

# Lead Director Network ViewPoints

Issue 11 August 4, 2011



## Engaging with strategy after the financial crisis

### Introduction

The tenth meeting of the Lead Director Network (LDN) took place on July 13 in Washington, DC. Members discussed how they and their boards engage with corporate strategy in today's post-crisis, global business environment.<sup>1</sup>

This issue of *ViewPoints* synthesizes discussions with members concerning corporate strategy. The network operates under a modified version of the Chatham House Rule. Member names and company affiliations are a matter of record, but members' comments are italicized and unattributed in *ViewPoints*. For further information about *ViewPoints*, see "About this document," on page 9. For a full list of contributing members, see the Appendix, on page 10.

### Executive summary

Companies are entering new markets, deepening existing ties to global markets, and competing with new or expanding firms. Corporate strategy is increasingly focused internationally, where businesses see growth opportunities and distinctive risks. Members reflected on board involvement with corporate strategy in the current environment, covering four central topics:

- **The board's role in corporate strategy: an update** (*Page 2*)

While members acknowledge differences in the particulars of the board's role in strategy, they generally agree on the fundamentals: oversight of strategy is one of the board's most critical duties; directors' full expertise should be brought to bear in delivering this oversight; strategic oversight should be an ongoing, not episodic, board activity. Members reflected on their 2008 discussion of the board's role in strategy and concluded that important shifts have occurred in both the global context in which strategy is developed and in the amount of time the board invests in strategy development.<sup>2</sup>

- **International opportunities and risks are front of mind** (*Page 3*)

The dynamic growth of the developing world is even more impressive when compared with the stagnancy of the US economy. Corporate strategy at many member companies focuses on ways to capitalize on globalization, expand the company's customer base, and deepen ties to international markets – not just on enlarging the company's geographic footprint. However, members remain concerned about the breadth and depth of international market risks such as political instability, bribery and corruption, threats to intellectual property rights, and scarce resources.

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<sup>1</sup> The LDN brings together a select group of lead directors, presiding directors, and non-executive chairs from Fortune 500 companies for private, candid discussions about ways to improve board governance. For the purposes of this network, the term *lead director* is used to refer to all three titles – lead director, presiding director, and non-executive chairman – except where otherwise stated.

<sup>2</sup> See Lead Director Network, "The Board's Role in Corporate Strategy," *ViewPoints*, November 24, 2008.

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- **Improving strategic oversight of international opportunities and risks** (Page 5)

Strategic oversight is improved when corporate boards are composed of knowledgeable, engaged, and diverse directors. Members reported that boards can expand their knowledge base by drawing on available resources from within management and from outside experts, diving deeply into especially important topics. Boards and their members should be exposed to – if not immersed in – key international markets. Boards should also consider when it is appropriate to recruit specialists, such as non-nationals who are expert in different geographies, or homegrown technical specialists fluent in issues that are central to international growth, such as trading regimes and governmental relations.

- **The lead director's unique role in strategy** (Page 7)

Most members believe that the lead director has the authority and responsibility to improve the board's engagement with corporate strategy. Lead directors should help craft board agendas that are focused on strategic opportunities and risks; they should also ensure productive discussions concerning the company's strategic plan, support robust discussion and debate, and synthesize and communicate the board's views to management.

### The board's role in corporate strategy: an update

Members reviewed the discussion from a 2008 LDN meeting concerning the board's involvement with corporate strategy. Then and now, members acknowledged that the first step in improving board engagement with strategy is by defining what is meant by the term "strategy." *"Part of the role of lead director is to answer the question 'what is strategy?' One director might believe it is which transmission goes in a car, another how to enter China, and a third might think strategy is determining whether the industry is globally consolidating."* Perhaps the most succinct and comprehensive definition of strategy offered by a member was this: *"Strategy is answering the question 'how are we going to beat the competition sustainably?'"*

The evolution of board involvement with strategy was a focal point at the 2008 meeting: "prior to the current financial crisis, the board's traditional level of involvement in corporate strategy had increased from the remote, episodic review of the 1980s to a more continuous model of engagement."<sup>3</sup> At the time of that meeting, loss of liquidity and broader financial turmoil caused by the financial crisis was at the forefront of members' minds. One member predicted that board involvement with strategy would expand: "I think boards have continued to evolve and will continue to, especially now ... Strategy is the next frontier, and we will continue to question how boards can become more involved in strategy."<sup>4</sup>

Having weathered the worst of the crisis, members reevaluated their engagement with corporate strategy – and responded to the prediction that boards would become even more involved in strategy.

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<sup>3</sup> *Ibid.*, 10

<sup>4</sup> *Ibid.*, 5.

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A recent survey conducted by McKinsey found that directors spend almost exactly the same amount of time on strategy today as they did in 2008: it takes up 23% of board time now and took 24% then.<sup>5</sup> Seventy percent of those surveyed by McKinsey said they want to increase the amount of time the board spends on strategy, making strategy the primary area in which directors wish to spend more of their time.<sup>6</sup> Contemplating those findings, some members said that finding more time for strategy is not easy:

- *“I am not sure we are able to spend much more time on strategy. One of the biggest challenges with the NYSE listing standards and Sarbanes-Oxley is that the board’s time is already oversubscribed. There is a real difficulty finding time.”*
- *“New regulations and pressures have consumed available board time. At every board meeting, one full session is occupied by risk. Coupled with other necessary activities, there’s not much time left.”*

However, several LDN members reported finding ways to make more room for strategy and stressed its importance:

- *“Our involvement in strategy has definitely ramped up over the last few years. We are spending less time on presentations and more time on real discussion than ever before.”*
- *“The financial crisis increased the time that my board focuses on strategy. There has been so much restructuring, and management was very receptive to these discussions.”*
- *“Strategy is more important and takes more time for directors, especially now that great company results aren’t automatic. We need to be focused on the future if we want to thrive.”*
- *“Now directors are less interested in discussing what happened in the past, like operating reports. [They are] focusing instead on the future.”*

There was a consensus that the focus of strategic review has shifted to the opportunities and risks inherent in the rapidly globalizing business environment.

### International opportunities and risks are front of mind

Members are focused abroad, and with good reason. Standard & Poor’s estimated that in 2009 the S&P 500 derived approximately 46.6% of their total revenue abroad, representing \$8 trillion in earnings.<sup>7</sup> Members believe those figures will only increase, with particularly strong growth in the developing world: *“Growth markets are front and center. The US is stagnant, but certain countries are off the charts.”* Another member agreed: *“A bigger share of the pie is going to have to come from emerging markets.”*

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<sup>5</sup> Chinta Bhagat, Martin Hirt, and Conor Kehoe, [“Governance since the Economic Crisis: McKinsey Global Survey Results.”](#) *McKinsey Quarterly*, July 2011.

<sup>6</sup> Ibid.

<sup>7</sup> Larry D. Spears, [“Global Investing: Five Foreign Revenue Stocks That Will Boost Your Profits.”](#) *Money Morning*, February 14, 2011.

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Data suggest it will. Depending upon the source, 50%–70% of world economic growth over the next few years is forecast to come from emerging markets, with China and India accounting for 40% of that growth.<sup>8</sup>

### Globalization has increased the number of risks on directors' minds

One member cautioned, *“Opportunities abroad come with risk from unstable political environments, corruption, and elsewhere.”* Members are concerned with a growing list of risks from global operations:

- **Political instability.** Members are concerned with political instability in countries where they have operations or that otherwise affect their business. Several members noted that the recent instability in the Middle East and North Africa is troublesome for businesses with significant oil needs and has *“large spillover potential”* for the rest of the global economy.
- **Bribery and corruption.** Enhanced enforcement of the US Foreign Corrupt Practices Act (FCPA) and the new UK Bribery Act have heightened board attention to corruption risks.<sup>9</sup> According to King & Spalding partner Chris Wray, the “sea change” in the breadth and depth of FCPA enforcement over the past five years requires extra vigilance. The UK Bribery Act requires just as much attention from corporate directors.<sup>10</sup> Members remain focused on these issues. As one member noted, *“Directors are looking at the international [compliance] hotlines at each audit committee meeting.”*
- **Intellectual property infringement.** One member observed, *“There isn’t much intellectual property protection in some markets.”* Indeed, one audit committee chairman recently said, *“We’re bringing new technology into the market, but we’ve accepted that we can’t protect it.”*<sup>11</sup>
- **Time to market.** With production changes, some products now take longer to come to market, and this can create problems: *“As we’ve shifted manufacturing of certain products overseas, we’ve become very concerned with the seasonality of products. It takes much longer to bring products to market, and they may no longer be coveted by the time we can get them there.”*
- **Disaster recovery.** Directors should evaluate whether a particular area is more susceptible to high-impact events – or will be affected more deeply by them. As one director recently said, *“[Natural disasters] can happen anywhere, but the concern we have in these countries is their ability to spring back after a natural disaster.”*<sup>12</sup>
- **Scarce resources.** Many members were concerned about the availability of resources, both generally and in particular markets. More aggressive resource nationalism<sup>13</sup> is particularly relevant to one member: *“I’m most interested in resource scarcity and resource nationalism. My companies can’t make the products we need to compete if foreign materials become unobtainable. That’s a big concern.”*

<sup>8</sup> See for example, Ernst & Young, *Tracking Global Trends: How Six Key Developments Are Shaping the Business World* (Ernst & Young Global Limited, 2011), 4, and Adrian Woolridge, “The Emerging Emerging Markets,” *Economist*, November 22, 2010.

<sup>9</sup> See Audit Committee Leadership Summit, “Bribery and Corruption Risk,” *ViewPoints*, July 14, 2011.

<sup>10</sup> Pulina Whitaker, “The UK Bribery Act: Be Prepared,” *King & Spalding Client Alert*, July 1, 2011.

<sup>11</sup> Midwest Audit Committee Network, “Overseeing International Risks and Opportunities,” *VantagePoint*, July 7, 2011, 3.

<sup>12</sup> *Ibid.*

<sup>13</sup> See, for example, Robert F. Cetuka, “Implications of Asia’s Rising Energy and Resource Nationalism: Implications for the United States, China and the Asia Pacific Region,” remarks at the National Bureau of Asian Research Energy Security Conference, Washington, DC, May 4, 2011.

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### Directors want strategies that capitalize on foreign growth

Members cited trends that are affecting their company strategies as they search for growth opportunities abroad:

- **Population growth and movement.** Members are watching general population growth and movement, particularly rapid urbanization. *Foreign Policy* magazine notes, “Half the global population already lives in cities and generates more than 80 percent of global GDP. And each week, the urban population increases by more than 1 million people, an amount equivalent to adding seven Chicagos to the face of the planet each year.”<sup>14</sup>
- **Regional differences in aging.** One member remarked prior to the meeting, “*Demographic changes are very interesting. China and Europe are rapidly graying, worldwide teens will soon be 50% of the population, and the US is the youngest Western country – these are the things that boards should be reflecting upon.*” Others talked about the importance of regional age in the context of the political unrest in the Middle East and North Africa.<sup>15</sup>
- **The burgeoning global middle class.** The *Economist* reports that 700 million inhabitants in emerging markets will enter the middle class over the next decade.<sup>16</sup> “*That’s a lot of new customers,*” one member said.

### Improving strategic oversight of international opportunities and risks

Members discussed how boards can help their companies exploit globalization’s opportunities while managing its risks. Members suggested several ways boards can strengthen the foundation from which they engage with strategy.

### Ensure directors understand the business and its strategy

One member said that the lead director has a responsibility to ensure all board members are effective participants in strategic discussions: “*The emergence of non-executive chairmen, lead directors, and presiding directors is directly related to pressure from watchdogs, shareholder groups, and shareholders to get more involved in strategy.*” Encouraging directors to “*do their homework*” is therefore part of their job.

Only 21% of the directors McKinsey surveyed felt they had a thorough understanding of their company’s current strategy, which leaves plenty of room for the lead director to help.<sup>17</sup> One member said, “*One thing a lead director can do is try and get directors to orient themselves to issues by talking to management and outsiders.*” Members’ companies may do “deep dives” into relevant subjects with subject matter experts from within or outside the company.

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<sup>14</sup> Richard Dobbs, Jaana Remes, and Charles Roxburgh, “[Boomtown 2025: A Special Report.](#)” *Foreign Policy*, March 24, 2011.

<sup>15</sup> See Ragui Assaad, interview by Jayshree Bajoria, “[Demographics of Arab Protests.](#)” February 14, 2011.

<sup>16</sup> Adrian Woolridge, “[The Emerging Emerging Markets.](#)”

<sup>17</sup> Chinta Bhagat, Martin Hirt, and Conor Kehoe, “[Governance since the Economic Crisis: McKinsey Global Survey Results.](#)”

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Members mentioned three sources of expertise in particular:

- **Management.** Many members said that their primary source of information regarding global corporate strategy comes from management. Members said they especially appreciate the portion of management presentations reserved for directors to *“probe, ask questions, push, [and] get additional data.”* Several members recommended bringing business and geographic unit leaders with direct day-to-day responsibility for higher-risk locations into board meetings.
- **Outside experts.** Boards often rely on consultants, academics, and skilled professionals like bankers and lawyers for outside expertise. One member reported feeling *“daunted at the prospect of evaluating international expansion without the benefit of a report from a major consultancy.”* Another member appreciated having an outside academic *“walk the board through the political, social, and economic environment of markets we’ve entered or consider entering.”*
- **Fellow directors.** Obviously, the knowledge, intelligence, and experience of individual directors help the board as a whole understand the business environment: *“The central reason for seeking a truly diverse board is to be able to draw on those experiences when making decisions.”* One member put it succinctly: *“You rely on the people in the room who know the answers.”*

### Deepen experience with international markets

Several members found immense value in traveling to particularly important foreign markets: *“There’s no substitute for being there, for spending a full day in the factory and getting sweaty while talking to employees.”* Convening board meetings overseas is a common method for ensuring that directors are exposed to foreign markets. One member said, *“On a recent trip abroad, we visited manufacturing facilities, major customers, and relevant government officials. It was very tiring and not at all fun, but it was an invaluable trip.”*

Directors can also visit important sites in foreign countries when their own travels – for other businesses or for personal reasons – take them to the region. One member leveraged a trip to Russia to visit with business and government leaders relevant for a different business: *“I got much better insight that I knew would be useful when our board finally addressed whether to invest in the area.”*

However, traveling to foreign business locales is not always practical. One member suggested an alternative: *“If we can’t get a board meeting in a particularly relevant market, then we need to bring the country managers to us and have them put on a seminar.”*

### Recruit specialist directors when appropriate

Members frequently mentioned recruiting experts on particular markets or issues relevant to the global business environment. Recruiters who work with boards to fill board vacancies mention *“an uptick in interest in seeing candidates ... with international experience – people who have either lived overseas or worked with an international company, particularly in Asia.”*<sup>18</sup>

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<sup>18</sup> *“Take Five: Board Recruitment,”* (interview with Julie Hembrook Daum), *Boardmember.com*, 2009.

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Several members reported that their non-US directors were *“invaluable. My board always has two or three foreign directors. If we lose them, we find another. I find it critically important.”*

Boards also recruit technical specialists for issues particularly relevant to their global operations and ambitions – for example, in such areas as foreign affairs, intellectual property, or trade. Of course, there are not enough board seats for experts on every relevant issue: *“Composing a board of directors is a 3D chess game – you do need international expertise, but you also need to know the government, relationships with your stakeholders, and many other things. The right composition requires a lot of different skill sets and backgrounds for balance.”*

### The lead director's unique role in strategy

Many members suggested that lead directors have a special responsibility for strategy oversight. One noted that the title of lead director *“creates an obligation on our part to truly lead the board toward better strategic discussions.”* Members described several ways in which lead directors fulfill the responsibilities implicit in their title.

#### Ensure agendas focus on truly strategic issues

Board time is scarce. One member said, *“Global trends should be on boards’ minds, should be considered and should be discussed. But fitting them in ... requires a significant amount of discipline from the lead director or chairman.”*

Lead directors are almost always involved in agenda setting, although the specifics of their role may vary.<sup>19</sup> Members said that the more involvement they have, the more they are able to ensure available time is used efficiently. Foremost on members’ minds was keeping the board’s attention at the right level: *“One of the lead director’s responsibilities is ensuring that the agenda on board meeting day is focused on strategy. Boards need to stay out of the weeds – the temptation following the financial crisis is micromanagement.”*

#### Orchestrate when and how to discuss the company’s strategic plan

Several members saw advantages to more active management of discussions concerning the company’s strategic plan. Members suggested that extra care and attention should be spent orchestrating productive conversations concerning the development and evaluation of the strategic plan.

Lead directors have an important influence over how topics are presented to directors before and during board meetings. Specifically, the lead director can help pace the board’s consideration of strategy as it evolves and contextualize discussions among management and the board. *“It’s better when the directors know a broad, detailed discussion on strategy is coming. The strategic review done by one of my companies involves a three-day offsite with six-hour presentations from each major division. But we aren’t being talked at – more than 50% of each session is reserved for discussion. Everyone is well-prepped and these conversations are skillfully facilitated – it’s an effective model.”*

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<sup>19</sup> LDN members may have a broader agenda-setting role than other lead directors. Compare Lead Director Network, [“The Relationship Between the Lead Director and CEO.” ViewPoints](#), March 24, 2011, which suggests that LDN members have a robust agenda-setting role, with data drawn from the broader [2010 Spencer Stuart 2010 Board Index](#) (Chicago: Spencer Stuart, 2010), 23, which suggest that lead directors infrequently develop board agendas.

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Lead director involvement in setting the agenda with the senior management team also affords a distinctive opportunity to affect what information is shared at each meeting. Lead directors can filter unnecessary information, sequence information presented from management to the board (and from directors to management) to best effect, and help pace conversations to assure directors are appropriately engaged with the strategic plan.

### **International differences in board involvement in corporate strategy**

A recent McKinsey survey suggests that many directors are involved in overseeing and setting corporate strategy. Of the roughly 1,600 survey respondents from around the world, 41% said that they develop strategy with management, 44% approve and oversee management's proposed strategy, and 11% develop strategy themselves. Directors from companies headquartered in North America are more likely to simply review and approve management's strategy: only 35% of those directors develop strategy with management.

Source: Chinta Bhagat, Martin Hirt, and Conor Kehoe, [Governance since the Economic Crisis: McKinsey Global Survey Results](#).

### **Engender a culture of robust discussion and debate**

According to one member, lead directors have a unique responsibility *“to ensure that discussion is robust, resources are used, outside experts [are retained when necessary], [and] management digs in where it needs.”* Active, skeptical questioning should be encouraged, members said. *“The lead director should move the discussion forward, calling on people with relevant experience to weigh in.”* Another member added, *“Lead directors should make sure that the hard questions and the oddball questions are raised.”*

Careful use of executive sessions can help create an appropriately inquisitive culture, according to members. At an earlier meeting, one member said, *“My biggest frustration is ... sometimes directors won't speak up in a meeting when you want them to talk. And then I go to them after the meeting and say, ‘Why didn't you speak up? That was your chance.’”*<sup>20</sup> A member said that executive sessions *“help directors overcome any reluctance to speak. In executive session, directors will mention their concerns.”*

### **Communicate the necessary messages to management**

Lead directors are responsible for communicating the views of independent directors to the CEO. Clear messaging to the CEO is essential, members said. This is easiest when the board is in agreement. Unanimity not always possible – *“some directors are fractious”* – but lead directors should seek to surface dissent and move the board toward consensus, according to members. *“The most effective boards are able to come together and say, ‘Here is our view of the world,’ and the best lead directors help boards get there.”*

Occasionally, directors need to challenge a CEO's views or assumptions. If the board believes that management has not addressed all relevant issues or has shared a weak analysis, then lead directors will

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<sup>20</sup> Lead Director Network, [“The Board's Role in Corporate Strategy.”](#), 7.

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ensure that this opinion is raised with management. One member recalled concerns that a CEO was not fully aware of the competitive environment and remembered encouraging management to “*reach out [to an expert] who [could] expand the company’s thinking.*”

### Conclusion

To contribute to the performance of their companies, corporate boards must understand the international risks and opportunities that are at the heart of much of today’s corporate strategy. Boards seek to attract, retain, and develop a group of skilled and diverse directors who are conversant in global markets and issues. Boards and companies benefit when board members have experience in implementing global strategies, when directors are informed and engaged, and when strategic boardroom discussions are of the highest caliber. Many members believe that lead directors can – and should – push their boards to strive toward those goals.

### About this document

*ViewPoints* is produced by Tapestry Networks to stimulate timely, substantive board discussions about the issues confronting lead directors. The ultimate value of *ViewPoints* lies in its power to help all constituencies develop their own informed points of view on these important issues. Anyone who receives *ViewPoints* is encouraged to share it with those in their own companies and their colleagues at other companies. The more board members, members of management, and advisers who become systematically engaged in this dialogue, the more value will be created for all.

*The Lead Director Network (LDN) is sponsored by King & Spalding and convened by Tapestry Networks. The LDN is a group of lead independent directors, presiding directors, and non-executive chairmen drawn from America’s leading corporations who are committed to improving the performance of their companies and to earning the trust of their shareholders through more effective board leadership. The views expressed in this document do not constitute the advice of network members, their companies, King & Spalding, or Tapestry Networks.*

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### Appendix: Contributing members

The following members attended the July 13 LDN meeting:

- Peter Browning – lead director, Nucor
- Dan Carp – non-executive chairman, Delta Air Lines
- Gene Fife – presiding director, Caterpillar
- Ray Gilmartin – lead director, Microsoft; presiding director, General Mills
- Karen Horn – lead director, Eli Lilly
- Bob Kidder – non-executive chairman, Chrysler; lead director, Morgan Stanley
- Linda Fayne Levinson – lead director, NCR
- Jack O'Brien – lead director, TJX; non-executive chairman, Cabot

Additionally, Ambassador Susan Schwab, the 15th United States Trade Representative and a director at Boeing, Caterpillar, and Federal Express, participated in the meeting as a network guest.

The following King & Spalding partners participated in all or some of the meeting:

- Zack Harmon, Special Matters and Government Investigations Practice Group
- J. Kelley, Corporate Practice Group
- Russ Ryan, Special Matters and Government Investigations Practice Group
- Chris Wray, Chair, Special Matters and Government Investigations Practice Group

The following members were unable to attend the meeting but provided their thoughts in pre- or post-meeting discussions:

- Frank Blount – lead director, KBR
- Roy Bostock – non-executive chairman, Yahoo! Inc.
- Dan Feehan – non-executive chairman, RadioShack
- Dick Goldstein – presiding director, Interpublic Group
- Bonnie Hill – lead director, The Home Depot
- Phil Humann – presiding director, Coca-Cola Enterprises and Equifax; non-executive chairman, Haverty Furniture Companies
- Ed Kangas – non-executive chairman, Tenet Healthcare
- Bob Lawless – lead director, Constellation Energy Group
- Jim Robinson – presiding director, The Coca-Cola Company
- Wes von Schack – lead director, Bank of New York Mellon; lead director, Edwards Lifesciences