The Role of the Board in Employee-Ownership Governance

By Anthony Mathews

One of the common misconceptions about employee stock ownership plan (ESOP) companies among the general public is that they are inefficient because of the necessity to constantly respond to scrutiny from employees (which, of course, isn't true) and constant oversight of government regulators (which is occasionally true, but in the long run, mostly a good thing). Over the years, though, ESOP companies have developed an operating style, unique to them that responds to this and is based on a dynamic collaboration among three entities.

The first of these is the board of directors. The board (also known as the settlor in some cases) establishes the ESOP and determines how it will operate within the parameters of the law. The board is the overarching guide of the business side of the business and is responsible to see that our employee-owned company succeeds in creating the wealth it is designed to create. The board oversees the highest level of management of the company, but it does not manage the company. That responsibility rests with an empowered management that is charged with designing, renewing and implementing corporate strategies that achieve the success all members of the company share. It also is up to management to see that employees are tuned into the common vision and are informed and enabled to an extent that allows them to be proactive contributors to the success of the business. The third participant in this collaboration is the fiduciary that oversees the operation of the ESOP and is charged to act on behalf of and as the shareholder. Consistent with the rights of the shareholder, the fiduciary acts to protect the value that has been created for the employee owners and to preserve the opportunity for further value in the future. Finally, the fiduciary monitors the performance of the board of directors.

The collaboration works very well, and when it is at its best, it provides a very adaptive mechanism that is perceptive and quick to react when reaction is needed. Whether it gets to its best or not, though, rests on each of the elements of governance knowing and steadfastly adhering to its role. Keeping clear definition of those roles and setting the tone of the collaboration is almost completely within the purview of the board of directors.

In that quest, four things the board should keep in mind:

1. The board's focus is strategic. The board is responsible for the strategic direction of the company. That implies that the board must have a clear vision of what the strategy for the company is and the organization needs to take it there.
2. The chair of the board is just another director. Unless the by-laws give the chair some extraordinary powers (which they mostly don't) the chair is an organizational position not a position of authority. Boards get dysfunctional when the chair is an authority position and the full value of the range of contributions a board can provide is lost.
3. The board is not management. The board's job is to look farther ahead and keep the company on the larger track. Where boards descend into management (personnel matters, compensation matters below that of the CEO, operational issues, etc.), it robs the company of strategic oversight. Effectively, where the board tries to do the management job it usually means that there is neither an effective board nor an effective management.
4. The company can really benefit from having outside perspectives on the board. Where the board comprises an assortment of internal employees chaired by the CEO, 1) and 2) above will inevitably come into play and the board will not be effective.

So, a successful board will be strategic rather than operational. It will operate on the basis of true consensus rather than be dominated by a single voice, will keep its expert eyes on the large picture, and will introduce into the picture outside perspectives.

There are only a few good reasons for adding an outsider to the board: 1) They bring some special skill or knowledge base that the company needs to guide its strategic path; 2) they have some connection to the industry that can help the company find its way along the chosen strategic path; 3) they have some legacy connection to the company itself.

Most important for an ESOP company, board members must like the idea of employee ownership. The fastest way to destroy a culture of ownership is to give the company a board that thinks of the investment that is being made in employee ownership as constricting the company's growth. The most significant vulnerability of an employee ownership culture is its own leadership.

But, where the board is solid in support of employee ownership and keeps all the roles straight, an employee ownership culture can develop, and there are few things more powerful.