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FROM IDEAS TO OUTCOMES: NEXT STEPS IN CORPORATE GOVERNANCE & PERFORMANCE

A speech to the Canadian Centre for Ethics & Corporate Policy by

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CHECK AGAINST DELIVERY

Thank you all for being here this afternoon.

For much of the past 18 months, the corporate world, and indeed much of the rest of the world, has been participating in (or at least subjected to hearing) an often compelling, sometimes polarizing, and occasionally passionate debate about corporate governance.

We've all heard, read, and talked about splitting the role of Chair and CEO; about the ratio of independent directors; about the composition of audit, governance and compensation committees.

These are all terribly important issues – and I'm not going to talk about any of them.

The debate on these issues is well-developed, and several of the people in this room can speak to them more articulately and authoritatively than I can. I don't believe that I can offer any fundamentally new insights into those questions.

However, based on the work that Leman Group does with leading Fortune 500 / FP 500 companies, I believe that I can provide some new perspectives on corporate governance, and in particular on where we believe the evolution of governance is going next.

The hotly-debated issues of the last 18 months have typically been structural issues, and have largely been oriented around Boards of Directors.

As companies discuss and resolve some of these issues, they are looking around and asking "Is that enough? Are we sure that this will improve governance *outcomes*?" And they're generally concluding that the answer is "No."

The question then becomes, "What's next?" If you're a leading company, and you want to lead in this area too, what should you be doing? What questions should you be asking, what should you be thinking about, and in what areas should you be taking action?

We believe that what's next is a focus on actual *outcomes*. Can Boards better exercise their mandate for oversight? Can executive management more effectively know, direct, and communicate what's going on, and what needs to happen next? Is it possible for large, diverse, and often geographically-dispersed organizations to be governed effectively, and with the level of accountability that is demanded of both management and Boards?

Based on our firm's work with companies in many different sectors, we know that it is possible to take action that will achieve those better outcomes. Today I'd like to share with you our framework for understanding how that can happen.

- I'm going to advance two central propositions – two ways in which the discussion of corporate governance can be broadened in order to *really* affect governance outcomes.

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First, governance needs to move beyond purely structural issues. Structure is important, but better outcomes really hinge on *how the organization operates*.

This means two very basic things:

1. How information flows through an organization to support better decision-making; and,
2. How decisions, once made, are acted upon, executed and followed through.

Let's discuss each of these briefly.

First, the challenge of how information flows through the organization to support better decision-making. Fundamentally, this means ensuring that decision-makers at all levels get the information necessary to make the right decision. It means ensuring confidence in the clarity, timeliness, and accuracy of that information. It means recognizing that different levels of the organization require different types of information – that the Board and executive management need meaningful distillation of data; they need synthesis and pattern analysis.

But it also means achieving this without re-interpreting and re-shaping information at each level, in a game of broken telephone. It means having transparency and being able to drill back down all the way to the workface to know what's really happening.

The second main element of making governance *operational* is to understand how decisions, once made, get acted upon, executed, enforced, and followed through. It means giving Board, and executive management, and decision-makers at all levels, the confidence of knowing that, once a decision has been made, it is in fact “sticking” out there in the organization, where it needs to be made real.

This means having visibility, to see the follow-through of decisions, and enforce accountability. It means having both the capability, and the will to exercise it, in order to ensure that the organization is actually *doing* what was envisioned and decided.

Doing this is difficult. In large organizations, senior management can have difficulty knowing with confidence what's really going on throughout the organization. Functional “silos” can prevent communication from flowing laterally; so-called “clay layers” of management can prevent it from flowing vertically. Sometimes even knowing *whether* initiatives succeed or fail can become unclear; discerning the underlying *reasons* for success or failure can become as murky as debating the true meaning of Stonehenge, or the origin of crop circles – which is to say it becomes an almost mystical question, not a matter of *fact*. Needless to say, it can be difficult to run a business that way, and virtually impossible to foster accountability.

But to say that doing these things is difficult is not to say that they can't be done – they are *being* done, by organizations in widely-different sectors, with different strategies and capabilities, who share nothing more than a common understanding of how valuable it can be to have real control of the business.

Let me give you a specific example. Leman Group worked with a client who was undertaking a huge turnaround and improvement program throughout its organization. This program had over 60 functional areas that were targeted for significant improvement, ranging from capital and equipment upgrades, to worker safety, environmental protection, plant operation and maintenance practices, and many others. It represented a five-year capital and operating investment of over US\$1 billion, and involved over 2500 person-years of effort annually, for five years.

We helped this client develop a capability to plan and manage all of that work to a level of control where status of all of this work was being reported weekly. This included cost, schedule, and resource information; it included risk management and the escalation of issues and actions requiring senior management attention; it included integration across all 60+ projects, to allow senior management to decide how to make the appropriate trade-offs when individual projects conflicted.

Importantly, it captured all of this information (on over US\$1 billion worth of work) in a consistent and timely way, from each of the individual teams in the field, where the rubber meets the road, and then rolled it up and synthesized it for progressively more senior audiences, while retaining drill-down capability to the detail. This meant that executive management and the Board could see high-level overview information, yet know that it was rooted in the detailed data about what was really going on in each area.

Let me give you another example. We had a technology company as a client, who needed to better understand and integrate a diverse range of development efforts going on within the company. This included internal product development efforts, as well as the customization of solutions for large clients who needed something other than a standard product. In addition, senior management needed better control over how to assess, screen, and prioritize incoming new opportunities and requests, and make choices and trade-offs among them. Executive management, and in turn the Board, also needed to understand how these disparate efforts were aligning strategically, how they inter-related and supported one another, and what the return on investment was for the company in pursuing these efforts.

Working with the client, we developed a capability where executive management could, at any time, from their desktop, have access to a single screen showing every such effort underway across the company, the stage of the life-cycle that each project had reached, and Red / Yellow / Green status. From there, they could drill down, by project, by organization, by client, by technology, or by any number of other criteria, and get all the way down to detailed technical, financial, customer, and project documentation, all in real time, all showing the best, most current information available anywhere in the company.

This can be done not only to manage specific strategic initiatives, but to control the routine “base work” of the business as well. In another case, we worked with a client to revamp the way their organization performed their entire business planning and budgeting process, which \$2 billion per year, over a five-year time horizon.

We helped them move from a head-count and department-based way of working (where this year’s budget was based on last year’s headcount, plus a little more, of course) to a

way of understanding their business based on the *work* that was being done. By challenging managers to first break down the *work* that they planned to do, and only then consider resources, we fundamentally altered the logic of how planning was done, and enabled senior management to make informed and specific choices about setting priorities.

This brought tremendous clarity to the process, for both senior management at Head Office, and for line managers in the field. It enabled decisions to be made about what work would and would not be done, based on financial and resource constraints. And most importantly, it ensured that the low-priority work would be shelved first.

So, to really make governance capable of affecting *outcomes*, we need to move beyond purely structural issues of Board composition, and hopefully I've been able to at least episodically illustrate that this isn't just an abstract or normative goal – it's a realistic objective for companies to pursue now, in a variety of different ways.

All of which brings me to my second main proposition, which is that in order to accomplish this, in order to *operationalize* governance, it needs to move beyond the Board.

The Board may have ownership of and overall accountability for governance, but governance cannot live in the Boardroom alone. It needs to permeate the organization at all levels; it needs to become an ingrained part of what the company does, like so many other things that cut across all parts of an organization, from pursuing cost efficiencies, to valuing customer satisfaction. These are basic themes across most businesses today. Governance needs to become just as fundamental to everyone – not just the Board.

There is some initial evidence that companies are moving governance out of the Boardroom and into the organization. Companies such as Pfizer, Motorola, and GE have created Directors or VPs of Governance, or Chief Governance Officers.

These are positive steps, insofar as they move governance beyond the Board, but there are risks in making it one person's job. It can create a false sense of relief elsewhere in the organization, in that others can point to the "the Governance guy," and not see governance as part of their job. There is also a risk that this approach becomes as purely audit-oriented or compliance-oriented exercise – and as we've talked about, the challenge is much larger than that.

Ultimately, these can combine to create a false sense of security, and in doing so, keep companies from really addressing the full scope of what corporate governance can and should mean – let's not forget that even Enron had compliance officers.

So these may be valuable transitional steps, but ultimately we believe there's more to the story. This isn't about having a "cop" supervising the organization – it's about orienting

the whole organization to value and act on these things. An understanding of and respect for what governance means needs to be intrinsic and fundamental – it needs to be everyone’s job. This means having *all* employees understand that this is an inherent part of their jobs and obligations – not lip service, not a quarterly or annual exercise in going through the motions.

How can we do this? In large part, by tying strategy (including corporate governance) to operations. By helping line managers and employees throughout the organization understand how their day-to-day work contributes to achieving the departmental and divisional goals that in turn are the basis for meeting the big strategic objectives that are communicated for the company as a whole.

There are powerful and effective ways of doing this, which can help align employees around key priorities like corporate governance, and over time, can create the basis for making governance an element of performance reviews for a wide range of managers and employees. After all, if governance is everyone’s job, then it should be part of their performance appraisal.

Let me be very specific - *the real challenge is to effectively align corporate governance and corporate management of the business.*

Whether you see the over-arching purpose of governance as the protection of shareholders, or the maximization of shareholder value, or the conscious and explicit oversight of management, it all boils down to the same thing – making the company successful – which means improving performance.

Good management should facilitate effective governance. Good governance should enhance and reinforce management’s ability to drive the organization to new heights.

This isn’t a challenge to the *authority* of management – it is more fundamentally a challenge to management, the Board, and to employees, to improve performance – and to do it in ways that the Board, shareholders, regulators, employees, and other stakeholders can understand, support, and see as consistent with the long-term health and continued *future* performance of the business.

The pursuit of good corporate governance is a lever that companies can use to improve performance – it’s no different than the pursuit of other strategic priorities.

Which brings me to the final element in this new framework for understanding corporate governance. **In the work that Lemman Group does, we have come to understand that Governance is what Quality was 20 years ago.**

What do I mean by this? I mean that corporate governance is really still in its infancy in terms of the impact that we believe it will ultimately have on the corporate world. And

more significantly, that governance will follow much the same trajectory that quality did in its development.

That is to say, governance is moving through various stages:

- **from fringe interest** – where only a very few specialized and committed people think about it, and they're often seen as well outside the mainstream corporate culture;
- **to necessary evil** – where it's grudgingly acknowledged as something that needs to be done, but continues to be resented;
- **to cost centre** – where it may be seen as legitimate, but is still just an overhead cost, and every effort is made to “cover the bases” with the least amount of effort and cost;
- **to profit centre** – where it's understood as a competitive advantage, and as an instrument for improving a company's performance in any number of ways;
- **to fundamental guiding tenet** - where it permeates the organization, and becomes an important part of shaping corporate strategy and behaviour in all its different manifestations, and in fact becomes routine.

As in the case of quality, there will be those who see governance as a passing fad; there will be those who hope that the silly preoccupation with it will soon blow over; there will be those who think it doesn't really apply to them – it's someone else's problem.

But more importantly, there will be those who grasp the potential of what improved governance can mean in driving improved performance. Those who understand that better information leads to better decision-making; better accountability leads to better implementation; and better execution means better performance – in market share, in customer satisfaction, in ROI, in stock price – in all the measures we use to assess performance.

It is *those* people that I want to embolden. It is them that I want to know that it *can* be done.

- Better, more complete, more relevant information *can* flow throughout the company.
- Better, more timely, more meaningful decisions *can* be made.
- More effective execution of those decisions *is* possible.
- Directors and managers *can* gain more confidence and assurance that the right things are happening.
- Better accountability *can* be had at *all* levels of the organization.
- Staff (from the CEO to the floor sweeper) *can* more effectively understand and align to where the company is going and how they can be a part of it.

There are tremendous opportunities for those companies who want to lead in this area – for those directors and executives (and line managers) who grasp the powerful benefits that can flow from understanding that governance and performance can be one and the same thing.

As you leave here today, this is the challenge I pose to you – think about where your company fits in this mix. Think about where it *could* go and what it *could* do to be ahead of the curve – to lead, and reap the benefits of doing so. And think about what action you can take, from your position in the organization, to stimulate or lead that kind of change.

It *is* possible to take action and make things *substantively* better – I think it's incumbent on all of us to try.

Thank you very much.

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