

Creating value through governance: boardroom guide

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A practical action guide for boards and senior management of all organisations to accompany the consultation paper *Creating Value Through Governance - Towards a New Accountability: A Consultation*¹.

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¹ <http://www.accaglobal.com/gb/en/technical-activities/technical-resources-search/2014/february/creating-value-consultation/creating-value-background.html>

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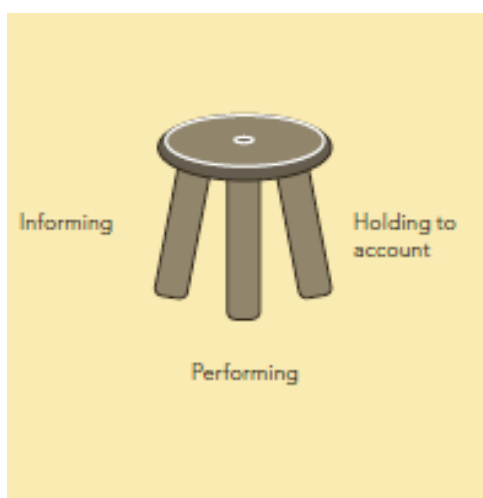
INTRODUCTION

This guide has been written for boards, directors and senior management of all organisations to accompany and support the consultation paper *Creating value through governance – towards a new accountability: a consultation*. The aim is to show how the thinking in the Consultation can be used in a practical way to help create value.

The objective is to assist the reader to take action within their organisation, rather than just consider the concepts cerebrally. It is also intended to raise awareness of the contribution of governance to creating value among a wider range of accountants, directors, thinkers and others who might not initially decide to take the time to read the full paper.

The key eight questions of the Consultation appear at the end of this document, alongside a number of practical actions being recommended to enable individuals to enhance value creation within their own organisations.

This guide uses the same three legged-stool framework of *Holding to Account, Informing and Performing*. The Consultation suggests governance is about making sure these elements work throughout the organisation to create value. In this structure boards should hold executives to account for their performance and executives similarly should hold to account those reporting to them for their performance. The Consultation also says that shareholders need to hold boards to account, this will be the subject of another paper and is not considered in detail here.



Holding to account requires boards to deliberate and decide upon their expectations ahead of action and communication. This guide also challenges the reader to consider how Strategy, Risk and Control are aligned.

The comments in each of the boxes below are deliberately stark and designed to challenge boards to consider the implications for their own organisations. There is no simple generic answer. Value creation is down to each organisation and the need to find its optimal and appropriate governance.

The word governance comes from the ancient Greek verb kyberan meaning to pilot or to steer.

If an organisation were a cruise liner, the board's role would be to keep the ship on course so that it safely reaches its destination with its passengers and crew intact. As well as navigating, the board must ensure the ship is sound, adequately provisioned and has sufficient crew who know what they are doing, and how to handle the anticipated idiosyncrasies of the other crew and passengers they are surrounded by.

UK Parliamentary Commission on Banking Standards in its 2013 report into the failure of HBOS commented ironically 'we are shocked and surprised that, even after the ship has run aground, so many of those who were on the bridge still seem keen to congratulate themselves on their collective navigational skills'.

At the outset of the journey it is essential to understand how uncertainty can affect the ship's progress.

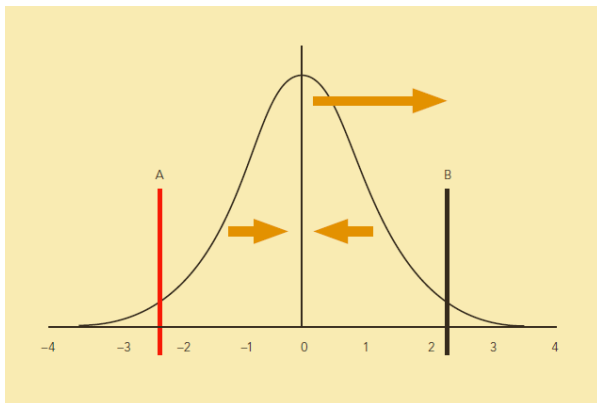


Figure 4.3 in the Consultation illustrates how boards may want to think about uncertainty. Governance, risk and performance can be thought of in terms of outcomes that can be measured. The curve represents the range, or expected range, of possible outcomes for a particular measure. The measure could be financial: a firm's share price, profit, sales, costs or asset values; or non-financial: quality, oil reserves, emissions, ethical health or staff motivation.

For assets, incomes and anything we want or need more of, performance is about shifting the bell curve to the right. The performance component of governance is about making sure the right outcomes are sought, that the organisation has the capability to achieve them, and that management pursues and achieves the right objectives in the long-term interests of shareholders and other stakeholders.

Boards should be aware that most measures are at best just proxies for the performance desired and that poorly designed measures might incentivise the wrong sort of performance.

Risk management is about limiting undesirable outcomes – removing the tail to the left of vertical line 'A'. The tail to right of vertical line 'B' represents the upside which may or may not be desirable. Removing the upside will narrow the range and improve predictability².

Boards, directors and senior managers should:

- Consider how these concepts apply to their organisation
- Recognise how, when and why governance creates value in your organisation
- Read the full Consultation and participate in the wider ACCA discussion.

² Or if you wish to be technical reduce the standard deviation of possibilities.

HOLDING TO ACCOUNT³

Those in a position to hold others to account for their performance must be clear in their own minds of their expectations, their tolerance surrounding those expectations, the pressures influencing the expected outcomes and able to differentiate between areas of certainty and areas of flexibility.

Unless those people whose job it is to perform know what is expected of them the whole process of 'holding to account' is arbitrary or meaningless. It is up to the board to determine how much granularity is needed when communicating their expectations. In some situations, simply articulating a clear vision is all that is needed. In others, more command and control will be needed. There is a tendency accelerated by US Sarbanes-Oxley Act and crises in financial services and parts of the public sector to attempt to centralise and prescribe control. It is a natural response but it can stifle initiative, foster a 'jobs worth' mentality and sometimes create a subversive culture where people ignore the spirit of rules. Balance, sensitivity and flexibility are required.

Effective governance requires a clear understanding by all of the meaning of value and success for the organisation.

The values, the 'tone' and the ethical norms of the organisation must be set, supported and recognised by those in authority and embedded in behaviour throughout the organisation.

STRATEGIC VISION

WHAT do you expect the future to look like in (say) five years time?

WHAT do you want your organisation to look like then?

HOW can you be confident that the vision can be achieved?

NB For some organisations this vision may simply be to survive or stay the same. In a changing world this may not be an option.

STRATEGIC GOALS

WHAT do you need to do to realise your vision?

WHAT are the five key measurable aspects of your visions? Can you define five tangible steps?

WHAT are the tolerances? How much departure from your plan can you accept before worrying?

³ Creating value through governance full document: chapter 6 and throughout

CONTROL AND MONITORING

HOW do you satisfy yourself that you know what progress is being made towards the vision or strategic goals?

HOW does the chairman, or equivalent, lead the establishment and challenge the strategy and its risk parameters?

HOW sure is the board that there a genuinely independent perspective around the boardroom table?

How does the board ensure that a range of views is always considered and that important decisions are not simply nodded through?

RISKS

DOES the board assume that the future will be an extrapolation of the past?

HOW confident are you that the organisation would be resilient in the face of reasonably foreseeable risk events. What about unforeseeable events, the unknown unknowns?

IS the organisation sufficiently resilient and flexible to withstand or adapt to anything?

ARE the board and executives and staff sufficiently engaged?

ACTIONS REQUIRED

Establish a timeframe for realising the vision.

Define GOOD, SUCCESS and VALUE for your organisation; both now and during the extent of your timeframe.

Be clear how you measure and incentivise performance.

Align people's responsibilities, rewards, goals and measures to help you to be able to monitor operational effectiveness⁴

⁴ Creating Value through governance full document: page 29

INFORMING⁵

We operate in a society where information overload is the norm. We demand and require instantaneous data to keep us informed. It becomes harder and harder to see the wood for all the trees.

We attempt to reduce and simplify to help us feel more in control. Reduction and simplification can however lead to unintended consequences particularly where performance measures or targets are used. There are numerous examples of where performance measures, inexpertly applied, caused serious problems. In healthcare it can mean staff work to the measure but omit patient care as it cannot easily be measured. In banking, it contributed to what would have been meltdown of the financial system.

STRATEGIC VISION

DO the performers in an organisation understand the vision and what the organisation is really there for?

HOW do the performers inform the holders to account in the organisation? If this is only ritualistic and formulaic, as human beings we fall into our habit and expectation mode..."I do this because I do this, because I do this!"

WHERE does the informing take place? How formal should informing be? Is there a need for formal structured meetings?

HOW does a board detect the normal 'smell' of the organisation and therefore rapidly detect when that 'smell' changes.⁶

STRATEGIC GOALS

HAVE you a clear understanding of the value drivers within the organisation and how to measure them?

HOW clear are you what information is required, what measures you will use and how those measures might result in unintended consequences?

CAN you simplify, without over simplifying, the content and number of reports to remove clutter from internal and external communications.

CAN you report to stakeholders how the the organisation contributes to public good?

⁵ Creating value through governance full document: chapter 5 and throughout

⁶ The word 'smell' is used to suggest that we need to encourage a wider use of our natural senses.

CONTROL AND MONITORING

HOW well do you understand the theory and the actual practice of the control mechanisms in your organisation?

HOW do you balance trade-offs such as that which exists between quality, time and cost?

RISKS

HOW efficacious is your approach to managing risk? If you have a risk register, is it controlled, reviewed, analysed, challenged and reported by the right people? A list of risks is unlikely to be sufficient to ensure resilience, what else do you do? Is it enough? Is risk management embedded within the organisation or is it another silo?

HOW do you think about the unknown and how would you respond to unforeseen events? Would staff feel able to use their initiative in a crisis or would organisational hierarchies frustrate speedy decisions?

ACTIONS REQUIRED

Build a picture of the organisational journey using Key Performance Indicators – note the word KEY, this should mean a maximum of 5 core indicators: aligned with the Holding to Account goals above! Be aware though of the possible unintended consequences of the use of these KPIs, such as creating a culture that works to the KPI rather than the KPI being a genuine measurement of change.

Critically review your current reports and informing structure; 'weed out' the unnecessary.

Find the right communication methods and the best communicators in your organisation, it is not a skill possessed by all.

Try imagining the unimaginable, the worst that could happen, and think how the organisation might deal with it.

PERFORMING⁷

It is those who are required to perform who will determine whether or not value is created – “the best laid plans of mice and men...”. A performing organisation needs individuals, teams, executives and the board to perform.

Effective, value-creating performance requires effective and timely decision making. In most organisations the ‘board’ is both the ‘holder to account’ and the place where the senior ‘performers’ have the opportunity to ‘inform’ the wider group of progress against strategy.

The correct alignment and behaviour within the boardroom (executive : non-executive; involved : independent; holder to account : performer) will be both the driver and the creator of organisational value – the efficacy of the Chairman’s leadership is intrinsic to this success – “good boards are created by good chairmen”⁸

STRATEGIC VISION

IS everyone in the organisation clear what the organisation exists to do, how it creates value, and their own role in contributing to value creation?

ARE people aware of the expectations of them, the required ‘informing’ and measures used to assess and give information about performance?

ARE you clear what key stakeholders expect from you or the organisation?

DO you understand how the organisation creates value? Does the organisation contribute in some way to public good? Can you articulate how?

STRATEGIC GOALS

HOW well does the organisation work as a team? Do people feel enabled and empowered or repressed and controlled?

HOW well do the measures used for performance work in practice. Are they as good as they can be?

IF I am a performer, how do I know when I have performed?

⁷ Creating value through governance full document: chapter 4 and throughout

⁸ Board Effectiveness section 1.4, FRC, September 2011 – this goes on to say “The chairman creates the conditions for overall board and individual director effectiveness”.

CONTROL AND MONITORING

HAVE you a performance measurement or management system? If so, how fit is it for purpose?
Does it have unintended consequences?

HOW can you ensure incentives are aligned?

HOW do you ensure that people working in the organisation have the right ethical values and take responsibility for their actions?

ARE the performers aware of their entitlement to perform, their modus operandi and their delegated authority?

RISKS

ARE there misaligned incentives driving motivation to succeed⁹ Are there incentives for individuals to perform that work against the organisation directly or indirectly?

HAVE we correctly identified the stakeholder expectations?

ARE there key aspects of performance, such as those concerning reputation quality or teamwork, which are difficult to measure objectively? If so, is there a risk that these aspects will be forgotten about as people work within a performance management system?

DO people know what level of risk they can and cannot accept?

ACTIONS REQUIRED

Draw a picture with supporting text of your business model and how value is created.

List the top ten things that need to work in the business model to create value within your organisation.

Ensure an appropriate target is set for each task, against the strategic timeframe of those 'holding to account'.

Tabulate the risk and acceptable range around each target, be certain of the extent of the bell curve and the inherent implications on either side of the median.

⁹ Creating value through governance full document: page 27 and chapter 2, see the Meyer example in particular

Recommended actions to commence or continue the process of value creation

1. Establish a timeframe for realising the vision.
2. Define GOOD, SUCCESS and VALUE for your organisation; both now and during the extent of your timeframe.
3. Be clear how you measure and incentivise performance.
4. Align people's responsibilities, rewards, goals and measures to help you to be able to monitor operational effectiveness.
5. Build a picture of the organisational journey using Key Performance Indicators – note the word KEY, this should mean a maximum of 5 core indicators: aligned with the Holding to Account goals above! Be aware though of the possible unintended consequences of the use of these KPIs, such as creating a culture that works to the KPI rather than the KPI being a genuine measurement of change.
6. Critically review your current reports and informing structure; 'weed out' the unnecessary
7. Find the right communication methods and the best communicators in your organisation – it is not a skill possessed by all.
8. Try imagining the unimaginable – the worst that could happen- and think how the organisation might deal with it.
9. Draw a picture with supporting text of your business model and how value is created.
10. List the top ten things that need to work in the business model to create value within your organisation.
11. Ensure an appropriate target is set for each task, against the strategic timeframe of those 'holding to account'.
12. Tabulate the risk and acceptable range around each target, be certain of the extent of the bell curve and the inherent implications on either side of the median.

The eight core questions from the main consultation paper

1. Has corporate governance become too focused on form and compliance at the expense of the quality and integrity of decision making?
2. Is creating sustainable value the overarching purpose of governance? If not can you suggest a better purpose?
3. Do you find the framework likely to help to improve corporate governance and help focus companies on creating sustainable value? What could make it better?
4. Which of the three areas, performing, informing and holding to account, is most problematic? Are there any simple fixes?
5. Which of these relationships is most problematic?
Between executive management and boards
Between boards and institutional shareholders
Between institutional shareholders and savers.
Are there any simple fixes?
6. Should economic and other policies to promote growth attempt to encourage companies to create value rather than capture value that others have created? How could regulators, investors and employees do this?
7. Is lack of trust a problem? What should policy makers, businesses, and investors do to restore trust?
8. Is it a major problem that much regulation, particularly in financial services, has allowed people to avoid personal responsibility or to fail to apply moral judgement? What can be done?

Readers are encouraged to download and read the entire discussion document and provide feedback to Paul Moxey at ACCA. paul.moxey@accaglobal.com.

Further details of the consultation, videos, a questionnaire and supporting information can be found at <http://www.accaglobal.com/gb/en/technical-activities/technical-resources-search/2014/february/creating-value-consultation/creating-value-background.html>

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