take a powerful and innovative lead in the area of corporate governance.

The recommendations that emerge from this research can be summarised as follows:

- Corporations should no longer assume that the shareholders that constitute the corporation's share registry necessarily have common objectives and aspirations.
- Corporations should survey their shareholders in order to establish their quantified objectives.
- Corporations should adopt a corporate/strategic planning process that adopts shareholder objectives as the corporate mission and reason for existence, and use this metric 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 corporate planning model helps minimise the effects of the dysfunctional and deleterious consequences of such subjectivity on shareholder satisfaction.
- Corporations, that 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.

The implications of this study call into question some of the fundamental models and relationships adopted by management and boards. They suggest that corporations should question the way that they manage the interdependencies between elements of their organisation and the decision processes used by them. Adoption of the model proposed initiates a rigorous assessment of all strategies, techniques and tools used by corporations against quantified shareholder-based outcomes rather than against often-subjective criteria established by managers or directors. The potential for radical realignment of focus, rationalisation of non-value adding (to shareholders) 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 proposed model provides for the identification of owner objectives as the corporation's key drivers, and 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 research underpins the philosophy behind what I term "Owner Accreditation". A paper outlining the Concept of Owner Accreditation is attached.

Owner Accreditation is a process, analogous to Quality Accreditation, but based on independently verified metrics, whereby owners of organisations (i.e. the shareholders) are able to ensure that their organisations are aligned toward the achievement of their collective objectives thus significantly decreasing investor risk. The metrics relate to owner expectations regarding benefit, value, growth and risk.

Should there be interest within Government in this concept and the model, I will happily meet with members of your committee to explain the details of, and arguments for, the establishment of an independent accreditation body to develop, promote and maintain Owner Accreditation in Australia.

The benefits to the Government from the adoption and successful implementation of the Owner Accreditation proposal include:

- Sees that the onus for corporate governance is accepted and exercised by shareholders.
- Sees the initiation of an effective non-government regulatory process that is equally applicable for all organisations.
- Avoids accusations of "big-brother" regulation.
- Sees leading-edge and world-first corporate practices introduced into Australia.
- Relieves some pressure from the Australian Securities Commission, Australian Stock Exchange and others to ensure compliance and prudent governance practices.
- Enables Australian commerce to be seen as less risky for investors.
- Will attract investment capital into Australia.
- Supports new and more rigorous corporate structures and accountabilities that will avoid a repetition of the heady days of the 1980s.

Benefits to shareholders, management, directors, and other stakeholders are also outlined in the document.

I write to you for the following reasons:

- I wish to formally acquaint the Government with the results of my research which has been acclaimed by a range of establishment and academic bodies as groundbreaking and a "world first". The concept resulted in publication as the "cover article" in the Australian Institute of Company Directors journal some time ago. (Ref: http://www.companydirectors.com.au/Media/Company+Director+Journal/1999/August/Are+YOU+listening+to+your+shareholders.htm)

- Fairfax will be publishing my recent book relating to the alignment of corporations to shareholders. The implications are important for regulators, corporations and shareholders alike. (Ref: http://www.abbeys.com.au/items.asp?id=122799&name=Corporate%20Crap:%20Stupid%20Management%20Myths%20That%20Destroy%20Shareholder%20Value)
- I seek to enter into discussions with the Government to determine how it can help the establishment of an Owner Accreditation Body and the extent that the Government wishes to be seen as the leader in this initiative.

I can be contacted most directly on 0419 340 448.

Yours faithfully

JJJ

Dr Jack Jacoby
Managing Director
Jacoby Consulting Group

A Proposal to the Australian Government

To Sponsor the Establishment of an Independent Body to Establish, Promote and Administer Owner Accreditation

Jacoby Consulting Group Pty Ltd

April 2008

Contents

1.0 What is Owner Accreditation

Owner Accreditation is a process, analogous to Quality Accreditation, but based on independently verified metrics, whereby owners of organisations (ie. the shareholders) are able to ensure that their organisations are aligned toward the achievement of their collective objectives. The metrics relate to owner expectations relating to benefit, value, growth and risk.

2.0 Objectives of Owner Accreditation

To provide the means by which existing and potential shareholders of corporations can:

2.1 Make more informed investment decisions through the provision of independent and quantified representation of shareholder objectives of accedited corporations.

2.2 Make more effective investment choices by identifying and thus enhancing the probability of satisfying each individual investor's objectives.

2.3 Diminish investment risk for investors.

2.4 Provide a reliable and objective method for measuring the performance and competence of a corporation and its C.E.O. in their ability to fulfill shareholder objectives.

To provide the means by which the **directors and management** of corporations can:

2.5 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.

2.6 Provide directors with the information against which management and board decisions and actions can be made and against which their outcomes can be assessed.

2.7 Provide directors with the information needed to assess corporate, C.E.O. and management performance.

2.8 Provide clear and unambiguous expectations against which directors and management are held accountable.

3.0 Why is Owner Accreditation needed

Some notable quotes assist in setting the context.

> *"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, and shareholder activism is central to the proper functioning of our capital markets" (Alan Cameron, Chairman, Australian Securities Commission, in address to Corporate Governance 1995 Conference, Melbourne, Page 7)*

> *"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. Formal communication through annual*

meetings or presentations to institutions does not provide a sufficient connection.” *(Ian Matheson, Executive Director, Australian Investment Managers’ Association, in address to Corporate Governance 1995 Conference, Melbourne, Page 8)*

“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,...” *(Ira M. Milstein, in address to Corporate Governance 1995 Conference, Melbourne, Page 2)*

“...despite the huge size of modern institutional ownership (in the U.S.) and its concentration, the power of ownership does not encompass control of the corporation.” *(Ira M. Milstein, in address to Corporate Governance 1995 Conference, Melbourne, Page 9)*

“Even as shareholding becomes increasingly institutionalised, ‘representation’ as in ‘constituency representation’ of these shareholders on the board is not generally the rule.” *(Ira M. Milstein, in address to Corporate Governance 1995 Conference, Melbourne, Page 9)*

“Individual shareholders are arguably becoming more demanding of those who manage and oversee their investments. Brokers, corporate advisers, auditors and lawyers would also agree that we are entering a new age of ‘investor consumerism’, where there is no place to hide.” *(Ivan Deveson AO, in address to Corporate Governance 1995 Conference, Melbourne, Page 5)*

4.0 How does Owner Accreditation work

It is intended that an Owner Accreditation Entity will be established to design, develop and oversee Owner Accreditation. Qualified organisations will be licenced by the Owner Accreditation Entity to work with corporations to assist them in becoming accredited.

4.1 The Owner Accreditation Process

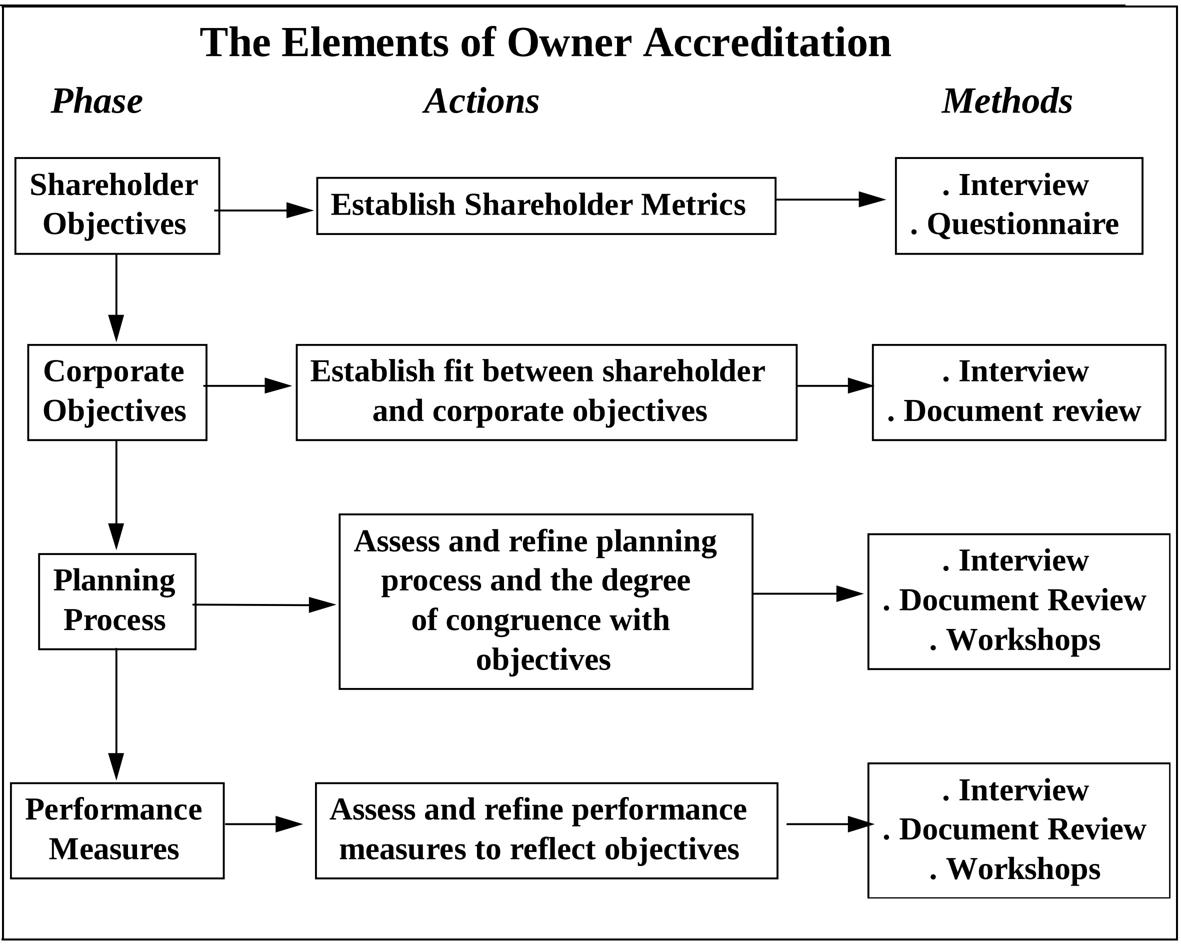
There are four fundamental elements of the Owner Accreditation process.

Phase 1 Establishing shareholder metrics. (Section 10 provides greater detail as to the process, mechanics and frequency with which this will be done)

Phase 2 Aligning quantified shareholder objectives with quantified corporate objectives.

Phase 3 Assessing the corporation’s internal planning and other processes to ensure that they support and are consistent with the achievement of corporate, and therefore shareholder, objectives. (Section 11 discusses the rationale for ensuring that an organisation’s internal planning processes are consistent with owner objectives.)

Phase 4 Assessing the corporation’s internal performance measures to ensure that they reinforce those outcomes that are required to satisfy shareholder objectives.



4.2 How does a company become Owner Accredited

The typical steps in gaining Owner Accreditation might be as follows:

Step 1: A corporation requests information from the Owner Accreditation Body (the Body) on Owner Accreditation.

Step 2: The Body either provides the inquiring corporation with detailed literature relating to Accreditation and its requirements, or a representative of the Body calls on the corporation to talk through Accreditation issues and requirements.

Step 3: The inquiring corporation determines that it is interested to pursue Accreditation but needs to establish what it needs to do to satisfy Accreditation requirements.

Step 4: The corporation contacts the Body who provide it with a list of licensed Owner Accreditation specialists. The corporation is free to choose any of the specialist providers listed.

Step 5: The licensed Owner Accreditation specialist calls on the corporation who contracts them to conduct a *Pre-Accreditation Assessment (PAA).* This PAA is intended to identify those areas within the corporation that require change, amendment or refining in order to comply with Owner Accreditation requirements. All PAAs are registered with the Body.

The PAA will specify not only what has to be done, but also will describe the outcome needed from the change. This outcome should be sufficient to pass the Accreditation requirements.

The corporation may undertake the change process itself, or may elect to use the PAA outcome as the terms of reference to brief external change providers. The corporation would be free to choose any suitably qualified change agent to undertake the change needed. Such change agents need not be licensed Owner Accreditation providers, but in the corporation's best interest, they should be reputable and skilled in the areas in which they have been asked to assist.

Step 6: When the corporation feels itself ready to formally seek Accreditation, it contacts the Body and requests that an Assessment for Accreditation be undertaken.

Step 7: The Body and the corporation discuss the "ground rules", including timeframes, scope of assessment, documents required, access to management personnel, access to key shareholders, costs incurred and payment terms, preparedness to re-accredit, etc. Based on a clear and formal understanding between the Body and the candidate corporation, the assessment commences.

It is made clear at the outset of all assessments, that Accreditation is not automatic and that candidate corporations must satisfy the Body's criteria before Accreditation will be granted at each level of Accreditation.

As each of the Phases in the Accreditation process will consume considerable elapsed time, the Body will grant candidate corporations *Phased Accreditation* as they progressively satisfy the requirements of each phase. The three phased and one final Accreditation levels are:

Phase 1 Accreditation - Shareholder Metrics

Phase 2 Accreditation - Alignment

Phase 3 Accreditation - Process

Phase 4 Comprehensive Accreditation

Comprehensive Accreditation will only be granted following satisfactory compliance with Phases 1 to 4 requirements.

Where a corporation fails to satisfy the requirements at any phase, then Accreditation will be denied it for that phase. However, all failures will result in a detailed statement from the Body of the areas of deficiency and what is required for the corporation to rectify the issue and thereby gain Accreditation.

Corporations will then be given a specified time (commensurate with the scope of the rectification needed) within which they must rectify the issues identified and submit to re-assessment. As it is not the intention of the Body to "punish" corporations for trying to comply, the Body will re-test as often as required until compliance is secured. Naturally, the costs of re-assessment must be born by the candidate corporation.

4.3 Re-Accreditation

As shareholder objectives change over time, it is vital to ensure that the corporation's ability to satisfy those changed objectives remains congruent and relevant. Accordingly, it will be necessary for all Accredited corporations to be re-accredited.

As a guide, re-accreditation would be undertaken once every second year after the initial Comprehensive Accreditation. 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-accreditation only every, say, five years, while those corporations in volatile industries may require more frequent re-accreditations.

It may be that the determinant of frequency of re-accreditation will be the degree of churn on the corporation's share-registry. The higher the churn, then the higher the frequency of re-accreditation. Corporations will therefore be motivated to satisfy owners in order to minimise *negative* registry churn in order to minimise the risk associated with longer planning horizons.

The desire to identify changing owner objectives (<u>and doing something about it</u>) must be counter-balanced by the need for management to have a relatively "stable" environment over which to manage corporate issues and make critical operational and strategic decisions. The issue is not how frequently one gathers the information, but rather, the frequency that the information of changing owner objectives is used <u>to change the focus, strategies and actions of the corporation.</u>

4.4 Use of consultants/licencees

There are two key relationships with consultants and licencees.

During the time required to fully develop the Owner Accreditation process, a leading Chartered Accounting firm (to be tendered) in conjunction with the Body and its constituent members, would be used to design, develop, pilot and make operational the necessary elements of Owner Accreditation processes and systems. During this period the chartered firm would be an observer on the Body's Board, but the work undertaken would be on the basis of a consultancy relationship between the Body and the chartered firm.

When development of Owner Accreditation has been determined by the Body to be "complete", chartered firm would become an automatic licensee of Owner Accreditation Services (Steps 4 and 5 in Point 4.2 above). In so doing, it would relinquish its observer status on the Board in order to avoid conflicts of interest. Thereafter, the chartered firm would be granted renewals of its licence on the same basis and conditions that would apply to all licencees.

It is the intention of the Body to licence legitimate, competent and reputable practitioners to undertake Owner Accreditation Services (Steps 4 and 5 in Point 4.2 above) in order to ensure the widest commercial coverage, support and appeal of the Owner Accreditation process. The Body would determine the characteristics and attributes required of licencees and the timing that licences will be granted.

4.5 Cost of Accreditation

The costs associated with Accreditation will vary depending on the character, size and dispersion of candidate corporations.

To conduct an Accreditation assessment for a large corporation with 200,000 shareholders spread around the globe and with many fully-autonomous subsidiaries using their own processes and systems; will be more costly than the conduct of an assessment for a small public company with 500 shareholders, a single operation with standardised corporate-wide processes.

It is envisaged that the costs will vary in proportion to the complexity of the candidate corporation. Similarly, the fees charged by licencees to conduct a PAA will vary for the same reasons, as will the cost of preparing candidates for accreditation, as this will be based on “what has to be done” which will vary among corporations.

The actual fees to be charged will be calculated on the basis of the Accreditation process requirements and will be presented to the Body for ratification.

5.0 Benefits of Owner Accreditation

5.1 For Shareholders/Investors/Owners

a. Decreased risk in making investment decisions by matching an organisation’s overall shareholder objectives with their own objectives.

b. Informed investment decisions through the provision of independent and quantified representation of shareholder objectives for each participating company.

c. Enable more effective investment choice by allowing investors to select from a range of shareholder objectives of different companies. The investor would select the investment that provided the greatest probability of fulfilment.

d. Provide a reliable and objective method for measuring the performance and competence of a corporation and its C.E.O..

e. More easily identify areas of poor performance or under-performance and a greater ability to scope the impact of such under-performance.

f. More easily able to “gather the evidence” to justify a change to the Board as a result of poor performance.

5.2 For Boards and Management

a More effective and easier 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.

b. More easily able to determine and resolve efficacy and appropriateness of management and board decisions and actions.

c. More easily able to monitor and assess the outcomes of management and board decisions and actions.

d. Better able to assess corporate, C.E.O. and management performance.

e. Clearer and less ambiguous expectations against which directors and management are held accountable.

f. Better able to match shareholder objectives with management objectives and strategies therefore better able to meet shareholder expectations.

g. Ability to communicate and individually report to each shareholder based on that shareholder's personal objectives.

5.3 For Brokers

a. Better able to gauge investment options for clients using the *Investor Profile* tool.

b. Better able to provide effective investment-specific performance measures which will assist in identifying performing and underperforming investments.

c. Better able to decrease broker/client risk by increasing the frequency that broker advice will satisfy client expectations.

d. Better able to decrease the perception of risk in the investor community and thereby bring otherwise risk-averse investors into the market.

e. Decrease the "speculative" character of investments.

f. Increase the opportunity of enhancing the relationship between investor and broker through a better understanding of the character of client objectives.

g. Enhance the opportunity for brokers to develop their own owner profile methodologies which mirror Owner Accreditation, and which enable account relationships to be personalised and enhanced.

5.4 For Regulators, Legislators and Government

a. Sees that the onus for corporate governance is accepted and exercised by shareholders.

b. Sees the initiation of an effective non-government regulatory process that is equally applicable for all organisations.

c. Avoids accusations of "big-brother" regulation.

d. Sees leading edge and world first corporate practices introduced into Australia.

e. Relieves some pressure from the Australian Securities Commission, Australian Stock Exchange and others to enhance regulation.

f. Enables Australian commerce to be seen as less risky for investors.

g. Will attract capital into Australia.

h. Supports new corporate structures and philosophies which will avoid a repetition of the heady days of the 1980s.

6.0 An Owner Accreditation Body

6.1 Participating Bodies

It is proposed that some or all of the following entities will form the Owner Accreditation Body:

The Australian Investment Managers' Association

The Australian Shareholders' Association

The Australian Securities Commission

The Australian Institute of Company Directors

Royal Melbourne Institute of Technology

Jack Jacoby (as creator and innovator of the Owner Accreditation concept)

6.2 Ownership

It is anticipated that ownership of the Body would be by those entities named above.

The legal structure of the Body is yet to be determined and would be subject to specialist legal and accounting recommendation.

6.3 Operating Budget

Principle income sources would be:

- *Fees charged for the conduct of Accreditation assessments*
- *Royalties received from domestic licencees*
- *Royalties received from foreign users/subsidiaries/affiliates*
- *Fees charged from non-conflicting, client-specific requests for assistance (eg. training in Owner Accreditation principles and the Planning Model - see section 11)*
- *Publications*
- *Provision of data services regarding Investor Profiles of listed companies (possible royalty income from outsourced function)*
- *Shareholder subscriptions: news, updates, interpretations, etc*
- *Provision of national, international and industry Owner Accreditation benchmarks*

Principal expenditure items would include:

- *Salaries for Accrediting and support staff*
- *Accommodation and office management costs*
- *Promotion and Advertising*
- *Education and training of licencees and others*
- *Travel and Accommodation*

The Body would initiate and monitor formal budgeting and approval processes to manage its operations.

6.4 Distribution of profit/surplus

Although the objectives of Owner Accreditation as a concept do not relate to profit creation (see section 2), it is necessary for the on-going operations of the Body to create profit in order to further the work of the Body and its constituent members.

It is envisioned that surplus/profits will be applied as follows:

a. To the growth of the Body and its philosophy in Australia and overseas

b. To the promotion of shareholder interests

c. To the promotion of the interests of business and commerce

d. To the facilitation and initiation of research into the above issues

The Body may distribute profits not allocated for the above purposes to the entities listed who may apply those funds as they see fit.

6.5 Operations

The Body would operate with its own charter, Articles and Memorandum, clear objectives, mission and operating strategies.

It will hire staff, buy or otherwise procure resources, establish a location separate from any of its constituent members, and in all ways, administer its affairs and operate as an accountable but independent entity.

The appropriate time to establish the operational elements of the Body and scale of such a start-up would be determined by the Body's constituent members.

6.6 Development funding

On-going funding for operations would come from incomes derived. (See 6.3)

Start-up funding could be derived from one or more of the following sources:

a. From all constituent members contributing to the development costs.

b. More than one but not all constituent members contributing to the development costs.

c. One member only contributing to the development costs.

d. *Sponsorship/s of the development costs by a non-constituent member*

e. *Government grant*

Constituent Members may have other options available for funding which should be considered. However, the Body would determine the appropriate funding source and the method by which that funding may be derived.

6.7 Development Program

A very high-level and tentative development plan is presented below. Its purpose is to provide the reader with a "feel" for the timeframes and issues involved rather that to provide a detailed chronology of intended outcomes.

Stage	Step	Milestone or Task	Tentative Completion Date
1	1.1	Present concept to all proposed constituent members and their organisations	30 September 2008
	1.2	All proposed members determine interest/involvement	31 October 2008
2	2.1	Develop and submit application for Government grant	31 November 2008
	2.2	Develop detailed work-plan and commence development of Accreditation process - Phases 1 & 2	1 December 2008
	2.3	Establish Owner Accreditation Body	1 January 2009
3	3.1	Identify and confirm Pilot corporation/s	31 January 2009
	3.2	Pilot Phases 1 & 2	31 March 2009
	3.3	Review & refine Phases 1 & 2	31 April 2009
4	4.1	Commence development of Phases 3 & 4	31 May 2009
	4.2	Pilot Phases 3 & 4	30 June 2009
	4.3	Review & refine Phases 3 & 4	31 July 2009
5	5.1	Design Launch Program	31 August 2009
	5.2	Launch	1 September 2009
6	6.1	Design licensee operations	Late 2009
	6.2	Invite applications to be appointed Licensee	Late 2009
	6.3	Appointment and training of Licencees	Early 2010
	6.3	Licensee operations commence	1 July 2010

7.0 Australian Market

See Section 12 for a breakdown of the anticipated tasks associated with each phase of the accreditation process. It is on the basis of these tasks that estimated costs have been calculated. Each corporation is different and the extent of the process will vary according to the candidate's character and structure. The figures provided are therefore only estimates but based on many years of consulting experience.

Estimates of Cost to Accredited Company from the Accreditation Process ($'000)

• Pre-Accreditation Assessment	50 - 150
• Accreditation	
• Stage 1: Shareholder Assessment	100 - 400
• Stage 2: Alignment of Objectives	50 - 150
• Stage 3: Planning Systems Assessment	50 - 250
• Stage 4: Performance Measurement Assessment	50 - 250
	250 - 1,050
	300 - 1,200
• *Accreditation Costs for the sake of market estimation*	*675*
• Two-yearly re-accreditation costs	100 - 250
• *Re-accreditation costs for the sake of market estimation*	*200*

Australian Market Estimates

• Estimated number of candidate companies	2000
• Penetration over 3 years of 10%	200
• Accreditation income (200 @ $675K)	135 million
• Re-accreditation income ($200K x 200/2)	20 million per annum
• 5 year objective: 25% penetration	
• 10 year objective: 50% penetration	

8.0 International Scope

International Market Estimates

• Accredited companies within 10 years	10,000
• Accreditation Revenues	$ 6.75 billion
• Re-accreditation Revenues	$ 1 billion per annum
• Royalties to Australian Accreditation Body	
(say 3% of accreditation and 5% of re-accreditation)	$ 252 million per annum

9.0 Next Steps

9.1 Government determines its position on Sponsoring the project.

9.2 Each proposed constituent member formally contacted and invited to participate.

9.3 Each proposed constituent member asked to declare interest or non-interest.

9.3 Meeting of all interested parties in Canberra early October 1999 to discuss:

a. formalisation of the concept

b. establishing detailed and costed workplans

c. securing funding

d establishment of the Body

e. legal structure of the Body

f. entitlements and relationship between members of the Body

g. other related issues

10.0 ANSWERS TO FREQUENTLY ASKED QUESTIONS

10.1 Ascertaining shareholder objectives:

10.1.1 How would shareholder objectives initially be ascertained?

Shareholder objectives would be ascertained primarily through personal interview of the top 50 shareholders and questionnaire to all remaining shareholders. (See question 10.1.2 below)

It is difficult at this stage to suggest specific questions that may appear in the questionnaire as these may be misinterpreted and the style and construction of such questions is necessarily a specialist skill. Furthermore, the Owner Accreditation Body with its constituent members would significantly assist in identifying the issues requiring examination. It is envisaged that RMIT, assuming its participation, would play a critical role here.

However, the following is an indication of the types of issues that might require examination within the interview and questionnaire process:

- *What benefits does the investor seek from the investment?*
- *What importance (ranked) have each of the following for the investor:*
- *dividend, asset growth, capitalisation, security, share price, etc*
- *How important is dividend to the investor?*
- *What dividend would the investor regard as satisfactory?*
- *What dividend would the investor regard as poor?*
- *What dividend would the investor regard as exceptional?*
- *Over what time does the investor want to achieve the desired dividend outcome?*
- *What dividend result would motivate the investor to sell his investment?*
- *What dividend result would motivate the investor to buy more equity?*
- *How important is asset growth to the investor?*
- *What asset growth would the investor regard as satisfactory?*
- *What asset growth would the investor regard as poor?*
- *What asset growth would the investor regard as exceptional?*
- *Over what time does the investor want to achieve the desired asset growth outcome?*
- *What asset growth result would motivate the investor to sell his investment?*
- *What asset growth result would motivate the investor to buy more equity?*
- *How important is capitalisation to the investor?*
- *What level of capitalisation would the investor regard as satisfactory?*
- *What level of capitalisation would the investor regard as poor?*
- *What level of capitalisation would the investor regard as exceptional?*
- *Over what time does the investor want to achieve the desired capitalisation outcome?*
- *What capitalisation result would motivate the investor to sell his investment?*
- *What capitalisation result would motivate the investor to buy more equity?*
- *How important is risk to the investor?*
- *Is gearing seen by the investor as a risk element?*

- *Is diversification seen as a risk element?*
- *Are there other issues that are perceived as risk issues by the investor?*
- *For each type of risk, what level of risk would the investor regard as satisfactory?*
- *For each type of risk, over what level of risk would the investor regard as excessive?*
- *For each type of risk, what risk level would motivate the investor to sell his investment?*
- *For each type of risk, what risk level would motivate the investor to buy more equity?*
- *When the investor assesses investments, what criteria does he/she use to make the assessment?*
- *Which ratios, if any, does the investor use to assess an acquisition opportunity?*
- *Which ratios, if any, does the investor use to assess the performance of the investment?*
- *How important are each of these ratios to the investor?*
- *If the corporation satisfies the investor's objectives, what, if anything, would motivate the investor to quit the investment or buy more stock? Issue such as environmental and ethical issues could/would be examined here.*
- *Against what alternative investment options does the maintenance of equity in this corporation need to compete for the investor?*

10.1.2 How often (and in what manner) would shareholders be consulted to ascertain changes in objectives? (eg 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 (<u>and doing something about it</u>) 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 <u>to change the focus of the corporation.</u>

The reality is that at the moment, management is generally only aware of trends in the top echelon of 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 Owner Accreditation maintains the necessity to monitor such changes in owner objectives.

It is envisaged (but entirely open to other suggestions) that the entire shareholding population would be "consulted" on the following occasions:

- once as part of the accreditation procedure
- once every second year after accreditation as part of a company re-accreditation process. 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-accreditation only every, say, five years, while those corporations in more volatile industries may require more frequent re-accreditations.

It is also envisaged that new entrants into an accredited company's share registry would receive a questionnaire, possibly with their share script, 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.

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-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.

Re-accreditation would involve re-interviewing the top 50 shareholders as they stand at the time of re-accreditation with all other shareholders receiving a questionnaire.

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

The Owner Accreditation concept rests on the premise that organisations exist to satisfy their owners' objectives. As such, the accreditation process is intended to provide a tool/technique for making organisations more accountable to their owners and more likely to satisfy owner objectives. The paradigm 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.

Furthermore, the paradigm maintains that no organisations exists 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.

Therefore the effective management and satisfaction of stakeholder objectives is the domain of the Board and of Management. Owners require their objectives satisfied *irrespective* of non-owner stakeholder objectives or demands.

10.2 Making sense of shareholder objectives

10.2.1 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" is rejected.

The Owner Accreditation process will achieve a number of outcomes:

a. 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 accredited organisation being independently verified as having the systems and processes to better enable its stated and declared outcome (ie. its Investor Profile) coming to fruition.

b. The owner and prospective owner will be able to choose the “Investor Profile” that most closely matches his/her 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).

c. 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 knowledgable in the process.

d. Where a shareholder has an investment in more that one company, and where one of those investments is an accredited company, 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. Accreditation will bind the desires of the owners more closely with the functions and destiny of the corporation than ever before.

As the Owner Accreditation 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 inconceivable.

Certainly there will be some shareholders whose objectives differ from those of the vast majority of shareholders (ie 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 where shareholders quit the registry when they no longer feel confident that their objectives have a high probability of satisfaction.

10.2.2 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 envisaged that the range prior to or at accreditation will be wider than post-accreditation, as the accreditation 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 criteria, say one aspect of risk, might look something like the following:

The debt/equity range where shareholders regard the gearing ratio as an unacceptably high risk	**Wiggitt Limited Shareholders** as at 30 June 19XX	
	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**

Wiggitt Limited Shareholders by value of Shareholding ($'000) as at 30 June 19XX								
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**

Issue	**Wiggitt Limited Policy and Objectives**
Debt/equity ratio	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. A gearing level of 50% or lower will ensure that extreme risk will be avoided for the following shareholders by value of their shareholdings: ***Share Holdings*** ***($'000)*** — ***Percentage*** Less than 5 — 98.38% 5 - 50 — 98.76% 50 - 250 — 91.55% 250 - 1,000 — 93.28% 1,000 - 10,000 — 90.52% 10,000 - 50,000 — 88.57% Greater than 50,000 — 100.00% The **strategies** it will use to decrease gearing to 50% are: Strategy A Strategy B Strategy C

It is not the intention of the Accreditation 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 the knowledge of their shareholders' objectives. *The accreditation 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 either 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 an accredited company 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.

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

To some extent, this has been answered above. 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 in point 10.2.2 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 have 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 Accreditation process provides the information against which Boards and Managements can make informed decisions.

10.2.4 Might a handful of large shareholders (with their own agenda) combine to influence the setting of objectives and the direction of the company? (eg 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 accreditation, 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 accreditation in light of the published quantified objectives of owners. This is because the data upon which the policy is developed will be in the public domain and open to scrutiny, not only by shareholders, but also by the media, analysts and others.

Best case scenario, accreditation will minimise both the frequency and degree of “tampering” with corporate direction by self-interested shareholders.

Worst case scenario, there will be no difference to the current state experience.

10.2.5 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 accreditation, Directors will not have to “concur that the objectives are appropriate” as shareholder objectives will be quantified and described. This will be a given. 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 accreditation process provides the necessary information which will 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 decision 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.

The interesting issue that arises here, is that corporations will be pressured to compete amongst themselves on the basis of, among a range of issues, governance effectiveness. It will not take long for poorly governed corporations who are unable to satisfy shareholders to be perceived as poor investment targets. Poor direction from the Board will exact a heavy price in the market.

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

Perception is important and the independent Accreditation Standard is the means by which such perception will be generated. However, at the end of the day, the shareholder wants the tangible benefit, and not only the *feeling* that he is going to get the benefit. Perception without performance will be unsatisfying to a shareholder.

Accreditation certainly enhances a favourable perception of an accredited company 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.

The accreditation stages of matching shareholder objectives with corporate objectives is critical. As are the next two stages of ensuring that the company's planning processes and performance measures enable those objectives to be realised.

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

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

The accreditation and re-accreditation processes will be undertaken externally to the company by the Accreditation Board or its licensee and as such, will be verifiable. Dynamic tracking between re-accreditations will be undertaken by the company itself.

Stage two of the accreditation process is the independent verification of the match between shareholder objectives and company objectives. If a company cannot justify its corporate objectives by the shareholder data, then accreditation will be withheld or denied.

The Investor Profile may include a tracking section that looks something like this:

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

10.3. Confirming objectives with shareholders:

10.3.1 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 accreditation and re-accreditation. 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 own objectives as captured in his most recent questionnaire. Where a shareholder has expressed a low risk tolerance for example, it will be possible to write to him explaining a proposed project and discussing in detail its risk elements thereby diminishing the perception of risk associated with that project by that shareholder. Modern mail merge technology makes such personalisation easy.

It is believed that those corporations who are shareholder-focused, will use this new capability to build and personalise the relationship between company and owner. It is not the intention for the Accreditation Process to dictate when such communications should occur.

However, the ability for such personalised communications has been made possible through the shareholder information collected by the process. It is felt that this new capability will be quickly seen as a major competitive edge in attracting investors and enhancing perceptions of corporate "value".

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

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

Under accreditation, the shareholder is able to establish from the Investor Profile, his "position" relative to other shareholder objectives <u>before he makes his investment</u>. If he has extreme objectives, then it is quite likely that he would have a low probability for satisfaction and he is best served by looking for an Investor Profile better matching his objectives. If on the other hand he falls within a reasonable range of objectives, then the probability of satisfaction increases.

Where an existing shareholder has extreme objectives such as very high dividends, then the company has a few options. Of course, it may choose not to communicate with the shareholder and allow the shareholder to determine his 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 are not as remote as they 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 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.

10.3.3 Would the agreed objectives be communicated to all shareholders?

Yes. 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, subject to ASX and Security Commission's support, that an Investor Profile would be 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.

10.3.4 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 receipt or denial of accreditation or re-accreditation at Stage Two of the process will provide the shareholder with an independent view of the degree of fit or disparity between shareholder objectives and corporate objectives.

10.3.5 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 accreditation. However, under accreditation, it will be easier for shareholders to “dimension” the degree of probable dissatisfaction or disparity between shareholder objectives and company performance and gauge the probable level of support they may gain in a motion to replace Board members.

10.4. Context

10.4.1 Support of institutional investor and regulatory body

Both bodies are important in determining the ultimate success of the concept.

10.4.2 Willingness of a company or companies to submit to the process

This too is important but not critical.

To establish the concept and fully develop the methodology, it will be useful to have a pilot company which would agree to submit to the process. Each of the intended constituent members of the Accreditation Body have a wide range of corporate contacts, many of whom would be favourably disposed to participation.

In terms of the on-going operation of the process, it is felt that companies will be “pushed” by their owners to become accredited and “pulled” by the desire for competitive advantage in their own industry. It is further felt that over time, all “large” companies will feel compelled to become accredited in the same way as Quality Accreditation is becoming a minimal corporate attribute rather than a discretionary issue.

In Management Consulting for example, any company wanting Government contracts is required to be Quality Accredited. It is felt that Owner Accreditation will emulate this characteristic. Companies who rely on investor support of their corporation, will need to ensure that investor are “comfortable”. Lack of accreditation certification will increase the perception of risk and enhance investor discomfort.

11.0 What if all shareholders don't want the same thing? Implications for directors.

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Business has undergone many changes in style and practice during the 20th century, much of which has been stimulated by promises of increased effectiveness and efficiency. The focus of such changes has traditionally been on directors and management, because they have been perceived as the controllers of corporate destinies. When most business was small and operated with the daily involvement of its owners, this was an appropriate perspective as the distinction between owners and managers was minimal.

However, the face and structure of industry has changed, as has the average corporation that has grown in size and complexity. The relationship between owner and manager has therefore also changed. For all intents and purposes, and notwithstanding employee share structures, owners, particularly owners of large corporations, are rarely the same individuals and entities that make the daily management decisions which impact on the performance and destiny of organisations.

This evolution has led to fundamental differences in perspective as to the role and relationship that the corporation plays regarding its shareholders. The 'property' view sees the corporation as a vehicle intended to advance the purposes of its owners. The 'social entity' view sees the corporation as an institution, an 'entity separate from its owners, one that pursues its own lawful economic interests and objectives separate from and, at times, even contrary to those of shareholders'[1].

In discussing corporate philosophy with the leaders of business, the writer concludes that there is little doubt that the dominant view of mainstream business today is that of the Social Entity proponents – that the corporation exists to pursue its own interests rather than those of its owners. This is despite well-publicised rhetoric to the contrary.

Research conducted into shareholder objectives[2] and their relationship to corporate steerage examined assumptions that underpin modern business practices that have profound effects on shareholder satisfaction and on the way enterprises should conduct business.

The core assumptions examined in the research were *that all shareholders hold the same objectives*, and that *managers and directors act in the best interests of shareholders*.

Refutation of these assumptions should have profound implications on contemporary business practices, corporate regulation, corporate governance, director responsibility and shareholder expectations. Some of the issues that could legitimately be raised in the event of successful refutation would include:

- How can directors and management reconcile differing shareholder objectives within the context of their own corporation's objectives and outcomes?

[1] Francis, I. 1997, *Future Direction: The Power of the Competitive Board*, FT Pitman, Melbourne, 34
[2] Jacoby, J. 1999, *Reframing the relationship between the corporation and its shareholder owners*, Doctoral Thesis, RMIT

- How can directors satisfy their obligation to all shareholders when they use a small segment of shareholders as a proxy for all shareholder 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?
- To what extent do executive remuneration structures based on management incentives threatens the enhancement of shareholder wealth that such incentives are meant to engender?
- To what extent is a corporation's mission and strategies inappropriately directed and influenced by the natural subjectivities and foibles of its directors and managers and to what extent do they detract from shareholder optimisation?
- What methods are available to align a corporation's mission with its shareholders' objectives?

The research examined the on-market performance of the top-20 shareholders in five banks over a ten-year period. The banking industry was chosen because it has traditionally been regarded as a reasonably homogeneous industry. If shareholder differences could be identified in a homogeneous industry – then how much greater would be the implications of such a finding in heterogeneous industries?

What's wrong with the status quo?

There are basically four reasons why the existing relationship between owners and directors/managers is flawed and leads to the under-optimisation of corporate outcomes in terms of satisfying shareholders.

Firstly, corporations have exhibited an inability to resolve the classic dilemma of the incongruence between what is good for the organisation versus what is good for shareholders. When management chooses to adopt TQM, for example, it usually does so at 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? How much harder is it to solve this dilemma, based on a "Property" view of the corporation, when you don't actually know, in pragmatic terms, what those shareholders want?

Secondly, the attitudes, perspectives and subjectivities (among other influences) of directors and management shape corporate destinies. Instead, based on a "Property" view of the corporation, they should be shaped by viable and commercially logical strategies that lead to the delivery of acceptable and pre-established owner-driven outcomes.

On one hand, boards and management argue that shareholders have generic objectives, are not fully informed, have conflicting interests and suffer from a range of other attributes, all of which contribute to their “inappropriateness” in determining the destiny of the organisation in which they hold ownership. This philosophy holds that the board and management are better placed to determine the destiny of the organisation and determine the outcomes that the corporation will deliver. Shareholders who don’t like the way the company is run (so the “Social Entity” philosophy goes) can quit the registry and take up ownership elsewhere.

The contrary view held by many, perhaps most shareholders, regulators, and certain key associations, maintains that the organisation exists to deliver shareholder satisfaction. As such, the organisation is the servant of the owners and all that the organisation does, must in one way or another enable those shareholder objectives to be fulfilled or enhanced.

Examples abound of management which has taken an organisation down a particular path for a range of seemingly admirable reasons only to find that its owners either flee the registry or whose best interests are seriously damaged.

The problem with boards and management who are beholden to no one except themselves is that they have no reference point against which decisions and strategies can be assessed and determined. An organisation whose principal accountability is to itself is not compelled to maximise owner benefit or even to avoid owner harm if it believes that such a course “is not in the best interests of the corporation” or is in some other way defensible.

Corporations that act in other than the best interests of owners (including those who only give lip service to the concept of shareholder satisfaction) create decreased probability of satisfaction, and imply higher risk to their owners. Investors denied access and input feel vulnerable to the character and machinations of management. They will tend toward other forms of investment where probability of outcome is stronger, and where the investor is offered greater accountability from the chosen investment vehicle and less susceptibility to the foibles of individuals.

Corporations must ultimately be accountable to their owners and the outcomes delivered by those organisations must be unashamedly aimed toward satisfying and/or enhancing owner objectives - whatever they may be. It is only through the establishment and enforcement of an external accountability on a corporation that owners can start to feel some comfort (but no guarantee) that their organisation is striving to achieve that which its owners intend or want.

Thirdly. Whether we are prepared to admit it or not, many boards abrogate the responsibility for steering the organisation to management. During interviews with some corporate icons of some of our largest corporations, I was stunned to be told that the board does not review strategies and visions for the organisation because “that is the responsibility of management”. And yet managers, as we all know, are coloured or biased by human individuality and subjectivity. If the board, whose job it is (among other things) to ensure shareholder “optimisation”, then how much harder is optimisation to achieve when the strategies for their delivery are abrogated to those who may subjectively determine what is to be optimised, how it is to be achieved and when it is to be achieved.

Fourthly. CEO and corporate performance is most frequently measured against the performance of peer CEOs and corporations. On a regular basis, one sees in the general or specialist media the corporate performance ranking for a range of industries.

The principle seems to be that the organisation, and therefore the CEO, with the “best” ratio or set of ratios are deemed to win the prize. A prize incidentally, that can be worth considerable investment funds while a low ranking can spell financial disaster for those at the bottom of the list. The problem with this is simple. If a company has the best, say ROI, of its peer group, then (assuming this was the only criterion), it is deemed to be the best company. But what if the ROI was achieved through high gearing and/or high risk, and what if the corporation’s shareholders were risk averse? Is the CEO still the best?

Understanding why companies must recognise that “value” is whatever shareholders consider of “value”.

My work at the governance end of scores of corporations, together with much detailed work within the depths of those organisations leads me to observe that much (but nowhere near all) of what corporations do, is often a product of unjustified or unvalidated subjective assessments by management.

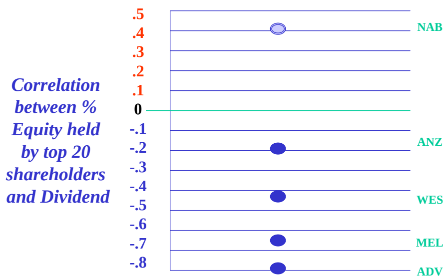
As an example are the range of definitions for the concept of “Value”. Is “Value” for the corporation the same as “Value” for the shareholder? What does RONA, EVA or some other measure do to drive corporate performance and to deliver shareholder satisfaction? If, as has been said to me by Chairmen of leading organisations that “all shareholders want the same thing”, then surely the same measure of “Value” would be applicable to all – and this is demonstrably not the case. The research shows that different shareholders *want* differing outcomes in the same way that different organisations *create* different outcomes.

If different measures of “Value” create different outcomes, as they do, then the process used to establish what is “Value” is as important as the outcomes it is meant to deliver.

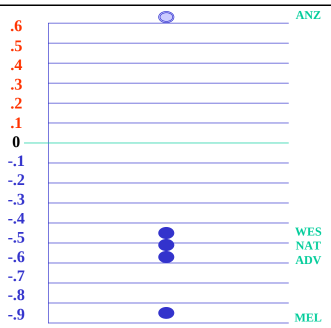
Matching one with the other is a skill required of both corporations and shareholders. And the easiest way to do this is to define “Shareholder Value” as “the delivery of the outcome which shareholders want”. The challenge then is to determine exactly what that is.

Recognising the diversity of shareholder objectives

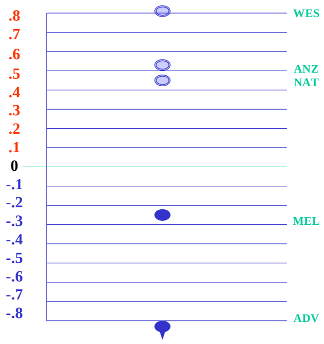
One aspect of the research tested the thesis that shareholders do not have common objectives and that the same shareholder has different objectives for different investment targets. The following charts illustrate some of the findings.



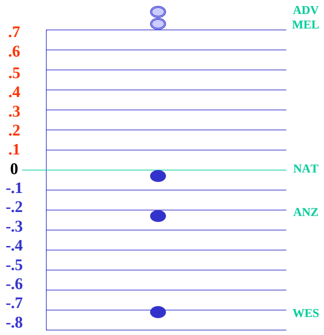
Correlation between % Equity held by top 20 shareholders and % Debt/Equity



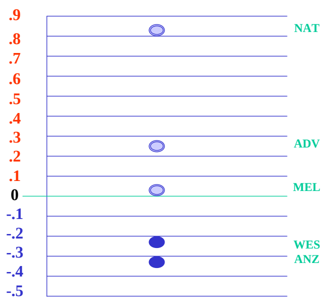
Correlation between % Equity held by top 20 shareholders and Market Capitalisation



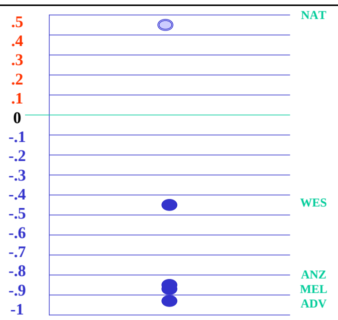
Correlation between % Equity held by top 20 shareholders and % Dividend Yield



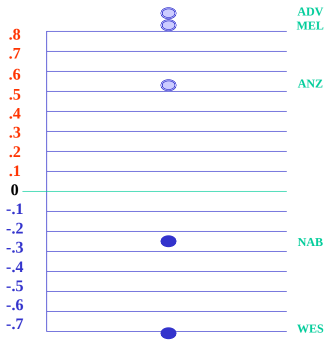
Correlation between % Equity held by top 20 shareholders and Net Tangible Assets per share



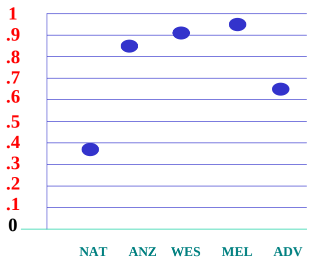
Correlation between % Equity held by top 20 shareholders and Earnings per share



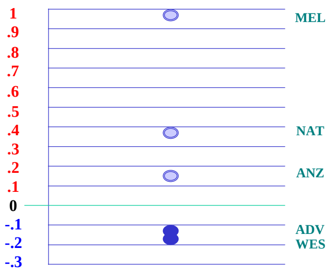
Correlation between % registry churn and % debt equity



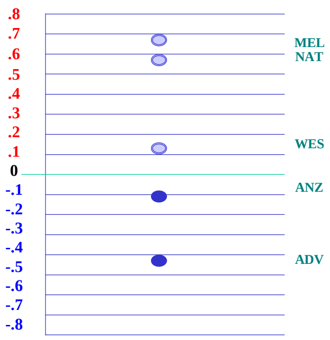
Correlation between % registry churn and market capitalisation

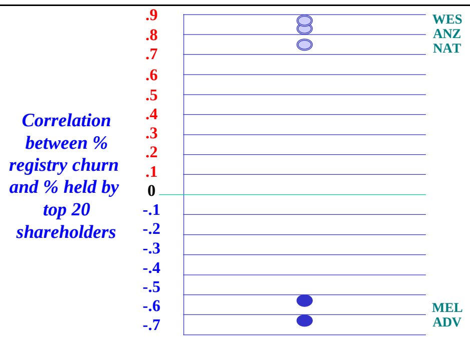


Correlation between % registry churn and dividend per share



Correlation between % registry churn and net tangible assets per share





A common response to these findings is "I can explain why these differences between the banks occur." These explanations of why differences occur only reinforce that the differences exist.

It was clear from these findings that shareholders have different objectives and perception of "value" and that the same shareholders have different "value" expectations from their differing investments.

Conclusions and Implications for directors

The results of the research, 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 model proposed in the research study (but not discussed here) 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.

Director and management 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 model proposed in the research study 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 ensures 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'. Directors and management 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 model proposed in the research study 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 that 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 different objectives despite a high degree of ownership overlap between the five banks studied. The research thesis maintained 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 thesis presented 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 ensured those 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 established 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 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 determine the markets from which those deliverables must be secured - which define the product and service options used in those markets to extract the deliverables - which define the methods and channels used to bring the product and services to the market - which define the resources (human, technological and knowledge) needed to achieve these outcomes - which 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 research 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 research 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.

The recommendations that emerge from this research can be summarised as follows:

- Corporations should no longer assume that the shareholders that constitute their share registries necessarily have common objectives and aspirations.
- Corporations should survey their shareholders in order to establish their quantified objectives.
- Corporations should adopt a corporate/strategic planning process that adopts shareholder objectives as the corporate mission and reason for existence, and use these 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 planning 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.

The failure to acknowledge the continuing evolution of the relationship between owners and their corporations is both naive and arrogant. Such naivety and arrogance will impinge on an organisation's ability to adapt to the changing needs of its owner constituency.

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12.0 Indicative and Tentative Task list for Each Phase of Owner Accreditation

Phase 1 - Shareholder Metrics

- Discussions and interviews with board members and senior managers
- Discussions with share registry managers
- Review of annual reports and other internal documents
- Develop Phase 1 workplan
- Customisation of survey instrument
- Pilot testing of survey instrument
- Interview of top 50 shareholders
- Printing of questionnaire
- Mailing of questionnaire
- Receive & Process questionnaire
- Data validation processes
- Mop-up mailing
- Cross-tabulations
- Phase 1 Accreditation Report - Shareholder Metrics
- Establish process for dynamic mailing and processing of new shareholders
- Meet with Board and Management to present and discuss findings
- Prepare recommendation to Accreditation Board - Certification Committee
- Advise candidate of granting or withholding of Phase 1 accreditation
- If withheld, develop compliance plan and discuss with Board
- Prepare Accreditation documentation
- Advertise granting Phase 1 Accreditation

Phase 2 - Alignment of Objectives

- Discussions and interviews with board members
- Development of Phase 2 workplan
- Review internal documents, corporate, business, market and strategic plans
- Discussions and interviews with senior managers
- Phase 2 Accreditation Report - Alignment of Objectives
- Meet with Board and Management to present and discuss findings
- Prepare recommendation to Accreditation Board - Certification Committee
- Advise candidate of granting or withholding of Phase 2 accreditation

- If withheld, develop compliance plan and discuss with Board
- Re-assess after advice from candidate that they are ready for re-assessment
- Prepare recommendation to Accreditation Board - Certification Committee
- Prepare Accreditation documentation
- Advertise granting of Phase 2 Accreditation

Phase 3 - Assessment of Processes

- Discussions and interviews with board members
- Development of Phase 3 workplan
- Review internal documents
- Develop or examine process view of organisation
- Develop or examine view of approval processes
- Develop or examine view of planning processes
- Discussions, interviews and workshops with senior managers and key personnel
- Phase 3 Accreditation Report - Assessment of Processes
- Meet with Board and Management to present and discuss findings
- Prepare recommendation to Accreditation Board - Certification Committee
- Advise candidate of granting or withholding of Phase 3 accreditation
- If withheld, develop compliance plan and discuss with Board
- Re-assess after advice from candidate that they are ready for re-assessment
- Prepare recommendation to Accreditation Board - Certification Committee
- Prepare Accreditation documentation
- Advertise granting of Phase 3 Accreditation

Phase 4 - Assessment of Performance Measures

- Discussions and interviews with board members
- Development of Phase 4 workplan
- Review internal documents
- Identify performance measures used in organisation
- Discussions, interviews and workshops with senior managers and key personnel on use of and rationale of performance measures used
- Phase 4 Accreditation Report - Assessment of Processes
- Meet with Board and Management to present and discuss findings
- Prepare recommendation to Accreditation Board - Certification Committee
- Advise candidate of granting or withholding of Phase 4 accreditation

- If withheld, develop compliance plan and discuss with Board
- Re-assess after advice from candidate that they are ready for re-assessment
- Prepare recommendation to Accreditation Board - Certification Committee
- Prepare Accreditation documentation
- Advertise granting of Phase 4 Accreditation
- Organise major press release and promotion on new Comprehensive Accreditee

13.0 Curricumulm Vitae – Dr Jack Jacoby

Qualifications:

- Doctor of Business Administration
- Master of Business Administration
- Bachelor of Arts (Sociology and Economics)
- Trained Mediator

Current and Past Associations:

- Fellow of the Australian Institute of Management
- Certified Management Consultant - Australian Institute Of Management Consultants
- Chairman of RMIT DBA Course Committee
- Chairman and member of Swinburne University Business School Course Committee
- Member of Society of Senior Executives
- Committee Member and member of Victorian Dispute Resolution Association
- Member of Australian Marketing Institute
- Member National Speakers Association of Australia
- Associate Fellow of the Australian Marketing Institute
- Member of the Australian Market Research Society
- Member Master of RMIT Corporate Governance Course Development Committee
- Business Mentor - La Trobe University Technology Enterprise Centre
- Judge: Melbourne University Business School Entrepreneurial Challenge
- Member of RMIT's MBA Committee of Practice Course Committee

Key Achievements:

- CEO of 465 bed hospital (over 500 staff supervised) for over 5 years
- Director in Ernst & Young's Management Consulting Practice for over 5 years.
- National Marketing Manager $100m Telco operation
- Developed Innovative Business Planning methodology
- Developed Shareholder Metrics Concept
- Developed Innovative Knowledge Management Model
- Business Planner for Government and Private Corporations
- Appointed to restructure various Government Departments
- Appointed to conduct Prison Review for WA Government
- Appointed to review Fire Brigade for WA Government
- Appointed as commercial expert by Victoria Government on tender evaluation panel
- Developed Collaborative Networking Concept
- Founder of the VisionCircle Movement
- Founder of "20Force" (XXF) concept
- Founder of the Owner Accreditation Concept
- Innovator of the Knowledge-In-Confidence Mentoring Service
- Conference Speakers and Author of various articles

Expertise

- Operations and Management
- Organisational structure, efficiency and effectiveness
- Strategy development and implementation
- Business planning
- Troubleshooting
- Market strategy
- Knowledge Management
- Life Coach and Mentor

Experience:

- Major Projects for companies such as AWB, Fujitsu, Fosters, Amcor, Telstra, Ericsson, Kraft, Bell South, Coles Myer, Colonial, Comalco, Commercial Union, Crown Casino, Ernst & Young, Elcom, Loy Yang Power, Ford, Fortis Insurance, Bell South (USA), Brambles Industries, Colonial Mutual Insurance, Export Finance and Insurance Corp., FAC - Melbourne International Airport, Gas & Fuel Corporation, Gordon and Gotch Limited, Lend Lease Properties, Melbourne Water, Mercantile Mutual, Olympic Park Trust, Pine Australia (for Softwood Industry of Australia), Public Record Office Victoria, Queensland Phosphate Limited, RACV, Reader's Digest, South West Petroleum Corporation (USA), TV New Zealand, United Energy, Victoria Police, Victorian Accident Rehabilitation Council, Village Nine Leisure, WA Building Management Authority, West Australian Fire Brigades Board, Westralian Sands Limited many government departments at Ministerial level.
- Projects undertaken in USA, Europe, Malaysia, Singapore, Hong Kong, Canada, Brazil
- Developed Shareholder Metrics Concept that enables organisations to align activity and resources to shareholder satisfaction.
- Developed Innovative Knowledge Management Model that identifies mission-critical knowledge and mission-critical know-how without the need for expensive consultants. Also, uniquely, has developed method to convert tacit to explicit knowledge.
- Appointed by Ministers to oversight and audit management decisions, particularly related to major agency restructure.
- Appointed to conduct Prison Review for WA Government.
- Appointed to resolve major public conflict within Fire Brigade for WA Government.
- Appointed by Victorian Government as Commercial expert on major tender evaluation panel
- Project Manager of initial program to identify method to maintain electronic records for 100 years (VERS) – Now adopted as Australian standard for electronic archives
- Conference Speaker and Author of various articles and being adopted world-wide.
- Developed marketing strategies for organisations with turnover as large as $5.5 billion per annum.
- Taught Strategy in Masters of Management Course with the Australian Institute of Management joint venture with the Norwegian School of Management BI Executive School (Bedriftsokonomisk Institutt).

- Taught strategy in the Australian Institute of Company Directors, Director Accreditation Program.
- Taught strategy, market research and consumer behaviour at post-graduate and graduate levels at RMIT, Swinburne University, Victoria University – Melbourne and Hong Kong.
- Royal Melbourne Institute of Technology University - Past Member Master of Corporate Governance Course Development Committee
- Examiner of Research – Doctor of Business Administration
- Supervised over 20 Masters of Management Research Students

Detailed CV on Web

Web address: http://www.jacobyconsulting.com.au

Publications

- Jacoby, J. (1999). *'Are you listening to shareholders?',* in Company Director, Australian Institute of Company Directors, Vol 15, No 7, August
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- RMIT, Press Release, How can company directors justify pay rises to their shareholders?*, 28 October 1999,*
- *Gartner Group web site: http://www.gartnerg2.com/Growsmart/fw_forcesCompetition.asp discussion on Guru Theory hyperlink to JCG web site.*

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