The impact of governance on the performance of a high-growth company: An exemplar case study

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Abstract

Research into the contribution boards make to company performance has proliferated over the last few decades. However, research findings have been inconclusive and the contribution boards make to both strategy and business performance still remains unclear. Corporate governance is of "enormous practical importance", so efforts to understand the governance–business performance relationship must continue. But the current research agenda must be shifted and the black box of governance systemically opened if causality is to be established.

The aim of this paper is to present a summary account of recent case study research investigating the contribution that boards make to the performance of high-growth companies in New Zealand. A qualitative case study design and theory-testing framework were used to examine the impact of strategic decision-making on performance. The research identifies and develops the understanding of factors that affect the governance–business performance relationship in high-growth companies shifting the discussion from relationship to causality. Three significant insights were developed from the study, namely, board involvement in the development of strategy was observed to positively affect performance; the board aligned decision making directly with strategy; and, the board upheld an atmosphere of open communication and trust with management.

Keywords: black box, case study, decision-making, establishing causality

1 Introduction

Over the last four decades the search for business performance has increasingly shifted from the CEO to the boardroom. Consequently, research into the contribution boards make to performance has proliferated. More so since the high profile company failures of the early 2000s. Much governance research has focussed on large companies and specifically on board structure (Cowling, 2003), composition (Nicholson & Kiel, 2007) and practice (Adjaoud, Zeghal, & Andaleeb, 2007). Governance is a complex phenomenon (Sargot & Rita, 2011) and, as yet, there appears to be little evidence that board contributions result in better performance. Evidence to conclusively associate governance activity and strategic decision-making with company performance remains elusive (Machold, Huse, Minichilli, & Nordqvist, 2011).

Many companies that start well fail to sustain high performance over the long-term. Ineffective governance appears to be one of the contributing factors (Schmidt & Brauer, 2006). The New Zealand jurisdiction seems to be no different from elsewhere, except that high-growth companies are the primary means of improving the country's economic growth. Therefore, the development of a clear understanding of how governance contributes to the performance of high-growth companies is crucial to New Zealand's economic development, especially given the board's proxy to maximise company performance (Bainbridge, 2002) and the important contribution company performance makes to economic growth (Gamber & Scott, 2007) and social wellbeing (Friedman, 2005).

This research investigated the contribution that governance makes to the performance of high-growth companies in New Zealand. It builds on prior literature and includes a detailed investigation of one company by way of an exemplar case study (Clegg, Hardy, Lawrence, & Nord, 2006). Because prior literature suggests a relationship exists, a theory-testing framework was used. However, the nature of the relationship and contributing factors are not yet apparent. The source of strategic decision-making was also examined: whether or not strategic decision-making can be attributed to the board. The research questions were therefore "does a relationship exist between governance practice and subsequent company performance in New Zealand high-growth companies?" and "if a relationship exists, what form does it take?"

2 Literature review

The contribution boards make to company performance has been the subject of much, but largely ineffective, research (Bennis & O'Toole, 2005). Most of this research has been influenced by the legalistic and adversarial agency theory (Fama, 1980; Jensen & Meckling, 1976). It postulates that governance structures and control mechanisms can mitigate the agency problem. Stewardship theory has been proposed as an alternative to agency theory (Donaldson, 1990). It presents a co-operative view of governance founded in psychology (Donaldson & Davis, 1991), whereby relationships and interests converge. Stewardship theory is perhaps more applicable than agency theory to younger, high-growth companies, because founders and managers typically share a common motivation to work together towards a common goal (Muth & Donaldson, 1998). Another theory is resource dependency theory (Pfeffer & Salancik, 1978). Grounded in sociology and organisational theory, it presents the board as an important bridge that facilitates connections with external parties (Zahra & Pearce, 1989) to secure much needed resources.

The major governance theories offer different perspectives. The board’s priority under agency theory is to “control and monitor”; under stewardship theory to “enable and empower”; and, “facilitate and supply” under resource dependency theory. However, none of the theories satisfactorily account for all cases of governance (Nicholson & Kiel, 2007). Therefore, more research is required, especially inductive theory-building research, if a universal theory of governance is to be discovered.

Boards provide the vital link between company owners and managers (Fama & Jensen, 1983), and structural variables have been assumed to be important to protect shareholder interests (Becht, Bolton, & Roell, 2002). Researchers have studied board composition and structure in an effort to identify the best configuration to maximise company performance. Their findings provide “scant support” (Dulewicz & Herbert, 2004, p. 263) for the three main governance theories however. They support assertions that the pursuit of a “one size fits all” governance model (Davies & Schlitzer, 2008) and an “optimal board structure” (Boone, Casares Field, Karpoff, & Raheja, 2007) may not be practical. This is far from surprising given the inclinations of human nature. As a result, the establishment of causality between boards and performance is likely to require a different set of lenses than that commonly adopted. The crude input–output model of board attributes and company performance is no longer credible.

Governance structures and processes in venture-backed companies often vary from those in traditional companies (van den Berghe & Levrau, 2002). The small company literature suggests that boards add a strategic dimension (Zahra & Filatotchev, 2004) and are more active (Arthurs, Busenitz, Hoskisson, & Johnson, 2009); the Chair’s leadership effectiveness and board effectiveness are correlated (Machold et al., 2011); and, that governance structure can affect their efficiency (Nanka-Bruce, 2011) and growth (Lappalainen & Niskanen, 2009).

Company performance is heavily dependent on the selection and implementation of appropriate strategies that enable the company to compete effectively (Ahenkora & Peasah, 2011) and maximise value (Simons, Davila, & Kaplan, 2000). Some researchers have suggested that boards should be actively engaged in the strategy development and decision-making process (Ingley & van der Walt, 2005), because they are responsible for maximising company performance. While the development of strategy is now widely recognised as a major task of the board (Huse, 2007), a board’s involvement might be active or passive (Golden & Zajac, 2001), or somewhere in between (Wheelen & Hunger, 2006). When researchers studied how boards contribute to strategic decision-making (Pugliese & Wenstop, 2007), working style, including cohesiveness (Levrau & Van den Berghe, 2007a) and vigorous debate (Kerr & Werther, 2008), was a more important antecedent of effectiveness than structure or composition.

The paucity of any conclusive governance-performance causal explanation confirms the understanding of how boards contribute to company performance is, at best, limited (Leblanc & Gillies, 2005). Helpfully, the literature provides some guidance to direct future research efforts. It suggests behavioural factors are far more important than structural and composition factors when determining the board’s contribution to company performance. Further, it indicates that direct observation (Leblanc & Schwartz, 2007) is crucial to understand the processes and behaviours that contribute to decision-making and effectiveness, because assumptions of congruence in the black box cannot be relied upon (Lawrence, 1997).

3 Research method

The contextual nature of board interactions requires direct observation of the phenomena rather than the continued adoption of proxies, which have contributed mostly little to date. Case studies are widely recognised as the appropriate method when conducting in-depth research into a complex phenomenon with many relationships and variables (Eisenhardt, 1989). They have the potential to expose causality in situations that are too complex for statistical or experimental methods (Yin, 2009). Consequently, a qualitative case study design and established case study process (Stake, 1995) was used. Formal and informal pathways were used to approach companies that met the purposive selection criteria, including the use of existing relationships to advocate access (Leblanc & Schwartz, 2007). The company that agreed to participate in this research (from an initial list of 23 companies) was known to the researcher through his professional network.

Several different techniques were used to collect data including interviews with key governance actors; direct observation of a board meeting; and, the inspection and analysis of archival data. Inductive (Griggs, 1987) and positivist (Lockhart & Taitoko, 2005) analysis techniques were used to identify common themes, decision points and performance inflections. Respondent validation (Bloor, 1978) and triangulation techniques (Stake, 1995) were used to improve credibility. Therefore, the relationship between board decision making (as minuted) and subsequent activity was established.

The Chairman and CEO were interviewed using a semi-structured interview technique. A list of questions was used to guide the in-depth interview, and interviews were recorded. One full board meeting was observed. Direct observation enabled the researcher to see through the Board's eyes, take less for granted, be sensitive to context and be flexible to cope with unexpected events or findings (Marshall & Rossman, 1999). The researcher, who was a silent observer and was seated apart from the participants, recorded the meeting (audio) and made handwritten notes. Over fifteen years of archival data - including annual reports, share register, Company website, marketing brochures, other published material, and a list of current and previous directors - was reviewed to understand historical decisions and performance patterns.

Data was codified using the pictorial timeline framework developed by Lockhart and Taitoko (2005). This positivist approach, which was used for triangulation, enabled the timing of major company decisions and events to be identified relative to other significant events and subsequent performance inflections.

4 Results

The Company selected as the exemplar case for this research is domiciled in New Zealand, with operations in New Zealand and Australia. Founded in the early 1990s, it employs approximately 230 staff. The two founders were involved in day-to-day operations throughout the first decade when the Company experienced rapid growth. Originally a family-owned firm, the Company now has approximately 195 shareholders and a Board of four directors. None of the directors are employees, however, all have prior CEO experience. No strategic decisions are made outside normal board meetings. Audit and remuneration committees meet when required. An analysis of the interview, observation and archival data revealed that the Company has experienced four distinct growth phases since its formation.

4.1.1 Phase 1: Formation and initial growth

The first phase spanned the period 1992–2001. The Company experienced high growth (over 130% Compound Annual Growth Rate (CAGR)) throughout this phase. No explicit growth strategy was apparent. The Board appears to have become a formal construct about three years after the company was founded. Four significant decisions contributed to the Company moving from "growth" to "plateau". These included decisions to appoint a new CEO (unsuccessful); consolidate operations into one location (culture changed from "entrepreneurial" to "made it"); establish a joint venture with a global telecommunications systems company (unsuccessful); and, to appoint non-executive directors to the Board.

4.1.2 Phase 2: Plateau

The second phase spanned the period 2001-2005. The Company operated profitably and paid shareholder dividends throughout this phase, however, there was no revenue growth. The lack of growth indicates the Company had begun to lose its way as an entrepreneurial high-growth company. With the benefit of hindsight, the culture of the Company - so important to building momentum, binding the shareholders and staff together and achieving strong growth - had become the strategy. Throughout this phase, a Board was in place and functioning. Despite membership changing from an executive majority to a non-executive majority, the Board appears to have been largely passive with respect to strategy. Management continued to take a strong lead in decision-making. The Board's primary contribution was to set financial growth targets, of which few were met.

4.1.3 Phase 3: Professional management

The third phase occurred in the period 2005–2008. It commenced with the employment of an external CEO to pursue growth. The new CEO proposed a high-risk growth strategy, which appears to have been endorsed by the Board. There is no evidence to suggest the Board understood the importance of what was being proposed, or that it monitored the implementation of the new strategy effectively. Revenue remained relatively static and EBIT performance declined sharply. Despite declining financial performance, the Board remained relatively passive. It was only when a manager approached the Audit Committee directly that the disquiet amongst staff was first signalled to the Board. Unfortunately, the Board failed to monitor the Company's actual trading performance sufficiently closely to expose the true situation itself - until it was almost too late.

4.1.4 Phase 4: Reinvigoration and new growth

The fourth phase started in 2008. Following the near failure of the Company, the Board determined that a new CEO and Board were required to provide effective governance and leadership. The CEO departed, and an Acting CEO, a new Chairman and a new independent director were appointed. Two directors remained from the previous Board. For the first time in its history, the Company had a Board comprised of astute, business-focussed directors with considerable market knowledge. A mature governance platform for reinvigorating the Company had been established. The incoming Board became actively involved in the decision-making process. A series of immediate expenditure reductions were made to stabilise the Company's cash position and resecure the bank's support to continue to trade. Once this was achieved, the new Board resolved to appoint the Acting CEO permanently.

4.2 Development of strategy

Historically, strategy was developed with little active involvement from the Board. This was implicit in the early phases of the Company's life cycle, when the Board was relatively immature and largely comprised of executive staff. During the Professional Management phase, the CEO developed strategy with little if any contribution from the Board (other than approval). In contrast, the current Board and management develop strategy together. Strategic options and significant business opportunities regularly appear on the Board's agenda.

The Board and management explore strategic options together at strategy days held twice per year. External parties with specialist knowledge are invited to contribute. The CEO consolidates the output from the strategy day into a draft statement of strategic intent, which is presented to the Board for discussion and ratification. Once ratified, the statement of strategic intent becomes the agreed high-level strategy of the Company. The CEO develops detailed plans to execute the agreed strategy. The Board uses the agreed strategy as a benchmark against which the annual plan and budget, major proposals and business opportunities are assessed. The CEO is expected to clearly demonstrate how any subsequent proposal advances the agreed strategy.

The researcher observed the December 2011 board meeting. There was no interaction between the governance actors and the researcher, other than an acknowledgement by the Chairman that the researcher was a silent observer. Notwithstanding the CEO's formal reporting role, the directors treated the CEO as an equal contributor, by actively inviting his participation in discussions. The Chairman summarised the discussion from time-to-time, particularly during longer or more complex agenda items, and prior to any formal decision point.

The Company has embraced an intentional board-level decision making process under the leadership of its current Chairman, to ensure all strategically important decisions are considered prudently; all of the costs are understood; and, that proposals are clearly aligned with the Company's agreed strategy. The process generally commences when the CEO presents a summary of the proposal to introduce the Board to the proposal. This is to secure initial feedback prior to any substantive proposal development takes place. The summary proposal generally takes the form of a discussion paper. Often, the Chief Executive discusses strategic options and draft proposals with the Chairman at their fortnightly meetings. After discussion, proposals are finalised for presentation to the Board. The Board considers all proposals in the context of the agreed company strategy. If a proposal does not clearly contribute to the strategy, it is unlikely to be endorsed. One director in particular challenges every proposal in this way - to determine “fit” with the Company’s overall strategic intent.

5 Discussion

Three significant insights were developed from this research. First, in the exemplar case company, performance and the level of board involvement in strategy development appear to be directly linked. Second, the quality of strategic decisions is highest when proposals are directly linked to previously agreed strategy. Third, an open and direct communications style amongst governance actors is conducive to this requisite decision-making.

5.1 Board involvement in the development of strategy

The results indicate a link between company performance and the level of Board involvement in strategy development. This insight is consistent with prior research (Wheelen & Hunger, 2006; Zahra & Schulte Jr, 1992). The current Board is highly involved in the development of strategy and the Company is experiencing high growth as a result of that contribution. In contrast, earlier Boards were not involved in the development of strategy nor was strategy execution actively monitored. Earlier in the Company’s history, the Board and management seemed to adopt a rather passive attitude towards strategy. The Board approved the previous CEO’s strategy, even though it had not rigorously challenged the strategy when it was developed. The Board was culpable for arguably poor performance because it did not moderate the decision preferences of the CEO, nor did it monitor strategy execution and company performance adequately.

5.2 Decision-making and alignment with strategy

The results indicate that the quality of strategic decisions and impact on company performance appears to be highest when proposals are directly and explicitly linked to the Company’s strategy; strategic priorities; values; and, available resources. The decision process is determined and understood by each member of the Board before the decision is made. The Board actively seeks input from external specialists to ensure it is fully informed (particularly about market conditions and trends, and the Company’s ability to deliver against the proposal). Further, the Board has the opportunity to consider the proposal and develop their thinking over time. This insight is consistent with prior research (Van den Berghe & Levrau, 2004).

Whereas previous Boards were somewhat passive with respect to their consideration of strategic options and assessment of performance, the Chairman reported the current Board is “active and brutal”. For example, the Board rejects any strategic option or proposal that does not demonstrably contribute to the agreed corporate strategy. The Board’s incremental approach to making strategically important decisions enables directors to ponder options, consider risks carefully and make independent enquiries before making a decision. Further, the low level of interaction between governance actors between board meetings suggests most of the strategic decisions are made when the Board is together at regularly scheduled meetings.

5.3 Communication and trust

The results indicate an open and direct communication style is conducive to robust debate and effective decision-making. The nature of the observed informal interaction between directors prior to the meeting, and the commitment to build relationships outside formal governance activities, suggests that high levels of trust and respect exist between the governance actors. The Board questioned the CEO assertively and forcefully offered opinions on several occasions. The open and inclusive style employed by the Chairman to ‘chair’ the meeting, announce agenda items and solicit questions, comments and discussion appeared to promote dynamic engagement and effective decision-making (Levrau & Van den Berghe, 2007b; Vallaster & Koll, 2002). The Chairman and CEO both indicated that the interactions during the observed meeting were typical of those in other board meetings. Overall, the open communications style displayed by the Board is consistent with prior research that suggests open communications; robust debate; and, a high trust environment are necessary antecedents to Board effectiveness (Caldwell & Hansen, 2010).

6 Conclusions

The research revealed a correlation between company performance and the Board's level of involvement in the strategy development process; the quality of their strategic decision-making; and, the Board's expertise and commitment to the governance process. Company performance improved when the Board was actively involved in the development of strategy and strategic decision-making. The Board and management work together as a cohesive, as opposed to adversarial, unit. Throughout the life of the Company, changes in Board structure or composition contributed little, if anything, to performance. Accordingly, the research questions are supported. These results are consistent with prior literature that suggests that board process and behaviours are more important than structure or composition when determining the board's contribution to company performance.

The insights and conclusions gained from this study are restricted by several limitations. While the results suggest that a relationship between governance and company performance exists, a single case study provides insufficient evidence to prove causality beyond the case. Also, only one board meeting was observed, so the impact of any actor-observer effect could not be determined. This limitation could be addressed in future studies if several board meetings were observed. Governance actors would be expected to revert to authentic behaviours and interactions, if indeed they had been modified for the observed occasion.

Notwithstanding these limitations, it is not unreasonable to expect similar results elsewhere. But whether or not an explanation can be extrapolated to population norms from the observation of one phenomenon continues to plague scientists. High-growth companies appear to have structural similarities including under-developed governance, founder-leadership, limited equity capital, and strained access to debt capital at their establishment. Importantly, the pursuit of fast growth, providing it is successful, may be a key driver of change (as it was in this study). High-growth companies have emerged in the absence of diffused equity capital, in family firms and in entrepreneurial firms. Perhaps the pursuit of high growth is the common important motivation rather than formality of governance process.

The case study is the appropriate method and direct observation a useful data collection technique when trying to discover how boards actually work (Leblanc & Schwartz, 2007). However, its application needs to be extended to ensure sufficient data is gathered and triangulated to credibly demonstrate any convergence in the results. Helpfully, Chan, Bhargava and Street's thesis (2006)—that the challenges smaller companies face when they sustain high-growth converge—suggests the findings of a more rigorous study might be generalisable to a wider population. Thus, a longitudinal multiple-case study (Johnston, Leach, & Liu, 1999) may provide sufficient evidence to expose convergence; confirm the existence of a governance–performance relationship; and, expedite the discovery of the elusive causal link that has caused considerable frustration amongst scholars and practitioners.

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