

## THE ROLE OF BOARDS IN STRATEGY FORMULATION

### 30<sup>th</sup> JULY, 2016 | MUMBAI

#### SUMMARY OF DISCUSSIONS

##### BACKGROUND

*The pivotal role that Boards of Directors have to play in the promotion of stakeholder democracy is increasingly translating into Boards seeking a larger role in the formulation of strategy. In support of this seemingly activist role, Boards are placing emphasis on the importance of a well-crafted strategy in ensuring improved business performance, in a manner consistent with the interest of all stakeholders. As against this, it is often contended, not without merit, that Boards of Directors, as they are presently comprised, do not have the expertise or domain knowledge to put together a strategy that seeks to comprehensively address company-specific problems and possibilities in the face of external challenges. It is also argued that even if the Boards have adequate expertise residing in them, infrequent meetings coupled with the part-time responsibilities of some of the Board members leaves the Board underequipped to address the challenge of putting together a farsighted strategy.*

*It is fairly widely accepted that the Boards are the co-owners of strategy. The question is whether co-ownership can be ensured if Boards do not co-create strategy along with managements. In practice, this could translate to one of at least two possibilities. The first possibility is that the management puts together a draft strategy which the Board, after intensive engagement with the management, finalizes for implementation by management. The second possibility is for the Boards to contend themselves with approving or endorsing without questioning the strategy formulated by management, and deriving therefrom a sense of satisfaction that mere ratification or endorsement is sufficient for co-ownership of strategy.*

*If Boards are to play their legitimate role, without either transgressing into the area of management, or playing too passive a role in boardrooms, it is necessary that a balanced approach ought to emerge.*

#### DISCUSSIONS

##### CONTEXT SETTING

###### Strategy Formulation

- **Strategy is integral** to the growth and future of a company.
- The **time spent in Boardrooms in discussing strategy has increased**. Frequent changes and disruptions in business are responsible for this change.

###### Law and Regulations

- In the Companies Act, 2013, strategy formulation is mentioned as one of the duties of Independent Directors.
- As per SEBI's Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015, both the key functions as well as the other functions of Directors refer to strategy formulation.

##### BOARD -MANAGEMENT INTERFACE ON STRATEGY

- Often there is **tension between the Board and the management** in regard to their roles in strategy formulation because of the need to protect turf. However, in reality, **their roles are not competing**. They have to work together towards common goals for their common stakeholder, the company.
- **Managements feel that since Boards** do not have domain knowledge, which is important for strategy formulation, they **should, at best, have an advisory role**. However, at times Boards try to expand their role and stray into the area of execution of strategy, which is the domain of only the management.
- **Boards lack role clarity** as far as their role in strategy formulation is concerned. They are not clear whether they are expected to co-own strategy with management or co-create strategy, in order to co-own it with management.

- Since the Board and the management have only one stakeholder, the company, they should not compete with each other for formulating strategy. They should understand that they should **work together towards co-creating strategy**.

## ROLE OF BOARD

- The **role of a Board in strategy formulation cannot be prescribed** since there cannot be a one size fits all approach to it. **They can contribute in several ways**. Broadly speaking, **their role is to guide and inspire the management**.
- **Board's role in strategy depends on a number of factor**, such as
  - Stage of evolution of the company
  - Ownership pattern
  - Type of management
  - Size of the company
  - Composition of Board
  - Background of Directors
  - Role clarity of Board
- There **are two broad-based possibilities that can define the role of the Board** in strategy formulation.
  1. Management presents a draft strategy for Board's deliberations and post the deliberations, strategy is finalized.
  2. Board approves the strategy prepared by the management without any questions or deliberations.
  - The first approach is definitely the right way of finalizing strategy. While Boards cannot co-create strategy from the beginning for a number of reasons such as limitation of time and lack of domain expertise, they should **constructively challenge the draft version** and in the process, co-own strategy.
- If **Directors consider co-creating strategy as their responsibility**, they would contribute effectively to the discussions. As per law also, this is one of the responsibilities of each Director to all the stakeholders of the company.
- **Strategy is based on assumptions** about the future and future trends. These assumptions undergo change on a continuing basis. The **diverse experience of Board members can help in value addition** to the deliberations. Their cumulative experience, both in terms of quality and quantity, is several times that of the management, even though they are not domain experts. This helps them raise the right type of questions, often macro in nature, such as on risk and finance, that helps the management, which is an expert in the domain, in finalizing strategy. **While the Board can show the lens, managements can build on it**.
- **Board members should not shy away from dissenting constructively**. Conformity should not be encouraged.
- Boards should encourage **periodic strategy audit**, which is important in today's changing times.

## ROLE OF CHAIRPERSON

A **Chairperson has a major role** in Board deliberations on strategy formulation. She has, *inter alia*, the following roles to play in this context:

- **Setting the context** for discussions on strategy.
- **Setting the right tone** at the top to promote healthy discussions.
- **Promoting trust and transparency** between the Board and the management.
- **Selecting the right Directors**, as part of Board composition, since the quality of Directors would directly impact the quality of discussions on strategy in the Boardroom.
- **Defining and communicating the role and expectation** from each Board member as well as from management for their role in strategy. Most good Directors will be unhappy with being associated with a Board that focuses only on compliance and might, as a result, resign from such Boards.

- **Finalising the agenda** for strategy meetings.
- **Ensuring that all Board members function as a team.** This is often missing since Directors do not bond/ interact between Board meetings. This could be for a variety of reasons such as geographic diversity / gender diversity resulting in perceived discrimination against some of the Directors. Also, most Board members are experienced executives who do not know what to expect when they first join Boards and at times, it takes a while for them to adjust to the culture of a Boardroom. If the Chairperson attempts to make the Board work as a team, it will increase the effectiveness of the Board.
- **Ensuring that all Directors contribute** to discussions on strategy.
- **Ensuring that she understands the motivation for each Director,** in order to help in extracting value from each one of them, both individually and as a team.
- **Ensuring that the Board members and management do not compete** with each other while finalizing strategy.
- **Understanding the Board dynamics** and the politics in the Board, both of which cannot be ignored.
- **Promoting a culture where there is no finger pointing** even if a Board member's views on a matter turned out to be incorrect.
- **Persuading a Director to leave the Board in case she is detracting from value.**

### ROLE OF MANAGEMENT

- There has been a **positive change in the mindset of the management** towards the suggestions of the Board. Management should be open to the suggestions of the Board members. Managements should not think that they know it all. They **should not consider the Board to be their opposition party**, since this can cause a needlessly strong pushback from them to the suggestions of the Board.
- While Board members might not be domain experts, they often raise fundamental questions that help in finalization of strategy, owing to their vast experience.
- Unlike in the past, the **context / time horizon for strategy cannot now be 5 or 10 years** because of the dynamism in the market. To keep abreast with the changes in the market, **strategy needs to be continuously reviewed.** To expect Board members to remain updated on their own with all the changes and to contribute in 4 annual Board meetings is unrealistic and unreasonable. Hence, managements have a huge role to play. They should provide all the relevant information to the Board to aid in their contribution.
- While working on strategy, **managements should step back from their routine work in order to bring in objectivity.**
- **CEO has an important role** in deliberations on strategy since she is the interface between the Board, who helps finalise strategy, and the management that will execute it.

### SEPARATE STRATEGY SESSIONS/ MEETINGS

- **Offsites for strategy meetings are effective** since more time is spent in deliberating only on strategy. In Board meetings, where strategy is one among several agenda items, only incremental changes/ modifications are normally be suggested.
- The **agenda for these strategy meetings, along with supporting documents, should be sent in advance** to the Board members to make the meetings effective.
- In addition to the top executives of the company, **persons one level below the top persons should also attend such meetings** since these persons are also very knowledgeable but are not usually a part of the Board meetings.

### ENABLERS TO EFFECTIVE CONTRIBUTION

- **Managements should provide relevant, accurate, complete and timely information to Board members on a periodic basis.** It is sometimes wrongly assumed that Board members can hit the ground running from day 1. However, there are times Board members require the help of management to be upto date about the trends in the industry.

- **Right culture, both at the Board level and within the company**, helps promotes effective discussions on strategy. Board members often do not spend time in understanding the culture of the company, which too is important since the execution of the strategy decided at the Board level will depend *inter alia* on the culture within the company.
- **Contribution of a Board member depends largely on the expectations communicated** to her and on the culture in the Boardroom.
- **Ownership pattern of the company plays an important role in deciding the degree of involvement of a Board** in strategy. If the promoter family focuses on strategic management, their engagement with the Board on strategy will be higher than if the promoter family focuses on the operational side of business. In Public Sector Undertakings (PSUs), Boards often play a limited role in strategy.
- **Selection of Board members too has a big role in quality of deliberations** at the Board level. Nomination and Remuneration Committee (NRC) should be strong and should be able to identify the type of expertise required at the Board level. Business cycles have reduced to 10-20 years. With changes in business, the type of Directors needed at the Board level too would change. NRC should not ignore this while working on Board composition since the quality of Directors would decide the quality of deliberations at the Board level.
- **Quality of top management** in a company too impacts strategy execution in a very big way.

### **HINDRANCES IN CONTRIBUTION BY BOARD MEMBERS**

- Some Boards feel that **managements do not have the capacity to absorb the Board members' collective wisdom** on strategy. As a result Board members end up contributing only as much as the management can absorb according to them because ultimately the management has to execute the strategy.
- **Domain expert(s) on the Board could, and often will, detract from value creation** since management will consider the expert(s) to be a competition as they would be second guessing the management.

### **GOOD PRACTICES**

- **On common themes such as industry changes, cyber security, there should be a platform to encourage sharing** between companies in the same group or same industry.
- **Directors should proactively improve their knowledge** relating to the industry of the company on whose Board they sit.
- A number of MNCs setup **Advisory Boards comprising experts** that help the local office of the MNC in strategy formulation and local issues that it might be facing. These Boards could be in addition to the mandated Boards.

**EXCELLENCE ENABLERS**  
**CORPORATE GOVERNANCE SPECIALISTS**

**ADDING VALUE, NOT TICKING BOXES**

## **EXCELLENCE ENABLERS PRIVATE LIMITED**

Excellence Enablers Private Limited (EEPL) is an initiative that focuses on implementation of better corporate governance practices, improvement of Board performance, including audit and evaluation, training of directors and engagement with stakeholders of governance. It is founded on the firm belief that the gap between performance and potential can, and must, be bridged. Consistent with that belief, all our offerings are tailor-made to the specific needs of the organisation or the individuals concerned.

Given that our founder, Mr. M. Damodaran, introduced Clause 49 of the Listing Agreement, dealing with corporate governance in India, and has been a part of both public sector and private sector Boards, as well as performing and underperforming Boards, we offer experience based consultancy and courses on the journey from compliance through governance to performance. Further, given his success in turning around organisations that had been written off, we are uniquely positioned to offer courses on leadership, organisational transformation, and building winning teams.

EEPL has a number of highly experienced and renowned consultants and faculty members who have helped, and continue to help, us deliver programmes that have been well received.

### **All rights reserved.**

No part of this publication may be reproduced, stored in retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without the prior permission of Excellence Enablers Private Limited.

Views expressed do not represent the views of Excellence Enablers Private Limited and are a summary record of the observations made by the participants at the interface.