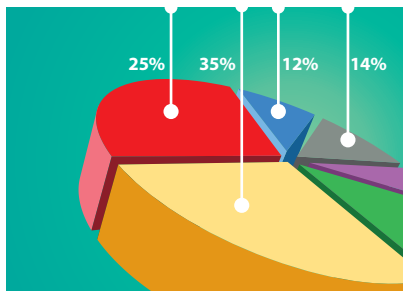


Executive Briefing

# IT GOVERNANCE: THE NEW AREA OF FOCUS INSIDE THE BOARDROOM

Trestle Group Research



Trestle Group Research  
Global Business Architects -  
Bridging Onshore and Offshore  
Markets

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# Introduction

The question is no longer “whether” the board should be involved in Information Technology; the question is “how”? This recent assertion by the Harvard Business Review indicates that board-level governance of IT has become a hot topic as technology complexity, investment, and risk continue to increase. In the past, the absence of board oversight has allowed IT functions to operate under the radar screen of free cash flow. The results of these ungoverned activities have not been pretty, with reports of the destruction of vast amounts of shareholder value. In today’s post-Enron era of heightened liability for directors and officers, a continued lack of IT governance puts the firm and its leaders at imprudent levels of risk. This scenario begs the following questions:

What is governance?

What is the purpose of IT?

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

What is the role of management in fulfilling this purpose?

How can these roles be managed to be complementary?

## What is governance?

The word “governance” has probably been said more in the last three years than the last three hundred. Yet rarely if ever has it been defined. And we all know what happens with undefined terms: People use them to suit their own needs. Heads of one type of practice or another become heads of governance practices; the national association of XYZ professionals becomes the association for governance professionals; corporate raiders become governance experts. How ironic that the use of this word has not been governed. It’s time we define governance in a meaningful and disciplined way - based on facts and management principles, rather than opportunity and convenience.

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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
- Advocate

## Fiduciary

In the broadest terms, the fiduciary role is asset protection. Traditionally, fulfilling fiduciary responsibilities has meant complying with governing rules and regulations, behaving prudently, and taking only calculated risks - in short, playing defense. But as the saying goes, the best defense is a good offense. And the best way to protect shareholders' assets is to ensure these assets are stronger and more robust than those of your competitors. In this context, competitors are all alternative investments of comparable risk.

A solid offensive plan for protecting shareholder investment is to develop an asset utilization plan that will produce operating income greater than the annual cost of those assets, where this overage is also greater than the overage produced by the firm's competitors. This balanced approach to the fiduciary role – both defense and offense – creates an effective financial context for the advisory role of corporate governance.

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## Advisor

The purpose of the advisory role of the board is to help management formulate a winning strategy, the equivalent of a “straight course for the good of the whole”. Strategy is best defined as an integrated and coordinated set of commitments and actions designed to first, develop and then, exploit strategic assets to produce sustainable competitive advantages and long-term shareholder value. The fiduciary role quantifies long-term shareholder value, thereby serving as a contextual framework for strategy formulation. In sum, the advisory role of governance assures effectiveness - doing the right things.

## Overseer

The oversight role of governance assures a smooth operation by focusing on efficiency – doing things right. As overseer, the board holds management accountable for developing and utilizing a method - or system - to efficiently implement strategy and actually achieve the end goal of long-term shareholder value. The key to success here is a masterful understanding of both entity and procedural interdependencies - the anatomy and biology of business. When used effectively, this system of interdependencies maximizes:

- Integration
- Coordination
- Overseer
- Advocate

The greater the supply of adaptability, the greater the firm's ability to respond to the demand for change caused by external forces beyond its control. Enabled by the principle of supply and demand and systems theory, the oversight role of governance assures that management adapts and adjusts to "maintain a smooth operation" and stay on a straight course leading to long-term shareholder value.

"The key to success here is a masterful understanding of both entity and procedural interdependencies - the anatomy and biology of business."

## Advocate

In carrying out the governance roles of fiduciary, advisor, and overseer, the board can, in good faith, play the role of advocate: marketing and selling the company to current and prospective employees, customers, and shareholders as a great place to work, buy and invest.

# The purpose of IT

The purpose of IT can be derived to a significant degree 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 operating 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. He also shares alternative contexts he considered, and explains why he feels the context he selected is the most effective context in which to have the conversation. 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 lesson here 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? The answer is the question.

It's a hard fact that when boards ask questions, they create work in the organization. The trick for boards is to know when to ask what questions to create a context for management doing work that produces long-term shareholder value. One such question is most simple: What's the purpose of this work? At American Standard, the Fortune 200 durable goods firm, a major IT project was failing. After nearly two years of effort and millions of dollars of expense, the "C" suite 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."

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# What is the role of management in fulfilling this purpose?

Management's role in achieving the purpose of IT needs to be divided into two categories: the role of line management, responsible for the primary activities of the firm; and the role of support management, responsible for enhancing the success of line management. Overall, line management is the customer of support management. At the same time, line and support are partners, working together on behalf of the shareholders. Management needs to ensure all work is done in the context of long-term shareholder value. It is helpful to use financial metrics that expose every IT project as either a creator or destroyer of shareholder value. Management teams that talk openly and honestly about destroying shareholder value tend to do it less than firms unwilling to speak in these terms.

It is also management's role to understand what technology is, and what it's not. Recent research established that technology causes neither success nor failure. Technology is mostly an accelerator of momentum. If the management system is designed to fail, technology enables it to fail faster. IT professionals should not agree to automate any line management process unless and until the IT function is convinced the process is:

- Necessary to the end goal
- Effectively designed
- Efficiently administered

Expertise in the disciplines of Six Sigma and Theory of Constraints are invaluable to IT professionals seeking to assure all work meets these standards. These disciplines provide the knowledge, skills, and abilities to design and implement IT capital investments projects that increase operating income by amounts greater than the cost of capital needed to fund the project. These disciplines help to:

- Expose and eliminate work that is a source of below average returns and competitive disadvantage
- Identify work that's a source of average returns and competitive parity
- Identify work that's a source of superior returns and both temporary and sustainable competitive advantages.

With work segmented into these four categories, IT is positioned to pass on destructive work in favor of work that creates long-term success: the alignment between strategy, culture, structure, systems, skills, beliefs, and behaviors; the pursuit of zero defects, zero lead times, and zero variability; all work done in the context of free cash flow.

# How can these roles be managed to be complementary?

The key to the board and management fulfilling the purpose of IT in a complementary way is to focus on their common ground: Protecting the assets of the shareholders; developing and implementing a winning strategy; behaving legally, ethically, and morally. In addition, management should view the board as a strategic asset and competitive advantage that can help them improve performance. This is a new and somewhat counter-intuitive view of the board-management relationship. By holding the board accountable for helping to exceed shareholder expectations, management will create a harmonious, shared-purpose relationship with its directors while honoring the distinctions between the role of the board and the role of management. This is interdependence at its best. This is the goal of IT governance inside the boardroom.

# About Mark Sickles

Mark W. Sickles is an advisor to boards of directors and top management teams. He is the author of *Shareholder Value Assurance — The Cure for Enronitis*, *The Mark W. Sickles Handbook for Well-Intended Boards and Directors*, plus numerous articles on achieving long-term shareholder value, including *Tool Kit for the Post-Enron Board*, published by the National Association of Corporate Directors (NACD). Mark has served as an adjunct professor and faculty member at The Singapore Institute of Management, American Management Association, and Rutgers University. He currently teaches his newly designed corporate governance certification course to boards and senior management teams at Drexel University's LeBow College of Business, where he serves on the Advisory Board of Inside the Boardroom and the Krall Center Board for Corporate and Executive Development. Mark has been a featured guest on television and radio talk shows as well as keynote speaker for business and professional organizations.

A founder of two businesses and former Fortune 500 officer and senior executive, Mark is also the founding President and CEO of the New Jersey Chapter of NACD ([www.nacdnj.org](http://www.nacdnj.org)). He serves on the Editorial Advisory Board of HR Innovator Magazine and Rutgers University's State Advisory Council. Mark formerly served on the board of Abington Health Care Corporation, and is an active member of Trestle Group's Board of Directors.

# About Trestle Group Research

Trestle Group Research is committed to providing thought-provoking research and practical insights into such topics as corporate strategies, regulatory issues and global trends in outsourcing. This research enables organizations to maximize benefits from outsourcing initiatives. Trestle Group Research is part of Trestle Group, an international management consultancy firm specialized in outsourcing. Trestle Group works with companies to help develop outsourcing strategies, locate the right location/service provider and support the implementation of the appropriate outsourcing model.



# TRESTLE GROUP

Trestle Group is an international firm providing services solely focused on global sourcing. Through our diverse and complementary set of services, clients benefit from support ranging from strategy through to implementation. Whether you are interested in setting up operations in Eastern Europe, outsourcing to India or ready to make the world a better place through our Foundation ([www.trestlegroupfoundation.org](http://www.trestlegroupfoundation.org)), Trestle Group is a solid partner. Experience Trestle Group today.

## Sourcing Lifecycle



## Trestle Group Value Proposition

### Focus

Trestle Group focuses entirely on IT and BPO sourcing. This emphasis provides clients with concentrated specialists that understand how to best design and implement sourcing strategies.

### Company

Trestle Group's current client portfolio and past project experience establishes a solid foundation of market knowledge, expertise, methodologies, and best practice experience.

### Experts

Trestle Group market experts bring professional personalities, first-hand market knowledge and innovative approaches to deliver solutions to complex sourcing challenges.

### Research

Trestle Group demonstrates thought leadership through market publications and remains current by following industry trends and peer research.

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