Corporate strategy in the recovery

*In this extract from a recent speech,[1] the **Governor** says that now there is less need to concentrate on short-term survival, companies should focus on the longer-term strategic choices. For this they will need breadth of vision even greater than during the recession from which we are now emerging. Non-executive directors can make an important contribution in ensuring that these issues are not ducked but faced.*

For many companies I believe that the agreeable improvement in profits and liquidity that took place last year, and is continuing this year, gives rise to two questions. Where will future growth come from? And what can be done to reduce the vulnerability of the company to pressures on margins in the future, whether those pressures come from a fall in demand because of economic cycles, or from low-cost competition from abroad? The answers must come from one, or a combination, of three broad approaches:

- further cost savings using present equipment and resources;
- investment to produce basically the same products and processes more efficiently;
- investment in new products.

When I talk about investment, I do not just mean purchasing fixed assets. I include the acquisition of technology, either by licensing or by in-house research and development, and I include strengthening the company's capabilities in other ways, which might include higher quality or better marketing. In short, I mean expenditure on developing the future capability of the business.

A few generalisations are possible. Some companies still have more to achieve by way of economies from existing plant and resources, though I suspect that much of this will amount to cutting out residual loss-makers rather than improving operations that remain in being. To invest in new processes to reduce the cost of making a basically unchanged product implies a judgement that, at its lower cost, the product will continue to find a market for long enough to earn an adequate return on the cost of the new equipment. It still leaves the company dependent on the cycle in existing products and on cutting costs at a faster rate than competitors. If both conditions can be confidently met, then investment in greater efficiency in producing existing products may be the right course. If not, then investment in new products needs to be contemplated despite the risks.

I have a distinct impression that many of the companies that came most easily through the recession were those which, whatever their sector of operation, were producing higher value-added products or services and had been progressive in the introduction of new technology. Conversely, those that fared worst were in fairly standard 'commodity' type products and services. No doubt this was partly because competition is fiercer in the latter, partly because protection by governments against new products is generally less than against old, and partly also because a producer has better control of margins in a product whose price he can set because there is less competition. Questions of strategy are undoubtedly difficult. There is no low-risk strategy. Staying in the present product area may be the easiest course in the short term, but also the riskiest course in the longer term. The question is whether it is sufficient only to do better the things we already do, or whether we need to consider wider options. One challenge is that of clear strategic thinking. For many companies the luxury of choice between longer-term objectives has not existed during the recent phase of concentration on short-term survival. Now there is a need to focus on longer-term survival. The skills that are required to make strategic choices, looking five and more years ahead, are quite different, wider-ranging and in many respects more difficult than those required for pruning and rationalisation.

Given the difficulties which many companies had been facing in PRO NED's early years, there has been some concentration on the role of the non-executive director in being alert to the symptoms of decline, and insisting on timely corrective action. My theme today is to emphasise in addition the contribution which the non-executive director can make to planning for growth—insisting that strategic options are considered, and strengthening the executives to resist any understandable tendency to concentrate on the immediate to the exclusion of the longer term.

A particular concern of the non-executive director will be to satisfy himself that the company is not being allowed to drift and confine itself to its current mainstream activity without a positive and reasoned decision that this is the best course. The detailed technical appraisal of strategic options, whether these

(1) At a PRO NED/CBI seminar in London on 31 July.

involve staying in the same line of business or branching out in related but different businesses, and whether this is by greenfield initiative or by acquisition, is in the first instance for top management and the executives on the board. The task of the non-executive is to make sure that such strategic issues are not ducked but faced, and squarely. It is not an easy role, and all that I have to say about it emphasises the need for people to be appointed who can bring those qualities of experience and independence which the job requires.