University of St.Gallen

International Center for Corporate Governance

Strategic Governance in Swiss SMEs

Paper presented at the
11th workshop on Corporate Governance,
St. Gallen, Switzerland
October 27-28, 2014

© 2014   Prof. (FH) Dr. Roman Lombriser,
International Center for Corporate Governance (ICfCG)

Overview

1. Research Problem & Objective
2. Research Methods
3. Theoretical Framework
4. Empirical Study – Phase 1: Online-Survey
5. Empirical Study – Phase 2: In-depth interviews and observation of four "real life cases"
6. Conclusions
7. Provocative Statements for Discussion

Overview

1. Research Problem & Objective
2. Research Methods
3. Theoretical Framework
4. Empirical Study – Phase 1: Online-Survey
5. Empirical Study – Phase 2: In-depth interviews and observation of four "real life cases"
6. Conclusions
7. Provocative Statements for Discussion

Research Problem:

theoretical perspective:

- **board *process*** (as opposed to board *characteristics*) still lacks research in several important areas such as e.g. **strategy development** and **control** *(Hendry et al. 2010; Finkelstein & Mooney, 2003)*

- most **recommendations** for board practice offered by researchers are aimed at big corporations, **not SMEs** *(Calabrò & Mussolino, 2013; de Kluyver 2013).*

practical perspective:

- many top managers and board directors want to **clarify their role** in strategy *(Huber/Hitchman, 2011; Bhagat et al. 2013)*

How forward-looking boards should spend their time
(Casal & Caspar, 2014)

Traditional board agenda ■ Additional, forward-looking activities

Recommended Board Activities
(Casal & Caspar, 2014)

Fiduciary
① Annual accounts
② Annual budget directives
③ Next year's budget
④ Auditors' report
⑤ Audit-planning approach
⑥ Audit-committee reviews

Strategy
⑦ Set framework for the year
⑧ Define broad options
⑨ Outline/select options
⑩ Approve final strategy approach
⑪ Review strategic and competitive position, key performance indicators

Investment
⑫ Engage in ongoing review of investment proposals

Talent
⑬ Set talent-review objectives for the year
⑭ Review top 30–50 people

Risk
⑮ Determine risk-review objectives for the year
⑯ Conduct annual risk review, including mitigation approaches

Board reinvention
⑰ Conduct board 360° evaluation
⑱ Determine approach for board-process enhancement

Decisions
⑲ Engage in decision making—eg, on budgets, investments, M&A, and key nominations

Board education
⑳ Travel with sales staff, customer visits
㉑ Visit R&D facilities
㉒ Visit new geographies
㉓ Inspect production sites
㉔ Attend customer conference

Objective of the study

▪ The **objective** of the study was to answer the following questions:

– how do **board of directors (BoD)** and **top management teams (TMT)** in Swiss SMEs „**strategize**" (i.e. perform strategic work)

– how are the **roles** in this task **divided** between board of directors and top management? **how effective** are the different approaches?

– what **strategic competences** are most important **in BoD** and how well are they developed in Swiss SME?

– how can BoD and top management teams in Swiss SME **improve** the effectiveness of their **strategic work**?

Overview

Research Methods: Overview

- quantitative & qualitative research:

  - *quantitative (Phase 1)*: online survey of board of directors and top managers in Swiss SME *=> short overview of results*

  - *qualitative (Phase 2)*: in-depth interviews with BoD and TM and observation of four "real life cases" to discover effective and non-effective strategy approaches in SME (content analysis) *=> focus of presentation: board's role in strategy development*

Overview

Who is responsible for strategy development?

de Kluyver (2013)

- **traditionally,** direct involvement of boards in strategy was only in the following situations:
  - retirement of an incumbent CEO
  - major investment decision or acquisition proposal
  - sudden decline in sales or profits
  - unsolicited takeover bid

- **required new role** due to regulatory and competitive pressures:
  - playing an ongoing strategic role
  - participating in annual strategy retreats
  - CEO performance evaluation on the basis of strategic parameters

Codes of Best Practice and Reality

de Kluyver (2013)

- In attempts to provide guidance on the issue of strategy, numerous "**codes of best practice**" have been proposed in recent years urging boards to play a more active role in strategy

- **Reality**:
  - in most companies even today boards **limit their involvement to approving strategy proposals** and to **monitoring** progress toward strategic goals
  - unclear: what does **active role** exactly mean?

How Boards Strategize: A Strategy as Practice View (Hendry/Kiel/Nicholson 2010)

- Research gap: „…our understanding of how boards address their role in strategy, especially how they work together with management on strategy, is limited."

- „strategy as practice view": strategy is something that people in organizations "do" rather than something the organization "has"

- more *qualitative* research is needed:
  – board meetings, strategy workshops, ad hoc director-manager discussions
  – Interview method

- passive-active continuum is an oversimplification

What does „active involvement" really mean?

passive vs. active =?

formal planning?
vs.
social interaction?
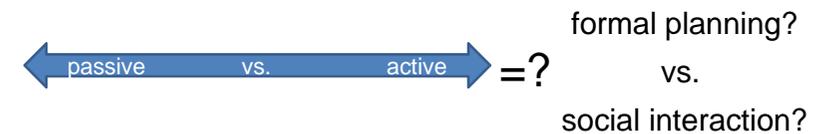
Procedural and interactive strategizing at board level
(Hendry et al. 2010:38)

***two different but complementary strategizing practices:***

Procedural strategizing:

- administrative, **formalized** and **hierarchical** focus

- key theme: formal review and approval of management's strategic proposals

- board functions as a selection and control body, responding to management's interpretation of strategy

Interactive strategizing:

- focus on **ongoing social exchanges** in formal board meetings and strategy workshops *as well as* in informal, sometimes ad hoc, strategy discussions between directors and management

- key theme: ***face-to-face*** collaboration between directors and management

- open and direct communication, persuasion and negotiation

Procedural and interactive strategizing: complementary rather than mutually exclusive

Interactive Strategizing
(social exchange / face-to-face)

	low → high (Procedural Strategizing)	
high	episodic collaboration	formal *and* informal collaboration
low	minimalistic involvement	formalized oversight

Procedural Strategizing
(formalized / hierarchical)
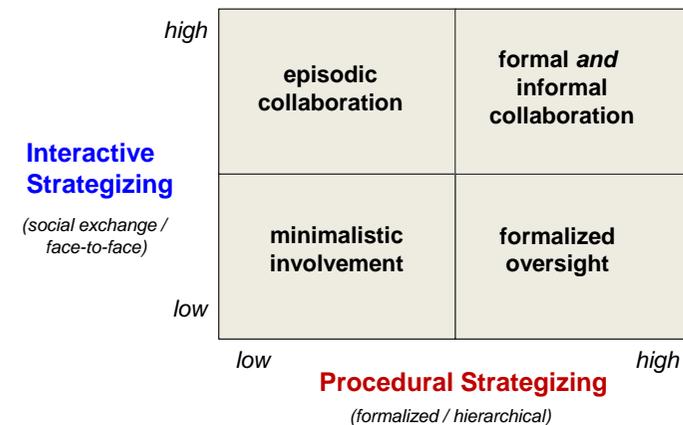
Procedural Strategizing "in extremis"

"Most corporate planning is like a rain dance ritual:
it has no effect on the weather that follows, but it makes
those who engage in it feel that they are in control.
**Most discussions on planning are directed at improving
the dancing, not the weather**."

R.L. Ackoff (1981)

Overview

Survey participants and their roles

- totally **252 BoD and/or members of top management** from **240 Swiss SMEs**

  - **144 BoD:**
    - 78 with pure board role
    - 66 with additional management role

  - **174 members of top management:**
    - 108 with pure management role
    - 66 with additional board role

Board of Directors (BoD)   **Top Managers (TM)**

78   **66**   **108**
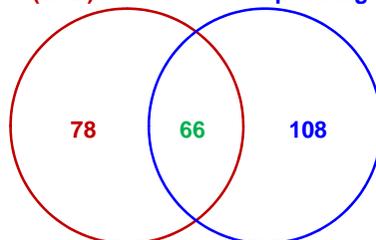
Measurement of effectiveness of strategic leadership by BoD and TMT

The survey used **seven** different **criteria** to **measure** the **effectiveness of strategic leadership** by BoD and TMT: (each of them was measured along a 5 point scale*)

criteria with influence on the overall success of the firm:

- **degree of satisfaction** with overall **strategic leadership** by BoD and TMT
- **degree of satisfaction** with **division of strategy tasks** between BoD and TMT
- fulfillment of **company objectives**

*criteria related to competitive position:*

- **relative competitive position** in core business today
- **development of relative competitive position** over last three years

financial criteria:

- **development of turnover** over last three years
- **profitability** relative to competitors

*statistical significance (p-value) $p < 0.05$

3.1 Number of directors depending on turnover

Ø number of directors depending on turnover (n=223)

Turnover	Ø number
<1Mio.	2.4
1-5Mio.	3.2
5-10Mio.	3.8
10-20Mio.	4.3
20-50Mio.	4.8
50-100Mio.	4.6
>100Mio.	5.5
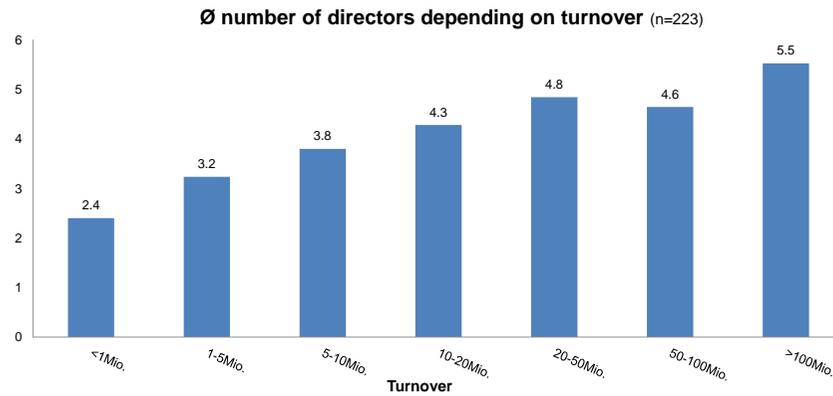
➢ **die average number of directors of all participating SME is 4.3**

5.1 Directors with dual roles: three examples

member of the **Board (BoD)** Member of **Top Management Team (TMT)**

exple.1: BoD and TMT consist of 8 persons (total)
=> *completely divided teams*
BoD *no operational activity*

exple. 2: BoD and TMT consist of 7 persons (total)
=> *1 of 4 directors is operational (=25%)*
BoD *partly operational*

exple.3: BoD and TMT consist of 5 persons (total)
=> *3 of 4 directors are operational (=75%)*
BoD *majority* operational

5.2 Directors with dual roles: frequency in SMEs

responses in % (n=222, without NPO)

BoD *not* operational — 36 — BoD TMT
no director is part of top management

BoD *partly* operational — 38 — BoD TMT
1 to maximum half of directors are part of top management

majority of BoD operational — 25 — BoD TMT
majority of directors is part of top management

How many directors are also part of top management (i.e. operational active)?
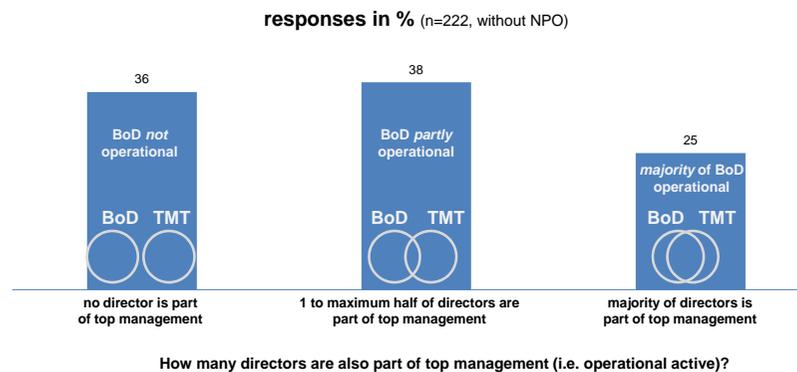
➢ **in 36% of participating SME, none of the directors is operationally active (i.e. part of top management)**
➢ **in 25% of SME, the majority of directors is also operationally active**

11.5 Involvement of the BoD and TMT in the main strategy phases according to theory (Hilb 2012)

	Strategic Guidelines	Strategy Development	Strategy Approval	Strategy Implementation	Strategy Control
BoD	●		●		●
TMT		●		●	
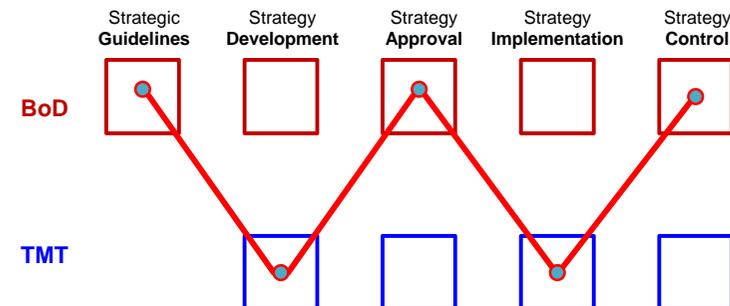
11.1 Involvement of BoD and TMT in strategy *development*

responses in % (n=216)

Who participates in strategy *development*?
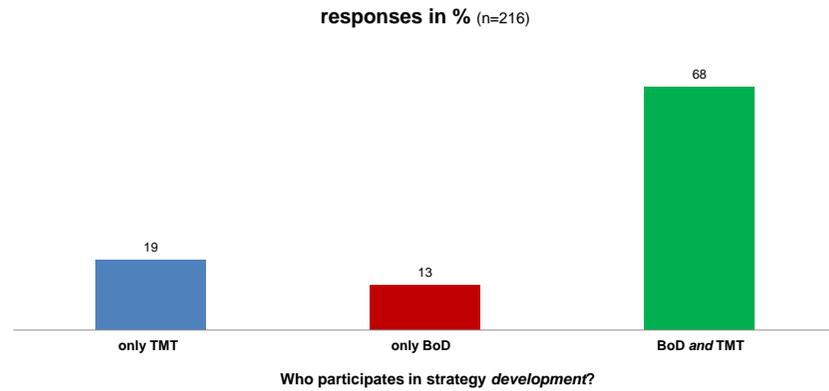
> ➢ in 68% of participating SMEs, strategy development is performed by both BoD and TMT
> ➢ only in 13% of SMEs does the BoD not participate in strategy development

11.4 Involvement of BoD and TMT in strategy *control*

responses in % (n=211)

Who is involved in strategy *control*?
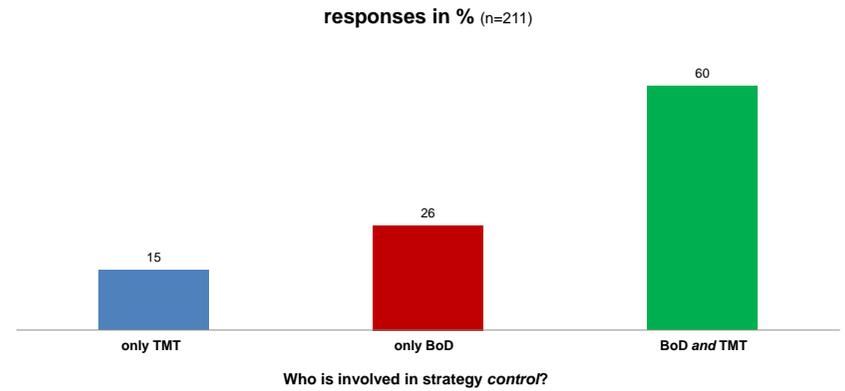
> ➢ in 60% of participating SMEs, strategy control is performed by both BoD and TMT
> ➢ in 26% of SMEs, strategy control is performed by the BoD only

## 11.6 Collective strategy development of BoD and TMT and effectiveness of strategic leadership

Ø Satisfaction with **division of strategy tasks between BoD and TMT**

Who is involved in strategy *development*?
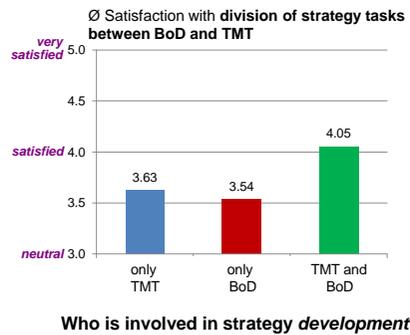
(n=160, only SME in which no more than 50% of directors are part of TMT)
scale 1-5)

> ➢ SMEs, in which strategy development is performed collectively by BoD and TMT show a higher score on all seven measurements of effectiveness, especially with regards to satisfaction with the division of strategy tasks between BoD and TMT, and development of turnover

9a. Involvement of the BoD and TMT in the main strategy phases: effective approaches in SME practice

Slide 56
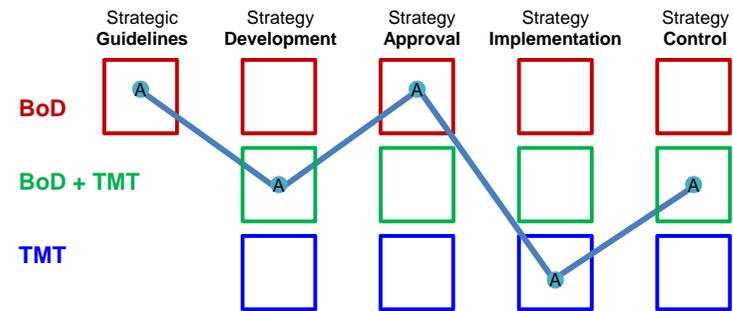
15.2 Time investment by BoD for strategic tasks: different assessments between directors and top managers

Assessment of time invested by BoD for strategy
(responses in % per category, n=148)

Time invested by BoD is...
- too little
- just right
- too much

member of the board: 21 / 74 / 5

top manager: 43 / 54 / 3

Role of survey participant
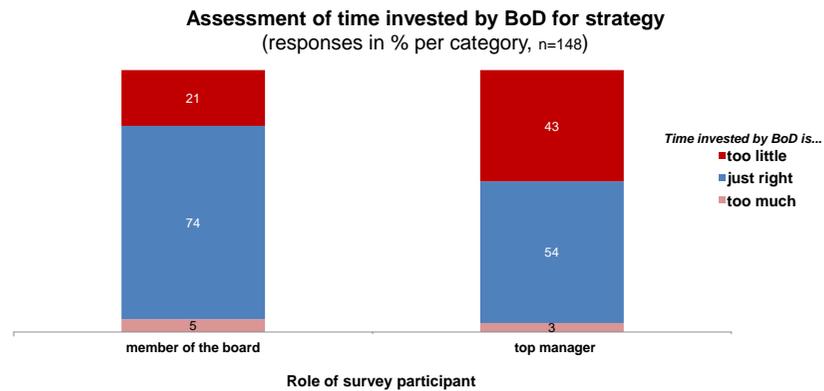
> ➢ **43% of participants with pure TMT role assess the time invested by BoD for strategy as too little (compared to only 21% participants with pure BoD role)**

Slide 63

Overview

Slide 66

Interviews and real life cases:

55 interviews with:

- 40 practitioners in their role as Chairman, CEO or member of TMT (22 of them in dual roles)

- 15 SME governance and/or strategy experts (most of them with top management and/or board experience)

4 „real life cases":

- author's direct observation of „strategy in action" (two regular board meetings, two daylong strategy workshops jointly held by the board and TMT)

Slide 67

Division of Strategic Roles between Board and TMT in strategy process

Strategic **Guidelines** · Strategy **Development** · Strategy **Approval** · Strategy **Implementation** · Strategy **Control**
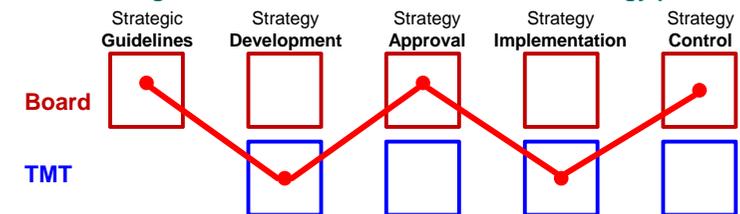
Board
TMT

„W-approach" of division of roles (Hilb, 2012)

successful SME practice („tilted W"):
cooperative interaction between boards and TMT

Board
Board + TMT
TMT
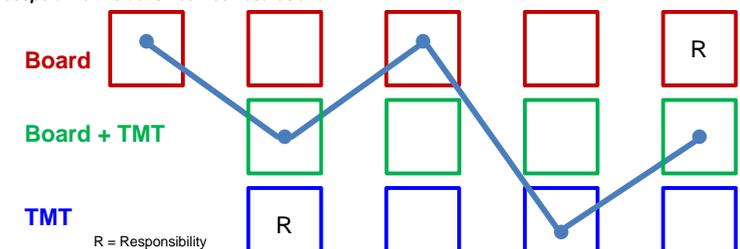
R = Responsibility

Strategic Guidelines – broad vs. narrow

Examples:

Guidelines

too broad (superficial, general)

← very broad →

„Our strategy should make a contribution to society"
(which companies does not want to do this?)

„We want to be No. 1 in our industry"
(what exactly does this mean? No. 1 in terms of what?)

arena of useful guidelines

situational definition of guidelines (broader vs. narrower)

„build new business in order to reduce dependence (lump risk) on single product XY"

„in emerging countries (BRIC): only premium strategy"

„no outsourcing (or relocation) of production"

too narrow (=concrete strategy)

very narrow

„entry in Eastern Europe with products X+Y. Sales only via partner Z."
(excludes other possible options, restricts discretion of TMT)

much too narrow (=implementation)

„launch new product line XY in March via these sales channels…"
(too operative)

> **strategic guidelines** are **important**, BUT they should be neither too broad nor too narrow
> most effective is a *combination of "hard"* (financial, product/market space etc.) strategic guidelines with „*soft*" (leadership, ethics etc.) guidelines

---

Phases and Tasks in the holistic Strategy Process

Owner Strategy

Strategic Guidelines
– planning / process parameters
– content

Strategy Development
– acquiring information
– analysis (SWOT)
– developing alternatives
– choice & proposal

Strategy Approval
– evaluation of alternatives
– decision

Strategy Implementation
– measures & milestones
– budgeting
– execution

Strategy Control
– implementation control
– effectiveness control
– review of strategy and its premises

Interactive Strategizing: where?
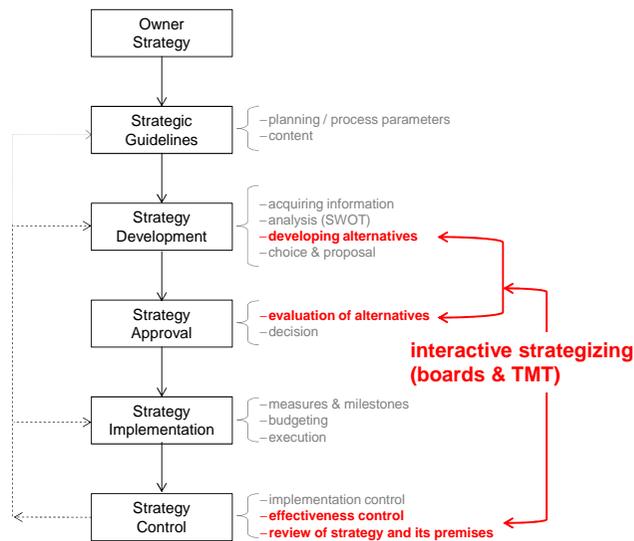
Owner Strategy

Strategic Guidelines
– planning / process parameters
– content

Strategy Development
– acquiring information
– analysis (SWOT)
– **developing alternatives**
– choice & proposal

Strategy Approval
– **evaluation of alternatives**
– decision

interactive strategizing (boards & TMT)

Strategy Implementation
– measures & milestones
– budgeting
– execution

Strategy Control
– implementation control
– **effectiveness control**
– **review of strategy and its premises**

Overview

1. Research Problem & Objective

2. Research Methods

3. Theoretical Framework

4. Empirical Study – Phase 1: Online-Survey

5. Empirical Study – Phase 2: In-depth interviews and observation of four "real life cases"

6. Conclusions

7. Provocative Statements for Discussion

Procedural strategizing as a main dimension for studying strategy involvement is not very helpful for SME

high

Interactive Strategizing

(social exchange / face-to-face)

episodic collaboration	formal *and* informal collaboration
minimalistic involvement	formalized oversight

low
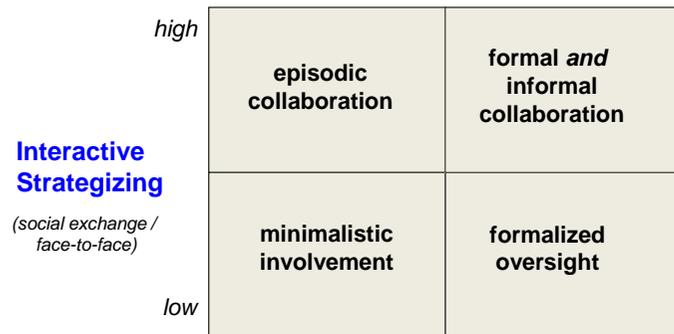
the main question is whether an SME has a concept of strategy at all!

Strategic leadership approaches by boards in Swiss SMEs

board dominates interaction

Interactive Strategizing (between Board and TMT)

(direct leadership)

cooperative dialogue

„hands-on" board

board as „commander"

board as „constructive sparringspartner"

„non-strategic" board

board as „pilot"

none — Strategic Guidelines — Detailed Strategy
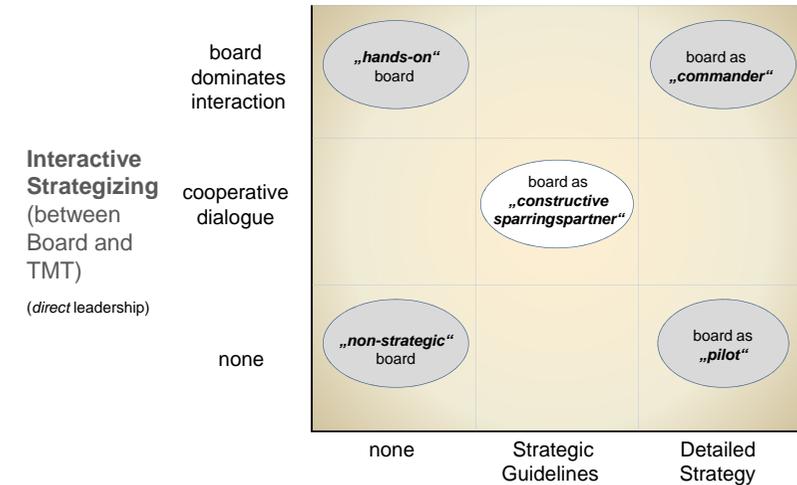
Conceptual Strategizing by Board

(indirect leadership)

Different Stages in the Strategic Dialogue

Objective:

developing alternatives
➔ *new perspectives*

selecting the best strategy
➔ *consolidation* & *consensus building*

sustainable decision
➔ *realization*

Strategic Dialogue

open discourse:
-developing possibilities & new perspectives
-disclosing all important assumptions

„what are the possibilites?"
„what are my & your assumptions?"
„what experiences do we & others have?"
„what new insights can I bring in?"

iterative process

Coming to conclusions:
-examining (Pros & Cons)
-weighting / evaluating

„what are the advantages & disadvantages?"
„how do we weight them?"
„what would be the consequences for us?"

Decision:
-deciding
-reasoning

„do we all agree or should we have a vote?"
„what are the reasons for our decision?"

Overview

1. Research Problem & Objective

2. Research Methods

3. Theoretical Framework

4. Empirical Study – Phase 1: Online-Survey

5. Empirical Study – Phase 2: In-depth interviews and observation of four "real life cases"

6. Conclusions

7. Provocative Statements for Discussion

Strategic Governance in SMEs: Provocative Statements

1. Boards in SMEs have more possibilities to be strategic than boards in big corporations.

2. Universal recommendations concerning the strategic role of boards in SMEs are useless. Situational factors (such as home country, size of SME, ownership, firm culture, leadership etc.) render any recommendation obsolete.

3. Don't look at boards or TMT: it's all about the CEO and the Chairperson and their working relationship!

4. The „constructive sparringspartner" is a fad. Either the Board of Directors *or* the Top Management Team is in charge of strategy. There is nothing in between.

IFPM-HSG **C**enter for **C**orporate **G**overnance
Universität St.Gallen
© R. Lombriser