

WHEN INNOVATORS LEAVE: INTERNAL AND EXTERNAL FAILURE

by Anne L. Washington, PhD

Six years after leading a worldwide transparency initiative in the financial services industry, the originating government agency has failed to leverage the innovation for themselves. What happens when innovators leave?

Context

The United States Securities and Exchange Commission (SEC) is an independent government agency that is responsible for regulating the securities industry. Regulations mandate information disclosure. The regulating agency subsequently publishes information necessary to confirm compliance. For instance, publicly traded companies must submit quarterly financial statements that are widely used to analyze the stock market. While essential for financial analysts, stockholders and investors, SEC reports are valuable for internal analysis and enforcement. According to one Senate Report (S. Rep 94-75 p79), institutional disclosure was intended to be used by the SEC to investigate how individual organizations impact the industry as a whole.

The SEC regulatory process largely involves company disclosure of information through the submission of forms. The Internet has transformed the mechanisms and the speed of this exchange. Since 1996, forms must be submitted electronically using the system called EDGAR, Electronic Data Gathering, Analysis, and Retrieval system. Because both stock markets and regulation are exchanges of information, data is an essential aspect of the SEC's work.

Leadership

Given the independent and political nature of commissions, SEC has more autonomy than other government organizations and is well-placed to test innovations. The Commissioner and the four-person commission are political appointees chosen to represent both sides of partisan interests. In 2005, a new Commissioner recognized that reports would be more useful as electronic data for efficient oversight. The Commissioner actively engaged legal, technology and accounting professionals in addition to issuing requests for comments on the new rules. The results were a series of innovations geared towards efficiently gathering and understanding electronic financial statements. The Commissioner was able to fund the data innovations before leaving in 2009. The next Commissioner, representing a different political party, took office during the

Domain

Public
Private

Non-profit
Commercial

Business: ____

Start up (0-1yr)
Growth (1-5 yrs)
Mature (5yrs +)

Micro (Staff <10)
SME (10 – 250 Staff)
Large (250+)

Regional
National
Multinational

Methods

Longitudinal
Cross-sectional

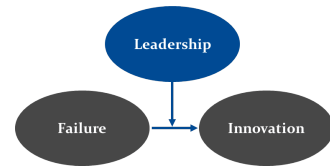
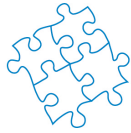
Access
Exemplar
Random

Innovation

Top Down
Bottom-up

Product
Process
Organizational

Radical
Incremental



financial crisis and chose to establish a different set of priorities for the agency.

Innovation

In 2006, SEC commissioned an interactive data standard for financial reporting. Working with accounting professionals, they described a machine-readable language that makes it possible to do calculations and make text comparisons. This data standard called XBRL, eXtensible Business Reporting Language, provides spreadsheet-like characteristics to written reports. SEC joined the US Congress and the Government Printing Office, as leaders in using extensible semi-structured languages for modernizing government. Their analytic capacity surpasses text formats. Within a few years, the XBRL standard had become a staple with accounting professionals worldwide. XBRL was phased in slowly and by 2012 was a requirement for filing key SEC reports.

Transformation

The innovative qualities of XBRL startled the status quo both externally and internally.

Externally, the financial services industry consider XBRL as an additional regulatory burden. Instead of integrating the data standard into existing computer systems, financial statements continue to be audited as they were before. The audited financial statements are sent to outside XBRL expert vendors for conversion. While both files are submitted to the SEC, there are no systematic checks for accuracy, much less any assurance that the XBRL and the report are equivalent. All files are accepted at submission including those with obvious mistakes such as missing fields, incomplete data or math errors.

The internal reaction to XBRL was unenthusiastic and the project fizzled after the Commissioner left in 2009. The SEC Investigator General (IG) found that when no one was given explicit jurisdiction over data, each department assumed that another was handling it. By the time XBRL was required for submission for all quarterly reports, no one at the agency had an incentive to use it; therefore no one was concerned with its quality. The IG also found that SEC was failing to meet its goals because it did not provide employees with proper tools for analyzing the increased workflow. For example, one observer saw an employee use a calculator to check whether the numbers on the screen came to a correct total. In a 2013 survey, SEC employees identified an organization culture of blame and distrust instead of cooperation and autonomy. Communication is stalled between hierarchical levels and between

Failure

- Caused externally
- Caused internally

- Step1 Invent
- Step2 Select
- Step3 Implement
- Step4 Capture

Transformation

- Internal to Organisation
- External to Organisation
- Delivered by Organisation
- Delivered by Others

Role of Leadership

- Strategic Recovery
- Employee-led Recovery

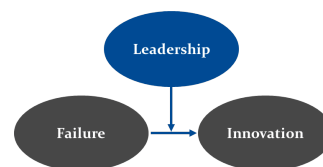
- New Leader Engaged to lead transformation
- Existing Leader-led transformation

- Recovery Strategy Published
- Recovery Led by Operational Activity

- Strategy Announced
- Recovery Evolved

Learning outcomes

- Design data for internal use
- Prepare technology systems for new data
- Data users are good data producers



departments. This made it difficult to detect the growing interconnected scandals that became the financial crisis.

Failure

With only the regulated companies monitoring the data, the extensibility of the standard XBRL tags grew out of proportion. For example, instead of using the standard tag for revenue, companies would add a company-specific revenue tag making it impossible to make comparisons. A 2012 Columbia University report found that the XBRL data quality is perceived by investors as unreliable.

Despite EDGAR now being free to the public, few individual investors have the skills to download, parse and integrate the data for comparisons. Many third-party companies provide those services, at a considerable cost, adding yet another layer of meaning.

Finally, taking advantage of XBRL requires what one former employee called "the triple threat". This rare person is comfortable with technology standards, is familiar with accounting rules and has an understanding of the financial markets. Like any translation process, ideally the translator is fluent in all languages and is able to catch any problems in interpretation.

The SEC innovation focused solely on establishing the data standard and failed to consider other aspects necessary for the use of the data. While initially poised to quickly make the transition from documents to data, the agency fell behind others. The SEC procedures are still geared towards slower rates of submissions in formats that invite visual instead of machine-readable analysis.

Data

This case study is based on interviews, Congressional hearings, and reports from government investigations.

Further Reading

Committee on Oversight and Government Reform United States House of Representatives. 2008. SEC Chairman Christopher Cox Securities and Exchange Commission. October 23.

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