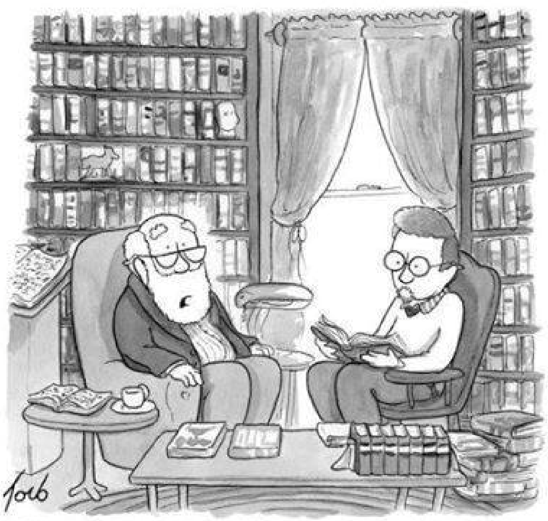
The origins of governance


"Those who don't study history are doomed to repeat it. Yet those who *do* study history are doomed to stand by helplessly while everyone else repeats it."

There has been quite a lot written over the last few months on governance (not the least by me[1]) including the publication of *ISO 21505 Project, Programme And Portfolio Management - Guidance On Governance* in 2017.

However, whilst a lot is written about governance, the appreciation of what governance is varies. The definitions of the terms are:

Governance (noun) is the action or manner of governing a state or organisation. It is a term closely associated with the concepts of ruling and controlling.

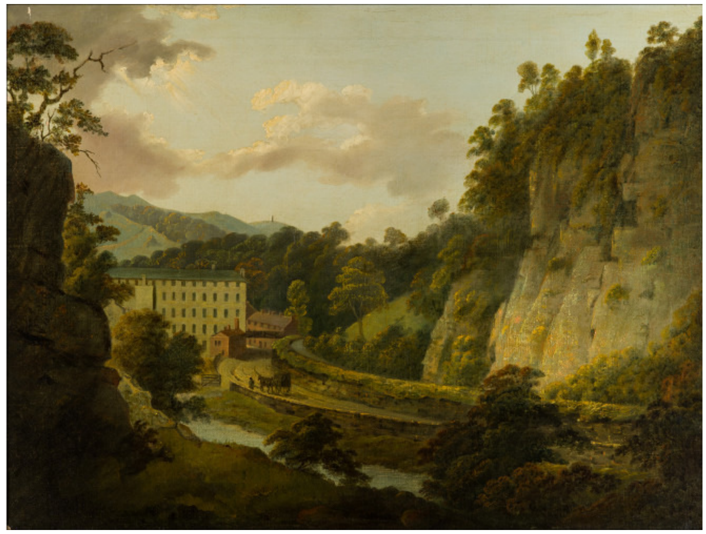
The verb is **govern**; to conduct the policy, actions, and affairs of (a state, organisation, or people) with authority, by using and regulating influence to direct and control the actions and affairs of others.

Governing bodies govern; the governing body is the group of people (or an individual) appointed or elected to govern a country or organisation.

For most of history States were a monolithic entity ruled by a Monarch, Emperor or Pharaoh; the ruler's power to govern being nearly absolute, and implemented through the direct and personal allegiances of various officials who literally risked their lives if they lost the trust of the ruler. There were exceptions, including the Athenian democracy and the Roman Republic where the power of the state was held by a select group but the 'business of state' was still undertaken by appointed individuals.

The transition from individual responsibility to organisational responsibility started in the 11th and 12th centuries, becoming relatively common by the 15th century. For example, the British East India Company was granted a Royal Charter by Elizabeth I on 31st December 1600. These 'chartered companies' were owned by investors (who owned and traded shares in the organisation) and were run by managers or proprietors. As with any 'new opportunity' the temptation to make money quickly attracted unsavoury operators, In 1697, Daniel Defoe (author of Robinson Crusoe) published: An essay upon projects; in which he discusses the Projectors (in today's language entrepreneurs) responsible for raising funds for their pet projects, in less than flattering terms: 'A mere projector, then, is a contemptible thing, driven by his own desperate fortune to such a strait that he must …… paint up some bauble or other, as players make puppets talk big, to show like a strange thing, and then cry it up for a new invention, gets a patent for it, divides it into shares, and they must be sold'; he held similar views of bankers and financiers……

[1] For more papers on ***governance*** see: https://mosaicprojects.com.au/PMKI-ORG-005.php


Arkwright's Cotton Mills, by Day

Speculation and unbounded opportunism, not to mention outright criminality are neither 'good for business' nor good for the governance of the State; particularly as the private sector began to fulfil more of the State's public obligations (eg, the construction of canals). However, introducing a regulatory framework was a slow process; most of the people responsible for creating the organisations that drove the industrial revolution were individual entrepreneurs who created their personal companies and who prospered or ended up bankrupt depending on its success or failure; some of the more successful entrepreneurs include:

- Josiah Wedgwood; pottery (1759).
- Richard Arkwright; cotton mills (1769).
- Matthew Boulton; steam engines (1775).

It was not until 1844 the British Parliament introduced the first *Joint Stock Companies Act* which introduced the registration and incorporation of companies making investing in shares a safer option. This was followed by the *Joint Stock Companies Act of 1856* which provided limited liability for all joint-stock companies (where the liability of investors in the event of the company failing is limited to their investment); and in the landmark 1897 case of *Salomon v A Salomon & Co Ltd* the House of Lords established that a company with legal liability, had a distinct legal personality, separate from that of its individual shareholders.

These Acts and Judgements laid the foundations for the emergence of Great Britain as the dominant world power in the 19th and early 20th centuries (and were copied world-wide). However, the challenge they created was the invention of the 'corporation' as a legal entity (effectively a 'virtual person') but one that is incapable of acting or thinking for itself, the corporation has to be directed by a 'governing body', the Board of Directors.

Overlay the concept of a corporation whose owners only have limited liability with the problem of regulations, which can only be enforced after a breach has occurred (you cannot prosecute someone for something they 'may do' in the future) and the need for some additional governance mechanisms becomes apparent. This need led the evolution of *corporate governance* towards the political, theoretical, and practical base we see today. Various codes of corporate governance provide a way of understanding the intentions of the 'governing body' of an organisation and suggest how the 'governing body' will behave in advance of issues occurring.

But again, change was slow in coming; the two seminal definitions of corporate governance were not developed for another 150 years:

1. Sir Adrian Cadbury (1992): *Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the*

leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship.

2. OECD (2004 p.11): *Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring.*

Based on these foundations, corporate governance has become widely accepted as an essential practice which the 'governing body' must understand and apply to achieve accountability and performance in the organisation they are governing[2]. And the wheel has turned full circle. In parallel with the increasing complexity of the private sector, the management of the business of government has become increasingly complex and devolved, leading to the need for *'organisational governance'* within the various government departments and within other NGO and 'not-for-profit' organisations that provide services to the population living within the State. Corporate governance is evolving into a more general concept of organisational governance.

There is also an emerging trend that recognises specialist areas of an organisation require specialist governance as a sub-set of the overall organisational governance system, this currently includes:

- The governance of Information and Communication Technology[3], and
- The governance of project, program and portfolio management[4].

However, the fundamental principles of governance remain unaltered;

1. You can only govern a 'legal entity' a Nation, State, corporation or other definable organisation.
2. Governance is the responsibility of the person or group responsible for governing the organisation, the 'governing body', in ancient times 'the Ruler'.
3. The governing body uses its legitimate authority and power to govern the organisation by regulating influence and directing and controlling the actions and affairs of the managers and other people working or living within the entity.
4. The governing body has obligations and duties to the owners or beneficiaries of the entity, the society in which the entity operates and the people being governed.
5. The functions of the 'governing body' are :
   - Determining the objectives of the entity
   - Determining the ethics of the entity
   - Creating the culture of the entity
   - Designing and implementing the governance framework for the entity
   - Ensuring accountability by management and others
   - Ensuring compliance by the entity.

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2 For more on the ***functions of governance*** see: https://mosaicprojects.com.au/WhitePapers/WP1096_Six_Functions_Governance.pdf

3 See ***ISO/IEC 38500:2015 Information technology -- Governance of IT for the organization***

4 See ***ISO 21505:2017 Project, Programme And Portfolio Management - Guidance On Governance***

In summary, this means a 'governing body' can only govern the people within the defined boundaries of the State or organisation under its control. It is not possible to govern external entities, or intangible concepts such as 'contracts' or relationships. And the purpose of governance is to ensure the entity serves the needs of its stakeholders.

The difference between the malfeasance described by Defoe in his 1697 essay and the modern day scandals such as the 'global financial crisis', and a string of other financial misdeeds is not the damage they cause to the individuals who lose their savings, rather with the emergence of a general appreciation of 'good governance' the modern day contemptible things driven by their own desperate fortune at least suffer from a general backlash from society and more often can be prosecuted by the States 'governing authorities' for a range of specific misdeeds.

Good governance is good business; we just need more of it!

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