GOVERNANCE: THE CPR FRAMEWORK

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One of the hottest issues in business today is that of corporate governance. This business activity is not really something new, but recent corporate scandals and the major business collapses that followed have caused a heightened, if not overblown, attention on this matter. With this comes a general confusion on what corporate governance is precisely. Specifically, *who performs it, to what end, and by what means?* At times there seem to be as many answers to these questions on the nature of corporate governance as there are people talking about it. While the end game of corporate governance has not changed - that of achieving sustainable financial results to the business, who performs it and by what means has evolved considerably from traditional concepts.

Historically, the end game of corporate governance has been sustained financial results *by means of a focus on financial management*, so much so that in the recent past, corporate governance was virtually synonymous with the measuring, monitoring, and reporting of the financial condition of the enterprise. While focus on sustained financial results is an appropriate and timeless end, the landscape upon which business is conducted has changed such that the *means* to achieving that aim must change in a number of important ways.

1. **Who performs it**
   Today's organizations are complex, distributed, networked entities in a complex, distributed, networked marketplace. In the past, it might have been possible for a single person or small group of people to "get the whole system in mind" and exercise governance. This is less and less feasible and is impossible in some cases. The impact is that *who performs corporate governance must change.* In the traditional view, Corporate Governance was the responsibility of the Board and its immediate and the focus was financial. In today's complex organizations, where the corporation's "value constellation" is made up of a constantly changing set of entities (some outside of the corporation's direct control), <u>governance activity must be extended both down into and outside of the organization to include an expanded role for internal staff and external entities</u>. In addition, as IT and security have emerged as significant risk areas to the business in addition to financial practices, IT and security auditors must be added to the mix.

2. **Scope of mechanisms for achieving the end**
   In the current business landscape of highly networked enterprises in a highly networked marketplace, normal operating conditions include a relative frequency and variability of demands (opportunities and threats) that are high and increasing. In this climate*, the scope of mechanisms for achieving sustained financial results must be extended beyond merely controlling for business risk to driving towards business opportunity*. While some see risk management as including understanding and managing both negative and positive risks (positive risks being opportunities), many do not. Controlling risk is an appropriate focus and the need for such focus is clearly increasing, but today's complex organizations may not be able to achieve sustainable results if driven solely by the avoidance of risk. Achieving sustainable results requires more than just "avoiding pain" (e.g., controlling, directing, and managing to avoid breakdowns, risks, and negative consequences); it requires "moving towards gain" (e.g., supporting and enabling of positive performance, and appropriate risk-taking.) As such,

a governance framework must provide a mechanism for both seeking gain (maximizing value) and avoiding pain (managing risk). Control is but one of many means to the end of sustainable results.

3. **Scope of stakeholders**
   The business landscape of highly networked firms in a highly networked market means the number of stakeholders relevant to a firm's sustained success might be an order of magnitude greater than in a landscape that is not networked. As a result, *the scope of stakeholders relevant to sustained financial results must be expanded, and along with it, the scope of effort required to manage both the reality and perception of the corporation's functioning*. Many corporations have stumbled as they worked towards achieving sustainable financial results for two reasons: (1) they overlooked important, relevant stakeholders, (2) the way they conducted themselves "turned off" rather than "turned on" relevant stakeholders. Proper governance requires attention to both *what* you do and *how* you do it in the eyes of relevant stakeholders.

4. **Scope of key performance indicators**
   The networked nature of today's businesses and marketplace means aspects beyond financial ones can have an immediate and lasting impact on the organization. The result is that *the scope of key performance indicators (KPIs) that must be managed to achieve sustained financial results must be expanded beyond the financials*. About a decade ago, Kaplan and Norton [1996] highlighted the fact that focusing on financial performance alone was not enough to ensure sustainable results. Kaplan and Norton dramatically extended the factors to be considered in corporate governance, recommending a "Balanced Scorecard" of governance dimensions:
   - Financial Performance
   - Business Process
   - Customer Fulfillment
   - Learning and Growth

   Weill and Ross [2004] on the other hand highlights the object of governance as six key assets to be managed:
   - Human
   - Financial
   - Physical
   - Intellectual Property
   - Information and Information Technology
   - Relationship

   Both the "Balanced Scorecard" and Weill and Ross' work are certainly contributions to the industry and useful tools to be included in any governance framework. These frameworks are working to answer the question, "What are the principal assets of a firm that any business must mind in order to thrive?" Effective governance necessitates an expanded focus to cover the four assets—infrastructure, clients, people & process, and value creation—that any business must manage, as defined through the Technical and Operational Architecture (TOA) dashboard developed by Pultorak [2001].

The TOA Dashboard

The TOA dashboard is a technical and organizational architecture dashboard because it encompasses both the technical (infrastructure) and the organizational (clients & external stakeholders, internal people & process, value creation) architecture that all firms must have to succeed.

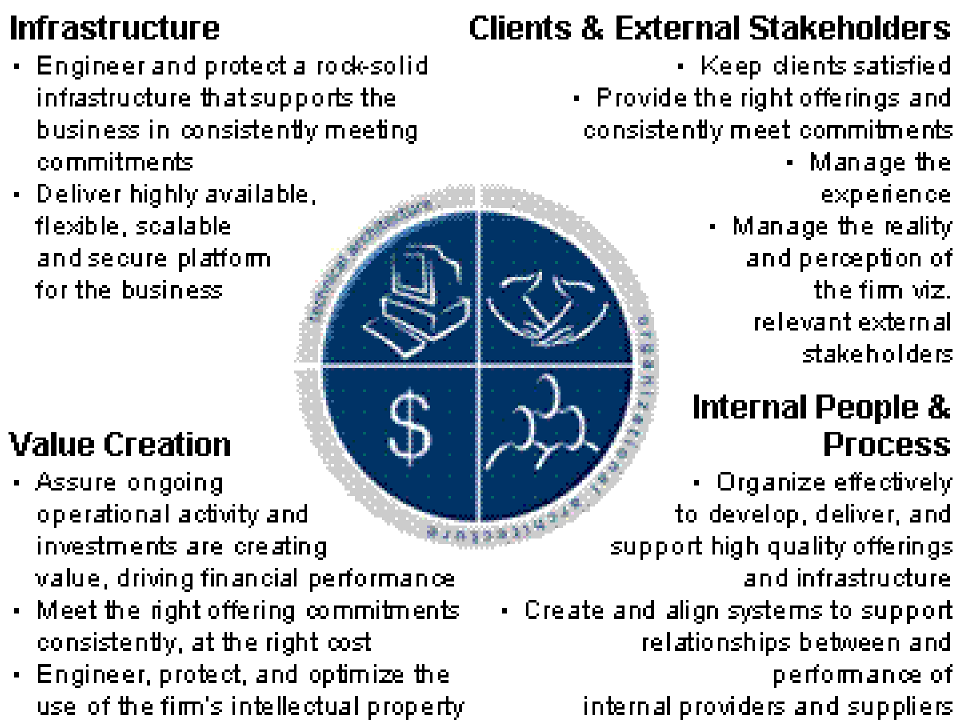

Figure 1: TOA – Technical and Organizational Architecture. The four assets any business must govern *.

The TOA dashboard is intended to capture the four assets that any business must manage, whether it is a bakery, a mid-market manufacturing firm, or a Fortune 500 financial services company:

- They must serve their customers in ways that make them want to come back.
- They must ensure relationships with external stakeholders are maintained in a manner that enables rather than disables the business, as the organization's reputation is often its most valuable asset, the most easily lost and the most difficult to regain.
- They must take care of the people who serve the customer, including suppliers, and ensure that business processes are optimized.
- They must ensure the value creation capability of the firm is maintained and enhanced so that the firm has the basis for driving towards business value and financial performance.

The TOA dashboard helps in establishing the structure for a sound governance framework that can be used across the corporation. Any useful operational definition of corporate governance must address these issues. The TOA scorecard forms part of such an operational definition, identifying the four assets any business must manage in order to thrive.

The CPR Framework for Corporate Governance

So far, we have already identified the key issues which must be addressed by any useful operational definition of corporate governance. The TOA scorecard forms part of such an operational definition, identifying the four assets any business must manage in order to thrive. What is missing is the specification of the dimensions along which these assets must be managed. The CPR framework, first introduced by Pultorak [2003], is just such a framework. The CPR framework, used in combination with the TOA dashboard, is intended as a governance framework applicable across the enterprise.

The CPR framework defines corporate governance as follows:

> *Corporate governance is* the systematic pattern of *behavior* of the board, management, and staff of a corporation that is *directed towards* the corporation *achieving sustainable financial results. The behavior that is corporate governance must be directed towards the four primary assets of the business:*
>
> - *Infrastructure*
> - *Clients & External Stakeholders*
> - *Internal People & Process*
> - *Value Creation*
>
> by *managing the current and creating the future state of the corporation by expending effort in three dimensions:*
>
> - ***C****onformance* - to legal and regulatory requirements
> - ***P****erformance* - financial and otherwise
> - ***R****elating Responsibly* – maintaining rapport with relevant stakeholders
>
> To ensure success, the behavior that constitutes corporate governance must be ordered within a framework established by the board that aligns and informs day-to-day decision-making, objective setting, achievement monitoring, and communication.

There are a number of important distinctions made in this operational definition of corporate governance:

- The aim of corporate governance is clear and singular: sustainable financial results. However, <u>sustainable financial results cannot be achieved solely by directing the management of the current state of the organization; it also requires directing the organization towards its future state</u>.

- <u>Governance is primarily *behavior* that constitutes a relationship between the corporation and its relevant stakeholders</u>. While artifacts like systems, policies, and controls may enable (and in some cases disable) governance, they do not constitute governance itself. Governance is constituted by behavior and it is that behavior which constitutes the relationship among relevant stakeholders, including owners/shareholders, the board, and top management.

- Effort expended on governance should be driven efficiently from the right source. The right source is the corporate board, thus the requirement in the CPR definition of corporate governance that, "<u>corporate governance must be ordered within a framework established by the board that aligns and informs day-to-day decision-making, objective setting, achievement-monitoring, and communication."</u>

The corporate governance framework set out by the board must constitute a compelling vision and a simple set of policies and procedures that serves four purposes:

- Clarifies the direction of the corporation
- Motivates people to take action in the right direction
- Prioritizes, informs, guides, and aligns the many decisions, actions, and communications made each day
- Provides a basis for monitoring progress

- Sustainable results require the supporting and enabling of positive performance, appropriate risk-taking, and "moving towards gain". As such, a governance framework must provide a mechanism for both seeking gain (maximizing value) and avoiding pain (managing risk).

Summary

Corporate governance should not be treated as just another regulatory requirement or audit area that public companies have to comply with. Rather, it should be seen as an opportunity to re-evaluate the enterprise and its supporting functions and ensure that it can attain sustainable financial results. Businesses today face multi-faceted pressures on all fronts, and corporate governance helps ensure that all these fronts are covered and considered.

However, the traditional corporate governance approach needs to be updated. In particular:

- Governance activity must be extended both down into and outside of the organization to include an expanded role for internal staff and external entities.

- Governance framework must provide a mechanism for both seeking gain (maximizing value) and avoiding pain (managing risk).

- Proper governance requires attention to both *what* you do and *how* you do it in the eyes of all relevant stakeholders.

- Effective governance necessitates an expanded focus on the assets that any business must manage.

The Technical and Operational Archtecture (TOA) Dashboard defines the expanded scope of assets that needs to be managed by any business, and covers the technical (infrastructure) and the organizational (clients & external stakeholders, internal people & process, value creation) architecture. The specification of the dimensions along which these assets must be managed are defined by the CPR framework. In essence, the CPR framework puts greater emphasis on:

- Directing the management of the current state of the organization as well as directing the organization towards its future state

- Governance as a behavior that constitutes a relationship between the corporation and its relevant stakeholders

- Governance framework established by the board that aligns and informs day-to-day decision-making, objective setting, achievement-monitoring, and communication.

Both the TOA and the CPR provide the governance framework that is recommended in today's business environment. Through these, the questions on corporate governance of "*who performs it, to what end, and by what means?*" may be effectively addressed.