Strategic Planning & Directors' Liability

The rules under which directors can become legally liable are changing all the time. Some of this potential liability is obvious but, as Graham Kenny explains, directors may soon be held to account for failed corporate strategies.*

The corporate blowtorch that has for so long been trained on employees, with massive redundancies, and customers, with depleted services, has now been pointed at senior management – with a vengeance. But this time it's different. It's not just "management" that's being labelled "crooked" and "incompetent" but, specifically, CEOs, boards, individual directors and chairs of boards.

With names like Enron, WorldCom, HIH and One.Tel ringing in their ears, is it any wonder that shareholders and the general public are wondering: Are there any competent CEOs out there? Are all boards and directors either crooked or asleep?

Shareholders have a right to demand better from their boards and CEOs when it comes to strategic planning. Why better? Most current levels are not meeting best practice standards and are shortchanging shareholders to a huge extent.

This leaves CEOs, boards, individual directors and board chairs open to further claims of incompetence and knowing underperformance.

What if?

What if a board failed to ensure that

1. an organisation had a strategic plan, or
2. the strategic plan was effective, or
3. the strategic plan was implemented, or
4. the strategic plan was modified in the light of changed circumstances?

As an organisation's strategic plan is the central instrument for achieving competitiveness, financial success and shareholder returns, would any one of the above conditions constitute grounds for action by shareholders of companies, members of associations, and so on?

There seems little doubt that a board has at least the responsibility to ensure that an organisation's strategic plan has been formulated by following best practice procedures, that its contents are in line with best practice and its implementation is reviewed and continually monitored. (Following best practice is a key element in effective corporate governance. See the emphasis placed on "best practice" in John Hall's CEO Report in *Company Director*, July)

As evidence of a board's responsibility take Rogers' CJ ruling in the AWA Ltd v. Daniels & Ors (trading as Deloitte Haskins & Sells) case. He ruled in 1992 that the board's function was fourfold:

- set the goals of the company
- appoint the company's chief executive
- oversee the plans of managers for the acquisition and organisation of financial and human resources towards attainment of the company's goals
- review at reasonable intervals the company's progress towards attaining its goals.

The source of this information is AICD's *Duties and Responsibilities of Directors and Officers* (17th edition), which concludes that "the duties of a director of a company on a day-to-day basis are now very wide-ranging and daunting" and that "the areas of law giving rise to personal liability continue to grow".

Failure in condition 1, i.e., not having a strategic plan at all, leaves an organisation open to attack by competitors, with consequent loss of revenue, market share, profit and shareholder value.

Equally, for a board to allow management to operate an organisation with an out-of-date plan (condition 4) could not be seen to advance shareholder interests. Both conditions would render a board liable to claims of negligence.

Condition 2 – failure to ensure that the strategic plan's contents are effective requires creating and writing a competitive strategy that follows best practice. Without effective competitive strategy, a strategic plan cannot be successful, and every organisation – even a church, school or hospital – needs a strategic plan to compete for resources.

From the author's professional experience over the past 15 years, managers repeatedly mistake activity for strategy. They leap from their views about industry direction to what individuals or department heads are going to do within their organisations.

To many people this may seem fine. Surely management's doing something about the situation, and isn't that enough? If the organisation hasn't developed any competitive strategy, it leaves itself open to attack by its competitors. This leads inevitably to the erosion of shareholder value.

Of course, in many organisations we see a mixture of activity and strategy that is labelled "strategy".

We recently did in-depth studies of 16 organisations that had from 4500 to 20 employees spanning a range of industries. We asked them to rate the extent to which their strategies were really competitive strategies – rather than descriptions of internal activity. Their answers varied from a high of 80 percent to a low of 5 percent, with a median value of 40 percent.

This means that, on average, 60 percent of the strategies that purported to advance their organisations competitively actually had no chance of doing so.

The question then is: Could it be construed as deceptive or negligent if a CEO and a board let such material disguise itself as competitive strategy in a strategic plan and be passed off as advancing shareholder interests?

Condition 3 in the "what-if" list concerns the implementation of strategy: What if a board failed to ensure that an organisation's strategic plan was implemented?

Many strategic plans, once completed and approved by their boards, find their way to a shelf to gather dust for a year, until the strategic planning process is recommenced. It's a regular joke in some management circles.

As a result, these boards fall into the habit of narrow concentration on monthly financial results, and they fail to review, in addition, progress against their organisation's strategic plans.

For such organisations, strategic planning is a sham, and their implementation level is close to zero. In effect, the managers, and through inaction by their boards, have deceived their shareholders by producing a strategic plan that has lain idle.

Is a board therefore culpable for not putting mechanisms in place to monitor the strategic plan's implementation? The Rogers' ruling previously referred to places emphasis on overseeing the plans of managers and reviewing at reasonable intervals an organisation's progress towards attaining its goals.

Now, not all organisations are run this badly. Many that do start out with good intentions to implement their strategic plans, only accomplish a percentage of them.

We asked those same 16 organisations to rate the extent to which their strategies were implemented. The answers ranged from 100 percent to 5 percent, with a median score of 50 percent. This means that, on average, half of the strategies that management contracted to implement were never carried out at all.

Once again: Could a level of achievement such as this be construed as deceptive and negligent on the part of a CEO and board? Don't shareholders have a right to know why management and a board were so casual in the discharge of their responsibilities that half of the strategies – that were supposed to produce a competitive edge and lift shareholder value – have remained unattended?

If by following best practice, management could have achieved a far better result, where does this leave a board in terms of liability?

An organisation can be likened to a high-performing athlete and its competitive potential considered in light of what it could have accomplished, versus what was actually achieved.

On average, only 40 percent of the strategies of organisations have any hope of producing a competitive edge and, on average, only 50 percent of these are implemented. If we multiply these two figures together, we obtain 20 percent. This is the average extent to which our organisational sample reached its competitive potential. (The lowest score was less than 1 percent.)

The percentage would be raised if an organisation wrote true competitive strategies – those that really would give a competitive edge. The overall result would also be higher if the second figure, 50 percent, were raised. This can only occur if management and its board focus their attention on effective implementation.

Would you be happy if you knew your favourite sporting team was prepared to settle for achieving only 20 percent of its potential? Would you be happy in the knowledge that your son or daughter was only achieving 20 percent of his or her potential? Would an Olympic athlete become a champion by reaching only this same percentage of potential?

Should management and a board settle for achieving 20 percent of an organisation's competitive potential? Shareholders have a right to be concerned, and boards have an obligation to take action.

Auditors have come under considerable scrutiny during the recent corporate debacles. It may surprise many to know that it is now routine for auditors to review an organisation's strategic plan and its implementation processes. The purpose is to assess strategic risk – part of assessing the broader concept of business risk.

To understand this risk, an auditor addresses questions such as:

- Do we (the auditor) understand their strategies?
- Do the strategies support one another and link together?
- Do we understand how the client goes about formulating its strategies?
- Are we able to evaluate the effectiveness of client strategies?

Central issues of concern in terms of the auditor's liability are: What if an auditor did not employ a best practice model in answering these and similar questions? Wouldn't its responses be flawed? Wouldn't it be liable to a board and shareholders if, as a consequence, its assessment of strategic

FULL
PAGE
AD

and business risk were deficient? We also find it hard to believe that any of the organisations we researched should have passed on strategic risk – yet all of them did. The best achievement of competitive potential by these organisations was still only 40 percent – far too low, we suggest, to be considered as advancing shareholders' interests significantly.

These results are typical and we believe that a host of organisations should be failing on strategic – and hence business – risk. Clearly they're not.

Many organisations employ consultants to assist them in their strategic planning. In doing so, they, and in turn their board and shareholders, place faith in the strategic planning knowledge and skills of the consultant.

Many consultants like to say they "do" strategic planning, as part of all their other consulting "specialities". What many of them haven't thought through is their responsibility to provide best practice.

This leaves management, a board, the auditor and the consultant in shareholders' gun sights – and quite rightly. So if your management consultant lists a whole string of specialised areas and adds, "Of course, I do strategic planning", beware.

A strategic plan is the fundamental driver of every organisation's competitiveness, financial success and, ultimately, of shareholder interests. Without effective strategic planning, organisations fail.

Even HIH, as evidence has shown and after all the personalities have been stripped away, appears to have failed from strategies that sought growth at any cost.

The second point is that following best practice lies at the heart of effective corporate governance. This is true of accounting practices, occupational health and safety, and strategic planning. To avoid liability, management, a board, its directors, auditors and consultants must all operate at best practice standards.

There are major risks to be addressed by directors as regards strategic planning. Much current practice fails the best practice test, which leaves directors legally liable for underachieving on financial results and shareholder value.

** Graham Kenny is managing director of Strategic Factors, a management consultancy specialising in assisting organisations to develop and implement strategic plans. He can be contacted on (02) 9969 7488 or e-mail gkenny@strategicfactors.com*