The Involvement of Boards in Strategy Implementation

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Abstract

The classical management perspective works on the assumption that CEO can design an explicit "grand strategy" for the entire enterprise. Later strategy perspectives question these normative assumptions and depict strategy as a messy, disorderly and disjointed process. In academic corporate governance research, it is widely agreed that boards should contribute to corporate strategy. But despite reasonable consensus on the board's responsibility for strategy, how boards should fulfill this responsibility has remained unclear. In parts this due to the fact that the role the boards in strategy formulation and implementation is still an empirically understudied phenomenon in corporate governance research. Hence, the purpose of this research is to explore the potential role of the boards of directors in strategy formulation and implementation based on case study example – two aspects that have so far been left largely unaddressed by corporate governance research and practice.

Keywords: *strategy formulation, strategy implementation, corporate governance, board of directors.*

JEL classification: L10, O32, M10

Introduction

The topic of corporate governance is attracting substantial interest from scholars in a wide array of academic fields. Attention to governance can be found in departments of accounting, finance, management, organizational behavior, and strategy as well as departments of economics, sociology, psychology and law. Much of this interest is due to some corporate scandals and frauds occurred on both sides of the Atlantic (Aluchna,2009). Lack of confidence in capital markets, state regulators and moral standards of top managers have been major concerns raised by disappointed investors, whereupon countries and regions rushed to improving this situation. Still, there are other reasons why corporate governance has been and will

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remain a central research topic for those seeking to understand the basic purposes and functioning of contemporary organizations. First of all, there are a number of fundamental organizational questions that, while not unique to corporate governance, reveal themselves particularly well in corporate governance context. Secondly, the domain of corporate governance is itself in flux; as corporations and societal norms evolve, so do the boundaries of what constitutes corporate governance.

Strategy research increasingly recognizes corporate governance as an important organizational factor affecting the firm's performance and long-term survival. Some recent papers have begun to combine the resource-based and agency perspectives to explain entrepreneurial behavior, strategic choice and organizational structure, and network dynamics (Toms, 2006; Toms & Filatochev, 2004). One of most preferred topics of researchers in corporate governance and strategic management remains the process of board involvement into corporate strategy. So far there is a lack of clear consensus about the nature of boards' involvement in strategy. Some possible explanations for these facts are offered by Brauer and Schimdt (Brauer & Schmidt, 2008):

- there is no clear definition of the board's role in strategy. Some previous studies have narrowly conceptualized board involvement in strategy, leaving a lot of room for interpretation of what is meant by strategy in the first place.
- the majority of studies addressing corporate governance relied on a single theoretical perspective – the agency theory. Board involvement in strategy is considered a complex, multidimensional organizational phenomenon that cannot be captured within a single theoretical perspective.
- scholars' limited accesses to strategic decision-making processes have clearly made ineffective the ability to generate deeper insights into this area. Most studies have imputed boards' strategic involvement from its antecedents or consequences, but have not directly observed actual board behavior (Ravasi & Zattoni, 2006). Thus, there is a great need for new ways that could be used in investigating boards' role in strategy.

The paper is structured as follows. First, it starts with a thorough description of some theoretical aspects, such as corporate governance and strategic management. Second, it continues with a description of the strategic activities and some benefits of boards' involvement in corporate strategies. Then, it analyzes the strategic involvement of boards in business strategies from the point of view of big retailer by comparing the actions taken by the board of directors that are highlighted in the Annual Report. Eventually, some conclusions are drawn.

1. Corporate governance and the strategic management process

The link between corporate governance and business strategy is shown through two theories, namely the agency theory and information processing theory.

Agency theory deals with mechanisms that serve to align the interests of a firm's managers with those of the owners of the organization. These mechanisms include the use of internal and external board members, longer-term compensation schemes, and the careful selection of top management teams. The board of directors and the top management team are central governance structures in the agency relationship (Jensen & Murphy, 1990).

Information processing theory's view is that since top management teams are located at the strategic apex of the firm, they are usually required to process more diverse and more extensive information. In competitive environments, firm responses and survival become more linked to the ability of top management to deal with higher levels of complexity. Consequently, both agency and information processing theories argue that more complex and turbulent environments demand more responsive governance structures (Sanders & Carpenter, 1998).

No matter what theory one might consider there is a clear consensus about the role of strategy for a firm. The strategy determines the course of the firm for several years; strategy guides the allocation of resources – financial, physical, and human. Clearly, strategy must be a subject that engages the interests of all the members of firm's leadership: top management, the board of directors and the Chief Executive Officer (CEO). Although there it is widely agreed that board of directors should be part of the business strategy process, there are still very few evidences about how does the board involve in strategy.

A study of CEOs conducted by National Association of Corporate Directors reveals that the board's participation in "strategic planning ranked number two in importance to their companies, yet only number 11 in their board's effectiveness (National Association of Corporate Directors and the Center for Board Leadership, 2000). In fact, Don Townsend, President of Donley Townsend Associates cites in a recent article some confessions made to him by different CEOs (Townsend, 2007). For example, one Silicon Valley CEO lamented, "Left to their own devices, my directors will try to design new products on a napkin. How can I get them focus on strategy?" Another chairman of a large Midwestern firm complained, "We're always straying off into the weeds. How can we keep our discussion strategic?" Another CEO at a technology firm groaned that "these guys want me to make a major acquisition; how can I get them to see that it doesn't fit the strategy we mapped out and agreed on eight months ago?" Judging from these CEOs' points of view one can say that engaging the board on strategy is a chronic concern and in practice the question of how to best manage the process is often expressed ironically.

These findings are supported also by a recent McKinsey Quarterly survey on governance which reveals that corporate directors are eager to spend more time developing long-term strategies (Chen et al, 2008). Indeed, they want to accord a higher priority to talent management and forward-looking strategies that maximize shareholder value and to spend less time dealing with issues such as compliance. But this may be easier said than done: in addition to saying that their priorities are misaligned, directors also indicate that they lack the knowledge, expertise and substantive interaction with management that could help them contribute to developing long-term strategy.

For a better understanding of how boards may involve in the business strategy process it is necessary to clarify first what is meant by strategic activity. According to Nadler, the term “corporate strategy” encompasses four different types of activity (Nadler, 2004):

(1) **Strategic thinking**. The first step in strategy development involves the collection, analysis, and discussion of information about the environment of the firm, the nature of competition and business design alternatives. Business design includes the customer value proposition, the scope of offerings, profit capture mechanisms, and sources of competitive differentiation. In multibusiness firms, strategic thinking also involves core questions about shape of business portfolio.

(2) **Strategic decision making**. Ultimately, strategy requires a set of core directional decisions. In the context of strategic thinking, there are fundamental choices concerning the business portfolio and the business design, which serve as the platform for the future allocation of limited resources and capabilities.

(3) **Strategic planning**. Once key strategic decisions have been made, priorities are identified, objectives set, and resources configured to execute decisions. This typically results in a plan and a set of budgets, though the plan evolves over time as consequences if firm’s actions are seen, the environment changes, and new information is obtained.

(4) **Strategic execution**. Reaching this stage, the firm focuses on implementation, monitoring results, and appropriate corrective action. This phase of strategy development can involve allocation of funds, acquisitions, and divestitures.

The devoted literature of corporate governance records the following benefits of boards’ involvement in strategy implementation (Brauer & Schmidt, 2008): (1) board members’ involvement in strategy implementation is a precondition to perform their fiduciary monitoring duties. It is believed that the board members can only fulfill legal requirements if they have a firm understanding of how management implements the intended corporate strategy they agreed upon; (2) the engagement of board members in strategy implementation seems to be beneficial since they are often industry experts and operate at the interface of the firm’s internal and external environment.

They are thus able to combine outside data about potential competitive changes with internal conditions, which is vital for the strategic positioning of the firm; (3) board involvement in strategy implementation should not be unrestricted but disciplined. A board should not directly engage in strategy implementation since such a direct engagement is likely to create role conflicts with the executive management of a firm. Next, we will try to examine the degree of a board involvement in strategic activities of a retail company based on the information presented in its 2009 Annual Report.

2. The strategic nature of the boards – case analysis on a retail company

For confidential reasons we decided to keep the real name of the group secret, so further on we shall referred it as CF group. The CF group is one of the world's leading distribution groups. The group currently operates four main grocery store formats: hypermarkets, supermarkets, hard discount and convenience stores. The CF group is a pioneering entrant in countries such as Brazil (1975) and China (1995), it currently operates in three major markets: Europe, Latin America and Asia. The group sees strong potential for further international growth in the future, particularly in such large national markets as China, Brazil, Indonesia, Poland and Turkey.

The strategic philosophy of the CF group is described in the following way: "*the strategy of the group is aimed at achieving organic, sustained, profitable growth in excess of the broad market growth rate, and has three levers: (1) client-oriented culture; (2) transformation; (3) innovation*".

The board of directors of the CF group is a collective body which represents all shareholders and acts in the company's interests in all circumstances. The board makes sure its membership is balanced and its operating procedures are appropriate in order to act in the company's interest and fulfill its missions. In 2009, the board of directors comprised of 12 members of which half of them were independent members. The board of directors has three specialized committees, which were established in 2008. The purpose of these committees is to examine specific issues in greater detail and to make recommendations to the board of directors. The three committees are: the Audit Committee, the Remuneration, Appointments and Corporate Governance Committee and the Strategy Committee.

The Strategy Committee assists the board of directors in guiding and setting the group's strategy and does not act as a replacement for it in this regard. It prepares the groundwork for the most significant decisions affecting the group's future (acquisitions and sales of assets, studies of external acquisition opportunities, store openings in new countries, etc.) and oversees the preparatory work for the board of directors' annual seminar. The membership of the Strategy Committee is as follows: one independent chairman and four members of which two are independent members.

During the course of the 2009 fiscal year, the board of directors met 14 times (including once in a strategy seminar), with an average attendance rate of 83%. During its meetings, the board of directors discussed the following issues in particular:

- their review of the strategy proposed by the Chief Executive Officer;
- the study of acquisition operations, rationalization of the business portfolio and internal restructuring;

- a determination of the Chief Executive Officer's scope of authority and his remuneration;
- approval of the annual and half-yearly accounts, an examination of the quarterly sales results and the related financial announcement, and preparation for the Shareholders' Meeting;
- implementation of the share-buyback program;
- the allocation of share purchase options and shares for years of service and/or performance to employees and the company representative, and the definition of a supplemental pension scheme for the group's top executives (Chef Executive Officer, members of the executive committee and a number of key managers);
- reports on the work of the Board's committees.

The executive committee contributes to the definition and implementation of the strategic and operational plan and ensures the roll out of projects. The cxecutive committee guarantees the teams' alignment and the dissemination of management and leadership principles. The executive committee brings together the members of the executive board and managers of business units and key positions within the company.

Conclusions

Obviously, the conclusions from our single case should be drawn with healthy caution. It is just a first step towards the empirical exploration of a board's role in strategy implementation. Our case study is a mere illustration of the suggested approach. If implementation consistency is meant to be used as a proxy for a board's effectiveness in strategy implementation, then we need to know more about desirable levels of implementation consistency. Anyhow, the results shown that there many similarities between what it is found in the devoted literature and what is to be found in practice. The board of directors from the case that we analysed is responsable for assisting the executive committee in developing, formulating and implementing the grand strategy.

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