



Overseeing Strategy

A FRAMEWORK FOR BOARDS OF DIRECTORS

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Preface

The Corporate Oversight and Governance Board (COGB) of the Chartered Professional Accountants of Canada (CPA Canada) has commissioned this publication *Overseeing Strategy—A Framework for Boards of Directors* to help directors of public and private companies oversee their organizations' strategy. It addresses the role of boards throughout the strategy development process, including the identification of critical steps and issues that directors must consider.

There are no standards for strategic planning and oversight, but conventional board review of strategy is not enough. The publication highlights the importance of strategy development and execution in creating value for shareholders and why a board needs to be involved throughout. It acknowledges the challenges in effectively overseeing strategy and offers tools and insights to assist directors in this important role. In particular, it underscores the board's role in long-term value creation, in the face of the pressures on the company to produce short-term results.

This Framework approaches strategy through four phases:

- preparation
- strategy formulation
- execution
- monitoring.

The roles that management and the board should play are clearly set out in each of the phases, as well as tools to assist directors fulfil their roles. These responsibilities may vary depending on the size and circumstances of the company.

Preparation phase sets the stage for longer-term strategic planning. Much of this phase involves ensuring management and the board have accurate and complete information and analyses regarding the company and its environment

in order to be able to move on to the next step. The key role of the board at this stage is to review the information and provide input to ensure the issues of concern to the board will be addressed in the process.

Development phase outlines the development steps, setting strategic goals, formulating strategic options, refining and prioritizing these options, then developing a comprehensive strategic plan. It recognizes that the process is often iterative as the details on the market and the company strategy may change the original goals and option set.

Execution of the strategic plan consists of the conversion of the strategy into action. The board must understand and approve, for example, strategic initiatives, the annual operating plan, and major projects regarding people, systems and processes.

The Framework includes the use of metrics as part of the monitoring phase, as well as reporting and mid-cycle reviews. This information gives the board the opportunity to review and provide input and refine the company's strategy if necessary.

In summary, this Framework provides an overview of the responsibilities of directors in overseeing the strategic direction and development, execution and monitoring of the company's strategic plan.

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Who This Document Is For

This document is designed to equip directors with a framework for their role in overseeing strategy development and execution, to identify critical steps and issues that will require their attention and to provide useful tools to assist them.

It was developed for directors of public and private companies and can be applied to most industries and enterprises of varying sizes.

Many aspects of this framework also apply to directors of crown corporations and not-for-profits.

Boards are encouraged to review this framework in the context of their organization and apply what is most appropriate and relevant.

Introduction

Strategy Is the Cornerstone of Value Creation

The company's strategy and its execution are usually one of the key determinants of shareholder value. So the importance of board oversight of strategy is clear, but finding an *effective* oversight approach can be challenging.

Most directors understand that they are responsible for overseeing strategy and would list it among their board's top priorities. However, they also recognize that reviewing a strategic plan developed by management once a year is not enough.

An annual review of strategy is both too little and too late for responsible oversight of this critical function. Too little, because the breadth and complexity of the strategic issues and opportunities most companies now face cannot be understood properly in a single meeting. Too late, because many of the things that determine the focus, goals and ultimately the value of the strategy happen early in the process:

- identifying what issues should be considered and researched
- anticipating the future state of markets, competitors, technologies and other key factors
- considering the company's strategic options.

Many boards readily acknowledge that oversight of strategy should be a continuous process, yet many struggle to identify and implement an effective methodology and model.

Boards should take a more active role in assessing and overseeing strategy to add value and to manage the risk of management bias.

Why the Board Needs to be Involved

Boards must assert themselves more directly in strategic oversight because directors offer valuable experience and an independent perspective, and management cannot objectively assess its own performance, capabilities and plans. Simply overseeing the process is not enough because there are no standards for strategic planning and oversight, and few (if any) authoritative sources for boards to rely on.

Strategy should form the basis for long-term value creation, but dynamic markets and quarterly earnings expectations often drive a myopic focus on short-term results. Management needs the board's long-term perspective to offset daily pressures to focus on the near term. Shareholders will ultimately hold the board accountable for long-term value creation.

In private companies, shareholders are often represented on the board to make sure corporate objectives and strategies meet investment expectations, while in public companies, larger investors increasingly expect to have a voice on strategy. In fact, many activist investors are now offering sound strategic ideas. The best defence against unwanted takeovers and hedge fund involvement is to listen to these investors, develop a strategic plan that incorporates compelling value-creation opportunities, and execute the strategy to fulfil what it promises.

We recognize that the board's role in the strategic planning process may vary. In most large companies, management develops the strategy, assessing the strategic context, analysing the options and planning a course of action. The management team can then be held accountable to execute the plan it developed. Smaller companies may not have the resources to undertake an equally robust planning process. In a smaller organization, management may need to rely more on the board's collective experience and insights. Strategic planning may even involve a hands-on role for certain directors in defining options, choosing direction and setting priorities. However, management must still own the plan and the board as a whole must provide an informed, objective assessment of it.

Overseeing Strategy A Framework for Boards of Directors

Our strategy framework has four phases:



Board's Oversight Role

Boards should provide input and have visibility into the strategy, including planning, development, execution, monitoring and assessing strategic risk.

This document sets out a framework for oversight to help directors fulfil their role and includes best practices across each dimension of strategy. While frameworks and models are useful, they are not a substitute for board experience and judgment.

The framework and the level of detail provided in this document are based on the authors' observation that, in spite of its importance, strategic oversight is an area of weakness for many boards.

In our experience, what passes as strategy often consists of:

- a binder of departmental plans, tied together with a short cover document (*Where is the strategy?*)
- a SWOT analysis listing initiatives to leverage strengths, overcome weaknesses, address opportunities, and ward off threats (*Will this be competitive and create value?*)
- goals without actions: "We will become..." (*But how?*)
- actions without goals: "We will do..." (*Why? Will it create value for shareholders?*)
- plans without milestones and metrics (*How can the board oversee the execution of a plan if it has no means to mark progress?*)
- plans the board does not understand (*How can the board learn enough in one meeting about the context, issues and options to intelligently approve a strategy?*)

Most directors have approved these kinds of plans at some point, often because they did not have the opportunity to comment or assist sooner.

Our goal is to put directors in a better position to engage in the process earlier, set clear expectations about quality, engage effectively to add value, and oversee execution that creates value for shareholders.

Strategic oversight does not mean directors get to sit in the third row and observe. Collaboration with the executive team is important. Directors should be active, undertake their own independent research, and bring objectivity and balance to the process.

A hand is pointing towards a network diagram consisting of interconnected circles and lines. The background is a blurred office scene with a computer monitor and keyboard. The entire image has a blue tint.

PHASE 1

Preparation

PHASE 1

Preparation

This first group of steps sets the stage for longer term planning.

It begins with understanding the process that will be used for developing a strategic plan and broadly articulating the environment the enterprise is operating in (including geopolitical, macroeconomic and industry-specific factors). It also involves identifying key issues and preliminary data needed to begin to build a plan.

Director involvement at this early stage is important for three main reasons:

1. There are no standards for strategic planning

Since there are no standards or common approaches for strategic plans, board members should have input to the planning process and plan design at the outset, including communicating any expectations related to quality and content.

2. Management needs the board's long-term perspective to offset pressures to focus only on the near term

Boards should agree on the relevant time horizon and be involved in determining the key issues to be addressed.

3. Having the right fact base matters

Directors should understand and provide input to the fact base for the strategic plan. The focus should be on markets, customers, key success factors and an objective assessment of the organization and its competitors.

OVERVIEW

1.1 Approach and Plan Design

Considerations	Management's Role	Board's Role
Planning cycle	Propose a planning period	Review and provide input
Planning process	Develop a proposed format, content and themes for the strategic plan	Review early and provide input
Format and content		
Staying informed		Review and provide input

1.2 Context and Key Issues

Considerations	Management's Role	Board's Role
Context	Develop content that provides sufficient context (past, present, future)	Review and provide input
Key issues	Identify key issues	

1.3 Information and Analysis

Considerations	Management's Role	Board's Role
Markets	Provide data and analysis	Review and provide input
Customers		
Key success factors		
Self-assessment and competitor assessment		

1.1 Approach and Plan Design

This section reviews

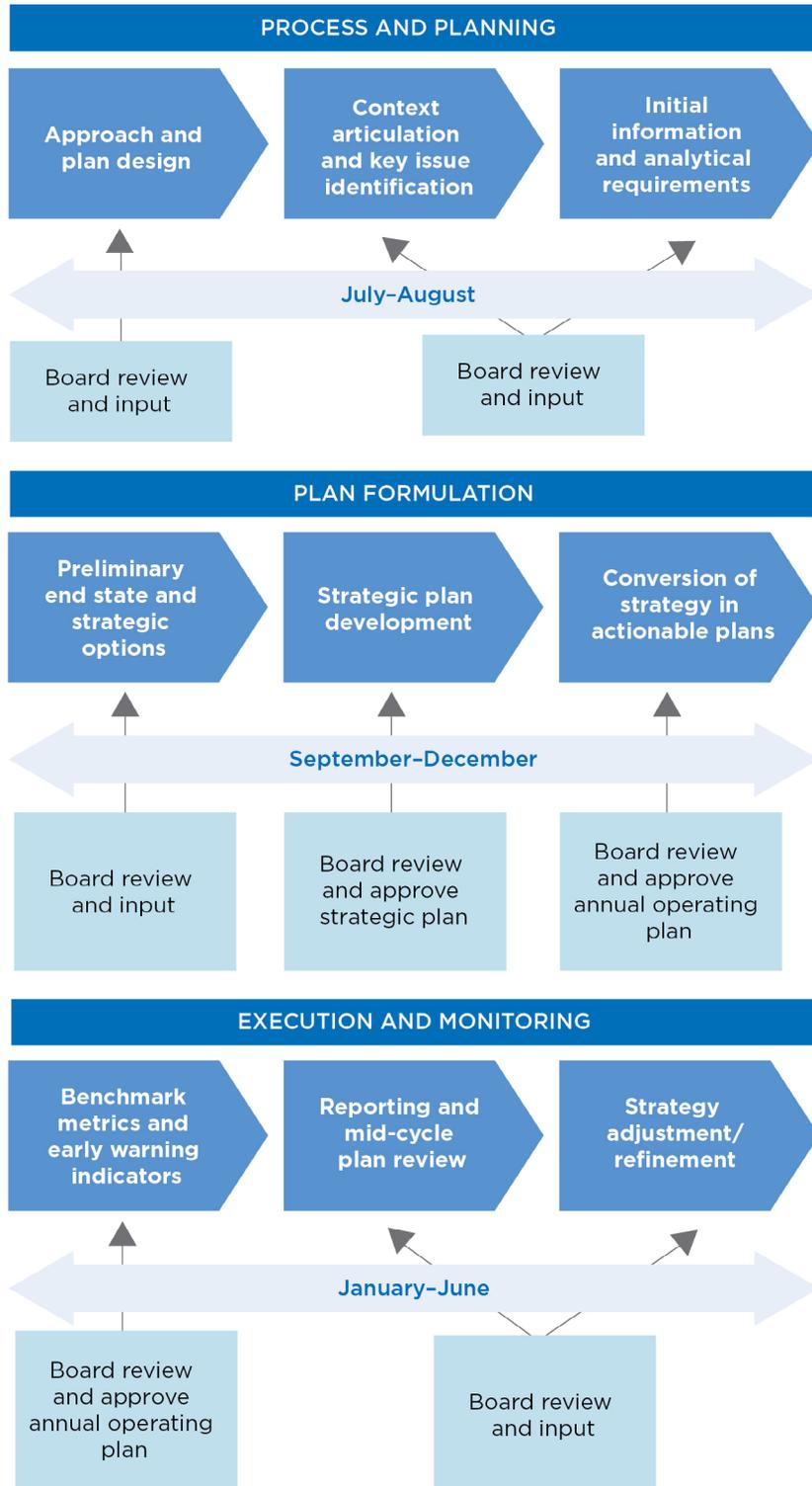
- Planning cycle (page 9)
 - The planning process (page 10)
 - Format and content (page 14)
 - Staying informed (page 15)
-

Since there are no standards for strategic plan design, results vary widely. Without director involvement at the outset, management has no independent parameters for determining the approach to the strategic plan and requirements (including format and content) and the result may be a plan that does not meet the expectations of the board or the needs of the enterprise.

The board should not dictate a favoured approach. Planning can vary from one organization to another depending on many factors, including the nature of the industry, competitive and external environments, positioning, goals, capital commitment periods and how far into the future the organization is able to project. The board should engage with management to be sure the approach is suitable and to resolve issues early.

Planning Cycle

For organizations with a December 31 year-end, the typical planning cycle and board involvement would be along these lines:



The Planning Process

There are many effective approaches to strategic planning, some proprietary and some available from consultants.

The best approaches share 12 characteristics:

1—Future-oriented

The context and goals should be considered early. In public companies, management is under continuous pressure from capital markets to improve short-term financial performance. It is important for the board to set a longer-term time horizon for objectives and related strategy.

2—Value driven

Long-term value creation should be the primary objective of the plan. This is essentially the value proposition to investors

An emerging best practice is to engage with major shareholders to better understand their expectations and hear their ideas. Whether you act on these ideas or not, *thinking* like an activist can stimulate the planning process by identifying sources of value you might not have considered otherwise. The rationale you develop for choosing whether to act on these ideas or not can form part of investor communications and activist defences.

3—Planning period fits the business

One of the important decisions early in the process is determining what the planning period should be. There is no simple “right” answer, because the appropriate planning period varies from organization to organization, but most strategic plans run three or five years.

The two most important factors to consider are visibility and length of commitments. In a highly dynamic external environment, it is very difficult for management and the board to accurately predict the future performance of the economy or of specific industries and competitors. Accordingly, a three-year planning horizon may be appropriate. But where enterprises have to make significant longer-term commitments, like major capital

The board has an important role to play in making sure the timeframe and goals for any strategic plan are sufficiently long-term. There is tremendous pressure from capital markets for short-term performance and shareholder return, and management performance goals and incentives are often aligned with shorter-term financial performance and share price. The board is responsible for the long-term interests of the enterprise and must encourage management to build the company on a sustainable platform for the future.

expenditures or long-term projects, a longer planning period is appropriate. In the extraction industry, for example, capital may be used for developing a project that could take at least five years. In that case, it is appropriate to think about a strategy (including financial projections) that spans the entire period so that potential risks and returns can be properly assessed.

4—Consider both internal and external factors

Some of the most sustainable competitive advantages are based on relevant, hard-to-replicate competencies. To execute a winning strategy, it is important to know what direction the industry and competitors are heading in, and what assets and skills should be developed and leveraged.

5—Appropriate level of focus and analysis

Executives tend to analyse what is available rather than what is important. For example, competitive analysis, while sometimes critical, is often light because it is hard to obtain. On the other hand, excessive analysis of unimportant issues can distract management and the board from higher quality thinking and focus.

6—External resources are used selectively

Where new issues or unfamiliar markets are being considered, input from an expert third party may be valuable. Engaging advisors to facilitate the strategic planning process can also be worthwhile, as long as management and the board don't abdicate their roles and their ownership of the strategy.

7—Include action plans

Many strategies fail to define what actions will be taken to execute the strategy, who is responsible and how results will be measured (metrics, milestones and accountability for key elements).

8—Include financial models

Well-considered action plans can be used to develop financial models of the strategy's outcomes. These models are much more valuable than the more typical extrapolations of past performance. They also make it easier to test a range of assumptions, forming a good basis for quantifying risks with sensitivity analyses.

9—Consider risk tolerance and appetite

Strategic risk is a critical exposure for any organization. Generally, strategic risk arises from selecting incomplete or faulty strategies, omission of critical strategies, failure to execute strategy in a timely manner or relying on invalid assumptions.

Boards should consider the risk tolerance and risk appetite of the enterprise. Both should be defined and quantified in the strategic plan.

Risk tolerance is the limit of risk the enterprise would be unwilling to exceed. It is generally expressed in financial terms, like debt limits or level of invested capital, however, it could also be defined by the level of resources, like people or infrastructure.

Risk tolerance is usually considered in the context of industry characteristics, the strength of the enterprise, its stability, performance and prospects, and the quality of risk management and mitigation, as well as investor expectations about risk and returns. An organization's risk tolerance may increase or decrease as conditions change.

Risk tolerance sets the *outside* boundaries for the strategy. The strategy must be designed so that those boundaries are never exceeded.

Risk appetite is the level of risk the enterprise is willing to accept to pursue its short and longer-term goals. It is also usually expressed in financial terms along with expected returns. The factors influencing risk appetite are usually the same as risk tolerance.

To illustrate risk tolerance and risk appetite, consider a corporation's acquisition strategy. Risk tolerance may be defined as limiting acquisition investments up to, for example, \$300 million (or 50% of its remaining debt capacity). Risk appetite may be defined in this context at \$125 million per transaction, as long as the expected return is at least 15%.

Directors may see their role in risk oversight as minimizing risk, moderating executive exuberance and preventing disasters. For most organizations, the most likely consequence of poor strategy is underperformance.

Even if a board is inclined to minimize risk, minimizing change is not the way to do it. The board must understand the strategic context and ensure sound strategies within the company's tolerance for risk, rather than its tolerance for change.

Risk only exists in the presence of uncertainty. Reducing uncertainty by choosing more conservative strategies can protect the downside, but may also limit the potential for better performance and returns.

Likewise, risks related to inaction are often ignored. In an ever-changing commercial environment characterized by globalization, industry restructuring, public policy and regulatory change, and new technologies, products and competitors, the status quo is rarely the safest choice.

10—Include risk analysis and stress testing

Uncertainty will remain, even with extensive analysis. Be sure to consider uncertainty from both sides: downside risks and upside opportunities. Implications should be quantified where possible. Certain strategies may need contingency plans and other strategic alternatives may need to be considered.

11—Involve an appropriate level of engagement

The collective knowledge and thinking of the organization is valuable in strategy development. Involvement also builds buy-in. However, more is not always better. Exhaustive company-wide planning exercises can consume valuable resources. And some aspects of strategy should be kept confidential.

Planning can be overdone. In some organizations, strategic planning has become a lengthy, exhaustive process that consumes valuable resources across the company year after year. The same frequency and depth of analysis may not be needed in every division and function every year. Boards should exercise some restraint in their planning demands and stay focused on the most critical issues.

12—Engage and involve the board early

The best strategy development processes engage board members and management at the outset. Directors should have the opportunity to articulate their expectations and concerns early so these matters are considered while the plan is being developed. The board should also have the opportunity to understand the issues and options, consider the risks, and provide constructive input before the strategy is finalized.

Achieving the right kind of engagement is a subtle task. If the strategy is presented as complete and ready for approval, the board may not be sufficiently engaged to gain real insight into the plan and related risks and it will be too late to influence the thinking that informed it. However, too much engagement dilutes management's responsibility and undermines its accountability.

A best practice is to engage directors early in the process. This early engagement may only involve selected directors that have insight into the sector or executive experience in strategy. For example, directors that have lived through multiple economic cycles in the same industry can often offer a valuable perspective on likely future economic scenarios and related issues to consider. Their perspectives will be more helpful if heard early. Having individual directors stress test the strategy and assess risk under different conditions can leverage their skills and strengthen implementation and contingency plans. This kind of engagement leverages the talents of directors without subjecting the entire strategy to wholesale revision.

Board members should give management input into strategy, however, the board as a whole must remain independent so it can assess strategy objectively.

Format and Content

Boards are frustrated when presented with strategic plans that are incomplete or uninspiring. How many times have boards been presented with plans that were the roll-up of departmental plans and forecasts rather than a top-down driven process and plan? Agreeing on a format and minimum expected content for the strategic plan at an early stage is incredibly valuable and important. (You can find an example of format and content for a strategic plan on pages 114 to 115.)

Management should send a draft outline of the strategic plan to the board for input. It should include a table of contents and an outline of each section, including the type of content that will be included. For example, the content description for a section called *Objectives* might be something like:

- Financial goals (revenue, earnings, cash flow, returns)
- Non-financial goals (including market share, entry into new markets, etc.)

You can find an example of an outline in Appendix 1.

Boards of directors receive the strategic plans they deserve. The board should clearly communicate its expectations before management begins to develop the strategic plan.

Staying Informed

Helping directors understand an industry and company well enough to add value to discussions about strategy and recognize strategic risks is an important task for management and the board. Sometimes directors are chosen for their industry knowledge, but typically few remain actively involved in the industries they are believed to be knowledgeable about. Some directors may have only been exposed to an industry through other directorships and have limited direct knowledge and experience.

Each director should be satisfied that he or she understands the company and its context well enough to play a responsible and constructive role in the strategic oversight process. Best practices include independent briefings about competitors and industry issues by analysts and consultants. Some boards also meet with key customers and vendors periodically, who provide a different perspective on the market, technology and competitive trends, as well as the enterprise's current situation and prospects.

Whether management (or the board agenda) provides educational briefings or not, directors have a responsibility to be informed and should not view management as the only source of information. A wealth of information about companies, products and industries is now publicly available. In addition to pre-reading materials and education opportunities, directors should use independent research and analysis to engage more constructively with management and fellow directors.

The importance of staying current on the company and its industry is underscored by situations that put directors on the front line, like a takeover or merger offer, the unexpected loss or removal of the CEO, or a crisis beyond management's experience or capacity. In an industry that is restructuring, for example, high-stakes M&A or sale decisions that require direct board involvement may need to be made. A board that is current on industry developments, understands the company's strategy, and has assessed the upside potential of the growth and sale options will be in a better position to take control of the situation and assess the best risk-adjusted value creation strategy.

A board that has kept current on the industry, has been engaged in strategy development, and has set each meeting and made each decision in the context of strategy will be in a much better position to make optimal decisions in critical situations.

1.2

Context and Key Issues

This section reviews

- Context (page 17)
 - Key issues (page 19)
-

Context

One of the most important issues to consider early is the context in which the strategy will be developed.

Many strategic analyses give lots of information about past performance and the current situation of the enterprise. But the future will be different as globalization, technological advances, regulatory changes and competitor dynamics will affect the market assessment and strategic and operational imperatives for most companies

Past, present and future contexts must all be considered.

Past

Past industry trends, market trajectories, and dynamics and influencing factors (including competitors) can help the board understand what might influence the market in the future, including whether market expectations, forecasts and any underlying assumptions are reasonable.

Re-examining past company performance and trend lines can also help the board assess how aggressive a proposed strategic plan is. For example, if growth in a market has been historically low, but the plan calls for rapid expansion, the board should be asking why. Similarly, the board should be skeptical if the business has negative performance trend lines, but the forecast in a plan shows “hockey stick” type projections.

The board should also consider management’s track record in achieving annual and longer-term targets, for obvious reasons.

Present

The present context should be analysed broadly and should include information about the macroeconomic and geopolitical environment, industry and customer-specific data and competitor information.

Depending on the size and the nature of the business, a macroeconomic and geopolitical environment analysis may or may not be critical. For smaller, domestic businesses, this type of analysis can be brief. For larger, multinational organizations (especially those operating in developing countries), the analysis should be more extensive.

Examining the industry in some detail is important. This involves looking at the size of the overall market and market segments, influencing factors, customers, the degree of competitor fragmentation, the basis of competition, the relative market shares of competitors, and competitor strategies and capabilities. Using the personal computer industry as an example, the overall market is very large and may show modest overall growth. But segmentation would show that while desktop product sales are continuing to decline, the mobile sector is growing. Factors influencing this trend might include changing technologies and product life cycles, consumer demand for greater mobility, etc. Customer information could be split between consumers and enterprise buyers, with emphasis on purchase criteria. The basis of competition in the personal computer industry would be technology (computing speed, battery life, weight and form factor), new product speed to market, price and unit cost, and marketing and distribution. Competitor analysis is critical. (You can read more about competitor analytics on page 27.)

Future

Strategic planning involves making assumptions about the future of the industry, markets, customers and competitors. But predicting the future is not simple or seldom accurate. The only certainty about the fast-paced commercial environment is that it will change—often unpredictably. It is useful for boards to

consider expected future performance and trends in the context of both the past and present and to use this information to make judgments about the reasonableness of their assumptions about the future.

The “what if” step at the end of the strategic planning process may reveal important potential changes, but may only lead to contingency plans when in fact the core strategy should be reconsidered. By considering possible future scenarios early in the planning process, the plan can present strategic choices in the context of the most likely future environment. Management and the board can then consider what competitors might do in the future and address that in the plan.

While the future cannot be predicted with any certainty, the board should expect to consider evidence of technology and regulatory change and market trends, and indicative competitive behaviour. A best practice is the use of different future scenarios – the likelihood and implications of each can be considered in developing strategy and analysing risk. In particular, competitive analysis and “war games” can reveal potential competitor actions that should be considered in the plan.

In industries like oil and gas or mining, assumptions about future commodity prices are both critical and unpredictable. Multi-scenario analytics are very important when this is the case.

Directors should be satisfied that the future context is plausible, well understood and forms an important basis for planning. This approach is more likely to lead to proactive strategies that take advantage of change. For example, some media companies participated in the development of tablet technology, while others developed contingency plans. Some mining companies anticipated and led global consolidation, while others prepared takeover defences.

Key Issues

A key issue list helps the board and management focus the strategy development discussion. The issue list might be along the lines of “what keeps us up at night”. It should not be limited to the external environment, markets or competitors.

In fact, many of the critical items are likely to be internal and could relate to such things as the competitiveness of capabilities, limitations around scale, sufficiency of capital, ownership, performance trends, organizational cultural integration, etc.

You can find examples of a contextual framework and key issues in Appendix 2.

Key issues lists help boards ensure important items are adequately considered in an enterprise's strategic plan. They also provide a valuable reference list for considering strategic risk.

1.3

Information and Analysis

This section reviews

- Markets (page 20)
 - Customers (page 22)
 - Critical success factors (page 24)
 - Self-assessment and competitor analysis (page 26)
-

Four kinds of preliminary information and analysis are needed to begin the strategic planning process:

- markets
- customers
- critical success factors
- self-assessment and competitor analysis.

High quality strategic plans are fact-based. Yet many plans tend to rely on anecdotal and unreliable evidence, particularly related to competitors and assessing the relative strengths and competitive advantages of the enterprise.

Markets

Overall Market Size and Trajectory

Market size should be expressed in both dollars and units (or another relevant measure). The market's past and projected future size should include cumulative average growth rates (CAGR), underlying assumptions and explicit reasons for any changes in market trajectory.

Addressable Markets

Understanding the size and trajectory of the market that can realistically be addressed is important. It identifies the real market opportunity for the enterprise, given its products and services, capabilities and geographic reach. The addressable market may have different characteristics and dynamics than the total market.

By definition, the difference between the total and addressable markets is the “un-addressable” market. It is always helpful for the board to understand why the enterprise chooses not to play in those segments. Sometimes there are attractive segments that may be accessed through alliances, joint ventures or acquisition.

Market Segmentation

Segmentation of the addressable market can be across multiple dimensions for example, by customers, products, industrial subsectors or geography. These segmentations are not mutually exclusive. It may be valuable to examine segments across all four dimensions. Using the personal computer industry as an example, it might be appropriate to develop market data for each geographic segment, showing consumer and major industrial enterprise sectors (such as financial, manufacturing, government), split between desktops, laptops and mobile devices.

Influencing Factors

Directors should understand what factors affect overall market behaviour by order of importance and a realistic range of impact for each factor. Influencing factors could be macro-level as well as industry-specific. In the automotive industry, for example, the overall market could be affected by the global economy, interest rates and oil prices. The market could also be heavily influenced by changes in automobile regulations, such as those related to emissions or fuel economy standards, and by shifts in consumer preferences.

The market trajectory review should include understanding market forces at play. For example, is the market undergoing fundamental structural change or normal cyclical change?

Typically assumptions must be made when assessing the potential effect of influencing factors. These assumptions should be clearly stated so they can be stress-tested later in the process.

Barriers to Entry

Barriers to entry to the industry should be articulated. Typical barriers might include economies of scale, capital intensity, intellectual property, strong brand identity, permits and licensing and high buyer switching costs.

There should be heightened awareness if new entrants are expected, or if a competitor launches a disruptive strategy that could alter the competitive playing field, regardless of the competitor's size.

Customers

For businesses with many customers, like consumer products and retail businesses, customer data and market segmentation are usually similar — broken into segments by characteristics like age, gender, geography, household income and education. For most other businesses, current and prospective customers are either known or can be identified easily.

Many companies take pride claiming to be customer-centric. Their strategic plans provide no shortage of detailed market information, but fail to identify a single customer by name.

Categories

It is helpful to categorize current customer information by relevant classifications like size, geography, industry segments, product purchases, etc.

Profitability

Analysing customer profitability can be insightful. Rank ordering of customers by revenue, gross profit, gross margin and absolute operating profit, and operating profit as a percentage of revenue, often yields surprising information.

For example, 80% of the revenue for a business often comes from 20% of its customers, but that same 20% typically accounts for a much lower percentage of gross profit and operating profit. Gross margin analysis may show that larger customers have greater influence and buying power, resulting in lower margins. After applying direct sales and allocated marketing expenses, those larger customer margins may shrink even more. Conversely, smaller customers can make up a smaller percentage of revenue but be highly profitable. Ironically, smaller profitable customers are often largely ignored.

Share of Wallet

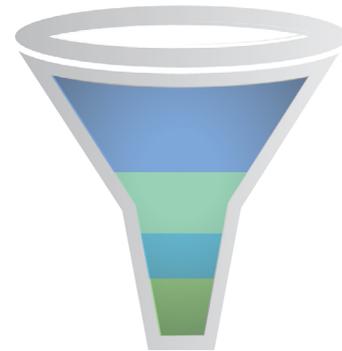
Understanding the amount of business done with major customers in relation to the customer's total spend (known as *share of wallet*) can identify opportunities for further penetration or potential risk. Importantly, share of wallet trends can show either progress in customer penetration, or exposures if the trend lines are negative.

Backlog

If businesses have customer contracts that span several quarters or more, backlog data can help them understand future revenue trends. Backlog information should include sales information by customer and estimated profitability.

Prospective Customers

There are several useful ways to display prospective customer information. One is the customer funnel analysis (see right), which identifies a list of known prospective customers and the current progression in the sales process. Trends in prospective customer conversion rates can be particularly insightful for showing whether lead generation, qualification and closing sales are working effectively.



It is helpful to analyse annual revenue between repeat business with existing customers and new customers, and win/loss data (including trend lines) on prospective customers conversions.

Customer Purchase Criteria

The most critical information is what criteria customers use to select the products and services they need. It is surprising how many enterprises rely on anecdotal or superficial information about buying criteria rather than using a systematic, fact-based approach.

The most reliable method to understand customer purchase criteria is to ask. Customer interviews, conducted in person or by telephone, by a qualified, independent firm, is the most effective approach.

Interviewers may choose to contact more than one individual at each customer. For example, it might be helpful to receive input from both users and procurement staff.

There are two ways to conduct interviews. The first is to openly disclose the enterprise and the reasons for the interview, making it fully transparent and usually easier to set up interviews with key customer contacts. The other is to frame the process as an industry-wide survey, without naming the business, and tends to provide more objective data.

The foundation of a go-to-market strategy is determining how to serve target customers better than anyone else. Yet, strategic plans often fall far short of understanding who their target customers are and what they actually want.

It is also possible to use both approaches—the first for current customers and the second for discussions with competitors and former customers. Input from former and competitor customers can provide insightful and objective information about the product or service value proposition of the enterprise and the effectiveness of its sales and marketing initiatives. It also can help the enterprise better understand broader competitor strategy and customer satisfaction.

Key questions about purchase criteria can be prompted or unprompted. Unprompted questions tend to be open-ended, while prompted questions provide a list of criteria for interviewees to rank the importance of.

Customer Satisfaction

A secondary benefit of customer surveys is assessing customer satisfaction (quantitatively and qualitatively) and gaining comparable competitor data. Surveying current, former and competitor customers on overall levels of satisfaction and satisfaction related to specific purchase criteria can be valuable, particularly if done periodically to discern trend information.

“A satisfied customer is the best business strategy of all.” — Michael LeBoeuf, author, former professor of management, University of New Orleans

Critical Success Factors

Critical success factors in an industry are the fundamental activities or processes a firm must excel at to outperform the competition and deliver superior results.

For most industries, there are usually no more than eight to 10 factors, and they should be considered in an industry context rather than at the enterprise level.

The fundamental question to answer is: “If a firm was considering entering this sector, what would it have to do better than its competitors to be successful?”

This is not a question of capabilities or resources (we will address those later in this document)—it is about how an enterprise must perform to be the most successful relative to the competition.

Delivering on the most critical success factors in the industry is the cornerstone of competitive strategy. Being able to execute on those factors better than competitors is derived from competitive advantage including competencies and resources.

In the personal computer industry, for example, some key success factors might include:

- continuously developing and using new technologies to maintain a steady stream of new products at varying price points that anticipate the future needs of customers
- building strong brand recognition and retailer relationships
- achieving a low cost position
- creating effective distribution channels.

The follow-up question is: “If we were to do all these things better than any other firm, would we be the most successful in this industry?” If the answer to that question is no or uncertain, your list is incomplete.

The Effectiveness of Strategy Against the Critical Success Factors

Often a combination of objective data and judgment determines the effectiveness of a strategy.

At the risk of oversimplification, using a sample grid like the one set out below can be very insightful.

With a complete list of critical success factors, the board should look at how management’s strategies meet each factor and a comprehensive assessment of how they compare to competitors’ strategies and the underlying reasons why the leading competitor outperforms the others.

Critical success factor	Enterprise	Competitor A	Competitor B
Develop and launch new innovative products on a high frequency cycle	Over the past three years, launched seven new products, capturing 7% of the market with an average gross margin of 23%	Over the past three years, launched 14 new products, capturing 17% of the market with estimated average gross margin of 32%	Over the past three years, launched five new products, capturing 3% of the market with an estimated average gross margin of 18%

Assessment

Competitor A has achieved the most success in launching successful new products over the past three years. It uses a product development model geared to a new product (or existing product enhancement) launch each quarter. It has a scale advantage through its development group consisting of 74 staff located in three global sites at an estimated annual cost of \$7 million.

Our company has also been successful in launching new products but has been unable to match Competitor A's drumbeat of new products due to limited resources (staff of 39 and overall cost of \$4.7 million) and two product launches that did not meet projected revenue and margins.

Competitor B is a much smaller player with limited scale and resources and tends to be a follower.

Self-assessment and Competitor Analysis

Objectivity is the key to self-assessment and competitor analysis. This is inherently difficult for management because they are often (and appropriately) focused on the positive in communications with employees, customers and the markets, and regard competitors as the enemy to be defeated, not emulated.

Self-assessment and competitor analysis should be about objectively evaluating competitive advantages and disadvantages—other perceived strengths and weakness might be nice to know, but in the end may not be relevant to strategy.

To ensure objectivity, boards should be satisfied that assessments are fact-based and, in particular, consider any available external assessments, such as industry reports and analyst reports on the company and its competitors. In private companies and public companies with institutional shareholders or activist investors, investors can sometimes provide valuable analysis and outside perspectives.

Almost unfailingly, strategic plans provide superficial self-assessment and competitive information. Most are in the form of so-called SWOT (strengths, weaknesses, opportunities and threats) analysis. Such analysis can have serious limitations. For example, SWOT analysis may not get at the heart of strategy because it may not comprehensively address how the enterprise stacks up against the competition on the industry's key success factors. This type

of information is often biased and lacks an objective factual base. So-called strengths and weaknesses are often less relevant to the success of the enterprise and therefore may not address the heart of strategy.

Competitive advantage can be achieved in several ways—through a unique strategy, by positioning and by the depth and quality of competencies and assets. An example of a unique strategy would be to develop and launch new innovative products on a cycle that is far shorter and more frequent than the competitors. Competitive advantage through positioning may be achieved through scale and related economics by becoming the largest player in the sector. Having superior competencies in critical areas such as product development, sales and marketing can make the enterprise highly competitive. Extensive patents or low cost manufacturing sites are examples of advantage through asset ownership.

Enterprise self-assessment and competitor analysis should be across the following dimensions:

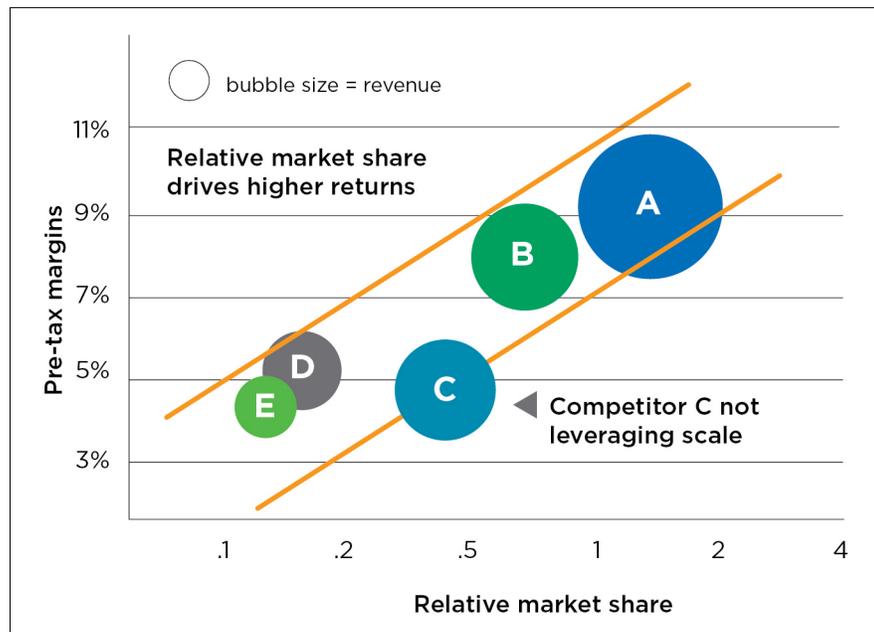
- the effectiveness of strategy against the critical success factors
- positioning
- competencies
- assets
- financial position and available capital
- competitive disadvantages.

Self-assessment and competitor analysis should be about objectively evaluating competitive advantages and disadvantages—other perceived strengths and weakness might be nice to know, but in the end may not be relevant to strategy.

Positioning

In most industries, scale can create a competitive advantage that ought to drive higher profitability. The analytics should include absolute and relative market share as well as estimated profitability in absolute terms and as a percentage of revenue. Relative market share measures the size of an enterprise relative to its peers. For example, say the enterprise has a 30% share of the market and two of its competitors have 60% and 10% respectively. In this case, the enterprise would have a relative market share of 0.5x (30% divided by 60%) of the largest player and a relative market share of 3x (30% divided by 10%), compared to the smallest competitor.

The chart below correlates relative market share and profitability. It would appear scale drives higher profitability and Competitor C is underperforming relative to its scale advantage.



Competencies

Capabilities and competencies are often used interchangeably.

Capabilities refer to the capacity to do things—the acquisition of skills to complete tasks. *Competencies* refer to the degree of skills gained through knowledge and experience, and the positive effect of behaviour and attitude in determining how well things can be done.

Assessing capabilities or competencies is often subjective and can be biased. Statements like “we have the highest quality marketing staff in the industry” routinely show up in strategic plans. Such assertions beg these questions: “How do we know?” and “If that is the case, why are we number three in the industry by size and growing no faster than the two larger players?”

Keep four things in mind when assessing the competencies of the enterprise and the competition:

1. **Competencies should be tied to key success factors.** The focus should only be on capabilities that matter strategically.
2. **Competencies are most often correlated to performance.** In the extreme, it is highly unlikely for the competitor with the greatest competencies to lag the performance of other players. So when strategic plans assert that the enterprise has the greatest competency in a certain area, it should be backed up factually by relative historical performance.
3. **Look for factual data to support assertions.**
4. **Management may overstate competitor competencies because of their organization’s underperformance or to justify the need for more resources.** Conversely, sometimes competitor competencies may be understated as a result of arrogance or ignorance.

Assets

The assessment should cover both tangible and intangible assets.

For capital-intensive industries, physical assets can be a source of competitive advantage. Assessing fixed assets involves understanding the level of investment and replacement value, quality of assets, their location and strategic value. For example, strategic value may be derived from a highly efficient factory. In capital-intensive industries the sheer volume of physical assets and the capital required to acquire such assets can pose a competitive advantage and a strong barrier to entry.

Intangible assets typically include patents, copyrights, know how and other forms of intellectual property as well as reputation. The assessment of intangible assets also examines strategic value, level of investment and asset quality.

The value of reputation should not be underestimated. Assessing competitor reputation should not be subjective. The best source is commentary provided by stakeholders — current, former and competitor customers, suppliers, and former employees.

Financial Position

Assessing financial position contemplates the strength of the balance sheet and usually relates to the level and nature of indebtedness (including repayment terms) compared to shareholders' equity. It should also examine historical and projected cash generation. It is also beneficial to understand the ability of the enterprise—and its competitor—to access further capital such as unused lines of credit, sale of non-strategic assets and the potential to raise debt and equity from external sources.

Competitive Disadvantages

Competitive disadvantages are vulnerabilities and conditions that expose the enterprise to adverse consequences. These weaknesses may relate to gaps in strategy (such as being a high cost producer), insufficient capital, aging assets, an over-leveraged balance sheet, poor reputation and limited capabilities. These vulnerabilities are true competitive disadvantages and should relate to the critical success factors and required resources.

With a thorough understanding of the universe of competitive disadvantages for the enterprise and its competitors, the strategy must be designed to overcome or minimize the potential impact on the enterprise while exploiting competitors' weaknesses. A simple example: the enterprise has a product or service cost disadvantage but a reputation for building superior quality products and services. The strategy would avoid competing in price sensitive categories and focusing on high quality, premium products that command higher prices.

A hand is pointing towards a network diagram consisting of interconnected circles and lines. The background is a blurred office scene with a computer monitor and keyboard. The entire image has a blue tint.

PHASE 2

Strategy Formulation

PHASE 2

Strategy Formulation

To a degree, plan formulation is an iterative process. It starts with setting out the desired end state of the enterprise — what the enterprise should look like at the end of the planning period. To achieve this end state may involve considering several alternative strategic options, including organic and inorganic strategies for growth. Once those options have been considered and prioritized, a comprehensive strategic plan can be developed. Once developed, it may be necessary to revisit the plan's objectives, strategies and expected results to determine if the initial end state is considered achievable and within the enterprise's risk tolerance or if it requires modification.

Directors should focus on three areas during this process:

1. Preliminary end state and strategic alternatives

This stage starts with setting out the desired end state of the enterprise — what the enterprise should look like at the end of the planning period. This may involve considering several alternative strategic options, including organic and inorganic strategies for growth.

Boards should assess the proposed characteristics of the preliminary end state: Will it create shareholder value within acceptable risk parameters? Have all viable strategic alternatives been identified?

2. Refining the strategic options

Directors should be satisfied that strategic options have been fully developed and prioritized, and less viable options eliminated.

3. Developing the strategic plan

Once those options have been considered and prioritized, a comprehensive strategic plan can be developed.

Directors should be heavily engaged in reviewing the strategy and not tolerate an incomplete, unrealistically ambitious or unconvincing plan.

OVERVIEW

2.1 Preliminary End State and Strategic Alternatives

Considerations	Management's Role	Board's Role
Establishing a framework	Develop preliminary end state description and preliminary strategic options	Review and input
Preliminary end state		

2.2 Refining Strategic Options

Considerations	Management's Role	Board's Role
Competing	Develop more detailed strategies	Review and input
Review of preliminary end state and strategic options	Develop more detailed strategies	Review and input
Mergers and acquisitions	Develop strategic rationale, screening criteria and candidate search and target selection	Review of process and input
Multi-business companies	Examine options for each entity of a material size	Review and input
Strategic risk	Assess risk	Review and input

2.3 Developing the Strategic Plan

Considerations	Management's Role	Board's Role
Structure	Draft final plan for board review and approval	Review, input and approval
End state		
Objective		
Context		
Strategies		
Resource strategies		
Forecasts and financial modelling		
Strategic initiatives		

2.1

Preliminary End State and Strategic Alternatives

This section reviews

- Establishing a framework (page 35)
 - Preliminary end state (page 37)
-

Establishing a framework

The customary framework for a strategic plan begins with a vision statement, outlines the enterprise's mission, core values, goals, objectives, strategies and ends with tactical plans.

Much has been written and debated in the boardroom about the importance and value of statements of vision, mission, core values and goals. Many strategic plans start with articulating those four basic concepts.



Vision statements

Vision statements are designed to provide a picture of the “preferred future,” a statement that describes how the future will look if the organization achieves its ultimate aims. These statements tend to be very broad and often lofty and aspirational. This is Amazon’s vision statement: “Our vision is to be earth’s most customer-centric company; to build a place where people can come to find and discover anything they might want to buy online.”

Mission statements

Mission statements usually provide a sense of the reason for being—what we do, how do we do it and for whom? This is Starbucks’: “Our mission is to inspire and nurture the human spirit one person, one cup and one neighbourhood at a time.”

Core values

Core values are the principles and ideals that bind the organization together including the customers, employees, vendors and other stakeholders. They are developed to frame an ethical context for the organization, and to many they are the “ethical standards” of the organization—the foundation for decision-making. Whole Foods has the following core values: “Selling the highest quality natural and organic products available; satisfying and delighting our customers; supporting team member excellence and happiness; creating wealth through profits and growth; caring about our communities and our environment; creating ongoing win-win partnerships with our suppliers; promoting the health of our stakeholders through healthy eating education.”

Goals and objectives

Goals are general statements of what an enterprise wants to achieve. Typically, they are integrated with the vision and mission. Walmart describes its primary goal as “Becoming an international brand”.

Well articulated vision, mission, core values and goals can be helpful in framing the context for detailed strategic planning. These statements are usually so aspirational that they provide very limited direction and are not actionable.

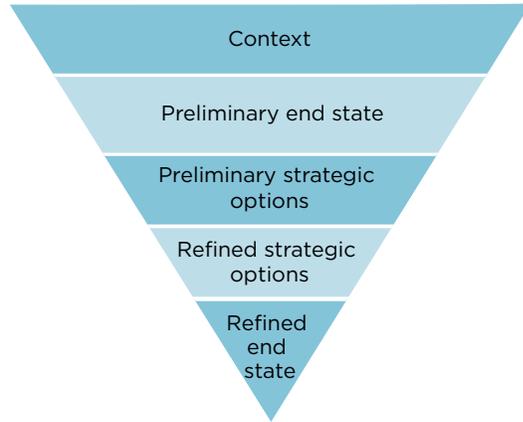
At the risk of being controversial, we are ambivalent about whether or not the strategic plan includes vision, mission and core value statements or a list of goals.

But we are adamant that the plan start with a clear description of the planned end state—a tangible and realistic view of what the enterprise should look like in the future rather than aspirational or vague statements.

End state model

The model below is designed to address five basic questions:

1. In what context is the enterprise likely to be operating during the planning period (see Phase 1)?
2. What should the enterprise look like at the end of the planning period (preliminary end state)?
3. What are our alternatives to achieve the end state (strategic options)?
4. Of those strategic options, which are the most preferred in terms of effectiveness and risk?
5. Given the preferred options, is it necessary to refine the desired end state?



Preliminary End State

At a minimum, the end state description should cover the following:

End state description

Size (estimated revenue)	Organization
Position within the industry	Expected profitability and financial position
Businesses/divisions	Ownership
Key product and service lines	Implicit returns to shareholders
Geographic footprint	

The concept of the framework graphic on page 38 is to develop a preliminary view of the future end state compared to the current position. The difference between the two effectively becomes the objectives.

The differences between the end state and the current position in effect become the objectives – quantitative and qualitative. Strategies are then to be developed to achieve the objectives with implementation through defined initiatives and action plans.

We purposely describe this step as developing a *preliminary* end state description because effective strategy development is iterative. That is, having articulated a desired end state, can strategies be developed that will deliver those results within the timeframe and within risk tolerance levels? Many organizations find that as they work through the strategies to achieve the end state targets, the required strategies are too aggressive or involve too much risk. The end state and related targets must then be revised.

Seldom does the preliminary end state description represent an extrapolation of the current position and performance—nor should it. Effective strategic planning should involve reassessing the status quo and developing realistic opportunities for expansion and improved returns.

2.2

Refining Strategic Options

This section reviews

- Competing (page 39)
 - Review of preliminary end state and strategic options (page 42)
 - Mergers and acquisitions (page 44)
 - Multi-business companies (page 49)
 - Strategic risk (page 51)
-

Competing

In Phase 1, management and the board have reviewed and discussed the context for strategy, including the key issues of the enterprise and analyses of the industry, markets, customers and competitors as well as a self- assessment. Having articulated a preliminary end state description, it is now time to examine strategic options—all designed to achieve the end state within the planning period.

Strategic options generally include:

- continuing with the current business and strategies
- altering strategies for the current business
- entering new markets or lines of business
- exiting current markets or lines of business
- reallocation of resources among product or business lines.

There are three things to keep in mind when developing strategic options:

- Where to compete— which markets are attractive?
- Why the enterprise can be successful— what are its competitive advantages?
- How to compete— how to leverage advantages and allocate resources?

Those three questions should be considered both where the enterprise currently competes and where it intends to compete. We will draw the distinction between the two as we examine each question.

Where to Compete

Determining where to compete involves assessing market attractiveness in terms of:

- Which markets including specific market segments?
- Where in the value chain?
- Which geographies?

The *where to compete* analysis should identify attractive markets likely broken down by segment and geography, and those currently served, as well as adjacent markets that could be of interest to enter.

Determining which markets are attractive involves an understanding of each market's overall size, trajectory, market segmentation, addressable market segments as well as influencing factors, barriers to entry and competition. For example, as the pulp and paper industry consolidated, first nationally then internationally, some companies worked to achieve a low-cost position in commodity paper markets (for example, Abitibi-Price, now Abitibi Bowater). Others selected niche specialty paper market segments where they could leverage unique competencies and retain high margins (for example, Appleton Papers). The risks in each case were different: the high-volume commodity players would be exposed to continued price-based competition in cyclical markets; the niche players were betting that lower-cost players could not match their quality and that their customers would continue to demand that quality.

The assessment of which part of the value chain within the market is the most attractive involves understanding the market size and profit pools in each sector. IBM chose to exit the personal computer market and instead further invested in developing downstream software and services. The strategy reduced IBM's exposure to low-cost competitors and limited margin potential, and recognized the value of IBM's customer insights and relationships for extending software licensing and services.

Because market characteristics vary by geographical segment, the analysis of market attractiveness must include geographic considerations. CN chose to develop a North American railway and believed it could compete on a North

American scale as a superior scheduled freight railway. The scheduled railway had not been tried on a large scale in freight before, but, on the upside, the move opened large growth potential. As another example, McCain Foods chose to enter India to be on the ground floor of a developing food processing industry.

Can we Compete?

After determining which markets appear to be attractive including those currently served, the next stage involves determining if the enterprise is able to compete successfully. This can be achieved by assessing the potential competitive advantage—unique strategy, positioning or depth and quality of capabilities and assets as described on pages 27 to 31. This work should have already been completed in Phase 1 for markets currently served. The preliminary outcome should be a confirmation of market attractiveness and an assessment of the potential for competitive advantage. Should these markets continue to be aggressively pursued, harvested or potentially exited? Note that the final determination of pursuing current markets should be made after the analysis of how to compete (including planned changes going forward) and after considering alternatives.

Understanding new or adjacent markets generally requires extensive analysis since there is limited in-house knowledge and experience.

Directors should expect to see an analysis that answers the following questions:

- What are the critical success factors for this market (see pages 25 to 27)?
- How fragmented is the market? What is the market share of each of the major players?
- How does each competitor stack up in terms of execution of strategy against the critical success factors (define their competitive advantages)?
- How important is scale?
- What are the barriers to entry, ranked by order of importance?
- What competitive advantages do we currently have? What additional advantages do we need to develop or acquire?
- Are there disruptive opportunities to gain traction in this market?
- What resources are required in order to become a major player in this market?

How to Compete

After determining which markets are attractive and those where there appears to be an opportunity to compete, the next question is *how* to compete.

This step is about defining specific strategies. As the enterprise already has strategies in its current markets, the discussion should focus first on understanding how the strategy has worked in the past and if changes in the market could alter the basis of competition in the future. If those strategies have not achieved the desired objectives, is it a question of a flawed strategy or is it an issue of execution? If the strategy has been effective, is there a need for change given market and competitive dynamics? Would the acquisition of a competitor accelerate growth and enhance competitive advantage through scale, breadth of products and services, improve cost competitiveness or other means?

For new or adjacent markets, the initial focus should be on market entry strategies. Does the enterprise possess the competencies and resources to build competitive advantage to pursue an organic growth strategy or is it necessary to make an acquisition?

At this point, detailed strategies may not be fully fleshed out. In fact, for new market opportunities, it is likely that there may only be some preliminary thoughts around how to compete.

Review of Preliminary End State and Strategic Options

At this stage, management should present its initial description of the desired end state and strategic alternatives to the board for its review and input. Strategic options would include participating in current markets and new opportunities. If there are multiple options, it is worthwhile to include the criteria for ranking the options by degree of attractiveness and risk. These criteria would mirror the questions raised earlier in this phase.

Criteria for assessing strategic options

Market	Self-assessment
Market size and overall profit pool	Position in the market
Degree of fragmentation	Degree of competitive advantage
Entry barriers	Degree of strategic risk (see page 54)
Relative strength of competitors	Resource availability
Resource requirements	Degree of risk

No board approvals are required at this relatively early stage. However, there should be extensive dialogue between management and the board about the preliminary look at the desired end state and strategic options.

Directors should consider these questions:

- Does the end state look realistic or is it aspirational?
- If the end state is achieved, what are the expected returns to shareholders? Is this sufficient?
- Are the strategic options complete? Are they ambitious enough? Are there other alternatives that should be considered?
- Are the analytics complete or is there more work to be done?
- Is there agreement on the assessment criteria and rank ordering of the strategic options?
- Which options should be further refined? Which should be eliminated?
- If multiple options are being considered, does the enterprise have sufficient resources including organizational bandwidth to simultaneously pursue these alternatives?

The outcome of the discussion between management and the board should identify any changes to the end state and general agreement on which strategic options should be further refined, with the understanding that that the strategy development process is still iterative and the end state and strategic options may be altered as the strategy is further developed.

This is a good point in the process to ask: “What would an activist investor do?” As noted earlier, today’s activist investors are not all simply focused only on short-term value realizations such as through asset sales, cost cutting and refinancing. Their external, value-driven mindset can lead to consideration of more aggressive strategic options, such as M&A or portfolio rationalization. This is not to say the company should do what the activist prescribes, but by considering this perspective, the company may put new options on the table that warrant further analysis in the next phase.

Refining the Strategic Options

Inevitably, following the review of the preliminary end state and strategic options, further refinement and deeper analysis is required for the shorter list of strategic alternatives.

For the markets currently served, the degree of refinement is likely to be relatively light. For new markets (or market segments), the refinement process may be much more extensive. If the planned entry into new markets is through an organic model, then the focus is likely to be on precisely how to compete. It will likely involve a deeper look at such areas as product and service development, marketing and sales, and resource requirements including capital investment.

Mergers and Acquisitions

Mergers and acquisitions can play an important role in strategies for expansion within current markets and entry into new markets. This is the stage in the process to consider the role of M&A, if any.

Again, this draws on a forward-looking analysis of the industry context. Are any of the industries in which the company operates or wish to enter likely to restructure? What is driving the restructuring? Are there first mover alternatives to gain scale and scope? Is there an opportunity for step-function increase in scale?

Different and equally compelling forces are driving changes in industry structure in manufacturing, retailing, resources, transportation, health care and pharmaceuticals. Virtually every sector is affected by changes in global markets, technology, demographics, and regulation at home and abroad.

Industries can restructure in a variety of ways. The most familiar is consolidation through the merger of like companies within a market. Industries may also restructure along the value chain. This can occur by vertical integration—for example, the oil industry is largely integrated from oil exploration to gasoline retailing. Value chain restructuring can also occur by disaggregation. For example, the natural gas industry has separated into producers, pipelines, utilities and retailers.

Understanding what is driving the restructuring is important, as the underlying reasons highlight the skills and competitive position required to succeed. For example, the US financial services consolidation was prompted by the repeal of

interstate banking restrictions, but it is driven by economies of scale and scope in the products and distribution channels supported by technology — economies now available to large Canadian banks.

In the energy sector, emerging public policy in many jurisdictions is driving a shift in demand toward renewable resources. Smaller operators are producing run-of-river hydro, wind and solar power, fragmenting the network of suppliers in an industry once highly concentrated and fully integrated.

In media and telecommunications, the long-anticipated convergence and the shift from print to digital media is now driving industry restructuring. The shift to digital has also accelerated the globalization of this industry, which was once protected in many countries, including Canada. Regulation is changing to allow foreign ownership and the formation of global communications companies.

Such forces can change the future context for competitors by changing the scale, scope and skills required to compete. While most companies will eventually have to react to these changes, those that anticipate changes will be in a better position. A best practice is to consider what might happen early in the restructuring or, ideally, before the trend begins. The board needs to understand why and how the industry may restructure in order to assess the company's strategy in that context. Fewer strategy options will be available the longer the company waits.

In restructuring industries, the companies that do not acquire early will often become targets (such as INCO and Molson). While sale premiums can be attractive, boards should also consider the value created by those that lead such restructurings (such as Xstrata and Inbev Brewing, respectively). To protect the company's long-term interests, directors need ensure the company anticipates such developments or they may eventually face a sale with few options.

Anticipating how an industry will develop requires a long view on the industry and the company's development. The companies that lead industry restructurings start early, build skills and financial capacity, and establish a track record of deal success. Those that wait may be presented with an offer to purchase including a premium for the stock that would be attractive to shareholders. In the absence of a compelling growth plan of its own, a board that is presented with such an offer has little option but to auction the company.

A plan to sell the company to consolidators can be a legitimate and even the optimal choice in a restructuring industry. Again, understanding why and how an industry may restructure can lead to strategies that position the company as an attractive target to the most desirable partners and optimize the timing and value of the sale. Waiting too long can cost the company dearly, as in the case of Blackberry, so the board should be asking about sale or merger options long before it is necessary.

Assuming the board is not planning a divestiture, M&A strategy development in this stage is in three parts:

- determining where M&A fits in the overall strategy
- acquisition rationale and screening criteria
- candidate search and target selection.

Depending on how far the M&A strategy has advanced, the third step may not take place until the strategic plan has been developed.

Role of M&A

The role of M&A in the organization's strategy should be explicit. Having no M&A strategy is acceptable only if the company does not intend to seek acquisitions and does not expect to be targeted by others, either to buy or be bought—an unlikely scenario in most industries today.

Directors should be directly involved in assessing the role of M&A in the company's strategy early in the strategy development process. It is important to understand precisely how M&A fits into overall strategy, and the specific rationale for making an acquisition, long before candidates are identified.

This includes assessing:

- the need to acquire, divest or sell
- how M&A alternatives align with the company's end state to enhance its competitive advantage
- management's capacity and ability to execute an M&A strategy.

Acquisition Rationale and Screening Criteria

There should be a clear rationale for making an acquisition:

- Why is the enterprise pursuing an acquisition?
- How does it fit with and complement the current organic strategy?
- What are the expected minimum risk-adjusted returns?
- What will the end state look like and what competitive advantages will be gained, assuming the acquisition is executed successfully?

There are four broad sources of value in M&A:

- Cost synergies—the benefits of increased scale in operations and administrative functions (common in industry consolidations)
- Revenue growth—when the combination offers revenue synergies, like access to new markets, new products or new channels for existing products
- Strategic value—when the combination creates a better positioning or better platform for future growth
- Other sources of value from change of ownership—creating value by changing the financial structure of a business or the way it is managed.

Each should enhance competitiveness and drive shareholder value. Many transactions offer a combination of all four sources of value, but it is useful to examine each separately because they present different challenges and risks and require different skills for success.

Once the company has clearly articulated its M&A acquisition rationale, it should develop a comprehensive list of acquisition criteria, ranked in order of importance.

The rationale should clearly state what gaps the M&A strategy is intended to fill, how value is to be created, and what the company's M&A risk tolerance is.

Screening criteria will vary, but should always relate to the buyer's M&A strategy and how it plans to create value. Well-delineated criteria concentrate the company's efforts on candidates that fit and avoid wasting time on those that do not.

Common categories include:

- size
- location
- valuation
- apparent synergies
- depth and quality of management
- uniqueness of products or services
- condition of tangible assets
- quality of intellectual property and other intangible assets
- nature and loyalty of the customer base
- history of profitability and cash generation
- level and structure of indebtedness.

Candidate Search and Target Selection

Once a company has defined its M&A strategy and determined its acquisition rationale and criteria, the next step is to compare and select possible acquisition targets or merger partners.

It is important to consider several different companies, even if one company seems like a perfect match for the company's strategy (or so good that it inspires a new strategy). At the very least, knowing the alternatives will help determine an appropriate price for the preferred target.

If there are only a few alternatives to the preferred candidate, they can all be considered in detail and even approached. More often, though, there will be many possible alternatives, including companies the buyer does not yet know, and companies that may not have considered a merger, sale or acquisition before.

The company should go through a proactive process to search beyond obvious and convenient targets to develop a rich universe of possibilities. The list should even include apparently disinterested targets or partners and, in prioritizing candidates, companies should consider factors that may influence candidate interest and the likelihood of completing a transaction.

An organization's M&A strategy, if executed effectively, should create value for shareholders. Determining how M&A is likely to create value also helps assess the potential opportunity and risks, and dictates the criteria for screening possible targets. Risks inherent in the strategy will guide the company's choice of targets or merger partners.

This, however, presents a dilemma: a strategic approach calls for proactively considering all of the available alternatives, since responding only to opportunities that walk in the door is not strategic. It usually is not practical, however, to analyse every alternative in enough detail to truly understand its value potential. Skilled third party advisors can be part of the answer to this problem.

Having deliberately expanded the search universe to consider a richer set of options, how can targets be screened without excessive analysis? The best way is to look at candidates in stages, analysing and making cuts at each stage.

Acquisition screening

Stage 1	Stage 2	Stage 3
Basic information is enough to build a profile of each company's products, markets, revenues, profitability, ownership, executives and directors. A smaller number of candidates can be selected for stage two analysis (typically 10 to 15).	Secondary research to analyse all available data to prioritize candidates and select (typically) up to five possible targets.	More detailed research to prepare the buyer for a possible approach. Considers two kinds of criteria in gathering and weighing information: how attractive the target is and how likely the transaction is to succeed.

Where to Learn More

Read more about oversight of M&A in CPA Canada's publication *Overseeing Mergers and Acquisitions – A Framework for Boards of Directors*.

Multi-business Companies

For enterprises in multiple diversified businesses, the preliminary end state model as shown on page 40 should be applied to each business. Initial information and analytical requirements, preliminary end state and strategic options should be developed for each entity, and the board's oversight role should be similar for each entity of a material size.

Separately, the board also has strategic oversight for the combined entity. In terms of strategy development, there are two primary considerations:

- How does the parent company add value to the portfolio? The intended role and required competencies of the parent should be aligned with the corporate strategy.
- What businesses should the enterprise own?

In one extreme, the company may hold a diversified portfolio of businesses that has little potential for integration. In such cases, the parent company, such as Berkshire-Hathaway, may act as investor only and choose not to intervene in the individual business (other than by exercising its fiduciary duties on any boards of its holdings including influencing leadership selection and potentially providing financing). In this case, the parent company's role essentially is to grow and allocate shareholder capital by buying and selling companies and by monitoring performance.

A diversified portfolio may also be held by a parent company that adds value through management skills. General Electric, for example, holds a diversified portfolio and adds value by training management and by sharing management skills, tools and disciplines (for example, Six Sigma).

At the other extreme are multi-business companies that are, or can be, highly integrated. In these cases, the parent company facilitates the sharing of resources and/or reforming the structures and relationships of the holdings. For example, the large media companies now use content across media and products. The various new structures created to develop and exploit digital media illustrate how the parent can add value through integration. These parent companies typically have competencies in the industry, and the parent's strategy is industry-specific and deeply related to the strategies of the holdings.

Between these extremes, the parent company can play a range of roles. The important point is that the strategy of the parent, the competencies required and the related risks are role-dependent. The board of the parent company should understand how the parent adds value.

Just as the board of a single business entity should understand the strategic goals at this point in the process, the board of a multi-business company needs to understand the desired end state of the parent company and strategic options. Those options are around an expected risk/return model to determine which assets to hold (and potentially further invest), those that are to be sold and new businesses to be acquired.

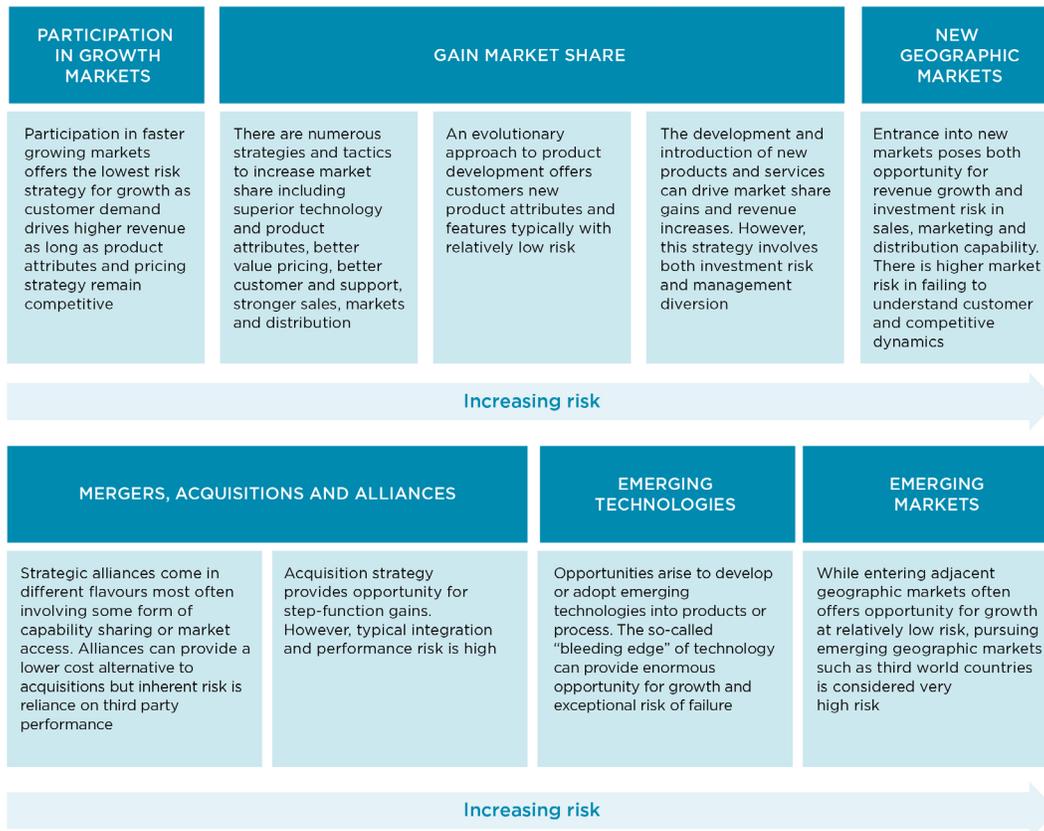
Any change in the parent company's role (for example, warranted by a change in context or an opportunity to create value in a different way) needs to be acknowledged so that the strategic risks can be properly considered. A change in role may also mean that different skills or resources are required of the parent.

The strategy process for diversified businesses can be top down or bottom up or, ideally, both. That is, the end state of the combined entity defined first can guide the strategic plans of the individual entities. However, the combined end state of the enterprise can also be informed by the individual business strategies. Defining the portfolio end state first allows the parent company to work through the types of assets it wishes to invest in including specific industry sectors without regard to the issues in current portfolio. This process can be liberating in the sense that the investment decisions are not encumbered by the current issues of each individual business. However, a bottom up approach usually works well as the individual businesses develop and present their preliminary end states and refined strategic options. Although no decisions need to be made at this stage, the parent company has the opportunity to initially assess its investments from a strategic perspective and then develop its own end state description that may or may not involve further investment or potential divestitures of businesses currently in the portfolio.

Strategic Risk

Strategic risk is any exposure associated with the development, omission or execution of an enterprise strategy designed to achieve specific objectives.

Common flaws include failure to develop a sustainable competitive advantage or superior customer value proposition, failure to overcome imbedded vulnerabilities, failure to implement strategy effectively, and overestimating the competitiveness of capabilities and resources.



When considering strategic options, it is helpful to understand risk in a ranking continuum. The model below can be used to assess risk related to strategies designed to grow revenue.

There are a multitude of other risks that can affect long-term performance. For example, underlying assumptions on the external environment like market performance, interest rates, the macroeconomy, etc. can vary, and they generally fall into an external risk category. Similarly, the capability to execute a plan depends on effective leadership and retaining key staff, among other things, so organizational risk can affect executional performance.

The art form for the board is finding the right balance of ambitious goal setting for growth and financial performance to drive shareholder value with risk and resource and capability limitations. Boards are encouraged to push for setting aggressive preliminary targets and then, through the planning process, make informed judgments about whether or not those targets should be modified.

2.3

Developing the Strategic Plan

This section reviews

- Structure (page 54)
 - End state (page 55)
 - Objectives (page 56)
 - Context (page 57)
 - Strategies (page 58)
 - Forecasts and financial modelling (page 70)
 - Strategic initiatives (page 70)
-

At this stage, the preliminary end state and strategic options have been developed, reviewed by the board and subsequently refined. It is now time for management to develop a strategic plan.

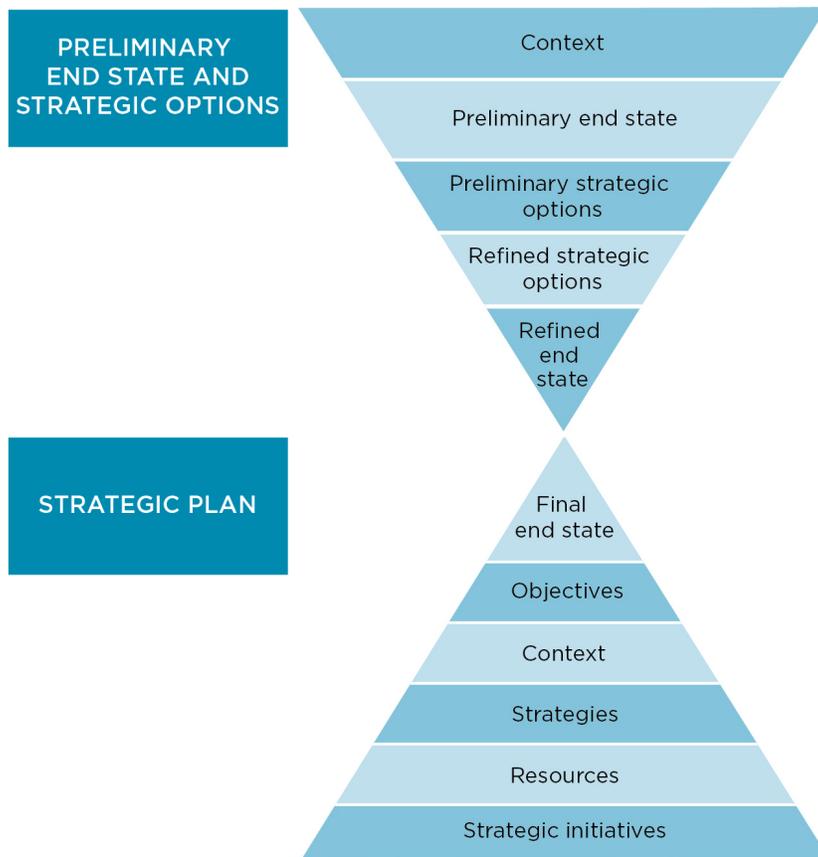
Recognizing each strategic plan should be tailored to the specific enterprise and its circumstances, we felt it would be helpful to provide boards and management with a fundamental framework for a strategic plan as a basis for a constructive dialogue on expectations for format and content.

There is no standard format or content for a strategic plan. While management typically develops and presents the strategic plan, in smaller organizations board members are directly involved in the development of the detailed strategic plan.

Structure

At this stage, the development of the refined end state and refined strategic options have been completed, reviewed and refined.

The next step is to develop the strategic plan as structured below.



The strategic plan framework is designed to address six questions:

- What should the enterprise look like at the end of the planning period (final end state)?
- How does that end state compare with the current situation (the difference forms the objectives)?
- In what context is the enterprise likely to be operating in during the planning period?

- What does the enterprise need to do to achieve the end state (strategies)?
- What resources will be required?
- What specific actions are required to implement the strategy and how are they be measured and monitored?

The end state in the strategic plan is likely to be the same as the refined end state developed earlier in the process. Sometimes when detailed strategies are developed, achieving the end state may become less realistic or involve too much risk, so the final end state may need to be revised.

The strategic plan may not require a context section, particularly if it has not been changed when presented as part of the preliminary work. For completeness, it is helpful to include the contextual information in the main body of the strategic plan or in an appendix.

End State

As described in Phase 1, the end state should be a clear description of what the enterprise should look like at the end of the planning period. Some organizations typically include vision, mission core value statements. Our preference is for a more tangible and realistic view of the enterprise at end of the planning period. Below is a sample description of an end state—typical content of an end state is set out on page 40.

Sample Description of an End State

By 20xx, ABC Corporation, a North American based public company, will have become the third largest widget producer worldwide. Revenue will have increased to \$1.8 billion, representing a 13% cumulative average growth rate. The company will remain multi-divisional, organized on a geographic basis. Its product lines will have been expanded to include widgets made from lightweight composite materials.

To achieve the planned growth, approximately half will be achieved organically through modest overall market growth and an increase in market share. The balance of the revenue growth will come from one or more acquisitions in South East Asia that will provide both a manufacturing centre and an entry into that geographic market.

Through the period, a sound capital structure and favourable debt rating will be maintained with overall indebtedness not exceeding \$400 million. Through leveraging a highly competitive cost structure, earnings are expected to grow by 16% annually resulting in a return on equity of 14% by the end of the planning period. Cumulative free cash flow before acquisitions will be \$625 million.

Objectives

Goals and objectives are often used interchangeably. We draw the distinction—goals tend to be less structured longer-term aims while objectives are more concrete with defined metrics that usually are to be achieved within a specified timeframe.

While goals may provide an overall sense of direction and purpose, they usually are not quantified and often read like motherhood, whereas clearly stated objectives drive both strategy and organizational behaviour toward achievement.

Mercedes-Benz defines its goal as: “Our overriding corporate goal is to achieve sustainable profitable growth and thus to increase the value of the Group. We strive to achieve the leading position in all our businesses.”

The objectives are derived from the difference between the end state and the current situation—and they should contain both quantitative and qualitative statements.

Sample Objectives

1. Increase revenue organically from \$1 billion to \$1.4 billion over five years, representing a 7% cumulative average growth rate.
2. Acquire one or more companies in South East Asia to contribute at least \$400 million in revenue.
3. Increase net earnings by 16% per year, attaining \$170 million by the end of the plan period with a return on equity of 14%.
4. Generate \$625 million in free cash flow before acquisitions over the plan period.
5. Increase widget worldwide market share from 21% to 24% over five years.
6. Maintain a sound balance sheet with overall indebtedness not to exceed \$400 million and a debt equity ratio of 0.5x.
7. Develop and launch a new composite widget product line.
8. Strengthen the leadership organization and fill succession gaps by recruiting five new executives within the first two years of the plan.
9. Improve labour productivity by an average of 2% per year through a combination of automation and training.
10. Improve health and safety performance by reducing lost-time accidents by 10%.

Context

The contextual framework set out in Phase 1 is summarized below.

Historical Information

Industry/Market	Company Specific
Industry trends	Financial performance
Market performance and trajectory	Relative competitive position and trend lines
Past influencing factors	

Current Macro and Industry and Customer Information

Macro Environment	Industry/Market	Customers
Macroeconomic situation	Critical success factors	Purchase criteria
Geopolitical environment	Overall market size	Categorization
	Addressable market	Revenue/profitability
	Current influencing factors	Share of wallet
	Market segmentation	Backlog
	Barriers to entry	Prospective customers

Competitive Information

Competitors	Self-assessment
Key issues	Key issues
Effectiveness against critical success factors	Effectiveness against critical success factors
Positioning	Positioning
Capabilities	Capabilities
Assets	Assets
Financial condition	Financial condition
Competitive disadvantages	Competitive disadvantages

Assumptions

Geopolitical outlook
Macroeconomic outlook
Interest rates
Commodity prices
Foreign exchange
Industry/market outlook and performance

Strategies

In an earlier stage, directors considered strategic options for where the enterprise could compete (which markets) and its capability to compete (competitive advantage and resources). With the fundamental strategic options now solidified and objectives set out, the focus is now on how to compete—determining what needs to be done to achieve the stated objectives.

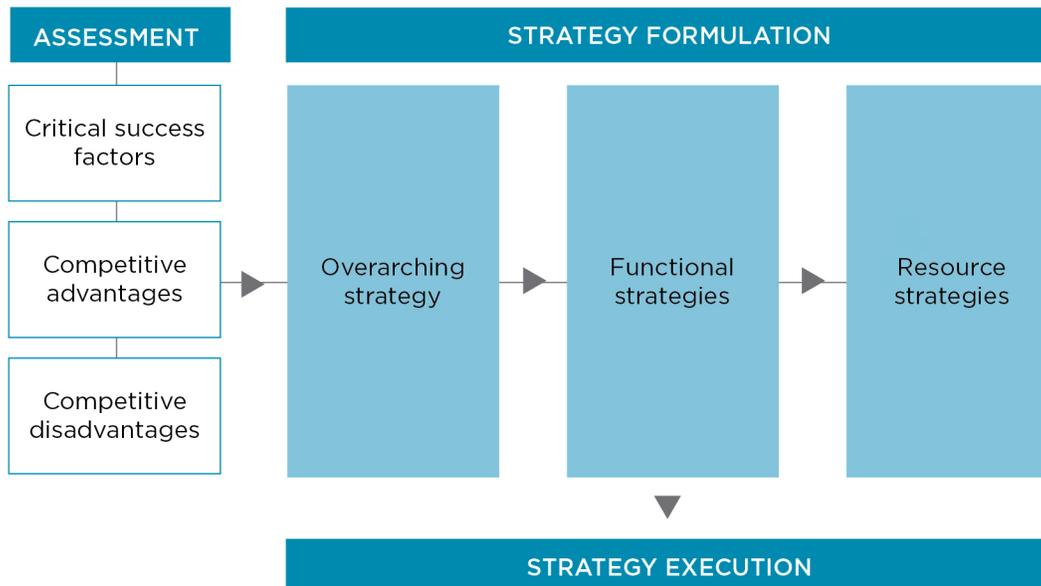
There are three layers to enterprise strategy:

- Overarching strategies—related to critical success factors
- Functional strategies
- Resource strategies.

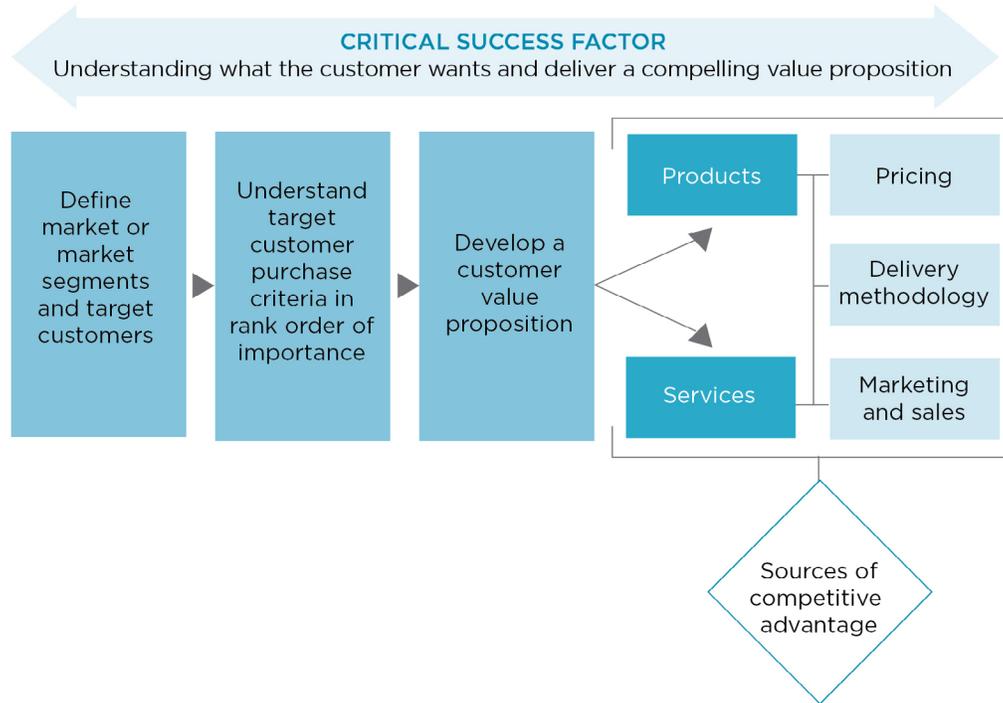
Overarching Strategy

The foundation of effective strategy is understanding the critical success factors in the particular industry that the enterprise serves, the enterprise's competitive advantages and disadvantages, and then developing specific overarching strategies for each factor. Such strategies are broad, most often involving many of enterprise's functional capabilities.

For each critical success factor there must be an overarching strategy.



A straightforward example of an overarching strategy is tied to the universal success factor of meeting the needs of the target customers. Understanding and fulfilling those needs is the cornerstone to an overarching go-to-market strategy.



Once the market and target customer base have been determined, the next step is to determine the customer purchase criteria ranked by order of importance (this should have already been determined in Phase 1). As part of an overarching go-to-market strategy the enterprise should define its customer value proposition—determining what products and services should be developed, and how they would be priced, sold and delivered to customers. Each component of the value proposition offers the opportunity for competitive advantage. Finally, this value proposition should be tested through a financial model to determine if it generates satisfactory returns.

The go-to-market overarching strategy should fully address how to achieve the organic revenue growth objective.

Sample Go-to-Market Strategy

Objective:

Increase organic revenue from \$1 billion to \$1.4 billion over five years, representing a 7% cumulative average growth rate and a 1.5% increase in market share.

Overarching Strategy:

For the North American market, pursue current and potential customers with widget requirements of at least \$20 million annually.

Provide those customers with a range of high quality widgets of varying sizes typically priced at the upper end of the market to generate gross margins of at least 32%. Support those customers with a two-year warranty program along with post warranty widget repair services.

Develop and launch a minimum of two new widget products annually (see R&D strategy section for more details).

Delivery will be direct, usually within 10 days of ordering.

Sales would be a direct model combined with marketing support as set out in the sales and marketing strategy section of the plan.

Overarching Acquisition Strategy

Strategies related to acquisitions should set out, at a minimum, the strategic rationale and acquisition criteria as shown on pages 50 to 52. If candidate screening has been completed, then the list also should be included in the plan, ranked in order of preference.

Overarching Strategies to Achieve Earnings

Strategies to achieve earnings invariably have multiple components—revenue, margins, costs and expenses. The path to achieve the revenue and margin objectives should have already been set out in the go-to-market section. For product and service costs and expenses such as marketing and sales, general and administrative, research and development and interest, it is common to set out a financial model showing what percentage of revenue each component is expected to represent. The detailed strategies for each cost and expense component would be addressed in subsequent sections within strategy.

Overarching Strategies Related to Cash Generation and Financial Position

Cash generation is a function of earnings excluding non-cash items such as depreciation, changes in working capital and after investments such as for capital expenditures and acquisitions. The strategic plan should therefore address how working capital is to be managed and maintained such as planned changes in customer or supplier payment terms and ways to minimize inventories. Similarly, planned capital expenditures and other investments

should be described either in the strategy section or separately in the plan along with rationales. A financing strategy should be shown separately (see page 71).

Functional Strategies

Because integrated strategies invariably involve various functions within the enterprise, it is necessary to ensure each functional area is aligned with the overarching strategies. In addition, each functional area will have additional detailed strategies to achieve the specific functional objectives often related to optimize functional performance.

Using the overarching go-to market strategy example on the previous page, the marketing component of this strategy might involve advertising, web-based lead generation and various branding plans. However, the functional strategies for marketing would also include other strategies such as marketing cost optimization, agency selection, trade shows, promotions, etc.

Examples of typical functional strategies are shown below.

Operations

Operational strategies usually surround the creation and delivery of products and services. For product companies, typically this would include manufacturing and distribution and likely a customer service component. For service businesses, the strategy is around how services are to be delivered.

Manufacturing strategy should cover:

- facility footprints (location, size, capacity, etc.)
- product costs including labour productivity, materials including supply chain and overhead expenses
- product quality
- delivery and time to build
- strategies for inventory can either be in this section or included in cash generation strategies
- required capital expenditures for capacity expansion—sustaining capital should be included here and then summarized in the Resources section.

Distribution strategy would cover methodologies such as direct distribution or through independent distributors as well as how costs are to be optimized.

Service delivery strategy would involve the delivery structure, service costs including opportunities for productivity gains and speed to market. Planned development of new services (unless included in the R&D section) should be included in this section.

Marketing

Marketing strategy is extensive and critical for certain industries like consumer products and retail. In other industries, marketing may play a lesser role. Target market segments, customers and competitive analysis should be included in this stage if they have not been addressed earlier in the Context section.

Common components of marketing strategy include:

- pricing
- market research
- enterprise and product positioning
- branding and brand development
- direct marketing
- advertising
- trade shows and other promotions
- web-based strategy including the use of social media
- planned expenditures.

Sales

The role of sales can vary widely depending on the industry, however, typical components include:

- how sales and marketing strategy align
- account segmentation
- lead generation
- sales processes
- sales channels
- sales force organization and infrastructure
- planned expenditures.

Research and Development

First, there should be a clear distinction between research and development. Research tends to be more abstract with a focus on innovation through new technologies or methodologies. Research generally falls into categories such as basic research (very broad targets), applied research (solving a known problem or opportunity) and advanced research (optimizes feasible solutions).

Development packages feasible and risk-reduced features and capabilities in both form and function into products planned for release to the marketplace.

Typically R&D strategy sets out the following:

- the approach to innovation in research and development
- R&D structure and organization

- major planned research projects ranked by order of importance including rationale, planned expenditures and timeline
- product development roadmaps ranked by order of importance including milestones and costs.

Note that some organizations have a product management group that is tasked with providing the internal interface between product development and marketing and sales. This role is to assess, filter and prioritize new product/service opportunities for future development.

Project Management

Some enterprises, such as engineering firms and companies in the extraction industries, are project focused. In these cases, the strategic plan should include a section on projects—those underway and those planned. Typically the plan would have a listing of current and planned projects including the scope, status of completion, milestones and actual and planned expenditures.

Information Technologies

IT strategies typically consist of current and planned:

- architecture (hardware, software, operating systems, networks)
- critical applications and related integration
- decision-making tools
- operations (sourcing model, services and support, infrastructure)
- major projects (in order of priority)
- planned expenditures.

Administrative Functions

Depending on the nature of the enterprise, there may be a need for the strategy document to include strategies related to certain administration functions. In a technology business, for example, it may be appropriate to have a patent filing, protection and licensing strategy.

Other Functions

Conspicuously absent in the functional strategies are finance and human resources/organization. They should be addressed in the Resource Strategy section.

Resource Strategies

While strategies are designed to answer what needs to be done to achieve the objectives, the resources section is about what resources are required to gain competitive advantage and to successfully execute strategy.

The resources section should address what the enterprise needs to do to build resources to increase the probability of executional success and to gain further competitive advantage.

There are three types of resources—people, assets and capital. The key components of resources are included here.

RESOURCES		
PEOPLE	ASSETS	CAPITAL
Leadership	Condition	Structure
Competencies	Sufficiency	Quantum
Depth of talent	Cost	Availability
Structure	Replacement	Cost
Cost	Capacity	Sources

This section should cover:

- organizational strategy
- financing strategy
- tangible and intangible assets.

Organizational Strategy

Organizational strategy should address five questions:

- Does the enterprise have the right leadership to develop and lead the execution of strategy? If not, what additional leadership skills are needed?
- What capabilities and competencies are required to execute the strategy and build competitive advantage?
- How should the enterprise be organized to execute strategy and what should it look like in the end state?

- How should the enterprise acquire, develop and retain the necessary talent?
- What is the desired culture?
How should it be reinforced and supported?

Without leadership, all other resources are ineffective. Leadership in today's world is about constantly adapting to changing business conditions while staying the course toward the planned end state.

Leadership

“Control your own destiny or someone else will.” —*Jack Welch, former CEO General Electric*

Leadership is the major force in the enterprise that aligns and, through effective communication and motivation, drives the organization towards its goals.

The strategic plan should include an assessment of leadership depth, quality, apparent gaps and set out plans to address leadership gaps and succession needs. Members of the leadership team should be assessed on a performance and scalability perspective. That is, given the objectives and planned strategies, does the senior organization have the competencies and bandwidth to execute, or are more or different leaders needed? (Note that the CEO should only share this part of the strategic plan with the board and not disseminate it to management in order to maintain confidentiality.)

Competencies

Competencies form an important component of competitive advantage. The questions to consider are which competencies and how important are each? To a large degree, required competencies go back to the industry's critical success factors. For example, in the automotive industry, designing and developing new competitive products and technologies with speed to market is a key success factor. The competency requirement is therefore in automotive design and engineering across the vehicle platform including engine, drivetrain, electronics, chassis, suspension and steering systems, body styling, etc. The number of designers, engineers and technologists to gain competitive advantage depends on several factors including the breadth of the product line, degree of outsourcing, length of the design and development cycle, cost and, most importantly, affordability. Scale can provide competitive advantage because it usually creates a cost advantage, and larger organizations can fund greater resources including the breadth and depth of competencies.

The strategic plan should identify required critical competencies both qualitatively and quantitatively, the current inventory of skills and the gaps to be filled. In practical terms, because of size differences, not all competitors

in the industry can afford the same level of competencies. On the surface this places smaller organizations at a competitive disadvantage. Many smaller companies, however, are able to compete with much larger players through such things as innovation, nimbleness, narrower focus, operating in low cost jurisdictions and outsourcing non-core activities.

Organizational Structure

This section addresses two questions:

- Does the organizational structure need to change to implement the strategy and operate the enterprise day-to-day?
- What should be the optimum organizational structure, given the description of the desired end state?

There is a seldom a right or wrong answer for designing an organization, but if a major organizational change is seen as necessary, it should be undertaken with careful planning.

As businesses grow, particularly on a multinational level, organizational complexity increases and usually requires some form of matrix structure. While organization around lines of business can provide focus and leverage, it is sometimes encumbered by lack of geographical knowledge and senior in-country leadership. Conversely, organizing on a regional basis provides sound geographical leadership but can sub-optimize product or business line performance because of lack of focus and shared resources.

Talent

The importance of having the right talent cannot be underestimated. Yet many boards spend a disproportionate amount of time on succession planning. If there is insufficient talent in the organization, succession planning is worthless. Conversely, with sufficient depth and breadth of talent, most succession issues can be addressed.

Attracting, retaining and motivating talent is about providing opportunities—to be part of a progressive organization, for personal development, career advancement, stability and wealth creation.

The talent strategy should address four questions:

- How does management plan to create and sustain the right culture?
- Do performance management systems identify top performers and provide accelerated career advancement?
- Do development programs have a particular emphasis on expanding accountabilities and exposure to strong leaders and mentors?

- Are compensation systems competitive? Do they align with strategy and adequately reward above average performance, and pay exceptional talent in the top quartile by internal and external standards?

Financing Strategy

The financing strategy should be explicit. It should start with setting out the current capital structure (debt and equity components) and expected financing requirements, which are derived from the projected balance sheet and statement of cash flows. Typical financing requirements can arise from higher working capital needs as the business grows as well as funding for capital expenditures and investments such as acquisitions.

The document should also contain forward capital structure projections that would include debt capacity and the amount of available financing over and above the forecast under the proposed capital structure particularly at peak periods, which may not be at year-end.

Having set out the financing requirements, the financing strategy should address how those requirements are to be funded, whether from internally generated cash or from external sources of financing. This may involve additional debt or equity, or a combination of both. If so, the document should spell out the timing, expected terms and status of discussions for each source of funding. For example, if a new credit facility is required either because of higher funding needs or because the current facility is expiring during the plan period, the financing strategy should set out the expected terms (term, amount, expected interest rate and fees, and other key terms such as collateral and limitations on borrowing) and the status of discussions with lenders.

The plan should also address the potential impact on the company's debt rating, as this can materially affect the cost of debt. If the plan calls for a substantial change in financial structure or risk, it may be appropriate to consult rating agencies.

Assets

The final resource requirements are assets, both tangible and intangible.

Capital-intensive businesses such as automotive, energy, mining and chemicals require large investments in assets and often represent competitive advantages and barriers to entry. Other businesses such as software and hardware companies are less reliant on physical assets but intangible assets in the form of intellectual property are critical. Virtually all companies view their reputation or brand as a valuable asset.

The strategic plan should address the condition, sufficiency and value of the current pool of tangible assets and the required expenditures over the planning for orderly replacement and capacity expansion along with the expected related internal rate of return.

For intangible assets, a similar assessment should be made. For certain types of intangible assets, such as brands or patents and intellectual property, the plan should also set out planned expenditures and, ideally, expected returns.

Resource Allocation

Allocating resources is an important strategic decision and can be a major contributor to driving shareholder value. For this purpose, we define resources as capital and people. While assets are important resources, we embrace allocation of assets as part of the discussion around capital.

Often overlooked as a fundamental strategic item, resource allocation is vital in determining the future of the enterprise. It is one of the most important responsibilities of the board.

Capital Allocation

There are four areas where the enterprise may invest its capital:

- investing in the current business including capacity expansion, maintenance capital expenditures, working capital and funding initiatives including R&D, marketing and acquisitions
- investing in new businesses through an organic growth model, mergers and acquisitions or a combination of both
- repaying debt
- returning capital to shareholders through dividends or stock buybacks.

Within the first area—investing in the current business, there are a couple of variations. First, many companies own multiple businesses or business lines often at various stages of maturity, so capital allocation must be between existing businesses. The second is what we call *inadvertent capital allocation*—continuing to pour capital to continually fund losses in current businesses.

Investment in current or new businesses should be predicated on expected risk adjusted returns, expressed in relationship to the cost of capital of the enterprise. Put simply, the enterprise accesses capital from investors and lenders, each with expected returns. Debt holders receive those returns as interest payments and the ultimate return of its capital. Investors measure returns as the growth in value of the enterprise plus the value of dividends. The

corporation is tasked (in fact its sole purpose) to use that capital to generate returns over its cost of capital—the blended rate of interest costs and required minimum returns for shareholders.

While the return on investment criteria is theoretically simple, the application is not. How certain are the expected returns both in amount and timing? How much downside risk lies in the investment versus the opportunity?

Debt repayment decisions involve either:

- contractual principal repayments included in loan agreements
- optional debt repayment to reduce financial risk and to lower interest expense.

When considering returning capital to shareholders, it is important to consider other investment alternatives and investor expectations. Returning capital to shareholders in many ways defeats the purpose of the corporation. Theoretically, capital should only be returned if it cannot reasonably expect to earn a return greater than the cost of capital. In many cases, corporations have no shortage of uses for capital so returning capital to shareholders is usually considered an unattractive scenario. There are, however, circumstances where return of capital is appropriate. For instance, businesses with stable revenue, earnings and cash flow streams such as utilities are sound investment vehicles where the investor expects modest appreciation in enterprise value and a consistent stream of dividends with periodic increases. Another instance is where a business continues to accumulate so much cash (such as Apple) that paying a reasonable dividend does not impede any plausible investment opportunity. Stock buybacks are another vehicle for return of capital, generally done on the premise of perceived equity market undervaluation.

Staffing Allocation

There are two people-related deployment decisions. The first is similar to capital allocation—where to invest staffing to yield the best returns. This may involve the trade-off of reducing administrative staff while increasing staffing in sales, marketing or R&D. These types of decisions are reasonably simple but are not as easy to implement because of silo protection and the cost and anxiety around staff reductions.

Resource allocation decisions in a strategic context are often circular. They cannot be made without understanding the potential and risks of the alternatives.

One allocation decision that often goes unnoticed is management time. Troubled or smaller businesses can frequently take up a disproportionate amount of management time—so the opportunity cost is real. Human nature drives executives not to give up on problem businesses, believing in their ability to turn them around and to discount the opportunity cost. The board can add value by simply encouraging management to dispose of underperforming assets and concentrate all resources, people, capital and management time on successful businesses with greater potential for growth and returns.

Forecasts and Financial Modelling

Strategic plans should be supported by a robust financial model, allowing management and the board to test sensitivities around varying assumptions and performance levels and scenario planning.

The forecast should cover the entire planning period, providing consolidated financial results (statement of income, cash flows and balance sheet), divisional financial forecasts as well as relevant analyses, depending on the nature of the business. The forecasts also should include a breakdown of planned capital expenditures and other investments including acquisitions.

Strategic Initiatives

Without effective execution, strategy development is worthless. This involves converting strategy into specific initiatives, aligning those initiatives with shorter-term plans, assigning accountabilities, providing resources and measuring results.

The next two sections address the importance of each implementation step and provide an overview of best-in-class processes as well as a framework for board oversight.

Key Questions on Strategy

1. What are the critical success factors for this enterprise?

2. In rank order of importance, what are the customer criteria for purchasing the company's products or services? How does this map against the company's customer value proposition?

3. Does this business serve its customers better than any other firm? If so, how? Would its customers recommend this company's products or services to other potential customers?

4. How does the company's position, performance, resources and capabilities compare with its competitors against the key drivers in the industry?

5. Does the company have a business model that can consistently produce earnings and positive cash flow even in poor economic periods?

6. If executed effectively, will the company's overall strategy result in increased shareholder value?

A hand is pointing at a computer screen. The screen displays a network diagram with various nodes and connections. The text "PHASE 3" is overlaid on the image in a bold, white, sans-serif font.

PHASE 3

Execution

PHASE 3

Execution

Plan execution involves the conversion of strategy into actionable plans including the selection of specific tactics and initiatives with appropriate timelines.

The implementation plan also should set out the level and deployment of resources including organizational needs, capital and required investment in tangible and intangible assets.

Director involvement should focus on three areas during this stage:

1. Conversion of strategy to actionable plans

Implementation is where the rubber meets the road, yet director oversight of implementation is frequently unstructured and sparse. Greater board participation is warranted.

2. Deployment of people

Deploying staff is multifaceted with leadership, talent, accountabilities, communication and culture considerations. Strategy execution is completely dependent on people, however, director experience can add significant value and lower execution risk.

3. Systems and processes

Management is responsible for systems and processes. Directors do not need to be extensively involved except when establishing linkages between the execution results and executive compensation.

OVERVIEW

3.1 Conversion of Strategy into Action

Considerations	Management's role	Board's role
Planning and execution model	Development and execution	Input and approval
Strategic initiatives		Review and input
Annual operating plan		Review and approval

3.2 People

Considerations	Management's role	Board's role
Leadership	Recruit, organize, develop	CEO selection Assess capabilities and depth
The right people	Development and execution	Review and oversight
Accountability and authorities	Assignment	Oversight
Culture	Execution	Input
Positioning	Execution	Input and oversight

3.3 Systems and Processes

Considerations	Management's role	Board's role
Project management	Development and execution	Oversight
Performance management		
Compensation and recognition		Input and approval
Measurement and reporting		Input

3.1

Conversion of Strategy into Action

This section reviews

- Planning and execution model (page 76)
 - Strategic initiatives (page 78)
 - Annual operating plan (page 80)
-

Many companies are reasonably proficient at developing compelling, competitively differentiating strategies, however, many of them then fail in execution.

While strategy development is intellectually stimulating and the organization can be energized about moving forward, without well-defined actions and accountabilities, progress can become stalled with lack lustre results. Often root cause analyses incorrectly determine the strategy was flawed when failure was due to poor execution.

It is widely recognized that poor execution is to blame for underperformance at least as much as for weak strategy. Why has there not been a greater emphasis on developing a solid plan for strategy implementation?

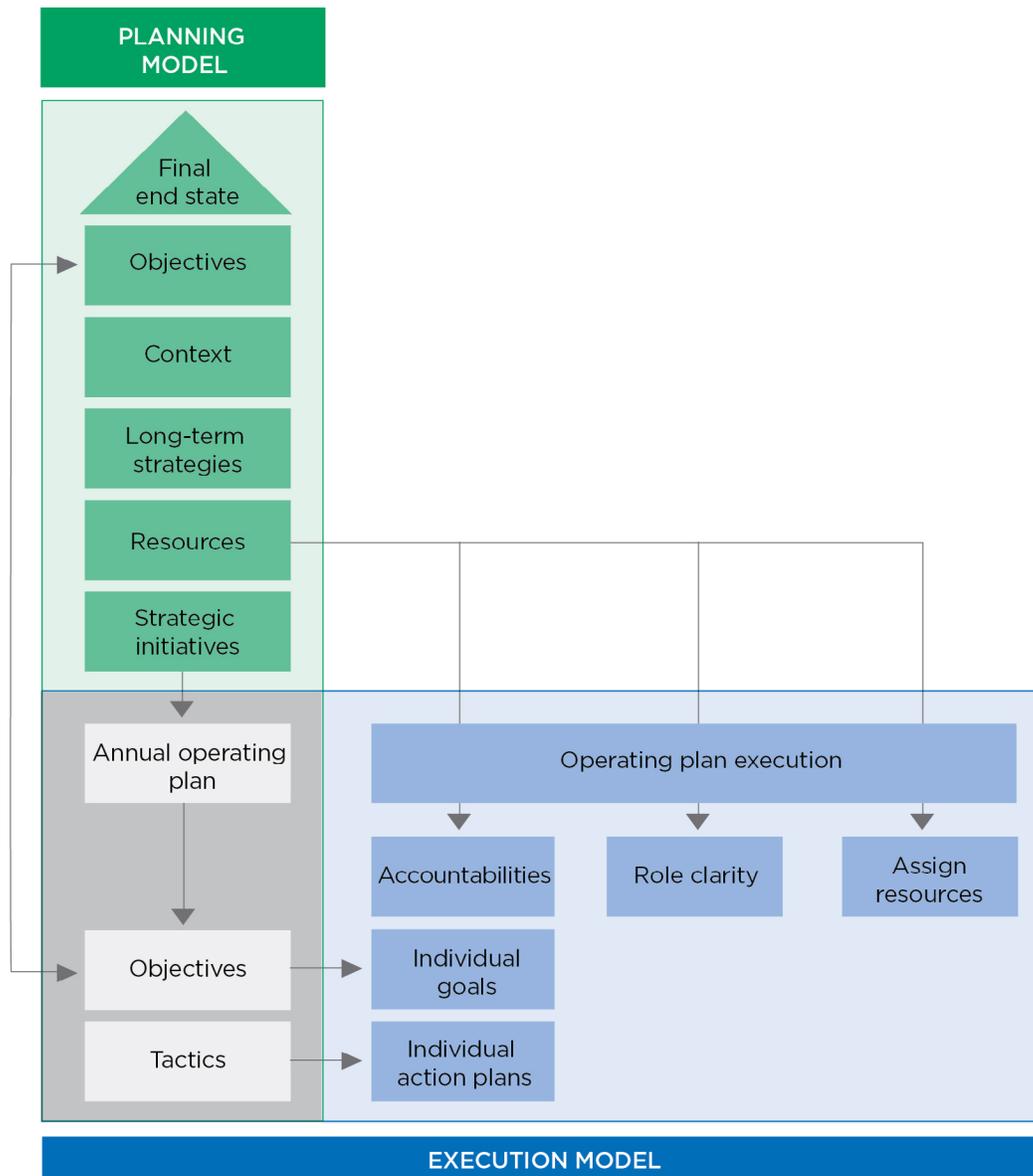
Directors should not accept an incomplete or non-existent implementation plan as they would an underwhelming strategic plan.

In our view, successful implementation of a strategic plan requires four important elements:

- an effective execution plan and model
- leadership
- effective deployment of resources—people, capital and assets
- systems and processes.

Planning and Execution Model

In the previous sections we outlined the planning model for defining the end state to strategy development and resource requirements. Let's now examine the execution model and how it aligns with the strategic plan



Following strategy development and resource determination, it is now time to convert those strategies into actionable bite-size pieces. While this process is less glamorous, its outcome can make or break effective strategy.

Strategy implementation is a multi-step process that cascades strategy right down to the individual level within the organization. It starts with defining strategic initiatives over the strategic planning period, converting those initiatives into specific annual objectives and tactics, which, in turn, are further broken down in individual goals and action, plans with defined accountabilities, roles and resource allocation.

Ideally, the implementation plan should be part of the strategic plan presented to the board. This is seldom the case for two reasons. First, it is much more efficient to develop detailed implementation plans after the board has signed off on strategy. Second, the detailed execution planning work takes considerable time with a much broader management team involved. The board should expect to be presented with an implementation plan six to eight weeks after it has approved the strategic plan.

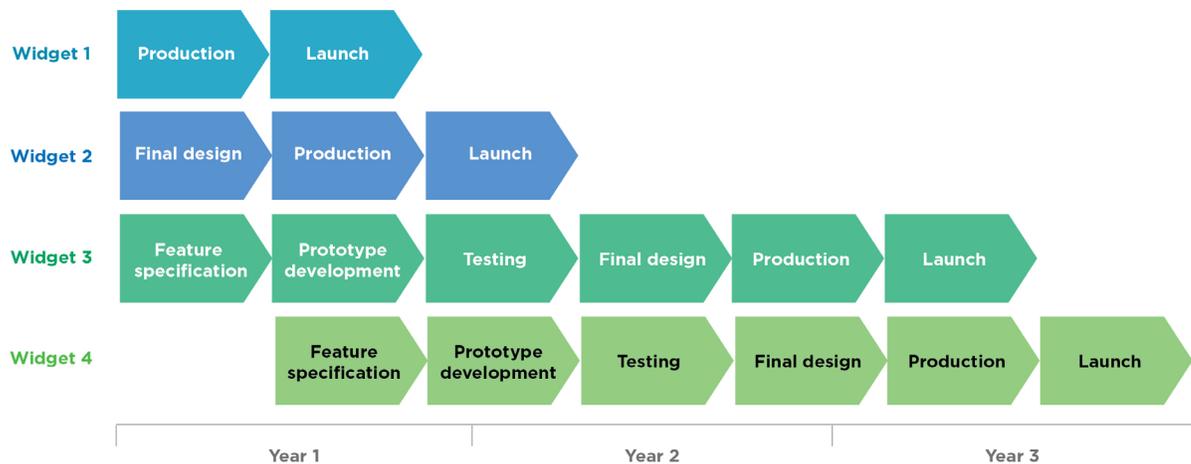
There are differing models for implementation plans. One way is to develop detailed strategic initiatives and flow accountability, timelines and milestones down through the organization. A second model, which we prefer, is to define the strategic initiatives and flow those down through an annual operating plan. Regardless of which model is selected, the board should be tasked to review and ultimately approve the implementation plan.

Strategic Initiatives

Defining strategic initiatives is the first step in putting strategy into action. This involves taking each strategy and breaking it down into planned actions and activities that often span the full planning period.

Let's look at a couple of illustrative examples.

Our fictitious widget company has a strategy to increase revenue and market share that includes developing and launching two new widget products annually. The related strategic initiative should include a product development roadmap as illustrated below. In this case the product development leader would be responsible for delivering the final products consistent with this process and timeline. Other parts of the strategic initiative would include marketing, sales and production.



A second strategic initiative might be tied to the objective of increasing profitability through a cost reduction strategy. The initiative could be broken down by various functional groups as shown here:

MANUFACTURING	MARKETING	SALES	FINANCE
<p>Lower product cost by 11% over three years by:</p> <ul style="list-style-type: none"> • Redesigning products for manufacturability • Lowering labour cost through automating final product inspection • Reducing material costs through consolidating vendor purchases 	<p>Maintain market expenses at the year 1 level by:</p> <ul style="list-style-type: none"> • Reducing the number of trade shows • Lowering support for aging products • Offset by increased spending on planned new product launches 	<p>Reduce sales expenses 4% per year by:</p> <ul style="list-style-type: none"> • Changing sales commission structure • Consolidating sales territories • Closing four regional sales offices 	<p>Lower annual interest costs by \$12 million through:</p> <ul style="list-style-type: none"> • Reducing working capital by 9% by extending vendor payments and lowering days receivable outstanding • Renewing credit facility to take advantage of lower market interest rates

Once the strategic initiatives have been developed, it is common practice for organizations to assign specific responsibilities with related timelines and accountabilities down to the individual level. In the example above, one of strategic initiatives for manufacturing is redesigning products for manufacturability. The head of product engineering would be responsible for developing and undertaking the project plan, which would include selecting the products for redesign, assigning responsibilities to various design engineers with specific timelines, milestones, internal or external resources if required, as well as budgets.

Ideally, strategic initiatives should be included in the strategic plan, although some organizations develop the specific initiatives following the board's review and approval of the overall strategy. Either way, the board should be presented with all significant strategic initiatives for review and comment.

Annual Operating Plan

We fully subscribe to creating robust strategic initiatives with timelines, milestones and accountabilities.

But we also endorse a process to cascade and embed the strategic initiatives into an annual operating plan for two reasons.

First, organizations typically set annual corporate-wide performance objectives, annual tactic plans and flow objectives and plans down to the individual level where they are measured and monitored, usually on a quarterly or semi-annual basis. Short-term bonus plans are commonly tied to achieving individual objectives. The second reason is that strategic plans and related initiatives are often revised annually, so measuring performance against these initiatives beyond one year is cumbersome at best.

The annual operating plan should be presented to the board for review and approval. Directors should expect to see direct links to the strategic plan objectives, strategies and specific strategic initiatives set for that year.

The annual operating plan serves several purposes:

- It crystallizes annual objectives that should tie directly to the strategic plan.
- It should also outline the specific tactics to achieve the annual targets, again related to the strategies and specific strategic initiatives.
- Most importantly, the operating plan should flow down through the organization to the individual level for specific objectives and plans.
- The operating plan objectives are almost invariably used to set short-term incentive compensation targets and thresholds.

You can find an outline of a typical annual operating plan in Appendix 3.

3.2 People

This section reviews

- Leadership (page 82)
 - The right people (page 84)
 - Accountabilities and authorities (page 85)
 - Culture (page 85)
 - Positioning (page 86)
-

“A strategy, even a great one, does not implement itself.” — *Anonymous*

While planning is crucial, execution is all about people:

- how they are organized and coordinated
- how roles and accountabilities are assigned
- how information flows and how systems, tools and other resources are put to use.

Only 11% of the managers we have surveyed believe that all their company's strategic priorities have the financial and human resources needed for success. That's a shocking statistic: It means that nine managers in 10 expect some of their organizations' major initiatives to fail for lack of resources.” — *Harvard Business Review, March 2015*

Leadership

“Great leaders are both idealistic and realistic. They have great goals. They seek to close the gap between what is and what can be, but they have no illusions that success is either certain or simple. They consider the past and evaluate the present, so they can create the future.” — *Michael Josephson*

A visionary leader may not be the best at implementation. Directors should assess leadership skills and capabilities for developing strategy and those required for execution. Clearly, they are different and may not be resident in the same executive.

The role and skill of leadership in executing strategy is fundamentally different than in strategy development. For the latter, leadership entails using a combination of analysis, vision, creativity, realism and intellectual horsepower.

Effective strategy implementation requires leadership not just from a single executive, but also from the full leadership team. To be effective leaders in executing strategy, some of the key skills include candid, constructive communication and the ability to motivate and engage an organization, to allocate resources (including staff, capital and managerial attention), delegation, problem solving, the ability to translate strategies into measurable initiatives and action plans. This means knowing when to put the foot down on the accelerator, when to abandon initiatives that are not working, and when to seize new opportunities that are aligned with the strategy. Failure to abandon failing initiatives is often difficult and, as a result, leaders can spend a disproportionate amount of time and resources trying to fix things rather than redeploying resources to more promising initiatives.

Leaders take ownership of the implementation process, empowering teams to focus on the high priority actions while managing and balancing the distractions of day-to-day responsibilities.

Alignment

One of the key leadership tasks is to fully align the organization.

This requires several things:

- common objectives that cascade down through the organization
- clear accountabilities and authorities
- leadership consistency
- a cadence of communication with consistent, straight-forward messaging
- an organizational structure and culture that promotes cross-functional integration

- effective systems—recognition and rewards, data gathering and reporting, project and performance management
- effective measurement and constructive feedback mechanisms.

Cascading objectives involve setting high level strategy and then aligning its implementation through the organization so that each individual knows their goals, role and accountabilities to drive success and also understands cross-functional responsibilities. Objectives, strategies and initiatives must be disseminated through the organization so each individual understands the context and what is expected of them and their teams to drive the strategy forward.

In reviewing the implementation plan, the board should probe executives on achieving organizational alignment—how objectives and tactics are delegated, how cross-functional activities are assigned and managed, what systems are in place to measure and report on performance, and how performance is tied to compensation.

Internal Communication

There is an old adage: “When you are so tired of saying the same things over and over again, it is probably just getting through to the organization.”

While understandably parts of strategy such as M&A activities should remain confidential, leaders tend not to be forthright with their internal communications on strategy. Middle managers want straightforward answers to three questions: Where are we going? How are we going to get there? What am I expected to do? Yet executive presentations and town hall meetings are filled with voluminous PowerPoint presentations and lengthy lists of confusing priorities and initiatives. Executives increase the confusion when messages are changed frequently.

Execution-focused leaders should distil their longer-term strategic objectives into clear shorter-term goals so employees understand how long-term goals and near-term goals are aligned. The messaging should be consistent, straight forward and often.

External Communication

External communications need to be consistent with internal communications, but focused on the interests of each audience. Reaching each audience will use different channels and, therefore, requires separate communication planning.

Investors are a key audience. Their interest is in understanding the enterprise's strategy to assess the potential for incremental value creation and risk, so communicating strategy effectively is important. It is also about balance—providing enough information so investors can comprehend the key elements of the strategy but not over-disclosing for competitive reasons.

Investors have a voracious appetite for information but the focus of external communication of strategy and key messaging should be on three areas:

- Where to compete— which markets are attractive and why?
- Why the enterprise can be successful— what are its competitive advantages?
- How to compete— how the enterprise can leverage advantages and allocate resources?

Leaders should create an open, creative, environment that encourages idea sharing and candid, constructive feedback. Periodic review meetings should focus on the status of critical actions, and promoting a personal and team accountability in a productive way.

The Right People

Execution starts with having the right people in the right places. Their competencies, experience and drive make the difference between executional success and failure. Does that sound remotely familiar? Yet how many organizations remain clogged with staff that has neither the capabilities nor the self-motivation to

achieve success? The quality of talent may be the enterprise's best competitive differentiator. Successful strategy execution typically requires higher levels of cross-functional integration. There is no substitute for having the right people, in the right seats to move the execution needle.

Board or committee review of talent tends to focus on top performers and succession planning. Seldom does it include an assessment of capability to execute strategy. Specifically, directors should examine the required leadership and depth of talent to effectively implement strategy.

Accountabilities and Authorities

Accountability involves first clarifying individual goals and action plans, and then providing individuals with responsibility for execution and delivering results. Authority to act is important, and tied to accountability. Defined authorities provide managers and staff the appropriate freedoms and constraints to act. When these two concepts are unaligned, nothing good will come of it.

The blurring of authorities is more common in larger, complex organizations. Small companies tend to be more agile with clear definitions of roles and responsibilities. In complex enterprises, approval levels and processes can become tortuous.

Culture

Achieving cultural alignment is complex. If the culture is already instilled and the organization is both team-based and performance driven, strategy execution with other things being equal, is usually straightforward. When there are cultural differences that create barriers, however, the risk of ineffective execution rapidly increases. This issue often arises when acquisition integration is also underway or with leadership changes.

Virtually every organization strives to build a “performance-based” culture yet over-emphasis on performance can impede execution, particularly if the organization is driven to achieving numerical targets over everything else. This results in setting conservative targets and an unwillingness to take risks that could result in strikeouts, thereby missing the opportunity for homeruns.

A culture that supports execution must embrace the importance of teamwork, agility, openness and innovation. The combination of agility and innovation requires a willingness to experiment without negative consequences.

Positioning

Interestingly, the position of the enterprise can affect executional success. This may be best described by example. For industry leaders with clear advantages of scale and scope, it may be difficult to implement compelling, engaging and innovative strategies. The tendency is focus on maintaining the lead rather than driving for even greater success. That in itself can create vulnerability if smaller, more agile competitors are able to out-innovate the leader.

The challenge for leaders, regardless of the position and condition of the enterprise, is to create a compelling story to rally the organization to drive change.

The converse is also true. Organizations in crisis or transformation are able to effect dramatic change because they have no choice. And, the organization invariably will step up to that challenge.

3.3

Systems and Processes

This section reviews

- Project management (page 88)
 - Performance management (page 88)
 - Compensation and recognition (page 88)
 - Measurement and reporting (page 89)
-

Effective strategy implementation requires certain underlying systems and processes.

Typically, in any enterprise there are no shortages of systems and processes. Our focus will be only on a few that we believe are critical to executional success:

- project management
- performance management
- compensation and recognition
- measurement and reporting.

Project Management

Project management systems can be very complex or reasonably simple.

Generally, all such systems share four common themes:

- project charter that defines the deliverables and scope
- detailed project plan including assigned accountabilities, milestones and schedule
- resource requirement
- reporting mechanisms.

The use of program management tools can be extremely effective in tracking and controlling broad strategic initiatives as well as cascading detailed plans at the departmental level. In some larger organizations with large numbers of strategy-related initiatives, a separate program management office is established. Its role is to work with each department in developing the project plan and to provide oversight on tracking and controlling progress. In smaller enterprises, projects are disseminated with each department being accountable for the deliverables using common project tools.

Performance Management

A robust performance management system is useful in strategy execution in three ways. First, it should align and reinforce the individual personal objectives with strategy implementation goals. Second, it provides a mechanism to track individual performance that can identify on the down side why initiatives may be failing and equally important, why other initiatives are successful. Finally, the system should provide objective data for setting compensation.

Compensation and Recognition

Directors should consider three key questions in relation to compensation:

- Who participates?
- How should compensation be structured?
- How much?

“Follow the money”

It is important to align the performance, reward and recognition systems with strategy execution earlier in the process. Nothing creates better signaling and focus than compensation tied to the executional results.

It is certainly feasible to have every staff member's compensation aligned to strategy in some way, if only through personal objectives set in the performance management system. For managers and above, it is common for incentive compensation for managers and above to be awarded based on achieving the results of strategy execution.

Recognition can take the back seat to compensation. It should not. Clear accountabilities, metrics, milestones and frequent review meetings provide a perfect opportunity to recognize individual performance and overtly acknowledge progress.

Instinctively, it would seem logical to tie long-term incentives to strategy. Our view is the long-term incentives should be directed to executives who can directly influence longer-term results. This would certainly apply to the chief executive officer, his or her direct reports and potentially the next layer of management. There are numerous long-term incentive plan structures. The trend is to tie incentive awards to achievement of specific longer-term targets such as the key objectives of the overall strategic plan.

The planning and execution model cascades objectives and tactical actions into the annual operating plan. Using short-term bonuses for achieving one-year targets, including individual goals, can be a powerful tool and most relevant to managers. There is nothing like a cheque at the end of the year as tangible evidence of success.

The amount of variable pay varies by affordability of the enterprise. Our only comment is that incentives should be meaningful to the individual. Better to reduce the participation list than spread thin bonuses widely.

Measurement and Reporting

We will not delve deeply in information systems here. What is important is that there are internal mechanisms allowing management to establish targets, milestones and timelines and track progress. This can be in the form of sophisticated software in one extreme and simple spreadsheets at the other end of the spectrum.

The board's review of systems and processes does not have to be extensive related to the implementation plan. Many of those systems and processes are already reviewed as part of committee mandates. Nevertheless, directors should be satisfied that the infrastructure in place does not impede effective strategy execution.

A hand is shown pointing towards a network diagram consisting of interconnected circles and lines. The background is a blurred office scene with a computer monitor and keyboard. The entire image has a green tint.

PHASE 4

Plan Monitoring

PHASE 4

Plan Monitoring

In this section, we address the development and use of metrics and milestones to measure progress and identify early warning signs. We also introduce the notion of a mid-cycle review process by the board and then put forward some thoughts around why, when and how to revise strategy.

Plan monitoring has three dimensions. The first is establishing appropriate metrics and timelines for implementation. The second sets out the reporting requirements including a detailed mid-cycle review. Finally, depending on performance, positioning and external factors, it may be necessary to refine or revise strategy, or in more extreme situations, develop new strategy.

Director involvement should focus on three areas during this phase:

1. Establish progress metrics and milestones

To effectively monitor strategic performance, boards require periodic reporting using relevant metrics and milestones. They should participate in selecting the measures and reporting structure.

2. Reporting and mid-cycle review

Directors should consider a formalized agenda item to conduct a formal mid-cycle review of strategy to assess overall performance and determine action items and required strategic adjustments.

3. Refining the strategy

All strategic plans are set at a single point in time and all have an expiry date. Strategy must be fluid. Directors need to determine when it is time to update, refine or create a new strategic plan.

OVERVIEW

4.1 Progress Metrics and Early Warning Indicators

Considerations	Management's role	Board's role
Strategic objectives	Development and reporting	Review and input
Annual operating plan		
Strategic initiatives		
Executive objectives		
Competitive metrics		
Other early warning indicators		

4.2 Reporting and Mid-cycle Reviews

Considerations	Management's role	Board's role
Mid-cycle reviews	Development and reporting	Review and input
Sample board agenda		

4.3 Refining the Strategy

Considerations	Management's role	Board's role
Fluidity of strategy	Development and reporting	Review and input
Refining the strategy		

4.1

Progress Metrics and Early Warning Indicators

This section reviews

- Strategic objectives (page 94)
 - Annual operating plan (page 94)
 - Strategic initiatives (page 95)
 - Executive objectives (page 95)
 - Competitive metrics (page 95)
 - Other early warning indicators (page 96)
-

As discussed in the previous section, measuring progress is an important aspect of board oversight. “What gets measured gets done.”

Monitoring progress in strategy implementation involves several dimensions:

- tracking against overall strategic objectives
- measuring performance for cascading objectives as set out in the annual operating plan
- metrics for executive accountabilities
- competitive information.

Strategic Objectives

As counterintuitive as this might sound, tracking performance against the broad objectives set out in the strategic plan may not be particularly useful in the short term. Those objectives are framed in a directional context—the desired end state. The reality is that this strategic plan will be superseded by a new plan before the end of the planning period and while the type of objectives may not change, the numbers most certainly will.

The cascading operational objectives, however, are a different story. These require board attention, along with respective milestones.

Annual Operating Plan

The operating plan objectives should contain the financial targets for the year, usually in the form of an annual budget, as well as key metrics related to execution of the strategic plan. Both should be reviewed regularly.

Invariably, quarterly board meeting agendas include the review of financial performance against the annual plan or budget including explanations of major variances, plans for corrective actions and updated forecasts for the year.

The annual operating plan should contain metrics and milestones for strategy execution. Similarly, quarterly board materials should contain concise reporting showing, at a minimum, which initiatives are on track and those that are not. For the latter, depending on severity, the board should allocate time to understand the underlying reasons for underperformance, such as manpower limitations or priority changes, as well as planned corrective actions.

Review of data on strategic execution is often overlooked or receives negligible attention for several reasons:

- First, typically, quarterly board agendas are extensive, so available time is limited.
- Second, executional objectives and metrics often are buried or less prominent in the annual operating plan, so they tend to receive less attention.
- Finally, quarterly board materials may not contain succinct information on executional performance.

Strategic Initiatives

For those organizations that do not specifically embed strategic initiatives into the annual operating plan but choose to track performance of each program, the board should be provided with summary performance metrics on a quarterly basis as well as periodic reviews when initiatives are not meeting milestones or metrics.

Executive Objectives

One of the most powerful tools at the board's disposal is setting and tracking annual executive objectives. Commonly, annual executive performance is measured in two buckets—financial results against plans and specific non-financial objectives. These metrics usually are the basis for determining annual bonuses.

Too often annual non-financial targets for executives are vague and not quantified. Objectives that start with the words “continue to” should be avoided. Best practice is to assign objectives specifically tied to strategy execution—meeting milestones and delivering results beyond just the financial measures.

Board involvement in objective-setting is important. Establishing executive objectives for explicit accountability for strategy execution is critical. And performance against those objectives should be tracked through the course of the year—not just at the time when bonuses are determined.

Competitive Metrics

Strategy is about leveraging competitive advantage, so tracking performance should include comparative information about competitors. As set out on pages 27 to 31, the initial data gathering provided important competitive analysis. In the monitoring period, it is useful to maintain comparative competitive data and present those regularly to the board. There is considerable data available for public companies. Information on private enterprises is more difficult to obtain.

The following types of information and analysis are useful if available:

- financial performance including comparative analysis of sales growth, earnings, gross margin, cash flow and working capital
- total shareholder return (increase in market capitalization plus dividends)
- market share data

- highlights of public announcements including such things as mergers and acquisitions, ownership changes, product launches, new financings, executive changes
- any available information indicative of strategy or changes in strategy (a good source is management presentations at investor conferences).

Other Early Warning Indicators

All the progress data shown above represent important information. All are indicators of performance—some passive and some more forward looking.

In addition to customary financial and strategic metrics, there are other types of data that can indicate potential future executional problems. Some may be operational or organizational. For example, operational statistics show deterioration of product quality or customer satisfaction trends. Or organizational data identifies higher than planned voluntary turnover, particularly the amount of top performers and rising stars. Many companies also now conduct annual employee engagement surveys. All of these can yield early warning signals that may be indicative of executional issues or limitations.

There is no shortage of metrics and indicators. The challenge for management is to determine which are most relevant and how to concisely present the data.

The board's challenge is how to synthesize the information, understand root cause, focus attention on the critical areas, and create a sense of urgency for correction.

4.2

Reporting and Mid-cycle Reviews

This section reviews

- Mid-cycle reviews (page 98)
 - Sample board agenda (page 99)
-

Effective strategic performance reporting requires turning the customary reporting kaleidoscope model by 15 degrees.

The conventional reporting model tends to focus on financial performance and operational metrics.

A different model is required to answer these three questions:

- What are the important metrics to understand progress on strategy execution?
- How should those metrics be tracked and presented?
- If there are performance shortfalls, how can the root causes be determined, differentiated among inaccurate assumptions, unanticipated competitive actions, flawed strategy and shortcomings in implementation?

Mid-cycle Reviews

One of the most valuable tools is an annual mid-cycle review of the strategy. This is not a common board practice, but we believe it can be a useful tool for the board and management to set aside time to understand what is working and what is not. This assessment flows from directors' involvement in the input, review and approval of the

strategic plan, a separate assessment of strategic risks and a structured mid-cycle review session. The outcome of the mid-cycle review is for the board to calibrate the effectiveness of strategy and determine what actions, if any, are required.

While there will always be room for anecdotal information and opinion, mid-cycle reviews should be as fact-based as possible. The most important judgments will flow from the root cause analysis. That is, to the extent there are shortfalls in expected results, how much are self-inflicted versus the result of external factors including competitive actions?

The determination of what is mid-cycle will vary for each organization. For most organizations, however, a mid-cycle review should take place within nine months of the board approving the strategic plan.

The mid-cycle reviews can be challenging for management. It is not easy for executives to objectively assess the effectiveness of the strategy it devised and implemented. This is where directors have to roll up their sleeves and bring an informed and objective perspective.

Sample Board Agenda of a Mid-cycle Review

Agenda Item	Description
Original strategic plan overview	Objectives, strategies, key initiatives and expected results
Review of assumptions	Comparison of actual data versus original assumptions Revised assumptions
Competitive review	Performance Strategy
Key strategy	Outline of each strategy and related strategic initiatives Review of initiative—metrics and milestones actual versus planned Assessment of effectiveness of each strategy
Review of financial performance	Original forecast versus revised projections including results to date
Overall assessment of strategy effectiveness	
Summary of actions arising from the session	

One of the outcomes of the mid-cycle review is to determine to what extent the strategy requires modification, including the need for a completely new plan.

4.3

Refining the Strategy

This section reviews

- Fluidity of strategy (page 100)
 - Refining the strategy (page 101)
-

There is one certainty – strategic plans will eventually be out of date. The only question is when.

In the dynamic commercial environment, conditions continue to change and strategy must be adaptive.

Fluidity of Strategy

In fact, having an agile organization can be a source of competitive advantage.

Agility is a wonderful attribute.

Impulsiveness is not.

Directors should carefully think through any changes to strategy and base the decisions on facts.

While strategic plans represent the best thinking at the time of their development, strategy must be fluid. Directors should encourage and embrace adaptive and constant refinement of strategy.

Refining the Strategy

At a minimum, strategic plans should be updated annually. In the extremes, that may only involve updating assumptions and forecasts or, at the other end, the development of a completely new plan. If the board adopts a mid-cycle review process as outlined previously, this determination is one of the outcomes of that session.

Whether the planning horizon is three or five years, most strategic plans lose their relevance within 18 months.

The consequences of not rewriting a strategic plan when required is worse than having no plan at all because following an outdated strategy is self-fulfilling. Conversely, requesting management to do a complete rewrite, when only an update is required, can be a major distraction and divert management time away from more pressing items.

Conclusion

While the board is ultimately responsible for the company's strategic direction, management typically leads the development of the strategic plan. In most respects, this division of roles is beneficial—management has the resources to execute a rigorous process and, after developing the plan themselves, they can more easily implement it and be held accountable for it.

As a result, however, many boards are not close enough to the issues or the process to responsibly oversee strategy or properly consider the associated risks. Many directors lack the knowledge of the industry and company context they need to offer an informed, independent perspective. Many boards only schedule themselves for an annual review to influence strategy, whereas the dynamic environments of most companies demand adaptive strategies that cannot be set and agreed to all in advance.

This strategy oversight framework is designed to take directors deeper into the strategy process while remaining in the directors' role. Directors should be provided with the background and the opportunity to understand the context and influence strategy. The strategy development process and the board's role in it should be clear. The board has a role to play early in the process to ensure the right issues and options are considered. It also has a role to play in the approval of the strategy and oversight of its implementation. Directors should understand all levels of strategy—corporate, competitive and functional—so they understand which are important to the future of the enterprise and which can be the source of significant risk.

Moreover, in restructuring industries or in times of crisis, directors will be on the front line for company-defining decisions, such as a major merger, proposed sale of the company, possible insolvency or the loss of a CEO. If directors have been sufficiently engaged to really understand the context and have confidence in the strategy, they will serve the company well when the stakes are the highest.



Appendices

Appendix 1 — Sample Outline of a Strategic Plan for a Single Entity

Component	Description
1. Executive summary	A two-page summary to include concise information on each section—end state, objectives, strategies, resources, financial forecast
2. End state	A description of what the enterprise should look like at the end of the planning period For organizations that have adopted vision, mission, goals and values, statements for each should be included here
3. Objectives	A clear articulation of the list of financial and non-financial objectives
4. Context	Assumptions Summary information from Appendices 1, 2 and 3
5. Strategies (list each objective from section 3 with the strategies set out underneath)	Revenue generating strategy including market related Profitability and cash flow related strategies Strategies related to non-financial objectives Mergers and acquisitions, divestitures Functional strategies Marketing Sales R&D Project management Information technology Administrative Other
6. Resources	Organizational strategy Leadership Talent—competencies Organizational structure (current and end state) and talent allocation Systems—compensation, performance management, development, succession Culture and communications Financing strategy Current capital structure Capital requirements and capital allocation Dividends and other return of capital to shareholders Financing strategy including end state capital structure Assets Asset requirements including capital expenditures Intangible asset investments (unless covered under R&D and elsewhere)
7. Financial forecast	Projected statement of income, analysis and commentary Projected statement of cash flows, analysis and commentary Projected balance sheet, analysis and commentary

Component	Description
Appendix 1—Historical information	Industry/market Industry trends Market performance Competition Past influencing factors Company specific Relative market position and trend lines Five year financial performance
Appendix 2—Current situation	Macro Economy Geopolitical Industry/market Critical success factors Overall market size Addressable market Current influencing factors Barriers to entry Customers Top customers by revenue, profitability and share of wallet Customer purchase criteria Current backlog data Funnel of prospective customers
Appendix 3— Comparative information—competition and self-assessment	Key issues Performance/effectiveness against critical success factors Market position Customer value proposition Capabilities Assets Financial performance and condition Embedded vulnerabilities
Appendix 4— Strategic initiatives	If completed, each strategic initiative would be defined (scope), planned activities, milestones and accountability assignments

Appendix 2 — Examples of Key Issues

External Issues

Market Performance

The widget market is mature, with limited growth potential over the planning period. Limited opportunity for growth may drive competitors to attempt to gain share of market through pricing strategies that could erode the industry's available profit pool.

Interest Rates and Available Financing

The company intends to use long-term debt to finance the planned Asian acquisitions. Currently, the interest rate on this type of debt is very attractive. However, interest rates are expected to rise within the next 24 months and could result in lowering expected return on the acquisitions.

Foreign Exchange Rates

With the strengthening of the US dollar against most currencies, the company's products are less competitively priced in non North American markets. If these rates are sustained, there would be margin pressure as well as non-cash translation losses.

Competitors

The intensity of competition is expected to rise over the planning period for several reasons. First, there are several small new entrants into the market with low cost manufacturing capability in Asia and seemingly less concern about margins. Second, overall market growth is limited, so gaining market share is a priority for all competitors.

Internal Issues

Margin Erosion

The combination of higher product costs and competitor pricing actions has resulted in gross margin deterioration over the past five years from 37% to 32%. This also infers product differentiation may also be weakening.

Customer Concentration

The top 10 customers represent 70% of revenue and 60% of gross profit. Of those 10 customers, five are distributors. The company is exposed if adverse revenue and earnings performance if it was lose two or more of these customers.

Product Development — Depth of Talent

In the past year, voluntary attrition in the product development department has increased from 8% to 15%, and even higher for design engineers and technicians. This has resulted in new product schedule slips and increased recruitment costs. The cause of the increased attrition is due to greater competition for this type of talent, particularly to competitors who offer equity-based compensation.

Leadership Succession

Currently there are three major succession gaps at the executive level—CEO, CFO and CTO. There are no internal candidates that will be ready to step into those roles for at least another three years.

Limited Acquisition Integration Experience

The company has made several acquisitions. The executives of teams of advisors have excellent transactional and integration experience in North America. The company will require and be more reliant upon advisors for planned acquisitions in Asia.

Appendix 3 – Sample Outline of an Annual Operating Plan

Component	Description
1. Executive summary	A one or two-page summary to include concise information on each section—annual objectives, annual plan for strategic initiatives and related functional plans and budgets.
2. Objectives for the year	A clear articulation of the list of financial and non-financial objectives. These objectives should represent the first year targets for the objectives set out in the strategic plan.
3. Context	Assumptions (highlighting any changes from the strategic plan) Market forecasts for the year
4. Strategic initiatives (related to strategies as set out in the strategic plan)	Revenue generating strategic initiatives and related annual plan Profitability and cash flow related strategic initiatives and related annual plan Strategies related to non-financial strategic initiatives and related annual plan Mergers and acquisitions, divestitures plans for the year, if any Functional annual plans including budgets Marketing Sales R&D Project management Information technology Administrative Other
6. Resources	Organizational strategic initiatives and plans Financing strategic initiatives and plans
7. Financial forecast	Projected annual statement of income, analysis and commentary Projected annual statement of cash flows, analysis and commentary Projected annual balance sheet, analysis and commentary Reconciliation of annual forecasts to the forecast in the strategic plan with explanations of major variances

Where to Find More Information

CPA Canada Publications on Governance (available at www.cpacanada.ca/governance)

The Director Series

The 20 Questions Series

20 Questions Directors Should Ask about Building and Sustaining an Effective Board

20 Questions Directors Should Ask about CEO Succession

20 Questions Directors Should Ask about Codes of Conduct (2nd ed)

20 Questions Directors Should Ask about Crisis Management

20 Questions Directors Should Ask about Crown Corporation Governance

20 Questions Directors Should Ask about Director Compensation

20 Questions Directors Should Ask about Directors' and Officers' Liability Indemnification and Insurance (2nd ed)

20 Questions Directors Should Ask about Executive Compensation (2nd ed)

20 Questions Directors Should Ask about Governance Assessments

20 Questions Directors Should Ask about Governance Committees

20 Questions Directors Should Ask about Insolvency

20 Questions Directors Should Ask about Internal Audit (2nd ed)

20 Questions Directors Should Ask about IT (2nd ed)

20 Questions Directors Should Ask about Responding to Allegations of Corporate Wrongdoing

20 Questions Directors Should Ask about the Role of the Human Resources and Compensation Committee

20 Questions Directors Should Ask about Special Committees (2nd ed)

20 Questions Directors Should Ask about Strategy (3rd ed)

Director Briefings

Board Oversight of Tax Risk—Questions for Directors to Ask

Controlled Companies Briefing—Questions for Directors to Ask

Diversity Briefing—Questions for Directors to Ask

Guidance for Directors: Disclosure and Certification—What's at Stake

Guidance for Managers: Disclosure and Certification—What's at Stake

Shareholder Engagement—Questions for Directors to Ask

Sustainability: Environmental and Social Issues Briefing—Questions for Directors to Ask

Frameworks

A Framework for Board Oversight of Enterprise Risk

Overseeing mergers and acquisitions—a framework for boards of directors

CFOs

Deciding to Go Public: What CFOs Need to Know

About the Authors

John E. Caldwell

John Caldwell has extensive executive level and board experience having served as a chief executive officer in three public companies for over eighteen years. Through his career he has also served on a total of thirteen boards of directors.

In 2011, John retired from being President and Chief Executive Officer of SMTC Corporation, an international public electronics manufacturing services company. John was also President and Chief Executive Officer at CAE Inc., the world leader in civil and military flight simulation and training services and Geac Computer Corporation, a leading ERP software company.

Currently, John is a director for Advanced Micro Devices, Inc., a world leader in semiconductors for computing and consumer electronics; Faro Technologies, Inc., the world leader in three-dimensional manufacturing measurement systems; IAMGOLD, a leading mid-tier gold mining company; and Samuel Son & Co Limited, one of the largest North America metal processors and distributors and industrial manufacturers. Currently he serves on three audit committees, chairing two; four corporate governance committees, chairing one and three compensation committees chairing one.

John has broad and board and executive level experience in distressed situations having Stelco Inc., Geac Computer Corporation, Mosaic Group and SMTC Corporation providing valuable insight into enterprise risk. Previous boards also include ATI Inc., CAE Inc., Cognos Inc., Parmalat Canada, Rothmans Inc., and Sleeman Breweries.

John also has a background in finance, having served as a chief financial officer of CAE Inc., and Carling O'Keefe Breweries and attained his chartered professional accounting designation with PriceWaterhouseCoopers.

Kenneth W. Smith

Ken Smith, Managing Partner, Dundee Associates Limited, is a strategy consultant and a corporate director.

Ken has practiced as a strategy consultant for over 25 years, beginning with McKinsey & Company and later with SECOR Consulting, Canada's leading strategy boutique, where he was a Managing Partner and Chair of the Board (SECOR has since been acquired by KPMG). His client work and research interests have been focused on growth strategy and M&A in restructuring industries. He has published extensively on strategy, M&A, and industry restructuring, including articles for the Harvard Business Review, the M&A Journal, Business Week, Canadian Business and the general business press. Much of this work is included in his book "The Art of M&A Strategy" with Alexandra Reed Lajoux, McGraw Hill, New York, 2012.

Ken has been active in corporate governance as a director, an advisor to boards and a leader in the governance community. He is a director of ACCERTA, The Arthritis Society, the M&A Leadership Council (US), and a member of the (federal) Steering Committee for Financial Literacy, serving on strategy, HR and governance committees. He is a former director of the Guelph Chamber of Commerce, former director and Chair of SECOR Consulting, and past-Chair of the Ontario Chapter of the Institute of Corporate Directors (ICD). He has been an advisor on matters of strategy and governance to corporate and crown boards. His views on the board's role in strategy were earlier summarized in "20 Questions Directors Should Ask About Strategy", 3rd Edition, a CPA publication. He has also written on governance matters for the ICD and NACD.

Ken holds a B.Sc. in Mathematics from York University, and an M. Sc. and Ph.D. in Mathematics and an MBA from the University of Toronto. He is also a Certified Management Consultant (CMC) and an accredited director with both the Institute of Corporate Directors (Canada) and the American College of Corporate Directors.



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