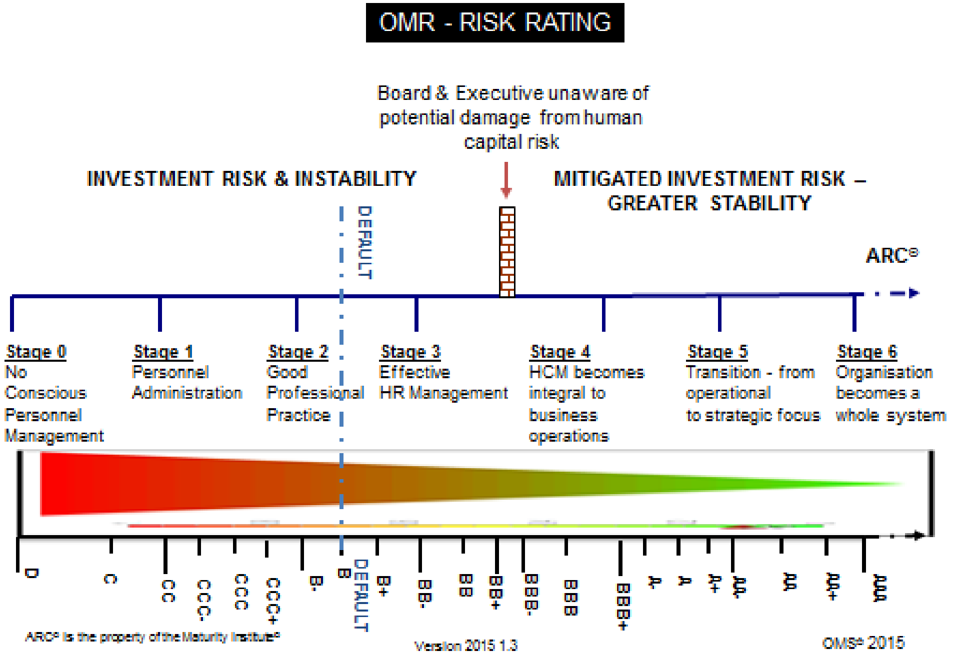
OMS Organizational Maturity Services LLP

Human Governance Risk Grid©



Introduction to the Governance and Culture Risk Grid©.

Conventional management without a mature approach to human governance and culture has to be regarded as a 'default people capability'. The rating for a default position on the OMR scale is a 'B' (point 8 on a 22 point scale). Any organization in this position comes with intrinsic human governance and culture risk unless and until there is acknowledgement at board and Exco level that an explicit human governance risk management strategy is necessary. The best indicator that this is in place is that Human Governance (HG) is an explicit board level responsibility with a nominated committee or 'Head of Human Governance' with the authority and appropriate methods to ensure risks are assessed, managed, and mitigated wherever possible.

The HG Risk Grid identifies common areas that need to be addressed by any organization. Our analysis sees the organization and its supply (value) chain as an indivisible, whole system. In any whole system, when a risk manifests itself as a failure, non-compliance or breakdown the whole system is not only affected but could result in total system failure (e.g. Arthur Andersen's demise in the wake of Enron). Therefore each and every heading below has to be addressed together, strategically and in parallel, not sequentially.

Why is Human Governance and cultural risk not routinely analysed and examined?

The answer to this question can be traced back to the severe limitations of conventional auditing practice. These limitations are already recognised within the <IR> (integrated reporting) community and there are now serious efforts being made to incorporate human capital and 'culture' into company reporting. Without it auditors and risk managers are delivering inaccurate and even misleading information. Our focus here, therefore, is specifically on independent and objective methods for measuring the risk of human governance and cultural issues, offering predictive analysis to highlight incipient signs of organizational dysfunction and, wherever possible, help to avoid large scale value loss.

Key risk areas in Human Governance and Culture:

Risk		**Nature of risk**	**Examples of financial impact & value destruction**	**Symptoms**	**OMR analysis (based on [MI Pillars])**
1	**Skewed value proposition - single variable focus**	Cost efficiency or earnings driven strategy at expense of other value variables of Output, Cost, Revenue, Quality	BP: Oil platform failure Gulf of Mexico $20-30 billion 50% drop in share price after 5 years Walmart - "Always Low Prices Always" – staff related inventory shrinkage, low employee productivity/service & litigation VW emissions scandal – growth/volume motive overrides value Tesco accounting scandal	Business strategy statements with narrow focus Business plan objectives that allow trade-offs that undermine total value Excessive use of KPIs and management metrics that conflict	Total value concept misunderstood and proxies of profitability and shareholder returns used. Value not measured holistically, resulting in trade-offs e.g. with quality, output and customer satisfaction. (1)

2	**Brand led Human Governance; shallow 'corporate social responsibility' and pseudo compliance**	Corporate awards focus ("Best Company); 'tick-box' commitments to issues such as human rights, diversity quotas, UN Global Compact, CSR, CSV etc.; strong HCM policing necessary to ensure compliance	Nestlé strategy on baby milk powder, noodles in India, water in California. Pharma drug trial scandals Nike forced to review labour in supply chain[i] Apple and Foxconn	HCM has pure 'talent' remit and employer branding. No integration with business operating model. Focus on political correctness and PR for damage limitation. Website and annual reports refer to 'CSR', 'CSV' etc. to portray a societal purpose.	Misaligned HCM ethos and systemic failure to understand nature of HCM and business risk (1, 6 & 10)
3	**Systemic disconnection: reward & value outcomes**	Reward from senior executives through to management and staff does not relate to value and encourages other outcomes. This is now widely recognized as being endemic in the majority of corporations. Exceptions are few and Handelsbanken is a rare exemplar in this respect.	In 2000 Enron's top five executives received payments of $282.7 million[ii] before it collapsed the following year Financial re-engineering to drive stock price/EPS improvement (e.g. GE, Astra Zeneca)	Lengthy 'justification' in annual report without sound reward principles e.g. causality, long term planning & sustainable value. Benchmarking (non-evidence based) remuneration consultants used (9)	No mature performance and reward system in place from principles to remuneration plans.

4	**Weak/ineffective governance**	Ineffective governance starts with poor clarity of organizational purpose, and weak societal motive. Evidence shows that shareholder primacy does not maximize shareholder value.	HSBC Mexico money laundering & Swiss banking scandal	Lack of Human Governance responsibility or even narrative in Board remit	Company is fundamentally failing (on all 10 Pillars) to realize its value creation potential.
5	**Knowledge & learning failure:**	Failure to utilise existing, critical, internal knowledge which leaves firm in disadvantaged or precarious market position Inability to learn from mistakes or innovate for the future; causing material value damage	Microsoft missing key product opportunities (search, social media, mobile) Virginia Mason Hospital – move from blame to learning culture lowering material cost of repeated mistakes and sparking ongoing innovation. Low innovation rates - Pfizer innovation rate of 0.03% compared to Toyota 500%+ per annum	No learning system in place, no common discipline of problem solving throughout the organization, no explicit feedback loops. Training inputs used as a proxy for learning value. Much higher probability of whistleblowing activity and information leakage	An organization that cannot learn is bound to suffer serious business failure at some stage. (4 & 7)

6	**Supply/Value chain failure**	Weak oversight of supplier leads to erosion of supplier product/service value Disincentives for quality outcomes	Tesco's (B) treatment of suppliers versus ARM Holdings (BBB+) reference to "ecosystem" relationships BP Gulf of Mexico Horsemeat/supermarkets Takata car air bags	Dominant market position results in 'squeezing' suppliers rather than working in partnership to improve total value	Dominance as a 'supply chain strategy' is self-defeating in the long run and encourages suppliers to cut corners, offer lower value and work around quality assurance requirements. (1,3, 6 & 8)
7	**Target and goal setting**	Excessive, meaningless and/or conflicting performance targets & KPIs drive adverse outcomes	GSK bribery/pharma mis-selling scandal $450 million fine/$ GFC incentives UK NHS A&E waiting lists Sainsbury driving revenue through 50p per customer poster	Narrow profit and sales targets that do not consider wider value/values.	(1, 5 & 8)

8	**Organizational leadership, management & decision-making**	Top down, driven organisation leads to poor decision making; Hierarchy leads to slow implementation of decisions; inability to embed new strategy Low accountability and unclear responsibilities causes inefficiency.	A general problem affecting the majority of organizations RBS (Goodwin); Microsoft (Ballmer); Tesco (Leahy/Clarke)	Despotic leadership Matrix' organization has no clear reporting lines. Silo organization breeds poor cross functional cooperation.	Organization design is best managed organically but using clear design principles and strict discipline before any changes are made. (3 & 6)
9	**Behaviour and conduct**	Individuals or small teams in one or more locations behave or act such that catastrophic organisational damage occurs	Rogue traders (Barings bankrupted, UBS $2 billion' Soc Gen €4.9 billion) VW software designers News International - hacking GSK sales bribery	Lack of clear purpose, narrow value motive, no embedded values "We cannot control every single person" attitude. "One bad apple" excuse. "Behaviour not part of our values or outside protocols" etc.	OMR's whole system analysis suggests that the 'rogue trader' is a myth. (3)

10	**Quality assurance failure/process failure**	Quality control of final product/service is a poor, high cost substitute for quality assurance of every part of the process	VW operating margin of 6% (compare Toyota 9%) substantially due to adopting QC (quality control) rather than QA philosophy. GM ignition switches Nestle noodles Drug quality failures	Inspection regime putting problems right that should have been right first time.	It is over 40 years since the TQM 'revolution' but authentic QA is rare and replicators fail to copy the whole, critical, human element system of the Toyota Production System. (4 & 7) - see also Risk 12
11	**Internal trust, engagement, collaboration breakdown**	Dysfunctional organisation Hostile employee relations environment Damage to OCRQ value	Lonmin mines BA/Gate Gourmet cabin staff Walmart inventory shrinkage	Staff whistle-blowing Industrial action Anti-union activity	(8 & 10)

12	**Ineffective HCM and strategic planning**	Lack of due diligence on M&A and subsequent integration. Insufficient attention to human capital aspects of M&A activity contributes to high costs of integration, subsequent under-performance & failure to match expectations. HCM not built into long term plans such that strategic decisions creating company vulnerability.	Myriad M&A failures	Legally led due diligence HR alignment with strategy or business support function	(2,3,5 & 6)

References

[i] http://www.theguardian.com/environment/green-living-blog/2012/jul/06/activism-nike
[ii] http://www.forbes.com/2002/03/22/0322enronpay.html