

# Six Sigma: A Healthy Compliance Regime for Corporate Governance

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## Abstract

Companies that have adopted a 6-Sigma model for continuous improvement of their key business and management processes will find that they already have in place important components for a compliance regime such as the Sarbanes Oxley Act of 2002. They will have the culture and systems for identifying and defining compliance risks, the methods and systems for maturing them through a rigorous review process, and the ability to analyse and put processes under control.

Publicly traded companies that are reviewing their current business practices in the context of compliance to governance standards and laws find little comfort in knowing that achieving and retaining excellence in governance is not a one time event but a continuous monitoring and improvement regimen. Retooling the core values, culture, and operations to ensure the level of internal trust, and the trust of investors supported by auditable reporting processes will be expensive. Costs are expected to be more than \$4 to \$10M to place and retain such a regime.

These changes and increased scrutiny of management comes at a time when companies are all trying to increase their global presence. Their markets are dispersed, research, development, and production operations are also globally dispersed, and there is little correlation geographically. Successful CXOs are finding out that geography is history, distance is defined by time, and business events and decisions are the bridge between history and future. Success is now dependant on managing global events in real-time, by running a fine tuned business network through which knowledge, decisions, and processes flow naturally and without additional management overhead.

This environment has motivated companies to increasingly look at continuous process-improvement models such as 6-Sigma to unify their company. Led by stalwarts like Jack Welch, Larry Bossidy, Jim McNerney and their GE legacy, 6-Sigma has proven itself as a game-changing, culture-changing, result-delivering method with legs for adoption and growth unlike predecessor fads.

The value of the DMAIC (define-measure-analyse-improve-control) closed-loop control system is exactly the same principle mandated by the Sarbanes-Oxley (SOX) Act, although the act itself is silent on the necessary methodologies. SOX was enacted to reign in corporate management and their unhealthy and borderline incestuous relationship with their audit firms. This article explores the characteristics of a closed-loop control system for management processes, and attempts to show that 6-Sigma commitment is a simple path to good governance and leveraging a new culture to corporate and stockholder benefit.

### ***A common sense look: What is driving global companies today?***

Consider some interesting trends being visited on global companies:

- a) Globalization is here to stay, and most companies will need to do business globally, access global resources, and sell to global markets.
- b) Companies must increasingly embrace diversity within their corporate culture. Diversity impacts how business is done and how business communicates. Communication, knowledge transfer and decision-like transactions will occur in a boundary-less environment
- c) Competitiveness is not just “nice to have” - it is now essential for survival
- d) Compliance is not an option. Jail is the alternative to material non-disclosure or lack of control mechanisms.
- e) Company officers can face serious personal and legal liability for ignoring obscure foreign laws in countries where they do business.
- f) Tracking decisions, their complexity, and their inter-relationships with issues, risks, mitigations, actions, and other decision-oriented artifacts are all critical for compliance management.
- g) “Continuous improvement” will be the watch phrase. The core management team will be forced to think through all implications of every control and the associated costs. These analytics will apply to every aspect of a global business.

Companies committing to 6-Sigma, CMM, ISO and other maturity models do so in order to deliver continuous improvements to core technical, operations, and management processes. Manufacturing firms may improve processes related to supply chain or their manufacturing techniques, while management teams may improve sales and forecasting processes. The ultimate goal is improved predictability and a failure rate of less than a few parts per million – a failure rate outside the 6-Sigma limits of the distribution. The obvious benefits are cost reductions and improvements in profitability, in addition to strategic benefits from better competitiveness. But, there are many more important opportunities companies can pursue, because in addition to core operating processes, other processes that can be matured through 6-Sigma are:

- Developing people and expertise – e.g. training and developing a cadre of green belts, black belts, and master black belts
- Improving analysis and self-assessment of processes for gaps in control and risk analysis
- Improving business intelligence gathering, knowledge delivery, and decision making & tracking
- Improving compliance to applicable laws, corporate policies and rules, and ethical standards.

The DMAIC process shown in Figure 1 tracks 6-Sigma opportunities through the define phase, where the opportunity is defined (D) and developed. This is followed by the (M) measurement phase, where baseline performance to the KPIs (Key Performance Indicators) is measured. The analysis (A) stage is where the Black Belts, with the help of the Master BB, develop problem- analysis, performance models and simulations. In the (I) improve stage process, changes are implemented, and the process under control is matured. The (C) control phase is the long term monitoring and assurance that the original KPIs, and the delivered outputs, are falling within 6-Sigma limits of the post -improvement environment.

A cadre of belts (Green Belts, Black Belts, and Master Black Belts) is responsible, along with the project team, for developing and moving opportunities through the DMAIC funnel. Project teams and belts work with the toll-gate reviewers and they gain expertise in problem solving and statistical analysis, while developing black-belt and master-black-belt skills. Figure 2 shows how people, their expertise, and skills are matured during execution of closed-loop management controls.

Figure 1: A typical DMAIC toll gated funnel process following an idea generation and qualification process that streams viable projects into the 6-Sigma stream.

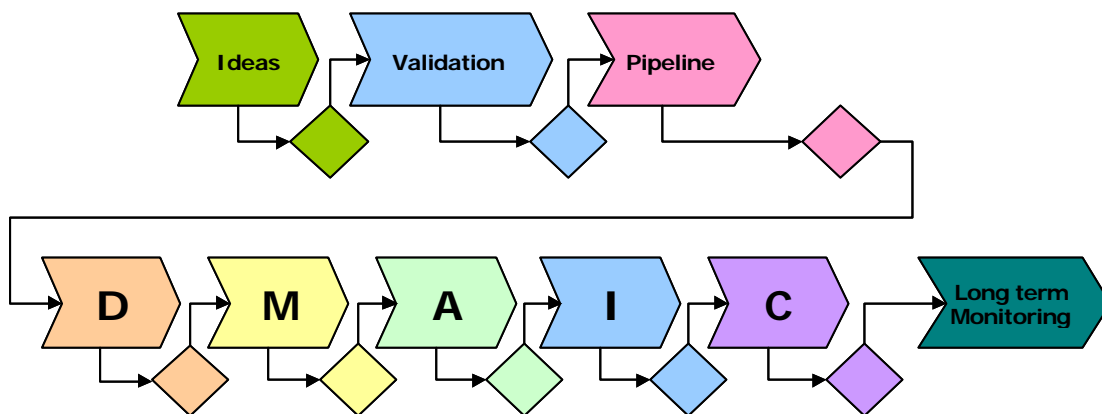
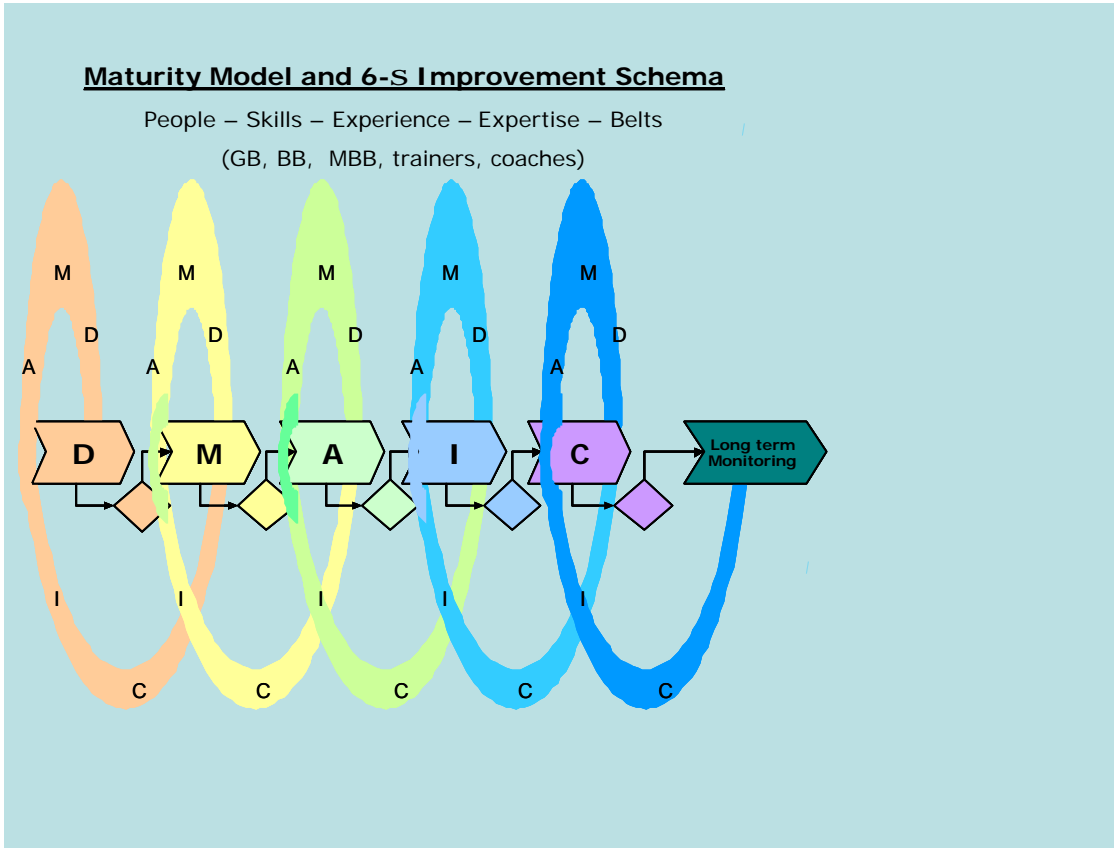


Figure 2: A typical DMAIC toll gated funnel process following an idea generation and qualification process that streams viable projects



Beyond the clear value of bringing a substantially higher level of understanding of company processes, maturation models like 6-Sigma also create a powerful environment for growing expertise and skills in disparate areas. These include team leadership, thought leadership, deep analytical skills in eclectic disciplines, and working with a globally diverse cultural workforce.

So, Figure 2 really depicts the continuous growth and maturation of the most important asset of a company – the knowledge worker and his [to hell with politically correct!] ability to lead and mentor a global organisation even as it conducts the daily business of creating excellent products, at lower costs, to get more customers and to keep them satisfied.

Compliance, and Sarbanes-Oxley for companies publicly listed in the US under the SEC's scrutiny, is forcing management to think about governance and their stewardship.

Professions have always prized a code of conduct that exalts the highest standards of ethical behavior and tradition. Doctors, plumbers, and even lawyers have their codes. Now, management of public corporations have an enacted law, H.R. 3763 the Sarbanes-Oxley Act of 2002, that gives them three clear alternate paths to chose from

- a) Work hard to find loopholes, and look for new ways to game the system and tinker with financial engineering by exploiting gaps in US and international law. These companies, are like gamblers who do not realise the odds favor the house – or in this case, shareholders and taxpayers – and they will lose in the long term. These managers are not interested in compliance at any level – spirit, intent, or letter of the law. Like the recent film their attitude is one of “Catch me if you can” arrogance.
- b) Do the minimum—watch and follow others—while minimising the costs associated with compliance. These companies may have managers who can cope with mounting external pressures, but lack leadership. Since compliance is a net cost , they will apply a compliance regime based mainly upon audits and reporting, using a “prison guard with a rubber stamp” attitude. These companies try to comply by meeting the letter of the law, using an expensive army of public accountants and lawyers.
- c) The third and optimal alternative is to leverage the need for compliance into a pervasive infrastructure and culture that seeks constant opportunities to improve, risks to mitigate, and then to innovative ideas into achievable distinguished by solid analytical skills and rigor. These companies will not only comply in spirit and intent, but in letter as well. They will go beyond compliance, achieving significantly better return on investment as they become more competitively agile and now-automatically aware of their business environment.

The rest of 2004 and early next year prove the superiority of alternative “c” above.

## **Why Compliance and Governance call for similar control regimes as 6Sigma Maturity Models**

6-Sigma is just a smart way to do business. SOX compliance and re-engineering a company to adopt clean, ethical governance is just smart business. The underlying control regimes required for both models are remarkable for their similarity.

<b>6-Sigma</b>	<b>SOX Compliance</b>
Will succeed only with honest unstinting management and commitment.	Will succeed only with honest unstinting management and commitment.
Requires frequent and focused re-visits and work-shops and training from mentors such as BB and MBB	Requires frequent and focused re-visits and work-shops and training from mentors
Requires closed loop control – observe-orient-decide-act	Requires closed loop control – observe-orient-decide-act
Identify and Define opportunities for improvement that can be measured	Identify risks in management decision making and financial reporting processes
Analyse opportunities and related processes with analytical and statistical techniques to quantify status quo and ex-post improvement	Analyse risks and modes in which these risks can be realised. Primary and consequential effects of such events are analyzed and control models to counter them are considered.
Implement improved processes or design ideas and test the improvement hypothesis	Implement the new or modified controls and test for risk mitigation. Report changes to the compliance regime and the external stakeholders and the Commission.
Control the process or design to ensure that the output deviation is within 6-Sigma limits. Continue to measure and improve to maintain 6-Sigma or better.	Ensure the controls are functioning and test the management decision making and reporting chain for gaps using audits and indirect indicators.

Consider these propositions if you are a CXO leading a publicly traded company today:

- If your activities in a remote part of the world affect the shareholder's value—and they are not disclosed—you can bet your company and its management will be prosecuted. In other words, Sarbanes-Oxley is a borderless projection of the highest standards of corporate governance on US-based publicly traded companies, and all companies will be affected globally, one way or another.
- There can be, and there should be, a positive return on investment for implementing a compliance regime. By itself, the costs of 404 assessments, disclosure and reporting, and record keeping can be staggering (\$4-10Million in the low end). When treated as an integral part of a corporate health and control program, such as a 6-Sigma model, compliance management will share the same information framework and infrastructure required for closed loop management control and reporting. The bottom-line benefits and strategic advantages can be huge and a direct benefit to the stockholder.
- Quality cannot be inspected into a world-class organization. Good corporate governance cannot be audited in. But an all-pervasive environment can and should constantly alert, monitor, and seek to improve business practices and transactions.
- Widgets don't give competitive advantages to a company. But an information framework that molds itself around your corporate organisation is now an essential regime, and should be a natural byproduct of compliance systems.

It stands to reason that moving fast to a pervasive culture of closed loop management controls is the healthy alternative to ducking the issues for a short or medium term.

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