

GOVERNANCE AND CULTURE

- inter-dependent drivers of organisational performance outcomes -

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“Poor [corporate] culture can undermine ... trust and confidence. By contrast, good culture, which is more conducive to good conduct, helps maintain trust and confidence.

John Price
ASIC Commissioner

1. What is Culture?

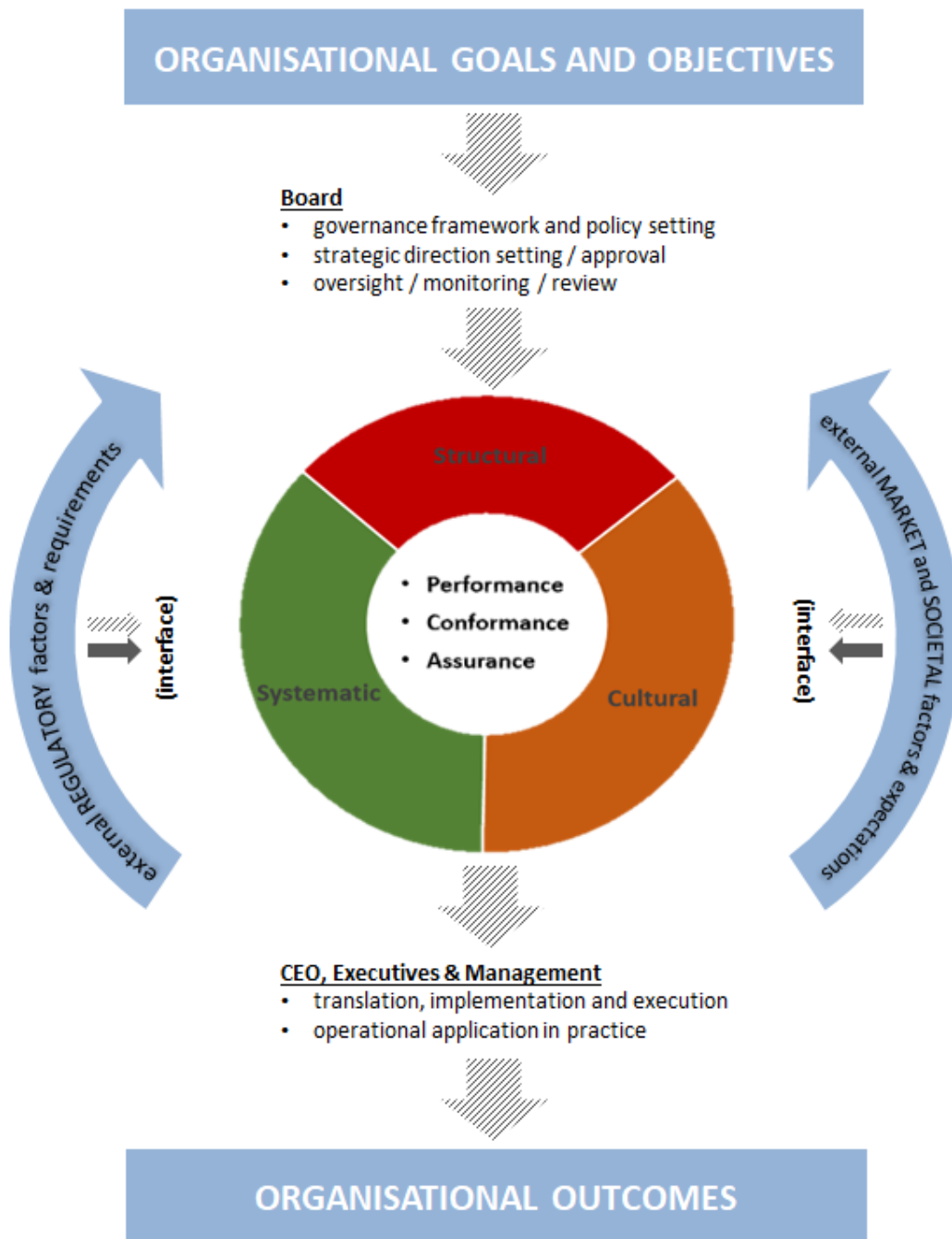
So what is “culture” in the context of organisational governance? Some definitions include:

- “The sum of the shared values, principles and behaviours of an organisation and its people.”
- “A set of shared mental assumptions that guide organisational conduct and practice by implicitly licensing how people may and may not behave.”
- The sum total of accepted ways of behaving built up by a group and which are transmitted to others joining the group.”
- “The way we do things around here.”
- “The implicit collective relationships, shared assumptions and power structures that exist within an organisation.”

Further, in an organisational construct, “culture” may apply to the organisation as a whole, or there also may be organisational sub-cultures that are embedded predominantly in groups or divisions within the organisation, although such sub-cultures should not be in conflict with the broader organisation-wide culture.

There is no doubt that “culture” is an essential element of any effective governance framework. In this context, reference is made to Table A following concerning the structural, systematic and cultural aspects of an organisational governance framework:

Table A – Structural, Systematic & Cultural Aspects of an Organisational Governance Framework



Behaviour and culture are essential parts of operational management. Effective management is only feasible if organisational structure and culture go hand in hand.

De Nederlandsche Bank 2015
(Behaviour and Culture in the Dutch Financial Sector)

Accepting this proposition, and assuming effective governance can deliver enhanced performance outcomes and the better management of risks for an organisation, then it behoves boards to better understand culture and the impact, positive or negative, that culture can have on organisational governance and therefore organisational outcomes.

2. Dimensions of Culture

There are 2 dimensions or perspectives to consider when addressing organisational culture.

(a) Qualitative perspective

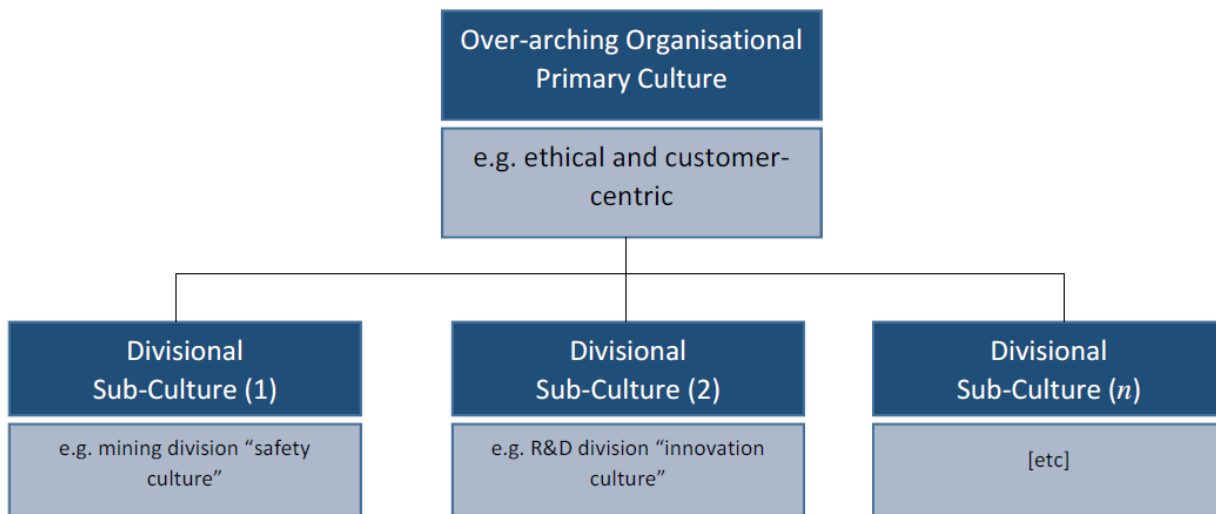
“Culture”, as simply defined in its own right, is a neutral term. It is a “non-qualitative” noun, which only gains special meaning by qualifying adjectives or phrases used in conjunction with it, such as:

- “ethical culture” (implying a strong behavioural underpinning for fair dealing, Judeo-Christian values and respect of others);
- “customer-centric culture” (fostered by ASIC and the Financial Conduct Authority of the UK in the context of recent criticisms of the banking industry with a view to ensuring market integrity and restoring society’s trust and confidence in financial institutions);
- “risk aware culture” (fostered by APRA in the context of Prudential Standard CPS 220 for the insurance industry, and also by ASIC);
- “safety culture” (fostered by the mining, manufacturing and construction industries in the context of a heightened awareness for human health, safety and welfare in the workplace);
- “innovation culture” (as fostered by Australia’s Prime Minister Malcolm Turnbull at the time of his taking that office).

Each of these cultural descriptors has logical meaning and attraction in its own right. Nor is any one descriptor necessarily mutually exclusive from any other one. So if all these cultural descriptors are attractive, then why should organisations not aspire to them all, or might cultural confusion and competing cultural priorities arise? There are probably no black and white answers to these questions.

Especially in large diversified organisations with multiple business divisions or subsidiary operations, there may be organisational sub-cultures that apply discretely to a business division or a subsidiary’s operations. This may allow the inculcation of a primary over-arching organisation-wide culture yet at the same time allow to exist subordinate sub-cultures attuned to the specific needs of the relevant business division or subsidiary operation. However care needs to be taken to ensure that the sub-culture is not in conflict with or anathema to the primary over-arching organisation-wide culture. Table B below depicts an example of this in diagrammatic form:

Table B – Over-arching Primary Culture and Subordinate Sub-Cultures



This concept is not materially different to a large diversified organisation having an over-arching strategic objective or plan, yet still allowing and encouraging its subordinate business divisions or operating subsidiaries to have their own strategic plans, not inconsistent with the over-arching strategic objective or plan, and hopefully complementary to it, which subordinate divisional plans are more attuned to the industry and markets serviced by the relevant business division or operating subsidiary.

(b) Quantitative perspective

Discretely from the qualitative perspective, organisational culture also needs to be addressed from a functional or quantitative perspective, as to how strong or robust and how well embedded is the culture in the fabric of the organisation and its people.

This involves analysis and assessment of:

- is the relevant culture universally accepted throughout the organisation?
- does the culture have normative respect and expectation of application throughout the organisation?
- is the culture generally evident by its consistent translation into policies, procedures, behaviours and practices of the organisation and its people?
- is the culture enforced, expressly and/or implicitly, by peer approbation and opprobrium (as applicable)?

A culture with affirmative responses to these questions might be regarded as STRONG, whereas a culture lacking affirmative responses to these questions might be described as WEAK.

3. **“Good” v’s “Poor” Culture**

Judgemental terms such as “good” or “poor” are often generically used in the context of culture, but what do they really mean? The term “good culture” probably implies a culture which is both:

(a) [from a qualitative perspective] a reasonable collective of those descriptors of “culture” which align the conduct and behaviours of the organisation and its people, including in the context of its strategic objectives, with society’s generally accepted expectations, mores and values;

[AND]

(b) [from a quantitative perspective] strong or robust, and well embedded throughout the organisation and within its people (refer section 2(b) above).

The term “poor culture” is generally the obverse of “good culture” to the extent it either fails to align with society’s generally accepted expectations, mores and values [OR] it is “weak” and therefore not universally understood, consistently applied or evident in conduct, or does not have peer engagement and enforcement.

4. **Establishing an appropriate organisational culture**

(a) Ethical Framework

Informed writings on the subject suggest the need for an organisation to develop an “ethical framework” which is discrete from, but complementary to, its “governance framework” (which in itself may contain a Code of Conduct or Code of Ethics as one of a suite of key policy statements contained within a governance charter or like instrument). In fact, those informed writings suggest that this ethical framework should sit at the heart of the organisation’s governance framework.

The nature of an “ethical framework” is to GUIDE rather than DIRECT those making decisions and exercising behaviour on behalf of an organisation.

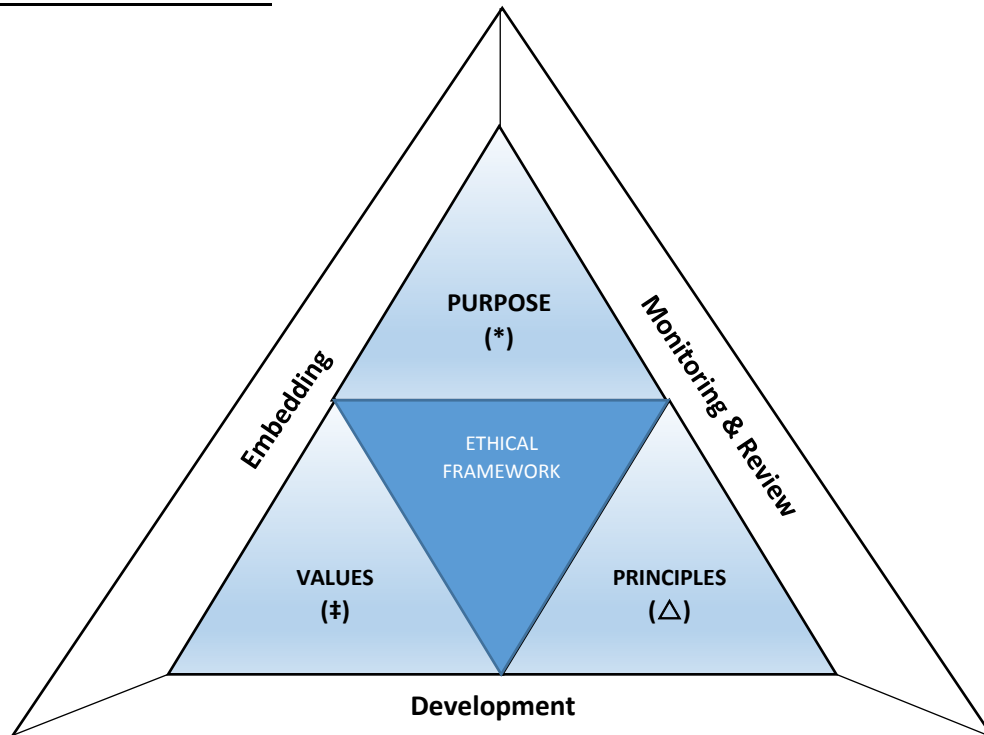
It encourages the exercise of judgement in decision making and behaviours by reference to an established framework of:

- values; and
- principles,

that serve the defined purpose of the organisation.

TABLE C following depicts an “ethical framework” with the organisation’s values and principles underpinning and supporting its purpose.

Table C – Ethical Framework



(*) PURPOSE:

Describes WHY the organisation exists as distinct from its:

- Mission – what the organisation does;
- Vision – what the organisation wants to be.

It goes beyond self interest and profit motives to:

- demonstrate its ethical core;
- explain how it seeks to impact lives and contribute to society;
- provide meaning to whatever it is that the organisation does.

(‡) VALUES:

Are expressions of what the organisation and its people prioritise as being of intrinsic worth, merit or usefulness. They are the ideals or customs that usually arouse an emotional response, either for or against, in the organisation’s people. Values are often a quality or an attribute considered to be desirable either as a means to an end, or even as an end in itself.

(Δ) PRINCIPLES:

Are accepted or professed rules of action or conduct, often expressed as laws, normative behavioural truths or doctrines, i.e. the way we do things around here (“TWWDTAH”). If “values” help show an organisation and its people where they should go, then “principles” tell the organisation and its people how they should get there. By way of example:

- (i) if the value is “integrity”, then an aligned principle serving that value may be “transparent reporting”;
- (ii) if the value is “innovation”, then an aligned principle serving that value may be “license to take measured risk”.

(b) Developing an Ethical Framework

Defining and clearly articulating an organisation's ethical framework (encompassing the organisation's purpose, values and principles) in a succinct and easily comprehensible form can be as challenging as defining and clearly articulating the organisation's vision, strategy and governance arrangements.

Desirably it should involve an iterative exercise, respecting the legitimate inputs and expectations of a broad cross-section of the organisation's stakeholders, including both "top down" and "bottom up" engagement, input, co-ordination and alignment.

A cultural survey of the organisation and its people may be a useful start, along with other available data that may give indicators of the culture of the organisation (e.g. HR data including staff turnover, complaints data, exit interviews etc). The results of that survey and other data analysis may then be "mapped" against the organisation's desired ethical framework and culture. This can then be used to develop a pathway to indicate specific aspects to be focussed upon and actions to be taken to encourage the movement of the organisation's then current culture to its desired culture.

(c) Embedding an Ethical Framework

Much as a comprehensive charter setting out an organisation's governance framework is of little value if it is merely adopted by a corporate board and put in the "bottom drawer", so too is a well developed ethical framework of little value unless it is embedded throughout the organisation.

Even if the executive management team should take a lead role to co-ordinate the architecture of the ethical framework and embed it throughout the organisation, the organisation's board must "own" it and display its adoption and normative expression as part of the organisational fabric, through "walking-the-talk" so as to demonstrate what is colloquially referred to as "tone from the top". The behaviours of the organisation's leadership group, both in the performance of their roles for the organisation and in a personal or domestic setting or environment beyond the organisation's boundaries, must be consistent with that desired culture.

Board members must also understand the actual culture of the organisation if they are to properly perform their governance oversight responsibilities. Given the ethereal nature of culture, this may well involve board members engaging in extra time around "the factory floor" to gain a true appreciation of the culture of the organisation and its people first hand rather than merely relying on board papers and executive reports on the topic.

"Institutional investors expect directors to walk the floor of the business, engage with employees from all levels (and not just in events organised well in advance), engage with key stakeholders and monitor changes in key data related to culture and conduct. If directors cannot "feel" the culture of their organisation, they are not doing their job."

Prue Bennett
Head of Investment Stewardship Asia-Pacific
Blackrock
AFR 26 February 2018

The organisation's ethical framework should then:

- (i) be translated into and be embedded throughout the organisation's governance charter, systems and policies, its strategic and risk management plans, its business model, its human resource and management procedures, and its remuneration and incentivisation arrangements, so as to manifest the behaviours sought to be promoted as part of that framework;
- (ii) be communicated throughout the organisation to its employees and broader stakeholders to assist them in understanding the framework including the organisation's purpose, and the values and principles championed by the framework;
- (iii) be reinforced by appropriate education and training, both formal and informal, individual and group, as well as appropriate incentivisation of behaviours and conduct consistent with the framework, and disincentivisation of behaviours and conduct which are contrary to the framework (in this respect the organisation's human resource function may have a special role to play).
- (iv) be monitored as to the degree to which key aspects of the framework are being observed by the organisation's people and represented in the application of the organisation's governance and management related systems, policies, processes and procedures, with remedial action being taken to the extent of any shortcomings in the application and embedding of the framework throughout the organisation (in this respect the organisation's internal audit function may have a special role to play); and
- (v) be reviewed from time to time to ensure its continuing "fitness for purpose" and continuing suitability having regard to the evolving social mores and values of the community of which the organisation is a part and from which it draws its "social licence to operate", and following such review, adjusted as necessary with any adjustments re-embedded in the organisation (refer (i) – (iv) above as a continuous virtuous loop).

5. **Conclusion**

There is considerable contemporary attention being paid to "corporate culture" as society's trust and respect for corporate endeavour, and the extent of the licence to operate conferred by society upon corporations, are being questioned.

Society, in seeking to address its concerns as to such matters, is looking to its regulators, who in turn are looking to those reposed with the governance, direction and management of corporations (i.e. the hearts and minds of the corporation – its directors), to do something about it – the traditional "agency risk" and solution approach to corporate regulation.

Different agencies are putting their own emphasis on the qualitative nature of an organisation's culture to meet their own needs. ASIC has expressed particular interest in a "customer-centric" culture for banks and financial institutions to restore society's trust and confidence in the sector. APRA on the other hand has expressed particular interest in a "risk-aware culture". ACNC might express particular interest in a "caring culture" for its constituents.

The UK Prudential Regulation Authority suggests that a culture of personal responsibility and accountability first has to be embedded throughout an organisation as a preliminary step in order to give foundation to the appropriate qualitative culture then desired to be developed and embedded, and without which preliminary step, embedding of the desired qualitative culture may struggle to gain normative acceptance.

Although it is generally accepted that the board has a key lead role to play in organisational culture, especially in its development, in giving oversight to embedding it throughout the organisation and by displaying “tone from the top”, it is not the only player responsible.

To be truly embedded, with normative acceptance throughout an organisation, culture must be “everybody’s responsibility”, with lead being taken from a seminal statement by former Australian of the Year and Head of the Army, Lieutenant General David Morrison OA, who in fact attributed its origin to David Hurley, former Chief, Australian Defence Force:

“The standard you are prepared to walk past, is the standard you are prepared to accept.”

Footnote:

An excellent joint publication on this topic has recently been released and is commended reading for all corporate officers and governance professionals:

“Managing Culture – A good practice guide.”

[First Edition, December 2017]

- Chartered Accountants Australia New Zealand
- The Ethics Centre
- Governance Institute of Australia
- Institute of Internal Auditors – Australia