



## Where is your company headed?

**There is an old saying that failing to plan is planning to fail. With the business environment becoming more volatile it is essential that directors engage in strategic thinking about where the company will be in five years' time. Domini Stuart outlines why this is a vital function for directors.**

We're running faster than ever – a recent survey by KPMG found that 93 per cent of executives expect significant change to at least one aspect of their business model within the next three years. At that speed, it helps to know exactly where you're heading.

"These days, successful organisations have very clear and demonstrated value for their customers," says James Allt -Graham, lead partner in KPMG's Business Performance practice. "At a fundamental level you need to know what markets you're in and what you're going to do to win in those markets. It takes time to build capability and you need to know what to build."

An effective strategic plan is critical – and, as most board charters name guiding and monitoring as an overarching obligation, there is an expectation that directors will play a role in shaping the future of their company. However, the exact nature of that role is not clearly defined and the respective responsibilities of board and management may not be well understood. That leaves many directors unsure the most effective ways of making a contribution..

"Ideally there should be a clear delineation between the responsibilities of board and management," says Gail Bergmann, a principal of Ernst & Young. "Shareholders appoint the board to monitor and provide oversight, and the board appoints the CEO and executive team to take the company where they want it to go. But the practical reality is that there are times when the board does need to be more actively involved. And there are also times when boards are so actively involved that management can't get on with their job.

“I have seen a situation become unworkable because directors insist on overstepping the mark. This may be a response to shareholder demands, and perhaps shareholders need to be educated as to what the role of the board actually is. The point is that, whatever the reason, if the directors become tied up with managing and micromanaging, we lose the control mechanism of the board.”

Allt-Graham agrees that large businesses tend to have a very skilled executive team; a board that questions every decision will not add a great deal of value. However, smaller organisations may not have all of the skills covered at executive level and would benefit from more board involvement.

“It's horses for courses,” he says. “You need to look at the combination of skills and work out how they can best be used. The most important thing is that the board and management discuss the issue and agree on the role the board should play.”

### **Hands on, hands off**

The level of involvement invited by management can vary widely.

“At one extreme, management might take the board off-site for two days and bombard them with wall-to-wall PowerPoint slides for 10 hours each day,” says Gary Turner, a partner in the Sydney office of Bain & Company. “Here, they're often looking for a rubber stamp, and they leave no room for the board to discuss, iterate, test or challenge. At the other extreme, management might offer a summary of the situation the business is in then sit back and wait for the board to opine and provide solutions. Both of these options are equally unproductive; the ideal lies somewhere in between.

“Strategic planning is, by definition, an iterative process. The most successful strategy sessions come about when management has put a huge amount of thought into providing realistic options, and supplies valid analysis around those options. The board is then invited to comment and challenge on an equal basis.

“In our experience the best way to do this is for board and management to go away, say, once a year for an ‘imagining’ session – thinking through together what the business will look like in three to five years. They need to get out of the office environment because the process requires thinking that is fundamentally different from the every day.”

“Often there isn't enough strategic thinking before the planning component, particularly around the risks associated with the strategic plan,” says Tony Adcock, founding director of Red Pill Performance Consultants. “Strategic thinking is actually more important than strategic planning, but we often see a disconnect between thinking, planning, risk and execution.

“Strategy starts with a statement of intent – but a statement like ‘our intention is to grow the business by 200 per cent over the next 12 months’ means

nothing until you put some granularity around it – until you fill in the details of how you’re going to achieve that. Even then, if you haven’t done enough strategic thinking up front, your actual capacity for growth might be 1000 per cent or five per cent.”

### **What is needed?**

If a board’s contribution to strategy can vary according to the size of a company, it will also vary according to the situation. In a crisis, where there’s a write-down of 50 per cent of profits, the CEO has been asked to leave and a major strategic turnaround is required the board would want and need to be far more intrusive than in less turbulent times.

“Generally, board members should leave the development of strategy to the executive and use their wider experience to focus on challenging the strategy,” says Adcock. “What is the reality of the strategic intent? Have we considered all options? Have we thought left field? What are our cost constraints? Are there people outside Australia doing similar things? What lessons can we learn from other organisations? If we’re looking at a groundbreaking idea, do we really want to be the first cab off the rank? The board must ask effective questions – and it’s management’s job to equip them with the information they need to formulate them.”

Turner describes this as a ‘weed the garden’ approach – acknowledging that things are going to grow back. “From a board perspective, this means never accepting the status quo,” he says. “A very important element of being an effective board is continuously cajoling, pushing, testing – but in the wholehearted spirit of co-operation. It’s not about checking up on management.”

Nor is it about force of will. Executives will often recommend whatever strategy feels most comfortable for them and the board should question this. But it is management who must ultimately deliver. If they’re edged too far out of their comfort zone, they probably won’t.

### **Insight and experience**

While more companies are recognising the importance of strategic planning and including this in their check list of skills for new board members, commentators tend to dismiss the idea of recruiting a specialist strategist.

“Most board members have 20, 30 or even 40 years’ experience,” says Turner. “They may have seen things outside the generational experience of the management. They can draw analogies and see patterns forming. Over the years our observation has been that good directors from a multitude of backgrounds bring phenomenal wisdom and insight. If specific strategic skills and expertise are needed at a point in time there are many talented consultants.”

John Barrington of Barrington Consulting Group agrees that a board needs the insight to deal with complexity and uncertainty, and the inevitable interactions with other organisations.

“Strategy doesn’t exist in a vacuum,” says Barrington. “When a company deploys a strategy, competitors respond, so thinking strategically also has implications for other organisations. It’s like a game of chess – some people have the ability to think one or two moves ahead and a grand master perhaps six or eight moves ahead. Business isn’t finite like a football game where you play for 120 minutes and either win or lose. A company goes through cycles again and again and again, sometimes as a competitor and sometimes as a collaborator.

“In order to function as effective leaders, board members should ensure their organisation remains very clear about what they’re going to do and what they’re not going to do, then stays focused on what they want to achieve. That won’t be the same for every type of business. For instance, not-for-profit organisations have a much broader canvas – they need to bring in money but they also want to make a difference. Government organisations want to deliver a service. Whatever your goal, you need to look beyond the short term into the medium and long terms. The challenge for boards is to think across all three time horizons simultaneously.”

### **When the rubber hits the road**

A plan is meaningless until it is implemented, yet this is where many businesses founder.

“In my experience, most companies are appalling at execution,” says Adcock. “Plans are often too complicated to be easily executed, with far too much detail. I believe that strategy should be kept very, very simple, and also with a maximum three year focus because the world changes so fast.”

“Strategies can be very aggressive,” says Allt-Graham. “Management may want lots of things done, and done quickly. But driving change through a business is a major challenge. It takes time – and executives often underestimate how long it will take to do things like upskill staff. Typically, strategies are neither effectively resourced nor well prioritised - a slip against the timetable causes panic.

“The board needs to find out exactly what management is trying to achieve and ask the tough questions about resourcing. Where will the dollars come from? Who is going to do the work? Employees already have a day job – are you asking them to do 30 per cent more in 10 per cent less time? If there is a slip, what should be cut first?”

Bergmann believes that strategy works most effectively when the whole company is aligned.

“For example, some companies insist on lower levels of management having training in legal and regulatory constraints so that they understand why controls are in place – that they’re not there because management is being pedantic,” she says. “It’s the same for strategy. If everyone can see the bigger picture and knows why they’re being asked to do certain things, they’re more likely to feel comfortable and to buy into it.”

The key is effective communication and, again, it’s horses for courses. “As smaller companies have fewer people to communicate with, a strategic plan may not need to be quite so formal,” says Allt-Graham. “There’s a big difference between a family business, where the key people can drive the strategy through the whole company, and an organisation where strategy affects thousands of people.”

Clear, well-communicated strategy can even help build investor confidence.

“After the debacles we’ve seen in recent years, a company’s ability to communicate strategy to the investor community, and then show progress against that strategy, can have a positive impact,” says Allt-Graham. “David Jones CEO Mark McInnes won support by releasing high-level strategy, then reporting back against key initiatives. Most large corporates are now doing the same – though some better than others. Investors are actively looking for good strategic thinking and a clear plan gives them confidence in the management.”

### **The tyranny of compliance**

Should a director’s good intentions falter, the most likely reason will be simple lack of time.

‘I’m hearing from a lot of directors who are feeling weighed down by both a growing burden of compliance and expectation from shareholders that they should be across the minutiae of the organisation,’ says Bergmann. “They feel they can’t spend as much time as they would like on strategy. And there are also concerns that this is causing boards to become risk averse. Management may want to try a new direction – to push the envelope – but boards are pushing back because they have to spend so much time on compliance issues. We’re getting this as feedback companies of all sizes.”

Bergmann feels we’re approaching a crossroads.

"Some directors are already saying ‘Let’s take a step back. If we are buried in compliance we’re not using the talents of the board to the best advantage.’ They’re starting to ask whether they are receiving too much information. Are they spending board meetings ratifying or acknowledging past indicators of performance rather than looking at leading indicators? Could some of the compliance be filtered through committees? Are they spending time looking at things just because they’re nervous about not looking at them?

“It takes a leap of faith to push detail out of the boardroom because you do run the risk of something cropping up later and having shareholders ask ‘why weren’t you across that?’. It’s a balancing act.”

“As the burden of compliance increases, there is a real threat that compliance issues will squeeze out strategic dialogue,” says John Barrington. “You have to be careful you don’t achieve fabulous compliance but no performance.”

### *Breakout box 1*

## **The seven habits of an effective board**

Bain & Company’s checklist can help directors assess and enhance their company’s strategic performance.

### **Own the strategy**

Effective boards ensure that non-executive directors contribute to developing the strategy and feel a sense of ownership of the strategy and use it as a basis for decision-making.

### **Build the top team**

Boards have a key role to play in selecting, developing and evaluating the executive team. This should extend to the bench depth in the organisation and knowing competitors’ top talent.

### **Match reward to performance**

Executives’ remuneration benchmarks just keep on rising. One solution is to ensure that exceptional pay requires exceptional performance. Importantly, any reward system must be simple, fair and balance short- and long-term value creation.

### **Ensure financial viability**

Directors must be able to understand as well as trust the numbers to provide a challenge where necessary, with all major investments scrutinised for value and risk.

### **Match risk with return**

Boards need to understand, accept and monitor the risks inherent in any strategy. Bain research finds only one in eight companies generates sustainable growth, 70 per cent of major acquisitions fail to create value and 70 per cent of moves made away from the core business and into new

markets also fail.

### **Build corporate reputation**

Doing what's right for the board and the company means not succumbing unduly to outside pressures. If boards are to avoid the trap of 'check-box' compliance and short-term focus, they need to take action to reclaim control over the agenda, in particular focusing on key stakeholders and those investors who are in for the long term.

### **Drive effective board processes**

An effective chairman sets the tone from the top and ensures a governance model that works in practice.

### *Breakout box 2*

### **Executives suggest areas for improvement**

Executives who responded to a recent online survey conducted by *The McKinsey Quarterly* believe that their companies could be a lot more effective at developing a strategy and implementing strategic plans.

- More than half say that important strategic decisions are made by a small group of senior managers, most importantly the CEO.
- Those whose companies make good use of a formal process seem to be more satisfied with strategic planning.
- Only 25 per cent say that their board is actively involved in developing the content of the strategy.
- Most respondents find the current role of their board satisfactory: only 7 per cent believe that greater involvement by the board would improve their company's strategic planning. However, those who are satisfied with their company's approach to strategic planning are twice as likely to say that their boards help develop strategy. Boards where respondents are satisfied are twice as likely to monitor the company's progress against the strategic plan and three times as likely to spend time identifying key strategic issues facing the company.
- Some 28 percent say that their company produces a strategic plan that reflects the company's goals and challenges but is not effective. Another 14 percent say the strategy and plans for executing it are not necessarily aligned with each other.
- The top two suggestions for enhancing strategy development are improving the company's alignment with the strategic plan and developing a method to monitor progress against the plan.
- Executives are concerned by a lack of integration between the company's strategic-planning group and its human resources group.

- Fewer than half of all respondents say that their company's approach includes identifying growth opportunities outside the core business.
- Only 53 percent of respondents say that their strategic planning process focuses on their company's most important strategic issues.

Tom Saar, Director, McKinsey & Company (Australia/NZ), was surprised by the lack of enthusiasm for increased board involvement. “When we did similar research among board members we found that they were generally focused on governance and champing at the bit to spend more time on strategy and talent. Perhaps the executives are nervous that more involvement would mean moving from challenging into doing.”

He was also interested by the apparent disconnect between strategic planning and human resources.

“We’re finding more and more that a company’s strategic effectiveness is as much about the capabilities of the people and responsiveness to change as it is making big strategic decisions. HR needs to work more hand in hand with the strategy group.”