

## ICGN Viewpoint

### The Board's Role in Overseeing Culture

January 2020

---

Regulators and investors across the globe are interested in how companies leverage culture to accelerate long-term success and enhance viability.<sup>1</sup> Culture is becoming a substantial factor in investor assessments of a company's performance. Executive managers and boards therefore must not only oversee and shape corporate culture: companies must also get better at telling their "culture" story to their investors and other interested stakeholders.

ICGN's Global Governance Principles state that "the board should adopt high standards of business ethics, ensuring that its vision, mission and objectives are sound and demonstrative of its values. Codes of ethical conduct should be effectively communicated and integrated into the company's strategy and operations, including risk management systems and remuneration structures."<sup>2</sup> Without a shared understanding of acceptable behaviours, tolerance of slight indiscretions may quickly evolve into accepting more egregious actions.

Culture may sometimes be regarded as a "soft" issue because of these challenges in defining and measuring it. But, if soft, it is also very real and can have a hard impact on company performance and sustainable value creation. Speaking at an ICGN conference in 2016, former ICGN Chairman Peter Montagnon observed that corporate culture is rapidly becoming the new frontier of corporate governance: "It matters because ethical behaviour impacts companies. We don't really know what corporate culture is, we don't really know how to measure it, and we don't know how to encourage companies to develop a strong corporate culture. We don't always know how to promptly identify the signs of a weak culture."<sup>3</sup>

---

<sup>1</sup> Embankment Project for Inclusive Capitalism (EPIC), November 2018; <https://www.epic-value.com/>

<sup>2</sup> ICGN Global Governance Principles, 5<sup>th</sup> edition, 2017 <http://icgn.flpbks.com/icgn-global-governance-principles-2017/#p=9>

<sup>3</sup> ICGN Frankfurt conference, 2016: Corporate culture and ethics as a means of mitigating governance failures and value destruction, Dr. Ann-Kristin Achleitner, Arnaud de Bresson, Annachiara Svelto, Jens Wilhelm, Chaired by: Peter Montagnon, <https://www.icgn.org/corporate-culture-and-ethics-means-mitigating-governance-failures-and-value-destruction>

This Viewpoint discusses the role that culture plays and presents questions for investors to ask a board of directors-- so investors may better understand the culture of a company and assess the board's grasp of and interest in corporate culture. Boards can also ask these questions of themselves, to better understand and influence the culture of the companies they are responsible to oversee—and to understand why culture is an important factor in investors' minds.

### **Why is culture important—and what drives it?**

One approach that may lead to a shared understanding of culture is to identify a clear corporate purpose that is beyond profit generation. Company purpose can relate to a company's ultimate aspirations and contributions, but also reflect a shared vision as to how it will evolve and transform itself.<sup>4</sup> Culture reflects a consistent and shared understanding of that corporate purpose, and that requires consistency between interpretation of purpose and the reality employees, customers and other stakeholders experience. From an investor perspective culture might be framed as the organizational ethos and behaviours that support – or could possibly threaten-- successful long-term performance.

Investors often place substantial weight when making investment or voting decisions on tangible measures such as compensation, but intangible factors, including talent and culture, are now estimated to make up 52% of a company's market value (for some companies, it can be as high as 90%).<sup>5</sup> Culture can be an important contributor to the discrepancy between a company's book and market value. The Embankment Project for Inclusive Capitalism (EPIC)<sup>6</sup> identified talent and organizational culture among the key drivers of long-term value, and influential institutional investors are including company purpose, culture and human capital management among their global engagement priorities. In addition, research conducted by the academics Edmans, Li and Zhang showed that companies with high employee satisfaction, as measured by inclusion in the list of the "100 Best Companies to Work for in America", outperformed their peers by 2-3% per year.<sup>7</sup> The Edelman Trust Barometer 2019 finds that "nearly two-in-three investors surveyed believe maintaining a healthy company culture and enforcing a corporate

---

<sup>4</sup> Forbes, Purpose-Driven Companies Evolve Faster Than Others, Caterina Bulgarella, Sept. 21, 2018

<sup>5</sup> [Global Intangible Finance Tracker \(GIFT™\) 2018](#), October 2018,

<sup>6</sup> Supra, note 1

<sup>7</sup> Employee Satisfaction, Labor Market Flexibility, and Stock Returns Around the World, Alex Edmans, London Business School, Wharton School, NBER CEPR and ECGI Lucius Li, Warwick Business School, Chendi Zhang, Warwick Business School, June 30, 2014, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2461003](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2461003)

code of conduct at all levels of the company, impact their trust significantly in that company.”<sup>8</sup> This suggests a strong business case for addressing culture, and to better understand the roots of what influences corporate culture.

The World Economic Forum’s Drivers of Change Future of Jobs Report<sup>9</sup> identifies important drivers that influence culture, including the changing nature of work (increased flexibility), a middle class in emerging markets which brings with it changing values, geopolitical volatility, and woman’s economic power. Geopolitical changes impact trade and talent mobility, employees are increasingly concerned with carbon footprint, an aging population influences employee culture, and women and a younger demographic may have different priorities. Boards and investors need to be aware of these cultural dynamics and can see the example of the #metoo movement to see the powerful impact social media can have on a culture-related issue with strong implications for many companies.

### **How to assess culture?**

Culture is esoteric and the key indicators are often intangible, so it is difficult to assess. How a business recruits, retains and incentivizes its employees, how it works with suppliers, customers and other stakeholders and how the board functions, oversees and remunerates key executives are examples of processes that reflect culture, but they can be complex for companies and investors to identify and define. For example, culture was explicitly the focus of media accusations of a culture of greed following misconduct at several Australian banks, leading to the publication of *The Royal Commission on Misconduct in the Banking, Superannuation and Financial Services Industry*<sup>10</sup>.

Boards and investors must be aware that the employee’s experience of culture may be quite different from their own perception. The 2017 NACD Blue Ribbon Commission on Culture as a Corporate Asset<sup>11</sup> report suggests that boards tend to focus mainly on the risks identified by management and are reticent to ask awkward questions about difficult aspects of culture, such as sexual harassment. It has also been found that boards seldom have a frame of reference for consideration of “social” issues. “Many directors reported that they are feeling increasingly overwhelmed by the growing range of ‘social’ issues coming at them and that boards are not

---

<sup>8</sup> Edelman Trust Barometer 2019, <https://www.edelman.com/trust-barometer>

<sup>9</sup> World Economic Forum, Drivers of Change Future of Jobs Report, 2017, <http://reports.weforum.org/future-of-jobs-2018/>

<sup>10</sup> Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Wikipedia

<sup>11</sup> [https://www.nacdonline.org/insights/publications.cfm?ItemNumber=48252&airtk=nacd-gs&\\_aiid=nacd-gs](https://www.nacdonline.org/insights/publications.cfm?ItemNumber=48252&airtk=nacd-gs&_aiid=nacd-gs)

equipped with the background, tools, or support to adequately assess which are material in the context of corporate strategy.”<sup>12</sup> Despite that, examples exist of red flags that could have been clearly identified.

### **What does a red flag look like?**

A 2018 report by the Financial Consumer Agency of Canada found targets and incentives in banks contributed to a heavily sales-focused culture in Canadian banks that “increases the potential for mis-selling products and services that may be incompatible with consumer needs and financial situations, as well as breaching market conduct obligations.”<sup>13</sup> As an example of the dangers, it pointed to U.S. bank Wells Fargo’s pressures on its salesforce to sell, which led employees to open accounts and credit cards without customer knowledge, in addition to other ethical breaches, including forgery of signatures. Wells Fargo CEO John “Stumpf’s mantra to employees, “eight is great” meaning, ‘get eight Wells Fargo products into the hands of each customer’”<sup>14</sup> was well known. Only in retrospect was it acknowledged that these incentives were signals of potentially dangerous cultural issues or practices.

It is likely that many directors don’t know what makes their company’s culture tick, or that company messaging emphasizes a culture that is significantly at variance with what is actually happening. A board needs to be, and investors want to be, aware of what the culture really is -- including the tangibles and intangibles that construct it. However, it appears that boards and investors do not always recognize clear signs of cultural difficulties that are accessible to them.

The board must oversee and hold management to account on how it is defining, aligning (to purpose and strategy), embodying and reporting on culture. Research from FCLT Global suggests “a well-functioning, long-term board of directors wields the power to meaningfully influence the purpose, culture, and direction of an organization, setting an appropriate long-term tone for both corporate management and shareholders, as well as

---

<sup>12</sup> High Meadows Institute Blog: Is It Time to Rethink Corporate Governance? Chris Pinney, March 8, 2018 <http://www.highmeadowsinstitute.org/time-rethink-corporate-governance/>

<sup>13</sup> Review of sales practices at Big Six banks finds risks of 'mis-selling' to customers, Geoff Zochodne, March 20, 2018 <https://business.financialpost.com/news/fp-street/review-of-sales-practices-at-big-six-banks-finds-risks-of-mis-selling-to-customers>

<sup>14</sup> How The Wells Fargo Phony Account Scandal Sunk John Stumpf, Maggie McGrath, Sept. 23, 2016 <https://www.forbes.com/sites/maggiemcgrath/2016/09/23/the-9-most-important-things-you-need-to-know-about-the-well-fargo-fiasco/#7d710ce23bdc>

ultimately driving long-term value creation by insulating management and the company as a whole from short-term market pressures.”<sup>15</sup>

The board appoints and oversees the CEO, and as such can influence corporate culture through clear expectations of CEO behaviour. To do that however, the board must understand the specific practices that underlie both the existing culture and the culture they desire. Boards and organization leaders must have a clear and disclosable definition of the attributes of the culture their company needs, to achieve strategy and engage their people. However, “[C]ulture is like a Russian doll, there are layers to it. At the inner circle, there is compliance culture.”<sup>16</sup> The outer layers of culture may be less clear than compliance: for example, how does the board know if there is a culture of inclusivity, one in which employees can make decisions without retribution, or how customers are engaged? Ideally investors should seek to gauge the perspective of key stakeholders including employees, customers and suppliers.

The current regulatory and investment environment reinforces the work of investors, with culture being prioritized. Governance codes are creating a pathway for investors to assess the board’s knowledge of basic information about culture. For example, the 2018 UK Corporate Governance Code includes the provision that the board should assess and monitor culture. It remains difficult though, for boards to clearly identify the culture and associated behaviours they desire in the company they oversee. Furthermore, their confusion regarding a company’s culture may cause investors to be misled. Investors can gain additional information on culture through reports including press releases, surveys and internet applications such as Glassdoor.<sup>17</sup>

### **Investor engagement on culture**

In exercising their stewardship responsibilities investors can also gain a better understanding by asking questions that encourage boards to more deeply consider the *actual* culture of the company and make sufficient inquiries to ascertain how key parts of a company are run.

---

<sup>15</sup> Harvard Law School Forum on Corporate Governance and Financial Regulation, The Long-term Habits of a Highly Effective Corporate Board, Ariel Fromer Babcock, FCLTGlobal, April 19, 2019, <https://corpgov.law.harvard.edu/2019/04/19/the-long-term-habits-of-a-highly-effective-corporate-board/>

<sup>16</sup> Dr. Ann-Kristin Achleitner, Supra, note 5

<sup>17</sup> Glassdoor is a website where current and former employees anonymously review companies. One of its applications can be as a gauge of corporate culture and employee relations: <https://www.glassdoor.com/research/>

### **Questions for investors to ask the board to assess culture**

1. Can the board describe the *actual* culture of the company? If not, do they understand where such a disconnect is coming from?
2. How would the board define the behaviours that demonstrate the culture they desire? Are there observable and measurable criteria to achieve that?
3. Can the board describe how the executive team is modelling the culture they are compensating? How is management's compensation impacted where there are issues of poor conduct?
4. Is the company proposing strategies that are likely to cause serious fractures in the corporate culture? Can the business withstand such damage to its culture without endangering its core competences and basic market position?
5. If essential changes that could jeopardize corporate culture are considered necessary (due to changes in fundamental market conditions, technological disruptions, etc.), what alternative measures and enticements have you considered to alter the culture successfully and in the least painful way to employees?
6. Please describe how the organization's vision and stated values reflect the culture the board desires?
7. What risks has the board identified associated with a break down in culture (employee misconduct, retention, customer retention, employee ethics, data breach etc.)?
8. Does the board review how the CEO's language matches his /her behaviour and stated culture in external and internal communications? Are you satisfied such communication is consistent with the stated culture and values of the organisation?
9. What is the process in place to respond to employee objections? Is there a whistle blower policy? Please explain how the whistle blower policy works and its independence from management?

10. What information does the board review to assess culture, and how much of it is learned from sources other than senior management (for example customer surveys, engagement with HR, site visits or private time with non-executive employees, information about hotline concerns, reviews of social media, Glass Door or alternative applications and so on)?
11. What information does the board receive on why employees /customers leave, why customers do not use their products, why potential employees don't join the company?
12. Is data collected about hotline calls, exit interviews, lawsuits, customer complaints, staff turnover, disciplinary procedures, and treatment of suppliers? Who reviews it and how often?

The board should also assess its own culture and practices on a periodic basis, for example as part of the annual board evaluation process. How an organization is governed will directly influence culture and possible questions for the board to consider include:

- Can the board describe how they are overseeing culture?
- How does the board consider diversity of membership, whether they have the right mix of members? Are there members who are a part of the digital / social media generation?
- Does the board embed culture in compensation, strategy, risk discussions or is it a separate agenda item to be discussed?

## **About ICGN Viewpoints**

This ICGN Viewpoint was drafted by Gigi Dawe, co-chair of ICGN's Board Governance Committee. While not defining a formal ICGN position on the subject, ICGN Viewpoints provide opinion on emerging corporate governance issues and are intended to generate debate.

ICGN Viewpoints are produced by Secretariat and by our member-led Policy Committees, and we encourage dialogue with the ICGN Secretariat and Committees as follows:

Gigi Dawe, co-chair of ICGN's Board Governance Committee: [GDawe@cpacanada.ca](mailto:GDawe@cpacanada.ca)

George Dallas, ICGN Policy Director: [george.dallas@icgn.org](mailto:george.dallas@icgn.org)