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Strategy should start in the boardroom

After five years of intense focus on compliance following the excesses of the 1990s, it is time for the boards of US companies to concentrate their attention where it belongs: on strategy. This means discussing strategy often and in depth and, crucially, repopulating boards with people who have real industry experience.

We find that chief executives and chairmen from other companies often make the most capable directors, particularly in their ability to provide strategic insights. Yet senior executives are increasingly unwilling or unable to take board seats. Corporate governance reforms such as the 2002 Sarbanes-Oxley Act have substantially increased the time that boards spend on inward-facing issues such as compliance. This, combined with a perceived increase in personal liability, has made directorship a less appealing prospect.

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Even if they are willing, top managers often find themselves unable to serve because their companies have, sometimes under pressure from investor groups, restricted the number of boards on which the CEO and chairman can sit. The net result: top executives from other companies now account for only 32 per cent of new board appointments, down from 53 per cent five years ago.

At the same time, demand for academics, managers from the not-for-profit sector and retired executives has increased. But while these people may have a grounding in general management, they can lack deep industry experience of fast-moving business trends, such as the development of China and India. They want involvement – we have observed in recent years a fourfold increase in the number of off-site retreats to discuss strategy – but most do not have the industry expertise to participate effectively in shaping strategy, much less reshaping it on the fly in response to changing circumstances.

On a board of, say, a dozen directors, we believe at least three or four should have expertise that is relevant to the company's core business, a considerable understanding of the industries in which it operates and fluency in the company's competitive situation.

The success of private equity firms holds an important lesson in this regard. They view strategically minded governance of the companies they own as a source of real competitive advantage. They bring intense, expert oversight to bear in support of business strategy. Public companies should take note.

To be sure, a period of inward focus among the boards of public companies was necessary. Sarbanes-Oxley and related reforms have increased board independence and restored investor confidence. But compliance alone does not create value for shareholders. In an era of intense global competition, boards have an increasingly important role to play in helping executives think about where and how to compete – the essence of strategy.

We do not envision boards that collectively and independently set strategy. Top management should lead the strategy-making process. The role of boards is to debate, test and approve the strategy that management crafts.

While no single approach will suit every company, some concrete steps can start to build a strategic mindset in the boardroom.

First, ensure that strategy is debated regularly. We find it strange that corporate boards often have committees devoted to political affairs or technology but no vehicle through which strategy can find its way on to the agenda of every meeting. One solution is to make strategy a formal subset of the regular work of an existing committee, for instance the nominations or governance committee, on which strategically minded directors can sit. Some oldguard CEOs will no doubt fight against boards getting more involved. Such resistance should serve as a warning to investors.

Second, ensure the influence of the CEO in choosing directors. While no one wants a return to the days when CEOs were free to create boards that did not challenge them, neither does it make sense to deny the company's chief strategy architect sufficient say in board composition. Even value-minded CEOs can now find themselves taking a back seat to the chairman of the nominating committee when it comes to selecting directors. This denies them the opportunity to identify people who are in step with their strategic approach. We believe a mutual veto arrangement between the committee and CEO can ensure boards are populated not with puppets but with experts capable of developing a "challenging partnership" with the CEO.

Finally, boards need to move beyond annual retreats as the forum at which directors and executives debate strategy. Too many retreats take the form of show-and-tell sessions in which operating executives give updates on the progress of key initiatives. These are snapshots of a company's current status, as opposed to a continuing dialogue about a company's strategic direction.

To match the rapid pace of change, CEOs should lead regular strategy debates no less frequently than at every second board meeting. These updates should assess the impact of new information and events. For example, should the company keep to its strategic course following the merger of two big competitors? Do directors see new risks that might argue for a different approach?

None of these steps need undermine the CEO's role. Rather, they should reinforce checks and balances and stimulate a debate. For their part, CEOs will need the ability to articulate a clear strategy and the personal confidence to welcome experienced, hands on oversight. The give and take may be uncomfortable at times. But better strategy will result.

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