# STRATEGY COMMITTEES IN CORPORATE GOVERNANCE

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*Corporate governance has for some years been one of the most intensively discussed topics in business. Until now, accounting and compliance issues have primarily been at the centre of the debate. However, some authors have started to point out that it might be time to let these discussions move backstage and to focus on alternative aspects of corporate governance such as the question of how a board of directors may and should exert influence on the corporation's strategy. Corporate governance is concerned with the resolution of collective action problems among dispersed investors and the reconciliation of conflicts of interest between various corporate claimholders. The objective of this article is to determine which role strategy committees play and have played within the corporate governance concept and to establish which tasks these committees routinely perform.*

*Key Words: Startegy Committee, Corporate Governance, Development, Board*

## Introduction and Literature review

Research findings on the processes and conduct of boards of directors are generally very scarce (Charkham, 2005). And especially the topic of boards' involvement in strategic processes has received very little attention to date. Yet, while accounting and compliance issues have taken centre stage in most of the discussions, the ongoing corporate governance debate starts to direct researchers' interests to the board's role in strategic planning as well. In this context, the installation of strategy committees is sometimes recommended (Welge, 2005).

In order to understand and assess the role and tasks of strategy committees in corporate governance and in German and Swiss corporations in particular, a substantial knowledge base had to be built, drawing from secondary as well as primary sources.

Secondary sources such as textbooks and publications in journals and on the internet were first of all used to establish an insight into the theory of corporate governance and to provide an overview of how directors' involvement in strategy integrates into the corporate governance framework. Moreover, an overview over the academic debate on strategy committees of the 1970s and 80s is provided, including a discussion of the benefits and drawbacks of board participation as suggested by proponents and opponents of the idea. Finally, the historical development as well as advantages and disadvantages of specifically strategy committees are depicted.

## The Strategy Committee

Committees represent a means available to the board of directors to develop an organisational structure in order to support the internal allocation of tasks (Müller- Stewens and Lechner, 2006; von Werder, 2005). They do not constitute permanent units, but traditionally only become active at certain intervals in order to either prepare or make decisions (von Werder, 2005). Among the topics which a committee may be asked to explore in detail are investments, financing, the nomination and compensation of management as well as explicitly the strategy of the corporation (Government Commission German Corporate Governance Code, 2005).

Concerning strategy committees, first of all it has to be noted that the precise nature of the committee may again vary depending on its function, that is whether there is a mandate for the formation or simply for the oversight on the strategic planning process, on its composition, chair and integration with the remaining board committees (Beekun, Stedham & Young, 1998; Harrison, 1987). Consequently, various authors pointed out a series of options concerning the design of a strategy committee.

Most notably and persistently, Andrews (1981a,b, 1987) has called for the introduction of a strategy committee composed exclusively of outside directors. This committee would not necessarily have to become familiar with detailed discussions shaping specific strategic alternatives, but rather be concerned with the management of the strategic process within the company as well as the evaluation of strategic choices and the CEO's performance.

Wommack (1985), envisions a strategy committee which could function as a vehicle for the establishment of formal procedures and routines to facilitate board involvement in strategic matters. Once a routine has developed, the committee could after a few years then be enlarged to include all outside directors. Wommack (1985) emphasizes that it should be the committee's role to discuss, debate, modify and ultimately approve strategy, while the responsibility for developing proposals should remain with management.

According to Harrison (1987), committees may become involved in the strategy process in various manners. They may for instance perform a strategy formulation role or simply have an oversight function. He continues in suggesting that it would be the most reasonable approach to allocate the task of strategy formulation to a strategy committee and leave the full board in charge of strategic oversight. The appropriateness of the introduction of a strategy committee will depend on a set of conditions, Harrison (1987) further claims. He outlines that strategy committees are most valuable to companies, which have recently appointed a new CEO, face rapid change, or where management has not been actively concerned with planning. On the other hand, a committee may not be as effective in situations where the full board is already considering strategic issues, where other committees perform a strategic function, or where the firm's business is very narrowly defined or stable. Regarding the composition of strategy committees, Harrison (1987) found that on average four outside and two inside directors built the committee and presented data on the most common types of directors to form part of a strategy committee (see Figure 1). Finally, he draws attention to the importance that should be given to the coordination of the various board committees' activities as well as to the securing of CEO support.

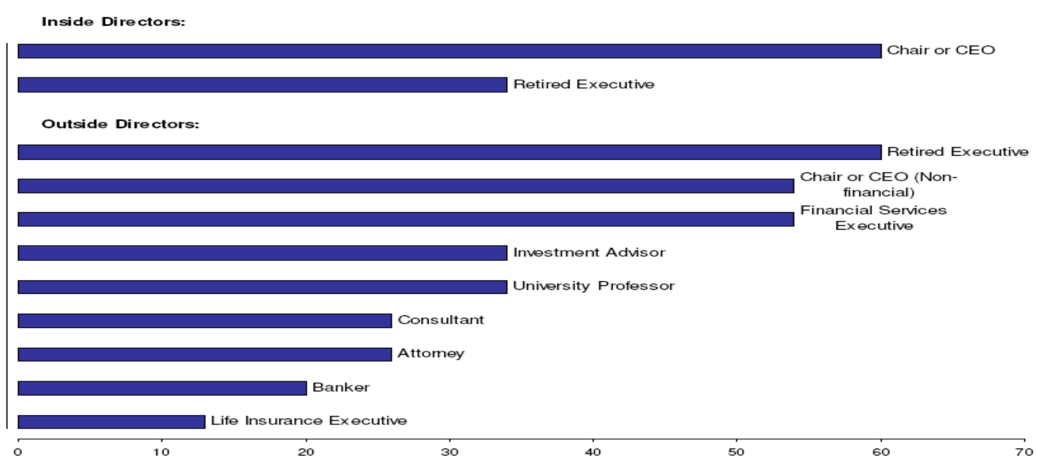


***Figure 1 Composition of Strategy Committees Adapted from Harrison (1987), p.121***

In line with Harrison's (1987) illustrations, Zahra (1990) reports that strategy committees are found to perform a wide range of tasks such as the review of corporate missions and strategies, the evaluation of competitive positions as well as the definition of diversification targets and of criteria to evaluate these targets. Texas Instruments' corporate objectives committee is mentioned as an example of a strategy committee, which establishes organisational missions and guidelines for managerial actions to be taken.

In contrast to Andrews' (1987) beliefs, Henke (1983) feels that the strategy committee should not be reserved to outside directors only. Instead, he thinks that the committee should consist of a balanced number of inside and outside board members. Depending on the complexity of the business and the time requirements associated with it, a group of four or six people is considered to be an appropriate number. It is recommended that meetings take place regularly or at least once a quarter throughout the year.

A rather different model than those mentioned above is presented by Donaldson (2000), who advocates the installation of a "strategic audit committee" (p.54). This committee would be composed of ideally three outside directors and endowed with the authority to establish criteria for and methods of strategic review. The committee's duties would include not only the selection of the review criteria, but also the oversight over the required data collection processes, the identification of topics for discussion with management, and the ongoing update of the remaining board members on strategy issues. In contrast to other proposals, Donaldson (2000) however suggests that the committee should meet only about once in three years, for he claims that it may otherwise run the risk of drifting from a strategic into a rather operational review and of mistaking insignificant changes in specific indicators for important trends. Yet, he admits, that the frequency of meetings will also be determined by the degree of turbulence in the company's environment and the nature of the industry the corporation operates in.

In order to get an impression of the reception of the strategy committee idea in practice, an overview of the historical development of these committees shall be helpful.

### *Historical Development of Strategy Committees*

As reported e.g. by Rosenstein (1987) and Harrison (1987) the 1970s saw a sharp rise in the introduction of audit, compensation and nomination committees. In the early 1980s, a number of studies however concluded that despite an increasing emphasis on board involvement in strategy, only very few corporations had actually installed a strategy committee (Brown, 1981 as cited in Harrison, 1987, p.117; Ballout, n.d. as cited by Harrison, 1987, p.117; Harrison, 1987; Henke, 1983). Henke (1983), e.g. analysed data from 227 predominantly manufacturing companies and found that only 13.2% of the corporations used a committee to address strategic planning (see Figure 2).

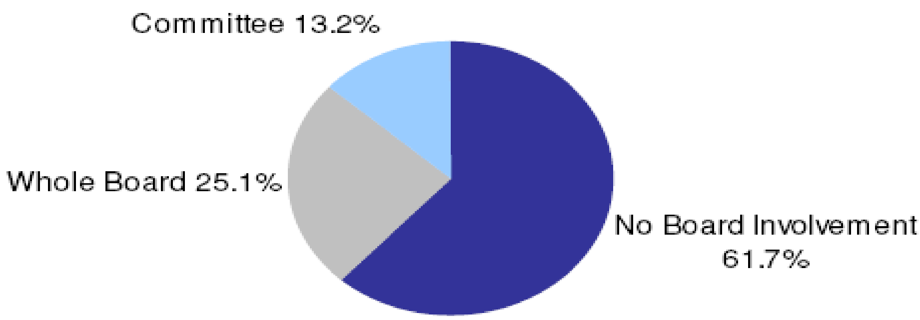


***Figure 2 Manner of Board Planning Involvement in Firms Practicing Strategic Planning Adapted from Henke (1983), p.89***

Furthermore, Harrison (1987) in his examination of 1982 proxy statements of 753 large American manufacturing firms could only detect 15 corporations which had reportedly introduced strategy committees. He concedes that this figure might underrepresent the actual number of strategy committees because the disclosure of this type of information on proxy statements was not required by the SEC at the time. To support the validity of his research findings, Harrison (1987) however points to the studies of Brown (1981 as cited in Harrison, 1987, p.117), Ballout (n.d. as cited by Harrison, 1987, p.117) and Henke (1983), who reported similar findings. Brown further discovered that, with the exception of two strategy committees created in the 1960s, all were established between 1972 and 1980 (see figure 3).

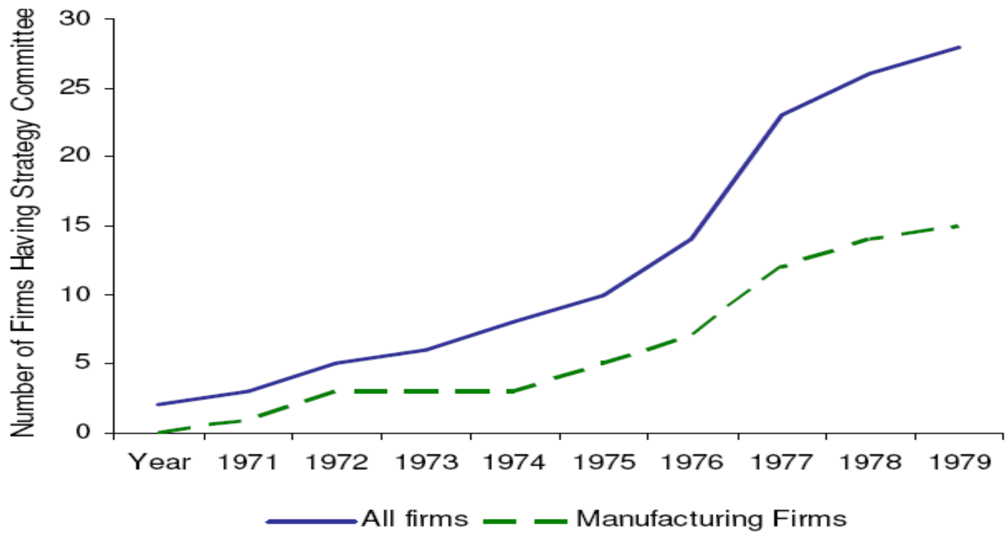


***Figure 3 Strategy Committee Existence Adapted from Harrison (1987), p.118***

In accordance with these findings, Rosenstein (1987) has noted that there was "no proliferation of strategy committees comparable to the rush to the audit and the nominating committees in the 1970s" (p.31). Yet, as already mentioned, he claims that by 1979 there were indications that in large US corporations, the typical board might be "on the verge of a significant degree of involvement in strategy, possibly through the addition of another major committee" (p.31).

Yet, during the 1980s, an increase of strategy committees was not to be observed (Harrison, 1987; Rosenstein, 1987). In the face of an only inconsiderable establishment of strategy committees, Andrews (1981b) suspects that his persistent calls for the introduction of such a committee might have been ignored mainly because many CEOs oppose board involvement in strategy processes. He suggests that consequently, they seek to limit directors' participation to a minimum and most importantly to keep the consideration of strategic matters out of the reach of an especially informed and qualified committee. Towards the end of the 20th century, Dimma (1998) observes that strategy committees remain uncommon. Nowadays, executive, audit, nominating, compensation, and finance committees are said to be typically installed, with audit committees being compulsory for US listed companies according to sec. 301 SOX (von Werder, 2005). Carey and Patsalos-Fox (2006) highlight that there has been a fourfold increase in the number of board of directors' retreats devoted to strategy, but claim not to have detected a sole US company which has introduced a committee to deal with the review and formulation of strategy. Nevertheless, they suggest that directors' involvement in strategic questions may soon arouse more interest, as attention starts to turn away from compliance issues and new sources of shareholder value are sought.

### *Benefits of a Strategy Committee*

Despite the low empirical use of strategy committees, its installation has continually been recommended (Andrews, 1981a,b, 1987; Donaldson, 2000; Harrison, 1987; Henke, 1983; Welge, 2005). It is argued that a number of advantages may be derived from the establishment of a strategy committee (see table 1).

The various suggestions brought forward may be condensed to basically six major benefits of strategy committees. First of all, a committee is believed to economise board time and concentrate directors expertise on a set of specific problems (Andrews, 1987). Secondly, the existence of a strategy committee is claimed to increase directors' involvement in strategic matters (Harrison, 1987; Henke, 1983; Welge, 2005; Wommack, 1985). This idea is supported by the insight that increased size may inhibit board involvement (Goodstein, Gautam & Boeker, 1994;) insofar as the installation of a smaller committee should then have a favourable impact. Moreover, board members are supposed not only to be more involved but also better informed and more capable of discussing corporate strategies if a committee is introduced (Harrison, 1987; Henke, 1983). Next, the presence of a strategy committee might render directors in a stronger position toward the management team and increase their influence on strategic decisions (Dimma, 1998; Henke, 1983). Furthermore, the committee's work allegedly raises awareness for strategic planning processes and strategically relevant issues and helps ensure the structured and formalised examination of important topics (Harrison, 1987; Henke, 1983; Wommack, 1985). Finally, the mere existence of a committee was found to convey an impression of responsible activity and structured analysis to the external environment, irrespective of the true proceedings within the committee (Donaldson, 2000; Harrison, 1987).

### *Drawbacks of a Strategy Committee*

As to the disadvantages of strategy committees there are three significant arguments (see table 1). First of all, the committee may expose board members to increased liability risks (Harrison, 1987). Secondly, a divide between those directors concerned with strategy matters and those who are not directly involved may be induced (Andrews, 1981b; Dimma, 1998). And finally, a strategy committee is claimed to risk crossing the line which separates the roles of the board from those of management (Dimma, 1998).

| Benefits | Drawbacks |
|---|---|
| - **Economisation of board time**<br>- **Increase in directors' involvement in Strategy**<br>- **Improvement of directors' knowledge**<br>- **Improved position of directors towards management**<br>- **Raised awareness for strategic planning**<br>- **Conveyance of positive impression on environment** | - **Increased liability risks for directors**<br>- **Divide between committee members and remaining directors**<br>- **Risk of board assumption of managerial duties** |

***Table 1 Benefits and Drawbacks of Strategy Committees***

## Conclusions and recommendations

The strategy committees are deeply embedded in the context of continuously evolving corporate systems and that's the reason why special attention should be given to such issues involving strategic decision-making processes.

Now that a theoretical foundation regarding strategy committees in the context of boards' involvement in strategy has been established against the background of the general corporate governance debate, it shall be of further interest to investigate the role and tasks of strategy committees in large German and Swiss corporations today.

Yet, only four companies have installed strategy committees. Upon a comprehensive review of the literature, one may ask why so few corporations have taken this decision. The advantages of installing a strategy committee seem striking. In light of the much debated globalisation of today's economy and steadily augmenting competitive pressures, companies should seek to tap into all potential sources of competitive advantage available to them. This includes the expertise of board members, their experience and analytical competencies. While it is difficult to specify what exactly the optimal committee's design would have to be, it may be suggested that they be composed of four to six non-executive directors, who take the chance to intensely discuss future business opportunities and the corporations' strategic direction.

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