Corporate Responsibilities

Understanding Responsibilities and Accountabilities for High Performance
Submission by David White November 2005

1. PURPOSE AND BACKGROUND

This submission is to the Parliamentary Joint Committee on Corporations and Financial Services, in regard to their enquiry into corporate responsibility. The purpose of the submission is to assist the Committee in understanding the roles and responsibilities of directors, managers and others by providing a conceptual framework based on research into high performing organisations.

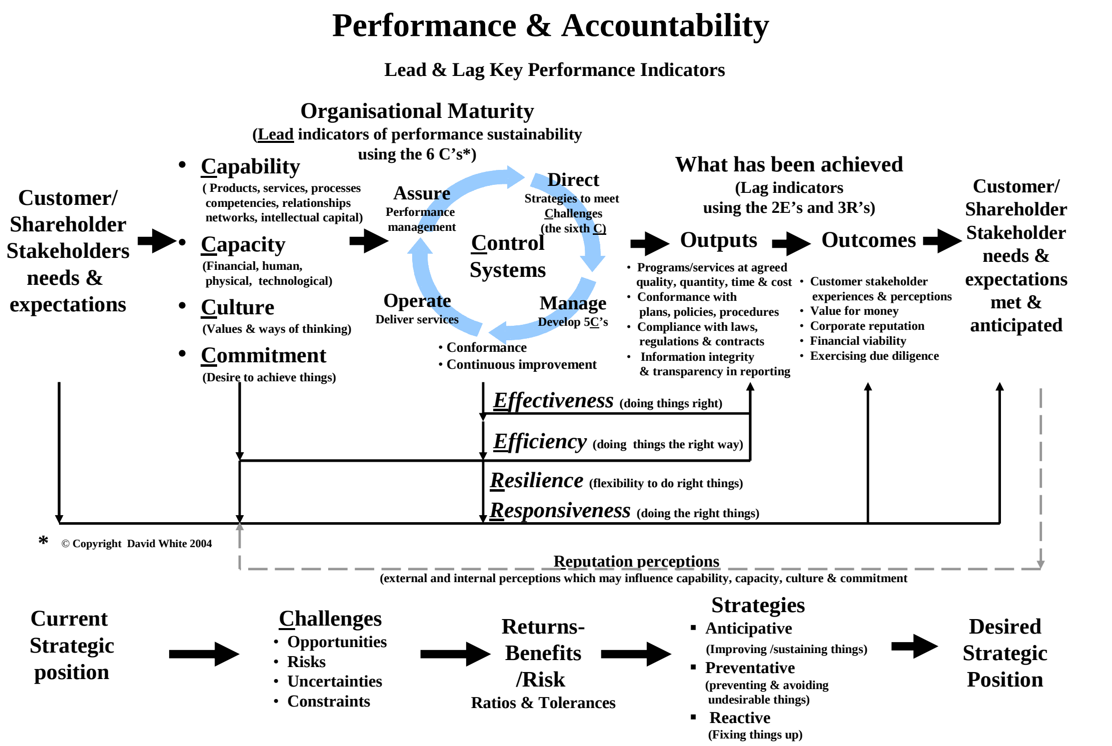
The submission highlights that regulation cannot enforce intangible behavioural factors critical for high performance and corporate failure avoidance. Due diligence defences must therefore encourage organisational control systems which support the development of intangible factors.

The submission is based on a view that decisions on changes to law should be based on evidence based research. The submission overviews an effective system of control based on research being conducted as part of PhD in governance by David White. It should be noted that the research is still ongoing and further work is required to validate findings. The detailed results of surveys and other work are not provided. Papers on the surveys conducted and results both in Australia and overseas are available if required.

The submission is provided from a practical rather than legal perspective.

2. SYSTEM OF CONTROL FOR ORGANISATIONS

A conceptual overview of performance and accountability for medium/large organisations highlighting the importance of a control system is overviewed as Figure 1.
Figure 1



An effective control system maintains operations that are:

- resilient – the operation must be sufficiently flexible and capable of adapting to change;
- responsive – the operation responds to changing demands and expectations of the shareholder interests, customers, employees, regulator, communities and others which may influence the operation's future;
- effective and efficient – the right products and services are be delivered the right way at the agreed quantity, quality, time, cost, location and image.

An effective system of control for directing means executives and others are able to spend a significant portion of their time developing the capability (including competencies and processes), capacity, culture and commitment (4 C's).

These elements should be integrated and aligned as a control system (5^{th} C) to address long term (5, 10 and 15 years) opportunities, risks, constraints and uncertainties (summarised as the challenges –the 6^{th} C).

If directing has been effective and there has been a strategic performance focus, then what is delivered is product/service delivery systems, plans, policies, procedures, competent people, information systems etc in advance to address the challenges ie an effective system for managing and operating.

In turn this enables front line and middle managers to run day to day operations and manage current risks with minimal supervision and cost effective oversight (called a low conformance focus). There will still be some risks not foreseeable and/or preventable which will require reactive management and problem solving but these should be minimal if an effective system for directing has been established.

If a control system integrating directing, managing, operating and assuring has not been effective then directors and managers spend a considerable portion of their time reacting to current problems and risks. This can become a 'muddling through' reactive cycle of solving problems. At worst the future viability of the organisation may be placed at risk.

A high performance / low conformance focus is an important indicator of sustainable performance improvement. Research suggests in the knowledge age sustainable improvements in performance tends to be related to more intangible factors including creativity, product innovation, brand image, teamwork and capability development.

High performing organisations may have at least the same level and in some cases higher levels of mistakes (particularly where creativity is a critical success factor) than lower performing organisations.

However organisations that can sustain high performance tend to have higher levels of intangibles such as teamwork and trust. When there are high levels of intangible factors, mistakes, risks, opportunities, constraints and uncertainties tend to be responded to, prevented, detected and/or corrected more quickly.

The quick identification of issues enables a more responsive and efficient organisation with less paperwork and bureaucracy to take advantage of opportunities sooner and/or address risks before major problems become apparent.

An important indicator of the effectiveness of intangible factors such as teamwork, competency, trust etc is the length of time it takes before foreseeable and preventable problems and issues are openly discussed and reported before those that govern an organisation finally realise they have a problem. The response to the issue also gives another indicator on the level of the intangible factors.

Broader scope directing, managing and internal audit systems are needed to support, monitor and audit these intangible factors.

In contrast organisations tending to have little or no improvements in performance can have strategies primarily focused on tangible factors such as restructuring, cost control, process improvement and new information systems. Not surprisingly, there is a more traditional focus by directors and managers on plans, policies, procedures, financial and compliance auditing of information and processes.

3. IMPORTANCE OF ORGANISATIONAL MATURITY

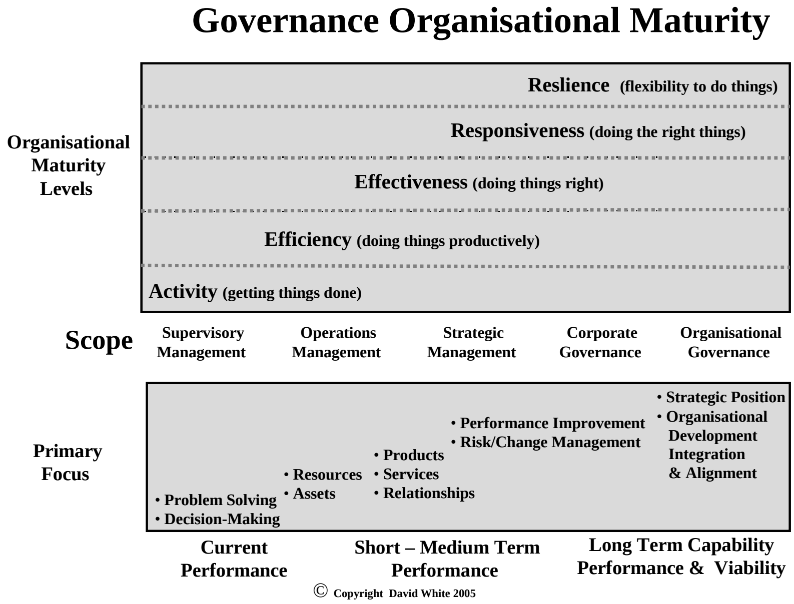
The development of capability maturity models (CMM) has originated from the US. In response to a perceived crisis in software development related to escalating software cost and quality problems, the US Department of Defence established the Software Engineering Institute (SEI) at Carnegie Mellon University in Pittsburgh, Pennsylvania in the early 1980s.

I define Governance Organisational Maturity or GOM as a broader assessment encompassing the maturity not just of processes but cultures and competencies and taking into account lifecycle modelling of organisations, people, products, services and relationships. Capacity, culture and not just capability are considered. Figure 2 overviews the governance organisational maturity of organisations that was provided as part of a paper and workshop presented at a corporate governance conference in April 2005.

Organisations typically mature in managing current and future performance. Their maturity is reflected in a progressive maturity to focus on:

- activity - solving problems and making decisions in relation to getting things done;
- efficiency and effectiveness – the right products and services are be delivered the right way at the agreed quantity, quality, time, cost, location and image.
- responsiveness – ability respond to changing demands and expectations of shareholders (if private sector) public interest (if public sector), customers, employees, regulators and others;
- resilience – the capability to be sufficiently flexible and capable of adapting to change, uncertainties, opportunities and risks.

Figure 2



There is no “one size fits all” maturity required. In general, organisations that face higher risk environments with dynamic change, major uncertainties, opportunities and risks require a high level of maturity to manage current and future performance.

Intangible success factors become more important in higher risk environments and must be designed by combining certain processes, competencies and cultures and integrating and aligning them as an outcome of a direct-manage-operate-assure enterprise wide system.

An organisational control system which integrates all activities in an organisation is needed because it is more comprehensive and effective than a corporate governance system which primarily focuses on directing/managing.

There is a need for sound business judgments by directors and managers on organisational maturity given foreseeable risk environments using relevant standards and frameworks.

‘One size fits all’ governance standards which typically exist in most countries including Australia may be of limited usefulness in assisting directors and officers make sound business judgments on organisational maturity.

There is "no one size fits all” or “if not why not” levels of compliance with governance standards but rather a level of governance maturity appropriate to an organisations foreseeable operating environment.

4. IMPLICATIONS FOR ACCOUNTABILITY / DUE DILIGENCE

The forgoing has highlighted the importance of intangible factors in sustaining high performance of organisations and avoiding major mistakes which can lead to failure.

Of course one of the reasons corporate regulation is ineffective is, whilst it be possible to regulate for tangible factors, it cannot regulate intangible behavioural factors. However it may be possible to frame regulation in such a way as to support systems and organisational maturity that maintain critical intangible factors.

Under an effective high performance control system described above:

- directors and executives would be primarily accountable for responsiveness and resilience of an organisation including the 5 C's lead indicators;
- middle/front line managers and others should be primarily accountable for lag indicators (outputs/outcomes) including for:
    - effectiveness and efficiency of operations including delivery of products and services at an agreed quantity, quality, time and cost;
    - compliance with plans, policies, procedures, codes of conduct, laws and regulations;
    - information integrity including completeness, accuracy, timeliness and security of information;
- specialist governance advisers and assurance providers including internal auditors may be accountable for assurance on 5 C's in high risk areas.

From a due diligence defence perspective, regulation which encourages development of the intangible (as well as the tangible factors critical for performance) may protect directors, managers and others if they:

- establish and maintain an enterprise wide direct-manage-operate-assure system integrating and aligning responsibilities, competencies, plans, policies, procedures, cultures, codes of conduct etc including regular auditing of the system;
- make honest, rational and informed business judgements on effectiveness, efficiency, responsiveness and resilience including having regard for the organisational maturity of operations to progressively achieve the required outputs/outcomes;
- determine an appropriate strategic performance/conformance focus and delegate based on assessments of organisational maturity in capability, capacity, culture and commitment;
- rely on specialist advisers and assurance services provided they are competent to advise on systems, organisational maturity and other critical success/risk areas.

The need for a chief governance officer and an effective system is critical in an environment where there is a need for:

- devolvement to manage diverse complex operations;
- cost effectively assessing intangible human outputs and outcomes and/or reliance on lead indicators due to complexity/difficulty;

- integrated/connected service delivery;
- a responsive cohesive organisation.

With the international trend towards accountability, auditing and reporting on governance practices, the chief governance officer should be the primary accountable officer for providing such reports and assurances.

For organisations without a senior governance officer, there is a risk that plans, policies, budgets, performance management, accountability, reporting and other practices and information requirements are developed in isolation without integration and alignment as a control system. The organisations maturity may not be objectively assessed.

It should be noted that whether an organisation/operation is currently performing does not necessarily mean that executives/managers are performing/exercising due diligence. This is because current performance may typically be a consequence of decisions made many years ago on staffing, facilities, control systems, culture etc which may not have been made or controlled by the executive/managers/others.

Executives, managers and others may not be performing and/or demonstrating due diligence when:

- he/she/team inherits a ‘muddling through’cycle and cannot progressively manage out of this cycle;
- he/she/team creates the potential or an actual ‘muddling through’ cycle by their own actions.

5. CONCLUSION

This submission has highlighted the need for a conceptual framework and evidence based information as the basis for objectively determining the responsibilities and due diligence defences of directors, managers, specialists and others.

If regulation is to be effective, there should be a proven link between directors and others duties / due diligence defences and the tangible/intangible factors that support high performance/avoid mistakes and failures.

There is "no one size fits all” or “if not why not” levels of compliance with governance standards but rather a level of governance maturity appropriate to an organisations foreseeable operating environment.

The submission should be viewed as a starting point for discussion rather than a prescriptive end point for change.

David White