Culture – the go-to influencer on company behaviours

It appears there exists many reasons for why companies are struggling with their governance practices.

The broad consensus, when faced with often-substantive ineffectiveness of governance in dynamic and complex organisations, is a call for boards to adopt a more robust approach in their governance practices.

To some it may appear that this challenge has emerged somewhat suddenly. However, arguably, the meaningful change began prior to the Global Financial Crisis (GFC) and has become a more common occurrence. These failures re-enforce the view that management and directors are overly-dependent on outmoded or ineffectual governance practices.

The following Harvard Business School thoughts were prompted by the GFC but certainly are not defined by such experiences.

"We [Harvard Business School] recognised the legitimacy of many issues raised by the media, the public and politicians about boards' ineffective oversight of financial-service firms and other complex companies whose actions contributed to the current recession."

"As we reflected on how and why boards had fallen short, we came to a tentative conclusion. The problems that surfaced in 2008 and 2009 largely differed, we believed, from those that had prevailed in 2002, when boards failed to identify and stop management malfeasance and fraud. By contrast, the more recent boardroom failures were primarily attributable to the growing complexity of the companies that boards are charged with governing."

Jay W. Lorsch, Joseph L. Bower, Clayton S. Rose, and Suraj Srinivasan, Perspectives from the Boardroom — September 2009.

Subsequently it could easily be suggested that it continues to get worse.

Anyone involved in a senior governance position, can acknowledge that organisations face constant challenges as they attempt to operate successfully in a highly competitive and dynamic world. Those challenges come from anywhere, internally, or externally; and can offer little or no warning. Hence it becomes even more important for organisations to support having their people 'drawing together' as one. There is a need to forge a co-ordinated approach across the whole organisation to gain really positive synergies that can be generated, and effective outputs and outcomes delivered.

The benefits to be gained by driving a much stronger integration of an organisation's functions within a holistic governance framework are compellingly attractive.

Yet, still, there are many organisations which persist in investing time and effort in governance practices that offer limited value and fail to deliver the achievement of sound governance.

What has emerged as a critical challenge is to determine what is the true role of governance in an organisation. Surely it must be that governance, itself, is what makes the most valuable and sustainable contribution to an organisation's future success?

Corporate governance

Governance Institute suggests that there is not one conclusive definition of corporate governance; and offers as one definition:

"*Governance encompasses the system by which an organisation is controlled and operates, and the mechanisms by which it, and its people, are held to account. Ethics, risk management, compliance and administration are all elements of governance*."

In other thoughts Governance Institute suggests that:

"*Governance means the method by which an organisation is run or governed, over and above its basic legal obligations. Governance can be argued to have four key components:*

- *Transparency: being clear and unambiguous about the organisation's structure, operations, and performance, both externally and internally, and maintaining a genuine dialogue with, and providing insight to, legitimate stakeholders and the market generally.*
- *Accountability: ensuring that there is clarity of decision-making within the organisation, with processes in place to ensure that the right people have the right authority for the organisation to make effective and efficient decisions, with appropriate consequences for failures to follow those processes.*
- *Stewardship: developing and maintaining an enterprise-wide recognition that the organisation is managed for the benefit of its shareholders/members, taking reasonable account of the interests of other legitimate stakeholders.*
- *Integrity: developing and maintaining a culture committed to ethical behaviour and compliance with the law*."

Ultimately, what is clear is that seeing governance primarily in terms of laws, regulations, accounting standards and compliance only is flawed. There is a clear need for a holistic view, which considers the organisation as one, in other words via a universal lens. This starting position is re-enforced by Governance Institute paper on whole-of-organisation governance.

Whole-of-organisation Governance

Governance Institute acknowledged that "*Good governance does not stop at the boardroom but needs to cascade throughout the organisation to enable performance."*

The essence of a whole-of-organisation governance approach is to ensure the focus is on:

- *the effort undertaken by all employees across the organisation is aligned with the strategic objectives*
- *clarify individuals' roles, authorities, and accountabilities in achieving strategic objectives*
- *empower individuals to make decisions that are aligned with strategic objectives*
- *clarify the controls and boundaries that apply to the exercise of authority*
- *provide for clear and effective accountability for the decisions taken and authority exercised.*

It looks deceptively simple from the outside — we know that it is not. And nor is it about adding layers of bureaucracy."

This approach to the practice of governance seeks for all leaders and especially every organisation's board and executive group to make a change in their basic assumptions.

The paradigm shift

Companies need to be assured of their readiness to meet ever-faster changes involving different areas of the business and across a variety of fronts. Boards and management together, need to be confident of having the mastery of new and complex challenges; all in near real time.

Governance itself is demanding a more pivotal organisational role to enable the board and management to be fully across what is occurring within the organisation. This means that what constitutes governance must better inform the board and management of what is occurring within the organisation; thereby enabling directors and management to be better informed and to enable their governance role to be far more effective.

This is not a matter for boards to seek more information, as information overload is not a solution. Rather boards and management need to be receiving value-adding governance information; hence striking the right balance to enable effective governance oversight.

An understanding of the magnitude of the shift can be seen in the UK's Financial Reporting Council (FRC) study results, published in July 2016, which explored the relationships between corporate culture and long-term business success. The report involved a collaboration with CIMA, the City Values Forum, IBE, IIA and CIPD, as well as interviews with over 250 chairmen, CEOs, and leading industry experts, from the UK's largest companies.

The report explored the importance of culture to long-term value and how corporate cultures are being defined, embedded and monitored.

Sir Winfried Bischoff, Chairman of the FRC, said:

"A healthy corporate culture leads to long-term success by both protecting and generating value in the UK economy. It is therefore important to have a consistent and constant focus on culture, rather than wait for a crisis. A strong culture will endure in times of stress and change.

Through our research, it has become clear that establishing the company's overall purpose is crucial in supporting and embedding the correct values, attitudes, and behaviours.

The extremely positive response from many individuals and organisations, demonstrates how important the subject is. I would like to thank all those who joined the debate to foster sustainable growth and long-term business success in the UK."

The key findings of the FRC's study can be summarised as follows: -

1. Recognise the value of culture
   It is the board's role to determine the purpose of the company; and to ensure that the company's values, strategy and business model are strongly aligned to it. This offers all companies not only a competitive advantage, but also contributes to the creation and protection of long-term value.

2. Demonstrate Leadership
   All leaders must embody the desired culture and ensure that that culture is experienced throughout the organisation. The board is the steward of an organisation's culture.

3. Be Open and Accountable
   Good governance means a focus on how openness and accountability is delivered from an organisation-wide perspective and across every level.

4. Embed and Integrate
   The organisation's approved values must consistently inform the behaviours which are expected of everyone connected to the organisation.

5. Assess, Measure, and Engage
   It is the board's responsibility to monitor the culture and be sufficiently informed to enable it to challenge instances of misalignment with values, or lack of effectiveness of relevant processes and practices.

6. Align Values and Incentives
   Every performance management and reward system should support and encourage those behaviours which are consistent with the company's purpose, values, strategy, and business model. The board is responsible for approving, explaining, monitoring, and enforcing its alignment.

7. Exercise Stewardship
   Effective stewardship should include active engagement with the approved organisational culture and encourage openness and accountability, and better reporting to all stakeholders.

The above commentary offers a stark insight into the size of the change and at the same time hints at the fundamental governance assumptions which are challenged. In essence it covers the core role of Boards and management and staff as part of the necessary integrated and universal governance practices. It highlights the urgency to clearly articulate more relevant and appropriate roles for all positions, to ensure the involvement of multiple stakeholders in our understanding of governance practices.

It seems that the apparent disconnect between what are the boards and or senior executives' responsibilities and having them accountable for the mistakes resulting from an organisation's activities and outcomes, has led to this seismic shift in the view of what governance needs to be. At its most fundamental, it raises the important consideration as to what is the current state of effective governance within organisations.

The follow-up question therefore concerns what ought to be the Board's true role in the governance of an organisation? A reflective question after this has been resolved may be whether there would be a different outcome for the corporate fraud, misbehaviours, and failures, of the recent past, if this new purposing of governance had been in operation at that time?

The importance of Culture

In the recent Grant Thornton Corporate Governance Review 2017, it was found that over half of the FTSE 350 were discussing how they measure culture in their annual reports. Boards are using the following as indicators: -

- employee surveys and/or
- HR data i.e. employee retention and turnover.

For those more advanced boards, they are using dashboards, which combine "metrics and measures of culture, with employee engagement - and treating culture as something to understand holistically."

The common theme that has strongly emerged now is that all boards need to have a "a clear picture of what is driving (their organisation's) culture, and how it feels on the ground, not just how it looks on paper."

Unfortunately, the embedding of acceptable culture practices within organisations, continues to be a major challenge for many boards.

Embedding of practices

Not surprisingly the most significant determinant of every organisation's culture rests with the influential people who, generally, are those in management positions. What for many may be surprising, is that there are various core practices which underpin the effective delivery of an organisation's commitment to improved culture. These are:

1. sharing a clear vision
2. widespread acceptance that everyone can be challenged
3. all actions are aligned to vision
4. people have a passion for the organisation
5. acceptance of accountability
6. openly acknowledged KPIs
7. regular monitoring and feedback
8. widespread collaboration

"*An organisation's governance is substantively strengthened when leaders hold themselves accountable for what goes on within the organisation. Two-way communication is a key along with showing your confidence in staff. Whenever any matter arises the organisation's systems and processes need to fully meet expectations. In other words, it is not the policy or code or piece of paper or electronic form; it is all about what the leaders did. Ultimately it is all about imbuing the appropriate culture, such that there is alignment with what is effectively implemented.*" (source: Grant Thornton Corporate Governance Review 2017)

The erosion of trust in organisations across all sectors of society; and the seemingly sterile nature of governance to either respond at all or be effective has left many in our community with the sense that it is broken!

There is an increasing call for change, especially in the light of the urgent need for addressing the negative and quite destructive social impacts which so frequently accompany these corporate governance failures.

Our community is saying that the time is now; and so each individual organisation should likewise assume full responsibility, deciding that enough is enough and for their Board and leaders to act.

A call to action

Sir Winfried Bischoff Chairman of the UK's Financial Reporting Council in the foreword to its "Corporate Culture and the Role of Boards" report, comments:

"*Rules and sanctions clearly have their place, but will not on their own deliver productive behaviours over the long-term.*

A healthy culture both protects and generates value. It is therefore important to have a continuous focus on culture, rather than wait for a crisis.

Strong governance underpins a healthy culture, and boards should demonstrate good practice in the boardroom and promote good governance throughout the business. The company as a whole must demonstrate openness and accountability, and should engage constructively with shareholders and wider stakeholders about culture."

These words so very strongly summarise where every board and each director's thinking needs to be in 2018 and moving forward.

If boards and directors are not in this space now, then it is their governance responsibility to determine a clear pathway to make the change. Enterprise Care can certainly help and strongly suggests starting with undertaking a Whole-of-organisation Governance Audit. This offers you the important datum point. It can then be used to monitor the success of your governance transformation and improved organisational performance.

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