The Director's Focus

Where to Spend Your Time and Energy

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READY FOR YOUR BOARD MEETING?

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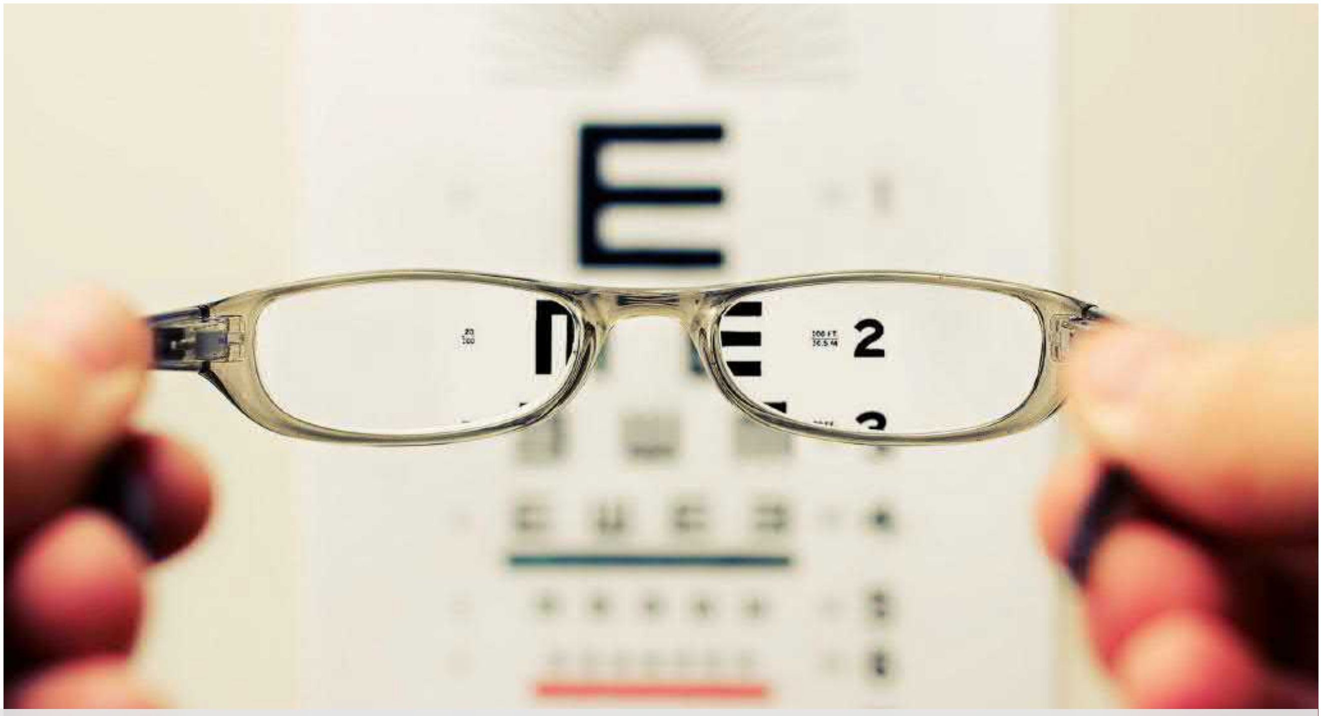


Focus on strategy, people, finances, and risk.

To be effective, board directors must make the best use of the limited time available to them. They need to differentiate between what's housekeeping and what's vitally important, so they can focus their time and energy in the areas where they can add the most value.

These four areas are strategy, people, finances, and risk.

Effective directors focus on these four aspects of the business as they prepare for board meetings. And a good portion of each board meeting agenda should be focused there as well.

Making the Best Use of Your Time

Time is at a premium for everyone. There's a particular time crunch for directors who are serving on a volunteer board in their so-called 'spare time.' Frequently they are juggling family and work obligations and trying to carve out a little time for themselves, in addition to serving on a board of directors in a cause they care about.

Even directors who are retired from full-time employment and whose children are grown still find many demands on their time.

Board work does indeed require a considerable time commitment, especially when committee work and extra activities – such as board retreats, training and development, and (for charitable organizations) fundraising events – are factored in.

That's why it's so important to focus in the right areas - those that will allow you to make the best use of your skills and add the most value to your board.

Consider these tips to make the most of your limited time:

Find out about the time requirement from the get-go.

Be realistic about your availability.

Set aside uninterrupted time for meeting preparation.

Follow a consistent process to get ready for meetings.

Follow-up on any action items immediately.

Focus Area One - Strategy

At its core, an organization's strategy is about choices.

It's important for every organization to have clear goals. Goals are where the organization wants to end up, but it needs a strategy to get there. If the goal is the destination, then its strategy is the travel plan.

An organization's strategy is about choices - choices about what it is going to do, and also what it will choose not to do. When the strategy is clear, you'll find that it provides guidance for future decisions.

And when the strategic direction is communicated widely, it creates alignment of efforts throughout the organization.

The Board's Role in Strategy

The process of developing strategy usually encompasses analyzing the current state, defining the desired future state, developing the strategic plan, and determining how the plan will be monitored. In medium to large organizations, management usually conducts these steps, and the board's involvement is often limited to providing input at the beginning, reviewing updates as the work progresses, and approving the plan at the end. In smaller companies, the board may take a hands-on role throughout the entire process.

Whether or not the board is actively involved, directors must understand the strategy well enough to challenge assumptions, assess risks, offer advice, influence direction, and be confident that the plan is sound. The board will want to know how the organization's budget aligns with the plan and whether the organization has the capacity – both financial and human — to execute the proposed strategy.

Developing a formal strategic plan generally occurs only once every three to five years, but the board's responsibility for providing oversight of the plan's execution is ongoing. Without such oversight, the plan risks becoming a once-and-done document collecting dust on a shelf somewhere. Oversight holds management accountable for results and ensures the plan remains relevant to the changing environment.

The strategic planning process is intensive and time-consuming. Generally, this work takes place at special board meetings and/or board retreats, as there is seldom enough time available on the regular board agenda. Regular board meetings, however, should always allow for time to monitor progress against the strategic plan. In many cases, authority for strategic direction is kept in the hands of the full board, but a board might choose to establish a strategy committee or delegate the work to another committee.

Strategic Choices

In *'A Playbook for Strategy: The Five Essential Questions at the Heart of Any Winning Strategy'* (©Harvard Business Review, January 2013), authors A.G. Lafley, Roger Martin and Jennifer Riel write that strategy involves answering five basic questions:

- What is your winning aspiration? What is the organization's goal as expressed in clear, compelling mission and vision statements?
- Where will you play? What field will the organization operate in? What needs will it address? What customers will it serve? How broad or narrow will be its approach?
- How will you win? What methods will the organization use? How will it create value? What brand reputation will it build?
- What capabilities must be in place? What does the organization need to be really good at?
- What management systems are required? What processes, structures and measures have to be in place to make this plan work?

How You Can Add Value to Strategic Planning

Board directors add value not just during the formal strategic planning process, but on a continuing basis as the strategy is executed and reported on.

- **Exercising foresight.** Take a long-term perspective to help offset the short-term operational pressures that occupy management. You should be constantly thinking about opportunities, risks, and possible scenarios over the long term.
- **Considering the plan's duration.** Most strategic plans run from three to five years, but there is nothing magic about those numbers. You can question the underlying assumptions about the best planning period to fit the pace of the business
- **Staying alert to changes in the environment.** In a highly dynamic environment, plans can easily lose their relevance before they are set to expire. Your insight helps the board see around corners, asking the kind of catalytic questions that uncover issues on the horizon that may require adjustments to the plan.
- **Thinking about strategy and risk holistically.** Strategy and risk are intertwined. A new strategy invariably brings new risks. You can ask key questions like *'What are the strategic risks?' 'Are they within the board's risk tolerance?' 'How will these risks be managed?'*
- **Evaluating management capabilities.** Ask questions like *'Are the skills of the CEO and the management team a good match for the new strategy? Or is there a gap to be closed?'*
- **Allocating resources and funding.** Make a point of ensuring that the organization's capital and operational budgets are aligned with its strategic initiatives.
- **Assessing board competencies.** Think about the board's own composition in light of the changing strategy. Ask yourself: *'Do we have the skills we need around the board table to support the CEO in executing the new plan?'*

Focus Area Two - People

Our organizations are accountable to a broad base of stakeholders.

Given what's happening in our world, the idea that organizations should be accountable to a broad base of external stakeholders has gained traction, pushing the topic of stakeholder engagement to the top of many board agendas. After all, our organizations don't exist in isolation. They are influenced by the same forces of change that we're all dealing with – forces like climate change, truth and reconciliation, social justice, activism, and so on.

In addition, it's more obvious every day – if there was ever any doubt – that an organization's long-term success is dependent on attracting, retaining, and engaging talented people. And so Human Capital Management has become a top-of-mind concern for every board of directors,

Stakeholders

Stakeholders are persons or groups with an interest in an organization who can affect or be affected by its decisions and activities. All organizations have stakeholders, although who they are varies widely based on its activities – what it does, where it operates, and who is impacted.

Some organizations have a very long list of stakeholders - employees, unions, contractors, customers, suppliers, investors, regulators, NGOs, governments, pension plan members, special interest groups, media, and the community. Non-profits may need to add members, clients, families, volunteers, donors, funders, and neighbors.

The term stakeholder engagement refers to the work that organizations undertake to identify, understand, communicate with and involve their stakeholders. The idea that organizations should be accountable to a broad base of stakeholders has been gaining traction, pushing the topic of stakeholder engagement to the top of many board agendas. Effective stakeholder engagement builds trust between an organization and its stakeholders. Organizations benefit by accessing valuable information, creating goodwill, and identifying potential issues. Stakeholders, in turn, benefit by helping the organizations understand their needs.

Stakeholder engagement begins with identifying the organization's own unique set of stakeholders. Not every stakeholder group merits the same degree of attention. Some are far more important to the organization's success than others. That's why prioritizing stakeholders is important.

Answering question like, *'How influential are they?' 'Do they have power over the organization?' 'Are they actively engaged with the organization or disinterested?'* helps the organization determine how to engage with each group of stakeholders.

Zeroing In on Stakeholders

Who are the people the board needs to focus on?

Internal Stakeholders

- The CEO or Executive Director
- The Executive Team / C-Suite
- Senior Management
- Employees
- Volunteers

External Stakeholders

- Customers / Clients
- Suppliers / Service Providers
- Shareholders / Investors
- Funders / Donors
- Community
- Public

The CEO

The relationship between the board and the CEO is a close one. Often the CEO is an *ex officio* member of the board. This relationship can have a huge influence on organizational success. The CEO and the board play different roles, but they have to pull together on achieving the organization's goals. If they're pulling in opposite directions, the organization will be at an impasse.

Mutual trust is at the core of a strong board-CEO relationship. The interactions between CEOs and their boards require honest, direct conversations to ease the tensions that arise. When there's a strong relationship, it's easier for the CEO to speak candidly and for directors to be clear about what they want from management.

The CEO is the board's sole employee, so there are interactions that are typical of an employment relationship, such as establishing compensation, conducting performance evaluations, and planning for succession. Often these activities are the responsibility of a Compensation Committee or Human Resources Committee, but in smaller organizations they might be conducted by the board chair.

Zeroing In on Stakeholders

The Executive Team

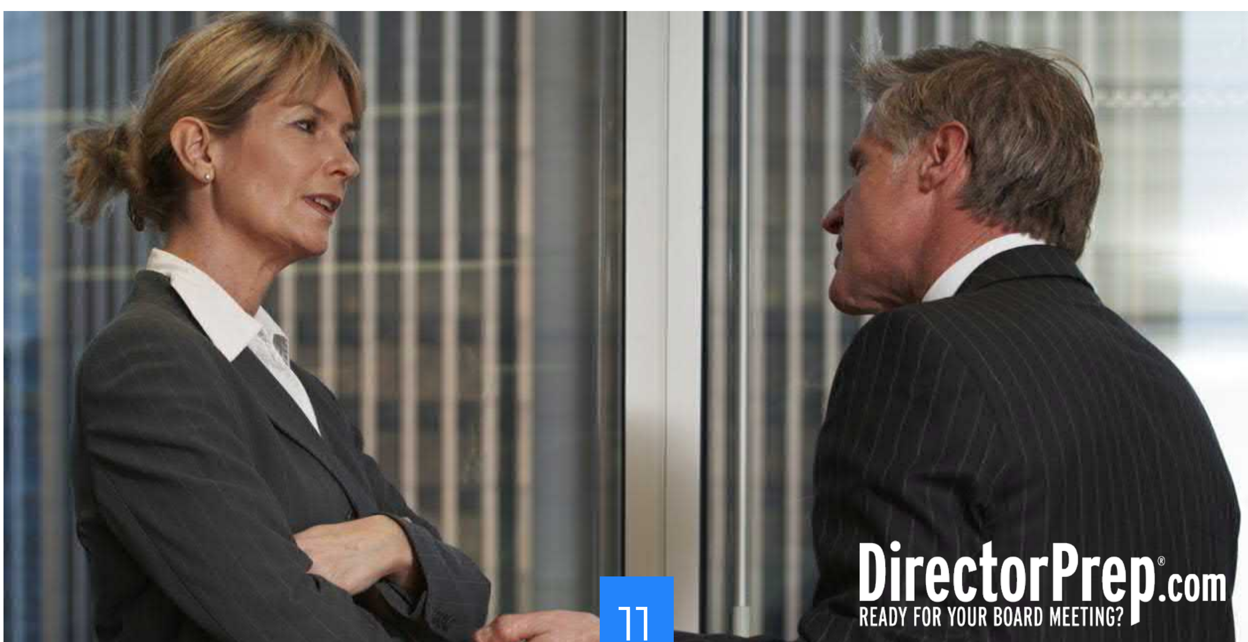
The board's people focus includes members of the executive team – you might call it the C-suite - and the senior management team. They often attend board meetings, support committee meetings, and are present at board retreats. They're also a focus for the board because they might be candidates for the CEO role at some point in the future. Directors focus on how these individuals are performing and on their compensation.

Employees

The organization's employees are also a focus for the board. Many boards take an active interest in employee engagement, which impacts an organization's culture, its ability to attract and retain talent, and how it innovates and performs over time. Given the importance of employees to the success of the organization, some boards have been experimenting with ways to better hear their voice at the board table.

Customers and Funders

Another key group of people are the organization's customers (depending on the sector, you might call them clients, users, beneficiaries, or simply the people who receive your services). And then there are funders such as investors, shareholders, major donors, etc.



The Board's Role in Stakeholder Engagement

Most stakeholder engagement processes occur at the management level as they are in the best position to identify and prioritize stakeholders. The board's role is usually seen as one of oversight to confirm that there are processes in place to identify, prioritize and understand stakeholders, and to provide challenge and direction. However, there are some circumstances where the board, or a committee, may decide it should engage directly with key stakeholder groups.

Ensuring that the organization has a culture that places a high value on trust in its relationships with stakeholders is part of good governance. In addition, directors themselves should develop a keen awareness of the stakeholder environment and understand stakeholders' perspectives and interests. This usually comes in the form of management reports, but some boards may want to bring the stakeholder view to the board via mechanisms such as advisory panels, forums, meetings, consultants, site visits, or townhall meetings. Depending on the stakeholder environment, a board might even establish a stakeholder committee to provide further focus to this function.

How You Can Add Value to Stakeholder Engagement

Effective directors have a keen interest in the environment in which the organization operates and genuine curiosity about its stakeholders. They seek to ensure that there are robust processes in place for two-way communication with key stakeholders so there are no unpleasant surprises.

They understand that stakeholder engagement is not just a nice-to-do or a way to earn brownie points. It's an essential element of running a successful organization - a way to build trusting, respectful relationships that help them pursue their purpose. Positive stakeholder relationships help them understand their environment, leading to deeper understanding, stronger decision-making, and better risk management.

Curious directors ask thoughtful, purposeful questions about the perspectives of the company's employees, suppliers, customers, and other stakeholders. Their questions ensure that, when making decisions about the future of the organization, the potential impact on stakeholders is always taken into consideration.

Here are some questions for your board to think about:

- Which groups are vital to the organization's long-term success?
- What is the level of mutual trust between us and our stakeholders?
- Are we getting the right information about stakeholders?
- Should the board be engaging directly with any stakeholder groups?
- How does our decision-making process reflect stakeholder perspectives?
- Are we spending enough time on stakeholder issues?
- Do we regularly review the effectiveness of our stakeholder strategy?
- What independent data do we have to speak to our stakeholder relations?

Focus Area Three - Finances

Stewardship of the organization's resources is a fundamental board role.

One of the fundamental roles of the board of directors is stewardship of the organization's resources. This duty includes the responsibility to protect the organization's assets and to oversee its financial affairs.

The organization's day-to-day finances are the responsibility of management; but the board has ultimate responsibility for overseeing its financial affairs and ensuring its financial health.

The board is also responsible for assuring reasonable internal controls through independent third-party reviews.

Financial Literacy

Directors without a financial background are often intimidated by the financial oversight aspect of their duties. It is tempting for them to leave the work to the accountants and financial experts on the board. But that won't do. Not everyone needs to be an expert, but basic financial literacy is a prerequisite for effective oversight.

All board members have a personal responsibility to understand the financial information provided to them and the financial implications of their decisions and actions. They're expected to probe and question until they are satisfied with their organization's financial information and the direction in which the organization is moving.

As a board director, you should be able to read and understand the organization's financial statements, budget, and reports. That doesn't mean you need the same level of financial expertise as a professional accountant. But you do need to understand what someone of your skills and background would be expected to know about the financial matters on the board's agenda.

The Financial Cycle

Focusing on three steps in the financial cycle ensures that directors are able to fulfill their responsibilities with respect to:

1. Approving the budget for the upcoming year.
2. Monitoring financial results compared to budget.
3. Approving the audited financial statements for the previous year.

The Budget

An organization's budget is a forward-looking document that projects the expected income and expenditures for the forecast period (usually one year) as well as the expected financial status at the end of the period.

Oversight of the budget requires directors to understand the organization's business model. What goods does it produce, or services does it deliver? To whom does it provide those goods and services, and at what price? Who pays, when and how? What inputs are needed and at what cost? What other costs are involved and are they fixed or variable?

Budget oversight also requires understanding the strategic plan and business plan that define objectives and set priorities, as well as the assumptions about future trends in the financial drivers that impact the organization.

The Financial Cycle

Monitoring

Monitoring consists of reviewing management's regular financial reports that explain how the organization is performing against the budget. These reports are more than rows and columns of numbers - they include analysis and insight into why performance is what it is and how the organization is likely to fare during and beyond the forecast period. Significant variances and financial surprises need to be explained to the satisfaction of the board.

Monitoring also includes review of progress against the financial metrics outlined in in the business plan. These are often summarized and represented graphically on a dashboard to give directors a complete picture of the organization's key performance indicators.

The purpose of monitoring is to assess whether the organization is on track to achieve its forecast. When it fails to achieve or over-achieves against the forecast, the impact needs to be understood and the forecast may need to be revised.

Audited Financial Statements

The annual financial statements represent a look in the rear-view mirror as well as a snapshot of the organization's assets and liabilities at a point-in-time.

These important documents are subject to an external audit and, once audited, are made available to the organization's owners, members, shareholders and other stakeholders. They're often publicly available on the organization's website and are a key factor in many financial transactions.

The financial statements communicate financial information in a very specific way conforming to accounting standards that differ somewhat from one jurisdiction to another, and from one type of organization to another. For this reason, the expertise of a professional accountant is a core competency that every board seeks out.

The Board's Role in Finances

When it comes to finances, the board is definitely hands-off. Management develops the draft budget, prepares regular reports throughout the year, creates the unaudited financial statements, and supports the external auditor in the annual audit process.

To fulfill their oversight role, boards usually delegate most of the heavy lifting to a board committee. The draft budget is presented to the board's finance committee – if it has one, otherwise the audit committee may do this work – for vetting, feedback, and possible adjustments. The committee then recommends the budget to the board for approval.

Most often, the finance or audit committee also examines the monitoring reports in detail before they are seen by the full board. Monitoring the cash position to ensure that there is sufficient cash on hand – but not too much cash sitting idle – usually falls to management. In times of crisis, the board might lean in and ask about cash flow – cash inflows and outflows over a period of time. The board will want to make sure that there are sufficient cash reserves for the long-term sustainability of the organization.

When it comes to the annual financial statements, the audit committee – which should always include an accounting professional – is mandated to deal with the external auditor, examine the financial statements in detail, and recommend approval to the board.

The board's oversight also includes making sure that appropriate financial controls are in place. The audit committee questions the external auditor about the effectiveness of internal controls and ensures any breaches are reported appropriately. A delegated authority matrix is a useful tool for establishing limits for each position from the CEO on down. In the case of an expenditure that exceeds the CEO's limit, board approval would be needed.

How You Can Add Value to Finances

Every board director has the right – and the duty – to ask questions if they're curious about anything related to financial reporting. It's part of the board's due diligence. Always remember that the non-financial director's 'dumb' question may be the one that triggers a valuable discussion.

Effective directors look for internal consistency in the organization's finances. They keep digging to discover the story that the financial reports are telling.
Directors work to ensure that the annual operating budget is aligned with the strategic plan. The question of whether or not sufficient funds have been allocated to strategic priorities is the kind of intuitive question that a non-financial director might ask.

Directors question the assumptions that underlie the budget, forecasts and cash flow analyses – how realistic are they and how much wiggle room is there? What factors are most likely to affect the forecast, and what would be the impact? The board should consider what might happen to the forecast under different scenarios – asking management for best case, worst case, and most likely outcomes.

Focus Area Four - Risk

For a board director, it's always important to consider the balance of risk and reward.

A risk is the potential for uncontrolled loss of something of value.

For an organization, a risk is something that could prevent it from achieving its goals.

Every organization is exposed to and takes risks daily. Taking an action in the face of uncertainty brings with it the potential for negative outcomes. But that same action has the potential to bring rewards and opportunities. That's the upside of taking risks.

Risk Management

Risk management refers to how an organization identifies, assesses and mitigates its risks. The sophistication of an organization's risk management system depends on its size, complexity, maturity, and resources, as well as the industry it operates in.

The risk management system allows management to bring to the board's attention material risks so directors can understand and evaluate how these risks interrelate, how they affect the organization, and how they are managed. You can group risks generally into the following categories:

- **External risk.** These typically include economic volatility, industry cyclicality, industry structural change, and political change.
- **Financial risk.** The possibility that an organization may lose money or be unable to pay its debts. Types of financial risk include liquidity, capital availability, capital structure, currency exchange rates, and interest rates.
- **Operational risk.** Broad risks that are often unique to a specific type of organization. They include customer dissatisfaction, product and service quality, technological and cost competitiveness, capacity constraints, production disruptions, IT security, vendor dependencies, input quality and cost, cyber security, and supply chain.
- **Compliance risk.** The possibility that the organization may breach applicable laws, regulations, and codes of conduct.
- **Strategic risk.** The possibility of loss arising from pursuing an unsuccessful business plan, making poor business decisions, poor execution, allocating inadequate resources, or failing to respond well to changes in the environment.
- **Organizational risk.** The possibility of loss due to ineffective leadership, lack of a succession plan, poor performance of management or staff, inability to attract and retain talent, and a negative organizational culture.
- **Hazardous risk.** Threats to property, environment or health posed by natural disasters, environmental hazards, and occupational safety and health hazards.
- **Reputation risk**. The possibility that the perception of the organization by its stakeholders may be harmed on account of negative publicity.

Risk Assessment

A typical risk assessment involves trying to pinpoint the probability, or likelihood, that it will occur, and the severity or impact that will result if it does occur. The risks are then plotted on a risk matrix. There are sophisticated ways of performing a risk assessment, but it almost always involves a high degree of personal judgment.

An organization can deal with its risks is one of four ways:

1. **Accept.** If the organization decides that the degree of risk is manageable because the costs of mitigating are too high, or it's considered highly unlikely, or the potential rewards are too great, it can simply accept it and move on with the course of action.
2. **Mitigate.** If the level of risk is too high, the organization can put in place steps to lower the risk to reduce it to a level that balances the rewards. Typically, these steps include process changes, equipment, training, etc.
3. **Transfer.** The organization can transfer the risk to another party, usually by buying insurance.
4. **Avoid.** If the organization decides that there is no way to reduce or transfer the risk to an acceptable level, it may decide to avoid the risk and forego the rewards.

The Board's Role in Risk

The board's role is one of oversight, not day-to-day risk management.

The board's risk oversight role is not a one-time event. Thinking about risk as a matter of course, in quieter times, gives an organization a leg-up when it comes to responding to unanticipated events.

The board establishes the organization's risk tolerance - the limit of risk that the organization would not willingly exceed, expressed in quantifiable terms such as dollar limits, or in more subjective terms such as reputation risk. The board's risk tolerance should be less than the organization's risk capacity, which is the outer limit in the amount of risk the organization could actually undertake.

The board also sets the organization's risk appetite, a concept that is similar to risk tolerance, but factors in the expected rate of return for which the board is willing to take on risk.

The board's oversight role also involves satisfying themselves that effective risk management processes are in place and that they function effectively.

The board keeps risk in mind at an enterprise-wide level, including how various risks are interrelated and the potential impact of several risks materializing at the same time.

It's also important to view individual projects with a view to risks. Whenever the board is assessing and making decisions about a proposed course of action, its 'risk antenna' should be on high alert.

How You Can Add Value to Risk Oversight

Management has the expertise to properly assess the organization's risk.

Directors add value by probing to ensure their view is not distorted by rose-colored glasses. Directors look beyond the risks that management has identified and consider what additional unexpected risks might be out there.

This is an area where each director's unique background is valuable and diversity of viewpoints pays off. Each director's perception of risk will be somewhat different.

A robust discussion of risk in the boardroom strengthens the decision-making process and ensures that the board and management are forging ahead with a common view of the risk environment.

Strategy

At its core, an organization's strategy is about choices.

Finance

Our organizations are accountable to a broad base of stakeholders

People

Stewardship of the organization's resources is a fundamental board role.

Risk

For a director, it's always important to consider the balance of risk and reward.

About DirectorPrep

At DirectorPrep, we're focused on only one thing - helping you get ready to fulfill your role at the board table. Whether your board meeting is in-person or virtual, we want to ensure you feel competent, confident, and eager to get going each time you sit down to engage with your fellow board directors.

For more information about DirectorPrep, go to www.directorprep.com or click here.

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READY FOR YOUR BOARD MEETING?

Practical tools for board directors who choose a growth mindset.
Be ready to collaborate and influence decisions with confidence.