Designing Governance using VSM (Practitioner Paper)

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Abstract

In this paper, the authors look at the traditional model of governance and contrast it to governance as embodied in Beer's Viable System Model. They illustrate this by reference to three of their recent consultancy projects in designing governance structures and show how the VSM provided not just a useful and flexible design template, but also how it provided a variety of practical solutions to a range of different and specific governance issues.

Traditional and VSM governance models

Traditional approaches to governance are rooted in an hierarchical paradigm and focus on financial control. Even following recent high profile governance problems, the responses (Turnbull, Sarbannes Oxley, OFR) have been dominated by a reliance on tighter financial controls. There are several weaknesses to this approach. Traditional boards become bottlenecked with low level decisions as these decisions are escalated. Without effective co-ordination and control of change and innovation, the complex organisation will be at risk of failure, however well its finances are controlled.

A number of other commentators have pointed weaknesses to the traditional model. Lazonick & O'Sullivan (Lazonick & O'Sullivan 1998) recommended to the European Commission that corporate governance needed to be broadened to encompass issues around strategy and innovation - in other words governance needs to include the addressing the organisation's future, not simply internal control. In the UK, the OFR also referred to the need for a wider perspective on governance in its recent initiative on updating financial reporting, although this has now been abandoned by the Chancellor.

As Beer (Beer 1974, 1979, 1985) pointed out, to handle the sheer decision-making throughput required by a modern complex organisation requires a more sophisticated decision distribution governance framework. It requires one that allows those who are best placed to take decisions and one which can balance the need for adaptation and innovation with the need for financial control and cohesion. Beer's Viable System Model provides a rigorous framework that addresses these needs and has been used for designing governance structures for all levels of organisation (Hoverstadt & Bowling 2005).

Case 1 - Designing a governance structure to foster innovation in a virtual joint venture.

This project was carried out to support an IT service delivery company who were bidding to provide services to a large public sector organisation. The design of the governance structure was a critical component within the bid, an assessed part of the bid process and was seen as a key competitive differentiator. The design criteria were more complex than many such projects as the client organisation required the service delivery company to act as "a partner for change". The substance of this aspiration was twofold. Firstly, the client organisation employed many IT staff who would need to be comfortable engaging with any IT supplier for there to be seamless delivery, hence the need for partnership. Secondly, the client had not been successful in using ICT to significantly change its business processes, hence the need for a partner that could deliver change. This put two major constraints on the design - it had to allow staff from both the service delivery company and the client's own staff to work together on projects interchangeably, with staff from either organisation filling roles within teams on a "best qualified" basis, and secondly it had to foster innovation and change throughout the organisation.

The initial proposal of the client was to use a conventional structure, but with some shared membership of some governance bodies and boards. Their underlying paradigm was firmly rooted in the centralised control hierarchy tradition, with the client's role seen as control and with the pathway for innovation being a process of escalation to a high level for sanction. An analysis of this proposed structure threw up a number of problems all of which were familiar to both parties from other similar projects. Perhaps most significantly, it was possible to show how the separation of responsibility for delivery and decision making would create and foster a culture of mutual distrust not partnership and secondly to show that the proposed structure would inhibit innovation by creating a bottleneck for decision making.

The solution to the "partnership" element of the problem was to design the delivery organisation as a virtual joint venture. The governance was then designed as a joint structure with representatives from both organisations in each major decision making group. Using the VSM as a design tool made it very easy to identify what sort of decisions needed to be taken where and to understand how the boards and management groups related to one another to provide a coherent governance structure.

The solution to the "innovation" element of the problem was provided by the recursive structure of the VSM. The innovation network designed into

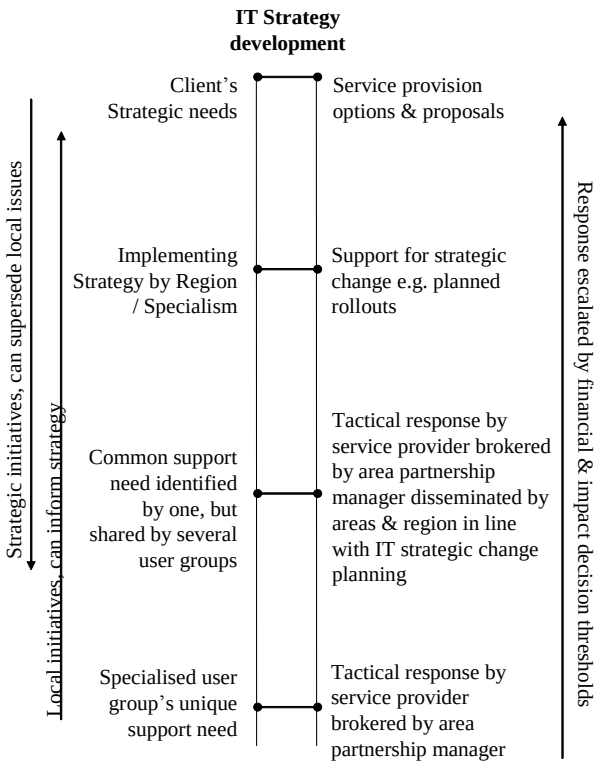

Figure 1 - Innovation Ladder

the governance structure was based on a set of interactions between VSM systems 3 & 4 at different levels of recursion. In practice this meant defined levels of autonomy and resourcing for development and innovation, backed up by a learning network. This network linked operations at different levels for sharing and standardising developments and to avoid duplication. This combined the need for innovation to happen at several levels with the need for the organisation as a whole to retain adequate control.

The design was seen as radical by both the client and the IT company, but was easily accepted by both. Partly this was because it was demonstrably a solution to their agreed needs and requirements, and it could easily be shown how the client's initial proposal would fail to do this. Partly it was because some easily understandable models and language were used to explain both the logic of the argument and the cybernetics of the problem. Typical of these models was the "innovation ladder" and hence "ladder governance" to describe the use of a recursive development structure which could enable development projects to be both initiated and resourced at several different levels of the joint organisation. This was in contrast to the client's escalation model which was described as a "bridge" with all change requests escalated to a single decision making body which would be swamped and would therefore act as a bottleneck stifling rather than fostering innovation.

Case Study 2 Designing Governance in a Probation Area to address the need for contestability.

The Cambridge Probation Area has recently initiated a strategic change programme. The new organisational design reflects both national and local requirements, but the main design driver is improved efficiency and effectiveness with built-in flexibility to cope with future changes in a time of ongoing national and regional change and wider environmental uncertainty.

One of the possible future changes for probation is the introduction of contestability. The new design separates interventions from offender management and is designed as a service delivery model with a clearly defined interface. Standardisation of this interface would protect the overall delivery from major impacts if either service provision or service procurement were to be changed organisationally. This change to a flexible structure was seen by the management team to be the low risk option compared with doing nothing or making minor changes to the existing inflexible structure. The new flexible organisational design was developed using VSM based modelling and facilitated workshops. The implementation of the new structure is still, however, a major undertaking, impacting in some way the jobs of practically all of the staff. To speed the implementation of joined-up working and issue resolution across the new structure, three Governance Ladders are proposed:

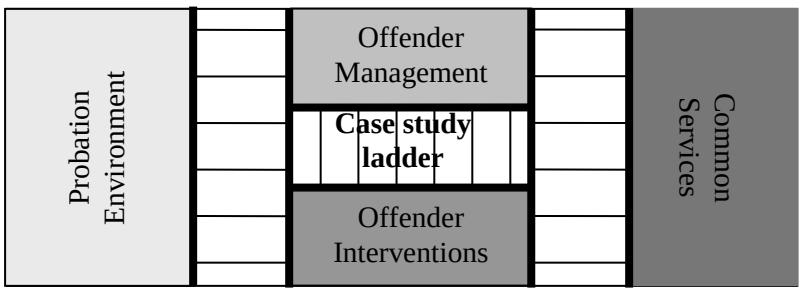

Figure 2 - The Probation Governance Ladders

This case study focuses on the ladder which joins Offender Management to Offender Interventions (see Figure 2 above). The governance ladder handles the spectrum of interworking from the board, to operational delivery. The overall purpose of the ladder is to enable swift, effective, consensual and informed management decision making and co-ordination across the new organisational divide. This is achieved by managers having explicit and agreed clarity about their authority to act within a well defined scope.

The specific objectives of the ladder are:

- To allow decisions to be taken at the most effective level in the organisation, balancing direct knowledge of the problem, solution impacts, resources and authority to resolve issues.
- To promote an effective join at all levels between the two management hierarchies and promote swift and consensual decision making.
- To document who collaborates with whom about what and to identify the authority to decide and implement resolutions to issues within explicit scopes.
- To ensure that the authorities implicit in the resource bargains in both organisations are co-ordinated across the join.

Supported by these three ladders, the organisation is now in place to encourage strategic and tactical organisational adaptation to environmental change and internal issue resolution by means of a fully integrated ongoing governance structure. (See Figure 3).

The probation organisation is focused on reducing re-offending behaviour by convicted offenders. This offender centric approach is implemented by a number of cross organisational virtual teams. e.g. a team centred on an offender, a team centred on a class of offending (an Offender Management Practice in Figure 3). These teams have members, for example, from courts, police, local services, outsourced intervention providers and individual citizens. The ladder relationships enable Offender

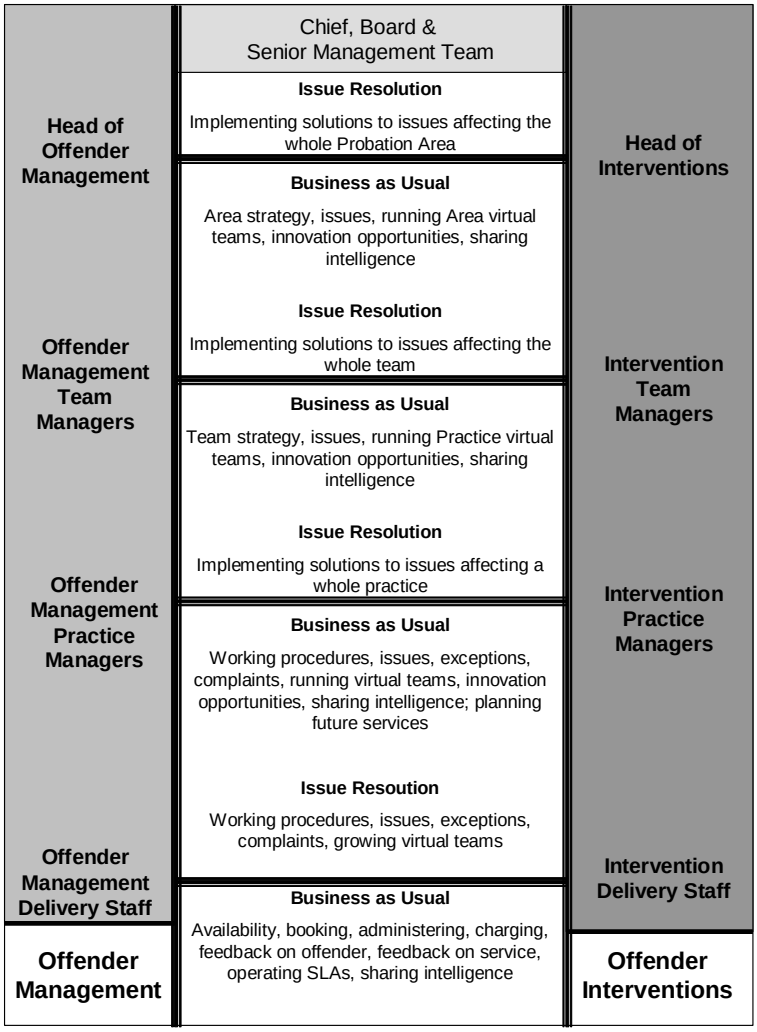

Figure 3 - The Offender Management – Interventions Governance Ladder

Management staff to form and operate these virtual teams as needed.

The ladders represent the overall framework of governance. The structure of the organisation (represented by the Area Chief and the uprights of the ladders), is controlled by a set of resource bargains, based initially on being able to deliver the expected demand for service across the "business as usual" component of the rungs of the ladders. This basic demand is driven from expected levels of offenders sentences, through offender management, where the wider needs of the offender are planned for, through to required interventions and then from both offender management and interventions to common services. This demand is matched for consistency up and down the three management hierarchies as sets of consistent resource bargains designed to implement the overall purposes, strategy and performance measures that the organisation is intent on achieving. The rungs of the ladder bolt together these resource bargains, based on business as usual. Then when problems occur, the issue resolution component of the rungs comes into play ensuring clarity on authorisation to implement a solution. This provides a consensual, joined up and responsive governance structure for resolving the many outstanding issues after such a significant change.

Case 3 - Designing a governance structure to manage growth and change in a small financial organisation

This was a project to help a credit union to continue to grow and chart a course through an uncertain future. Credit Unions are cooperatively owned charities run on a not for profit basis under cooperative ownership to provide financial services to their members. The union was in a deprived inner city area where conventional banks didn't operate and it had originally been set up by local people to offer an alternative to borrowing from loan sharks for emergencies and short term needs. The union had been very successful in displacing the loan sharks and consequently had grown in membership and turnover. It had been supported by a series of schemes from the local council as part of the council's plan for redevelopment of that area of the city.

The project to redesign the governance structure came from a growing recognition within the board that the union was facing an uncertain future, that it would need to take some complex decisions in the near future and that decision making with the current structure was slow and cumbersome. There was a political dimension to aspects of this perception, with a group of professional people on the board who saw themselves as "reformers" and another group who came into the organisation as members and volunteers, some of whom saw themselves as becoming increasingly disenfranchised from the decision making process. An unofficial part of the brief for the project from one quarter was that the board needed to be "slimmed down" from its current size of 14 members to produce a smaller and more cohesive body that could take decisions more quickly.

A constraint on the redesign of the governance structure was the regulatory framework which laid down some specific roles and relationships that needed to exist. These were rooted in a traditional financial control paradigm, but could all be accommodated in a design consistent with a cybernetic view with the exception of the requirement set for the supervisory committee which were widely seen as practically unachievable and which from a cybernetic viewpoint clearly were inconsistent with Ashby's Law (Ashby 1956). One problem that the regulatory framework had created for good governance was that it had concentrated attention on financial control and the short term, and away from critical environmental factors and the longer-term future. Using Ashby's law and the VSM to design the governance structure gave a very different conclusion to the suggestion to "slim down" the board. Instead the picture that emerged was of a governance structure that needed the capacity to take

more decisions about more issues that were deeply interconnected. These included: a need to find an alternative to reducing financial support from the City Council, an option to expand geographically, a need for a wider range of financial products, a need to keep abreast of changing demographics and of course a growing weight of regulation. In this context, the resource and breadth of experience and skills embodied in the large board and wider governance structure became an essential asset as a source of variety management capacity rather than a hindrance. With the existing structure however, this capacity was redundant and did in fact slow down decision making. The design solution was to use the principles within VSM and Syntegration (Beer 1994) to design a set of interconnected teams and committees.

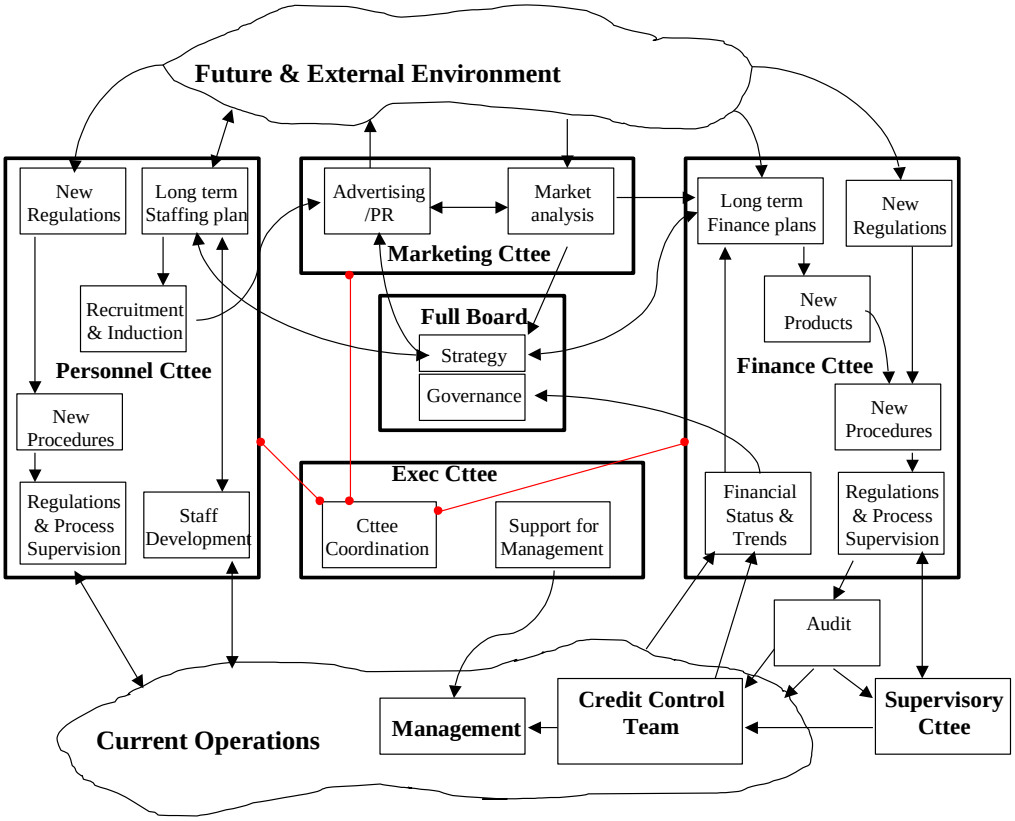

Figure 4 – Revised governance structure

This split the large unwieldy board up so that its members could work on several different problems at the same time in parallel in three functionally differentiated committees. These were in turn co-ordinated both by some shared membership and by an "executive committee" made up of the three Committee chairs and the board chair. The committees had executive decision making authority and also referred recommendations with wider strategic implications to the full board.

The Finance Committee had roles that mapped onto both systems 3 & 4 of the VSM and also managed the financial elements of 3* through both external audit and its own Supervisory Committee which was required by the regulator to perform this role. Finance's system 4 role included both long term financial planning, scanning for and anticipating the impact of new regulations and developing new financial products for customers. Its System 3 responsibilities were to ensure financial control, performance management and adherence to regulations and controlled processes. The Personnel &

Development Committee also had roles within both systems 3 & 4, whilst the Marketing Committee was exclusively focused on a system 4 role. The new structure was accepted and put into effect by the Union and has been effective in planning its future and growth.

Conclusion

These three cases highlight the practical limitations of the traditional approach to governance based in the financial control and command hierarchy paradigm. In particular, they show the problems the traditional approach has in constraining rather than enabling change and adaptation to new markets, technological futures and possibilities.

In each of these cases, the VSM, rooted in a paradigm that views governance as needing to balance control with adaptation provided a practical model for quickly developing governance structures that directly addressed organisations' specific needs and circumstances.

Given that the new forms of governance produced were in each case seen as radical, it is particularly significant that in each case, the management teams involved were able not only to see how the recommendations would address their issues in theory, but were also in each case able to quickly take ownership of the new model. In part this was due to the clear relevance of the design recommended to their particular circumstances, but it was also because conceptual cybernetic models were translated into more easily understandable forms, models and metaphors which managers could relatively easily grasp and start to use. We believe that this "de-jargonising" of management science played a key role.

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