Governance Insights Center
The board's role in strategy

March 2018

The board's role in strategy: getting the process right

Focusing on how your board oversees strategy can help make your board more effective.

Company strategies evolve and shift quickly today, due to acquisitions, new competitors or emerging technology adoption. So boards need to take a fresh look at how they think about strategy. This can help the board contribute to the success of the company's long-term strategic plan.

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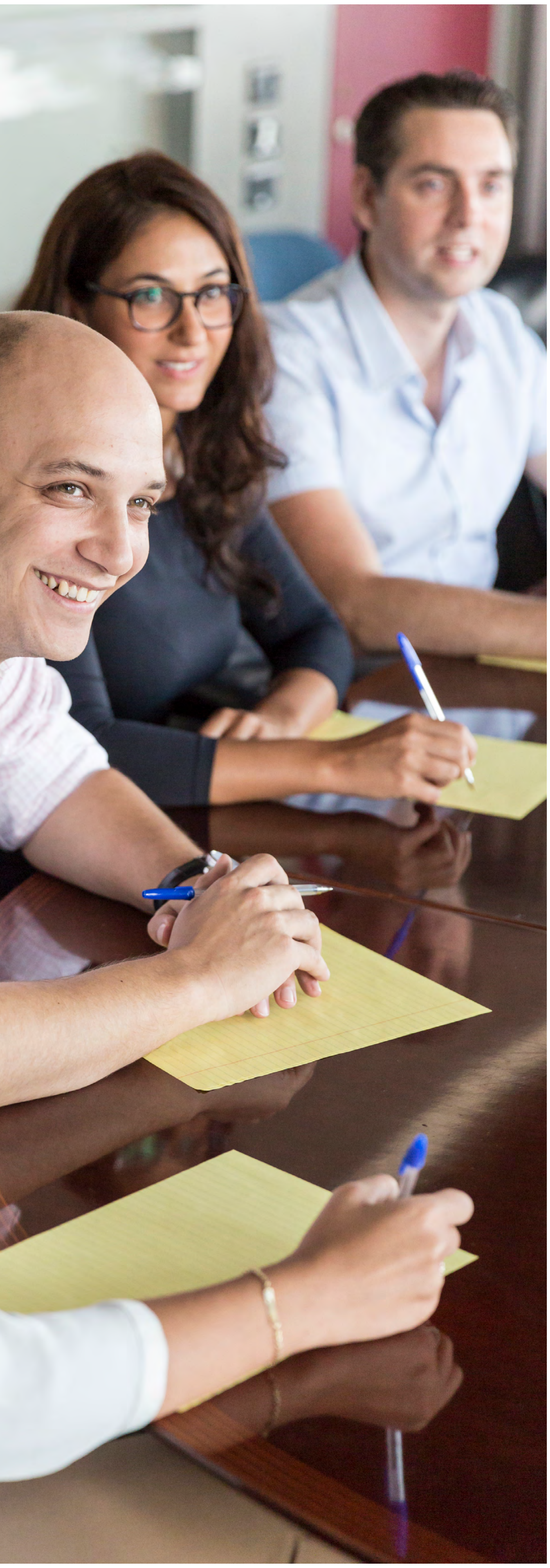
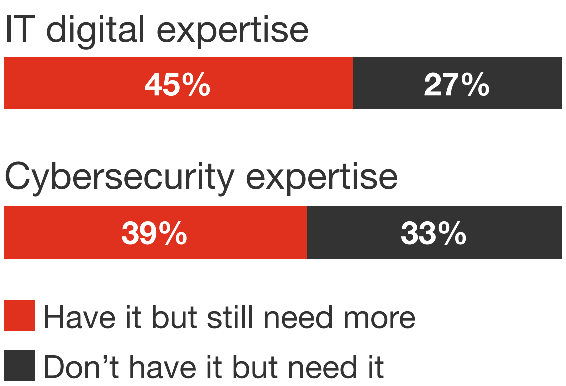


Most boards say they prioritize and talk about strategy a lot. But are they having the right conversations? Evaluating the process your board uses can help you determine whether the strategy is working. You may recognize opportunities to ask more questions, offer suggestions and try to find ways to improve the plan.

All of this boils down to understanding how your board goes about overseeing strategy. There is no "one size fits all" approach to choosing and executing on a strategic plan. Different processes and different approaches work well for different companies. But no matter what the approach, the board's role in oversight is critical. How the board executes that oversight can contribute to the success of the overall strategic plan by helping management out-think competitors, address obstacles, bypass disruptors and fine-tune its direction.

Gaps in tech expertise on the board?

How would you describe your board’s current composition needs with regard to:



Source: PwC, *2017 Annual Corporate Directors Survey,* October 2017. Base: 873-878

Connecting board composition to strategy

For effective strategy oversight, you need the right people at the table. Boards need directors with expertise in areas that are key to understanding the company’s business, such as deep industry expertise and finance, as well as skills that are critical to the company’s future. With technology disrupting so many industries and blurring industry lines, directors with technology, innovation and digital skills are becoming important for most boards.[1] Yet many boards are still searching for directors with those skills. When we asked corporate directors about their board composition, 72% say they need or need more IT/digital expertise on their board.[2]

As more companies move toward digital business models, they also become exposed to new threats that could expose them to a cyberattack. Cybersecurity is a critical enterprise risk management issue, but not all boards are bringing it into their strategy discussions. Cyber risk should be discussed on the front end of the strategy discussion—not after the digital business model is put into place. Many boards are also starting to look for directors with cybersecurity expertise. In fact, only 16% of directors we surveyed say their board has enough cybersecurity expertise.[3]

Do you have the right people in the boardroom? How is your board evolving? Are you considering the skills you need for today's business needs, as well as for where the company is going? Does the board succession plan ensure that you will always be a step ahead? Does your board have:

- Digital/technology skills
- Entrepreneurial backgrounds
- A contrarian voice
- Expertise outside the industry
- People with a "major" and a "minor"

▶ ***Make sure your long-term strategy is driving board composition***

It's also important to have the right mix of directors—some who naturally focus more on the short term and others who take a longer view. Boards need deep industry expertise, but almost all directors say they have this already.[4] By seeking out directors from outside your industry, the board may be better able to spot a potential disruptor. Those directors can also provide insight into what other companies are doing to get ahead.

Some boards may even look for a director who can really challenge management and the groupthink of the board. In fact, one-third of directors who participated in our *2017 Annual Corporate Directors Survey* say that they have a contrarian voice on their board.[5] Another thing boards may want to consider is having board members who more closely represent the company's customer base. This could mean adding younger directors, creating more gender or ethnic diversity on the board or even looking for directors with international backgrounds. Other boards bring in an expert or third party to help them with strategic oversight.

The board's composition ties directly to board succession. If your board doesn't have the right people in the boardroom for the strategy discussions, it should be considering bringing in the right board members who can really contribute.

Having one director advocating a certain perspective may not be enough to make a difference. Especially on larger boards, it can take at least two directors to really advance a viewpoint. With an average board size of 10 people,[6] you can't have two experts on every topic. So one way to think about it is to look for people with a "major" and a "minor" who can help represent two viewpoints or areas of expertise.

Strategy is challenging to oversee

82% of directors say it is at least somewhat challenging to balance short-term and long-term focus

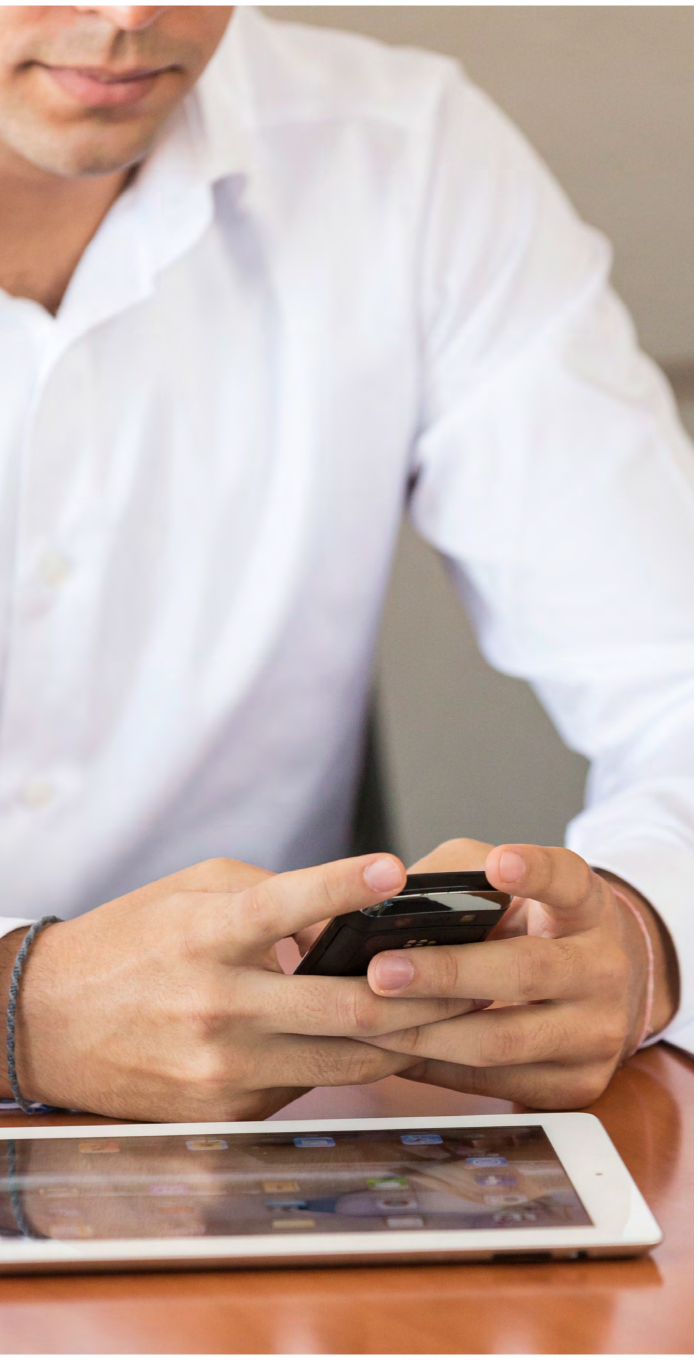
Source: PwC, *2017 Annual Corporate Directors Survey,* October 2017.

▶ ***Recognize the importance of balancing short- and long-term strategy***

Balancing the short-term and long-term

Time horizon is key when it comes to strategy oversight. Companies face all kinds of pressure to be successful now. Activist investors may target a company that is underperforming. And the pressure of meeting or beating earnings forecasts may impact business decisions. Boards have to be aware of shifting trends and quickly emerging competitors—and be ready to react. But most companies also want to deliver long-term value for investors, employees and customers alike.

Corporate directors tell us that balancing a short- and long-term focus is the biggest challenge to strategy oversight.[7] Companies that focus too much on either the present or the future are missing the boat. Your board needs to be thinking about both. And remember that you may need different information to address different time horizons. It's also important to think about the state of the company in terms of optimization and reinvention: how to optimize the business today and how to reinvent it for the future.



Finding the right frequency: strategy is not a one-and-done discussion

The average board meets about eight times a year, and the typical public company director spends 231 hours per year on board work.[8] That's not much time to cover all of the things boards want or need to discuss. Board agendas are jammed. Still, strategy needs to be a high priority. And many directors say they want to spend even more time discussing it.[9]

Over half of corporate directors tell us that their board dedicates an off-site meeting to strategy discussions.[10] While it is certainly good for your board to spend focused time thinking about and discussing strategy, a once-a-year meeting simply is not enough. Strategy changes all the time. So your board needs to supplement any dedicated annual meetings with regular discussions throughout the year. And most do: 71% of directors say they discuss strategy at every board meeting.[11]

Strategy should also be a part of all board discussions: capital allocation, talent oversight, CEO succession, executive compensation and risk oversight, to name a few. All of these should be looked at through a strategy lens: what is the company's strategy now and what will it be in the future?

▶ ***Infuse the strategy discussion in all other key board oversight topics***

When and how do we evaluate whether the strategy is working as planned? Boards may operate on different timetables based on the company's needs at the time.

- We check in at regular intervals every year
- We check in when we get certain data
- We get updates at every board meeting

▶ ***Use guideposts to measure progress and think about when to pivot***

Measuring progress and knowing when to pivot

It's helpful to think about two types of strategy discussions: those in a normal operating environment and a crisis environment.

In a normal operating environment, the board needs to ensure it is doing regular evaluation on whether the strategy is working and how to tweak it. Companies in quickly-evolving industries might talk about strategy more often than companies in more stable ones. In a crisis environment, like a supply chain disruption, environmental disaster or even a geopolitical event, your board will be discussing strategy even more.

One important step that sometimes gets overlooked is determining how often to check in to see if the strategy is working. And when to pivot if it's not. For longer-term strategies, we often see companies identifying "signposts" that can help them monitor the feasibility and appropriateness of the strategy over time. Every strategy has risks or assumptions that are critical to its soundness. As time passes, these assumptions need to be re-evaluated. The strategy may need to be tweaked or shifted to address the current environment. This can also help hold the management team accountable to a particular strategy.

If your company is in the process of reinvention or pivoting from its traditional strategy, then your board will want to develop new signposts to help determine if the strategy is working. But if the strategy isn't working, the board shouldn't just wait for change to happen. It needs to actively engage with management and help right the ship, potentially avoiding becoming an M&A or activist target.

For your information

What information do we need or want from management? Types of information boards are looking for to evaluate strategy include:

- Customer feedback, competitor analysis, customer behavior
- Emerging technologies and how they might affect your industry
- Management's rejected scenarios/ideas
- Underlying data used to test management's assumptions
- Views of employees below the C-suite
- Social media chatter about the company's products and positioning in the market
- Issues raised by investor portfolio managers
- Vulnerabilities raised in activist exercises

The information the board receives from management determines how the strategy review will go. For starters, make a list of the types of information your board gets from management. What's missing? Information on rejected strategic options, emerging technologies, and customer and supplier feedback are just a few of the topics directors say could be better.[12] Discuss with management what kinds of information your board expects and wants. And the level of detail that will work for your board—what's too much or not enough? It's important that the materials management provides are focused, but boards also want to cast a wide net to get all the information they need. The better the materials, the better the board will be able to challenge management's assumptions.

Boards need information about customers, competitors, employees, regulators and even societies that are affected by the company and its industry. The board relies on management for much of this. But directors also need to look beyond their board books. Analysts, consultants, investors and regulators can all provide valuable information. Boards need to do their own homework and determine what information they really need and how to get it—especially if what they get from management is not enough.

Some boards also make visits to competitor, distributor or supplier sites as part of their strategy oversight. These efforts can give boards more of a real-life look and understanding of what is really going on. As boards continually get educated, they can better challenge management's assumptions and critically evaluate strategy proposals.

How is your board getting experiences outside of the company that can help it better understand the industry and company and improve strategy discussions? Some practices include:

- Visiting an innovation center
- Visiting a distribution/supplier site
- Visiting competitors
- Engaging with customers
- Engaging with employees
- Visiting labs/academic institutions
- Presentations from employees outside the C-suite who are leading initiatives

▶ ***Ensure that the materials you get from management are focused and cast a wide net to get all the information you need***

Pushing back and checking in

When it comes to debating strategy, many directors say their board strongly challenges management's assumptions.[13] But more than one-third (40%) of directors say their boards don't.[14] How can the board know that management's strategy is the right one if they don't push back against the assumptions they are given? If the information they get from management is lacking, it makes that job even harder.

The board should ask about assumptions related to the company's abilities, the competitive market and the broader economic picture, as well as other external factors that management's strategy relies on. And the board may want to bucket their questions into categories to try to focus on the details of the strategy that need work.

Part of the challenge of being a good director is being able to walk the fine line between questioning everything management does and not questioning enough. If your board is regularly getting educated, it will have a better understanding of the company, the industry and the competitive environment—and know how to better challenge and ask the right questions of management.

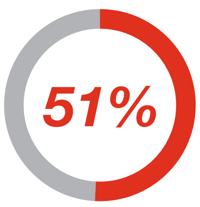
How does your board challenge management's assumptions? Since the board isn't involved in the company's day-to-day operations, many boards just trust the information they get from management. Boards can push back in various ways:

- We push on whether the data is correct
- We ask about the "what if" scenarios and whether management has response plans in place
- We ask about the timeline
- We question the proposed forecasts
- We push for explanations on alternative choices
- We use third-party experts and data

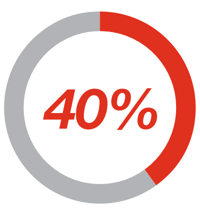
▶ ***Take an active role in challenging management's assumptions***

Many directors say ESG issues aren't relevant to strategy

% responding not at all



income inequality



climate change

resource scarcity

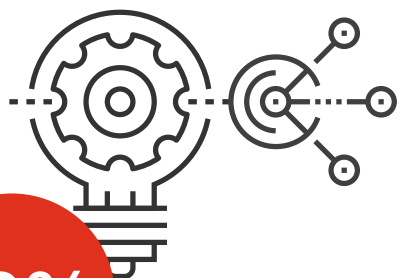
Source: PwC, *2017 Annual Corporate Directors Survey*, October 2017.
Q: To what extent do you think your company should take the following societal issues into account when forming company strategy?
Base: 816-819

▶ ***Ask for a comprehensive analysis of the risks that might impact the strategy***

Risk: the other side of the strategy coin

Strategy and risk should be part of the same discussion. It's important for the board to have a comprehensive analysis of risks associated with the company's long-term strategic plan. This includes risks related to risk oversight, culture, cybersecurity, enterprise risk management and crisis management planning, among others. Read more in our risk series.

Environmental, social and governance (ESG) issues are increasingly topics of interest for investors. Many want to know whether ESG factors are considered in the company's strategic plan. But not all directors believe ESG issues should impact strategy. If your company's strategy isn't considering all elements of ESG, such as climate risks, talent concerns, diversity and worker safety, you may be overlooking a major issue that resonates with a variety of stakeholders.



86% of directors said understanding emerging/disruptive technologies is challenging

Source: PwC, *2017 Annual Corporate Directors Survey*, October 2017.

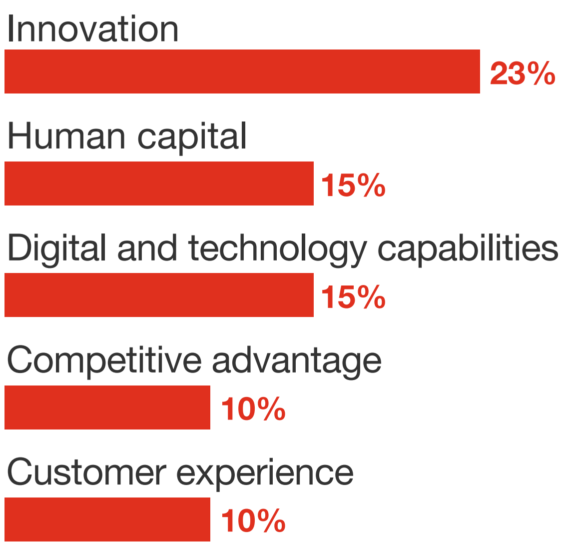
Playing the disruption game: offense and defense

Today there is continued risk of new technologies or competitors knocking the company off its course. Does the board think about disruptors when it discusses strategy? But narrowing in on what specifically might upset the company's strategy isn't easy. Thinking from an emerging technology perspective, a competitor perspective and a geopolitical angle are certainly places to start.

Management and boards alike should think about disruption in two ways. How could we be disrupted? And how could we be a disruptor?

It's important to support innovation and really think about where disruption might come from. Are you only thinking about your peers as competitors who might cause disruption? That list might not be broad enough. Your competitor today might not be your competitor tomorrow. Disruption can come from anywhere—beyond your peers and even your industry. And you want to be prepared.

How do CEOs want to get ahead?



Source: PwC, *20th CEO Survey,* January 2017.
Base: All respondents (1,379).

When it comes to emerging technologies, boards will want to think about which ones may lead to new competitors—which is not easy. More than five out of six directors say that identifying competitive threats poses a challenge for their board.[15] And they'll want to think about which technologies may create new opportunities. Out of a list of 12, global CEOs ranked innovation and digital and technology capabilities as two of the top things to strengthen to capitalize on opportunities.[16]

The board should also recognize the blurring of industry lines and look for disruptive new competitors from outside its traditional industry. And think about how the company might cross over. While economic and geopolitical waves can't always be predicted, it's important to remember that those are risks as well—and when they come, they can do serious damage.

How does your company stay on top of innovation and technological disruption? There's no one way to keep up—but every company needs to be pursuing opportunities like these.

- We partner with other companies
- We partner with a technology company
- We acquire other companies to get access into new businesses
- We have an innovation center that is integrated into our organization
- We recruit people dedicated to promoting innovation

▶ ***Be ready for disruption and seek out the opportunity to be a disruptor***

Executive compensation checks and balances

How do you use executive compensation and incentives to reinforce the strategy? Strategy is multi-faceted—as is a company's executive compensation program.

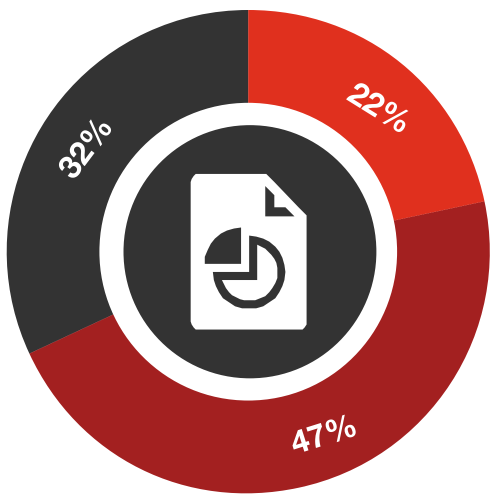
- We align exec comp with strategy by using more global financial targets like EPS on the assumption that if shareholder return goes up, strategy is working
- We tie targets to company-level or business-level goals
- We tie targets to individual goals
- We align short- and long-term incentives and with short- and long-term strategy

▶ ***Understand whether executive compensation plans fully support the strategy***

Strategy is also closely tied to executive compensation. Do the plan goals and performance targets line up with that strategy? Or are they at odds in some ways? Do any of the plans encourage the "wrong" behavior? It's important for the board to make sure that performance targets and incentive plan goals are aligned with the strategy. There should be a mix of short- and long-term incentives, too.

Boards should understand how their plans support their strategy—and what needs to be done if the strategy shifts. Those shifts might call for a change in performance goals. Tax requirements related to deductibility under Section 162(m) used to limit how compensation committees could adjust plan goals. With changes brought by the Tax Cuts and Jobs Act of 2017 and the elimination of the 162(m) exception for performance-based compensation, companies will not be so limited going forward. But changes to performance goals could still mean triggering proxy disclosure to explain the reasons.

Should directors engage with shareholders about strategy?



- 22% of directors say it's "very appropriate"
- 47% say it's "somewhat appropriate"
- 32% say it is "not at all appropriate"

Source: PwC, *2016 Annual Corporate Directors Survey*, October 2016.
*Does not add to 100% due to rounding

Create a strategy story and tell it

Telling your strategy story

After the board approves the strategy and the company implements it, it's important to communicate what that strategy is. That doesn't mean divulging all the details of how the company plans to execute. But it does mean laying out a broad plan of the company's goals and what actions it will take to achieve them. Doing this can help the company's relationship with investors. It's important to outline the company's plan for today, as well as its plan for where it wants to go—the company's optimization and reinvention stories.

While management leads the communication with investors, directors are increasingly engaging directly with shareholders themselves. Many believe strategy is an appropriate topic to discuss.[17] Whether directors are engaging or not, the board should know the story management will tell, including how decisions directly link to strategy, why investing in certain technologies will help with growth and how ESG issues play a role in the company's long-term value creation plan. Directors should be able to explain how the company's executive compensation plans incentivize the achievement of the strategic goals.

The company should tell its story not only to investors, but also to regulators, customers and employees. It's also important for the company to think about how to communicate any changes to the strategy, whether that's through proxy disclosures or direct communications.

Some large institutional investors are also calling out boards for their role in their company's value creation story. In his annual letter to CEOs in 2018, BlackRock Chairman and CEO Larry Fink stated that companies should "publicly articulate" their strategic frameworks for long-term value creation. In doing so, Fink said companies should "explicitly affirm that it has been reviewed by your board of directors." This shows investors that the board is engaged with the strategic plan. Fink also noted that BlackRock expects directors to describe their board's process for strategy oversight.[18]

The pace of change in business is faster than ever before. Now is a good time to take a fresh look at your board's process for overseeing strategy.

How PwC can help:

To have a deeper discussion about how this topic might impact your business, please contact your engagement partner or a member of PwC's Governance Insights Center.

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1. PwC, *A look at board composition: How does your industry stack up?*, February 2017.
2. PwC, *2017 Annual Corporate Directors Survey,* October 2017.
3. Ibid.
4. PwC, *2017 Annual Corporate Directors Survey*, October 2017. 62% of respondents indicated that their board has industry expertise and does not need more; 34% indicated that their board has industry expertise but still needs more.
5. PwC, *2017 Annual Corporate Directors Survey*, October 2017.
6. NACD, *2017-2018 Public Company Governance Survey,* December 2017
7. PwC, *2017 Annual Corporate Directors Survey*, October 2017.
8. NACD, *2017-2018 Public Company Governance Survey*, December 2017.
9. PwC, *2017 Annual Corporate Directors Survey,* October 2017. 64% said that they would like to spend more time and focus on strategic planning.
10. PwC, *2017 Annual Corporate Directors Survey,* October 2017.
11. Ibid.
12. Ibid.
13. Ibid.
14. Ibid.
15. Ibid.
16. PwC, *20th CEO Survey,* January 2017.
17. PwC, *2016 Annual Corporate Directors Survey*, October 2016.
18. Larry Fink, "A Sense of Purpose," Larry Fink's Annual Letter to CEOs, BlackRock, January 16, 2018.

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