



Corporate Governance Series Presents:

# Setting Strategy: How Should the Board Be Involved?

Michael Raynor, Distinguished Fellow in Deloitte Research, Deloitte Consulting LLP

December 5, 2007

Audit • Tax • Consulting • Financial Advisory •

# Agenda

---

- The tradeoff between strategic risk and return
- Strategic options and breaking the tradeoff
- Requisite Uncertainty: A new design principle
- Implications for the board

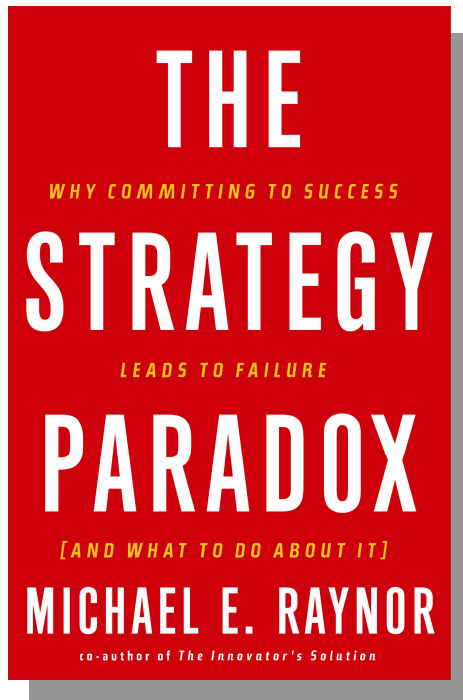
# The board: Counterintuitive conclusions

---

- To manage risk effectively, don't get involved in setting strategy
- High-powered compensation systems create perverse risk-seeking behaviors
- Shareholders don't come first...but neither does anyone else
- A new management-board relationship is needed

# Strategy: Returns...and risk

---



- The quest for profitable growth dominates the corporate agenda
  - Creating value by launching new growth businesses
- Innovation is the key to making this happen
  - Sustaining innovation → Keep what you've got
  - Disruptive innovation → Create something new
- What about the businesses you have?
  - Short term attacks by competitors
  - Long term competitive uncertainties
- Often requires material commitments
  - Big wins require big bets...and create big risk
- What is the risk/return tradeoff in strategy?

# Poll Question #1

---

To what extent do you agree or disagree with the following statement:

My company sees the effective management of strategic risk as a powerful lever for increasing total enterprise value.

- Strongly disagree
- Slightly disagree
- Neither agree nor disagree
- Agree
- Strongly agree

# How we (don't) think about strategic risk

---



- The most successful strategies are based on the boldest commitments
  - But how to know what to bet on?
- Are better results “free”?
  - What about risk?
- Sony developed sound strategies and executed them well
  - Betamax:
    - TV time shifting vs. movie viewing at home
    - The failure of the Videodisc
  - MiniDisc:
    - The Internet and flash memory
    - Napster and the iPod

# Poll Question #2

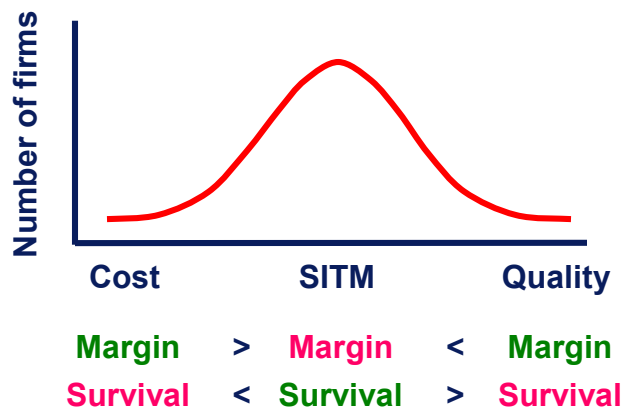
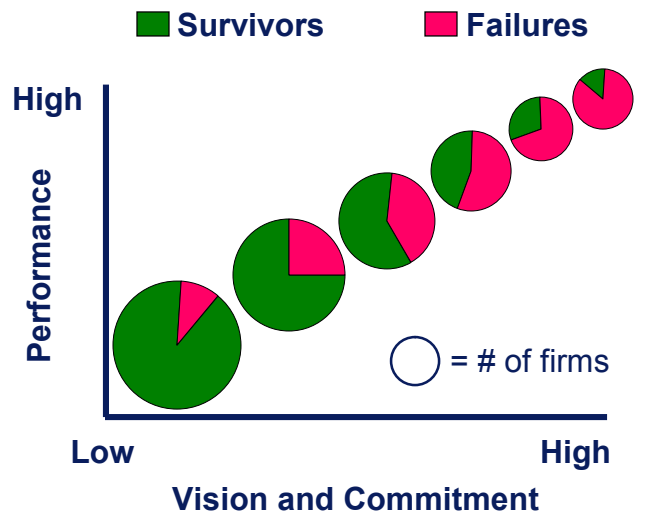
---

To what extent do you agree or disagree with the following statement:

My organization's board understands the risk/return tradeoff implied by our strategic commitments.

- Strongly disagree
- Slightly disagree
- Neither agree nor disagree
- Agree
- Strongly agree

# Identifying and quantifying strategic risk



- Everything we think we know about strategy is true
  - Bold commitments yield better results
- ...but it is dangerously incomplete
  - We have ignored strategic risk
- Few seem unable to manage it
  - The money lies at the extremes
  - But most companies cluster in the middle
- Maximizing the probability of success also maximizes the probability of failure
  - So most sacrifice the chance of higher returns for an increased chance at survival



# Poll Question #3

---

When reviewing and approving strategic plans, does your organization's board typically:

- Ask management to set more aggressive targets
- Agree with management's targets
- Ask management to set less aggressive, risk-averse targets
- Don't know/ Not applicable

**To assess the riskiness of your firm's strategy,  
take our "strategic risk diagnostic" at  
[www.thestrategyparadox.com](http://www.thestrategyparadox.com)**

# Embrace uncertainty, create options

---

- Microsoft has long appeared to manage strategic uncertainty
  - The company’s diverse portfolio has a clear strategic coherence
  - The objective is not merely “growth options” but true strategic options
- Historically, it was the PC ecosystem that was uncertain
  - Now it is the larger media space that it must contend with and compete in
- Managing strategic uncertainty creates a different curve



# Different horizons, different uncertainties

---

Organizational Level	Time Horizon	Strategic balance	Critical questions
----------------------	--------------	-------------------	--------------------

Board	10 yrs to $\infty$
-------	--------------------

Corporate	5 – 10 yrs
-----------	------------

Business Unit	3 – 5 yrs
---------------	-----------

Function	1 – 3 yrs
----------	-----------



What could affect our status as an ongoing concern?

What could cause our strategy to fall short of our goals?

What could cause our project to fail?

# Poll Question #4

---

To what extent do you agree or disagree with the following statement:

In my organization there is a clear differentiation in planning time horizons at each level of the hierarchy.

- Strongly disagree
- Disagree
- Unsure
- Agree
- Strongly agree

# Implications for the board

---

- Strategy development
  - You can't review objectively a strategy you developed
  - So, less involved, not more, in setting strategic direction
- Strategic evaluation
  - Focus on strategic risk
  - Help identify relevant strategic uncertainties
- Decision-making
  - Seek                      – Avoid
  - Accept                    – Manage

# An evolving relationship

---

## **Dependence**

**The Board believes everything management says**

*Kept in the dark and fed manure*

## **Independence**

**The Board doesn't believe anything management says**

*Build a "Chinese wall"*

## **Interdependence**

**The Board and management work together**

*A partnership serving the corporation*

# Poll Question #5

---

How would you characterize your board's relationship with management on strategy decisions?

- Highly dependent
- Somewhat dependent
- Independent
- Somewhat interdependent
- Highly interdependent
- Don't know/ Not applicable

# Closing thoughts

---

- Reducing risk without reducing returns is an overlooked way to increase value
- The board's primary *strategic* role is to establish the firm's strategic risk profile
- Accepting this role can create an interdependent relationship with management





# Questions & Answers

**Deloitte.**

Join us January 9<sup>th</sup> at 2 PM EST  
as our Corporate Governance  
series presents:

**Proxy Season 2008:  
What Should You Do To  
Prepare?**

---

Thank you for joining  
today's webcast.

To request CPE credit,  
click the link below.



# Contact Information

---

Michael Raynor

[mraynor@deloitte.com](mailto:mraynor@deloitte.com)

Steve Wagner

[swagner@deloitte.com](mailto:swagner@deloitte.com)

---

The information contained in this publication is for general purposes only and is not intended, and should not be construed, as legal, accounting, or tax advice or opinion provided by Deloitte & Touche to the reader. This material may not be applicable or suitable for, the reader's specific circumstances of needs. Therefore, the information should not be used as a substitute for consultation with professional accounting, tax, or other competent advisors. Please contact a local Deloitte & Touche professional before taking any action based upon this information.

---

## About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu, a Swiss Verein, its member firms, and their respective subsidiaries and affiliates. Deloitte Touche Tohmatsu is an organization of member firms around the world devoted to excellence in providing professional services and advice, focused on client service through a global strategy executed locally in nearly 140 countries. With access to the deep intellectual capital of approximately 150,000 people worldwide, Deloitte delivers services in four professional areas — audit, tax, consulting, and financial advisory services — and serves more than 80 percent of the world’s largest companies, as well as large national enterprises, public institutions, locally important clients, and successful, fast-growing global companies. Services are not provided by the Deloitte Touche Tohmatsu Verein, and, for regulatory and other reasons, certain member firms do not provide services in all four professional areas.

As a Swiss Verein (association), neither Deloitte Touche Tohmatsu nor any of its member firms has any liability for each other’s acts or omissions. Each of the member firms is a separate and independent legal entity operating under the names “Deloitte,” “Deloitte & Touche,” “Deloitte Touche Tohmatsu,” or other related names.

In the United States, Deloitte & Touche USA LLP is the U.S. member firm of Deloitte Touche Tohmatsu and services are provided by the subsidiaries of Deloitte & Touche USA LLP (Deloitte & Touche LLP, Deloitte Consulting LLP, Deloitte Financial Advisory Services LLP, Deloitte Tax LLP, and their subsidiaries), and not by Deloitte & Touche USA LLP. The subsidiaries of the U.S. member firm are among the nation’s leading professional services firms, providing audit, tax, consulting, and financial advisory services through nearly 40,000 people in more than 90 cities. Known as employers of choice for innovative human resources programs, they are dedicated to helping their clients and their people excel. For more information, please visit the U.S. member firm’s Web site at [www.deloitte.com](http://www.deloitte.com)

---

# Deloitte.