

The Governance Agenda in Modern Organisation -- do we get what we deserve?¹
- Roger Latham, IPA Governance Forum/ CIPFA Conference, 10 March 2010

I'd like to thank the organisers for extending an invitation to me to speak to you on the subject of governance. I had the opportunity to speak here before a couple of years ago when I spoke about the importance of trust in establishing a good governance, and how strong and vibrant market economy depended on that. Since that time the downturn that we've all experienced, and are currently coping with, has caused a number of people to be very critical of the governance and risk-taking attitudes within the financial services, and within the community generally.

Others, I'm sure, will talk further at this seminar about these issues, and I don't want to repeat myself, I want to look instead at the way that good governance is underpinned by good behaviour, and how that behaviour is conditioned by the kind of organisations in which we operate.

I want to make these four propositions in my presentation this morning:

- Governance – good or bad, depends on culture.
- Our current organisations promote a poor cultural environment
- Alternatives exist, but are not generally adopted.
- We can no longer afford the luxury of the status quo.

I think they're broadly self-explanatory, and I hope they will give some form of shape and summary to what I intend to say. Whether or not you think that I have established them effectively at the end of my presentation is up to you. I firmly believe that they are valid.

Governance – rules or principles?

Some folk have contrasted governance arrangements which are based on a written set of rules within which people are expected to operate, and contrasted these with a principles-based system which sets out broad guidelines, and then leaves it to people to interpret those guidelines in specific situations. Arguments in favour of the former suggest that you cannot control people's beliefs or how they think, but, as an employer or manager you can expect people to exhibit certain behaviours, and the rules ought to be aimed at defining what is and what is not acceptable. Those who favour a principles-based system argue that you cannot legislate for each and every possible issue, and therefore rules will always be deficient and will always be exploited by the unscrupulous.

¹ This paper was delivered through a slide presentation which is available separately on the Governance Forum Website or from the Forum secretariat

Getting people to agree to a set of key principles is what matters. Once they have agreed to these as being the basis for conduct, then detailed rulebooks are unnecessary. It rather follows the line of St Augustine when he recommended that one should "love God, and do as you will!"

Experience suggests that a rule-based system, on its own, is generally inadequate. What has happened in Westminster regarding MPs expenses is a classic example of the limitations of the rule-based culture, when it is not backed up with beliefs and standards that underpin behaviour in public life. In my own experience I have had the difficulty of trying to get both politicians and public servants to work within rules-based cultures in a way that is defensible to the public. The underlying issue was a perceived unfairness that those operating within the system felt, which led them to exploit the rules in unacceptable ways. In both cases people felt that their rewards for public service were inadequate, and that it was acceptable to use a system of expenses as a secondary form of income -- rather than a reimbursement of costs that they had properly incurred in going about their duties. As a result people milked the system for all they could get. They never asked themselves the key question "could you justify this to your neighbour/constituent"? And as people realised that their claims will be subject to an independent examination before payment, they made sure that they over claimed so that disallowed items did not mean that they got less than the maximum permitted. Hence claims for duck houses and moats, that were never approved, were nevertheless submitted to ensure that other, more valid expenses, were passed without scrutiny.

So it is not a case of rules or principles, in my view both are needed, but principles must underpin the rules. Let me give you a classic example. In a time when legislation is often poorly drafted, has unexpected consequences, and is subject to repeal, amendment, and alteration in the Courts, the Bills of Exchange Act 1882 shines out as a beacon. It is a masterpiece of clarity, and has never been repealed, or amended, and indeed was never significantly altered from the date it was passed until the arrival of the Cheques Act 1957. Its first clauses are classic. Clause 1 says "a bill of exchange is an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring a person to whom it is addressed to pay on demand or to fixed or determinable future time a sum certain in money to or to the order of a specified person or to bearer ". Clause 2 says "an instrument that does not comply with these conditions, or which orders any act to be done in addition to the payment of money, is not a bill of exchange". It is completely and utterly clear.

Why is it such a masterpiece of clarity? Because the rules it sets out simply codified the existing best practice and underlying culture of the City of London in late Victorian times over the issue of how effectively and properly to fund International trade using, in effect, a system of promissory notes -- bills of exchange. This system is in use to this day -- a cheque is a bill of exchange drawn on a bank payable to bearer on demand. What underlay this system was a basic principle of trust -- "my word is my bond" -- and a total transparency, in that a bill of exchange which was not honoured could be pursued all the way up the chain to the person who issued it with each person being jointly and severally liable for the whole sum.

The rules were underlain by a culture of honesty, transparency, and trust. I argue that the culture of our organisations underpins our behaviour. Our behaviour is not monolithic, but is something that we adapt to the group, organisation, or circumstances in which we find ourselves. There may be key items of belief, or faith, or principle which we uphold within ourselves and of ourselves, but for the most part our behaviour is dependent on our environment. Without us being dishonest we regularly put on a "face to meet the faces that we meet" -- as the poet TS Eliot put it. So, if we want to look at what is good and bad governance, we need to look at what the underlying culture is of the organisation to which the principles and rules of governance belong.

Different ways of looking at Organisations

At the last couple of decades people started looking at organisations in a new way. Traditionally the way we have thought about organisations, and the language we've used about them, as a machine. So, for example, when speaking of our powerlessness we say "I'm just a small cog in the machine", or if we feel we're going to be disruptive we claim that we are going to "throw a spanner in the works".

The alternative has been to develop thinking about organisations as if they were herds and flocks. We've learnt quite a lot about how animals congregate together for safety, to establish common purpose, and to live together. As we human beings are ourselves animals, it's no surprise that some of this thinking can, metaphorically speaking, transferred to the way the organisation is run.

What makes the organisation tick?

Taking then the two alternative scientific approaches -- here using the same colours as in earlier slides to identify them -- we look at the traditional machine type of organisation and it seems clear that what makes it tick are having defined objectives; a clear scientific approach; and clear roles and responsibilities. This is the world which we customarily inhabit, and its components are set out in the slide are probably very clear and need no further explanation to most people.

Looking however at the organic -- animal-based -- thinking of organisations is not easy to see what makes them work. Much research and analysis has developed three clear factors:

- First, they have vision and purpose which is clear throughout the organisation and which has genuine organisational ownership in that it is developed through dialogue and shared values and is not imposed by a hierarchy.
- Second, information is open and accessible throughout the organisation -- not seen as a source of power as it often is in hierarchical bureaucracies -- and is genuine information not the collecting a vast amounts of data (which is a feature

in hierarchical bureaucracies). Further, when furnished with key information largely derived from the frontline individuals are free to respond to it and are empowered to do so. Such organisations have a very high degree of devolvement.

- Third, these organisations are based fundamentally on relationships. Values and behaviours are key to their culture, not status and pay. They represent genuine partnerships of people who share the vision and information -- which can cut across conventional organisational structures that we have made up. This is genuinely "Total Place", not some artificial partnership in which the organisations are cynically described as operating "the suspension of mutual loathing in the pursuit of money". Such organisations do not look to the individual as the unit, but the team, and recognise that relationships within a team as key to how people behave. If you examine the behaviour of a flock of starlings for example you can guarantee that as they swoop and circle together they are not being guided by a Chief Executive Starling and a Management Team who are sending out edicts that "okay guys, we'll hang a left". Each bird in a flock uses the location of seven other birds, on average, to decide what is going to do next. We use networks of relationships in organisations to do exactly the same. We don't have to invent them -- they are already there. Finally members of teams do not have fixed job descriptions but, like a skein of birds heading south, will actually change position to take the lead, or fall back into supporting, or a resting role, to enable the whole flock to make progress. Similarly, in human organisations that are organised along these principles, individuals cycle through roles depending on their abilities, and the needs of the environment, rather than have them fixed.

Behaviours

If these are the basic principles upon which the two types of organisations operate, then what does it say about behaviours within those organisations?

Within the machine world the dominant pattern of relationship is that of principal and agent. The principal determines the objectives and what needs to be done; the agent carries out the principal's wishes, under the principal's supervision. This key division between management and workers is so common that it barely requires to be remarked on. Such organisations clearly have a hierarchy to determine the appropriate level in the organisation which deals with where key decisions are made, and how supervision is carried out. These are generally defined in terms of individuals and the individual's place within the organisation, and outcomes and key performance indicators attach to individuals. The personality variant developed by Douglas MacGregor, underlying this is "Theory X" -- people will only do what they are incentivised to do or compelled to do -- otherwise they will do as little as possible.

The upside of this is that the organisation is very clear about what is going to be done, and where the key decisions are being taken. There is a clear transparency within the organisation and a clear oversight and have responsibilities for various

actions. You know where you are in a hierarchy.

The downside of this is that people find working in situations where they have a high level of demand, but a low level of control, highly stressful. Such organisations often develop learned bad behaviours. Getting your way by bullying -- physically, verbally, or mentally, -- is seen as dynamic leadership. Games-playing within organisations, often around the control of key information, is commonplace. I once did some key work with a number of consultant psychiatrists in which we developed a model of dominant and dependent behaviour around the work of Niccolo Machiavelli. We identified three characters -- the unscrupulous boss - "big Mac"; the amoral sidekick who did the boss's dirty work and gained a status and reputation within the organisation way beyond their position in the hierarchy, and who was generally to be feared - "Mack the knife"; and the ambitious, unscrupulous, and unethical climber who did the boss's dirty work, but wanted to be the boss, and who was most dangerous because, at key moments, they were likely to turn assassin on big Mac - "Mac evil" (based on the Jacobean play character of somebody who was malevolent without necessarily good reason). We found that people could recognise these learned bad behaviours both historically, and within their own organisations and experience. Hierarchical bureaucracies -- which is what machine world tends to be -- are also tolerant people with personal dysfunctions because sometimes they fit organisational needs. So people who have Attention Deficiency Hyperactivity Disorder -- ADHD -- can masquerade as a dynamic and energetic manager who rushes round starting new initiatives, going with the latest idea, and who leads their staff a merry dance leaving them exhausted and confused. Or someone with a mild level of autism can be an ideal system administrator or auditor who cares more about the purity of the system than its effect on individuals.

Finally, the author Richard Sennett has identified in his book " The Corrosion of Character " the tendency of modern machine type organisations to demand high levels of flexibility from their staff, but to treat them with total disloyalty. As he points out this attitude is, after time, reciprocated and where loyalty is not given, it is not shown. Since he argues that this is generally contrary to people's desired attitudes, it has a corrosive effect on the overall character which has community consequences beyond the organisation.

Within the herds and flocks organisation the dominant pattern tends to be one of shared dependency -- that is people expect to be consulted, and to be informed, and to be asked for their advice and opinions and expertise on the objectives and direction of the organisation. People within the organisation build on existing networks of trust -- who do you trust to go to for advice? who you ask when you don't know what to do on a technical issue? whose shoulder do you cry on when something goes badly wrong for you?; who do you seek out to find out what's going on? These networks exist in all organisations, and in herds and flocks they come centre stage instead of being something that happens in the organisational margins. The grapevine -- that magnificent internal communications network -- becomes something that is integral to the organisation, rather than a threat to it. These organisations operate not around the individual, but around the team. It makes no sense to have individual performance

indicators and outcomes, and people realise that their performance depends critically on other people's performance and support. Finally MacGregor's variant that underlies this is "Theory Y" -- people generally want to do well, and the best that they can, they just have to be helped to do it.

The upside of this is that it seems to work with the grain of how people are in organisations. It feels natural, it feels like the way things ought to be, and it is comfortable. Given that we're told that in order to achieve happiness people need to have a belief in something that is other than themselves -- as well as some physical security and the love of a "significant other" -- then the herds and flocks organisation with its emphasis on vision and values and objectives can provide that key belief. Since many organisations go to considerable expense to inculcate such a belief, getting it as part of the deal seems like a good deal.

The downside of this is that such organisations often seem chaotic. It's not clear where authority lies at any given time and the whole thing can feel very uncoordinated. With a high degree of devolvement it is very likely that what happens in one part of the organisation isn't going to happen somewhere else either in terms of outcomes, or even how people are working. This inconsistency can lead to a sense of inequity if not properly handled. Given the responsibility that people have within teams, it is difficult to have point responsibilities in such organisations, and that means that both for good and bad outcomes it is unclear who has ownership for action.

A General Theory of Everything

This thinking about alternative organisations has not taken place in a scientific vacuum. It is part of a much wider pattern of alternative explanations for "how things are". It is my belief that there has been a steady shift in thinking about how things work from that of Newtonian physics towards that of quantum and chaos theory. In the Newtonian world we reduce a big problem to a little problem, and we solve it and put the bits back together again; we are certain that there is simple cause and effect, creating single solutions which are monotonic i.e. If you make a small change you get a small effect if you want a bigger effect you need a bigger change; and we are convinced that if we know enough information we can predict what will happen.

The changes to quantum and chaos theory do not look at the subparts, but whole systems. They determine the simple rules by which those systems operate, but acknowledge that this results in complex outcomes. They often demonstrate the "butterfly effect", in that small changes in initial conditions can create major changes in final outcomes because of the consequences of "phase shifting", and therefore such systems often have multiple solutions and unstable outcomes which can only be assigned probabilities, not certainties.

The Spread of New Thinking

From the first point at which the observed reality of the subatomic world no longer obeyed the simple principles of Newtonian physics the ideas of quantum and chaos have spread to many other scientific endeavours including our understanding of weather and climate, the nature of evolution and biological change, and the kind of switches that we have seen in the world's environment in the past. From these areas there has been a steady spread, as we have already seen, into issues of the political economy where the failure of conventional orthodox economics to explain growth and the business cycle satisfactorily has led to alternative explanations utilising the new style of thinking. Now it is spreading further into looking at organisations and social interactions and asking whether or not an alternative way of looking at organisations as whole systems creates an opportunity for doing things in a culturally very different way with the potential for major transformational change.

....at a price you cannot afford...

I hope that by now that I've established sufficiently clearly the fact that governance and the underlying culture is very much organisationally driven, and that the alternative patterns of organisation which I've outlined are not some random division of the world into two -- as Stephen Fry remarked "the world is divided into two groups; those who divide the world into two groups, and those who don't!" -- but is part of a fundamental underlying set of principles about how reality is, and that our developing understanding about the relative simplicity of systems, and the complexity of their outcomes, is a spreading the pattern across our body of knowledge during the last century.

What I want to argue now is that the choice between machine world and herds and flocks, is not simply a matter of preference, but increasingly, and in very difficult financial circumstances, is an issue that is essential to the continued delivery of public services. An English military observer once remarked to the Confederate Commander in Chief Gen Robert E Lee that although his people achieved great things in the furtherance of a bad cause they did so each time "at a price you cannot afford" -- that is that the losses that were taken cumulatively, seriously weakened the organisation. I believe this is so of machine world. There is much talk of the "work life balance" -- which is often an oxymoron in the what it means is how do you manage to get any kind of life when workplace dominates and determines so much of how you spend your time. There is no balance in the work life balance. Since a vast amount of our time is spent working in organisations, should not the achievement of outcomes be satisfying within that, and if it is not what does it say about the organisation and its objectives? The extremely uneven workload pattern that is a feature of machine world organisations is damaging, both to the individual and the community. When a small proportion of people find themselves working impossibly stupid hours, whilst others struggle to find any kind of employment at all, argues that something is wrong with the way we are organising things; or when some people find themselves being given ridiculously large bonuses whilst others struggle with the minimum wage it argues that we have got our priorities

wrong. In the long term this undermines trust in organisations and institutions and the market economy.

The problem it seems to me is particularly exemplified when we look at some of the future difficulties that we will face with increasing longevity. It is clear that people are capable of working for longer, and given the present pensions crisis, they may be required to do so. However a great many of our organisations destroy people emotionally well before they are intellectually feeling the strain of carrying on. When people retire, people often remark on seeing them in later, how well they look, and how active they are. Why could they not be so within the organisation? And if the organisation is responsible for the emotional impairment, is that not "a price we cannot afford". Such "burnout", particular high levels of organisations can be disastrous if someone is a position of leadership at a time when their stress levels are such that effectively they have PTSD -- post-traumatic stress disorder. While military history may not be always give a satisfactory example, it is replete with the disasters that occur when leaders, suffering stress, take bad decisions. If our organisations are responsible for delivering stressful outcomes in difficult environments -- how much damage can be done by a manager, or a chief executive, or a leader, who has basically "lost the plot".

It is not just the human cost of organisations that is significant. Many organisations bear quite a heavy overhead as the financial cost of dealing with bad behaviour within the organisation. I have no scientific evidence, but from my own experience I would guess that about a third of my HR resources when I was Chief Executive were taken up in dealing with the consequences of bad behaviour in one form or another. Further, when an organisation sponsors bad behaviour, stressed individuals, jobsworths, and inflexible systems, then it can expect that its levels of customer satisfaction will be poor and the organisation is unlikely to be trusted. I believe in many significant large hierarchical bureaucracies -- in both public and private sector -- this lack of trust is very evident. You only have to pick up a weekend newspaper to read of just how badly people feel that they have been treated, and the media then spreads the contagion of distrust throughout the community.

And if that is the downside, then it's made worse by the fact that the alternative type of organisation has so many benefits which are thrown away in the traditional pattern. To start with, herds and flocks type organisations are generally 20 to 30% more efficient in cost terms. At a time of extreme financial stringency it seems to be criminal to throw away that kind of cost advantage. It comes from reducing the level of transmission costs up and down the organisation and speeding its response; it comes from the loss of inspection costs that are unnecessary; and it comes from changing those who operate within the organisation from supervisory responsibilities into practically doing and delivering. Such organisations must be customer led and the only relevant performance indicators are those which relate to customer satisfaction. Anything else is internal to the team, and is irrelevant unless it leads to greater customer responsiveness. Able to change and responsive to change, such organisations are in a position to counteract the distrust that poisonously spreads in media reporting of organisations in the community.

The management of such organisations is very much turned on its head. The management guru W Edward Deming who was instrumental in developing the new thinking about organisations used to describe the traditional approach to targets in traditional organisations as being threefold. First, the data is distorted, manipulated, or suppressed. Second, people distort the system so as to produce the results that they want, rather than what is needed. Third, people reluctantly change the system. Getting through the first two stages takes time and destroys trust and faith in the organisation. You only have to think about how people have reacted in the UK National Health Service to the imposition of strict performance indicators to garner numerous examples of how people have fiddled figures, and bent the system, before finally making the change that was needed. Since in a herds and flocks organisation the role of management is not to manage people but to manage the system then there is a real opportunity to change things quickly without going through the distortions that Deming identified.

So what's stopping you?

So if the improvement is so obvious, what's stopping us?

In my experience I identify three key factors.

First, there are a large number of organisations that believe that they're operating in the more modern way of closer examination are largely deceiving themselves. So organisations say:

"We operate a no blame culture" -- until something goes wrong!

"Our people are our greatest asset" -- which is why we exhibit organisational disloyalty to them and still expect them to be loyal to us!

"I encourage risk and innovation" -- provided it works out okay!

"We devolve decision-making fully" -- which is why we have annual performance interviews, and individual key performance indicators and objectives.

All you have to do is to ask "tell me a story about what went well here" and "tell me a story about what went wrong here", to rapidly find out that despite these positive statements the organisation operates to very different standards.

Second, what I call alliances of the damned. Many people who find themselves in positions of authority within hierarchies are deeply reluctant to forego their power and status. Since such people often occupy senior positions of leadership, they can usually find 100 different reasons why change is not a good idea -- because it's not a good idea for them -- or sponsoring change elsewhere in the organisation, because it doesn't affect them. These alliances are strengthened when strange bedfellows get together. So I've experienced senior trade unions officials -- who rather thrive on the inherent conflict in the machine world type of organisation -- and senior management, who fear that their status and power, getting together to rubbish the suggestion that any change in

organisational type of structure would be advantageous. This often takes place in the face of clear support for such changes from frontline staff, and from those who feel that they have something to contribute, but have no means to be heard.

Third, there is fear. There is fear about taking up an organisational structure which is not commonplace, and which demands new thinking. The people are fearful about how they will go about making such an organisation work, not recognising that many of the networks that already exist in their organisation are already there, and do not need to be invented. Finally, there are those who have built up a considerable management expertise over the years and feel that all that technical ability is about to be put to one side, and that they will be bereft of understanding.

Be Bold...

If we feel unhappy with the way things happen in our organisations and we want to improve their governance, then I believe you have to look to the way the organisation is structured and its underlying principles. I believe that if an organisation operates on the traditional hierarchies of machine world that it brings with it a portfolio of bad and challenging behaviour with which we will struggle to manage, and which undermines our values and principles. It's long been my view that if you want to change the people, you have to change the system. I believe there is a viable alternative; I hope what I said this morning encourages you to think so too. It isn't easy -- my own experience tells me that -- and I struggled to try to get some of these ideas integrated into an existing organisation. I cannot claim that I was successful, but I do think that I saw the way to the Promised Land. I encourage you to be bold and to go forward.

Thank you for listening.