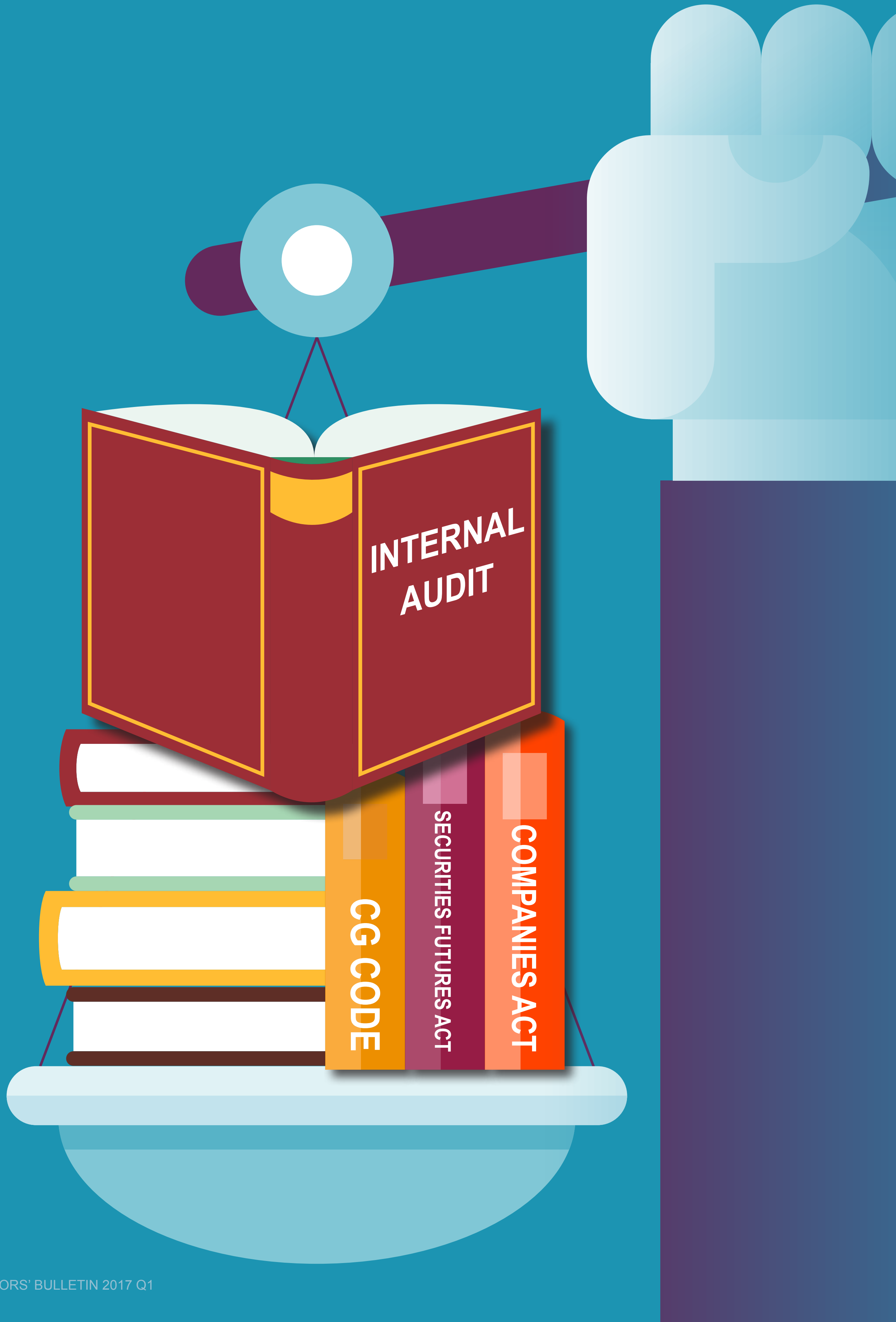
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CONFORMANCE BEGETS PERFORMANCE

By
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Compliance is a prerequisite to sustainable performance. But what can boards do about the compliance-performance tension that continues to put pressure on employees' performance and behaviours, and the company's bottom line?

Most companies place top priority on conformance to rules, regulations, policies and standards from a governance standpoint.

However, the message of zero tolerance for non-compliance can be diluted, or worse, whitewashed as compliance is regarded as a burdensome constraint on performance and growth. Even top leadership can falter in this area, as the recent example of Volkswagen in its aggressive push for financial growth showed.

This compliance-performance tension will only continue to be exacerbated by increasing global competition, closer regulatory scrutiny over businesses, and thickening compliance rulebooks over time.

It may come as no surprise then that the annual survey by North Carolina State University and Protiviti, *Executive Perspectives on Top Risks for 2016* shows that board members and C-suite executives rank regulatory change as the top overall risk for the fourth consecutive year.

Is compliance really such a big burden that it hinders the performance of companies?

The compliance-performance tension

Do rainbows appear on a bright and sunny day? On the contrary, we see rainbows only after the rain.

Similarly, we should expect sustainable superior performance to be possible only from a robust

Turning the Compliance-Performance Tension into a Reinforcing Force

Set strategic direction and priorities

The board should regularly review corporate strategies and capabilities to ensure their relevance at the forefront of competition. A McKinsey study (Bhagat and Kehoe, "High performing boards: What's on their agenda?", *McKinsey Quarterly*, April 2014) found that high-performing boards devote more time to strategy, spending on average eight more days in one year than other boards.

They also commit a lot more time thrashing out issues in board meetings, which averages 40 days a year. Each board member must have a voice to speak his or her mind candidly and freely. Only through honest deliberations can superior decisions be made.

As resources are scarce, the board should also bring clarity to key priorities in pursuing the identified strategic goals. What can be compromised and what cannot? What are the risk tolerances for the various risks? The board needs to ensure that the top management has communicated these strategic goals and key priorities effectively down the management line.

Align processes and outcomes

When staff and personnel operate under severe resource constraints to achieve high performance targets, they could end up potentially breaching safety thresholds or engaging in fraudulent behaviour to fudge the numbers to meet the performance targets.

The board should evaluate whether top management has provided adequate resources to support employees' efforts in delivering results commensurate with the targeted level of performance. It should ask questions such as: Is there adequate headcount, funding, training and technological know-how provided? Has the company built a robust system to produce the expected results? Do the performance numbers make sense in light of company developments and wider economic environment?

Align incentives

The board should also review key management incentive schemes to consider if they promote the right behaviour.

The board should always seek to anticipate and address any unintended consequences of incentive schemes. Incentive schemes should align individual and organisational goals. The performance targets should be realistic and achievable with reasonable efforts. Incentives should be both carrots (to promote good behaviour) and sticks (to penalise and correct wrong ones).

Keep in touch with ground zero reality

The board needs to be updated on what is happening on the ground. It should ensure direct channels of communication to facilitate the early detection of problems while being sensitive to cultural and other barriers that will hinder employees from whistleblowing or communicating upward.

As it does so, it should learn from past governance failures where boards are either unaware, or fail to act even when they are aware, of non-compliances such as when employees are pressured to achieve unrealistic performance targets without appropriate resources.

yet nimble system which is in touch with volatile market developments to deliver what customers want better than competition.

In other words, we expect superior performance only from a system that could weather any storm the business world throws at it. We cannot be really good at what we do if we do not play a fair game – just as the world now knows that Lance Armstrong and Maria Sharapova's prowess in the sports arena are not what we thought they were.

It is therefore crucial for the board to send a clear message across to the management which, in turn, needs to ensure that all employees understand this one simple truth: the company needs to truly deliver its promised value propositions. Even as compliance sets boundaries on what could be done in the pursuit of profits, it also forces the staff to train harder and smarter – without "steroids" or trickeries – to keep them focused on what that will strengthen and better the company and to produce results aligned with the goals.

Compliance boundaries cannot be crossed given how fragile trust is; once shattered, it is extremely difficult to salvage. A company is either trusted, or not. In short, high-performing boards view strong compliance as a critical component to build a solid foundation and discipline essential for pursuing higher performance objectives. Empirical evidence from studies shows that companies strong in ethical compliance derive superior financial performance.

Compliance and sustainable performance are therefore interlinked and mutually reinforcing. One cannot exist without the other.

Reinforcing the compliance-performance relationship

The reinforcing relationship of compliance and performance does not come naturally and must be worked on by the board.

While it might be easy for the board to set clear boundaries and emphasise the reinforcing relationship between compliance and performance at the conceptual and strategic levels, the reality remains that executing and achieving both objectives is challenging at both the management and operational levels.

How then can the board provide support to ensure that the compliance-performance tension does not become the company's Achilles heel? What are the elements essential to relieve the compliance-performance tension so as to support a high performing organisation, enabling it to play a hard and fair game?

The pointers in the box "Turning the Compliance-Performance Tension into a Reinforcing Force", set out some actions that boards can take.

Most of all, to transform the compliance-performance tension into a reinforcing force, it is imperative for the board to embed a culture that promotes responsible risk-taking that not only meets but also surpasses compliance objectives to fulfil fundamental ethical principles and responsibilities.

Apart from ensuring compliance, a high-functioning board is one that has a clear strategic focus, is diverse in composition, committed in both attitude and time availability, and open to dissenting views and honest discussions in tackling problems to push the company to greater heights.

Just as we can see a full circle rainbow from the sky under the right conditions, the board that focuses on compliance-performance as a reinforcing force, should be able to achieve sustainable and high performance built on a solid foundation of compliance and ethical principles. ■

PERFORMANCE TRUMPS CONFORMANCE

By
WILSON CHEW
Author, *Differentiation: How to win in a disruptive market*

The role of the board is to ensure its long term success, meaning that the company must perform. Conformance is hygiene and a matter of course. Performance is critical and can be achieved by developing and executing on a good strategy.

It is recognised that the role of the board is to take charge of the company and lead it from the top.

In so doing, its broad remit is to steer the company towards long term success. Executing this responsibility involves two broad areas: conformance and performance.

Conformance versus performance

Conformance is essentially about ensuring that the company meets its requirements in terms of legislation, accepted practices, rules, regulations and standards. These systems of checks and balances see to it that the company stands upright when accounting for its deeds.

Performance on the other hand is to do with ensuring that a company fares well as a result of the sum of the board decisions.

Many argue that conformance structures in a company contribute to its performance. Equally, there can be no success for a company without performance. As the chairman of a billion-dollar listed company once remarked to me, “If you don’t make money, what is there to safeguard?”

Rightly so, how a company is fundamentally organised drives performance because shareholders elect the board who, in turn, appoints management to run the company in the interests of shareholders. Annually, the board accounts to its shareholders how the company has performed.

It is no wonder therefore as to why boards are generally more obsessed with performance. In fact, according to SID’s *2015 Singapore Board*