



## 1. Introduction

Recent trends in Australia are placing a greater expectation on corporate decision makers. The Australian community has come to expect that 'good governance' is not simply a catch phrase, but a clear and meaningful concept, whose test is a distinct and real possibility, perhaps even within the judicial system.

This new and at times frightening concept is causing directors and those contemplating a directorship, along with senior executives in the public sector to consider carefully whether the potential risks now inherent in taking on this responsibility do not outweigh its benefits.

Even that mainstay of the business press, the Australian Financial Review, has featured front-page headlines addressing company reactions to legal issues of negligence ("Directors Cut: Why the boardroom is going private" - April 11<sup>th</sup>, 2005 – and "Crackdown on Negligent Managers" - ; May 13, 2005). Similarly, the Australian Institute of Company Directors (AICD) has focused on matters that concern corporate risk avoidance as witnessed by its briefing session held in April 2005 entitled "Where has the Business Judgment Rule gone? Is Risk Aversion best practice?"

Given the traditional notion that company directors' principal responsibility is to guide a company toward wealth creation for shareholders, risk-taking forms a natural part of their duties. Yet these same directors feel vulnerable before the law, given the change in their environment. The issue is that 'business judgement', once seen as a safeguard against claims of negligence, may no longer be sufficient in the eyes of the courts. Specifically, directors and executives worry about the efficacy of a defence, presented possibly years after the event, to a judge armed with hindsight but probably little business training. Consequently, in the event of failure, the concern for civil or criminal punishment impinges greatly on decisions to take a 'calculated risk'. An additional outcome of this setting is that focus on fundamental and strategic decision-making is increasingly being displaced by concerns on day-to-day issues.

## 2. Two tools to provide relief

This paper discusses a pair of tools, used jointly or separately, that can greatly aid executives and senior office-holders in discharging their duties; and avoiding the possible opprobrium of the community.

The first provides a method that reliably supports both a corporate ethos and strategy. Termed 'context-mapping', it is a means of capturing, as accurately as possible, the way the world looked to the decision-maker at the time the decision was made. This facilitates a reasonable reconstruction of events for any interested parties at some future occasion.

A context map records the significant factors of the decision landscape that influence deliberations. It also incorporates the subjective valuations of their relative importance that decision-makers inevitably and sometimes sub-consciously impose. The presence of this type of documentation can readily eliminate accusations of incompetence or lack of diligence.

The method is inspired by a common observation. The next time you witness an argument or debate, listen carefully to what really separates the protagonists. Rarely is it poor logic that fuels the argument. Most disputes originate in the assumptions made by the parties. Conflicts of opinion can almost always be traced to different interpretations. This is not in itself a bad thing. Within any well-functioning decision-making body, diversity and breadth of perspective is an asset. However, they should be made clear and transparent as the source of disagreement, rather than left appearing suspicious and conspiratorial, leading possibly to destructive and discordant emotions. This is what context maps are designed to dispel.

A physical analogy is helpful here. If you were asked to prove what you once saw while walking in a park, it would be more than useful for you to have recorded the time points and position coordinates that uniquely described where and when you stood, and the coordinates of the objects you saw. This would provide a clear and robust account of your perspective.

Similarly, when company directors make decisions and exercise their business judgement, due to greater statutory and community requirements they must be able to account for the contexts that influenced those decisions. These might include external economic parameters, market and political outlooks, social and cultural factors and internal corporate policies or strategies. Documenting these features in a systematic way will provide far greater likelihood of producing better decisions, quite apart from the enhanced ability it brings in their future justification.

This methodology offers special value when the decision being questioned or challenged has occurred some time in the past. For example, consider a director or executive, accused of acting negligently; possibly some years after an event. The strength of the defence will be related to the extent to which the 'reasonableness' of the decision can be shown and that can only be enhanced by a careful recording of the thinking that took place at the time.

The aim is not to produce one-dimensional and conservative decision-making. Rather, we wish to encourage courageous, creative and imaginative decisions, which may on first blush elicit surprise. Yet upon the review of the context maps and other documentation, we would hope that the decision emerges as entirely reasonable, and one that others would have made when faced with similar information.

### 3. How do we construct a decision context map?

To construct a context map requires that the decision-maker poses four simple questions for each contextual object:

What do I see?  
How do I rate it?  
What is its state?  
How do I know?

Let us take each question in turn.

#### 1. What do I see?

This simply identifies the elements of the decision context that are perceived as significant. They become the criteria by which the decision will be made. For the case of a business decision involving say a proposed investment, these might be items such as interest rates, employment projections, indices of consumer sentiment and perceived risk. Also to be included would be non-financial elements such as the corporate values, policies and customs. This question involves a judgment on what we think is important.

#### 2. How do I rate it?

The second question tries to assess how important these factors are, relative to each other. In the example cited above, interest rates might be noted as the most important, (say 40%), inflation a little less (say 30%) and the remaining two split (15% each). This constitutes a subjective yet transparent evaluation of relative prioritisation and feeds into almost all formal decision-making processes, including the AHP method (see below).

#### 3. What is its state?

The third question attempts to provide a measure of current and possible future status for each factor. That is, to identify where on some qualitative or quantitative scale it sits and the direction in which it may be moving. In our example of an investment decision, a set of percentage ranges could be listed for the interest rate, unemployment conditions, and a 'good', 'medium' or 'low' score given for the consumer sentiment.

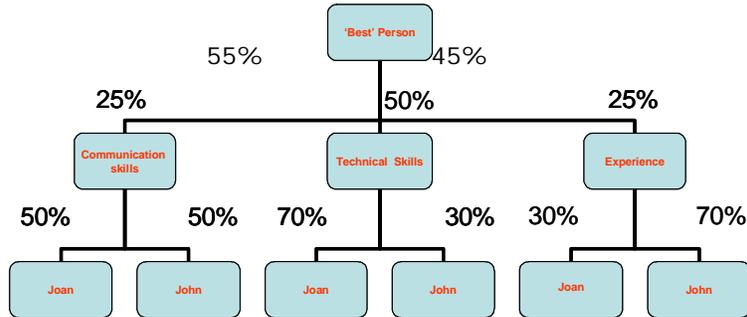
#### 4. How do I know?

This last question presses the decision-maker to provide support for the identification of its state, usually by citing references, publications or other corroborating materials.

The responses to the above questions represent the values of the organization and the likely causal determinants of the decision. The degree of accuracy and refinement can be increased as the need is perceived. Valuations can vary from the broadest and quickest guess to the most careful of research and analysis activity, depending upon importance.

#### 4. The Analytical Hierarchy Process

A second tool which can provide greater decision efficacy and protection for executive decision-makers relates to the Analytical Hierarchy Process (AHP). This provides a framework for the decision, including a structure for relating key components such as objectives, criteria, attributes, options and valuations. An example of a decision hierarchy is shown in the accompanying diagram. The bottom row of percentages reveals the preferences shown for each candidate against the corresponding decision criteria.



The row above that shows how the criteria themselves are rated against each other. These allow for a weighted calculation (shown in red) to be made for preferences of the candidates against the overall decision objective at the top of the tree. In this case, 'Joan' is preferred because she scored better on the most highly rated criterion ('Technical Skills')

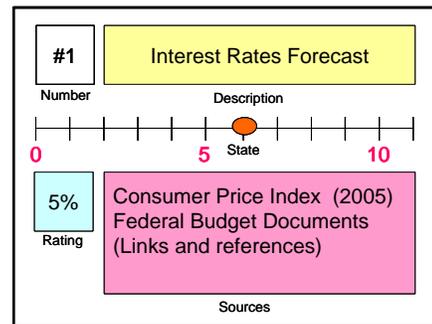
The AHP method is particularly useful for complex decisions, where while local components are well understood, often the aggregation of them stretches human capacity for accommodating and incorporating all of the details in a coherent and effective manner.

The process integrates perfectly with context maps, particularly in regard to the ratings question (number 2 above) and not only reflects individual, collaborative and corporate values inherent in arriving at decisions, but allows these to play out against each other, involving some calculation. These are analogous to delegating mechanical arithmetic calculations to a spreadsheet, without relinquishing autonomy of thought or judgement.

The result is a suggested decision option, to be interpreted as a 'second opinion', providing either confirmation of initial 'instincts', or a challenge to the conventional wisdom. In either case there is a distinct value-add to the process.

## 5. Representing Context Maps and AHP

Context maps can be constructed quickly and simply. For example, listing the contextual objects and answering the four questions for each of them. By mapping the context in this way, the decision-maker can represent the landscape without the need for sophisticated technology. A variety of graphical means are also available, providing a ready and clear representation of a given perspective.



This can easily be represented within a database application and we at Numerix have developed such a tool. It allows for the entry, maintenance and storage of these maps elements and provides the following clear benefits:

- The means for ongoing review of a decision, particularly in the light of changing contextual conditions
- The communication of a decision up, down or across the chains of command
- The establishment of corporate decision-making memory.
- The potential for effective collaborative brainstorming.

Through careful version control, the trajectory of recorded contexts as they evolve over time can be captured. This is an immensely valuable tool in assisting decision makers to anticipate the likely environment in which the efficacy of their decision outcomes will be judged.

The program also implements the Analytical Hierarchy Process (AHP). It allows the history of all decisions to be maintained, providing a viable resource to promote corporate memory and sound knowledge management. It is easy to use and requires little training outside of some basic AHP concepts.

## 6. Conclusion

Sound logic and fair and reasonable criteria are critically important in decision-making. When these are incorporated into a formal process, informed by a careful recording of the contextual characteristics of the decision, there potential for positive and beneficial outcomes is enhanced. When outcomes are less favourable, and scrutiny is brought to bear on the decision-makers, the approach provides for a transparent justification of the means by which the decision was reached.

This should free company directors and executives to get on with the job of making decisions creatively and with calculated risk - as they were always meant to do.