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Setting and vetting strategy: Bridging the chasm between CEOs and boards

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Abstract One of directors' key fiduciary duties is to set the firm's direction and then vet the strategy proposed by the CEO. Despite this, McKinsey reports that the majority of directors feel they do not understand their firm's strategy, and even if they do understand it, they do not feel they have the desired impact on their firm's strategy. This article argues that this shortfall stems from a failure to cross the chasm between CEOs and directors. We propose a framework to bridge this gap and assist board members to better understand and vet their firm's strategy.
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1. A challenge for the board

One significant challenge for board members is to vet their firms' strategies adequately (National Association of Corporate Directors, 2014). This challenge stems from the fact that directors lack either meaningful opportunities to participate in the strategy process or information to make a significant impact. This article reviews the reasons boards often fail to vet their firms' strategies effectively and then proposes a set of steps for CEOs and board members to follow. The proposed strategy setting and vetting process involves boards critically reviewing the CEOs' answers to three strategy questions: (1) Where is the firm today? (2) Where does the firm want to go? (3) How can the firm get there? Using our proposed 5Ps framework to actively work through these questions with CEOs ensures that directors effectively perform due diligence on their firms' strategy. Helping directors' bridge the process and informational chasm improves the quality of their firms' strategies (De Kluyver, 2013; Nadler, 2004) and firm performance (Zhu, Wang, & Bart, 2016). In addition, increasing director engagement

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in the strategy process enhances director buy-in and their satisfaction as board members (Bhagat & Kehoe, 2014; Nadler, 2004). While the proposed strategy setting and vetting steps involve additional effort from CEOs, it also benefits CEOs as increased directors' buy-in and satisfaction also increases CEO tenures (Felton & Fritz, 2005; Kerr & Werther, 2008).

2. Why boards fail to set and vet strategy

Strategy is a set of interrelated choices that CEOs make to serve the firm's target customers profitably (Porter, 1996). A critical, value-creating responsibility of boards is setting their firm's direction and then vetting the strategy proposed by the CEO to reach it (National Association of Corporate Directors, 2014). Although corporate directors need to be actively involved in the firm's strategy process to fulfill their role, McKinsey found that only 43% of nonexecutive directors surveyed felt they had influenced their corporation's strategy (Barton, 2011), and 44% of directors reported that they "simply reviewed and approved strategies" presented by the CEO (Bhagat, Hirt, & Kehoe, 2013, p. 17). These results suggest that many corporate board members are neglecting their duty of care with respect to setting and vetting strategy.

There are several reasons why boards are too passive when setting their firm's direction and then vetting its strategy, beginning with the fact that the typical corporate strategy formulation and approval process is not conducive to board input (Kerr & Werther, 2008; National Association of Corporate Directors, 2014). While boards are responsible for setting direction and vetting strategy, CEOs are responsible for formulating strategy. Some CEOs are reluctant to allow board member input into the strategy process as they are unsure how to constructively engage boards or fear that engaging the board may encourage directors to become more hands-on and micromanage the firm's executive team (De Kluyver, 2013; Roy, 2011). Other CEOs may believe that board members lack information to make a positive contribution to strategy and thus restrict opportunities for board input (Banta & Garrow, 2017; Kerr & Werther, 2008). Given this, CEOs typically present the firm's strategy not as a draft for board review, but rather as a finished product for board approval (Kerr & Werther, 2008; National Association of Corporate Directors, 2014).

For their part, board members may hesitate to be actively involved in the strategy process. A typical board strategy planning session involves presentations from the executive team on the firm's SWOT (strengths, weaknesses, opportunities, and threats), strategic alternatives, and implementation plan. Time is provided for questions from the board, but critically questioning the strategy recommended by the CEO may be viewed as a direct challenge to the CEO, so many board members simply rubber stamp the strategy (Mankins, 2007; National Association of Corporate Directors, 2014).

Boards also need to walk a fine line, as they are responsible for both reviewing the proposed strategy and monitoring the performance of the firm's strategy and its CEO (Kerr & Werther, 2008; National Association of Corporate Directors, 2014). If boards step over the line and force CEOs to adopt their preferred strategies, then it will be difficult for boards to assess the performance of the CEO. If board members are to fulfill their fiduciary duty, boards and CEOs need to cross the process chasm in a manner that allows both parties to fulfill their respective corporate governance responsibilities in a collaborative, rather than adversarial, way (Bhagat et al., 2013; Charan, 2005; National Association of Corporate Directors, 2014).

Another reason board members may do a poor job vetting strategy is due to the significant information asymmetry between the firm's executive team and the board (Beatty, 2012). Whereas most executives spend 2,500—3,000 hours a year on the business, the National Association of Corporate Directors (2016) reported that nonexecutive directors spend an average of 245 hours on the business. Recently, security regulators and large institutional investors have pushed corporations to increase the number of independent board members, who do not have intimate knowledge about the firm, which further exacerbates the information asymmetry problem (Bruni-Bossio & Sheehan, 2013). Given the significant differences in knowledge and time spent on the business, directors may lack information to fulfill one of their most important duties as a board member: performing due diligence on the strategy proposed by the CEO.

One common tactic to overcome the information chasm is to provide board members with a large amount of readings and data relating to the company (Mankins, 2007). However, this presents another cognitive challenge for nonexecutive directors as they must first read and absorb the information before being able to apply it and vet the firm's strategy effectively (Roy, 2011; Zhu et al., 2016). Indeed, providing directors too much information poses as much of a problem as providing them too little information (Nadler, 2004). Even if the quantity of strategy information provided to directors is appropriate, there is no guarantee that

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