Engaging the board of directors on strategy

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The corporate governance trailblazer, Sir Adrian Cadbury, provided a succinct description of the forces in play at the top levels of an enterprise: ''The basic governance issues are those of power and accountability''[1]. Nowhere are the issues of power and accountability more clearly in evidence than in the working out of a strategy for an organization. A firm's strategy determines the course it will try to pursue over several years; strategy guides the allocation of resources – financial, physical, and human. Clearly, strategy must be a subject that engages the interests of all the members of a firm's leadership – top management, the board of directors and the Chief Executive Officer.

Over the last several years, many corporate boards have sought a more substantial role for directors in the strategy-setting process. This quest has been enhanced by Great Britain's Committee on the Financial Aspects of Corporate Governance, the Conference Board in the United States, and the US Sarbanes-Oxley legislation. The implications and repercussions of this trend will likely endure for years to come. How then can boards, Chairmen, CEOs, and top managers forge an effective process to engage directors on strategy?

Perhaps because engaging the board on strategy is a chronic concern, in practice the question of how to best manage the process is often expressed ironically or with some frustration. One Silicon Valley CEO said, ''Left to their own devices, my directors will try to design new products on a napkin. How can I get them to focus on strategy?'' The Chairman of a large Midwestern firm said, ''We're always straying off into the weeds. How can we keep our discussions strategic?'' Another CEO at a $1 billion technology firm groaned that ''these guys want me to make a major acquisition; how can I get them to see that it doesn't fit the strategy we mapped out and agreed on eight months ago?'' Working together with corporate leaders we've developed a five-point process for effectively engaging a board of directors on strategy.

Step 1: Map out a strategy agenda with the board

A key beginning point is for the CEO to work out, in collaboration with the chairman and other directors, a year-long agenda of strategy topics for board meetings. Everyone agrees that strategy work is an iterative process, not a big bang event. Yet, often we treat it as though it were a one-time event by scheduling the board's strategy meeting or making strategy the key agenda item at the annual board retreat. Absent a rich context, directors are hard pressed to contribute effectively. Not infrequently, their contributions are destructive. That's why it is important to have a year-long agenda of strategy topics with the board. It might look something like this:

1st Meeting of the Year – Changing Competitive Environment.

2nd Meeting of the Year – Strategic Investments: People, Plant, Equipment.

3rd Meeting of the Year – Review Achievements against Strategic Plan.

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4th Meeting of the Year – Corporate Development. M&A Activities to Support the Strategy.

5th Meeting of the Year –Annual Board Retreat & Strategic Planning Workshop.

6th Meeting of the Year – Actions Individual Directors Can Take to Support the Strategy.

In developing the board’s strategic agenda, the Chairman and CEO will want to collaborate closely. One or both of them should speak one-on-one with each of the other directors to solicit their views and concerns. Whenever a CEO, Chairman, or director is new to their role, these one-on-one conversations provide an opportunity to discover the expertise of each other. Often in the course of such conversations, business leaders discover that many difficulties in strategy deliberations stem from the lack of a common vocabulary.

Mapping out the strategy process the board will follow provides time for thought, reflection, dialogue, and iteration and allows management to make meaningful use of directors’ expertise and knowledge.

Step 2: Describe your strategic planning process

Not infrequently, organizations run two separate strategy processes. One involves management; the second the board of directors. The intersection of these separate processes is often a presentation to the board of the results of management’s work. One Dallas-based organization, after three years of increasingly contentious debate between the CEO and the board, opened a board meeting with a detailed explanation of how management performed its strategic planning work. The talk covered the ‘‘how,’’ not the ‘‘what.’’ The CEO and the vice president responsible for strategic planning laid out all of the work streams that were brought together to make the strategy. As the strategy VP, (who possessed deep technical expertise in planning but was new to the organization), described the process, the CEO added anecdotes about changes made over the years to improve the process and the reasons for those changes. This exposition gave the directors the ‘‘how’’ and ‘‘why’’ of management’s work on strategy. Once the directors saw that management’s process was robust, their questions shifted from challenging management’s conclusions to fostering a dialogue that extended management’s thinking. Surprisingly, the directors’ involvement led to a more aggressive and slightly more leveraged strategy. Accustomed to pushback, management had become too conservative.

A number of CEOs supplement these board-meeting presentations with phone calls to individual directors based on each director’s interests and expertise. L.J. Seven, the founder of Seven Rosen and CEO of Mostek, the pioneer integrated circuit manufacturer, regularly drew out individual directors with his understated request, ‘‘Tell me that again; I don’t get it.’’ It was his way of seeking both understanding and agreement through dialogue with the director. Other CEOs use monthly letters to their board members providing the CEO’s perspective on a number of issues – some strategic, some tactical. Michael Ullman, CEO of J. C. Penney Company, composes a weekly, Sunday morning e-mail to keep his directors in the loop on strategy and execution. Whatever the method, CEOs with strong, positive board relationships keep their directors informed about both the ‘‘how’’ and the ‘‘why’’ of strategy to further their dialogue.

Step 3: Emphasize the external environment and competitive pressures

Author and law professor William Ian Miller identifies a CEO’s dilemma when deciding how much information to provide the board of directors about strategy: ‘‘God forbid one of them

should start thinking deeply about this stuff and expose the limits of my knowledge''[2]. At the heart of strategy for any reasonably complex business is our often unvoiced fear that we really don't know as much as we let others believe we do. In presenting strategy to the board, CEOs often rely on the internal view – products, revenues, growth and plans. Less is said of the customer loyalty, marketplace discontinuity, emerging competition and disruptive technology. The danger of this approach is subtle. Given nothing but the inwardly focused view, directors' questions tend strongly toward the inward looking plans and assumptions. From management's perspective, such questions then seem more like intrusions into the realm of management or attacks on management's conclusions. Either way, it makes for uncomfortable discussions.

Chairmen and CEOs who have forged an effective and collaborative path with their boards of directors focus considerable attention and board time on looking outward. The CEO of a highly successful Silicon Valley company altered his board's perspective considerably over a period of several years. When he first joined the firm, he described the board by saying, ''They are each brilliant when it comes to technology but they don't know a thing about what general managers do. I really don't need their help with this.'' Realizing this was a risky approach for a new CEO, he began changing the board's role in corporate strategy by focusing on the company's markets. Over the course of a few board meetings, the CEO and a handful of key executives briefed the board on markets, customers and distribution channels. He followed with briefings on key competitors and invitations to directors to visit key customers and suppliers along with members of his senior team. Then and only then did he bring the agenda around to technology again. As a next step, he scheduled an hour with the board to lay out the options and alternatives management had considered during its strategic planning work. After more than a year of careful work, the CEO noted that board discussions of strategy were moving from challenge and skepticism to collaboration and contribution.

Step 4: Be clear about the required resources

Typically, directors deal well with financial matters. Unfortunately, CEOs and their key executives fail to take advantage of the board's financial acumen in strategy discussions. Clarity around the resources required to execute a strategy helps the board have confidence in management and helps management develop the discipline to actually execute its strategy. Clayton Christensen of the Harvard Business School warns persuasively about the extent to which corporate resources are allocated more by the demands of current customers than by the official strategy[3]. Henry Mintzberg cautions that emergent strategies, what companies actually do, differ from their intended strategies, as presented to the board of directors[4]. Specifying the resources required for a strategy and where and how management plans to come by these resources provides an opportunity for real collaboration between the board and top management.

Resource-requirement discussions should include three areas:

- Financial resources.
- Leadership and organizational resources.
- Technological competency.

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Clearly outlining the financial resources required to implement strategic initiatives provides the board with convincing evidence that that management's plans are realistic and achievable in ways that enhance shareholder wealth.

Management must also candidly brief the board on the organizational and leadership capabilities required to implement strategies. Writing in McKinsey Quarterly, Tsun-yan Hsieh and Sara Yik noted that ''Few companies recognize the leadership capacity that new strategies will require. This oversight condemns many such endeavors to disappointment''[5]. Historically, CEOs have stayed away from discussing organization and people issues with their boards. Directors often agreed with the strategic thrust outlined by management, but their intuition, built up through years of experience, told them the company lacked the organizational resources to successfully execute their plans.

When the board's involvement in the strategic process includes discussion of leadership and organizational resources, their concerns and insights can be put on the table clearly and objectively. A two-stage approach works best here.

First, brief the board on your current organizational resources and capabilities.

- Be frank about how your people stack up in the marketplace.
- Describe how your structure fits your strategy.
- Demonstrate how the company's culture and esprit de corps make the achievement of your strategic goals possible.
- Show how your human-resource systems–goal-setting and performance management, recognition and compensation– support your strategy.

Secondly, think through and present to the board the changes the organization will need to undergo as your strategy is implemented. What talent must be recruited? What training will be needed? What reward systems will be altered? How will you produce the leaders needed for new products, markets, geographical regions? Presenting the board with well developed plans for meeting the organizational, leadership, and talent requirements of the strategy will often stretch a management team in new ways. As the CEO and his strategy team assess the structure and systems requirements of a strategy, they develop not only a fuller appreciation for the challenges ahead, but also new ways in which to involve the board. The realistic assessment of current leadership and talent can lead to productive changes in recruiting and training. New strategies often benefit as well from a thorough review of the company's performance management, recognition, and reward systems. Culture and employee satisfaction may need to find their way into the board's deliberations on strategy. When directors know that managers have realistically assessed their human capital, they feel more confident in the firm's ability to execute what it has planned.

Step 5: Know the warning signs of trouble and tell the board

Part of contingency planning is knowing the early warning signs that a strategic initiative is falling short. Perhaps sales are below expectations. Regulatory approvals may be behind schedule. Hiring plans may not be met. When management thinks through the right warning signs and presents them to the board with the assurance that they will be measured, the board can feel a greater degree of comfort in backing management even on risky ventures.

Another critical aspect of risk management is carefully assessing whether the strategic thrusts are within the firm's technological capabilities and know-how. Can manufacturing build what engineering designs? Does the product roadmap push the company to the bleeding edge of a technology and is management prepared to live on the bleeding edge? Can information systems be implemented and integrated so that products or services can be ordered and delivered? The CEO needs to insure that his management team provides the board with the evidence behind management's confidence in the organization's capability to execute the planned strategies.

Warning signs for the board itself

An excellent way to insure that the board's strategy deliberations are effective and efficient is to incorporate an evaluation of the board's contribution on strategy in their annual self evaluation. Often this will begin with a conversation at a board meeting about ''How are we doing on strategy?'' Open dialogue in both regular and executive sessions of the board can, and frequently does, lead to richer board involvement and contribution to the firm's strategy and strategic planning processes and to the identification of barriers to strategy implementation. Evaluation of board involvement is best when confined to qualitative measures: do we have the information we need; are we devoting the right amount of our time to strategy; are we integrating our strategy deliberations with our consideration of succession planning and capital allocation decisions effectively? If the answers indicate the need for improvement, the board and the CEO can refine their strategy setting agenda. This process of regular evaluation and change can create a virtuous cycle in which the board and CEO continuously improve their strategy formulation capabilities.

The number one reason for success and failure

In the day-to-day life of boards of directors, when the company is executing against its strategic plan, all is well. However, if the company is not executing against the strategy, eventually the board will probably start thinking about its most important task, selecting a new CEO. Indeed, a 2005 McKinsey & Company study that surveyed over 1,000 corporate directors, found that alignment on strategy between the CEO and the board was the number one reason for success and the number one reason for failure in CEO appointments[6].

This five-step formula for improvement is based on two premises. One is that the strategic work of an organization – the delineation of a future direction, the commitment to that direction, and the execution of the work needed to achieve the goals of a strategy – is a process that involves the whole of management. The second premise is that there should also be a process for appropriately engaging the board of directors on strategy. When the CEO thinks through this process and engages the directors, the board and the CEO can enter into a dialogue that leads to collaboration and a greater chance of achieving the goals of the organization.

Notes

1. Adrian Cadbury, *Corporate Governance and Chairmanship*, Oxford University Press, Oxford, 2002, p. 3.
2. William Ian Miller, *Faking It*, Cambridge University Press, Cambridge, 2003, p. 1.
3. Clayton M. Christensen, *The Innovator's Dilemma*, Harvard Business School Press, Boston, MA, 1997, pp. 101-103.
4. Henry Mintzberg, *The Rise and Fall of Strategic Planning: Reconceiving Roles for Planning, Plans, Planners*, The Free Press, New York, NY, 1994, pp. 23-5.
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6. Robert F. Felton and Pamela Keenan Fritz, The view from the boardroom, *The McKinsey Quarterly*, Special Edition, 2005, (electronic version), pp. 1-9.

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