

ROLE OF NON-EXECUTIVE DIRECTORS IN STRATEGIC DECISION-MAKING

EUGENE KANG

Companies' business strategies are of increasing importance to boards and command more of their focus.

In the recent SID-SGX *Singapore Board of Directors Survey 2015*, the top three areas identified by boards to be most important and that should take up the majority of the board's time moving forward are: business performance, strategy development and strategy execution. Compliance, risk management and other aspects of corporate governance come further down the rankings.

Not surprisingly then, more than half (55 per cent) of the boards surveyed held a dedicated board strategy session during the year. The majority of boards that did not hold such strategy sessions

said that this was because strategy was “largely management’s responsibility”.

Indeed, the question of the role of the board versus that of management in strategy development and execution can be a contentious one. How far should the board be involved beyond its basic oversight role on strategy (and other matters)?

Tied to this question of the board’s role is the issue of the value and nature of the non-executive directors’ (NEDs) participation in the strategy process. Executive directors (EDs) are, by definition, part of management and would already be intimately involved in strategy development and execution. What then is the value of NEDs’ participation and how can that be best optimised?

NED VALUE

The value of NEDs is the independent and fresh views that they can bring to the table.

As they are not tied down by the company’s historical baggage and traditions, NEDs can offer strategic inputs and perspectives that can improve the decisions being made. They are able to objectively evaluate and monitor the appropriateness of current strategies and hold management accountable for the strategic outcomes.

However, some management staff may view those from the outside of the company as having limited value in strategic decision-making.

They may argue that NEDs will not be as familiar with the strengths and weaknesses of the company nor the opportunities and threats that the company faces. This unfamiliarity can be compounded in complex and large firms that operate in multiple countries with diverse institutional and competitive environments.

NEDs are usually reliant on management to provide relevant information to them. Given the lack of intimate knowledge, they may be less willing to challenge the information provided by top executives to avoid the perception of ignorance and are thus more willing to rubber stamp the top executives' proposals.

It can also be argued that an NED's substantive involvement in strategic decision-making can lead to a loss of independence in judgement. It could result in excessive buy-in of the selected strategy that leads to a lack of cognitive will to challenge his or her own assumptions that these strategies are predicated on.

NED PARTICIPATION

There are clear challenges in involving NEDs in the strategic decision-making process. Each company should decide on the level of involvement of NEDs in the decision process based on its circumstances.

However, there are steps that boards can take to improve the contributions of NEDs towards strategy development.

First, the human and social capital of NEDs should be a key screening criterion adopted by the nominating committees. These directors should possess the necessary skills, experience and networks to contribute substantively to strategy development.

Second, nominating committees should appoint NEDs that collectively house a diversity of skills, experience and networks to enrich strategic decisions. Strategic decisions are largely made in uncertain environments that are constantly changing. Hence, a diverse board acts as a hedge against unanticipated changes. In particular, NEDs' networks that span diverse industries and boundaries are often useful sources of fresh insights.

Third, to further improve the effectiveness of NEDs in strategy development, newly-appointed directors should attend regular company-specific training programmes to increase their familiarity with the internal and external environments that the company is embedded in.

Fourth, boards must increase the awareness of cognitive biases in decision making, not just for NEDs but for EDs and other top executives too. Two decision-making biases that may reduce the effectiveness of decision making are: confirmation bias, where decision-makers unconsciously seek out (or ignore) information that confirms (or disconfirms) their initial judgement; and anchor and adjustment bias, where decision-makers often make insufficient adjustments to initial estimates that inform decision making.

Not surprisingly, the 2013 McKinsey Global Survey on Governance reported that reducing decision biases is the biggest aspiration for high-impact boards. Fifth, some turnover of NEDs is desired to combat the cognitive biases of prolonged involvement to allow fresh perspectives into strategic deliberations. Hence, nominating committees should take an active role in managing tenure diversity among NEDs, and consider doing so for EDs too.

Adopting the above practices, and institutionalising some as formal policies, will go a long way to ensure that NEDs have the needed company-specific and operating-environment knowledge to substantively contribute to strategy development, while minimising the potential risks of being less effective in their oversight and control role.

NEDs' involvement in strategic decisions will continue to be a fruitful area of discourse. Like walking on a tightrope, balance is crucial for such directors to create long-term value for investors. ■