THE Association AGENDA
PUBLISHED BY THE CANADIAN SOCIETY OF ASSOCIATION EXECUTIVES
Editor Bob Hamp Email b.hamp@csae.com

May 31, 2004 www.csae.com

Will Sarbanes-Oxley Kill Innovation?

If there's one issue on every association's agenda in 2004, it has to be governance.

One way or another, your members are clamoring for information on the topic, whether that includes hearing from governance experts at your annual conference, articles and coverage in your publications, or special meetings focused strictly on the unique and challenging governance issues of the time.

Much of the blame for this focus is a result of the ongoing hangover from corporate scandals involving Enron, Worldcom and others. And certainly, the biggest impact has been on US-publicly traded companies, who are subject to the many requirements of the Sarbanes-Oxley legislation. While the Act (SOX) currently applies to American private companies, there are many who believe that it, or something like it, will be imposed upon the not-for-profit sector in the U.S.

Yet one must wonder if this intense focus on governance and compliance is causing many organizations to throw the innovation baby out with the bathwater.

Through the years, you and your members have invested heavily in creativity and innovation. You've recognized that every organization needs to think and act differently to survive and thrive during a time in which change is relentless, ongoing, and dramatic. Through intense efforts at both the association and corporate level, you've managed to get people and organizations to become far more innovative, thus ensuring they can change at the pace the future demands of them.

Yet we might now be witnessing the annihilation of those efforts as a culture of compliance comes to the forefront and dominates the agenda.

The warning comes from no less than famed economist Milton Friedman. In a recent Investors' Business Daily interview, he commented that "everything you hear, from Sarbanes Oxley to CEOs is 'for God's sake, don't take any risks - don't take a chance." If that view really prevails, it would put a sure stop to growth and development."

If we lose our ability to take risks because we're so focused on governance and compliance issues, we might as well forget about our ability to innovate.

I dare not suggest that we should ignore efforts at cleaning up the business world. Certainly, the scandals suggest that something had to be done. But my fear is that we are now stifling the very culture which has permitted so many organizations to succeed through innovation.

One reason is simply the amount of time devoted to governance and compliance issues. Efforts in the corporate sector to deal with Sarbanes-Oxley are intensive and increasing daily. The most significant efforts now involve Section 404, a part of the act requiring management to assess the effectiveness of internal controls and financial reporting procedures, and to report upon these within the annual financial statements.

Originally subject to a June 15 deadline, the effort has proven to be of such magnitude that the deadline has already been pushed back to allow more time for compliance.

How big an effort does compliance involve? Considering that just a few months ago most companies reported they were only starting to make progress with Section 404 requirements, it's now obvious they've got a long way to go. And when you realize that Financial Executive magazine recently noted that in 2003 US public companies had spent over $1 billion on Sarbanes-Oxley related compliance, without even dealing with Section 404, you can see that the current effort is huge in scope.

Simply put, big money is pouring into compliance. It must be taken from somewhere - perhaps, from projects and efforts involving innovation.

The second big issue is that a culture focused on compliance can destroy a culture of risk-taking that has taken hold in many organizations through the years. A culture of risk is critical to innovation - without it, people will not try to step outside of the box.

Without risk, there's no innovation. Without the ability to make mistakes, and be rewarded for failure, no one will try anything new. And it seems to some that the intense focus on governance will result in just such cultural destruction. Recently, several bank CEOs raised an alarm about the impact of SOX, noting that it could be getting in the way of a board's ability to focus on risk-taking and long term value creation. If we destroy the ability for risk and innovation at the board level, it will disappear from the rest of the organization, too.

Third, SOX and other governance requirements can encourage a corporate "ticking-and-bopping mentality" that does little to support transformation of business processes. And that's a key point -- innovation isn't just about developing new product, it's about constantly redefining and changing business processes to save money, become more efficient, and to encourage more open collaboration amongst everyone in the organization.

Michael Hammer, in a recent Harvard Business Review article, coined the phase "operational innovation", outlining that many companies can benefit from fresh thinking in this regard. Yet here's the rub - as companies struggle to deal with Section 404 of Sarbanes Oxley, they're actually doing little to provide for innovation within their operations.

Indeed, in their rush to meet the deadline, many organizations are doing little more than documenting their internal controls and procedures in Word and Excel files. Sure, they are doing what's necessary to comply, but what is suffering is a missed opportunity to re-engineer and change internal business processes so organizations run leaner.

That's why Deloitte & Touche is now actively encouraging clients to realize that SOX shouldn't be just about compliance, but should be viewed as a springboard for operational transformation.

SOX and governance can result in a change in corporate culture; from one that is forward-thinking and innovation oriented, to one that is far too focused on compliance and governance. SOX brings us to an era of accountant-supremacy - a time when success is measured by the fact that all the paperwork has been properly completed, rather than a time in which the organization asks itself whether it can do things differently by doing things better.

There's nothing wrong with the roles accountants play in an organization - indeed, I'm a professional accountant, honored by my profession years ago by being recognized as an FCA. I just happen to think that an accounting mentality, if not properly managed, can lead to a culture in which the accuracy of the paperwork becomes the most important goal. In such an environment, creativity and innovation can take a back seat.

Last but not least, SOX is taking away precious management time. If we live in a world in which a tremendous amount of executive talent is spent in preparing for, and responding to, audits instead of concentrating on making money or improving services, then over time, the organization will suffer.

It really comes down to whether we want senior executives to provide leadership or management. Dean Kamen, perhaps one of the leading innovators of our times, offered up food for thought at a conference on innovation last week, "What's the opposite of innovation? Management. Management is about making things come out the same. Projects require management. Innovation requires leadership. You can't manage people, creativity or ideas. You can give them leadership, however."

The alarm bells are now ringing. Certainly, something needed to be done to restore investor confidence in the wake of scandal. But even the Wall Street Journal is worried about where SOX is taking us. In their editorial, "Sarbanes-Oxley: Is the Price Too High?", they noted, "American standards of corporate governance should not become the enemy of economic performance."

What does all this have to do with association executives? You play a role in helping to successfully drive your members into the future and providing the insight and direction needed to deal with a world of change.

As you go forward with your future plans and strategies, provide your members with the background by which they can successfully serve as managers and leaders at the same time. In other words, help them understand the impact of Sarbanes Oxley and all the other governance issues they're beginning to feel impacts from, but also provide the insight and guidance to help them retain the innovative culture they've worked so hard to achieve.

**Sarbanes-Oxley Act (2002) - U.S. States may apply the American Competitiveness and Corporate Accountability Act to not-for-profit corporations. The requirements for audits, ethics, documentation and management affirmation may be a model for associations to follow, whether or not it is yet official.*

Jim Carroll, FCA, spends his time providing his insight into issues of the future, trends, innovation and change. You can contact him at jcarroll@jimcarroll.com, and learn more about his presentations at www.jimcarroll.com

csae | scda™

CANADIAN SOCIETY OF ASSOCIATION EXECUTIVES
SOCIÉTÉ CANADIENNE DES DIRECTEURS D'ASSOCIATION