

IT Governance: A New Area of Focus Inside The Boardroom

By Mark W. Sickles

The word “governance” has probably been said and written more in the last four years than the last four hundred. Yet rarely has it been defined. And we all know what happens with undefined terms: They take on different meanings depending on the context, situation, and circumstance in which they are used. Post-Enron, governance has meant compliance, control, reporting, and shareholder relations. But governance has also meant dynamic leadership, great management, and long-term shareholder value. How ironic that the use of this word has not been governed. It’s time we define governance in a meaningful and disciplined way—keeping in mind whose money we’re spending, and what they expect in return.

Generally, governance is a method or system of management to establish a straight course and maintain a smooth operation for the good of the whole (Webster). In business terms, governance is a method or system for protecting the capital investments of the shareholders by formulating and implementing strategies that develop and exploit strategic assets used to produce sustainable competitive advantages and long-term shareholder value, all while behaving legally, ethically, and morally.

To practice governance, boards must skillfully play four interdependent roles: fiduciary, advisor, overseer, and advocate.

Information Technology

The purpose of information technology (IT) can be derived from the four roles of

governance. The reason is simple: IT is a support function. And like all support functions, the purpose of IT is to increase the effectiveness and efficiency of the primary activities of the firm. This is not unlike the purpose of the board. In more specific terms, the purpose of IT is to:

- Prevent business disruption.
- Increase operating efficiencies.
- Accelerate positive momentum.
- Create or strengthen strategic assets and competitive advantages.

The underlying purpose for all of these efforts is to increase operational free cash flows to levels that exceed the cost of capital needed to fund IT projects.

What is the role of the board in fulfilling this purpose?

This question brings to mind a valuable lesson taught to an audience of boards and directors by a CEO serving on several boards. When presenting to his board as CEO, he always begins his conversations by defining the context in which the conversation will be held. As a board member, whenever the CEO begins discussing a topic without first placing the topic in a defined context, he politely interrupts the CEO to ask about context. The point is that when conversations, functions, activities, projects, and work are done out of context, they are at best benign and at worst counter-productive. So, the role of the board in fulfilling the purpose of IT is to create a context conducive to the desired outcome. We recommend the Socratic method.

The Socratic method of governing recognizes the fine line between the role of the board and the role of management: Management does; the board assures. But how can boards assure what management does creates long-term shareholder value?

It’s a hard fact that when boards ask questions, they create work in the organization. The challenge for boards is to know when to ask

Director Summary: Directors should use the same powers of governance with their oversight of information technology that they use in all other areas. The author suggests “leading with the question mark”: ask industry and company-specific questions of management to assure sound IT governance within your firm.



questions that create a context for management doing work that produces long-term shareholder value. One simple but crucial question is: What's the purpose of this work? At a *Fortune* 200 durable goods firm, a major IT project was failing. After nearly two years of effort and millions of dollars of expense, the executive in charge had seen enough. He created an intervention in which all the executives in charge of the project—internal and external—were asked to state their understanding of the project's purpose. The silence was deafening! When the project was subsequently placed in the context of long-term shareholder value, the work looked different to people. Priorities changed. Relationships changed. Accountabilities changed. Goals changed. And morale improved. Said one middle manager, "I've been working on this project for over a year and a half, and this is the first time it makes any sense to me."

When leading with the question mark to create a value-added context for IT, boards are well-served by keeping in mind four vital insights about technology:

- Technology can easily create the opposite effect of its intended purpose.
- The only good reason to spend money on technology is to make more money than you would without it.
- It is more important—and more difficult—to install the system in people's heads than it is to install the system in their computers.
- The real IT revolution is about to begin.

Technology can easily create the opposite effect of its intended purpose

Psychologist Richard Farson asserts that "the consequences of applying technology are likely to be different than our expectations, and very often the opposite of our intent. Only by understanding this can managers intelligently apply technology, assess its effects, and be reasonably prepared to cope with the unpredictable eventualities it will cause." This view is reinforced by recent findings of researcher Jim Collins: "In every good-to-great case, we found technological sophistication. However, it was not mere technology per se, but the pioneering application of carefully selected technologies. Great companies respond to technology with thoughtfulness and creativity, driven by a compulsion to turn unrealized potential into results; mediocre companies react and lurch about, motivated by fear of being left behind." Examples of this mediocrity include companies who "decustomize" their information technology to enable a more efficient series of upgrade projects. Note the tail wagging the dog and, in the process, potentially discarding strategic assets and competitive advantages.

Like all support functions, the purpose of information technology is to increase the effectiveness and efficiency of the primary activities of the firm. This is not unlike the purpose of the board.

In a leading consumer products firm, the corporate IT function had become both large and powerful and to some, downright intimidating. This IT function decided to standardize the firm's enterprise systems by moving from two incompatible systems to one standard approach. Logical, sensible, practical. Nevertheless, things went wrong.

When one function in the organization that would need to switch systems learned about the time, effort, and cost of this standardization project, they asked IT to work with them to ensure the new system provided better support than the old one, since the old system did not support a "best practice" level of performance. IT said, "This project is not about improving performance, only about standardization. If we can give you the same functionality with the new system you had with the old, then the project will be a success." In frustration, the internal "customer" of IT called an outside consultant for help. After listening for a while, the consultant asked the frustrated client, "Who do you feel your IT department is more interested in satisfying—you or their external IT vendor?" The function head responded, "That's the easiest question I've been asked in a long time!" This IT project created shareholder value, but only for the shareholders of the external vendor. For the shareholders of the client firm, this project destroyed shareholder value—the opposite effect of its intended purpose.

There's only one reason to invest in technology—to make more money than you would without it

In a *Fortune* 500 pharma firm, the CFO, to whom IT reported, shared a private concern with his personal consultant: "When my head of tax comes in with a request, I can evaluate it intelligently. Same with my controller, head of audit, treasurer, and investor relations officer. But when the CIO walks into my office, I have no idea what he's talking about. The only thing I can be sure of, is that it's going to cost money—and lots of it."



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One way to minimize this problem is to house as much of the IT function as you can in the business units, and to minimize the size, cost, and influence of the corporate IT function. Under this scenario, a senior profit and loss executive, accountable to the CEO for “making the numbers,” will be the final decision maker on most IT expenditures. The number of such executives who’ll use, “I spent money on IT projects I don’t understand,” as an excuse for not achieving financial goals is very small and getting smaller ever day.

Install the system in your peoples’ heads before installing it in their computers

Upon hearing that a major IT/ERP implementation project was complete, the CFO of a *Fortune* 200 durable goods firm asked the following question: “If the project is complete, why aren’t we doing our work differently?” The answer is that, to the IT project leaders, “implementation” meant installing the new software in peoples’ computers. This is necessary, but not sufficient. Since the people still had the old way of working installed in their heads, they had not changed the way they were working. And since the newly installed software supported a different approach to work, the new software was seen as a problem, not a solution. This is a common problem in organizations. The CEO of a global industrial products firm complained to the external IT consultant that the board was asking him when they were going to see a return on investment in a multi-million dollar IT/ERP capital investment project. After two years of failure and frustration, the consultant had come to the end of his rope: “You’ll never get a return on investment unless and until you change the way you work.” As proof that some situations are hopeless, the CEO responded, “Now how do I explain *that* to the board of directors?”

The real IT revolution is about to begin

The last 25 years has provided us with the IT toolkit needed to transform the way we work, but it has only been in the last few years that the IT revolution has begun to have a positive impact on productivity.

The previous three insights help explain why it has taken so long to get increased productivity from these technological breakthroughs. From different perspectives, these insights reflect the fact that the recipe for *productivity* breakthrough includes more ingredients than just *technological* breakthrough. New business processes, new skills, and new abilities must also be introduced. For the foreseeable future, a critical success factor will be imagination: the ability to determine how all these enabling tools can work together to create new and better ways for adding value to employees, customers, shareholders, and communities. Now more than ever, Albert Einstein was right on the money, literally, when he said, “Imagination is more important than knowledge.”

Leading with the Question Mark

These four insights should serve as the guiding context for boards and directors in designing their leading questions to assure sound IT governance within their firm. Although questions should be tailored to fit the specific needs and environment of the firm, the following system of questions, grounded in timeless management principles, serves as a basis for action.

Board as Fiduciary:

1. What level (how much) and what mix (what types) of IT capital spending must our firm manage to assure long-term shareholder value?
2. Is our firm’s IT capital spending more or less than that of our competitors for capital?
3. What percentage of our firm’s IT capital spending is spent on strategic (discretionary) capital investment projects, compared to maintenance (non-discretionary) capital investment projects?
4. Is this mix skewed toward strategic projects to a greater degree than that of our competitors for capital?
5. To what degree are all IT capital investment projects designed to produce sustainable levels of income from operations which exceed the annual cost of the capital needed to fund the project?

Board as Advisor:

1. What percentage of our IT effort focuses on infrastructure? Operating systems? Applications?
2. What percentage of our IT effort focuses on increasing computational capability? Data storage? Input-process-output capability?
3. How do we determine what work should be eliminated, outsourced, or supported by proprietary technology?
4. What is our approach for integrating creativity, imagination, and innovation into our IT strategy?

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5. Do we have the organizational maturity and adaptability needed to exploit the ongoing flow of new technology and outsourcing opportunities?

Board As Overseer:

1. As a firm, does IT enable us to function at the departmental level of thought and action, or the systems level of thought and action, and why?
2. How are we leveraging IT toward the new standard of “the seamlessly interoperable organization”?
3. What is our understanding of the relationship between IT function and IT practice?
4. Does IT have a customer for all IT projects, and can that customer demonstrate a return on investment for the requested IT project?
5. What percentage, if any, of the IT budget results in corporate charge-backs to the business units?

Conclusion

The key to boards leading IT functions down a path of success is a shared focus on their common ground: Protecting the assets of the shareholders; developing and implementing a winning strategy; behaving legally, ethically, and morally. The four insights and corresponding system of questions provided in this article will enable boards to succeed in this vital task while functioning as strategic assets and competitive advantages. This is the essence of IT governance. ■

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