20 Questions

Directors Should Ask about Strategy

Second Edition

Dr. Chris Bart, CA

The Canadian Institute of Chartered Accountants

How to use this publication

Each "20 Questions" publication is designed to be a concise, easy-to-read introduction to an issue of importance to directors. The question format reflects the oversight role of directors which includes asking management — and themselves — tough questions. The questions are not intended to be a precise checklist, but rather a way to provide insight and stimulate discussion on important topics. In some cases, Boards will not want to ask the questions directly but they may wish to ask management to prepare briefings that address the points raised by the questions. The comments that accompany the questions provide directors with a basis for critically assessing the answers they get and digging deeper if necessary. The comments summarize current thinking on the issues and the practices of leading organizations. They may not be the best answer for every organization. Thus, although the questions apply to any organization, the answers will vary according to the size, complexity and sophistication of each individual organization.

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The Canadian Institute of Chartered Accountants

INSTITUTE OF CORPORATE DIRECTORS

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Strategy

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Preface

How do directors live up to increasing demands for better governance in a more complex and evolving regulatory environment? How do they contribute to the development and sustainability of successful organizations? They must ask intelligent, informed questions of management and of themselves. The Risk Management and Governance Board of the Canadian Institute of Chartered Accountants (CICA) provides such questions through its 20 Questions Directors Should Ask series in which this book is included. Topics of importance to directors are addressed through clear and concise questions.

The Risk Management and Governance Board (RMGB) created 20 Questions Directors Should Ask about Strategy to help members of boards with their role in the development of an organization's strategy. More than 3,000 copies have been distributed of the first edition. Board members have used the questions as a process for the development and approval of an effective strategy for the organizations they oversee.

Since publication of this book, there has been an increasing interest in the topic of governance and increased scrutiny of the board of director's role in setting and monitoring effective strategy. It is under these circumstances that the RMGB has undertaken a review of the first edition of this book to ensure it is still relevant and current. We are pleased to find the concepts and processes continue to be applicable and believe the questions asked and fundamental principles in this book stand up to recent regulatory initiatives and should continue to be helpful to readers.

High profile corporate failures and regulatory requirements make directors ever more aware of the increased personal risk associated with being a member of a board. This publication does not attempt to address these personal issues and risks that directors need to understand and manage. It focuses on assisting boards and their members to gain better insight into fulfilling their responsibility for contributing to the development of their organization's strategic direction and for approving and monitoring the strategic plan.

The Board acknowledges and thanks the members of the Directors Advisory Group for their invaluable advice, the author Dr. Chris Bart and the CICA staff who provided support to the project.

We are grateful as well to individuals who contributed to the first edition including Frank Barr, Michel Doyon, Dr. Parveen Gupta, Fred Jaakson, Colin Lipson, Mary Jane Loustel, and Keith Robson — former members of the Risk Management and Governance Board. Also, James Baillie and Purdy Crawford, former members of the Directors Advisory Group and CICA staff members Cairine Wilson, Greg Shields and Vivienne Livick-Chan.

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According to the November 2001 "Final Report of the Joint Committee on Corporate Governance":[1]

> "The objective of good governance is to promote strong, viable and competitive corporations. Boards of Directors are stewards of the corporation's assets and their behaviour should be focused on adding value to those assets by working with management to build a successful corporation and enhance shareholder value. A committed, cohesive and effective board adds value, first and foremost, by selecting the right CEO for the company. Beyond this, the board contributes to value in a number of ways (including)… *assessing and approving the strategic direction of the company*." (p.7) (emphasis added)

A board's role in strategy is also reflected in the Canadian Securities Commission's National Policy 58-201 — Corporate Governance Guidelines[2], under section 3.4, Board Mandate: "The Board should adopt a written mandate in which it explicitly acknowledges responsibility for the stewardship of the issuer, including responsibility for… (b) adopting a strategic planning process and approving, on at least an annual basis, a strategic plan which takes into account, among other things, the opportunities and risks of the business"

It is clear that the notion of the board's responsibility with respect to a corporation's strategic plan has become no longer debatable. Moreover, the Toronto Stock Exchange (TSX) has recently announced that for listed companies (and non-corporate TSX issuers, such as trusts and limited partnerships), *it now intends to expand the role of the board from its current mandate of simply "adopting a strategic planning process" to include the approval of the strategic plan itself*.

But what do these new responsibilities entail? And how should directors exercise them?

A board's involvement in strategy, as currently envisioned, must continue to honour the well-respected tradition that directors, generally, are not elected to micro-manage the corporation, but rather for *oversight*, *insight* and *foresight*. In terms of their 'oversight' function, directors must ensure that appropriate

[1] *Beyond Compliance: Building a Governance Culture*, Final Report, Joint Committee on Corporate Governance, Nov. 2001.
[2] Canadian Securities Administrators: National Policy 58-201 *Corporate Governance Guidelines.*

"Prediction is very difficult, especially about the future."

Niels Bohr

processes and controls are in place both to manage and monitor risks and to provide for the smooth, effective and efficient functioning of the business.

With respect to 'insight', directors are there to add their experiences and wisdom, not to second-guess management, but to supplement and enhance executive decision-making. As for 'foresight', the directors are there to provide a perspective on the future that helps management identify those opportunities that are most worth pursing.

Notwithstanding these traditional functions, the role of the board of directors continues to evolve. Directors today need to be much more active participants in the 'high-level' affairs of the organization. Further, they must be "constructively involved" in the development and approval of the organization's strategy. One way for this constructive involvement to be operationalized is presented in Appendix 1. These new divisions of responsibility require a corporate culture and climate of mutual respect and trust between the board and senior management. The participation of directors in strategy must be seen as cooperative rather than adversarial.

At the core of constructive involvement is the role that directors perform through the questions they ask. By asking questions, directors determine both the degree to which the corporation is charted on a proper course and whether it is being properly managed. But not just any questions will do. Directors need to ask the right questions if they are to perform their duties as engaged participants in helping the company find a future direction that ensures its long-term competitive survival. Indeed, doing so is the essence of all strategic planning efforts and the winning strategies that such planning efforts aspire to produce!

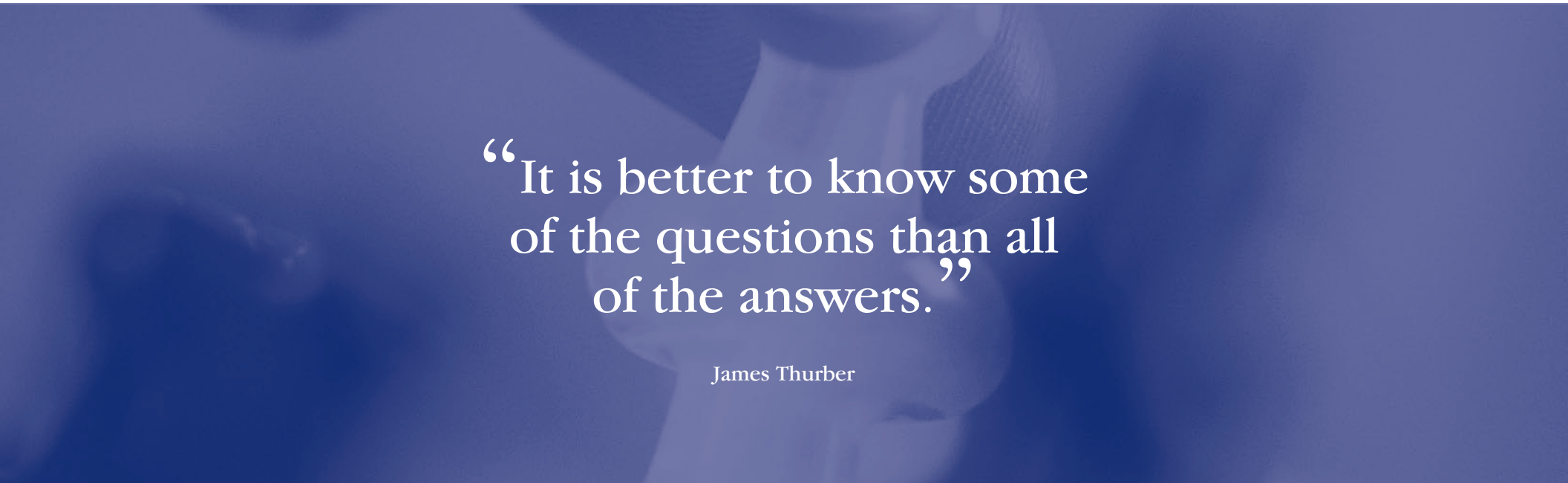
While the process of developing an organization's strategy requires managements and boards to consider a wide range of stakeholders (including employees, customers and communities, etc.), whose response to the strategy may be critical to the organizations' success, and to give particular attention to the owners (shareholders, members, etc.) of the organization. Boards should always remember that their primary responsibility is to the organization.

Questions directors should ask about strategy

The following set of "20 Questions" represents a structured framework through which directors can fulfill their new responsibilities in terms of "developing, assessing, approving, monitoring and changing" their organization's strategy.

The nine questions in the first section "In the beginning… understanding strategy" will help directors develop a common understanding of strategy in the context of their own organization. This provides a foundation for more detailed discussion and assessment of the strategy using questions 10 through 20.

While the questions are presented in a particular order, it is important to note that individual directors may prefer to begin at different points within the framework. It is strongly recommended though, that directors consider all of the questions.



In the beginning… understanding strategy

The first question that every director must ask in order to grasp the purpose and direction of the company is:

1. How is strategy defined at this organization?

While this question is easy to ask, it is often made difficult by the fact that various and numerous 'definitions of strategy' abound. As a result, directors often come to organizations with different and competing versions of the term. When combined with management's own definitions, there is often much confusion and conflict as to what constitutes the proper description of an organization's strategy.

> "Trying to predict the future is like trying to drive down a country road at night with no lights while looking out the back window."
>
> Peter Drucker

Rather than present and debate alternative definitions, this document presents one recent and contemporary description of strategy which appears to strike the balance that many directors seem to be looking for. It states that formulating and articulating a 'strategy' involves: 1) the determination of those long term goals (i.e., mission, vision and values) and objectives which reflect an organization's sources of competitive advantage and which address important stakeholder needs; and 2) the identification of scope (or domain) of business activities within which those goals and objectives are to be achieved. (source: "Lasting inspiration", *CAMagazine*, May, 2000, pp. 49-50)

While other definitions exist, this latter approach to strategy is one that is easily understood by any board member or senior officer. It answers the essential questions of strategy with which every board member should be concerned:

2. What are we ultimately trying to accomplish and where do we eventually want to get to? *The Vision Goal*

3. What is our purpose — or, why do we exist? *The Mission Goals*

a) Who are the 'key stakeholders' that have a significant impact on our business and its long-term survival (i.e., customers, employees, shareholders, society, suppliers, regulators, etc.)?

b) What specific needs do we try to satisfy better than our competitors for these 'key stakeholders' in order to secure their long-term loyalty, commitment and support?

4. What are the internal ethical and cultural priorities that attract stakeholders to us? *The Values Goals*

5. What are the specific measures and targets that we will use to judge our progress in achieving our macro-level vision, mission and values goals? *The Objectives*

6. In what specific business arenas have we chosen to operate for the purposes of achieving our objectives? Product/Market Scope & Domain selections

a) Who and where are our customers?

b) What products and/or services do we provide to them?

These detailed questions (i.e., 2-6) specify the salient components that define an organization's complete strategy. As such, boards need to consider them as a group when seeking to describe the strategy for their particular organization.

Interestingly, questions 2-6 are sometimes summarized in the more general query of "what business are we in?" But, experience today suggests that using such an approach is now perhaps much too vague to gain the sort of insights that directors are looking for. Nevertheless, whatever approach is taken, it

is vital that there be agreement both among the directors — and between the board and management — concerning how they choose to define and articulate their organization's strategy. This is required in order to establish clearly which decisions are strategic versus those that are not.

In fact, failure to do so will most likely result in poor communication, confusion and even conflict whenever the topic of the organization's strategy is raised. Thus, one important contextual question that every director must ask early on with respect to assessing and approving the organization's strategy is:

7. Is the definition of strategy in this organization shared by all directors and management?

The definition of strategy provided above is very robust and covers a variety of circumstances. It can be used to describe the organization's strategy that is currently in place — or one that is being proposed for the future. It can also be used to describe two terms which are often used interchangeably but which sometimes have quite different meanings: 'business strategy' and 'corporate strategy'. Generally speaking, the distinction between these two concepts turns largely on the breadth of a company's scope or domain of operations.

More specifically, the definition of what constitutes "a business" is typically regarded as a specific product or service offered to a specific type of customer in a specific location.

> "If you don't know where you are going,
> you'll probably wind up someplace else."
>
> Anon

Consequently, when the scope or domain of a company's operations is relatively narrow, there is virtually no difference between the organization's business and corporate strategies. They are synonymous.

Directors of large diversified companies, therefore, need to ask:

8. What are the major business strategies making up the overall corporate strategy?

As a company diversifies (i.e., adds additional major products, services and/or types of customers), there may be multiple business strategies at play (each defined using the strategic components provided in questions 2 through 6), which collectively represent an 'overall strategy' different from the individual business pieces. It is at this point that the corporate strategy (i.e., the collective strategy) becomes something separate and distinct from the individual business strategies.

In these latter circumstances, the board should focus its attention primarily on the corporate strategy. The board should only become involved with assessing and approving business strategies when they represent major changes to the overall corporate direction — such as, when a new business is added/acquired or an existing business closed/sold. Nevertheless, it is still advisable that directors be informed of and review the major business strategies of the corporation on an ongoing basis so as to better understand their impact on the whole organization.

9. Do circumstances warrant the board's involvement in (i.e., review, assessment and approval of) the organization's operating plan?

One area that most boards should work diligently to avoid is the review, assessment and approval of the organization's "operating plan". This does not mean to say that directors should refrain from specifying certain guidelines (such as hurdle rates, threshold levels and/or policy limits), which will shape and affect the development of the operating plan. Indeed, they should provide such guidance where appropriate.

The development and content of an operating plan, however, involves a multitude of specific details and action plans (typically referred to as 'tactics') concerning how the organization intends to actually achieve its mission, vision, values and objectives (given its choice of business arenas) based on the contributions of various staff members and individual departments.

"We always plan too much and always think too little."

Joseph Schumpeter

It gives 'flesh and bones' to the overall (i.e., corporate or business) strategy and typically addresses all of the major functional areas such as marketing, sales, manufacturing, engineering, R&D, finance and human resources.

Consequently, the main reason why boards generally should not get involved with operating plans is fairly straightforward: this is what management is hired and paid to do. Moreover, an organization's operating plan usually requires the involvement of many functional experts and innumerable decisions, which typically go well beyond the knowledge, competence and 'time availability' of most directors. And so, the responsibility for an organization's operating plan is typically seen as an activity falling outside the normal governance responsibilities of the board and its directors.

The three exceptions to this general rule are: a) when an organization is faced with a crisis and requires whatever benefit the board's collective wisdom has to offer; b) when very small companies are involved (and the board has been recruited specifically to advise at the operational level); or c) when there is agreement with senior management concerning the board's involvement in this area.

"It is never too late to become what you might have been."

George Eliot

Assessing and evaluating strategy

Once the hurdle of describing and understanding an organization's strategy has been navigated, the board and its directors are faced with their most important question:

10. Does this organization have the right strategy and, if not, what should it be?

While every organization has a strategy (which may be either explicit or implicit), not every organization necessarily has a good one. Given the board's responsibility for reviewing, assessing and approving the organization's strategy, it is incumbent upon them to do their utmost in trying to make the correct decision.

As a first step in assessing an organization's strategy, it is imperative that it be formally written down and communicated explicitly to all board members to give them an adequate opportunity to reflect upon and ponder the choice of goals, objectives or product/market scope imbedded within it.

"To conquer the enemy without resorting to war is the most desirable. The highest form of generalship is to conquer the enemy by strategy."

Ancient Chinese Warlord

11. What was the process followed at this organization to formulate the strategy contained in the strategic plan and does the plan's document contain all of the proper information?

One of the initial ways in which board members can determine the quality of the organization's strategy is knowing whether it was developed through a systematic and rigorous assessment process or more through 'gut feel and on the back of some envelope'. Research has confirmed that those organizations which develop their strategies using a formal strategic planning process produce better strategies and achieve higher performance results, on average, than those that do not. So what is strategic planning?

Simply put, strategic planning is the process, which helps establish the strategy of the organization. It results in a formal, written document which is referred to as the strategic plan. A good strategic plan sets forth the basis

upon which the mission, vision, values, and objectives of the organization were set and establishes why the organization's business "arenas" (i.e., product/market scope and domain) represent the optimal choices for achieving those targets. It specifies the environmental and resource assumptions underlying the strategic choices made and the major risks associated with those choices. Finally, a finely tuned strategic plan lays out the rationale for all the major organizational arrangements (i.e., structure, staff, reward and controls) and the changes necessary to implement the company's overall direction.

> "It's not the plan that is important, it's the planning."
>
> Dr. Graeme Edwards

While there are many different approaches and procedures that an organization can deploy as part of its strategic planning process, Appendix 2 provides a comprehensive list of the kinds of information that a good strategic planning process should produce. In assessing the quality of the strategy presented to them (and the planning process by which it was developed) directors should look especially to the following questions and see if they are sufficiently answered in the plan documentation.

12. Does the strategy have the right vision?

As a general rule, visions are concerned with achieving organizational greatness on one or more dimensions — be it, market share, quality, revenues/profits or admiration, to name just a few. Visions help provide long-term direction to an organization and enhance stakeholders' understanding of what the organization is ultimately trying to accomplish. One of the most famous vision statements ever created was that of General Electric under the former leadership of CEO Jack Welch. The company's vision was: To become the most competitive enterprise in the world by being number one or number two in every business in which we compete.

> "Perception is strong and sight weak. In strategy it is important to see distant things as if they were close and to take a distanced view of close things."
>
> Miyamoto Musashi

In making an assessment of their organization's vision it is important for directors to bear in mind that 'great' visions are often highly "aspirational" statements in which the ability — or way — to achieve it is neither readily apparent nor available. This is because the essential purpose of an organization's vision is to describe a future state that is so desirable that it harnesses both the intellectual and emotional commitment of major stakeholders and makes them want to work towards it.

Unfortunately, great visions also generally take a long time to realize. So, it is important for directors to ensure that the vision involves a suitable time frame for its achievement. Indeed, it is not unusual for a vision to take anywhere from 5 to 10 years to realize.

Finally, visions, which are explicit, clear and widely shared, have a powerful and positive impact on internal stakeholder (i.e., employee) behaviours. The more that individuals throughout an organization are committed to their vision's achievement, the more that this 'collective spirit' serves to reinforce desired behaviours and focus both individual and group efforts on desired outcomes. Consequently, it is vital for directors to assure themselves that their organization's vision is widely known, understood — and accepted — throughout the enterprise.

13. Does the strategy have the right mission?

A mission statement is a formal written document that is intended to capture and describe an organization's unique and enduring purpose and practices. It should especially answer the most fundamental question of organizational purpose: Why do we exist?

Generally speaking, every organization exists because it is able to meet and satisfy the needs of multiple stakeholders: shareholders, customers, employees, suppliers and society-at-large. The more an organization is able to meet and satisfy those needs better than its competitors, the greater the probability that the organization will succeed and win over the long term. Good missions, therefore, seek to attract and retain the loyalty and commitment of various stakeholders by responding simultaneously to their competing needs.

On the other hand, to the extent that an organization fails to satisfy a particular stakeholder group in a significant way, it risks alienating the loyalty

and commitment of that group to the organization and, even worse, goading them into an attack. This can lead, under extreme conditions, to problems in organizational survival.

Thus, it is the responsibility of directors to ensure that their organization's mission statement acknowledges the importance of multiple stakeholder groups to the organization's long term survival and to balance their competing interests. But, it is especially important that the specification of stakeholder needs contained in the mission be grounded in reality. Directors, therefore, need to ensure that the strategic plan indicates the basis upon which the needs of each stakeholder group were identified and selected (e.g., customer/employee surveys; comparative competitive positioning; benchmarking studies, etc.)

14. Does the strategy have a proper statement of values?

For an organization, it is important that the actions and behaviours of its employees — in striving to maximize shareholder value and achieve performance targets — can withstand the test of public scrutiny. Values constitute the internal ethical and cultural priorities (e.g., honesty, mutual respect, transparency, innovation, teamwork, etc.) that shape the way in which people behave and make decisions. When widely shared, they enhance especially an organization's ability to focus employee behaviour. Directors, therefore, need to make sure that their organization's strategy contains a statement of values which they consider important for the harmonious and ethical running of their operations. Organizations can then use their 'statements of values' and 'codes of conduct' as vehicles for attracting the right stakeholders to them.

One notable example of an aspirational vision occurred in the early 1960s when US President John Kennedy challenged NASA to: (sic) 'land a man on the surface of the moon and return him safely back to earth before the end of the decade'. Apparently, few persons in NASA actually believed that it could be done because it involved so many new technologies which had yet to be invented. Nevertheless, Kennedy's vision made the scientists at the space agency excited about the prospects of actually making it happen 'during their watch' and, of course, they eventually fulfilled it.

15. Does the strategy contain objectives which are well formulated and well stated?

An organization uses objectives to measure and judge its progress in achieving its mission, vision and values goals. As a general rule, objectives should be established for each of the goals contained within the mission, vision and values. It is also critical that an organization has objectives which are both well formulated and well stated. To accomplish this, directors need to make sure that their organization's objectives are:

- specific (to avoid ambiguity as to what the organization is trying to accomplish);
- measurable (to allow for the determination of the objectives' achievement or not);
- acceptable (to ensure that the method for measuring progress against the mission, vision and values is perceived as fair); and
- timely (as the great economist, Lord Keynes, once said: "In the long run, we are all dead!")

Regarding this last point, detailed organizational objectives are best stated for a time period of one to three years and revised at the end of each year as new information becomes available.

A key consideration in setting objectives is the degree to which the specific achievement targets contained in the objectives are perceived as realistic by those responsible for their achievement. To determine this, directors need to know the basis upon which the objectives were established (e.g., customer/employee surveys; comparative competitive positioning; benchmarking studies, etc.) and whether the objectives balance the conditions in the external environment (especially the performance of competitors) with the organization's internal capabilities (See also Question 16). Only when armed with this information can directors judge for themselves whether the objectives stated are realistic or not, and possibly in need of adjustment.

Organizational surveys asking if macro-level objectives are understood and accepted by employees at each level are also useful for determining the reasonableness of objectives.

Lastly, when employees feel connected to the organization's strategic objectives, they work more diligently towards their achievement. It is, therefore, essential for directors to assure themselves that those macro organizational objectives (which have been designed to measure an organization's progress in implementing its mission, vision and values) have been translated, disseminated and aligned throughout the organization — especially to the front line.

> "If you have boarded the wrong train, it is of no use running along the corridor in the opposite direction."
>
> Anon

16. Are the business arenas specified in the organization's strategy the right ones?

An organization should strive to identify and focus its resources on those business arenas (existing or new) where a) the potential market opportunity exists for the enterprise to achieve its stated goals and objectives AND b) the organization has the internal resources — either on hand or quickly available — to pursue and capture the opportunity.

When either (or both) of these conditions does not exist, an organization is faced with the difficult challenge of determining if and how the situation might be turned around and made more favourable — or whether to seek 'greener pastures'.

Making such business arena choices is generally regarded as one of the most demanding activities in the process of formulating or evaluating an organization's strategy. It involves the most amount of information gathering and typically represents the bulk of the organization's strategic planning efforts.

Accordingly, in making their assessment of the market potential and internal capabilities associated with various business arenas, directors need to have in place a strategic planning process, which ensures that the following questions are adequately addressed for each business arena:

- What is the nature and extent of demand for the products and services offered?
- What is the potential for profit?
- To what extent (and in what way) are customer needs currently being met by existing competitors?
- To what extent are the organization's products and services significantly differentiated from — and offer a clear advantage over — existing competitors?
- Does the organization have the resources, skills and capabilities required to pursue the growth and profit potential in the business arenas that it has targeted?
- If lacking a competitive advantage or any specific resources, skills or capabilities, how does the organization intend to acquire them — if at all?
- What are the major 'assumptions' underlying the choice of each major business arena?
- What are the methods of entry to or exit from the major business arenas selected (i.e., merger, acquisition, divestment, closure, sale, etc.)?
- What alternative business 'postures' (i.e., grow/invest, hold, harvest, divest, no entry) were considered and rejected for each business arena (both existing and new)?

> "Without competitors there would be no need for strategy, for the sole purpose of strategic planning is to enable the company to gain, as effectively as possible, a sustainable edge over its competitors."
>
> Kenichi Ohmae

Strategy implementation considerations

17. Have the proper organizational arrangements been selected, designed and 'aligned' to reflect, reinforce and support the strategy?

Given sufficient time, information and human intelligence, any organization is capable of designing outstanding strategies. The tough part occurs, though, when it comes to execution, i.e., turning the strategy into a reality.

One of the major ways in which execution happens is through the organization's operating plan. But, directors are generally discouraged from becoming involved in this area and for good reason (See the discussion related to Question 9).

The other major method by which an organization executes its strategy is when it aligns its staff, structures, reward and control systems to focus on, support and reinforce the organization's strategic goals and objectives. This is called 'strategic organizational alignment' and it entails, at least, four major considerations with which directors need to be concerned. The first involves translating the mission, vision, values and objectives into terms that are meaningful and understood by ALL organizational members so that they can, in turn, put forward a united and concerted effort towards the strategy's realization. Often, this requires that employees' jobs must be redefined or re-specified to take into account the requirements of the strategy. The second important element of 'alignment' requires that individuals be either hired on the basis of their ability to perform the critical tasks and priorities specified in the strategy — or be trained to do so. A third element stipulates that information systems be adjusted to regularly measure and report on an organization's progress against all aspects of its strategy as well as the contributions of individual members towards its achievement. In so doing, the effectiveness of both operating plans and specific job behaviours can be assessed and modified in order to better achieve the strategy — and before it's too late. Finally, the fourth element of organizational alignment stresses that reward systems be adjusted so that employees feel inspired and motivated to put even greater effort into making the strategy happen. When these organizational alignment modifications have been made, the probability of an organization achieving its strategic goals and objectives will be greatly enhanced.

Assessing strategic risks

18. Have all the significant internal and external strategic risks been identified, quantified and addressed in the plan?

In the course of developing a strategic plan, there is always uncertainty around its ultimate attainment. And with uncertainty comes risk, i.e., possible events (with varying degrees of probability attached), which if realized, will have an adverse effect on the organization and interfere with its ability to either achieve its business opportunities or overcome organizational weaknesses. The presence of risks can also significantly alter which opportunities to pursue, get in the way of certain organizational arrangements and make the accomplishment of objectives related to the mission, vision and values extremely difficult.

Consequently, it is necessary for directors to understand those risks associated with a particular strategy, their probability or likelihood of occurrence and their potential impact on the organization and its strategy.

While there are many different types of risk that an organization might possibly face, the main strategic risk areas of concern to the board parallel those which drive its strategy, namely, the risk that:

- stated objectives will not be realized;
- the market potential perceived to exist will not materialize (e.g., due to changes in: customers' demand/satisfaction, commodity prices, competitive intensity, regulations, government, etc.);
- internal resources necessary for strategic success either disappear or cannot reasonably be secured (e.g., the loss of key employees, a decline in company morale, the inability to secure a patent/technology or to innovate, failed marketing/sales initiatives, fraud and asset theft, etc.); and
- organizational arrangements chosen to implement the strategy will not function as intended (e.g., the benefits of moving to more centralization/decentralization do not materialize).

These risks should be spelled out in the strategic plan. And, directors should approve only those strategies where the associated risks — and their impact — are deemed to be tolerable given the potential for return.

The board should also be assured that the organization has put in place a risk management system for measuring and monitoring known risks, estimating their impact, mitigating their occurrence or effect (e.g., through insurance, hedging, codes of conduct or assigned risk managers), and identifying emerging dangers.

A more comprehensive discussion of current risk management practices is contained in a companion publication of the CICA called *20 Questions Directors Should Ask about Risk*. Directors should familiarize themselves with these questions as well.

Monitoring progress

19. Are appropriate mechanisms in place to provide the board with timely feedback on the organization's progress against its strategy, the underlying causes of any performance variance and any changes in the internal/external environments or risk factors which would cause the board to consider altering the organization's strategy?

In fulfilling their strategic and governance responsibilities, it is incumbent upon directors to monitor the organization's progress against its strategic objectives and related risk factors. Consequently, directors need to ensure that their organization's progress against each of its strategic objectives (along with an update on any significant business risks) be reviewed at each meeting of the full board.

A word about 'constructive involvement' and who does what

According to the OECD:

> "Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the Board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs." April 1999.

Today, the responsibility to actively participate in the development and approval of the overall strategy, to monitor the strategy's progress, and to oversee and guide the organisation represents some of the quintessential activities of corporate governance. And that responsibility, today, is seen to reside principally with the board.

As boards have taken on their tasks and duties in this area, there has been a shift in both the role and manner in which they interact with management — especially the CEO. Unfortunately, many senior executives have seen the board's new strategic responsibilities as incursions into decision areas that were once strictly within the domain of the executive suite. But, times have changed. And astute boards will recognize — and anticipate — the potential resistance that they may encounter from senior managers as they attempt to become more involved participants in their organization's strategic decision making.

Indeed, they have no choice. Boards must now participate in, assess and approve the strategy. (Appendix 1 lays out one framework in which the responsibilities for the organization's strategy and strategic planning are divided between the Board and Senior Management.) But, it is in no one's best interests if the relationship between the board and senior management is adversarial — especially when it comes to plotting the organization's future direction.

Boards, therefore, should seek to avoid creating such a situation. And to circumvent it, directors need to ask:

20. Are the board and its directors constructively involved in the organization's strategy?

To achieve a state of constructive involvement, one of the first steps that the board needs to take is to openly and candidly discuss with the CEO (and other members of senior management) the new governance responsibilities required from the board in terms of the organization's strategy. Ultimately, the board and management must come to some new understanding and agreement as to:

- 'who does what' in terms of formulating, assessing and approving the organization's strategy and strategic plan,
- what areas constitute strategic, and therefore, board decisions,
- what areas represent operational/tactical — or management decisions.

Senior managers need to understand that the board's tasks with respect to strategy are not being taken because of some lack of confidence in the organization's leadership. Rather, they are part of the stewardship role that the board is being asked to perform in order to avoid the two major governance mistakes of the past, namely, the 'rubber stamping' of major management decisions (especially the organization's strategy) and the board's micro managing of the organization's operations.

Of course, constructive involvement ultimately depends on the level of trust and mutual respect, which exists between the board and senior management. Directors need to feel comfortable in asking strategic questions. And senior management needs to feel that it can be forthcoming in its responses to those questions. Consequently, it is recommended that the board conduct an annual self-assessment in the area of 'constructive involvement', possibly with a skilled facilitator, to help directors determine the degree of trust and respect that exists with management as well as to help sort out mutual responsibilities. To the extent that problem areas are identified, the board can then consider what steps it next needs to take to correct the situation.

"There may be no single thing more important in our efforts to achieve meaningful work and fulfilling relationships than to learn and practice the art of communication."

Max De Pree "Leadership Is an Art"

Appendix 1: Constructive involvement: board and management roles and responsibilities for strategic plans and planning

The following table lays out one recommended framework in which the responsibilities for the organization's strategy and strategic planning are divided between the board and senior management. The precise division of responsibilities will depend on the size, complexity and resources of individual organizations. Each organization should determine the planning responsibilities of its board and management after considering the nature of the organization, the composition of the board, and any specific regulatory requirements.

TASK	RESPONSIBILITY	
	Management	Board
Developing a strategic planning process	X	
Assessing and approving the strategic planning process		X
Developing the mission, vision, and values (1)	X	
Assessing and approving the mission, vision and values		X
Developing the objectives	X	
Assessing and approving the objectives		X
Identifying the business arenas	X	
Assessing and approving the business arenas		X
Data collection and analysis with respect to the strategic plan (See Appendix 2)	X	
Preparing the written strategic plan	X	
Assessing and approving the strategic plan		X
Scheduling strategic planning and strategy review meetings	X	
Preparing operating plans	X	
Preparing budgets	X	
Approving budgets		X
Preparing reports on the organization's strategic progress and accomplishment of strategic objectives	X	
Monitoring the execution of the strategy and its achievement		X
Approving changes to the strategy as warranted		X

(1) while traditional practice generally restricts Board involvement to the assessment and approval of the mission, vision and values, recent research suggests that superior organizational performance and innovativeness occurs when Boards are more active participants in the development of these strategic documents.

Appendix 2: Strategic plans and planning

A Strategic Plan is a document that records the decisions the organization has made with respect to its future strategy. The plan should also contain the rationales, analyses and background information supporting those decisions. A good strategic planning process is one which facilitates the creation of a superior strategy and ensures that the appropriate information is contained in the plan. The types of information typically included in a strategic plan are:

Vision, mission and values

Objectives (related to the mission, vision and values)

Major business arenas (for achieving the mission, vision, values and objectives)

External environmental analysis

- Political, economic, technological and social demographics analysis;
- Market research related to identifying and satisfying (current & unmet) investor, customer and societal needs;
- Potential market demand/growth/profitability;
- Nature and degree of competition;
- Position of competitors and their degree of product/service differentiation;
- Barriers to entry/exit;
- Switching costs related to customers and suppliers;
- Nature and degree of customer and supplier dependencies;
- Industry benchmarks and performance standards.

Internal resource analysis

- Strengths and weaknesses analysis related to achieving objectives and increasing competitive advantage;
- Analysis of capabilities for innovation;
- Customer satisfaction survey results;
- Employee satisfaction survey results;
- Investor/analyst satisfaction results;
- Gap Analysis results;
- Key success factors;
- Plans for overcoming critical weaknesses or strengthening advantages.

Methods of entry into (or exit from) major business arenas

- Merger/acquisition;
- Joint venture;
- Strategic alliance;
- Divestment/closure/sale.

Risk analysis

- Major risks (internal and external);
- Risk impact analysis e.g., sensitivity analysis;
- Risk impact outcomes — including best and worst cases;
- Risk management/abatement tactics.

Assumptions

- Qualitative;
- Quantitative.

Major strategic alternatives

- A summary of major changes represented in the proposed/future strategy in relation to the strategy currently in use;
- Descriptions of major strategic alternatives that were rejected and the rationale for their rejection.

Rationales for the proposed strategy — i.e., how the proposed/future strategy will optimize the achievement of objectives in accordance with the mission, vision and values.

Strategic organizational alignment/strategy implementation

- Organization chart;
- Major changes in job definitions, information systems, and human resource practices in order to bring them into alignment with the strategy;
- Succession plan for key management positions;
- Potential areas of resistance to change and methods for overcoming them;
- Links between the strategic and operating plans.

Financial and other measurements

- The projected financial impact of the proposed/future strategy for at least 3 years;
- Key performance indicators;
- Milestones.

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Notes

Notes

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