GOVERNANCE/COMPLIANCE

Engaged directors fortify firm's strategy

By TOM BURSEY

An engaged board can be a great advantage for an organization, enabling it to fully benefit from the wisdom, experience, and connections of these key individuals. Constructively engaging directors in organizational strategy requires a common understanding among directors, the CEO, and senior executives regarding terminology, roles, and responsibilities.

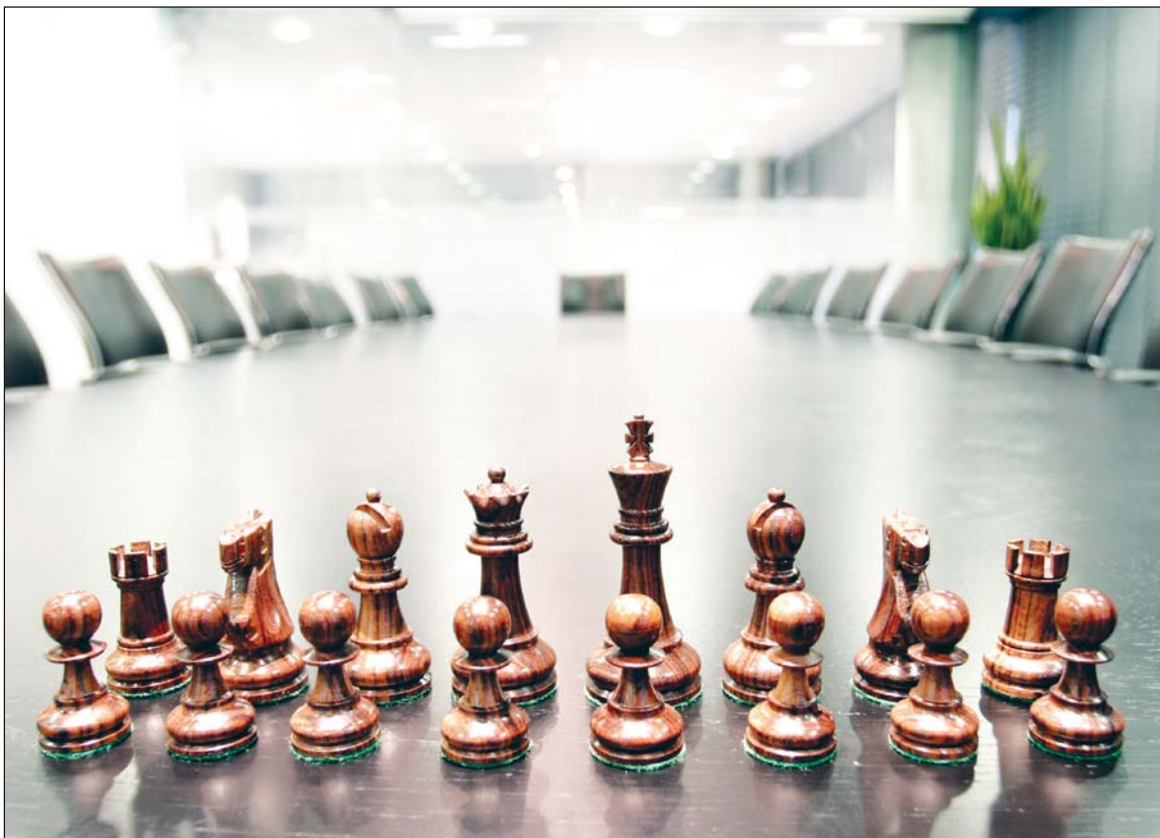
The Conference Board's *Corporate Governance Handbook* states: "The role of the board in strategy should be active and involved. Directors should advise senior executives on strategic planning by offering their expertise, analytical skills, and insights. In addition, the board must devise ways to oversee on a continuous basis the progress made by management in the pursuit of the company's strategic objectives, even in light of rapidly changing business environment."

The directors' role involves participating with the CEO and senior executives to help set the mission, vision, and values, and then constructively engaging with the CEO and senior executives to gain reasonable assurance that the overall strategic plan is plausible. This article provides insight on how this can be achieved through an assessment of key processes.

Current wisdom is that organizational strategy is best assessed and approved by the entire board, rather than by a board strategic planning committee. However, such a committee could assist the CEO and senior executives by offering their expertise in the preparation for the full board discussion and decision-making on strategy. A governance committee may also exist with the goal of maximizing the effectiveness of the organization's board, and as such, should take the lead for assessing the effectiveness of the board approach to strategy.

A critical step to ensure that the board and its directors are constructively engaged in the organization's strategy is for the board and the CEO to agree on terminology, roles, and responsibilities. Directors and senior executives all come to the boardroom table with different definitions of strategy planning, strategy, and the strategic plan, for instance, and all have different understandings of what the board and senior executive roles and responsibilities are for creating the plan.

A suggested starting point for agreeing upon terminology, for the purposes of the strategic plan and other organizational documents, is to define strategy according to Dr. Chris Bart, CA, author of *20 Questions Directors Should Ask about Strategy*. Bart states that "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."



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Tom Bursey, certified management accountant

The next step is to create a common understanding among directors, the CEO, and senior executives of roles and responsibilities. Again, according to *20 Questions*, management roles and responsibilities involve developing a strategic planning process; developing the draft mission, vision, and values; developing the objectives; identifying the business arenas; and preparing the written strategic plan.

Board roles and responsibilities involve: assessing and approving the strategic planning process; assessing and approving the mission, vision, and values; assessing and approving the objectives; assessing and approving the business arenas; and assessing and approving the strategic plan.

However, a common understanding of the strategic planning process is an essential starting point for constructively engaging directors in the organizational strategy used by directors, the CEO and senior executives.

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Two of the most useful principles in the strategic planning process and in the development of a strategic plan are: 1) a simplified, action-oriented approach to the strategic planning process; and 2) constructive engagement of directors with the CEO and senior executives which will build both trust and understanding. However, the engagement of the directors in this important activity is difficult to achieve for a variety of reasons, such as time commitment, limited knowledge of business or the organization, and social constraints such as board culture.

Most organizations will have a discussion at a board meeting to understand timelines and processes, and to determine who does what. Some boards will identify champions or delegate the responsibility for managing the strategic planning process to a strategic planning committee or task force. The committee provides direction and support to the senior executive team in both the strategic planning process and in the development of a draft strategic plan. However, the full board remains ultimately responsible for the assessment and approval of the strategy and the strategic plan.

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Bart's *20 Questions* also suggests that "superior organizational performance and innovativeness occurs when boards are more active participants in the development of these strategic documents but management is responsible for data collection and analysis with respect to the strategic plan."

To achieve constructive engagement of the board and to ensure the best possible organizational strategy, there are three questions that any organization needs to ask itself.

Where are we now?

Each organization needs to determine what information it needs and how to get it (a situational analysis). The challenge is to identify the most critical items that may cause a change in strategy. Typically, a Strength-Weakness-Opportunity-Threat (SWOT) analysis and a risk assessment are important processes to determine the need for change in strategic direction. Two reasons primarily drive this need: a lack of opportunity and a lack of capability to pursue opportunity. Clearly defining the individual roles and responsibilities of the directors, the CEO, and senior executives in a situational analysis is therefore essential.

Where do we want to go?

A key purpose of the strategic planning process is to ensure that CEO and senior executives consider the best available evidence to formulate or recommended strategic alternatives to the board (strategy formulation). The primary purpose of the strategic plan is it to record strategic choices approved by the board.

According to *20 Questions*: "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."

How do we get there?

After it has approved the strategic plan, the board must monitor the organization's imple-

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Take risks, but only calculated ones

To restore public confidence in capital markets and good governance, boards need to rise to the challenge of implementing effective risk oversight.

Michael Gunns, chartered accountant

By MICHAEL GUNNS

In the last five years, many boards of directors have made great strides in contributing to the development of their organizations' strategies. However, unless a board is engaged in an equally robust process of risk oversight, it may be unaware of hidden and cumulative risks. Conversely, boards also may potentially be curbing innovation through being too cautious.

High-profile disasters like AIG, Lehmann Brothers and BP are all examples of runaway trains, where boards may have failed to understand the risks inherent in management's plans and proposals. To restore public confidence in capital markets and good governance, boards need to rise to the challenge of implementing effective risk oversight.

Since 2005, Canadian regulators have required the boards of all public companies to exercise risk oversight for the organizations they serve. A very few have succeeded but most boards have only scratched the surface of this key responsibility. An October 2009 U.S. survey showed that directors reported that the biggest challenge in providing risk oversight was their lack of understanding of how to do it.

Risk has always been with us but the sheer complexity of the modern world has meant that today's boards of directors have to consider business risks more carefully than ever before. Additionally, the media rich world is much less forgiving than it might have been in the past — make a mistake and it becomes public quickly, and an organization can pay a huge price.

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There are many benefits to improving a board's risk oversight practices, but first there are a few questions that must be answered:

• Do the board and management agree on what are the non-negotiable risk elements of the enterprise?

• Has the board provided management with appropriate parameters for the inherent risks in the operation, planned growth and overall direction of the organization?

• Is the board aware of the cumulative impact of present and future risks?

• Is the company taking enough risk to encourage innovation and competitiveness?

A discussion of 'risk appetite' typically provides powerful insights and is an important building block in forging a common understanding of risk limits between the board and management.

Other benefits of establishing a risk oversight process include:

• Improving the organization's ability to avoid, or cope with, present and emerging risks, thereby building a more resilient and sustainable enterprise;

• Building an organization that is better able to confidently exploit new strategic opportunities and innovations, while suffering fewer surprises, leading to competitive advantage;

• Achieving a more robust shared agreement of board/management roles and responsibilities, and better linkages between management rewards and risk-based performance measures; and

• Giving the board a broader and deeper understanding of the company's business, which provides an increased opportunity to bring directors' skills and experiences to bear on issues.

Risk oversight is an evolutionary process. Where a particular board begins depends on where management and the board are in this evolution. Most organizations, through their audit committees, have good oversight over financial risks. Many companies have established or are introducing enterprise risk management programs. These can form the foundation for the establishment of the board's risk oversight processes.

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A board's involvement in risk oversight might require an extra meeting at the outset but, once things are up and running, much of the work can usually be done without additional meetings. Some boards might opt for forming a new risk committee but others may assign the ongoing oversight to existing committees, such as audit or governance. Ultimately, however, it's important that board members understand that risk oversight, like strategy, is a responsibility shared by the entire board.

The biggest potential pitfall is starting off on the wrong foot in terms of communicating with management. This is what happened with many boards when they first got involved in reviewing and influencing strategic planning. Chief executive officers and management went through much angst and extra work that could have been avoided if a game plan had been established up front.

The first step for a board in this process is to have a frank discussion with the CEO regarding approaching risk oversight on a systemic, rather than an ad hoc, basis. The next step would be to integrate a review of risk into the strategic planning process. It's remarkable that some boards would still even consider a strategic plan without looking closely at the risk environment in which it's to be executed.

Some boards will be able to introduce risk oversight using resources within the board itself. Others will be inclined to ask management to educate them or lead them through the process. However, a board taking this approach must be wary and be able to assure itself that this approach doesn't affect its objectivity.

Most boards will find that some form of expert professional advice and facilitation will enable them to be more efficient and effective, which should make for better results more quickly. Engaging outside expertise may also help boards avoid the possible pitfalls that can befall group discussions and decision-making in new, ambiguous and potentially contentious areas.

Risk management as a professional activity is relatively new and there are very few credentialed experts in the field. In many organizations, implementing enterprise risk management falls to the CFO. Often, these individuals have accounting qualifications that bring with them a broad business perspective and sense of objectivity. Similarly, accountants serving on boards can often help by bringing discipline and sound process to the board's risk oversight activities, as long as the board recognizes that the risks they must oversee go far beyond the financial.

The board's role is to take a wider view than management possibly could. If this wasn't so, we could go back to a world reflected in a widely known quote, from Irving Olds, chairman of U.S. Steel from 1940 to 1952, who once opened a speech by declaring: "Directors are like the parsley on fish — decorative but useless."

Today's boards have a great deal on their plates and may view risk oversight as another 'nice to have.' Management may also persuade them that too much emphasis on examining risk could stifle initiative. That would be a pity.

Interestingly, a common refrain of experienced directors is that management doesn't take enough risk. These directors understand that good brakes on a race car enable the driver to confidently drive very fast — the only way to win races. There's no evidence that possessing good brakes ever made anyone drive more slowly or tentatively. However, driving quickly with poor brakes is perilous.

This is well summed up in the words of U.S. Army General George S. Patton: "Take calculated risks. That is quite different from being rash."

Michael Gunns, FCA is managing principal of the Gunns Group in Toronto and a long-time champion of effective corporate governance. He can be reached at mgunns@gunnsgroup.com.

Always measure organization's results

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mentation of the plan and progress toward achievement. This is a critical step. As the old adage goes, "what gets measured gets done." The board, CEO, and senior executives need to have a solid grasp on how much progress has been made to better understand whether further adjustments may be needed to get the organization to where it needs to go.

In conclusion, directors, the CEO, and senior executives must have a common understanding of terminology, roles, and responsibilities. This understanding will allow directors to be constructively engaged in organizational strategy, and will ultimately allow the organization to thrive.

This begins with a common understanding of the strategic planning process, together with clearly defined individual roles and responsibilities in performing a situational analysis. Even with a common understanding and clear definitions of roles and responsibilities, however, constructive engagement is simply not possible without the core values of trust and mutual respect between the board, the CEO, and senior executives.

Tom Bursey, CMA, CHRP, C. Dir., ICD.D is a corporate director for profit and non-profit corporations. He has served as board chair and committee chair for audit and finance, HR and compensation and governance committees. He is executive director, corporate services at the Council of Canadian Academies.