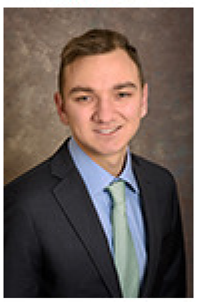
Published on *Directors and Boards* (https://www.directorsandboards.com (https://www.directorsandboards.com))



Having regulators as a shareholder — and even sitting on the board — puts the independent directors in a troubling fiduciary situation: the government's objectives may conflict with the traditional goal of shareholder value creation.

The role of the government as a shareholder is in and of itself highly problematic. Yet, even more troubling to investors is the notion of the government as a member of the company's board of directors. The issues created by the government as a shareholder are only magnified when the government has more influence on the company's decision making through board membership.

Whether by direct representation or significant involvement in the nominating process, the government can have much influence over board function. It also has a major impact over corporate direction, focus, and director conduct. The government as an investor does not consider shareholder wealth maximization as its primary goal. The principal objective of the government is to bolster societal benefits, usually in the form of jobs and political rewards for the investment it is making. When the government is heavily involved in the corporate decision-making process, these incentives conflict with the traditional goal of shareholder value creation.

Thus, where the government demands and receives some form of board representation, the representatives find themselves in a troubling fiduciary position. Such representation creates three major problems. They include conflicting obligations imposed upon the government's representatives themselves, disruption to the ordinary function of the remaining directors, and, finally, an increased mistrust in the ability of the board to maintain the best interests of the public investor as they carry out their responsibilities.

Markedly Different Objectives

The government-anointed director is caught in a precarious position. A government's investment in a corporation differs markedly from that of the other shareholders. Governments are political creatures and make investments to meet political objectives such as job preservation or, in the case of the financial crisis, economic stabilization. Long-term investment return is not a primary, or perhaps even secondary, goal.

The government has the incentive to demand changes in corporate strategy to meet its own objectives, without regard to its impact on ultimate shareholder return. The notorious case involving political pressure on General Motors to keep certain facilities open to preserve jobs in a particular congressional district is a significant example of this problem. The governmental representative director is under tremendous pressure to support the demands of his or her sponsor.

Unfortunately, all directors, regardless of how they were selected, are subject to the same historic legal fiduciary obligation of making decisions that protect and ultimately enhance shareholder value. Actions that are contrary to this obligation run counter to the law and general investor expectations.

Therefore, the governmental director is in a fiduciary bind — constrained by law to support shareholder wealth accretion and yet, by appointment, to meet their sponsor's political expectations. This is an impossible position to occupy and incapable of effective resolution. Additionally, such a director's actions to support politically expedient yet value-destructive corporate activity leaves that individual open to potential legal action by the other shareholders on classic loyalty grounds. They are, in proverbial terms, "damned if they do and damned if they don't."

Governmental representatives on corporate boards are also problematic for the appropriate functioning of the remaining directors. Their presence creates a different tone in the boardroom. They do not merely represent a particular investor, but the sovereign whose ultimate power and influence is overwhelming in any setting. To dissent from their dictates does not involve merely disagreement with an investor's viewpoint but opposes the will of a nation, with obvious potential consequence. The remaining board members have the real fear that the government, through regulatory fiat, may thwart their will or mandate their replacement should they be non-compliant with its goals.

The role of the government in various financial institutions, following the financial crisis, bears this point out well. The presence of such directors is stifling at best and suffocating at worse. With government delegates present, the other directors are under extraordinary pressure to accommodate them by making decisions considering the government's incentives — not those of the other shareholders and the corporation to whom they are legally bound.

Fueling Greater Mistrust

The final problem presented by the governmental director is external to the board in nature. When the government is an investor, its presence and purported influence over corporate affairs is widely expected and known to the other investors. With direct board representation, this influence becomes even more apparent.

Since the government's political objectives are generally detrimental to long-term shareholder value, this involvement is troubling to the investing community. The presence of governmental directors, whose significant influence is presumed, only fuels greater mistrust of the ability of the board to effectively promote greater efficiency and productivity on the part of management. This has a potential deleterious effect on share price and the corporation's ultimate success.

While the governmental director faces and creates obvious difficulties for the corporate organizations that they serve, the bigger issue concerns the government's financial involvement in the private sector altogether. For example, some have argued that government investment and board representation in Volkswagen led to the problematic culture and misalignment of incentives that created the current crisis the corporation faces.

Governments as equity holders and occupiers of board seats are, any way you look at it, bad news for their fellow corporate directors and, ultimately, the investing public. ■

Charles Elson can be contacted at elson@udel.edu (mailto:elson@udel.edu) [1].

Issue: 2016 Second Quarter

Source URL: https://www.directorsandboards.com/articles/singlegovernments-giant-shadow-boardroom
Links
[1] mailto:elson@udel.edu
[2] https://www.directorsandboards.com/subscription