The Duty to Think Strategically

Nadelle Grossman

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The Duty to Think Strategically

Nadelle Grossman*

ABSTRACT

Under Delaware corporate law, directors and officers have a duty to oversee their firm’s management of risk to limit losses. Corporate law does not, however, require directors or officers to oversee their firm’s management of strategy to create gains. Yet, managing both risk and strategy is essential to a firm in creating value. In fact, as I argue in the Article, the current focus by courts and commentators only on risk management to prevent losses could actually undermine a firm’s management of its strategy for gains. I therefore propose a model for how Delaware corporate law can drive firms to manage their strategies for gains, in addition to their risk of loss, all to create value.

This proposal is especially necessary in light of the fact that companies such as General Motors collapsed not because of excessive risk taking, but because they failed to sufficiently formulate and implement innovative strategies for gains. This proposal also opens an additional avenue to combat the significant problem of short-termism, or the drive by firms to create short-term profits regardless of whether that creates true value. It combats short-termism by creating an expectation for officers and directors to oversee their firm’s formulation and implementation of value-creating strategic objectives. Those objectives, rather than next quarter’s earnings targets, would then be expected to guide firm decisions.

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I. INTRODUCTION

For decades, General Motors (GM) was a pillar of strength among U.S. public companies. Not only was it among the three largest public companies in the United States from 1955 until its
bankruptcy in 2008, but for 77 years it was the largest automaker in the world.

Despite GM’s success, monsters lay beneath the surface. For years, GM failed to produce smaller, safer, more fuel-efficient vehicles in response to changing demand. As a result, it increasingly lost market share to foreign competitors over the course of three decades. GM also lagged behind its foreign competitors in standardizing its manufacturing processes and the platforms, body architectures, and components that it used to manufacture its vehicles. Without such standardization, GM not only faced substantially higher manufacturing costs, but it also lacked the manufacturing flexibility to respond to changes in demand.

These failures left GM flat-footed when the financial crisis struck in 2007–2008. Ultimately GM, together with Chrysler, received roughly $80 billion in federal financial assistance at the time of the crisis, and GM was forced to file for bankruptcy protection to restructure its business in a way that would enable it to compete in the future.

While we may never know the true causes of GM’s collapse, one factor in that collapse appears to be flaws in GM’s process for managing its strategy. For example, numerous auto industry experts have found that GM formulated its strategy for the creation of gains on the basis of unrealistic assumptions about its competitive environment. Even the Presidential Task Force on the Auto Industry, formed to investigate the causes of GM’s and

5. See infra Part II.A.3.
Chrysler’s collapses, found that GM’s restructuring plan, which set out GM’s strategy for future gains following its bankruptcy restructuring, was created on the basis of unrealistic assumptions about GM’s market share and pricing power.10

These unrealistic assumptions show flaws in GM’s process for formulating its strategy. That is because strategic planners must make realistic assumptions, on the basis of all available information, about a firm’s competitive environment if their strategy is going to effectively lay out a road-map for that firm’s competitive survival.11 A strategy that fails to reflect realistic assumptions about the future is not worth the paper on which it is written.

On top of these planning deficiencies, GM historically failed to implement the strategy that it had formulated.12 Thus, any benefits that GM would have derived from having formulated a strategy were lost.

These flaws in GM’s strategic management processes are not aberrational. In fact, numerous business commentators have identified the failure to maintain a current strategy and to implement the selected strategy as common causes for firms’ collapses.13 Ultimately, these flaws undermine a firm’s ability to generate value, for a firm can only hope to create sustained value in a market economy if it has a realistic, forward-looking strategic plan and if it effectively and efficiently implements that plan through its employees’ decisions and tasks.14

Creating value also requires a firm to engage in the complementary process of managing its risks.15 That is because while a strategic plan sets out a plan for a firm to remain competitive into the future, the future is uncertain and therefore risky.16 Because of risk, a firm faces the prospect that it will not generate the value that it expects from its strategic plan. Firms try

10. See infra Part II.A.1. The task force was comprised of members from the Department of Treasury, National Economic Council, Council of Economic Advisors, and the other Cabinet agencies involved in the President’s Task Force on the Auto Industry, as well as individuals at industry-leading consulting, financial advisory and law firms. GM VIABILITY SUMMARY, supra note 4, at 2. This group also consulted with outside experts and affected stakeholders. Id.
13. See infra Part II.A.
14. See infra Part II.A.
15. See infra Part II.A.
16. See infra Part II.A.
to control for these decreases in expected value by managing their risks.\textsuperscript{17} So, for example, a firm might purchase flood insurance to transfer the risk of a flood destroying its income-producing property to a third-party insurer. In this way, managing risk increases a firm’s ability to generate gains from its strategy.

Despite the integral relationship between processes to manage both value-creating strategic plans and risk, lawmakers have only focused on fixing flaws in risk-management processes. This is particularly true since the financial crisis struck, where faulty risk-management processes are thought to have paved the way for the excessive risk taking that lay at the heart of the crisis.\textsuperscript{18} However, those legal measures completely ignore the flaws that exist in the related strategic-management processes, which also impair a firm’s ability to create value. Most troubling, state corporate law imposes no clear duty on officers or directors to oversee the management of a firm’s strategy to create gains akin to the duty state corporate law imposes on officers and directors to oversee a firm’s management of risk.

Some might respond that corporate law does not need to impose any duty on officers or directors to oversee the management of strategy to create gains because officers already have incentives—in the form of stock options and other kinds of incentive compensation—to create gains and thus to implement processes to achieve that end. However, incentive compensation often motivates officers to generate gains over the short term rather than true, sustained value.\textsuperscript{19} Yet, a firm ultimately benefits from

\textsuperscript{17} See infra Part II.A.


\textsuperscript{19} Nadelle Grossman, Turning a Short-Term Fling into a Long-Term Commitment: Board Duties in a New Era, 43 U. MICH. J. L. REFORM 905, 932 (2010) [hereinafter Grossman, Short-Term Fling]. The disconnect between compensation and the creation of true value also explains why financial
value that is sustained. Thus, financial incentives do not necessarily ensure that officers manage a firm’s strategic plan to create gains.

To address the disconnect in corporate law between the management of risk and the management of strategy, I propose that the Delaware courts create an expectation on officers and directors to oversee not only their firm’s risk-management system but also its strategic-management system. In that way, fiduciary duties will better guide officers and directors as to what it means to act in a corporation’s best interest in an ongoing business context apart from merely attempting to prevent losses through the management of risk.

This Article is the first in the legal field to tackle in any depth the management of value-creating processes apart from risk management. For example, since GM’s strategic troubles initially surfaced, numerous commentators have articulated proposals designed to improve firms’ processes to manage risk. However, none of those proposals addresses in any depth the need for firms to create value through the related process of managing a firm’s strategy for the creation of gains. My Article therefore fills a significant gap in the legal literature and in the law in terms of corporate processes to create value.

incentives do not adequately deter excessive risk taking, for losses from excessive risk taking are generally only realized over time, after compensation has been paid. See id. at 940.

20. Id. at 941.


22. While Professor Bainbridge does mention the strategic-management context for risk management, his proposal is focused solely on curbing excessive risk taking without contemplating how that impacts the broader management of strategy. Bainbridge, supra note 18, at 985–90. Professor Pan also describes the board’s supervisory and advisory roles in the management of corporate strategy. See Pan, Rethinking the Board’s Duty, supra note 21, at 218. However, his proposal likewise focuses only on creating a more robust duty to monitor business risk, without focusing on the other aspects of strategy. See id. at 241.
My proposal also opens up an additional avenue for courts to combat the significant problem of short-termism, or the drive by firms to create short-term earnings regardless of whether that creates true value. If officers and directors were expected to manage their firm’s strategy, they would need to put in place processes to ensure their firm has a long-term value-creating strategic plan to fulfill that expectation. As such, that strategic plan, rather than such short-term indicia as next quarter’s earnings targets, would be expected to guide employee conduct.

This Article proceeds as follows: First, Part II explains the different stages and considerations involved in strategic management. It also highlights the relationship between strategic management and risk management in creating corporate value. Finally, that discussion explores the benefits of strategic management, as well as some of the challenges associated with the process.

Part III then discusses current corporate law requirements for directors’ and officers’ management of strategy and risk. That discussion focuses on state corporate law, as that law sets out directors’ and officers’ duties to the firms that they serve. However, Part III also considers those federal securities laws and stock exchange governance rules that most directly impact directors’ and officers’ strategic- and risk-management duties. As that discussion shows, current law only obligates officers and directors to create value through implementing risk-management programs. It does not, however, impose any clear, coherent duty on officers or directors to create value through the implementation of a strategic-management system either as part of a standard of liability or even as a normative standard of conduct.

Next, Part IV considers the consequences of the law’s failure to address the management of strategy apart from risk. I then propose some relatively modest shifts in corporate law with the goal of bringing about more effective strategic-management practices for the creation of value. Finally, Part V concludes.

II. STRATEGIC MANAGEMENT

This section explores what strategic management is. Given the absence of discussion of strategic management in legal literature, the bulk of this discussion has been derived from business

commentary and other business sources. While that literature is substantial, it is often also conflicting. Nevertheless, I have attempted to cull a simplified picture of strategic management from those sources to animate a discussion of how strategic management impacts the corporate governance legal landscape.

Strategic management refers generally to the process of managing a business in a way that maintains its competitiveness. Remaining competitive is critical to a firm, for that is the only way that the firm can survive in a market economy and thus create sustained value.

There are several different models firms can use to manage their strategies. For purposes of this discussion, I will examine a model that has three stages: First is the strategy formulation stage; second is the strategy implementation stage; and third is the

24. Other legal commentators who have written on aspects of strategic management have also cited to business authors as sources for strategic-management concepts. See, e.g., Constance E. Bagley, What's Law Got to Do With It?: Integrating Law and Strategy, 47 AM. BUS. L.J. 587, 588 (2010) (relying on the work of Michael Porter and his five-forces model); Norman W. Hawker, What Do Business Schools Teach About Antitrust?: Antitrust Insights from Strategic Management, 47 N.Y.L. SCH. L. REV. 67, 85 (2003) (concluding that strategic management and related scholarship offer valuable insights into why corporations act as they do and provide a useful lens through which to understand how corporations react to legal concerns); Felix Oberholzer-Gee & Dennis A. Yao, Antitrust—What Role for Strategic Management Expertise?, 90 B.U. L. REV. 1457, 1458, 1464–68 (2010) (relying on the work of Michael Porter and other business academics to illustrate the link between antitrust law and strategic management).

25. JAY B. BARNEY, GAINING AND SUSTAINING COMPETITIVE ADVANTAGE 6–7 (2d ed. 2002); DAVID, supra note 11, at 6; TONY MORDEN, AN INTRODUCTION TO BUSINESS STRATEGY 2–3 (2d ed. 1999). See also Rajiv Nag et al., What Is Strategic Management, Really? Inductive Derivation of a Consensus Definition of the Field, 28 STRAT. MGMT. J. 935, 942–44 (2007) (concluding, based on a survey of strategic-management scholars, that strategic management is a field that deals with (a) the major intended and emergent initiatives (b) taken by general managers on behalf of owners (c) involving utilization of resources (d) to enhance the performance (e) of firms (f) in their external environments). But see HENRY MINTZBERG ET AL., STRATEGY SAFARI: A GUIDED TOUR THROUGH THE WILDS OF STRATEGIC MANAGEMENT passim (1998) (explaining the ten different schools of thought as to strategic management).

strategy evaluation and revision stage. These stages.

The overall goal of managing a firm’s strategy is to create an enterprise that is competitive and, as such, continues to generate value. This and other virtues of strategic management are discussed in Section B. Section B also discusses some drawbacks to the strategic management process.

A. Stages of Strategic Management

This discussion explains the primary stages in the process of strategic management. First, Subsection 1 discusses the strategy-formulation stage. That discussion not only looks at the formulation of a firm’s strategy, but it also examines the formulation of a firm’s mission, which serves as the foundation for its strategy, as well as the formulation of objectives, which serve as the long-term goals that a firm’s strategy is designed to achieve. Together, a firm’s mission, objectives, and strategy are referred to as its strategic plan. Then Subsection 2 discusses the strategy-implementation stage. Subsection 3 next discusses the strategy-evaluation and -revision stage. Finally, Subsection 4 explores the board’s role with respect to this strategic-management process.

1. Strategy Formulation

Because firms exist to generate value, the goal of strategic planners is to create a strategic plan for a firm to remain

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27. These stages are generally consistent with the stages identified by a number of business commentators. See, e.g., DAVID, supra note 11, at 15 (depicting graphically the stages of strategic management as the strategy-formulation stage, the strategy-implementation stage, and the strategy-evaluation stage); THOMPSON, JR., ET AL., supra note 26, at 24 (describing the tasks of strategic management as developing strategic vision and business mission; setting objectives and creating strategy to achieve those objectives; implementing and executing strategy; evaluating performance; and reviewing and implementing corrections).

28. THOMPSON, JR., ET AL., supra note 26, at 41.

competitive into the future. Only if a firm survives into the future can it hope to generate value beyond current orders and prospects.  

The foundation of that plan is known as its mission. More specifically, a firm’s mission explains why the firm exists. In addition to revealing a firm’s core values, a firm’s mission often serves a motivational purpose. By telling employees what the ultimate goal of their efforts is, they can see how their tasks fit into the firm’s grand scheme. However, a mission is not designed to provide discrete operational goals. Objectives, rather, serve that purpose.

A firm’s objectives are the qualitative and quantitative goals toward which all resources and efforts are to be devoted, usually over the next five years or so. While some objectives are financial, others are more market based (for example, objectives tied to a firm’s market share). A firm may also have operational objectives, compliance objectives, or reporting objectives. While some of these objectives are primarily within a firm’s control (e.g., compliance and reporting objectives), others depend to a greater

shareholder primacists and director primacists] claim wealth maximization for the firm as the purpose in view.

30. For this reason, a firm’s true value is usually determined by the discounted value of its estimated future cash flows. Richard A. Brealey & Stewart C. Myers, Principles of Corporate Finance 27–28 (1996).
31. David, supra note 11, at 44.
32. Id.
33. Id. at 47–50.
35. Moeller, supra note 29, at 62.
36. Morden, supra note 25, at 112–13. See also Paul Fifield, Marketing Strategy: The Difference Between Marketing and Markets 18 (3d ed. 2007) (“Managers generally believe that their (and any) market becomes unpredictable beyond five years, so it is pointless (academic) looking out any further.”). Still, depending on a firm’s industry, product life-cycle, and other factors, a firm might plan for either a shorter or longer period. For example, Brown-Forman Corp., manufacturer of spirits such as Jack Daniels whiskey, has a ten-year strategic plan. Brown-Forman Corp., Annual Report (Form 10-K), at 20 (June 27, 2012), available at http://www.sec.gov/Archives/edgar/data/14693/000119312512285018/0001193125-12-285018-index.htm.
37. See Thompson, Jr., et al., supra note 26, at 33–34.
Setting objectives that are clearly articulated and challenging but achievable is essential to a firm; it causes those who manage a firm to have a clear and widely understood set of goals as to where the firm will be over the time period covered by those objectives.\(^{39}\) That, in turn, guards against a firm’s simply drifting along without any clear direction to guide its decisions.\(^{41}\) That is especially risky in a competitive environment, where a period of complacency or drift could place that firm behind its competitors.\(^{42}\) Moreover, a firm can track its progress against its objectives.\(^{43}\) Thus, objectives give firms outcomes against which the firms can measure and evaluate their performance. Employee compensation can also be tied to the achievement of those objectives.\(^{44}\)

Objectives do not, however, tell a firm’s employees how to achieve those goals.\(^{45}\) Rather, a strategy serves that purpose. Specifically, a strategy details how, functionally, a firm plans to achieve its objectives.\(^{46}\) A strategy lays out the concrete procedures and assignable responsibilities for achieving a firm’s objectives.\(^{47}\) So, for example, a strategy guides decisions such as which products to develop or manufacture and which market segments to pursue in an attempt to achieve the firm’s objectives.\(^{48}\)

The key to creating an effective strategic plan is ensuring that it reflects the firm’s competitive approach. In other words, the plan must reflect that firm’s competitive advantage, i.e., the quality that makes that firm unique compared to its competitors, leading to its hoped-for survival.\(^{49}\) There are a number of frameworks through

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39. See COSO ERM FRAMEWORK, supra note 38, at 21 (distinguishing objectives relating to the reliability of reporting and compliance with law, which are within the entity’s control, from achievement of objectives, such as attaining a specific market share or successfully launching a new product line, which are not entirely within the entity’s control).

40. THOMPSON, JR., ET AL., supra note 26, at 33.

41. See id. (noting that goals push organizations to be intentional and focused in their actions).

42. See id.; see also infra Part II.A.3.

43. See MORDEN, supra note 25, at 112–13; SALONER ET AL., supra note 34, at 10–12.

44. See DAVID, supra note 11, at 232.

45. THOMPSON, JR., ET AL., supra note 26, at 6, 37 (noting that strategy making is all about the "how" and that it follows the setting of objectives).

46. DAVID, supra note 11, at 133–34.

47. See FIFIELD, supra note 36, at 94–96; MORDEN, supra note 25, at 113–14.

48. See THOMPSON, JR., ET AL., supra note 26, at 37.

49. DAVID, supra note 11, at 9; MORDEN, supra note 25, at 49 (“[If a corporation] has no source of competitive advantage it will not survive. . . . Adding value, and developing or sustaining competitive advantage are both
which a firm can critically analyze the source of its competitive advantage. For example, under one framework, developed by leading strategic-management scholar Michael Porter, a firm’s competitive advantage stems from its position within its industry.\(^5\)

So, for instance, a company must be able to supply the same products to customers as its industry peers but at a lower cost—translated into a lower price—to compete.\(^5\) Or it must be able to supply its customers with a unique product that its competitors do not provide, or focus on a specific target-market, to remain competitive.\(^5\) Under another framework advanced by Gary Hamel and C.K. Prahalad, a firm’s competitive advantage is based primarily on the firm’s unique competencies.\(^5\) For example, a firm’s competitive advantage might stem from its unique technical know-how or a uniquely reliable process.\(^5\)

In addition to identifying its competitive advantage, planners must also identify and analyze a firm’s source or sources of weakness, or what the company does poorly compared to its competitors.\(^5\) If any such weakness makes a firm competitively susceptible, that firm might need to correct for that weakness to be able to compete.\(^5\)

However, a firm is limited in what it can achieve by leveraging its competitive advantage, even despite its weaknesses. These limits are sometimes referred to as constraints.\(^5\) Internally, a firm is constrained by its resources, competencies, skills and operational

critical to enterprise survival in competitive markets.\(^\text{a})\); \textit{Saloner et al.}, supra note 34, at 40. \textit{But see Manuel Becerra, Theory of the Firm for Strategic Management: Economic Value Analysis} 130–31 (2009) (stating that empirical evidence shows that competition does erode profits, but only over the long term).


\(^5\) \textit{Michael E. Porter, Competitive Advantage: Creating and Sustaining Superior Performance} 3 (1985). This type of competitive advantage is referred to as \textit{cost leadership}. \textit{See id.} at 12. It may not be sustainable over time, however, as peer firms learn how to produce products at lower cost. Thus, it requires continuous effort to keep cutting costs to prevent imitation. \textit{See id.} at 13–14, 112.

\(^5\) \textit{Id.} at 14–15. Supplying unique products is referred to as \textit{differentiation}. \textit{Id.} at 14, 119. Differentiation causes customers to be less price-sensitive by creating brand loyalty. \textit{Id.} at 120.


\(^5\) \textit{Fifield, supra note 36, at 105.}

\(^5\) \textit{Thompson, Jr., et al., supra note 26, at 111.}

\(^5\) \textit{See id. at 115.}

\(^5\) \textit{See, e.g., Morden, supra note 25, at 5.}
Some business commentators view shareholder demands for returns as an internal constraint on the basis that shareholders do not set a firm’s ultimate business objectives, but rather have a quasi-contractual interest that must be served as a condition to their continued financial support for the firm.\(^59\) External constraints, such as customer demand, social and environmental forces, competitive environment, and contractual commitments to external market actors, also limit what a firm can achieve with its competitive advantage.\(^60\) Moreover, the law limits what a business can—and cannot—do with its competitive advantage and resources.\(^61\) An effective strategic plan must not only lay out a path for competitiveness in light of that firm’s uniqueness, but must also reflect these constraints, which limit what the firm can achieve.

Still, a firm cannot be assured of success even after factoring in its constraints because the future in which the firm operates is unknown and therefore uncertain.\(^62\) Strategic-management processes seek to anticipate and respond to this uncertainty, which might either involve a potential future threat (i.e., risk) or potential future opportunity.

Broadly speaking, \textit{risk} is the potential for an outcome to deviate from what is expected.\(^63\) In the context of business, risk can cause a firm to generate a much lower level of returns than expected or can even cause a firm to generate a loss. For example, by holding over $43 billion worth of mortgage-related assets, Citigroup was exposed to significant credit risk if the creditworthiness of the borrowers on the debt contracts underlying those mortgages deteriorated. When the housing market collapsed and borrowers on such debt contracts defaulted en masse, Citigroup suffered major losses. In fact, more than half of

\footnotesize{58. See DAVID, supra note 11, at 93–95; MORDEN, supra note 25, at 35.
59. See, e.g., MORDEN, supra note 25, at 178–79.
60. See DAVID, supra note 11, at 61–74.
61. See id. at 68–69. But see Bagley, supra note 24, at 639 (“Law is more than a force that constrains managers and their firms. Properly harnessed by a legally astute management team, law can be a source of sustained competitive advantage.”).
Citigroup’s $65 billion losses are thought to stem from its mortgage-related assets.65

Risk, at least in theory, captures future events and circumstances that might yield greater returns than expected in addition to those that might yield lesser returns.66 Despite that, commentators and policymakers typically use the term risk only in its down-side sense, referring to risks that might cause results to be lower than expected.67 For that reason, I use the term risk in this Article exclusively in its down-side sense and use the term opportunity to refer to up-side risk.

Still, even risk is not necessarily bad. In fact, our economy is built on the notion that businesses will take risks that might lead to great gains—but that might also lead to losses.68 However, firms “manage” their risks in an attempt to limit unexpected downward swings in returns.

Managing risk at the strategic-planning phase involves first identifying the possible risks that might surface that could cause

65. Id.
66. See Simkins & Ramirez, supra note 21, at 577 (tracing the etymology of the word risk to two Chinese symbols that mean danger and opportunity).
67. See, e.g., CROUHY ET AL., supra note 63, at 4–8 (giving examples of risk that only involve loss or the potential for loss); MORDEN, supra note 25, at 211 (explaining risk in terms of actual or potential loss); Michelle M. Harner, Barriers to Effective Risk Management, 40 SETON HALL L. REV. 1323, 1328–29 & n.17 (2010) (adopting the dictionary definition of risk, which is “the possibility of loss or injury,” though expanding on that definition to include the consequences of that loss). The Committee of Sponsoring Organizations of the Treadway Commission (COSO), a private organization sponsored by a number of professional accounting organizations that influences frameworks for the implementation of accounting standards, has drawn a similar distinction between risks and opportunities. See COSO ERM FRAMEWORK, supra note 38, at 16 (defining risk as “the possibility that an event will occur and adversely affect the achievement of objectives” and opportunity as “the possibility that an event will occur and positively affect the achievement of objectives”). Nevertheless, the COSO ERM Framework, discussed infra in this Part II.A.1, contemplates processes to manage opportunities as well as risks.
the firm to generate lower returns than expected.69 Next, planners measure those risks by considering the probability of each of those outcomes.70 Finally, planners consider whether and how to respond to each risk should it occur, such as by eliminating the risk or mitigating the down-side effect of the risk.71 One way to eliminate risk, for example, is to refrain from the risky conduct.72 Ways of mitigating the down-side effects of risk include sharing or transferring the risk to a third party through hedging or insurance73 and preventative and responsive internal control measures.74 Of course, planners may also decide that it does not pay to reduce or eliminate risk and engage in the risky conduct nonetheless.75

Ultimately, risk management at the strategy-formulation stage helps planners both set objectives as well as select the strategy that they expect will achieve those objectives. It helps planners select strategy because they can select the strategy that they believe is likely to generate the highest level of “risk-adjusted” returns within the firm’s desired risk appetite and tolerance level.76 That level of risk-adjusted returns, then, can become one of the firm’s financial objectives. Thus, managing risk is critical to a firm’s management of its strategy, even though selecting a strategic plan calls for more than identifying, measuring, and planning a response to risk.

Firms vary in the approach they take to managing risk, which impacts the setting of strategic plans and other stages of strategic management. Some firms take what is referred to as the silo approach, where they approach different kinds of risk in separate

69. See James Lam, Enterprise Risk Management: From Incentives to Controls 27 (2003); Moeller, supra note 29, at 22–23 (listing “risk identification” as the first step in risk management).

70. See Moeller, supra note 29, at 22 (listing the “quantitative and qualitative assessment” of risk as the second step in risk management).

71. See id. (listing “risk prioritization and response planning” as the third step in risk management); Bainbridge, supra note 18, at 970.

72. Bainbridge, supra note 18, at 970.

73. Suleyman Basak et al., Risk Management with Benchmarking, 52 MGMT. SCI. 542, 542 (2006). However, it may be very costly to fully insure the downside effect of this kind of risk. Id.

74. See Crouhy et al., supra note 63, at 48–49.

75. See Bainbridge, supra note 18, at 970. In fact, firms are generally willing to accept risks that are core to their business because they are seen as having a competitive advantage in accepting that kind of risk. Corporate Risk Management (Donald H. Chew ed., 2008).

76. See Crouhy et al., supra note 63, at 367–73. Risk appetite refers to the amount of risk an institution is willing to take on in the pursuit of value. COSO ERM Framework, supra note 38, at 19; Moeller, supra note 29, at 51. Risk tolerance refers to the tolerable range of variance from expected values. COSO ERM Framework, supra note 38, at 20; Moeller, supra note 29, at 66.
and non-integrated silos apart from other kinds of risk. Moreover, different organizational units within a firm might approach risk separately from other units. For example, a firm’s credit group might manage credit risk, and its IT group might manage the risk from a disruption in the continuity of IT systems (such as IT credit systems), but there may not be any communication or coordination between these groups.

One of the biggest concerns with the silo approach at the strategy-formulation stage is that no one at the firm is deciding on an appropriate enterprise-wide risk appetite or risk tolerance when formulating a firm’s strategy. The silo approach also could lead to the failure to appreciate cross effects of risk between organizational units as well as kinds of risk. For these reasons, the silo approach is thought to lead to the management of risk in an ad hoc, informal, and uncoordinated way.

These concerns were the primary driving force behind the alternate approach to risk management referred to as enterprise risk management, or ERM. According to the Committee of Sponsoring Organizations of the Treadway Commission (COSO), a private organization sponsored by a number of professional accounting organizations that has promulgated the leading ERM framework, ERM is an integrated, holistic, process-oriented approach to managing risks, including at the strategy-setting stage, with the intent of maximizing value for the enterprise.

77. See Simkins & Ramirez, supra note 21, at 581.
78. See Moeller, supra note 29, at 49.
79. See id.
80. See Simkins & Ramirez, supra note 21, at 575–76.
81. Moeller, supra note 29, at 33–34 (noting that there might be risk interdependencies between business units that a silo approach to risk management might miss, such as in the case of Arthur Andersen, where offices did not consider risks generated by other offices).
84. Moeller, supra note 29, at 3.
85. DeLoach, supra note 83, at xiii; Moeller, supra note 29, at 3. ERM is integrated and holistic in that it is designed to break down the functional and cultural barriers that exist between different business and operating units such that risk is seen and addressed through a single, integrated framework. See DeLoach, supra note 83, at xiii; Frigo & Anderson, supra note 82, at 1; Stephen Gates, Incorporating Strategic Risk into Enterprise Risk Management: A Survey of Current Corporate Practice, 18 J. APPLIED CORP. FIN., no. 4, 2006 at 81, 83, 85. Thus, the focus is not on managing specific kinds of risks (such as
While many commentators point to ERM as the future of risk management, the ERM movement is still nascent. In fact, according to a study conducted on behalf of COSO, 60% of the respondents indicated that their firms’ processes for tracking risks were informal and ad hoc, or tracked within individual business silos rather than on an enterprise-wide basis.

Even if the ERM movement gains traction, its focus is on the creation of value through better risk-management processes. However, it does not focus on processes to create value apart from managing risk, such as through the management of strategy. Yet, because ERM’s primary purpose is to help a firm create value, the process is integrally related with strategic-management processes.

credit, market, or operational risk), or risk within specific business units or operating units (such as the marketing or finance business units or South American operations), but on managing risk on an enterprise-wide basis so that it conforms to the company’s desired risk appetite and tolerance level. Because of the enterprise-wide lens through which risk is viewed under ERM, it is performed in a top-down process. See Frigo & Anderson, supra note 82, at 1; Simkins & Ramirez, supra note 21, at 581. That means that officers who have an enterprise-wide perspective and sightline supervise a firm’s management of risk, though they do so in consultation with lower level managers. See Moeller, supra note 29, at 24–29; Frigo & Anderson, supra note 82, at 1.


87. See Monahan, supra note 38, at 119 (explaining how the low rate of adoption of COSO’s ERM framework may be, in part, due to its lack of guidance in how to design or implement an ERM system).

88. Mark S. Beasley et al., COSO, COSO’s 2010 Report on ERM: Current State of Enterprise Risk Oversight and Market Perceptions of COSO’s ERM Framework iii (2010), available at http://www.coso.org/documents/COSOSurveyReportFULL-Web-R6FINALforWEBPOSTING111710.pdf (finding from a study that only 28% of survey respondents reported implementing ERM systems that were “systematic, robust and repeatable” and 60% reported “risk tracking [that] is mostly informal and ad hoc”).

89. See COSO ERM Framework, supra note 38, at 14 (noting that management’s choice as to objectives and the allocation of resources, presumably to implement strategy, are not part of ERM).

90. See id. at 5–6 (“Enterprise risk management ensures that management has in place a process to set objectives and that the chosen objectives support and align with the entity’s mission and are consistent with its risk appetite.”).

91. See Enterprise Risk Management: Current Initiatives and Issues: Journal of Applied Finance Roundtable, 18 J. Applied Fin., no. 1, 2008 at 115 (interviewing Todd Perkins, the Chief Risk Officer of Southern Company, one of the largest utilities in the Southeastern U.S., who explained that Southern Company’s ERM group is “tightly integrated” into its strategic planning group); Protiviti Inc., Guide to Enterprise Risk Management: Frequently Asked Questions
The momentum behind ERM is confined to the risk-management field. In other words, there is no similar comprehensive framework that firms are encouraged to adopt in strategy selection. However, there does seem to be some consensus that firms should take a bottom-up approach to the formulation of strategic plans for value creation.92 Thus, lower level managers and employees formulate objectives and strategy, at least at the divisional and operational levels, and actively participate in the setting of overall corporate objectives and strategy by the firm’s officers.93 This sort of participation by employees and lower level managers in setting strategy not only allows those managers and employees to better understand what the firm is doing and why, but it also enhances their commitment to helping the firm achieve its objectives.94 Nevertheless, strategic-management scholars stress the need for firms to take a balanced approach to the formulation of strategic plans and adopt one that is deemed best for that particular firm.95

For an example of what happens when strategic-planning efforts go awry, consider the case of GM. While Roger Smith emphasized the need for strategic planning during his tenure as GM’s CEO throughout the 1980s,96 according to Maryann Keller, a financial analyst for the automobile industry who has extensively studied GM, GM’s process did not allow for the introduction of new ideas, which were perceived as a challenge to the existing way of doing things.97 That mentality would have undermined GM’s strategic-planning efforts, for it is hard to imagine creating


92. DAVID, supra note 11, at 302 (“[C]urrent research supports the bottom-up approach [to the process of formulating strategy], at least among U.S. firms.”).

93. Id. at 138, 302. Cf Cynthia A. Montgomery, Putting Leadership Back into Strategy, HARV. BUS. REV., Jan. 2008, at 6 (arguing that needing to create and recreate reasons for a company’s continued existence set the strategist apart from every other individual in the company and that guiding this never-ending process is the crowning responsibility of the CEO).

94. See DAVID, supra note 11, at 175.

95. Id. at 302.


97. See id. at 19–21.
innovative plans for the creation of gains where creative thought is stymied.

Moreover, Keller found that GM’s strategic-planning process relied upon numerous unrealistic assumptions. For example, for years GM assumed that foreign competitors were simply temporary opportunists who got lucky in the oil crisis, rather than long-term competitors who built better cars. It also assumed that customers would be loyal to GM regardless of the quality of its products or changing competitive environment. Such assumptions would have undermined GM’s strategic-planning process because that process depends on the making of reasonable assumptions based on available information. Without such reasonable assumptions, the planning process simply cannot proceed effectively.

The Obama Administration’s auto task force, formed to investigate the causes of GM’s and Chrysler’s collapses, also found that GM made unrealistic assumptions in its planning efforts. For example, it found that GM’s assumption as to its projected future market share was too optimistic in light of the fact that it had been losing market share to competitors for decades. The auto task force also found that GM’s assumption about product price increases was too optimistic in light of a severely distressed market, lingering quality perceptions and an increase in smaller vehicles, where GM has historically made lower profit margins. Once again, these unrealistic assumptions reveal flaws

98. Id. at 22–23, 25–26. See also JAMES E. HARBOUR, FACTORY MAN 136–37 (2009); PAUL INGRASSIA & JOSEPH B. WHITE, COMEBACK: THE FALL AND RISE OF THE AMERICAN AUTOMOBILE INDUSTRY 139 (1994) (noting that the Detroit automakers denied that they were uncompetitive in product quality, productivity, and cost in the early 1980s).
100. DAVID, supra note 11, at 79.
101. Id.
102. The task force was comprised of members from the Department of Treasury, the National Economic Council, the Council of Economic Advisors, and the other Cabinet agencies involved in the President’s Task Force on the Auto Industry, as well as individuals at industry-leading consulting, financial advisory and law firms. GM VIABILITY SUMMARY, supra note 4, at 2. This group also consulted with outside experts and affected stakeholders. Id.
103. Id. at 3.
104. Id. Professor Sydney Finkelstein at the Tuck School at Dartmouth College has also argued that GM managed its strategy on the basis of false assumptions. See Sydney Finkelstein, When Bad Things Happen to Good Companies: Strategy Failure and Flawed Executives, 26 J. BUS. STRATEGY 19, 25 (2005) (arguing that GM predicated its automation strategy on a false assumption—that GM was unable to compete with foreign competitors because of its labor force rather than its failure to adopt a lean manufacturing system—
in GM’s planning process and help explain why GM’s strategic plan failed to set out a realistic plan for its competitive survival.105

The Obama auto task force also found that GM’s restructuring plan failed to show how the company would remain competitively viable.106 This deficiency also demonstrates that GM’s strategic-planning process was flawed, for surely an effective process for formulating a strategy—whether or not in the face of a restructuring—should ensure that the plan on its face appears to achieve the purpose for which it was designed: to create a plan for a firm’s competitive survival.107

2. Strategy Implementation

Once a firm’s strategic plan has been formulated, the strategy included within that plan must then be implemented by everyone within the enterprise to assure that the business choices made in the strategy are carried out through day-to-day decisions and tasks.108 Effective implementation means that resources within a firm are efficiently deployed, and tasks carried out, to implement that plan.109 Successful strategy implementation also requires developing a strategy-supportive culture and organizational structure.

Managers at all levels often take the lead in the implementation of strategy, for it is the employees whom they oversee who carry out the day-to-day implementing decisions and tasks.110 For that reason, it is often essential that a firm’s strategic plan be clearly communicated to the employees tasked with carrying it out.111 Not and that this false assumption stemmed from its failure to understand how people and machines could be effectively integrated.

105. GM VIABILITY SUMMARY, supra note 4, at 3–4.
106. Id. at 4–5.
107. Other business commentators have also hinted at strategic-management missteps as at least part of the reason for GM’s collapse. For example, according to David Aaker, Professor Emeritus at the Haas School of Business, GM was preoccupied with short-term profits and, as a result, lacked strategic vision. David A. Aaker, GM’s Biggest Strategic Blunder, MARKETING PROFS (Mar. 10, 2009), http://www.marketingprofs.com/articles/2009/2866/gms-biggest-strategic-blunder.
108. See DAVID, supra note 11, at 212–13.
109. See id. at 213; THOMPSON, JR., ET AL., supra note 26, at 42 (listing out the principal steps in the process of strategy execution).
110. See THOMPSON, JR., ET AL., supra note 26, at 42.
111. DAVID, supra note 11, at 215.
only does this ensure that those employees understand where the firm is going so that they can help it get there, but it also helps them identify, and, in turn, communicate to top managers, where the firm skips its strategic track.113

Many firms use what is known as the Balanced Scorecard (BSC) as a framework to guide their implementation of strategy.114 The BSC is a strategic-planning and -management system designed to translate a firm’s strategic plan into specific business activities.115 It also gives firms a framework to evaluate how well their implementation efforts achieve the firm’s financial and non-financial objectives.116

Similar to ERM’s approach to risk management, the BSC takes a holistic approach to strategy by looking at strategy from the four perspectives from which an enterprise creates value: the financial, customer, internal business process, and learning and growth perspectives.117 Also similar to ERM, the BSC promotes an integrated approach to strategy implementation. It does that by providing a shared framework that allows all participants to see how their individual activities contribute to achieving the firm’s goals.118 Thus, like ERM, the BSC prevents silos from cutting off...
communication and coordination among business and operating units in the implementation of strategy.119

Despite its apparent merits, results are mixed as to whether the BSC improves results.120 Perhaps that explains why so many commentators have cited strategy implementation as firms’ primary challenge. For example, according to Larry Bossidy, former Chief Operating Officer of General Electric and CEO of Honeywell, and Ram Charan, well-known author and business advisor, the absence of strategy execution is the biggest obstacle to a firm’s success.121 Professors Kaplan and Norton, founders of the BSC, also recently concluded that most firms still struggle with implementing their strategies.122 As a result, firms only realize a fraction of the financial performance from their strategic plans.123 Thus, neither the BSC nor any other strategy implementation framework has the kind of momentum behind it that ERM efforts currently have in the context of risk management.

GM once again exemplifies a company whose progress was likely impaired by its failure to implement its strategy. In fact, according to Keller, despite GM’s focus in the early 1980s on strategic planning, GM’s strategies ended up on executives’ shelves gathering dust rather than in action.124 Thus, the virtues behind its having a strategy for the creation of gains were lost.

3. Strategy Evaluation and Revision

Once a firm has implemented a strategy for a period of time, it can assess whether or not that plan is indeed leading it on a path toward achieving its objectives and thus creating value for the firm

119. See Beer & Eisenstat, supra note 113, at 29, 32 (finding that one of the killers of strategy implementation is the operation by top managers in their own silos, refusing to cooperate effectively for fear of losing power).
120. See, e.g., Kathy Williams, What Constitutes a Successful Balanced Scorecard?, 86 STRATEGIC FIN., no. 5, 2004 at 19 (finding that fewer than 20% of the companies with BSC projects have realized overall performance improvement).
122. Kaplan & Norton, Execution Premium, supra note 112, at 3 (“Various surveys over the past two decades indicate that 60 to 80 percent of companies fall far short of targets expressed in their strategic plans.”). See also David, supra note 11, at 7 (noting that strategy implementation is often considered to be the most difficult stage in strategic management).
123. Kaplan & Norton, Execution Premium, supra note 112, at 5, 22–32 (reporting from the results of a survey that “[h]aving a formal strategy execution system made success two to three times as likely as did not having such a system”).
124. See Keller, supra note 96, at 109.
and its constituents. If it turns out that a strategy is not effectively driving toward firm objectives, that strategy (or those objectives) must be revised so that the strategy furthers the objectives.

One of the primary challenges in evaluating the success of a strategy is the lack of information with which a firm can measure achievement of nonfinancial objectives. In fact, the authors of one study found that despite numerous financial firms having identified nonfinancial factors as key drivers of their creation of value, those firms generally used low-quality performance measures to track the success of those factors. 125 Because those drivers of firm value are reflected in a firm’s objectives, 126 firms often do not have adequate measures in place to determine whether they have achieved their nonfinancial objectives through implementing their strategies.

Moreover, new risks and opportunities continually arise, and the probabilities of previously identified risks and opportunities change. In addition, a firm may develop a different strength, its competitive landscape may change, and other determinants of a firm’s strategy might change. Firms must ensure that these changes are not only identified but also communicated by employees to the appropriate people so that those people can decide whether or not an alteration in the firm’s strategy or objectives, or both, is in order. 127 They can also decide whether a change in the allocation of resources is needed.

Ideally, a firm communicates these changed circumstances to the planners who are responsible for formulating its strategic plan. 128 Those planners can then decide whether or not a shift in strategy or objectives is warranted. The key, then, is to have adequate controls in place to catch such changes and to communicate them to those planners.

While ERM controls are intended to serve this purpose as to new risks, and at least in the case of COSO’s ERM framework, new opportunities, 129 the absence of systematic, robust, and

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126. See *id.* at 727 (examining measurement standards across all uses, including setting goals, in conducting their study).
127. See *COSO ERM FRAMEWORK*, supra note 38, at 16 (“Management channels opportunities back to its strategy or objective setting processes, so that actions can be formalized to seize the opportunities.”); THOMPSON, JR., ET AL., *supra* note 26, at 11, 43 (noting that a company’s objectives and strategy have to be revised any time external or internal conditions warrant it).
128. See *COSO ERM FRAMEWORK*, supra note 38, at 85–86.
129. See *id.* at 61–62.
repeatable ERM systems suggests that companies do not have in place the controls they need to communicate such changes to the appropriate planners. In fact, in the COSO study mentioned above, organizational leaders at almost half of the responding organizations had either no, or only minimal, processes in place for identifying and monitoring emerging strategic risks.\textsuperscript{130} Moreover, an ERM system does not necessarily lay out a process through which a firm’s strategic plan is to be revised in light of such risks and opportunities—that process occurs as part of the strategic-management process.

If the factors upon which a firm’s strategic plan are based change and these changes are not reflected in that firm’s strategic plan, that firm may end up sticking with a strategic plan that is no longer optimal for generating value.\textsuperscript{131} In fact, business commentators widely identify continued adherence to the same stale strategy as one of the greatest management pitfalls.\textsuperscript{132} That, in turn, can undermine a firm’s ability to compete and, in turn, to generate value.

GM’s strategic-planning process failures mentioned above likely explain why it ended up sticking with a stale strategy for so many years. For example, its assumption that foreign competitors were only temporarily in the U.S. market in the 1980s\textsuperscript{133} might explain why GM’s strategic plan repeatedly failed to call for the manufacture of smaller, more fuel-efficient vehicles despite repeated surges in demand for those vehicles.\textsuperscript{134} Such an erroneous assumption about its competition might also explain why GM failed for some time to modernize its production processes to increase its operational efficiency.\textsuperscript{135} As a result of these strategic

\textsuperscript{130.} See \textit{Beasley ET AL.}, \textit{supra} note 88, at 9.
\textsuperscript{131.} See \textit{David}, \textit{supra} note 11, at 8, 286–95; \textit{Thompson, Jr., ET AL.}, \textit{supra} note 26, at 11–12, 43.
\textsuperscript{132.} See, e.g., \textit{David}, \textit{supra} note 11, at 288.
\textsuperscript{133.} See \textit{supra} note 98 and accompanying discussion.
\textsuperscript{134.} See Thomas H. Klier, \textit{From Tail Fins to Hybrids: How Detroit Lost Its Dominance of the U.S. Auto Market}, 33 \textit{ECON. PERSP.} 2, 5–7 (2009) (noting that the U.S. car companies only introduced small cars in 1957 long enough to stem the tide of foreign imports and thereafter resumed manufacturing larger cars and that when they reintroduced small cars in the mid-60s to respond to the resurgence of foreign imports, they were of inferior quality to foreign imports). For a discussion of the factors giving rise to demand for smaller, more fuel-efficient cars, see \textit{Harbour}, \textit{supra} note 98, at 136–37; \textit{Ingrassia & White, supra} note 98, at 13; Klier, \textit{supra}, at 2, 5–7.
\textsuperscript{135.} See \textit{Harbour, supra} note 98, at 70, 77–78, 117–25. GM’s organizational structure also contributed to its operational inefficiency, and may have in fact undermined its strategy-planning process. See \textit{Dinosaurs Wrecks}, \textit{ECONOMIST}, June 4, 2009, at 9, 9. GM tried to address its structural problems with a number of restructurings. \textit{The Decline and Fall of General
missteps, GM lost market share over the course of three decades\textsuperscript{136} and ultimately had to file for bankruptcy. Thus, GM demonstrates how a company can fail, or at least place itself in a precarious position, not because of excessive risk taking, but because of the systematic failure to critically assess its competitive landscape when creating its strategic plan.

4. Board’s Role in Strategic Management

The board plays a critical role in the strategic-management process. Specifically, boards supervise officers in managing that process.\textsuperscript{137} This role flows from the board’s function as the supervisory body over all corporate activities.\textsuperscript{138}


\textsuperscript{136} \textit{See GM Viability Summary, supra} note 4, at 3; \textit{see also} Bill Vlasic \& Andrew Ross Sorkin, \textit{G.M. and Chrysler Explore Merger}, N.Y. TIMES, Oct. 11, 2008, at A1, \textit{available at} http://www.nytimes.com/2008/10/11/business/11auto.html (stating that GM and Ford once “dominated the auto industry—until Japanese and other foreign car makers began making inroads into the American market” and that while “G.M. once commanded about 50 percent of the American vehicle market . . . its share so far this year [referring to 2008] has fallen to 22 percent”).

\textsuperscript{137} \textit{Carolyn Kay Brancato et al., The Conference Bd., Inc., The Role of U.S. Corporate Boards in Enterprise Risk Management} 6 (2006), \textit{available at} http://papers.ssrn.com/sol3/papers.cfm?abstract_id=941179 (“The full board clearly has oversight responsibility for strategy as well as ERM.”); \textit{David Larcker} \& \textit{Brian Tayan, Corporate Governance Matters: A Closer Look at Organizational Choices and Their Consequences} 169 (2011) (stating that it is management’s—not the board’s—job to develop strategy and that the board’s role is to scrutinize strategy to make sure that it is appropriate for stakeholders and then to monitor the contribution of corporate activities to the strategy); \textit{Frigo} \& \textit{Anderson, supra} note 82, at 1 (“It is the board’s responsibility to ensure that management is devoting the right attention and resources to ERM and is setting the right tone for ERM.”). \textit{See also} \textit{David, supra} note 11, at 200 (recommending that a board conduct an annual review of strategy much in the same fashion that it supervises an annual financial audit).

\textsuperscript{138} \textit{See Olson Bros., Inc. v. Englehart, 211 A.2d 610, 615 (Del. Ch. 1965), aff’d, 245 A.2d 166 (Del. 1968); see also Del. Code Ann. tit. 8, § 141(a) (Westlaw 2012) (“The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . .”). Officers, rather than directors, formulate strategy because they are generally more knowledgeable about firm resources, competitors, markets, customer demand, types of risks that are likely to occur and their likely impact, among other factors, given their day-to-day involvement in firm affairs. See In re Toys “R” Us, Inc. S’holder Litig., 877
Recently, commentators and policymakers have been clamoring for more board oversight over the management of risk. This undoubtedly flows from the financial crisis, which is widely believed to have been caused by inadequate risk-management oversight. While oversight over the management of risk is consistent with the board’s role in overseeing processes through which firms create value, such oversight only focuses on one aspect of that role. However, it ignores the board’s role in overseeing processes to create value through strategic management.

Importantly, the board often also serves an advisory role in the formulation and revision of strategic plans for the creation of gains. In that capacity, the board provides advice and suggestions to officers as to which strategic plan to select. It is perhaps because of this role that some commentators depict the board as an active participant in the formulation of strategy. Still, even where the board provides strategic advice, as a practical matter, and given their informational advantage, officers and their

A.2d 975, 1003 (Del. Ch. 2005) (noting that CEOs, CFOs, and other officers are well-positioned to act impartially and are better positioned than outside directors to act expertly “[w]hen it comes to determining what products to make or what suppliers to use . . . .”).

139. See infra Part IV.

140. See supra note 18 and accompanying text.

141. See Jeffrey L. Coles et al., Boards: Does One Size Fit All?, 5–6 (2005), available at http://ssrn.com/abstract=665746 (noting that outside directors serve to advise the CEO on business strategy); Lynne L. Dallas, The Multiple Roles of the Board, 40 SAN DIEGO L. REV. 781, 807 (2003) [hereinafter Dallas, Multiple Roles]. Boards also make some strategic decisions. Those strategic decisions, which require board approval under statute, include dissolutions as well as fundamental transactions such as mergers. See DEL. CODE ANN. tit. 8, §§ 251, 252 (Westlaw 2012) (requiring board approval for mergers); id. § 271 (requiring board approval for sale of all or substantially all assets); id. § 275 (requiring board approval for dissolutions). The decision to dissolve, or to pursue a fundamental transaction, is a quintessential strategic decision, for that decision dictates whether that enterprise will exist in the future and, if so, in what form. Because this Article is about the strategic management of firms in an ongoing business, it does not address the board’s role in these other contexts.

142. See, e.g., Dallas, Multiple Roles, supra note 141, at 808 (stating that survey respondents indicated that it is the board’s responsibility to become involved in both the setting and review of corporate strategy); Pan, Rethinking the Board’s Duty, supra note 21, at 217–21 (describing the board’s duties to monitor the performance of officers and to manage strategy by dictating corporate strategy).
subordinate managers, rather than directors, ultimately decide which wealth-creating strategy to pursue.\textsuperscript{143}

Boards also influence strategy through their selection of the CEO.\textsuperscript{144} That is because the CEO, given her position, is the top corporate strategist. By selecting a candidate who stands for a particular corporate strategy, the board effectively indicates which candidate’s corporate strategy it endorses.\textsuperscript{145} That is also true where a board creates a CEO succession plan; by deciding who is to take over upon the CEO’s departure, the board indicates which potential successor’s corporate strategy it agrees with.\textsuperscript{146} Thus, the board influences the strategic-management process through its selection of the CEO and her successor.

\textbf{B. Advantages (and Disadvantages) of Strategic Management}

It is clear that firms derive substantial value from managing their risks, for that process better ensures that firms realize value from their planned-for growth strategies by minimizing the adverse impact from risk-creating losses. However, there are numerous benefits that flow from deliberately managing a firm’s strategy for the creation of gains even apart from managing its risks.

For one, strategic management allows an organization to formulate better strategic plans for the creation of gains through a more systematic, logical, and rational process.\textsuperscript{147} That, in turn, causes a firm’s managers to be more deliberate and deliberative in planning the firm’s future and, moreover, to exert more control over that firm’s destiny.\textsuperscript{148}

Strategic management also causes a firm’s managers to be more cognizant of the firm’s source of competitive strength and

\textsuperscript{143} Franklin A. Gevurtz, The Historical and Political Origins of the Corporate Board of Directors, 33 HOFSTRA L. REV. 89, 105 (2004) (“As a practical matter, the outside directors must rely on information presented to them by the corporation’s officers when making decisions. . . . Given these constraints of time and information, the board can hardly initiate much of any corporate strategy or decisions. Instead, the board’s role largely falls to approval of such strategies and decisions as officers bring before the board.”).

\textsuperscript{144} See Dallas, Multiple Roles, supra note 141, at 789 (noting that boards typically select and determine the compensation of the CEO and occasionally of other top officers).

\textsuperscript{145} See Dirk Sliwka, Managerial Turnover and Strategic Change, 53 MGMT. SCI. 1675, 1675–76 (2007) (citing evidence that managers need to be replaced to successfully implement shifts in strategy, as managers are often reluctant to abandon the strategies that they have selected).

\textsuperscript{146} See id.

\textsuperscript{147} DAVID, supra note 11, at 16.

\textsuperscript{148} See id.
weakness; resources, competitors, and other constraints; and opportunities. That, in turn, allows the firm’s managers to more appropriately reflect all of these inputs, as well as risk, when determining firm objectives and strategy.

In addition, strategic management promotes coordinated activity within a firm, for it causes a firm to identify specific goals to be achieved, as well as a road-map for achieving those goals. Thus, employees are better able to understand to what ends their efforts are to be devoted and, as a result, do not pull the firm in all different directions with their various uncoordinated and undirected decisions and activities. Such coordination and communication can further augment employees’ commitment to the firm’s plan for the creation of value.\[149\]

Perhaps one of the most compelling reasons for managing a firm’s strategy is that it combats managers’ incentive to manage for the short term.\[150\] Short-termism refers to the undue focus by firms on short-term profits rather than the creation of true, sustained value.\[151\] As I argued in a prior article, short-termism derives in part from the public disclosure of information that has a short-term bent, leading investors to over-value such disclosed short-term indicia and to under-value undisclosed drivers of long-term value, such as a firm’s strategic plan for the creation of gains.\[152\] Investor short-termism impacts the behavior of directors through shareholders’ exercise of voting and other powers.\[153\] Directors, being responsive to their electing shareholders, tie executive compensation to short-term performance metrics rather than the creation of true value.\[154\] The end result is that firms under-invest in research and development and in new income-producing assets, as the benefits from such investments are only realized over time.\[155\] This, in turn, retards firms’ creation of true value.\[156\]

Strategic management combats short-termism because it is a method of managing a firm to achieve predetermined, long-term
objectives for the creation of true value.\footnote{157} Thus, managers at strategically managed firms are guided not by the next quarter’s expected results but by the firm’s plan for how to deploy its resources over time to achieve its wealth-creating objectives.\footnote{158}

Managing a firm’s strategy generates a number of indirect benefits as well. One indirect benefit of strategic management is that a firm’s objectives can serve as a framework for the development of a CEO succession plan.\footnote{159} Specifically, once strategists have formulated firm objectives under board supervision, the board can focus its succession planning efforts on finding an individual to best achieve those objectives upon the CEO’s departure.\footnote{160} And by addressing this risk \textit{ex ante} rather than after the CEO departs, a firm can better ensure the continuity of its existence and minimize the disruption that the transition to a new CEO has on its operations.

Strategic management can also benefit executive compensation efforts. Specifically, a firm that engages in strategic management will have identified what its objectives are and will also have designed a strategy to achieve those objectives. Firms that have designed such objectives and strategies can then tie their executives’ compensation to successfully achieving those objectives and efficiently implementing those strategies.\footnote{161} In fact, numerous commentators promote tying executives’ bonuses to such performance measures.\footnote{162}

While there are undoubtedly other benefits to managing a firm’s strategy for the creation of gains, those mentioned above are some of the more salient ones. And they likely explain why numerous commentators have found that firms that use strategic-management concepts are more successful, and more profitable,
than those who do not. Still, I would be remiss if I did not mention the disadvantages of strategic management.

Perhaps the most apparent disadvantage of strategic management is that it requires the commitment of valuable time and energy, often of key executives and directors. Some managers must focus not on managing current operations, but on planning for the future. Still, over time, these costs should be outweighed by the benefits of having in place and implementing a carefully designed plan to create value.

In addition, setting out on a predetermined path might give managers a false sense of confidence in the selected strategic direction, even causing them to put on blinders to new risks and opportunities. Moreover, a firm’s strategic plan for the creation of gains might become so embedded in its culture that managers simply cannot envision an alternate path. Of course, an effective planner might include, as part of the strategic-management process, a mechanism to prevent such moral or cultural attachment to any particular strategic plan. The board may also serve as a check on this kind of over-attachment to strategy, viewing the firm’s strategy for wealth creation from a more detached position. Thus, it is not clear that this challenge undermines the virtues of the strategic-management process.

Finally, a firm might not realize the benefits of strategic management if it does not implement an effective and efficient process. For example, as was discussed above, firms are often ineffective at implementing their strategy. As a result, they are not able to effectively harness the powers of their firm’s competitive advantage, as provided in their strategic plan, to create gains. Moreover, a firm’s strategic plan may not be updated when changed circumstances necessitate the plan’s revision. The result is the continued implementation of a stale strategy that may undermine that firm’s ability to compete.

This last challenge describes the risks attendant to the mismanagement of strategy, rather than the management of strategy. Thus, it is not necessarily a pitfall of the process, but rather a pitfall of the process done poorly. Still, managers need to

163. See David, supra note 11, at 17; Thompson et al., supra note 26, at 17.
164. See David, supra note 11, at 18–19.
165. See Mintzberg et al., supra note 25, at 15.
166. See id. at 16.
167. See supra Part II.A.2.
168. See supra Part II.A.2.
169. See supra Part II.A.3.
170. See supra Part II.A.3.
be wary of these pitfalls, which can undermine the benefits of the strategic-management process, and should attempt to create a process that controls for such pitfalls to the extent possible.

III. CORPORATE LAW STRATEGIC-MANAGEMENT DUTIES

As I explained in Part II, to manage a firm’s strategy is to manage that firm in a way that is designed to maintain its competitiveness so that it can continue to thrive, and create value, in a changing environment. To be effective, a firm’s strategic plan must not only create a road map for its operation in light of that firm’s risks, but it must also reflect that firm’s competitive advantage (and weaknesses), its resources and other constraints, and its opportunities. In other words, while managing a firm’s risks is critical to its creation of value, that process alone does not create value—a firm creates value by also conducting the corollary process of formulating and implementing a well thought-out strategic plan for the creation of gains. Nevertheless, as this discussion shows, legal duties focus only on the management of risk to prevent losses and ignore the management of strategy for the creation of gains.

This discussion begins, in Section A, by considering officers’ and directors’ duties under state corporate law to implement a strategic-management process at their firm. Because this Article focuses on strategic management in an ongoing business, that discussion does not focus on officers’ or directors’ duties in the takeover context. That is not to say that selling a business is not an important strategic decision—it is one of the most important strategic decisions that can be made with respect to a firm, for it could lead to the firm’s disappearance or continuance in an entirely different form. But this Article is focused on the context where a firm formulates and implements a strategic plan for the creation of gains through means other than such fundamental transactions.

Moreover, this discussion looks only at Delaware law because most public companies are incorporated in Delaware. In addition, Delaware law is often followed or looked to for guidance in other jurisdictions.

Section B then delves into federal securities laws. Federal securities laws also regulate, to some extent, the duties of officers and directors of public companies. They primarily do so through

172. Id. at 397.
Disclosure mandates, which indirectly impact conduct. Moreover, stock exchanges promulgate rules, some of which relate to the internal governance of listed companies. Section B considers those laws and rules that most directly relate to officers’ and directors’ strategic-management roles.

A. State Law Mandates

Directors and officers have an overarching duty to act in good faith and in a manner reasonably believed to be in the best interest of the corporation.173 This overarching duty is the foundation upon which fiduciary duties—the duty of loyalty and the duty of care—exist.174

This overarching duty is generally understood to have both a negative, as well as an affirmative, component. Namely, it has been interpreted as imposing a duty both to refrain from acting contrary to the interests of a corporation and to act affirmatively in a way that furthers the corporate purpose.175 As the Delaware Supreme Court held in the seminal case Guth v. Loft, Inc.,176 the director’s duty is “not only affirmatively to protect the interests of the corporation committed to his charge, but also to refrain from doing anything that would work injury to the corporation, or to

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173. Schnell v. Chris-Craft Indus., Inc., 285 A.2d 437, 439 (Del. 1971). See also Leo E. Strine, Jr., et al., Loyalty’s Core Demand: The Defining Role of Good Faith in Corporation Law, 98 GEO. L.J. 629, 643 n.31 (2010) (identifying the Schnell case as the classic case standing for this proposition with respect to directors); MODEL BUS. CORP. ACT § 8.30(a) (2009).

174. See Strine, Jr., et al., supra note 173, at 634.

175. See, e.g., Guth v. Loft, Inc., 5 A.2d 503, 510 (Del. 1939); see also Lyman Johnson, After Enron: Remembering Loyalty Discourse in Corporate Law, 28 DEL. J. CORP. L. 27, 39–40 (2003) [hereinafter Johnson, After Enron] (demonstrating that loyalty contains a minimum dimension, which precludes a director from personally benefiting from a transaction, as well as a maximum dimension, which requires that a director be affirmatively devoted to the corporate well-being); Julian Velasco, How Many Fiduciary Duties Are There in Corporate Law?, 83 S. CAL. L. REV. 1231, 1262–63 (2010) (arguing that the language in Guth, in which the Delaware Supreme Court indicated the affirmative and negative aspects of fiduciary duties, was general principles rather than part of the duty of loyalty); cf. MODEL BUS. CORP. ACT § 8.31 cmt. 1.A (2009) (quoting Gagliardi v. TriFoods Int’l, Inc., 683 A.2d 1049, 1051 n.2 (Del. Ch. 1996)) (noting that bad faith is presented where the board authorizes a transaction for some purpose other than a genuine attempt to advance corporate welfare or is known to violate applicable positive law).

176. 5 A.2d 503 (Del. 1939).
deprive it of profit or advantage which his skill and ability might properly bring to it.”177

Still, this overarching duty does not set forth an enforceable standard. Rather, it is enforced through the more specifically formulated fiduciary duties of care and loyalty.178 The duty of care applies to officers and directors, both when they are making specific business decisions and when they are not.179 When officers and directors are making specific decisions, the duty of care demands that they become informed of all information reasonably available.180 The fiduciary must then make the decision exercising appropriate care.181 When they are not faced with a specific business decision, the duty of care demands that officers and directors pay attention to the firm committed to their charge.182 This latter aspect of the duty of care is often referred to as the duty of oversight.

177. Id. at 510. Accord Mills Acquisition Co. v. MacMillan, Inc., 559 A.2d 1261, 1280 (Del. 1988) (“Not only do these principles [referring to fiduciary duties] demand that corporate fiduciaries absolutely refrain from any act which breaches the trust reposed in them, but also to affirmatively protect and defend those interests entrusted to them.”); see also Johnson, After Enron, supra note 175, at 58, 71 (“Corporate law discourse contains both the minimal and maximal strands of loyalty, though the former is considerably more developed. . . . Affirmative loyalty to corporate interests also is a legal duty, notwithstanding much judicial emphasis on the minimal need only to refrain from disloyal conduct.”); Strine, Jr., et al., supra note 173, at 635–36 (citing Johnson, After Enron, supra note 175, at 39–40) (“The Hippocratic maxim to first do no harm is of course relevant to a corporate fiduciary’s role, but, like the role of a physician, the director’s job demands affirmative action—to protect and to better the position of the corporation.”).

178. Stone ex rel. AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006) (holding that only the duties of care and loyalty, where violated, may result in liability, and that the duty to act in good faith does not establish an independent fiduciary duty).


181. Smith, 488 A.2d at 872–73; Aronson, 473 A.2d at 812. Despite the duty to exercise appropriate care in making decisions, courts tend to focus only on the duty to become informed under the duty of care. See, e.g., Brehm, 746 A.2d at 259.

182. In re Caremark, 698 A.2d at 967. See also DEL. CODE ANN. tit. 8, § 141(a) (Westlaw 2012).
Strategic-management processes would seem to fall under the purview of the duty of oversight. That is because the question whether officers or directors must ensure that their firm has a strategic-management system in place is not a question of whether officers or directors became informed in connection with a specific strategic decision, but rather a question of whether they otherwise paid adequate attention to the firm’s strategic-management processes. Thus, the rest of this discussion focuses on the duty of oversight. First, subsection 1 looks at the legal duty itself. Then, subsection 2 applies that duty to the context of managing a firm’s strategy for wealth creation.

1. Duty of Oversight

The seminal case regarding the duty of oversight is *In re Caremark International Inc. Derivative Litigation*, decided by the Delaware Chancery Court in 1996. In that case, shareholders sought reimbursement from directors of $250 million that Caremark had paid in fines to federal regulators and to settle suits against it involving its violation of Anti-Referral Payment Laws. Caremark and the defendant directors ultimately settled the derivative suit; however, under Delaware law, they were required to obtain the Chancery Court’s approval of the terms of settlement.

In his approval of the terms of settlement, former Chancellor Allen noted that the plaintiff’s case called into question the board’s duty of care, not in the context of making a business decision, but rather in the context of unconsidered inaction in the face of employee misconduct. A board has a duty in this latter context because, as the former Chancellor noted, business decisions of officers and employees deep in the interior of an organization can vitally affect the welfare of that organization and its ability to achieve its strategic and financial goals. Thus, former Chancellor Allen devoted the majority of his opinion to determining what duty a board has to assure itself that its corporation functions within the law to achieve its purpose so as to prevent a loss.

183. 698 A.2d 959.
184. Id. at 961–62.
185. Id. at 960.
186. Id. at 971.
187. Id. at 968.
188. Id. at 967–69.
a. Standard of Conduct

According to the former Chancellor, a board has a duty to ensure that

information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation’s compliance with law and its business performance.\(^{189}\)

This replaced the standard from *Graham v. Allis-Chalmers*, where the court imposed no specific duty on directors to “root out misconduct.”\(^ {190}\)

The Delaware courts have interpreted this standard in *Caremark* as a standard of conduct.\(^ {191}\) This standard is intended to guide directors as to what is expected of them in supervising a firm, even though it does not necessarily articulate a standard for liability.\(^ {192}\)

Neither the court in *Caremark* nor subsequent Delaware court decisions addressing the duty of oversight have clearly explained what *business performance* means under this normative standard. The absence of clarifying jurisprudence likely stems from the fact that the typical *Caremark* case involves a challenge to oversight over legal compliance systems or employee misconduct.\(^ {193}\) In those types of cases, there is no need to explain what *business performance* means because the cases rest on those other aspects of the duty of oversight. In fact, according to former Chancellor Allen, his motivation behind the *Caremark* standard of conduct

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189. Id. at 970 (emphasis added).
190. Id. at 970.
192. See id. For a discussion of the expressive function of the law, see infra Part IV.B.
193. See *In re Citigroup Inc. S’holder Derivative Litig.*, 964 A.2d 106, 123 (Del. Ch. 2009) (noting that the plaintiffs’ allegations were a “twist” on a typical *Caremark* claim, in which a plaintiff alleges that damages arose from a failure to properly monitor or to oversee employee misconduct or violations of law); Bainbridge, *supra* note 18, at 968 (“Although post-*Caremark* opinions and commentary have focused on law compliance programs, the original *Caremark* decision contemplated a similar duty with respect to the corporation’s ‘business performance.’”)
was to “change directors’ behavior through its simple statement that directors have a duty to oversee legal compliance.”

More recently, plaintiff shareholders have alleged deficiencies in information and reporting systems relating to risks other than the risk of a violation of law. In one of the most significant such cases, In re Citigroup Shareholder Derivative Litigation, shareholder plaintiffs alleged that Citigroup suffered massive losses from its overexposure to risk in the subprime mortgage market. According to the plaintiffs, those losses stemmed from Citigroup’s officers’ and board’s failure to assure that adequate and proper corporate information and reporting systems existed that would enable managers and the board to be fully informed regarding Citigroup’s risk related to the subprime mortgage market. In other words, the plaintiffs alleged a failure to oversee the implementation of an information and reporting system designed not to convey information about the risk of a violation of law, but rather credit risk.

In Citigroup, the Delaware Chancery Court dismissed the plaintiffs’ complaint, characterizing the plaintiffs’ challenge as one which sought to hold “director defendants . . . personally liable to the Company because [in hindsight] they failed to fully recognize the risk posed by subprime securities.” While the court’s holding is discussed in further detail below, in connection with a discussion of the standard of liability, the important point to note here is that the Citigroup court’s analysis focused only on a duty to oversee information and reporting systems relating to risk—or as then-

194. Jennifer Arlen, The Story of Allis-Chalmers, Caremark, and Stone: Directors’ Evolving Duty to Monitor, in CORPORATE LAW STORIES 323, 341–42 (2009). See also E. Norman Veasey & Christine T. Di Guglielmo, What Happened in Delaware Corporate Law and Governance from 1992–2004? A Retrospective on Some Key Developments, 153 U. PA. L. REV. 1399, 1436 (2005) (“[T]here is an evolving expectation in the standard of conduct [from Caremark] that boards will set up and implement effective law compliance programs.”). While this quote by former Chancellor Allen suggests that his primary purpose for the duty of oversight was to encourage more board oversight over legal compliance, I do not see that as undercutting its application to officers as well, especially given the bases Chancellor Allen gave in Caremark for the duty of oversight. See infra notes 206–17 and accompanying text for an analysis of how the duty of oversight ought to, and likely does, apply to officers.

195. 964 A.2d at 112. Shareholder plaintiffs also alleged that Citigroup’s managers committed a waste of corporate assets in connection with various mortgage-related investments, among other transactions. Id. at 115.

196. Id. at 123–24.

197. Id. at 124.
Chancellor Chandler called it, business risk.198 Thus, the court in Citigroup did not dictate any expectation on officers or directors in overseeing a corporation apart from the installation and implementation of systems to track risk.199

b. Standard of Liability

In terms of the standard of liability, Delaware courts have conceded that it is very difficult to establish oversight liability.200 This reflects courts’ reluctance to second-guess managers’ activities, even in the context of unconsidered inaction. Thus, under the standard of oversight liability, most recently expressed by the Delaware Supreme Court in Stone v. Ritter, directors are only liable for breaching their duty of oversight where they “(a) . . . utterly failed to implement any reporting or information systems or controls; or (b) having implemented such a system or controls, conscientiously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems...
requiring their attention. “

According to the court in that case, either of these failures reflects directors’ bad faith and thus amounts to a breach of the duty of loyalty.

The Citigroup decision, introduced above, reveals the Delaware courts’ reluctance to impose liability on directors for losses caused by lapses in oversight over “business risk,” over which a firm does not have control. According to the court in that case, holding directors liable for such lapses would undermine the well-settled policy in Delaware of avoiding hindsight evaluation. This policy exists because it is almost impossible for a court to determine whether the directors of a company properly evaluated risk in making an investment decision, and doing so could cripple decision makers’ ability to earn returns by taking business risks. Thus, the court in Citigroup was unwilling to hold directors responsible for oversight lapses absent misconduct or wrongdoing.

201. Stone, 911 A.2d at 370 (second emphasis added). The Delaware Supreme Court purported to affirm the Caremark formulation of the duty of oversight in Stone. Id. at 369. However, Professor Stephen Bainbridge has argued that the court, in reality, was affirming the duty as modified in Guttman v. Huang. See Bainbridge, supra note 18, at 975–76 (arguing that Stone raised the standard of liability from Caremark, as Chancellor Allen in Caremark had not premised oversight liability on directors being conscious of their torpor); see also Guttman, 823 A.2d at 596 (“Although the Caremark decision is rightly seen as a prod toward the greater exercise of care by directors in monitoring their corporations’ compliance with legal standards, by its plain and intentional terms, the opinion articulates a standard for liability for failures of oversight that requires a showing that the directors breached their duty of loyalty by failing to attend to their duties in good faith.”).

202. Stone, 911 A.2d at 370. A director may not be exculpated for such liability because she may not be exculpated if she is found to have acted in bad faith. See Del. Code Ann. tit. 8, § 102(b)(7)(ii) (Westlaw 2012) (excluding bad faith from the types of conduct for which directors can be exculpated).

203. In re Citigroup, 964 A.2d at 126 (“To the extent the Court allows shareholder plaintiffs to succeed on a theory that a director is liable for a failure to monitor business risk, the Court risks undermining the well settled policy of Delaware law by inviting Courts to perform a hindsight evaluation of the reasonableness or prudence of directors’ business decisions.”).

204. In re Citigroup, 964 A.2d at 126. See also Miller, supra note 18, at 98–99 (arguing that it is absurd to think that a vice chancellor or chancellor on the Delaware Chancery Court could possibly decide what kinds of risk-measurement models a financial firm should use, how they should be implemented, how they should be updated, how the proprietary data sets on which such models are based should be collected, and what risk tolerances they should use).

205. In re Citigroup, 964 A.2d at 130–31. The court did not, however, conclusively rule out liability for risk-management-oversight failures absent misconduct. See id. Professor Larry Ribstein has questioned the clarity of the line between inadequate controls of business risks, for which directors are generally
c. Duty of Oversight of Officers

Despite the fact that the Delaware Supreme Court has explicitly held that officers owe the same fiduciary duties as directors, no Delaware case has ever applied the duty of oversight to officers. Moreover, officers are thought of less as overseers and more as doers—or those individuals who make day-to-day decisions under board supervision. Thus, it is questionable whether and how the duty of oversight applies to officers.

Nevertheless, I believe that officers likely do—and ought to—owe a duty of oversight similar to that of directors. That is because the same three bases for imposing such a duty on directors also apply to officers.

First, according to former Chancellor Allen in Caremark, the duty of oversight derives in part from the seriousness with which not liable (e.g., In re Citigroup), and inadequate controls of insider wrongdoing, for which director may be liable (e.g., American International Group, Inc., Consolidated Derivative Litigation), arguing that this contributes to the indeterminacy of corporate law. See Larry Ribstein, Another Perspective on Citigroup and AIG, HARV. L. BLOG (March 8, 2009, 10:17 AM), http://blogs.law.harvard.edu/corpgov/2009/03/08/another-perspective-on-citigroup-and-aig; Am. Int’l Grp., Inc., Consol. Derivative Litig., 965 A.2d 763, 799 (Del. Ch. 2009) (finding that plaintiffs had alleged particularized facts showing that the directors failed to exercise oversight over fraudulent and criminal conduct).

206. See supra note 179 and accompanying text.

207. In a recent case, the U.S. Bankruptcy Court for the District of Delaware, applying Florida law, held that officers owe a duty of oversight like directors. See World Health Alternatives, Inc. v. McDonald, 385 B.R. 576, 591–92 (Bankr. D. Del. 2008). While the court in that case was applying Florida law, it looked to Delaware law in determining officers’ fiduciary duties because “[t]he Florida courts have relied upon Delaware corporate law to establish their own corporate doctrines.” Id. at 590 (quoting Connolly v. Agostino’s Ristorante, Inc., 775 So. 2d 387, 388 n.1 (Fla. Dist. Ct. App. 2000)). Language in Caremark also suggests that officers have a duty of oversight. See In re Caremark Int’l Inc. Derivative Litig., 698 A.2d 959, 969 (Del. Ch. 1996) (“The case [referring to Graham v. Allis-Chalmers] can be more narrowly interpreted as standing for the proposition that, absent grounds to suspect deception, neither corporate boards nor senior officers can be charged with wrongdoing simply for assuming the integrity of employees and the honesty of their dealings on the company’s behalf.”) (emphasis added)). Moreover, Professor Martin Petrin has argued that the U.S. Supreme Court’s decision in United States v. Park, which holds that “individuals who execute the corporate mission” have a duty to “implement measures that will insulate that violations [of law] will not occur,” appears to impose a duty on officers and directors analogous to the duty of oversight. Martin Petrin, The Curious Case of Directors’ and Officers’ Liability for Supervision and Management: Exploring the Intersection of Corporate and Tort Law, 59 AM. U. L. REV. 1661, 1682 (2010) (quoting United States v. Park, 421 U.S. 658, 672 (1975)).
corporate law views the board’s role. Officers also perform an essential role in a business corporation’s operation. In fact, without officers, there would be no one to make important day-to-day operational decisions or to supervise the lower-level employees who keep a firm running.

Secondly, according to former Chancellor Allen, the oversight duty derives from the “elementary fact that relevant and timely information is an essential predicate for satisfaction of the board’s supervisory and monitoring role under Section 141 of the Delaware General Corporation Law.” If relevant and timely information is an essential predicate for satisfaction of the board’s supervisory and monitoring role, then officers, too, must have responsibility for ensuring that systems are in place to deliver relevant information to the board. In fact, the Delaware courts already impose a duty on officers to disclose to their superiors “material information relevant to the affairs of the agency entrusted to them.” While this duty only requires officers to inform their supervisors of information of which they are aware, it would seem to undermine the board’s ability to supervise corporate affairs if directors only received information within officers’ knowledge. The information and reporting system that Caremark contemplates must not only be designed to bring relevant and timely information to the board—it must also bring relevant and timely information to managers, to allow them to make informed judgments. Thus, it would seem that officers must have a duty to establish an information and reporting system as a necessary predicate to the officers’ and their subordinate

208. In re Caremark, 698 A.2d at 970.
209. Id.
210. Hampshire Grp., Ltd. v. Kuttner, 2010 WL 2739995, at *13 (Del. Ch. July 12, 2010) (citing Sci. Accessories Corp. v. Summagraphics Corp., 425 A.2d 957, 962 (Del. 1980)). See also MODEL BUS. CORP. ACT § 8.42(b)(1) (2009) (describing an officer’s duty to inform her superior officer or the board, to whomsoever the officer reports, of material information about the corporation’s affairs known to the officer and within the scope of her functions); A. Gilchrist Sparks, Ill., & Lawrence A. Hamermesh, Common Law Duties of Non-Director Corporate Officers, 48 BUS. LAW. 215, 226–29 (1992) (describing the officers’ duty to keep the board of directors informed); RESTATEMENT (SECOND) OF AGENCY § 381 (1958). The Model Business Corporation Act imposes a similar duty on directors, with respect to the sharing of information with codirectors. See MODEL BUS. CORP. ACT § 8.30(c) (2009). However, Delaware does not impose an equivalent duty on directors.
211. See RESTATEMENT (SECOND) OF AGENCY § 381 cmt. a (1958) (“An agent may have a duty to act upon, or to communicate to his principal or to another agent, information which he has received . . . .”) (emphasis added).
managers’ abilities to fulfill their own respective management functions as well.

Finally, as former Chancellor Allen noted, the duty of oversight derives from the need to install legal compliance systems to receive reduced sanctions under the Organizational Sentencing Guidelines.212 This rationale would also justify imposing a comparable duty of oversight on officers. In fact those guidelines specifically contemplate that “[h]igh-level personnel of the organization [will] ensure that the organization has an effective compliance and ethics program, as described in this guideline.”213

While officers therefore likely have a duty of oversight similar to that of directors, given the more limited scope of officers’ responsibilities, an officer should only be required to oversee matters falling within her scope of authority.214 That is because it is difficult to imagine an officer being charged with ensuring that a comprehensive information and reporting system exists that is designed to transmit information of which she is not aware and would not need to know to discharge her function to officers to whom she is not accountable.215

The same standard of liability applicable to directors would likely also apply to officers. That is because it is equally difficult for courts to assess in hindsight whether officers have effectively overseen their subordinate managers.216 Nevertheless, given

214. For commentary suggesting that the scope of the duty of oversight might vary for officers as compared to directors, see Paul E. McGreal, Corporate Compliance Survey, 65 BUS. LAW. 193, 214 (2009) (arguing that “officers charged with day-to-day operations may owe a more precisely defined Caremark duty”).
215. This is consistent with guidance from COSO on the roles and responsibilities within an organization for internal controls: “[i]n a cascading responsibility, a manager is effectively a chief executive of his or her sphere of responsibility.” See COSO, INTERNAL CONTROL—INTEGRATED FRAMEWORK 4 (2002), available at http://www.coso.org/IC-IntegratedFramework-summary.htm.
216. In fact, the court in Citigroup was faced with oversight claims against officers, as well as directors, yet it did not distinguish officers in its oversight analysis, suggesting that perhaps the same standards applied to both. See Plaintiffs’ Consolidated Second Amended Derivative Complaint at 7, 38–41, In
officers’ more engaged involvement in corporate affairs, it is probably easier to prove that officers knew or should have known of a control system deficiency that failed to bring to their or the board’s attention relevant information than it is to prove such deficiency by directors.\textsuperscript{217}

2. Duty of Oversight Applied to Strategic Management

As Part II explained, directors oversee the formulation, implementation, monitoring, and revision of a firm’s strategic plan for the creation of value. Even where directors provide strategic advice to officers, they are also exercising oversight, for effective oversight means the ability to direct the person being overseen to modify her performance if she is not performing effectively.\textsuperscript{218} While the board’s provision of strategic advice does not necessarily indicate that officers are not performing their strategic tasks effectively, it is consistent with the dialogical role between the overseer and the overseen. Thus, oversight duties apply to boards acting in their advisory role.

Officers, too, supervise a firm’s strategic-management processes. That is because even though they are at the top of the management chain, they do not manage wealth-creating strategy alone. In fact, as I explained in Part II, given the predominance of the bottom-up structure of strategic management, lower level managers also make business decisions about strategy. Moreover, all employees throughout an enterprise are responsible for implementing strategy and for communicating changes in the factors underlying a firm’s strategic plan to strategic planners. Officers oversee these strategic-management efforts by their subordinates to ensure that employees are properly discharging these functions. For these reasons, and the reasons mentioned under the preceding Section, officers should—and likely do—also have a duty of oversight.

As mentioned above, the duty of oversight generally requires that officers and directors pay attention to their firm to ensure that it functions within the law to achieve its purpose. Thus, the duty, at

\textsuperscript{217}See A M. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 4.01 cmt. a (1994).

\textsuperscript{218}See In re Citigroup, 964 A.2d at 131 (discussing how the board’s duty of oversight allows directors to intervene and prevent frauds and other wrongdoing that could expose the company to risk of loss).
least in its broadest sense, would seem to require that officers and directors ensure that a firm has a reasonable strategic-management process in place, for that process is what leads a firm to actually develop the purpose (i.e., objectives) to be achieved.219 Furthermore, requiring oversight over strategic-management processes recognizes that employees deep within the interiors of a firm vitally affect not only the content of that firm’s strategic plan, but also its ability to achieve its objectives through its strategy. However, such a duty does not seem to exist either as a normative standard of conduct or a standard of liability.

a. Standard of Conduct

In terms of the standard of conduct for oversight, Caremark and its progeny create an expectation on officers and directors to implement systems designed to inform managers and the board about risks so that they can each make informed judgments. This expectation derives from the expectation that officers and directors will act in a firm’s best interest, even where they are not making specific business decisions. Therefore, the information transmitted to decision makers through such an information and reporting system helps them to become informed so that they can determine whether certain risks might necessitate responsive action to prevent losses in firm value.

However, no Delaware court has clearly articulated any sort of expectation on officers or directors to oversee a system designed to inform them, or other managers, about drivers of firm strategy apart from risk to enable them to make appropriate judgments about the future direction of a firm’s business performance.220 That is true despite the fact that such a system, like an information and reporting system relating to risk, would also increase a firm’s value. It would do that through, for example, the reporting of information about a firm’s competitive strength, or a new opportunity for the creation of gains. Without such a clearly expressed standard of conduct, there is no legal normative guidance to officers or directors in favor of this kind of system.

219. See supra Part II.A.1.
220. For further support for the proposition that the oversight duty is unclear, see Assaf Hamdani & Reinier Kraakman, Rewarding Outside Directors, 105 Mich. L. Rev. 1677, 1686 n.42 (2007) (“The jurisprudence concerning directors’ oversight duty is still in its infancy, and there are no clear standards prescribing what type of monitoring directors have to undertake in order to discharge these duties.”). While Professors Hamdani and Kraakman made this observation before the Citigroup case was decided, it seems to remain true even after that case was decided.
Moreover, even if we assume that the duty of oversight included a duty to implement an information and reporting system relating to strategic information in addition to risk, such a standard would be incomplete. That is because the aspirational standard under Caremark appears to only call for the implementation of an informational system. However, processes through which strategy is formulated, implemented, and revised depend not merely on the functioning of systems to gather and transmit information but also on systems that control for conduct, such as controls on the kinds of new opportunities that managers can pursue in discharge of the firm’s strategy. This is especially true in the strategy-implementation stage, when a firm’s primary challenge is ensuring that employees at all levels are actually carrying out the marching orders laid out in the firm’s strategy. It is certainly foreseeable that employees will either fail to pursue the course of action called for by a firm’s strategy or pursue an opportunity not called for by that strategy, given the troubles that so many firms have encountered when carrying out this stage of strategic management. Yet, the expectation that officers and directors only implement information controls in overseeing a firm’s affairs would fail to capture these other types of conduct controls.

b. Standard of Liability

While it is perhaps a bit clearer in mandate, obviously the standard of liability under the duty of oversight is intended to be more limited in scope. More specifically, liability under the duty of oversight is premised only on the risk of a violation of law or employee misconduct.

221. See Stone ex rel. AmSouth Bancorporation v. Ritter, 911 A.2d 362, 370 (Del. 2006) (noting that one of the conditions for director oversight liability includes the failure by directors to implement any reporting or information system or controls); In re Citigroup Inc., 964 A.2d at 131 (“Director oversight duties are designed to ensure reasonable reporting and information systems exist that would allow directors to know about and prevent wrongdoing that could cause losses for the Company.”); In re Caremark Int’l. Inc. S’holder Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996).

222. See supra Part II.A. This point would also seem to be relevant for risk management systems, which also include conduct controls in addition to informational controls.

223. The duty of oversight likely only enforces a duty to oversee these kinds of risks because firms are thought to have control over them. Other kinds of risk, such as credit risk and market risk, are largely out of a firm’s control.
Moreover, liability is premised on the need to prove losses.\textsuperscript{224} This means that even if the duty of oversight included information and reporting systems relating to strategy, such lapses might not give rise to liability, for strategic lapses often lead not to losses but to foregone gains. So, for instance, if a firm failed to install an information and reporting system relating to strategy, and, as a result, officers misidentified the source of a firm’s competitive advantage or were not aware of an additional opportunity, that failure would lead not to a loss but rather to a foregone gain.\textsuperscript{225} Therefore, there would be no prospect of liability under the duty of oversight.

The focus under the duty of oversight on preventing losses has likely thrown judges off the scent of the need to promulgate a clear expectation for directors and officers in overseeing their firms’ installation of wealth-creating processes. Specifically, because cases presented before those jurists involve challenged oversight lapses that led to losses, there is no need to address the demands of a broader duty of oversight for the creation of gains. However, the scope of a standard of conduct should not be limited by the context of cases brought before the courts.

In sum, the duty of oversight only calls for oversight over certain processes—the gathering and reporting of information—pertaining to certain aspects of a firm’s operations—its risks. It does not, however, clearly impose a duty on the board or officers, even as a normative standard, to oversee the management of strategy to create gains.

\textbf{B. Securities Laws Affecting Strategic-Management Duties}

Under a new SEC rule, public firms must disclose the extent of their board’s risk-management oversight role.\textsuperscript{226} Thus, under this

\textsuperscript{224}. It is likely that this element of a duty of oversight claim has led academic commentators to focus only on risk of loss when considering what directors must oversee under the duty of oversight. See, e.g., Bainbridge, supra note 18, at 968 (limiting the analysis of the contexts where \textit{Caremark} claims should lie to those cases where the corporation suffered losses); Pan, \textit{Rethinking the Board’s Duty}, supra note 21, at 210 (characterizing the duty of oversight as a duty to “ensure that directors are attentive and vigilant against the occurrence of \textit{harm} to the corporation” (emphasis added)).

\textsuperscript{225}. Injunctive relief also seems like an unlikely remedy because, as is discussed above, courts are unwilling to second-guess managerial decisions as to which processes to put in place to manage risk, much less strategy.

rule, firms must disclose whether the managers who are responsible for supervising risk-management report to the full board, the audit committee, or a risk committee.227

This disclosure, while it does not impose a substantive requirement on boards to engage in risk management, surely suggests that boards must be doing something to oversee the management of risk. It even implies that managers will report to one of three possible board committees. This rule does not, however, call for disclosure about how risk is managed apart from the board oversight process. Thus, companies need not disclose their other internal risk-management processes or policies.

Moreover, this rule does not call for the disclosure as to board oversight over the management of strategy. Thus, similar to state corporate law, the focus of the rule is on oversight over the process through which firms limit losses and not on the process through which firms create gains.

The New York Stock Exchange (NYSE) has also attempted to prod boards of listed companies into performing risk oversight. Specifically, the NYSE’s corporate governance rules require the audit committee of a listed corporation to have a charter that sets out the audit committee’s duties and responsibilities with respect to discussing risk-management policies.228 Even where the audit committee is not the sole body responsible for overseeing the management of risk, under these rules, it must discuss guidelines and policies to govern the process by which risk management is undertaken.229

This mandate, perhaps even more so than the SEC rule discussed above, is designed to bring about more board engagement in the risk-management process. It does so through encouraging more communication within the audit committee about risk-management processes. However, like the SEC rule, it too ignores processes to bring about more effective management of strategy apart from promoting better awareness on the audit committee as to the board’s role in overseeing the management of risk.

227. Id. at 40.
229. NASDAQ, supra note 228.
risk. Thus, the NYSE mandate, like the SEC rule, seems designed to prompt companies to enhance their processes to manage risk to avoid losses, but not also to enhance their processes to manage strategy to create gains.

C. Conclusion

As the preceding discussion reveals, corporate law does not specify any clear standards for officers or directors, either as an aspirational standard of conduct or standard of liability, to oversee the implementation of processes to manage strategy to create gains. Securities regulations and stock exchange rules also ignore the management of strategy and primarily seek to cause boards to be more involved in overseeing the management of risk. While these legal standards are designed to encourage firms to improve the processes through which they limit their losses from risks so that they can create sustained value, these legal standards do not take a similar approach to the corollary process through which firms actually create value—that is, the management of strategy.

The next section explores why the law’s failure to mandate oversight over the management of strategy apart from risk is problematic and what should be done to address it.

IV. CREATING A STRATEGIC-MANAGEMENT NORM THROUGH CORPORATE LAW

A. Making a Case for Change

As Part II showed, managing strategy is a multifaceted, multilayered process, integrated with the management of risk, all of which is designed to generate value.230 Despite that, judges, policymakers, and commentators have focused their attention only on the creation of value through better risk-management processes and ignored the creation of value through strategic-management processes.

Clearly, there are good reasons why state courts should be reluctant to hold officers and directors accountable for the strategic decisions that they make that turn out badly. Most notably, business necessarily involves uncertainty that planners simply cannot foresee, much less plan for, and to hold them accountable for the adverse consequences of such uncertainty could cause them

230. See Brancato et al., supra note 137, at 5–6 (According to a survey conducted by the Conference Board, directors acknowledged that “they must oversee business risk as part of their strategy setting role.”).
to be too cautious when selecting a strategy. But that does not mean courts cannot or should not demand that officers and directors put in place reasonable systems designed to inform them and other managers of information relevant to the firm’s wealth-creating strategic processes and to implement controls designed to ensure those strategies are effectively implemented. In fact, Caremark illustrates that while the details of a system can be left to the boards’ and officers’ discretion, the law can at least mandate the adoption of a minimally effective system.

Nor is the fact that managers have incentives to create value an adequate response to why courts should decline to set out standards relating to strategic management for the creation of gains. While officers would ideally be compensated for effectively managing strategy to create gains, the reality is that it is hard to design a compensation package that effectively does so given that some objectives are qualitative and thus difficult to measure.231 Moreover, as Professor David Walker has argued, there is a lack of understanding of which compensation instruments best link pay to long-term performance.232 To the extent that financial incentives alone cannot create a managerial drive toward achieving the creation of gains through strategic management, the law should pick up the slack, at a minimum, through an expressive standard of conduct.

The SEC’s disclosure rules and the NYSE’s corporate governance rules also focus solely on board oversight over the management of risk, neglecting to address the board’s and officers’ role in overseeing the management of strategy for the creation of gains.233 While the SEC’s and NYSE’s goal of protecting investors234 might bespeak a need to have firms educate those investors on risks that can lead to losses, surely investors are not protected if the boards and officers of the firms in which they invest do not also have a clear directive on their responsibility to oversee the implementation of processes to create gains.

There is also a dearth of discussions in the academic literature as to the management of strategy. In fact, in the past three years,
commentators have put forth numerous proposals for improved risk-management processes. Yet, none of those commentators discuss in any meaningful way how managing strategy relates to the management of risk or the need to encourage or require firms to more effectively manage the former in addition to the latter. Admittedly, many of those commentators make a good case for how improving the management of risk can enhance a firm’s value. However, that argument alone does not drive firms to more effectively manage their strategies to create value.

In one recent article, Professor Eric Pan provides some insight into the strategic context for risk management. For instance, according to Professor Pan, boards monitor officers by collecting and evaluating information about officers’ performance and the effectiveness of corporate strategy. Professor Pan also states that boards offer advice concerning (or, if necessary, dictate) corporate strategy. According to Professor Pan, these two roles are inseparable, for a board cannot fulfill its monitoring role without the ability to affect corporate strategy and respond to negative developments. Likewise, a board cannot carry out its managerial role without first collecting information about corporate operations through its monitoring activities.

Despite his discussion of the board’s strategic role, Professor Pan’s proposal focuses only on expanding the scope of risks for which the board’s duty of oversight applies. He focuses only on risk because he believes that is the context in which there is the greatest concern about officers’ ability to protect shareholders’ interests. However, as I have demonstrated in Part II, firms often fail not merely because they do not adequately manage their risks but because they fail to create strategic plans for the creation of gains or fail to implement those plans. Thus, if we want to encourage firms to create long-term value, we should not only charge the board and officers with oversight over the management of risk but also with oversight of the processes through which they generate returns. Focusing legal standards only on the creation of

235. See supra note 21 and accompanying discussion.
236. See, e.g., Simkins & Ramirez, supra note 21, at 583, 592–94 (noting that ERM is developing into a tool that can enhance firm value and proposing that the SEC require qualitative disclosure about a firm’s approach to ERM).
237. Pan, Rethinking the Board’s Duty, supra note 21, at 218.
238. Id.
239. Id. Cf. discussion supra Part III.A.2.
240. Pan, Rethinking the Board’s Duty, supra note 21, at 218.
241. Id.
242. Id. at 225–27.
243. Id. at 225–26.
value by managing risks, and not the corollary process of managing strategy, creates a number of risks.

First, such legal focus on risk-management practices could drive managers to focus on, not surprisingly, limiting losses through the management of risk at the expense of focusing on managing strategies for growth. In fact, according to Professor David Larcker, affiliated with the Corporate Governance Research Program at the Stanford School of Business, a check-the-box mentality associated with compliance is drowning out strategy.244 Even the NYSE, in a 2010 Report issued by its Commission on Corporate Governance, cautioned that new governance mandates and “best practice” recommendations over the last decade create a risk that even the best boards will adopt a check-the-box mentality rather than have corporate governance serve an integrated role in a company’s strategy.245 One sign that firms may be ignoring the management of strategy is the conclusion by numerous business commentators that firms often fail to either monitor the implementation of their strategies or fail to revise their strategies in response to change.246

While the bulk of the concern that compliance is drowning out strategy likely stems from the numerous SEC mandates on risk management, surely the problem is compounded where corporate law jurists and commentators focus narrowly on creating or proposing new mandates as to risk management without giving any clear sense for its strategic context or any imperative to perform the latter as well. This would also seem to influence the SEC’s view of the role and duties of the board and officers, for the SEC looks to state law for such matters in crafting its disclosure rules.247

244. See David Larcker & Brian Tayan, Why Does Corporate Governance Really Matter? New Book from Stanford Showcases Research into How Boards Can Govern Better, CORP. GOVERNANCE & LEADERSHIP WIRE, STANFORD UNIV. (May 19, 2011, 1:47 PM), http://www.stanford.edu/group/gsbcorpgov/cgi-bin/blog/?p=1973 (quoting David Larcker as saying that “our [referring to his and Brian Tayan’s] research shows that . . . [a] check-the-box approach is not what we need from directors. We need instead their best thinking and ability to manage risk appropriately for corporate growth”).


246. See supra Part II.A.

Thus, SEC regulations focusing on risk management may simply reflect what the SEC views as the state law role of boards.

Second, legal standards specifying how firms should or must manage risk to limit their losses might lead those firms to institute a disjointed process whereby they manage risks in one way to suit these legal requirements and manage their wealth-creating strategy entirely separately, without regard to such constraints. Yet, implementing such a disjointed process does not make sense given the integral connection between risk and strategy, both of which create value for a firm. In fact, implementing such a bifurcated process might actually impair ERM efforts, which promote the management of risk in a way that furthers the setting of firm objectives.\textsuperscript{248}

For example, one outgrowth of the post-financial crisis risk-management fury is the creation by some firms of separate risk committees of the board.\textsuperscript{249} In fact, the Shareholder Bill of Rights of 2009, which was a predecessor to the Dodd–Frank Act and introduced by Senator Charles Schumer, would have required that all public companies form risk committees of the board “responsible for establishing and evaluating the firm’s risk-management practices.”\textsuperscript{250} While a risk committee generally oversees the determination of a firm’s risk appetite and tolerance,
as well as the processes the firm uses to manage its risk, it is typically not responsible for general strategic oversight—that remains a function of the full board.252

Though it may make sense for certain firms to have separate risk committees, for other firms, such a committee would prevent the full board from understanding the risks attendant to the firm’s strategy.253 In fact, according to a survey conducted by the Conference Board, many of the responding directors indicated that they thought risk oversight should be a function of the full board because it is so integrally linked to strategy oversight.254 By stripping risk oversight from the full board’s domain, some boards might be less effective at overseeing their firm’s management of strategy to create gains.255


252. See supra Part II.A.4; see also discussion infra note 257 and accompanying text.

253. LÄCKER & TAYAN, supra note 137, at 195 (noting several reasons why a company might form a risk committee but also noting that risk management should not be an isolated function within a company and that any consideration of risk should be made in conjunction with a comprehensive review of a company’s strategy). The Dodd–Frank Act requires that certain large financial institutions form separate risk committees, though the purpose is to prevent and mitigate risks from the financial distress or failure of large, interconnected financial institutions rather than from individual firm risks. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 165, 124 Stat. 1376, 1899–900 (2010).

254. BRANCATO ET AL., supra note 137, at 6. The Conference Board noted how some firms embroiled in the financial crisis in fact had risk committees, though their processes proved to be ineffective. MATTEO TONELLO, THE CONFERENCE BD., THE ROLE OF THE BOARD IN TURBULENT TIMES . . . OVERSEEING RISK MANAGEMENT AND EXECUTIVE COMPENSATION 4 (2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1325028. The Conference Board has also suggested that firms consider forming a risk management executive committee led by the CFO or chief risk officer to allow functional managers to voice at the executive and board level any concerns expressed by lower level employees and to provide feedback on the effectiveness of the ERM program. Id. At least one dedicated director with risk oversight responsibilities would regularly attend meetings of that committee. Id.

255. See Veasey, supra note 68, at 14 (“The critical link between strategy and risk points to the need for the full board—rather than any one committee—to have responsibility for risk.”). Still, given the need for close collaboration with officers, and for developed expertise, it may make sense for some firms to establish dedicated risk committees. MATTEO TONELLO, THE CONFERENCE BD., EMERGING GOVERNANCE PRACTICES IN ENTERPRISE RISK MANAGEMENT 33–34 (2007). The Conference Board has more recently suggested that firms consider establishing risk management executive committees. See supra note 254 and accompanying text.
Additionally, short-termism may have derived in part from the absence of reinforcing mandates as to the wealth-creating aspects of strategic planning. Specifically, as discussed in Part II.B above, short-termism is the undue focus by a firm on short-term revenues rather than the long-term creation of value. A firm that does not have realistic long-term objectives or a strategy in place to achieve those objectives would not be able to provide its employees with guidance in making decisions designed to achieve that strategic plan. Without such a guide, they tend to make decisions with a focus solely on producing short-term revenues.\(^{256}\) Thus, failing to have an effective strategic plan in place contributes to the short-termism problem that Professors Lynne Dallas, David Walker, I, and others have identified and have put forth other proposals to address.\(^{257}\)

Even if we assume that managers currently manage their firms’ strategies effectively, there is no reason why the law should not impose a duty on managers to do this. In fact, a normative standard might be useful even to the most strategically minded managers, who might be faced with situations and pressures that are inconsistent with the objectives of long-term value creation. Moreover, without a clear statement on what is expected of officers and directors in terms of strategic management, those norms might shift or erode over time.

\(^{256}\) See supra note 158 and accompanying text.

B. Promoting Strategic Management Through Fiduciary Duties

State corporate law regulates the internal affairs of corporations. That includes setting out the powers and duties of shareholders, directors, and officers.

State corporate law regulates through standards rather than rules. There are several justifications for this approach. For one, standards are much more flexible than rules. They are therefore thought to be more appropriate in the corporate setting, where no two corporations, corporate managers, or corporate contexts are alike.

Moreover, standards are typically generated and articulated through stories told by courts. Thus, they have a narrative quality that is not shared by rules. In the case of corporate law, this is beneficial because, as Professor Edward Rock has argued, one of the true benefits of corporate law is that it provides a set of tales of good and bad managers that fills out the “normative job description of these critical players.” Thus, it is not necessarily the purpose of corporate law to sanction managers but rather to provide a set of normative standards with which managers try to

258. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 91 (1987); Cort v. Ash, 422 U.S. 66, 84 (1975) (“Corporations are creatures of state law, and investors commit their funds to corporate directors on the understanding that . . . state law will govern the internal affairs of the corporation.”).

259. Burks v. Lasker, 441 U.S. 471, 478 (1979) (“[T]he first place one must look to determine the powers of corporate directors is in the relevant State’s corporation law.”); Robert B. Thompson, Corporate Federalism in the Administrative State: The SEC’s Discretion to Move the Line Between the State and Federal Realms of Corporate Governance, 82 NOTRE DAME L. REV. 1143, 1146 (2007) (“It is state law that creates corporations and decrees the rights of the three key players in governance: shareholders, directors, and officers.”).


261. Id. (“The Delaware approach has tended to create incentives for particular good governance practices, yet also recognizes that what generally works for most boards may not be the best method for some others. The fiduciary duty form of accountability is well-suited to this sort of flexibility because it is context-specific in application.”).

262. Id. at 956, 979; Roberta Karmel, Realizing the Dream of William O. Douglas—The Securities and Exchange Commission Takes Charge of Corporate Governance, 30 DEL. J. CORP. L. 79, 81 (2005) (“The corporate governance provisions of Sarbanes–Oxley are proscriptive in an area where flexibility has long been valued.”).


264. Id.

265. Id. at 1016.
comply because they believe doing a good job is the right thing to do.” That is especially important for directors, who often are wealthy, well-reputed business people otherwise protected by insurance. Thus, shame and reputational damage might be a more effective disciplining mechanism than monetary damages.

That is not to say that state corporate law serves only a normative function. It also does, in some cases, provide a source of monetary liability or injunctive relief. Yet, the primary function of state corporate law, especially outside of the takeover context in the absence of self-dealing, seems to be to set forth the normative standards that directors and officers are expected to follow to be responsible corporate citizens.

Given all of these attributes of state corporate law, I believe that it is the appropriate medium through which to specify a strategic oversight duty on officers and directors. In particular, its flexibility is indispensable in setting out a standard for engaging in a process that simply cannot (and should not) be standardized. Moreover, its normative quality would allow courts to specify what is expected of directors and officers in terms of processes to ensure strategy is being effectively managed without requiring courts to pass on the merits of any particular strategy. Importantly, it would give managers a more complete normative picture of what is expected of them in terms of managing the creation of value beyond managing risk of loss.

To reflect the foregoing, I propose that Delaware courts clarify that the duty of oversight demands that officers and directors oversee the implementation of systems to inform them and other strategic managers of information relevant to the management of strategy in addition to risk. This clarification could come in the form of a clarification of the term *business performance* under the


duty of oversight. Thus, under the duty of oversight, officers and directors would have a duty to design and implement information and reporting systems to communicate information about competitive advantage and weaknesses; resources, competitors, and other constraints; and risks and opportunities to appropriate strategic managers so that they can more effectively manage strategy to create gains.

Clarifying that business performance includes the nonrisk components of strategy would show that officers and directors must oversee the implementation, not only of systems to prevent losses, but also of systems to create gains, for all of those dictate a firm’s business performance.

Moreover, Delaware courts should clearly indicate that the duty of oversight applies not only to information and reporting systems but to all systems designed to ensure effective management of strategy. Again, this would reflect the fact that managing strategy is not only about the reporting of information but also about the installation of conduct controls designed to ensure the strategy is actually implemented. Given the numerous instances of corporate collapse due to ineffective strategy implementation, it would seem that normative standards relating to business oversight should encompass oversight of these critical systems rather than just information.

These clarifications would take the form of normative standards of conduct. In other words, I do not propose holding officers or directors liable for failing to implement these standards. That is because for the same reasons mentioned by former Chancellor Chandler in *Citigroup*, it is difficult to envision how courts could determine after-the-fact whether a firm’s failure to achieve its objectives resulted from a flawed process or simply unforeseen risk. However, my proposal would provide officers and directors with a much-needed narrative of what is expected of them in overseeing a firm’s ongoing operations apart from the present ambiguous standard that seems to relate only to risk. This narrative would, in Professor Rock’s parlance, fill out the “normative job description” for these critical corporate players as to this critical strategic function.

Hopefully the manifestation of a clear norm on engaging in strategic management would encourage directors and officers to in fact implement more effective processes for the creation of gains. Thus, officers and directors could correct any strategic-management practices that fall below what is expected of them. It also would demonstrate courts’ understanding of the context for the management of risk, and the relationship between risk and strategy, that currently seem to be lacking. Also, setting out a clear
standard of conduct on the management of strategy would give courts the appropriate vocabulary and concepts to explain why business involves risk. And establishing such a clear norm could serve as an additional force in the battle against the pressures to create short-term value, for it would reinforce the need to create and implement long-term strategic plans to guide employee decisions, replacing the short-term earnings guidance on which they would otherwise rely.268

In addition, shareholders could utilize this normative standard to discipline errant officers and boards, perhaps by not voting in favor of a board that fails to meet the pronounced expectation for strategic management. They could also commence a derivative suit against any officer or a board that failed to perform its expected strategic-management role, arguing such conduct amounts to bad faith.269 Although the duty of oversight would not presently appear to capture such misconduct, the existence of a clear standard of conduct could give rise to a perceived need for liability for failures to conform to such expectation.

While pronouncing such a standard in the context of judge-made law requires the right case to come before the judiciary, I am fairly confident that Delaware courts will have ample opportunity to issue this kind of guidance in the aftermath of the financial crisis in future cases involving challenges to “excessive” risk taking. That is because strategic management is the corollary of risk management, and thus a case that intends to capture the full spirit of the duty of oversight would need to address not only what it requires in terms of loss-preventing processes but also gain-creating processes. Delaware jurists could also put on their commentator hats, as they often do, to give this kind of guidance even before an appropriate case comes before the courts.

Finally, implementing this suggestion would require courts to clarify that officers and directors are to primarily act in a firm’s long-term best interest. That is because only if officers and directors have a duty to look long term can they be expected to implement and oversee processes by which long-term value is created. Yet, as I argued in another article, corporate law currently does not require that directors (or officers) take such a long-term perspective.270 Mandating such a long-term focus would not only drive officers and directors to focus on ensuring that their firms

268. For several other thoughtful proposals on how to combat short-termism, see Dallas, Short-Termism, supra note 257, at 45–70.
269. See supra notes 200–01 and accompanying text (discussing the standard of liability under the duty of oversight).
270. See Grossman, Short-Term Fling, supra note 19, at 950.
have processes to guide their creation of long-term value but would also serve as yet another force to combat the myriad pressures on managers to manage for the short term.

This proposal would not only establish clearer standards as to board and officer conduct in overseeing strategy but would also provide cues to policymakers and courts of other jurisdictions as to what officers and directors should be doing with respect to the management of wealth-creation strategies. In fact, courts of other jurisdictions often look to Delaware courts for guidance in establishing their own fiduciary duty law.\(^\text{271}\) That may be increasingly the case as courts in jurisdictions outside of Delaware decide more and more cases under Delaware corporate law.\(^\text{272}\) Thus, those other forums may follow Delaware’s lead and be more cognizant of the need for managers to not only manage risk but also strategy, all to create value.

I do not anticipate that this proposal will transform businesses into effective long-term managing machines. But, it is intended to give business leaders the legal foundation, support, and urging that they may need to focus their attention on the critical processes through which their firms create value apart from limiting their losses through the management of risk. Yet, I can already anticipate a number of critiques to my proposal.

First, some critics might argue that Delaware law already reflects these expectations on directors and officers. That is because Delaware law already expects directors and officers to implement “[a]spirational ideals of good corporate governance practices” for they often benefit stockholders, sometimes reduce litigation, and can usually help directors avoid liability.\(^\text{273}\) Moreover, it already obligates them to act in a manner that affirmatively is in the corporation’s best interest.\(^\text{274}\) Together, these could be interpreted to mean that officers and directors should oversee strategic management, for that is good corporate governance practice and the way firms create value.

My response to this argument is that such a standard is too broad and generalized to be of much use to officers or directors. Such a standard, for example, might simply mean that officers and directors should not act in their own personal interest. Or it may

\(^{271}\) See supra note 171 and accompanying text.

\(^{272}\) See John Armour et al., Is Delaware Losing Its Cases?, 9 J. EMPIRICAL LEGAL STUD. 605 (2012) (finding that “the Delaware courts’ control of corporate opinion writing ebbed away dramatically as the [first] decade [of the 21st century] progressed”).

\(^{273}\) In re Walt Disney Co. Derivative Litig., 907 A.2d 693, 745 n.399 (Del. Ch. 2005) (quoting Brehm v. Eisner, 746 A.2d 244, 256 (Del. 2000)).

\(^{274}\) See supra notes 175–77 and accompanying text.
mean that they should ensure that risks that can lead to losses are managed because those risks deprive a firm of value. In any event, it should not be a mystery that officers and directors should manage a firm to affirmatively create sustained value and that they should do so not only through limiting losses through risk-management processes but also by creating gains through strategic-management processes.

This is especially true because the Delaware courts have hinted at a normative standard in the oversight context of installing information systems to inform directors and managers of business performance. Yet, the ambiguity associated with the term *business performance* fails to clearly signal to directors and officers what is in fact expected of them, and courts’ discussions only of risk in applying this principle compound this ambiguity.

In sum, given the relative dearth of judicial discussions concerning strategic management apart from risk, it is hard to determine a best practice for that process from existing fiduciary duty law.

Second, some commentators might argue that state law does not need to set a normative standard for the management of strategy, for the free market ensures that they will manage in this fashion if it truly creates value. According to this line of reasoning, officers already have financial incentives—in the form of stock options and other kinds of incentive compensation—to create value and thus to implement processes to achieve that end. Shareholders, too, want a firm to create value because shareholders are the residual beneficiaries of such value. Thus, they, too, can be expected to behave in a way that drives a firm to create value on its own, without needing regulatory interference.

There are a number of flaws in this argument. First, current compensation practices often motivate officers to generate value over the short term. In fact, those compensation practices are one of the primary drivers of managers’ excessive risk taking, for their compensation is typically not reduced by losses that materialize in the future, when risky future events unfold. Similarly, those compensation practices do not motivate officers to create true value through long-term strategic developments, again, because that value is only realized over time. As such, incentive compensation practices often motivate officers to generate value over the short term.

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275. See Grossman, *Short-Term Fling*, supra note 19, at 945–46 (explaining the rationale behind the notion that shareholders are residual beneficiaries).


compensation does not always encourage strategic management of a firm for the creation of true (rather than short-term) value.

Plus, there is some evidence that managing strategy might be costly in the short term. Yet, true value is often only realized in the future, when strategic initiatives have a chance to play out and create gains for a firm. Given the tendency for firms to focus on short-term results rather than long-term value, long-term strategic management is undoubtedly compromised.

Moreover, this argument ignores the expressive function of fiduciary duties, which is designed to encourage socially desirable conduct. It is hard to imagine conduct that is more socially desirable than the formulation and implementation of plans for the creation of durable wealth. President Obama recognized this when he called on the U.S. to resume its role as a leader in innovation to improve our livelihoods. While innovation does not only take place in the U.S. in for-profit corporations, most of it does. To be an effective innovator, a business needs to create and implement a well thought-out plan for the creation of gains. It cannot simply create durable wealth through innovation by wisely managing its risks.

V. CONCLUSION

In this Article, I have proposed that Delaware courts clarify existing fiduciary duties to reflect the broader roles and responsibilities of officers and directors in managing strategy. Effectuating this change is important because it would more completely reflect directors’ and officers’ true strategic functions, rather than simply their risk-management functions. Importantly, this change would also give the key corporate players a legal infrastructure to support their engagement in the process designed not merely to limit losses but also to create sustained value through wealth-creating strategic management. That, in turn, could benefit firms, their shareholders, other corporate constituents, and society.

278. See DAVID, supra note 11, at 18 (noting that some firms do not engage in strategic management because it is too expensive in time and money and that other firms view it as a waste of time because no marketable product is produced).

279. See President Barack Obama, Remarks by President in State of the Union Address (Jan. 25, 2011) (transcript available at http://www.whitehouse.gov/the-press-office/2011/01/25/remarks-president-state-union-address) (“The first step in winning the future is encouraging American innovation. . . . What we can do—what America does better than anyone else—is spark the creativity and imagination of our people. We’re the nation that put cars in driveways and computers in offices; the nation of Edison and the Wright brothers; of Google and Facebook. In America, innovation doesn’t just change our lives. It is how we make our living.”).