



Governance REIMAGINED

ORGANIZATIONAL DESIGN, RISK, AND VALUE CREATION

DAVID R. KOENIG

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and Value Creation**

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(b)right governance
PUBLICATIONS

INTRODUCTION

This is a story about creating things that never existed before. It's a story about people and how they best come together to build and do valuable things. Whether in for-profit companies or at nonprofit organizations, in virtual worlds, political economies, or informal associations, this story is about successfully governing the interactions of those who take risks in the pursuit of value.

My own journey towards a better understanding of how value is created began when I was 10 years old. At that time, my father purchased 50 shares of a company called Texaco. Every week we'd look up its price in the *Wall Street Journal* and, sure enough, this stock's worth grew over time. I noticed that it went up and down in price — sometimes for what seemed like extended durations. But mostly the value increased. This father-son activity of tracking the fluctuations of stock market prices, his explanations about why they happened, and the fact that the holding seemed to magically make money through no work on my part, intrigued me.

But stock markets are not the only place where value is created in our lives. And, even in this realm, there is far more to creating value that has to happen before we can watch a stock price go up. People have to imagine new ideas and take risks to bring them to life. Others must then see those ideas as worthy enough to invest in them or to acquire, experience, and enjoy them. And, since many people embrace diverse ideas of what is valuable, the interactions of people and technologies make the whole process of value creation quite “complex.”

We begin our reimagination of governance by looking at how humans move from where they are today to a better place. We're not talking just about physical movement, although that is sometimes part of the process. Rather, we're referring to how we go about achieving an improved life through our innovations and collaborations. To understand how this can

work, we need to re-examine some of our long-held beliefs about economics and take a closer look at the power that people have to self-organize in pursuit of safety, wealth, pleasure, and sometimes destruction.

Next, we move to an improved view of risk-taking. In order to create things of value, we must be willing to take risks. But the interaction of people and technology around risk is also not simple. Our organizations operate in a kind of social network, with rules and expectations. Hence, how others perceive us matters for our organization's success. In fact, the impact of perception and emotions on value is far more important than many of us realize.

For example, until a risk is realized, it is something we feel — it's an emotion. One important measure of success states that value can only be created when the gain from risk-taking is greater than the cost of the risk being taken. The emotion of fear affects our behavior and raises the cost of risk, making it more difficult for any organization that generates this feeling in us to create value.

Risk also has positive potential, as an understanding of it makes us smarter risk-takers and better creators of value.

This book brings together ideas from a variety of disciplines, from practitioners, advisers, and academics, including the ideas of multiple winners of the Nobel Prize in economics. Much of what you read here will be new to you, as it has never been assembled in such a manner before. And, once you finish the book, I promise that you won't be able to look at your work, your social life, or your day-to-day interactions with people and businesses in the same way again.

I've been flattered by the response to this book since it was first published in 2012. Some people whose work I greatly admire have provided their endorsements to encourage you to read the book as well. Others have reached out to me to learn how they can implement these ideas in their own work.

Our past and current governance of risk-taking in pursuit of value has left much to be desired — in politics, business, and even at charitable organizations. There is an opportunity here to understand and to take risk better. We need to understand how our organizations can best be structured both to innovate and to avoid disappointing those who will decide if they want to engage us and our ideas now and into the future. It's time for us to re-govern how we pursue our ambitions — to make our governance processes ones that help us realize our potential.

In the following pages, you'll be guided to reimagine a form of

governance that begets the freedom to make decisions, fosters innovation, and improves the effective use of scarce resources. We're looking to re-govern what we've been doing, so that we can do it far more effectively — creating more value, in its many diverse measures, and at the same time, more ably fulfilling our highly diverse values.

Achieving that success is what this story is all about.

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Not Everything is Dead in the Long Run

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PRAISE FOR THE FIRST EDITION OF
Governance Reimagined

“In the context of thinking that ‘the organization’ is the most important innovation of mankind, writing a book titled *Governance Reimagined* is quite ambitious. But David Koenig has delivered! I will recommend this book to friends and people I meet on my way.”

— Knut Kjaer, Chairman, FSN Capital; former President, RiskMetrics Group; and former Chief Executive Officer of Norges Bank Investment Management, the Norwegian Sovereign Wealth Fund

“David Koenig has always been on the vanguard of innovative ways to think and practice risk management. I have known David for over a decade and saw him make the link between environmental sustainability and corporate governance way ahead of his peers. Readers will greatly benefit from his ‘out-of-the box’ and multi-disciplinary approach to how reimagined governance can help create value in these turbulent but exciting times.”

— Richard Sandor, Chairman and CEO of the American Financial Exchange (AFX); CEO of Environmental Financial Products; “Father of Financial Futures,” “Father of Carbon Trading,” *Time Magazine* “Hero of the Planet”

“*Governance Reimagined* presents material about which I have thought long and reawakens memories of intellectual voyages in the past like Complexity Theory at the Santa Fe Institute. This is a well organized, presented, and written book. The writing is exceptionally jargon free and user friendly. It should be a great success.”

— Robert A. G. Monks, Lens Governance Advisors; and author of *Corporate Governance*, *Corporate Valuation for Portfolio Investment*, *The New Global Investors*, *Corporocracy*, *Capitalism Without Owners Will Fail*, *Power and Accountability*, and *The Emperor’s Nightingale*

“David Koenig is equally at home explaining what subtle factors drive you to buy an apple, for example, as why complex organizations can break without warning. What’s amazing, however, is how he weaves common sense with thorough academic knowledge to create a rich fabric that will enable readers to use governance for what it was intended: creating value.”

— Jon Lukomnik, Managing Partner, Sinclair Capital; Executive Director, IRRC Institute; past Deputy Comptroller, City of New York; and Co-author, *The New Capitalists*

“David Koenig has the rare gift of distilling complicated topics into logical components and then thoughtfully synthesizing them to make insightful points with such clarity that others can readily understand and grasp them. One reason for this is that David is an exceptional networker with real people who have ‘been there, done that’ credentials in the arena of hard knocks and know what works and what doesn’t. For that reason, you won’t find half-baked theories that will bore you in *Governance Reimagined*. David takes on the essential aspects of strong corporate governance in today’s dynamic world and uses that foundation to contextually contrast and integrate the interrelated disciplines of value creation and risk management. I greatly enjoyed David’s work in this book and have referenced it often in my own writings and discussions with other practitioners.”

— Jim DeLoach, Protiviti Managing Director; Author, *Enterprise-wide Risk Management: Strategies for linking risk and opportunity*; named to NACD Directorship 100 (2012–18) as one of the most influential people in the boardroom community

“*Governance Reimagined* is an insightful exploration into the design, practice, and underpinnings of how organizations best use and manage risk in this post-financial crisis period. The book begins, and maintains a focus throughout, just where it should: on the motivations and drivers of people, and groups of people, making risk/reward decisions big and small. It is a book that will benefit anyone involved with designing or managing an organization, no matter the focus of that enterprise.”

— Michael A.M. Keehner, Columbia Business School adjunct professor;
Board Member, Oppenheimer Holdings

“A fast-paced, informative, witty and eminently readable guide. *Governance Reimagined* provides an excellent road map for creating organizations that use larger, freer collaborations to transform how we think about our work and about the value we give and get from each other — a way to better fulfill your mission and unlock the full value of your organization. Anyone building or managing a for-profit, charitable, political or even social organization will benefit from David’s perspective on governance.”

— Jean Hinrichs, former Chief Risk Officer, Barclays Global Investors;
and Lecturer, Haas School of Business, UC Berkeley

“If there’s anything that’s long overdue for a little reimagination, it’s governance. Not only does this book contain new ideas, it is a delightful read, full of analogies, metaphors, and linkages to common everyday situations. I know I will refer to this book again and again.”

— Don M. Chance, Ph.D., CFA, James C. Flores Endowed Chair of MBA Studies
and Professor of Finance, Louisiana State University

“David Koenig provides a fresh call to action in this comprehensive and stimulating discussion of organizational design and risk governance. His enthusiasm and straightforward style makes the wide-ranging illustrations drawn from economics, complexity science, behavioural finance, systems and network theory both easily accessible and stimulating as a different way to think about governance. A thoughtful work for those involved in leading and managing organizations in today’s world.”

— Ruth M. Whaley, Member, Board of Directors, Nuclear Electric Insurance Limited; Principal, Barset Consulting LLC

“There are two sides to this book that make it extremely valuable. First, the book presents enlightening examples that illustrate the nature of risk which are unmatched by technical texts. Second, it addresses the major issue of governance in its relation to risk — unlike many of the classic texts that debate governance without a focus on this critical relationship — most notably in financial firms. The variety of approaches taken by David makes the book immediately relevant — once you start reading, you cannot stop until reading the end. Professionals will immediately absorb the substance. Academics will find the variety of approaches and the examples unique. Students will gain a new perspective on governance and risk. This is a bright text that readers will highly appreciate.”

— Joel Bessis, Professor of Finance, HEC Paris;
and author, *Risk Management in Banking*

“This is an excellent book — David Koenig has presented some very important and complex ideas in a simple manner and is a must-read for board members and managements. The ideas of networked and distributed governance, along with the management of risk capital as commons are very powerful. These ideas are important for corporations, governments, and nonprofits that must be accountable for profits, people, and the planet, and be more sustainable. The current crisis has exposed weaknesses in governance that need to be fixed, so this book comes at a very important time, not in a negative sense but in a positive, forward looking manner.”

— Saurabh Narain, Chief Executive, National Community Investment Fund

“David Koenig has masterfully broken down the complex components of governance and risk and challenges us to rethink our governance framework. This excellent book dares to break old governance models and re-govern with flexibility, and inclusivity, while bringing empowerment to all stakeholders.”

— Jennifer R. Sawyer, Principal, Rebound Enterprises; and
Sustainer President, Junior League of Minneapolis

“*Governance Reimagined* is brilliantly simple to understand. The relevance to today’s corporate boards and C-suite executives who have gone through the worst period of economic turmoil in nearly a century jumps out at the reader in every chapter. The author’s risk management background, combined with a philosopher/psychologist’s eye for understanding how humans operating in clusters and individually make decisions sets this book apart from all other economic, finance, and risk management books. Every board member and CEO who worried over unfathomable explanations of what can or did go wrong in an organization needs to read this book.”

— Allan M. Grody, President, Financial InterGroup Holdings Ltd; founder and retired Partner-in-charge of Coopers & Lybrand’s Financial Services Consulting Practice; adjunct professor, New York University Stern Graduate Business School; Editorial Board Member, *Journal of Risk Management in Financial Institutions*

“This should be a business book bestseller. David has always impressed me as an intelligent and likeable guy. However, he surprised me with this book. I wasn’t expecting a book so deep with such simple explanation — something abstract yet thoroughly grounded. It is a mixture and digestion of disparate sources like Systems Theory, Network Analysis, and Risk Management. The book simply and clearly explains the process of value creation. I highly recommend it.”

— Patrick Burns, Owner, Burns Statistics

“David Koenig lives and breathes governance and in this book he presents valuable perspectives along with contemporary examples that illuminate his innovations. The book is full of great citations and current situations spice up every chapter. He connects the entire governance social network, including potentially conflicting groups, and demonstrates how establishing appropriate missions and values complemented by diversity, a collaborative open culture and transparent governance process will improve chances for healthy long term success and increased enterprise value. *Governance Reimagined* is a great read that does not disappoint. It should be required reading for senior corporate management and boards.”

— Mark C. Abbott, PRM, Managing Director, Head of Quantitative Risk Management, Guardian Life; President, Buy Side Risk Managers Forum

“In my view there is a clear link between corporate governance and the success of corporations — it is the missing link in many corporate finance and strategy courses and texts. This book provides guidance to the amenable reader and brings the area to life. Highly recommended reading.”

— Steven Bishop, PhD, MCom(Hons) BEc FCPA; Visiting Fellow, Macquarie University Applied Finance Centre; Executive Director, Education & Management Consulting Services Pty Ltd

“Koenig envisions a fundamental redesign of capitalism based on a networked/distributive model centered around risk capital viewed as a “commons.” He weaves together ideas from a wide variety of sources, exploding many myths along the way. Central to Koenig’s emerging model is the role of trust in networks and the connections between agents. Koenig’s risk governance infrastructure could bring much more business intelligence to bear by more fully engaging employees and stakeholders. The habitability of Earth for future generations may depend on extending the concept of the commons to capitalism itself. Unless our businesses adopt a sustainable model, how can we expect to address our larger commons? Businesses are in the driver’s seat. Adoption of Koenig’s ideas could keep us from going off a cliff.”

— James McRitchie, Publisher, CorpGov.net and Shareholder Advocate

“When noted jurist Richard Posner describes some of our imminent risks as having the potential for the extinction of the human race, it is time to address such complex concerns as global warming and cyberterrorism with new and as David Koenig likes to say ‘fit for purpose’ forms of governance. The innovative and imaginative work that he presents in *Governance Reimagined* includes recommendations for organizational design that should be applied to the governance of states, countries, and global institutions equally as well as corporations, providing perhaps a viable mechanism for responding to complex global concerns.”

— Laurie Brooks, Board Member, Provident Financial Services;
Former Director, NACD New Jersey, Former Chief Risk Officer,
PG&E and PSEG; Co-author, *Teaching Controversial Issues*

“In *Governance Reimagined*, David R. Koenig goes to the heart of the role of the organization: creating value. He shows how risk-taking is fundamental to value creation, explores the role of behavioral economics in understanding risk, and provides insights about complex systems as they relate to good governance. With a fresh and thoughtful perspective of boards, this book should be on the reading list of everyone who’s invested in effective governance.”

— Alice Korngold, CEO, Korngold Consulting; Author,
A Better World, Inc. and Leveraging Good Will

“*Governance Reimagined* is insightful, engaging, and simply a great read. It is now on my ‘must-read’ list for every board that I deal with. Excellent job, David!”

— Mark Briggs, CSP, Vice President, Safety Management Resources Corp.,
Former Chief Risk Officer, The Ohio State University