CRSA Forum 16 December

Diagnosing Governance and Risk Management Issues and then Future Proofing Them

On 16 December 2016, the CRSA Forum was kindly hosted by the Department of Health at Richmond House, Westminster. The meeting was an interactive facilitated discussion on why corporate governance and risk management have failed to prevent frauds and financial crises. We diagnosed why current governance and risk management systems have seemed ineffective in many cases and what could be done in four different scenarios of the future. The 25 participants included governance and risk experts, academics and journalists.

Peter Bebb of Perendie began by reminding us of recent corporate collapses, corporate wrong doing including mis-selling, fraud, rogue trading, poor controls over corporate assets resulting in security beaches and loss of physical assets and oil spills, and failure of care in the NHS and the reputation damage resulting from these incidents. Nations too have suffered from governance failure as exemplified by the inability in 2008/9 of Greece, Portugal, Ireland, Spain and Cyprus to repay or refinance their debt without external support.

We were asked if there is any evidence that corporate governance and risk management are useful or that their cost is less than their benefit. It would be difficult, if not impossible, to prove that absence of governance problems was a result of good governance, an absence of mistake or wrong doing or because no one has noticed mistake and wrong doing.

Potential weaknesses in corporate governance and risk management include:

1. They are the concern of only a few people
2. They try to stop people doing things rather than make them do the right things
3. They pay insufficient attention to incentives
4. They don't take human factors into account
5. They work against psychology
6. They provide no defence against self-interest
7. They are over-complex and obscure
8. They are expensive but no one calculates their full cost
9. corporate governance and risk management reports:
    a. Retrospective
    b. Out of date
    c. Unchangeable
    d. Obscured by detail
    e. Incomplete
    f. Manipulated

    and don't

    a. Tell you whether the rules are being followed
    b. Tell you whether the rules are likely to be followed
    c. Say how the organisation will perform in future
    d. Mitigate risks
    e. Regulate behaviour

f. Support decision-making

Causes of failure of governance

In small groups we reflected on the causes and Tweeted our opinions of the causes of failure. These were:
A. Recognising & agreeing risk plus complexity of risk
B. Personal interest and lack of personal responsibility on individual board members
C. Lack of transparency or ethics
D. Lack of appropriate personal responsibility (1st)
E. Short term targets, over long term culture (3rd)
F. Poor ethics and accountability at the top
G. Board clarity & accountability
H. Governance is very challenging in an ever changing world
I. lack of protection of whistleblower, rule breakers don't often lose out (2nd)
J. Not just the rules, culture too

One group talked about the theme of individual and shared responsibility within an organisation and how the lack of each has contributed to corporate governance failures. It was agreed that an organisation should be set up in such a way that individuals are treated as responsible adults where relationships are built on trust and people allowed to go about their jobs with a minimum of interference. In this individuals should understand the culture and ethos of their organisation and the importance of their role in the wider context. Rules on governance should be explicit, transparent and clear to people at all levels. Individuals must be accountable in a legal sense and appropriate deterrents must be put in place, such as the threat of jail. It should, the group thought, be made clear how the board of directors in an organisation are held accountable for their actions.

We all voted on which were the most important. The first choice was 'lack of appropriate personal responsibility', the second was 'lack of protection of whistleblower, rule breakers don't often lose out' and the third was 'short term targets, over long term culture'.

Areas for action

We then Tweeted our suggestions for action. These were:
A. Culture and values (1st)
B. Clarity of purpose, enabling appropriate behaviour (3rd)
C. Individuals understanding what is expected
D. Recognising & agreeing risk plus complexity of risk
E. Create an international body who is able to hold the board to account
F. Accountability & audit design
G. Culture change - incentivise not penalise (2nd)

Getting culture and values right was seen as the most important, followed by culture change where based on incentives for a desired culture rather than penalties for those who misbehave) followed

by having clarity of purpose and enabling appropriate behaviour. Clearly all three actions are related with the second and third serving to reinforce the first.

We then moved on to exploring the future role and challenges for governance and risk management using four scenarios that have been used by Gill Ringland and her colleagues from SAMI Consulting in financial services, manufacturing, professional services firms and in a global supply chain conference to develop new insights.

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Background to the scenarios

- Project to create rounded views of the future of financial services
  – Supported by Long Finance community, www.longfinance.net

– Scenarios developed by SAMI
  – Fleshed out and tested through open events at London Guildhall and Barnard's Inn
  – Drafts of the report critiqued by Long Finance Kitchen Cabinet

– Report published in 2012
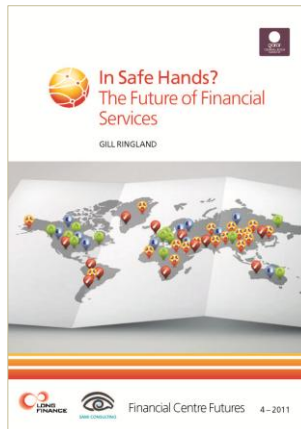
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The scenarios for 2040 all assume some changes in the world by then:

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Assumptions for 2040

- Global population will grow and get older
  – Most of the additional people in Africa and Asia
  – Turbulence as the world rebalances to new centres of economic power
- New centres may not share the value systems or structures, behaviours of the West
- Technology (info, cogno, bio, nano) will continue to introduce changes in personal capacity and lifestyles
- Ecological, energy and environmental limits tested or breached
  – Population increases
  – Population lives in cities (70% by 2040)
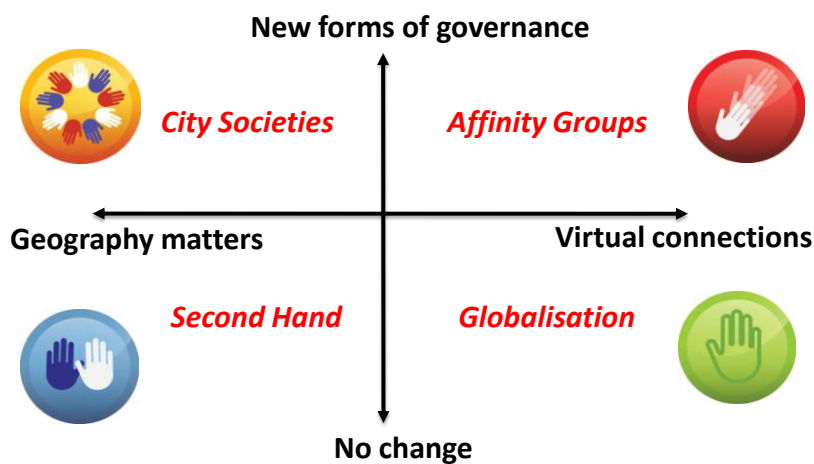 – New middle class uses electricity, travel, eats meat

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We considered the future developing along four possible paths, the scenarios.

In one, called *'Second Hand'* the world would seem most similar to today and has developed as a result of the changes above but without any significant disruption or systemic change. In the second, *'Globalisation'* the main change would be the increased importance of virtual (web based) connections with less significance given to geographical place. This could cause strains to the existing world order and nation states would be weaker. The homogeneity of a globalised system renders it less stable and so more prone to collapse.

In two of the four scenarios there were changes in the world order which could have resulted from a major systemic shock. In *'City Societies'* geographical place is still important but cities essentially took the place of nations. Cities become wealth clusters or brands, nation states fail and democracy, capitalism and western values compete with other organising concepts within different cities; and in *'Affinity Groups'* society has re-formed around affinity groups; multiple value systems are accommodated in a single geography. Democracy is not seen as universal good and there are complex arrangements of nation states and communities of affinity group. In this scenario, London could become a set of 20 or 30 ethnically diverse clusters, all globally linked more strongly than their local interactions.

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Scenarios

New forms of governance

City Societies   *Affinity Groups*

Geography matters   **Virtual connections**

Second Hand   *Globalisation*

No change

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We then formed groups to consider *Globalisation, City Societies* and *Affinity Groups.* The *Globalisation group* considered that most people would work virtually and anywhere in the world. There would be more isolation. Traditional management and governance controls may not work if people did not know what others were doing creating problems with lack of accountability a dereliction of responsibility. Whistle blowing is an important issue at present; how might that work in future? And virtual working could make it easier for corporations to control their staff, with unseen but all seeing eyes knowing where staff are and what they are doing.

In the *Affinity Groups* scenario groupings and people with whom others identify could take the form around common languages, corporations and conceivably intelligence as in Aldous Huxley's Brave New World - where the population was stratified according to intelligence, with Alphas at the top and Gammas at the bottom. Current concepts of control and responsibility may no longer be relevant or needed if people share a common purpose and culture, e.g. the current issue of formal incentives incentivising the wrong behaviours could be less if people have a common framework. However there could be rivalries e.g, between all powerful big corporations (as one Affinity Group) and other groups.

In the *City Societies* scenario a newspaper headline might read 'London's per head wealth 10 times that of Birmingham' as there are winner and loser cities. International affinity groups, including corporations, would be more powerful. Staff in corporations would have different cultures in different cities or they may try to impose a common culture across all the cities where they have staff. There would need to be trade agreements between cities and some commonality in the legal systems particularly around law of property. Cities would have good internal controls but there could be chaos externally. The more successful global cities might negotiate common frameworks benefitting all cities or they may benefit only the cities concerned with other cities becoming relatively poorer and ultimately disintegrating or being taken over by other cities. Some cities may create armies and try to expand by conquest. Others would expand by succeeding in the market place.

The four scenarios are not intended to be mutually exclusive. People felt that a combination of *City Societies* and *Affinity Groups* could be quite likely.

So what should we do today? The future is unknowable but consideration of these scenarios could help us better understand the world as it changes and spot what is happening earlier. The view of the room on corporate governance was very much around having a capitalism with social responsibility and having a shared sense of values and ethics. We should all try to view companies and the systems within which they operate from a boarder perspective looking down as if from a helicopter or observing it from several distant vantage points, or from the points of view of different stakeholders. We should focus on purpose but beware people whose purpose is world domination.

Some conclusions

- Globalisation, in some form, seems likely to continue in all four scenarios.
- Governance will need to embrace technology.
- In *City Societies* there must be accountability for leaders and transparency for cities and organisations.
- The importance of culture in governance is emphasised by *Affinity Groups*, governance structures need to reflect the values of diverse cultures.

In discussion, it was suggested that the old political labels left and right are last century and are no longer appropriate, For example some of what our present Prime Minister is saying on business is well to the left of the previous Labour government. A better future could be one where people

focus on responsibilities rather than rights. It was pointed out that ethical companies make more money and that should be a good incentive.

Finally, Peter Bebb asked whether participants would be interested in seeing, at a future Forum, a potential solution to the problems of corporate governance and risk management, namely a system which makes governance and risk management:

- Integrated - everything an organisation needs to produce, do and employ is linked and displayed at all levels for all stakeholders
- Inclusive - everyone is empowered and required to say how they will measurably contribute to the organisation
- Transparent - anyone, internally and externally, can see what everyone intends to employ, do and deliver, and their progress
- Predictive - the causes of success are identified and the probability of people achieving their outcomes is predicted, mitigating the risk and fear of failure

Notes

1. Gill Ringland's PowerPoint slides can be downloaded here
2. Peter Bebb's PowerPoint slides can be downloaded here
3. Slides showing participants Tweets and priorities here
4. More information about the CRSA Forum can be found at www.crsaforum.com
5. Join the CRSA Forum Linked In Group here
6. For further information or if you would like to attend future meetings contact paulmoxey@crsaforum.com
7. The next meeting will be on Board Oversight of Risk