

ADVANCED GOVERNANCE: STRATEGY AND THE IMPERATIVE OF PERFORMANCE

Mac Van Wielingen

Viewpoint Group



DISCLOSURE

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For additional information, contact:

Viewpoint Group

4301, 400 3rd Ave SW

Calgary, Alberta T2P 4H2 T: 587-393-8466

info@viewpointgroup.ca

www.viewpointgroup.ca



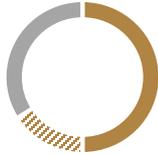
BUSINESS SURVIVABILITY & PERFORMANCE

THE EMPIRICAL REALITY IS THAT MOST BUSINESSES
UNDERPERFORM AND FAIL



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THE PERFORMANCE CHALLENGE



Half to 2/3 of newly formed companies statistically disappear within their first five years. ¹

THEORY OF POSITIVE SKEWNESS

Positive skewness, is a nonsymmetrical distribution within a portfolio, as the result of numerous small losses and a few extreme gains. **It tells us that only a few companies drive the real value creation in a portfolio.** This phenomenon can be seen generally across the business sector in public equity returns, private equity and venture capital.²

A recent study this year from the University of Arizona,³ which reviewed lifetime returns of 26,000 stocks (listing to delisting) over a 90-year period in the U.S., found that **six out of 10 stocks did not outperform low risk treasuries.**

Therefore, the fact that **the overall stock market has outperformed low risk treasuries can be attributed to positive skewness.**

“I focus on the point of performance, because I am always asking myself: *What is the typical experience for a management group or board of directors?* The evidence points to a serious challenge of underperformance.”

¹ Parsley, C., & Halabisky, D. (2008). Profile of growth firms: A summary of Industry Canada research. Ottawa: Industry Canada, March 2008. [https://www.ic.gc.ca/eic/site/061.nsf/vwapj/ProfileGrowthFirms_Eng.pdf/\\$file/ProfileGrowthFirms_Eng.pdf](https://www.ic.gc.ca/eic/site/061.nsf/vwapj/ProfileGrowthFirms_Eng.pdf/$file/ProfileGrowthFirms_Eng.pdf)

² Buchner, A. (June 2016). *Dealing with non-normality when estimating abnormal returns and systematic risk of private equity: A closed-form solution.* Journal of International Financial Markets, Institutions & Money. 45 (2016) 60–78. Available at <https://www.sciencedirect.com/science/article/pii/S1042443116300488?via%3Dihub>

³ Bessembinder, Hendrik. (November 2017). *Do Stocks Outperform Treasury Bills?* Journal of Financial Economics, Forthcoming. Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2900447

THE PERFORMANCE CHALLENGE IN CONTEXT

“Even the most established, leading companies eventually, predictably, **hit the wall of underperformance and are restructured, merged, or sold.**”

EXAMPLES FROM CANADIAN OIL AND GAS

- Encana
- Nexen
- Penn West
- Pengrowth
- SaskOil
- PetroCanada
- Bow Valley I
- Renaissance
- Dome

EXAMPLES FROM OTHER CANADIAN SECTORS

- Valeant
- Bombardier
- BlackBerry
- Nortel

EXAMPLES FROM INTERNATIONAL LARGE CAPS

- Lehman Brothers
- AIG
- Citigroup
- General Motors
- Washington Mutual
- Barings Bank
- Long-Term Capital Management
- Arthur Anderson
- Enron
- WorldCom

THE PERFORMANCE CHALLENGE & OUR BUSINESSES

“The performance challenge cuts across all businesses small and large, over all time, in the life of all companies. **If we are going to run our businesses like most businesses are run, it is only reasonable to expect that you will end up like most businesses.**”

“...but ***what about our businesses?*** What can we possibly do differently to increase the probability that we will survive?”

- There is **no room for complacency** – to think you are comfortable.
- There is **no room for arrogance** – to think you know, and that you are better than your peers.

“Complacency and arrogance feed an attitude of infallibility when the current reality is always of some degree of vulnerability.”

DRIVERS OF PERFORMANCE

WHAT ARE THE DRIVERS OF PERFORMANCE AND HOW
ARE THEY RELATED TO STRATEGY?



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DRIVERS OF PERFORMANCE & COMPREHENSIVENESS

“In my business career, I have been continuously searching for the one big driver of performance. The reality is that there is *no silver bullet*. **There are multiple drivers**. Each is essential; each offers the opportunity to create a competitive advantage. **If any one of the fundamentals is missing, your organization may be in peril.**”

PERFORMANCE FUNDAMENTALS

- Vision
- Knowledge & Expertise
- Leadership Competencies
- Execution
- Engagement
- Quality Decision Making
- Risk / Capital Structure
- Long-Termism vs. Short-Termism
- Innovation / Adaptation
- Access to Capital
- Culture

“I have had executive leaders say to me – *it sounds too complex – it’s overwhelming – how can we do it all?* The answer, I believe, relates to **strategy and the importance that your strategy is comprehensive** and includes all of the drivers of performance.”

GOVERNANCE OF PERFORMANCE

How do we really do this?

The governance of performance looks at the respective roles of management and the board, and the structure of responsibilities and authorities within an organization.

It is critical to look at the Board of Directors' authorities and how they link with performance.

The board has authority over all material fundamentals of an organization, including approval of:

- Issuance of debt and equity;
- Capital structure/strategic risk;
- Capital spending and allocation of capital;
- Material transactions;
- Compensation;
- CEO & Management team; and,
- If the organization should remain as a going concern.

- The role of the board goes way beyond passive compliance and advisory.
- The Board and Management are a partnership, sharing in the leadership responsibility of an organization – the board can be seen as the control partner and management is the executive partner.
- Management has the responsibility to develop and implement strategy, but the board has the ongoing responsibility for essential due-diligence and, ultimately, the decision if the strategy is good/great and justifies the commitments of the organization.
- Most boards operate at a sub-optimal level and don't recognize themselves as part of the leadership of the organization.

***“I confess, that when I see a company with a wrecked balance sheet,
I see a company with a board of directors who have failed.”***

ADVANCED PRACTICES

THE FOLLOWING OFFERS FIVE PRACTICES, WHICH I HAVE USED AND SEEN HAVE SUCCESS IN MY OWN EXPERIENCE, BUT THERE ARE MANY MORE THAT COULD BE ADDRESSED



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VISION

Find a way to describe your vision that is compelling and that is moving towards what is viewed as a leadership position in your industry.

ADVANCED PRACTICE

Ask yourself: How committed are we to being a leading business? // How do we define this? // How do we evidence that we are living our vision?

EXAMPLES OF VISION



We set out to be a “leading advisory and investment company with a focus on thought leadership and industry knowledge.”



In 1996, established vision as “premier ‘blue chip’ conventional oil and gas company in Canada, as measured by quality of assets, management expertise, and long-term investor returns.”



Vision transitioned from “Centre of Excellence” to “among the Best in Canada” to “aspire to be World Class.”



“To be a leading family office that catalyzes positive change in organizations and communities.”

Are you living your vision to be a leading business?



STRATEGY

How do you know you have a strategy, and how do you know it is a great strategy?

Strategy creates coherence and rationale for the commitment of the organization's resources.

- The most important condition is **comprehensiveness** (i.e. connecting all fundamental areas).
 - Ask yourself: Can we put a checkmark next to each fundamental area (see *slide 8*), and is there internal consistency next to each?
 - Is there the flexibility and scope necessary for change?

ADVANCED PRACTICE: Integration of Competencies and Culture

- Strategy has to be integrated into purpose.
- What you are trying to achieve is broader than one variable – it goes beyond solely profit. In addition to profit, purpose also needs to include a perspective on risk, timeframe, and quality of human experience.

Risk	<ul style="list-style-type: none">▪ We all know that we are trying to maximize profitability, but the other side is that we are trying to manage the predictability of profit. There is no such thing as profit/value creation without uncertainty.
Timeframe	<ul style="list-style-type: none">▪ Strategy is inherently long-term, and so is organizational development.
Quality of Human Experience	<ul style="list-style-type: none">▪ You want stakeholders to have a quality experience that is fulfilling and flourishing. To the extent that you can achieve this, you can create extraordinary cultures.

Can you evidence that you have a great strategy?

ORGANIZATIONAL COMPETENCIES

Evaluating leadership and communication competencies.

We are generally well-aware of technical and functional competencies, but not as much of organizational competencies (i.e. leadership and communication), such as:

- Priority setting;
- Determining what is material;
- Workplace coordination; and,
- Clarity and direction on values.

ADVANCED PRACTICE: 360 Performance Reviews

- Complete a 360 degree performance review for the CEO (annually) and the Management team (biennially) that is summarized and presented to the full board.

“If we’re paying people millions of dollars and their most important function is the oversight of people, don’t we want to have some objective information from the people who are reporting to them?”

Can you evidence an objective understanding of the leadership capabilities within your executive team?

ACCOUNTABILITY

Accountability is a proxy for performance.

- Accountability is the acceptance of responsibility and the willingness to be answerable for progress towards a desired outcome within a particular domain of responsibility.
- It is the process of aligning progress and desired outcomes.
- It requires the willingness to be open, transparent, and accountable for progress.

ADVANCED PRACTICE: Self-evaluated Progress Monitoring Report

- Simple, but powerful.
- Non-bureaucratic report.
- Progress is reported to peers.
- Can be effective in building a performance-based culture with high accountability.

Can you evidence that you have accountability processes that support learning, adaptation, and performance?

CULTURE

Strength of culture is a governance imperative.

There is a large body of research linking culture with performance.

- Includes areas such as trust, learning orientation, discipline, and engagement.

ADVANCED PRACTICE: 'Strength of Culture' Survey

- ARC Resources began 'strength of culture' surveys over 15 years ago, based on Gallup data.
 - Completed on an annual basis, electronically and anonymously.
 - Reviewed by the Board.
 - Actions plans made by department based on feedback.
- In partnership, Viewpoint and ARC Financial have developed an *Organizational Health and Effectiveness Profile* to measure organization health and effectiveness based on 16 different comprehensive factors.

Can you evidence an objective, unbiased understanding of
'strength of culture'?

SUMMARY

- The performance challenge is real and pervasive for companies at all stages, and the empirical reality is that most businesses underperform and fail.
- There are multiple drivers of performance, and strategy must be comprehensive to include all drivers.
- Sustained business success is rare and complex, and directors play a key role in performance.
- The role of the board goes way beyond a passive, compliance-based role. The Board and Management are a partnership, sharing in the leadership responsibility of an organization.
- In implementing Advanced Practices, ask yourself the following five questions:
 - Are you living your vision to be a leading business?
 - Can you evidence that you have a great strategy?
 - Can you evidence an objective understanding of the leadership capabilities within your executive team?
 - Can you evidence that you have accountability processes that support learning, adaptation, and performance?
 - Can you evidence an objective, unbiased understanding of ‘strength of culture’?

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