

Editorial: The Practical Challenges of Effective Governance

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A major issue in corporate life that has been growing in importance and focus over the last two decades or so in governance. This is a view about the issues of governance about the challenges of governance from the viewpoint of someone who has been a governor and chairman of several institutions in the commercial, public and the charitable sectors. More recently, as the chairman of the College Oversight Board at London Churchill College, I have been involved with the registration process whereby institutions of higher education must be registered by the new Office for Students (OfS) before their students can take out loans from the Student Loans Company. The matter of registration is vital; without it there are no student loans, and no student loans means no students and no College.

What is striking is the emphasis that OfS places upon governance. Governance is one of those words like 'civilisation'; everyone knows what it means, but it is impossible to define in a simple sentence. We can describe what we want of it, though. Governance is necessary to ensure that the actions of executives in managing their organisations do so in the best interests of the organisation's owners, customers, staff and the community. People of experience and standing exercise influence over the actions of executives and ensure that they behave properly in the exercise of their responsibilities. In practice this is more easily said than done. Sometimes it is difficult and even impossible to achieve. There

are, however, things that they can do to contribute to the organisations they work within.

Anyone who has been in a governance position, either as a governor or a non-executive director, knows that discharging these responsibilities is anything but easy. They sit at the top of the organisation, and their time in it is limited. They can, should and often do go into the operations of the organisation to meet the people and talk about practical, operational issues. These visits will seldom be casual, however skilled the governor's interpersonal capability. They will know more of how the organisation works and this knowledge is valuable, but they will never be part of it.

The business news carries stories every day about failures of governance. They vary from the auditors failing to spot problems in the accounts, ineffective business processes or, worse, crime.

Starting from this point I shall attempt to define what governance is, what is expected of governors, what governors face in trying to achieve this and make some suggestions about how things might be improved.

Overall the objective of any organisation should be the creation of value in the furtherance of human civilisation. This might be economic value (the simplest to define, measure and is applicable to all commercial enterprises), or educational value, or longevity (hospitals), or spiritual well-being (applicable to a host of activities). Overall,

governors' responsibility is to ensure that an organisation is creating value. It does this through actions that drive value creation, such as profit, or enhancing the knowledge and skills of students or making unwell people better. A driver of value is a manageable factor that has a direct link with the creation of value. 'You cannot act directly on value, only on the drivers of value' is an oft quoted saying of the late Jack Welch, 'Neutron Jack' who grew General Electric into the world's largest company by market capitalisation. In a well-managed organisation each jobholder should have direct responsibility over a driver of value, and, if the individual is successful, then the driver will create value.

Underlying the idea of governance is that governors are there to see an organisation is properly run for all the people who have an interest in it. For a privately owned Alternative Provider this includes the shareholders, students, the staff, the OfS, and the government in the shape of the Department for Education (DfE), as well as the press, politicians and the public at large.

While these aims are most laudable, there is a major challenge for governors regarding how they are to go about fulfilling them in only a few meetings a year.

This leads on to what should governors require of executives. From experience this can be summarised as holding the executive management to account for delivering the operational results of the organisation, behaving within the accepted norms of ethical business behaviour, ensuring that there is a long-term plan to preserve and further the interests of the

business and identifying and dealing with any wrong-doing. At the top is to define the cultural values which are seen as conforming to generally accepted norms in pursuit of the public good. These values dictate what the organisation should set out to do and how executives will go about doing it. If there is wrong-doing, the implication is that the governors should root it out. None of this baldly stated is in any way controversial, and there are guidelines. Here is an example of what is expected of governors of further education colleges, a direct quote from 'College Governance: A Guide' published in August 2014.

"The key internal accountability is to the college's governing body. Governors must hold the senior leadership to account for delivering the college's mission and for ensuring that the college serves the needs of its learners, employers and communities".

It is typical of the kind of guidance given in codes of practice in both the public and private sectors. The FCA's Listing Rules expresses similar sentiments about how non-executive directors should act in quoted public companies in a rather more detailed way, and there are many other examples.

Few governors would disagree with the sentiments. Experience shows, though, difficulties do not arise with 'what' but in the practicalities of the 'how'. On the how, guidelines are unhelpfully silent. Is this because the authors of the guidelines don't know how to achieve what is set out in them and they require in others?

Why Things Go Wrong

The blame culture, in which every misfortune is someone else's fault, permeates into what the general public expects of governance, whether it

applies to governors of public corporations in health trusts, the governing bodies of educational institutions, non-executive directors of companies or the firms that audit them. Yet the guidelines given to governors, be they from the institutions governing business or government departments responsible for public services, concentrate on good practice and process: never with identifying wrongdoing or dealing with poor performance.

Whether it is the Combined Code to the Listing Rules for public limited companies or the guidelines for governors of schools and colleges, the emphasis is always on what is required of governance. This is rarely controversial, frequently obvious, but rarely helpful in helping governors know how to achieve what is required of them. What are governors supposed to do when the accounts have been signed off by the external auditors as presenting a true and fair view of the results, the internal auditors have reported that the processes and policies running the organisation are effective, and regulating authorities have confirmed that regulations are being met?

There are frequent reports in the press about things going wrong in companies and in public sector organisations. In most of these cases one of the factors has been that the process of governance has broken down. The question is why did the process break down? Were the governors/non-executive directors asleep on the job?

There appear to be three principal reasons why things go wrong. In some recent examples, widely reported in the press, at Tesco income costs were not matched in the profit and loss

account as the principles of accounting require; so, profits were calculated using the cash income without deducting the costs incurred. This made the company look more profitable than it was. If the auditors could not pick this up, how could the non-executive directors? In the case of the Mid-Staffordshire NHS Trust, where the medical outcomes including death rates, were well outside accepted norms, the performance measures were not appropriate to measure the performance of the trust in looking after the health of patients. The management of the Trust were managing an organisation to provide a service to its clients in relieving them and ideally curing them of their ailments, not to achieve a high level of bed utilisation (which was one of the measures they had concentrated their efforts on). The management had, apparently, forgotten that. In the current case of Patisserie Valerie it looks as though there was a conspiracy among some of the directors to steal money through unauthorised bank loans but this was not picked up by the auditors. Then there are the examples of Carillion, Serco and Interserve, big companies. Abroad we have the cases of Enron and WorldCom in the USA, Olympus in Japan and Volkswagen in Germany. The list is long.

From experience, though, executives can misrepresent performance because they lack the capability to achieve their objectives and want to cover up their deficiencies. This can be compounded with inappropriate incentive schemes that incentivise managements to take decisions that may be in their interests but are not in the interests of the organisation or its stakeholders.

Finally, the commonest issue found in very large organisations (and too frequently in the public sector) is poorly structured organisation where there are too many reporting layers. The consequence is that there are levels of the organisation that do not create value or contribute to the furtherance of the organisation's strategic objectives. The people who populate these organisational levels realise this; so to protect their jobs they create procedures where they control the information on the operations of the organisation both upwards and downwards and thereby insulate top management from what is going on at the operational coalface.

In summary, the things that can go wrong and which non-executive directors and governors often are unable to access are: organised fraud; covered-up lack of capability to do the work required by key individuals; targets, objectives and incentive schemes that do not relate to the required performance of the organisation; organisational structures that hinder the achievement of the organisation's objectives.

Some Ways Forward

Nevertheless, there are things that governors can do that will reduce the problems of things going wrong. Here are some suggestions about what governors can do to fulfil their role.

First, governors should be proactive in setting out what they require of the executives. This includes defining the performance indicators by which they will judge how the business is progressing and which are directly connected to the organisation's mission, strategic and operational objectives and reflect its cultural values.

Secondly, governors should manage the external auditors, setting out what they want the auditors to judge, including how the accounts are constructed and where there are weaknesses, pitfalls and dangers.

Thirdly they should manage the internal audit and define the key business processes they want auditors to report on.

Fourthly, effective governance can only occur if the governors and the governed are trustworthy and are working towards the same success goals for the organisation. How is a governor to decide whether or not an executive is trustworthy? Underlying the principle of governance is trust: the trust that the governors have in the executives they govern that they have the best interests of the organisation they manage, and the trust the executives have in the governors that they will contribute constructively to help the executives manage better, advising on issues that are outside the experience of the executives. If this two-way trust is not there, then the effectiveness of governance breaks down.

Trust is a matter of judgement. And judgement is, as John Locke put it 'the faculty which God has given to man to supply the want of certain knowledge in cases where it cannot be had, is judgement'. Sometimes judgements get it wrong. Is this a justification for blame? In the end the path to trust is for the governors to know the executives well, and to this end should play an active role in their appointment.

Finally, governors will always find themselves shouldering the blame for something going wrong that they could not possibly have known about. This is in the nature of the role the world we live

in. In the physical sciences the idea of certainty was replaced by probability in the 19th century. The non-scientific world has yet to come to terms with this reality. Handling uncertainty and

complexity is what senior management is there for. As governors we have to live with this.