CULTIVATING CULTURE

What boards can and can’t do about behaviour
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Interviews and surveys took place from January to June 2016. Positions correct at time of interview.
There’s an ever-increasing volume of words and paper aiming to influence the way companies tackle culture, with the regulators energetically putting their shoulders to the wheel.

Everyone – including all the chairmen and CEOs we’ve met during this project – agrees that how people behave is crucial, and that boards have ultimate responsibility for this.

But often the discussion around culture isn’t very practical, and it doesn’t always take into account the realities of the boardroom and corporate life. It can leave boards unclear and frustrated on what they can or should be doing. It’s a problem we come across when we do board reviews.

So we applaud the initiative of the Financial Reporting Council (FRC) in aiming to find out what’s really happening with boards and culture, and we are pleased to have led the research on how chairmen and CEOs are approaching it.

At the risk of adding still more paper to the pile, we’ve aimed to set out our findings in a practical way – using the words of the business leaders we met, sharing useful examples, telling some of the stories and providing ideas to think about.

The main questions we’re covering are:

1. Who does what on culture?
2. How are boards dealing with culture?
3. What is meant by “culture“?
4. How can you know what you’ve got?
5. How do you influence culture?
6. The view from the C-Suite
“Culture is the embodiment of what we are trying to achieve and how we get it.”

Mike Evans, Chairman, Hargreaves Lansdown

“Culture” has become a term much loved by consultants, regulators, academics and the media. But many seasoned directors are uncomfortable using the word, and it makes some shudder in distaste.

However, it is in widespread use as a convenient and recognisable shorthand and we can’t come up with a better word, so rather reluctantly we will use it too. At the same time, we want to stress how much is covered by that one small word – as the definitions given below by chairmen reveal.

In this report, we have tried to pin down what it means in different contexts and to sort out some of the confusion that can arise. But most of all, we have focused on trying to help boards tackle culture in a practical way, asking ourselves:

• What does overseeing culture actually mean in practice for the Chairman, the non-executives and the CEO?
• What can and should they do to ensure employees and managers are “doing the right thing”?
• What aspects of culture can they influence and how?

Our aim has been to:

• base our analysis on extensive research. Asked by the FRC to find out what boards are doing, we interviewed 58 chairmen and 19 CEOs, and had further survey responses from 44 chairmen (29 of whom were also interviewed) and 33 company secretaries.

What is culture then?

…ethical behaviour, efficiency and agility.

Sir Michael Rake,
Chairman, BT Group

…how it feels to work here.

Ian Durant,
Chairman, Greggs

…the umbrella under which behaviour, standards and principles come together.

Philip Rogerson,
Chairman, Bunzl

…the most important ingredient in an organisation’s success.

Alastair Lyons,
Chairman, Admiral

…the way people behave and how you expect them to behave towards you.

Stephen Hemsley,
Chairman, Domino’s Pizza Group

…values, beliefs and behaviours: it’s an amalgam of intangibles.

Andrew Page,
Chairman, Northgate

…the principles which underlie how people act and make decisions.

Peter Johnson,
Chairman, Electrocomponents

…the way people behave and how you expect them to behave towards you.

Stephen Hemsley,
Chairman, Domino’s Pizza Group
• set out some practical ways in which boards exercise active oversight and show how the board fits into the overall picture

• puncture some of the “hot air balloons” that have taken to the skies

Contrary to what you might hear, we found:

1. There is not enough clarity about who is responsible for setting and communicating the organisation’s culture. Yes, the board as a whole takes overall responsibility, but for the NEDs, this means active oversight of what the executives are doing rather than doing it themselves. It is primarily the CEO and executive team’s job to establish and maintain the right behaviours as an integral part of running the business – and the NEDs’ to hold them to account.

2. Boards and executives are not generally dealing with culture as a distinct concept, and even less as a separate process. Like risk, it is an intrinsic part of strategy and how the business is managed. (The main exception to this is financial services, where a combination of regulatory pressure and past failings means that culture programmes – like risk management – need to be visible.) When the platform is burning, boards give it a lot of attention. The bigger challenge is constantly to maintain the right level of focus on culture even when things are going right.

3. Culture does not always mean the same to everyone. People’s behaviour is affected by many factors – some within the company’s control and some not. When looking at culture, it can be helpful to simplify it into two overlapping aspects – a push to stay out of trouble, and a pull to perform. When media, regulators and boards use the term, they should make it clear which aspect they are focusing on.

4. NEDs are not in a position to be fully confident of the culture. But nor are they completely in the dark. They can build up a good picture from multiple sources. Especially, they need to get out and about, talking to people and feeling things for themselves.

5. Maintaining a healthy culture is not inevitably complicated. Keeping it simple works best and there are various levers that can be used. The board needs to be scrutinising how the executives use these levers to drive the right behaviours.

6. The views of CEOs are largely aligned with those of chairmen. However, as a group, CEOs were pretty much united in putting particular emphasis on their leading role. They agree with chairmen that NEDs should make informal visits to feel the culture, but they want more control over the process.

The main messages for boards

Avoid being distracted by an unrealistic search for a way to “drive and embed the culture”. It can sometimes seem as though NEDs are being exhorted to do this themselves, but the exhortations need to be interpreted wisely. NEDs cannot be the prime movers in establishing the culture – this is for the CEO and executive team to do. The board’s first job is to get the right CEO in place and then oversee how he or she does it while supporting, guiding and influencing. At the same time, the board needs to be able to form a view on the company’s culture, ask the right questions and be ready to step in to take action if the CEO is failing.

Have a clear idea of the desired culture to make sure that a CEO candidate is the right one for the job. This means the board needs to talk about it, though not necessarily as a self-contained topic. Most of the time, it’s more important to treat it explicitly as an integral part of the business of the board’s discussions.

“Culture is now pervasive in all our board discussions.”

John Allan, Chairman, Tesco
Understand what’s actually happening on the ground. What is management doing to encourage the right behaviours and to stop the wrong ones? The only way to know that the CEO is living up to what’s expected is for the board’s oversight to be constantly vigilant. And this involves NEDs getting out into the business to see for themselves.

Obtain information and assurance to give comfort that executives are continually reinforcing the know-how, processes and management. This helps ensure that there is consistency and alignment in what they are doing – and that they have the monitoring in place to know when things are going off track. But don’t let “culture” become a burdensome process in itself, and make the most of the information and assurance that is already being provided before looking for more.

How to read this report

The report is based on the views of a large number of Chairmen, CEOs and Company Secretaries, given in interview or by questionnaire (and for some Chairmen, both). This sample is to some extent self-selected – it consists of those who responded to a request from the Chairman of the FRC, Sir Win Bischoff. So it is likely to represent the views of those who are most engaged and interested in the topic.

As such, it summarises how a lot of leading companies are approaching culture and provides pointers to where boards should focus their attention.

Our interpretation of the research findings is informed by our experience of working with more than half the FTSE 100. We have tried to distil what we have learned into something that will be both thought-provoking and readable. In pursuit of this, we have favoured war stories and quotations over statistics. Some of the war stories have been anonymised but all originate from chairmen.

The report is divided into the six sections summarised on the previous page. Each contains practical “Things to think about”: ways in which some boards are tackling behaviour and which others might usefully adopt – whether listed or unlisted, large or small, global or national.
There is not enough clarity about who is responsible for setting and communicating the organisation’s culture. The board as a whole takes overall responsibility, but for the NEDs, this means active oversight of the executives rather than doing it themselves. It is primarily the CEO and executive team’s job to establish and maintain the right behaviours as an integral part of running the business – and the NEDs’ to hold them to account.

The survey and interviews showed a clear consensus that the CEO and executives have by far the greatest influence over behaviour. They are in the best position to see and feel how people are behaving in the company and to communicate what’s expected. It is generally the executive team, and the CEO in particular, who nurture the culture, determine when and if behaviour needs to change, and make that change happen.

To many this may seem a blindingly obvious statement, but confusion arises when the board as a whole – executives and non-executives – are called upon to “drive and embed the culture” or to “lead its development” or to “set the tone”. This confusion is dangerous because accountability can become blurred.

So what is the board’s role in fact when it comes to behaviour?

Most chairmen and CEOs agree that the board’s single most important contribution to setting the culture is to hire a CEO with the right personal attributes to build and maintain the target culture. And then it must monitor what the executives are up to, influence them for good so far as it can, and fire them if they’re failing.

The board has a crucial supporting role as regards its own behaviour – setting a good example of how to treat others and demonstrating priorities by its own decisions.

Sending a message through appointments

“When I became chairman, the CEO was leaving. This gave us the chance to take the company in new directions. We had to ask ourselves what kind of person would help us to do this. We decided that we wanted a more aggressive growth-oriented company and this required a particular type of CEO. Coming into the company, he changed the culture because of his attitude to new products taking the company in new directions.”

“The CEO was a dominant force. He adopted an autocratic style. He engendered an air of fear. People were frightened to speak up. We had to remove him and build a new management team.”

The NEDs have a particularly important role in helping to foresee possible unintended consequences – including behavioural ones – of management proposals.

The Chairman is involved more than other NEDs because of greater presence and authority, but his or her involvement is still secondary to the executives’. The good counsel of an independent and supportive chairman is much valued by CEOs, and is critical to keeping a narcissistic CEO under control.

Alignment between the executives and non-executive directors is a powerful force for maintaining the

―The Chairman must work through the executive management and not undermine it. The Chairman and CEO can’t be in competition.‖

Mike Turner, Chairman, Babcock International

―The board can’t just be a sullen policeman. The organisation watches the attitude of the board, its reactions and what it values.‖

Anthony Habgood, Chairman, RELX Group
culture – chairmen aspire to this alignment, CEOs value it, and it’s necessary for any board to maximise its effectiveness.

And board composition should not be forgotten either. NEDs need to bring the right values in order to create the blend which is vital to a healthy boardroom culture. Their skills and experience are vital too: in order to influence, the board has to gain respect and in order to be respected, it must be perceived by executives to add value. Of course, this is true for other areas of influence but as regards shaping executive behaviour, it is doubly important.

### Alignment

Does everyone on the board know and agree on the type of behaviour they expect?

Do the NEDs support and encourage the executives to “come clean” both within and outside the organisation, or do their own reactions encourage a cover-up?

Do they stand together or distance themselves?

Does everyone broadly agree on the line in the sand marking the behaviour which will not be tolerated?

Do the NEDs treat management in a way which mirrors the target behaviours?

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“For a board and chairman, it’s the main task. You can build your culture for years and destroy it in the space of six months through behaving wrongly.”

*Dr Franz Humer, Chairman, Diageo*
“Cultural fit is the single most important thing in external recruitment. Will they be the kind of person who rolls up their sleeves and communicates informally? Will they be happy to wander around a market in Lagos? The only way you can detect this is by spending time with each candidate, asking them lots of questions and hearing their examples in detail.”

Richard Harvey, Chairman, PZ Cussons

“The CEO is the primary determinant of corporate culture, but the board can influence the CEO. His understanding of how the board will approach things shapes what he brings to the board.”

Geoffrey Howe, Chairman, Jardine Lloyd Thompson Group

“It is important to select a CEO who is a strong enough leader who has no problem with and even welcomes recruiting and/or surrounding himself/herself with people who he/she feels are maybe better or more expert.”

Gareth Davis, Chairman, Wolseley

“Only management can really know what is going on and the board can’t do their job for them. What the board can do is spot the inconsistencies in the things that they are seeing.”

Daniel Kitchen, Chairman, Workspace Group

“If the culture does not feel right, then the board should have a very direct influence through engaging with management to change it.”

Sir John Sunderland, Chairman, Merlin Entertainment

“The key thing is to be a living example of the values and behaviour that you wish to see in people. For example, if you say you have zero tolerance for bullying, you can’t act in an aggressive, bullying way at the board.”

James Pike, Chairman, RPC Group

Things to think about: What NEDs are doing on culture

1 Setting out what you want
Only by defining what is needed in a CEO will a board be able to make the right choice. Thinking of the behaviour of particular leaders – both negative and positive – can help define the type of person whom the board seeks. This has to be done in the context of the strategic direction and priorities of the company.

2 Reviewing the Chairman-CEO axis
The CEO and Chairman need to check from time to time that their relationship is working. Do you spend enough time together with no agenda? Can the CEO come with a problem or only with a solution? Can you trust one another? Is there the mutual respect that enables the Chairman’s independent counsel to have an impact? There can be a role for a good SID in keeping this relationship healthy.

3 Challenging yourselves on the CEO appraisal
Are you addressing behaviours as well as results? Do you see upwards feedback and is it reliable (only possible if anonymity is guaranteed)? Is the CEO encouraging and enabling his/her executives to develop? Have you had a chance to observe the executives in action, eg by sitting in on occasional management meetings or town hall sessions?

4 Feedback to NEDs
If a NED is not consistently demonstrating your behavioural standards, nip it in the bud. Maybe not publicly – that can put them on the defensive. But don’t wait for the next cycle of one-to-one meetings – the Chairman or SID should have a quiet word sooner. And certainly don’t put it off until the next external board review, even if it would be easier to leave it to a third party!
Boards and executives are not generally dealing with culture as a distinct concept, and even less as a separate process. Like risk, it is an intrinsic part of the strategy and how the business is managed. (The main exception to this is financial services, where a combination of regulatory pressure and past failings means that culture programmes – like risk management – need to be visible.) When the platform is burning, boards give it a lot of attention. The bigger challenge is constantly to maintain the right level of focus on culture even when things are going right.

Get employee behaviour right and it’s “value-adding”. It’s central to strategy in that how people behave can provide differentiation, give competitive advantage and make execution of the strategy possible. It can also create a competitive edge by giving people a sense of pride in belonging to a group which is working together on a worthwhile endeavour.

Get it wrong and it destroys value. Poor behaviour leads, sooner or later but always in the end, to unhappy customers, damaging headlines, employee fraud, accounting errors, penalties, and new regulatory impediments…

In normal circumstances, what works best for many chairmen and CEOs is making sure behavioural considerations are a prominent, consistent part of everything they do – and of just about every discussion.

When it all goes wrong, boards get actively involved, for example, in changing the CEO, replacing the incentive systems, or changing the information and assurance processes. In these cases, the process of determining and shaping the new culture is often visible and distinct, and it will feature as a separate item on the board agenda. In the financial sector, this approach has become the new normal.

Fire prevention

But the big question is – what should the NEDs be doing in a company with a stable culture to help their executives stay ahead? A board that finds itself fire-fighting has stepped in too late.

They certainly shouldn’t be looking to the financial sector for “how to do culture” as part of business as usual. Nor should they necessarily be undertaking sweeping change projects and ruminating at length on the relative merits of “integrity” versus “honesty” in a written value statement.

Some boards and managers find such discussions to be a useful starting point but, just as often, they are seen as an unhelpful distraction. Companies with beautifully crafted value statements have failed catastrophically to live up to them, whilst others with no statement at all have demonstrated exemplary standards of behaviour. So the production of a statement cannot in itself provide insurance against cultural failings.

The conclusion most chairmen draw is that it is more important for the NEDs to be continually calling the executives to account on how they are influencing the behaviours through communications, performance management and training. (See Section 5 on this.)
The committees have an important role to play in this – not a separate culture committee, except in very special circumstances, but all of the usual ones. Like the board, they need to take account of behaviour in everything they do.

As always in business, there are trade-offs: not all desired behaviours are readily compatible – such as cost-cutting and innovation. Business objectives can come into conflict too – rapid increase in sales volumes with customer service, geographical expansion with tight compliance, or centralisation with local initiative. Generally, people are expected to use their judgement in minimising the impact of the trade-offs. The audit/risk committee needs to understand where this might go wrong, how the risk is mitigated, and what monitoring is in place.

“In financial services you have to have two things: values written down in such a way that each member of staff can explain them, and rules which elaborate on what needs to be done in order to live up to the values.”

John Stewart, Chairman, Legal & General

“Boards tend to like it when the executive team proposes centralising a certain number of decisions. It gives them the feeling that better control will be exercised and risks better managed. However, in some cases, it may in fact end up making the operational managers less effective at developing the business and gaining market share.”

Bruno Angelici, Chairman, Vectura Group

“It is important to codify and write down the values and then the culture emerges. The board must work at this.”

Andrew Higginson, Chairman, Morrisons

“Culture is always there in lots of different topics discussed in the boardroom and it doesn’t need separate focus. It doesn’t need to be written down or over-dramatised. Culture is discussed in the context of all the committees. It features everywhere.”

Roberto Quarta, Chairman, Smith & Nephew and WPP

“You need to know your values and in particular, your main value which you believe in but, if you start writing it down, it will become an annual event and it shouldn’t be. People will feel they need to say something different and smarter each year just for the sake of it. And there’s no need – culture and behaviour come up naturally without being the subject itself.”

Sir Richard Lapthorne, Chairman, Cable & Wireless Communications

Culture and strategy

Chairmen and CEOs see culture as integral to strategy. Not just in relation to big strategic steps, but as an enabler for the execution of any strategy. That’s why they think it needs to run through all board discussion, as an inherent part of business as usual.

But of course, when a major strategic step is planned – acquisition, for example, or adoption of a major new initiative – then culture should feature even more prominently, because it’s how people behave that determines how things will turn out. Chairmen are united in thinking this is crucial, and several referred to walking away from acquisitions because due diligence revealed cultural incompatibilities which they did not believe could be overcome.

Chairmen think their boards could be focusing more on:

- **53%** The board’s role on culture
- **48%** The target culture and progress in achieving it
- **41%** The organisation’s behaviour versus publicly professed standards
- **39%** Expressing the culture which we expect management to develop and embed
- **30%** Ensuring the committees give cultural issues attention
Company Secretaries, however, are less sanguine about how the board exercises its strategic role in practice.

**Company Secretary views: in the last year, to what extent has the board discussed the impact on culture of a major expansion or new strategic initiative?**

- **35%** Sufficiently
- **30%** To some extent – but it could do more
- **35%** Not at all

“Culture is not a headline item but is embedded within the organisation.”

*John Watson, Chairman, Bellway*

**Aligning strategy and behaviour**

“Clearly enunciated (and understood) culture and values are a key enabler of successful strategy. At Travis Perkins, a new top management team took over in January 2014, having delivered a new five-year investment strategy to the City in the previous month. The final piece in the jigsaw was to develop a statement of the Group’s culture and values for the company. In doing so, management involved all layers of the organisation and interviewed 200 people, via a third party; both bottom up and top down. Board input was also sought.

The resulting five “Cornerstones“ values, as we call them, were communicated throughout the Group, and also to investors, customers and suppliers.

Our Group CEO often refers to these values, and many decisions are made by reference to them. Company employee awards are made annually for individual and team performance on each of the five Cornerstones. The whole process has energised the five-year strategy.”

*Robert Walker, Chairman, Travis Perkins*
The board’s role in strategy

Not everyone is clear about the board’s role in strategy, let alone its role in relation to culture as a strategic issue. So we have put what we learned from this research together with our experience of board reviews to set out a simple model of how it can work.

"Culture affects strategy because it precludes us from doing certain things."
Stephen Hemsley,
Domino’s Pizza Group

Things to think about: Strategy

1 Asking the simple question
Sometimes it is the fundamental questions that bring strategic discussion down to earth. How do we need to behave to increase our chances of success? What are we good at? Which aspect of our people’s behaviour differentiates us from the competition and has made us successful? How do we make sure we maintain and reinforce these behaviours? How can we ensure that our culture takes over in a deal situation rather than theirs?

2 Checking the behavioural angle
If you consider strategic decisions taken over the last two or three years – international expansions, new products, major IT projects, new performance management systems – what have been the positive and negative effects on behaviour? Have there been unintended consequences? Were they foreseeable? Was the likely impact on behaviour given enough attention at the time? What are the lessons to be learned?

3 Making sure it’s covered
It’s simple to say that behaviour is a part of all board discussions on strategy and risk. It sounds reassuring but how do you make sure it’s not forgotten? On some boards, one individual – not necessarily the Chairman – will call out the need to consider culture. If this does not happen naturally, consider appointing a ‘champion’ to keep reminding the board to do the behavioural checks.
There are two fundamental cultures: “What can I get away with, in the short term?” and “How can I make my organisation grow and prosper in the very long term?”

Anthony Habgood, Chairman, RELX Group

Culture does not always mean the same to everyone. People’s behaviour is affected by many factors – some within the company’s control and some not. When looking at culture, it can be helpful to simplify it into two overlapping aspects – a push to stay out of trouble, and a pull to perform. When media, regulators and boards use the term, they should make it clear which aspect they are focusing on.

There’s the lower limit of acceptable behaviour – breach this and social disapproval results. This gives the upward push. These minimum standards are influenced by law and regulation, society’s attitudes and the company’s own behavioural norms. It is this “keep-out-of-trouble” aspect which is the prime focus of codes of conduct and compliance functions. It is also the reason why culture features so prominently in the FRC’s guidance on risk management and internal control.

And in the other direction is the upward pull to conform with – indeed, to excel at – another set of behavioural norms in order to earn respect and appreciation within a particular social grouping. HR supports line management in encouraging this “we’re special and have the competitive edge” aspect. Companies have a huge influence over how far and in what direction they will pull. Even though industry and societal norms reduce their room for manoeuvre here too, this aspect of culture varies more than the other. (However, there are positive factors that everyone considers important, such as openness, the ability of employees to speak up, and willingness to learn from mistakes.)

The first aspect is a foundation that protects value; the second something that can be used to create value through encouraging performance. One is mainly about risk management, the other about strategy. Like risk and strategy, the two aspects of culture co-exist and overlap, even if people sometimes talk about only one of them.

And it is of course possible to have too much of a good thing. The “keep-out-of-trouble” aspect can dominate too much, teaching people to seek only the compliant answer and handicapping them when judgement is required: rules cannot cover all situations. And the “we’re special” aspect can grow into an unhealthy tribalism where members become insular and can think normal rules – the minimum standards – don’t apply to them.

Why does this distinction help?

Culture is not the same in all countries, regions or even departments of a company. Acquisitions are bolted on, left stand-alone or fully integrated. CEOs and chairmen speak of the need to accept and embrace certain aspects of sub-cultures – partly because you can’t expect to overcome fully local customs, and partly because there is great potential in being open to doing things in different ways to achieve better results. But sub-cultures can also bring reputational damage and even kill companies.

For this reason, there must be a clear understanding of the minimum standards of acceptable behaviour to be adhered to come-what-may in all locations and all departments. This is the aspect where regulation has a more obvious role.

“There’s a lot of peer pressure. People are embarrassed if they don’t do what’s best for customers.”

Glen Moreno, Chairman, Virgin Money
“Culture manifests itself in the spontaneous, instinctive behaviour in an organisation. It is about ‘the thing to do’ and about ‘how we do things around here’. So it has to be an internalisation of both ‘hard processes’ and of unwritten values and beliefs.”

Javed Ahmed, CEO, Tate & Lyle

“It’s about managing risk – long-term success depends on values and ethics.”

Andy Green, Chairman, IG Group

“In our highly devolved structure, we let business heads develop culture within a framework which is clearly set. You have to be careful – if you try to standardise too much, you can destroy a business.”

George Weston, Chairman, Associated British Foods

“We can all rent the same shops, buy the same gear and sell to the same customers from the same warehouses. There’s no opportunity to differentiate on these things. But you can differentiate by having better people doing the basic jobs better.”

Geoff Cooper, Chairman, Card Factory

**Things to think about: Sub-cultures**

1. **Maintaining focus**
   
   There are examples of companies becoming muddled between the minimum standards and the high performance aspects of their culture. In acquisitions, entities are sometimes allowed to retain their “high-performance culture”, which is fine – but not if it blinds the parent company to the need to ensure they are meeting the minimum requirements.

2. **Control levels**
   
   The message should not be “we’re not going to interfere with your culture”. It should be “we’re only going to insist on the basics – but we’re going to insist strongly, and check you’re doing them.” And audit committees should consider whether a new acquisition needs more internal audit and other assurance than elsewhere.
NEDs are not in a position to be fully confident of the culture. But nor are they completely in the dark. They can build up a good picture from multiple sources. Especially, they need to get out and about, talking to people and feeling things for themselves.

NEDs are increasingly getting out and about, making informal visits to observe how people behave in their natural habitat. They are meeting delivery men, engineers and sales reps, driving buses, helping out in warehouses and mystery shopping in the company stores. They are spending time with middle managers as well as a wide range of executives, talking to suppliers and chatting to customers. All this activity allows them to sniff and feel the culture for themselves. They match up their observations with impressions they have formed in the boardroom and spot the inconsistencies.

Some need to do more of this, but there are limits and NEDs must be careful – they are not executives. (Section 6 gives the CEO take on this.)

There’s no magic KPI, but there is a range of helpful indicators such as employee surveys or customer feedback. Before spending large amounts on new sources of information, boards should ensure they are getting the most out of what’s already there – and using it to check if people are actually behaving in the ways they expect them to.

Executives will always know more – they are running the business full time. The best CEOs strive to remain approachable and to spend a large amount of time meeting people and listening to them. (Even to the extent of giving up the express lift to the executive floor.)

HR as well as Internal Audit and other control functions are underused by some boards. But they are not a panacea either. The executive heads of business units have the main responsibility to ensure the culture is being maintained in their areas – functions like HR, Compliance, Risk and Internal Audit only play a supporting role, albeit an important one.

Boards should consider carefully what they expect from each of these functions and how far their resourcing and mandate actually enable them to make a valuable contribution. Are they working collectively to monitor and improve the culture? Have they been asked to take on a specific role?

For example, should Internal Audit be undertaking “cultural audits”? Despite the calls from professional auditing bodies, we found that a lot of CEOs and chairmen are sceptical of the value of such audits – not least because the objectives and remit are often ill-
defined, but also because they do not think that formal, evidence-based audit is the best place to generate behavioural insights. Many are not confident that most auditors have the right mindset for qualitative research around people. On the other hand, a significant number of chairmen and CEOs (although by no means all) set great store by receiving informal opinions and insights on the prevailing culture from HR, audit and compliance.

NEDs are “triangulating” from a range of sources

1 Checking expectations
New NEDs joining the board need to understand the time commitment involved, and existing NEDs can sometimes benefit from a reminder. The amount of time NEDs are expected to spend in the business varies greatly from board to board. Some expect none at all while others assume frequent visits. So it’s important to be clear that several days a year on “site visits” or “in the business” is the norm, over and above board meetings away from the Head Office.

2 Formal vs informal
NEDs should resist visiting in large groups and having an executive “minder” hovering over their shoulders – and CEOs need to resist the temptation to stage-manage visits. The Company Secretary can organise a schedule of visits which has the advantage of making sure that everyone is not visiting the same place. However, it’s important not to let this detract from the informality. (See section 6 for more on the CEO’s point of view.)
Building the picture: there’s no magic KPI but it can be done

Chairmen views: How much attention do boards give to information and indicators?

**STAFF FEEDBACK**

- Enough for now
- Some – but we should do more
- None at all

**INTERNAL CONTROL INDICATORS**

- Do I feel safe raising concerns?
- Am I proud to work here?
- Do I understand what is expected of me?

**HR REPORTING**

- Whistleblowing
- Compliance breaches
- Audit reports
- Health and Safety

**EXTERNAL INDICATORS**

- Absenteeism
- Turnover
- Exit interviews

- Investors
- Suppliers
- Community
- Customer surveys / NPS
- Complaints
- Social Media

66% of chairmen say: Enough for now
39% of chairmen say: Some – but we should do more
30% of chairmen say: None at all

67% of chairmen say: Enough for now
30% of chairmen say: Some – but we should do more
27% of chairmen say: None at all

40% of chairmen say: Enough for now
30% of chairmen say: Some – but we should do more
25% of chairmen say: None at all

38% of chairmen say: Enough for now
30% of chairmen say: Some – but we should do more
25% of chairmen say: None at all
Most boards are looking at a range of indicators but few bring it all together as a coherent whole, looking at readily available data through a culture lens.

“We should be hearing more directly from staff about how they enjoy working for us – and if not, why not”
Sir Brian Souter, Chairman, Stagecoach Group

“We should be hearing more from management about actions that have been taken in light of staff feedback”
Sir Roger Carr, Chairman, BAE Systems

“We look at a range of information from HR – people fired, disciplinary matters and warnings given.”
Charles Gregson, Chairman, ICAP

“Levels of attrition and sick absence are important indicators.”
Alastair Lyons, Chairman, Admiral

“Our employee survey helps identify pockets of inconsistency. For example, we ask people: if you saw someone doing this, would you report them?”
Philip Aiken, Chairman, AVEVA

“Exit interviews are very useful.”
Mark Nicholls, Chairman, Rathbone Brothers

“We get feedback from shareholders on our reputation.”
Jamie Hambro, Chairman, Hansteen

“Complaint handling is especially important, as this can be where the organisation closes ranks to tell the customer he’s wrong.”
Peter Johnson, Chairman, Electrocomponents

“I see all customer complaint letters addressed to me.”
Paul Manduca, Chairman, Prudential

“We get the results of quarterly client surveys. We are in constant listening mode.”
Mike Evans, Chairman, Hargreaves Lansdown

41% of chairmen say:

39% of chairmen say:

30% of chairmen say:

27% of chairmen say:

25% of chairmen say:

30% of chairmen say:

30% of chairmen say:

30% of chairmen say:

25% of chairmen say:

“The board is always looking carefully at safety targets.”
Sir Brian Souter, Chairman, Stagecoach Group

“Whistleblowing isn’t dominated by day-to-day complaints. People know that they will be protected, but they also know that it comes to the board so they don’t use it lightly.”
Sir Roger Carr, Chairman, BAE Systems

“We should focus more on supplier feedback”

“If all board members get the results of a quarterly client survey, we are in constant listening mode.”

“I see all customer complaint letters addressed to me.”
Paul Manduca, Chairman, Prudential

“We get the results of quarterly client surveys. We are in constant listening mode.”
Mike Evans, Chairman, Hargreaves Lansdown
“When you go out and visit places, you tend to get the polished version. I try to go out without executives and spend time with people.”

**Barry Gibson, Chairman, HomeServe**

“You need to meet the project managers who are the key people in the front line. You look at how they behave to make sure you get a good feel about it. NEDs visit projects and also talk to clients directly.”

**Rijnhard van Tets, Chairman, Petrofac**

“Donations to our charitable foundation are a sign of cultural consistency.”

**Sarah Bates, Chairman, St James’s Place**

“Internal audit is asked to identify where the systems are right but the tone feels wrong. They need to be encouraged in this as it’s not evidence-based in the usual audit way – so private meetings are the time to raise the issue.”

**Sir Roger Carr, Chairman, BAE Systems**

“NEDs speak to management gatherings, travel around the business and undertake mentoring of managers two levels down. This helps give them a sense of the pulse.”

**Douglas Flint, Chairman, HSBC**
Seeking a range of views from different levels and locations in the business

48%

Interacting enough with middle management and staff to get comfort on behavioural attitudes

44%

Making enough time to hear from senior management on how they see the current culture

34%

Using meetings with management or staff as opportunities to understand the corporate culture

30%

Chairmen think their boards could be focusing more on:

1 Joining the dots

Before seeking new sources of information, first take what you’ve got and look at it through a culture lens. Various indicators can be linked and compared to spot inconsistencies and messages. If nothing is coming through on the speak-up lines, does your employee survey have some answers? Does it ask about how safe people feel in speaking up? Is Internal Audit telling you what they pick up, not just what they have audit evidence for? A series of health and safety issues arise in one location – what are the staff turnover and absenteeism rates? And what are management learning from exit interviews? When you’ve gleaned all you can, set it out in one place so you can see the whole picture. After that, you should be ready to decide if you need more.

2 Challenging the staff surveys

There are many different approaches to surveys. Some are intuitive and easy to use, getting to the heart of what matters. Others are complex and seem to be designed to tell you that everything is fine. It is important to check that employee and other surveys are really providing answers to the questions you want to ask. For example, staff motivation is an important part of the picture but does the survey tell you how the expected behaviours are communicated, or attitudes to risk management and control?

3 Following up

People are quick to sense if they’re not being listened to and it makes them reluctant to speak up in the future. Following up on the issues raised and making this visible is, arguably, the most important step in any survey exercise. Asking executives for follow-up actions can help ensure they do not get lost among all the competing priorities.

4 Asking why HR and Internal Audit are not giving you a view

Have they been asked in the right way, in private sessions? Beyond the normal assurance reporting, it can be worth asking them for their instinctive feel. They might be surprised and not very forthcoming at first, but with the right encouragement they may provide valuable insights. And if they can’t, ask if they’ve got the resources and mandate to meet the board’s needs.

5 Looking outside

It isn’t enough to listen to what employees think. What also matters is what others see in their day-to-day interactions. What are customers saying? What are they complaining about and how does management respond to complaints? What about suppliers? What can the external auditors tell you about middle management’s attitudes and behaviour? And other professional advisors – what do they think of how the executives behave when the board isn’t in the room?

“Good HR will have multiple sources of information on engagement – this is very important and valuable.”
Bruno Angelici, Chairman, Vectura Group
Maintaining a healthy culture is not inevitably complicated. Keeping it simple works best and there are several levers that can be used. The board needs to be scrutinising how the executives use these levers to drive the right behaviours.

Communications around expectations drive behaviours if they are perceived to be sincere – and if they are kept simple. The CEO’s voice is the loudest, and the tone is as important as the content.

Communications fit into a wider narrative around the purpose of the business which gives meaning to people’s work, a sense of pride and a common frame of reference. The narrative thread runs through conversations in all levels of the business, allowing employees to reconcile the business’s values with those of wider society. Sometimes the narrative requires actions which are contrary to short-term financial goals. Utilities work to help customers with energy efficiency, banks help them avoid overdrafts and the makers of unhealthy or addictive substances encourage them to consume less.

Part of the communications effort is centred around the company’s response to good and bad behaviour. Looking at specific cases at the board allows a discussion on culture to become tangible and real – even if the executives are relating their response rather than expecting a decision from the board. To encourage openness, chairmen need to work hard at creating the right atmosphere at the board – taking time to understand the root causes, to hear how management have reacted and to respond fairly. Moreover, in creating this mind-set at the board, the same degree of openness is encouraged throughout the organisation.

If the much-loved expression “tone at the top” is to have an impact, it must have practical meaning – without over-complicating things. The messages need to be kept simple. With rare exceptions, setting it down in writing doesn’t help much, beyond setting minimum standards: it’s about “doing” rather than “saying”, and using the stories of good and bad behaviour.

How managers behave and the examples they set are key. Quite apart from demonstrating consistency of values across the organisation, which is crucial if they are to be taken seriously, people are very influenced by role models.

Learning and development is another important lever in getting people to understand expectations and training them – middle managers in particular – to behave accordingly.

Managing performance is about managing culture to get more of the right behaviours and less of the wrong. Pay is part of it but there are many other incentives – promotion, job security, peer approval – which can prove more powerful and sustainable. They all have to be consistently aligned.
The main areas for NEDs’ oversight

**LEVERS OVER BEHAVIOUR**
- Communications
- Training
- Performance Management
- Business model

**PROCESSES**
- Maintaining the narrative and sense of purpose/pride
- Equipping people to do their job
- Telling the stories of good and bad behaviour
- Getting managers to act as role models
- Setting goals, standards, targets
- Assessing performance
- Setting up business processes: autonomy vs centralisation

**INCENTIVES AND DISINCENTIVES**
- Praise and recognition vs criticism
- Sense of achievement vs disappointment/shame
- Increased pay and bonuses vs low pay progression
- Career opportunities vs stagnation or dismissal

New priorities, new culture... new management

“We were pushing too hard on revenues and offering rewards which were too high. At call centres, people weren’t following the script and were closing sales in an inappropriate way. With hindsight, we saw that people were earning way too much for working in a call centre. We’ve been on a journey of change where we have re-focused on the customer. This has been led by the board and involved the divisional CEO and much of the senior management team. We have changed the reward structures, and we make sure now that we’re rewarding the right behaviours.”

**Exporting the culture**

“It has been a great achievement that we have managed to export the culture. We’ve done this in a structured way, recruiting the intended CEOs from the local countries – albeit with international management training – and then sending them to our UK office for 12 months. They get to meet everyone and work in different departments. We ask them to write a business plan. It means they understand and feel the culture and get to know the people. They go back to their country and then recruit a local management team of the same type.”

**Alastair Lyons, Chairman, Admiral**

“You need a strong Learning and Development team to keep the culture alive because it’s vital to give people the professional skills and the management tools to be able to do their jobs in the right way.”

**Dorothy Thompson, CEO, Drax**

“We’re not happy with under-performance, but we are focused on success in the right way.”

**Andrew Higginson, Chairman, Morrisons**

“The most important thing is to have a clear sense of purpose. The board needs to refrain from pressing for anything which is contrary to it.”

**Glen Moreno, Chairman, Virgin Money**
5: How do you influence culture
continued

“You need to understand what the purpose of the company is, and this is driven by the CEO, the Chairman and senior executives. Then, if you look at the incentive system, it should not be doing something different and pushing in a different direction. It can’t be encouraging people to behave in ways that contradict the purpose.”

**Anthony Habgood, Chairman, RELX Group**

“If you have a strong adherence to the values but are not performing, then you need to be coached in order to reach the right results. If you have a strong adherence to the values and are performing well, then this is the ideal situation. If, however, you are performing well but you have the wrong values, you need to go.”

**John Stewart, Chairman, Legal & General**

“People model themselves on those behaviours observed in their seniors – it matters more than what is written.”

**Andy Duff, Chairman, Severn Trent**

**Things to think about: Levers**

1 **Prioritising the values**
   Challenge the executives on ‘toxic’ managers. Those, for example, who are successful at delivering results but unable to keep their team together. They might be workaholic bullies – we’ve all come across them. It sends a strong signal when such people are shown the door, despite their good financial performance.

2 **Discussing what you’re hearing**
   No reported cases of bad behaviour is good, right? But if you are not hearing about at least some problems, why not? It would be something of a statistical rarity for 100% of employees to be angels. The board needs multiple opportunities to discuss behaviours in a real context. Discussing the good and bad stories gives the non-executives and executives the chance to reflect and agree on future approaches. Consider if there is space – outside the formal board meetings perhaps – for reinforcing the positive behaviours as well as dealing with the negative ones.

3 **Were we too tough or too soft?**
   If you look back at instances of poor behaviour which came to your attention in the past year, was the board’s response a fair one? Or were you perhaps too quick to blame? Or too tolerant of poor performance? It is worth considering with hindsight if root causes were sufficiently explored, and also what action was taken to limit the chance of recurrence. Finally, consider how the board’s or the Executive’s decisions and actions were made known; most companies rely on the grapevine, but some favour “public hangings” for the most egregious cases… pour encourager les autres. The aim is to create an environment to hold people accountable, but one in which they feel they can speak up if they make a mistake.
“The tone has to come from the CEO – he is responsible for delivery globally of a culture that values high standards of conduct.”

Sir Martin Sorrell, CEO, WPP

Rather pleasingly, the views of the 19 CEOs we spoke with largely aligned with those of chairmen. However, as a group, they were pretty much united in putting particular emphasis on certain points.

The executives lead on culture. Almost unanimously, CEOs are even more adamant than chairmen that it is their job and not the board’s to set and deliver the culture. They value the NEDs – particularly the Chairman – being engaged in the joint endeavour to get the culture right. But once endorsed, they should let the CEO get on with leading.

The board’s most important role on culture is to hire and fire the CEO. This was given particular – almost provocative – emphasis by a number of CEOs. “They chose me as leader with my own personal culture,” is the subliminal and sometimes overt message, “so they should let me get on with it.”

It’s an integral part of running the business. CEOs speak of processes and information, business model and strategy, know-how and finance. They find it difficult to speak about maintaining and changing the culture in isolation because it is so integrated with their core responsibilities in managing the whole enterprise. In contrast to chairmen, a sizeable body of whom see value in making explicit statements of values and culture, CEOs are usually content to leave it implicit – or at least short and simple (though none the less important for that).

Communications are vital for influencing the culture. The CEO must work continually on this, as what he or she says is amplified and can have a major effect quickly. CEOs identify a number of attributes that help make their communication effective: see the next page.

It’s difficult to know what you’ve got. CEOs find it a challenge to keep on top of the culture in different parts of the business. So they recognise that, for NEDs, it is even more difficult. CEOs feel it is their responsibility to communicate the culture to the NEDs, but it is hard – even impossible – to give assurance. There needs to be trust, albeit informed by reporting and first-hand experience.

NEDs are welcome in the business. Most CEOs are very open to NEDs getting out and about, particularly the Chairman, and appreciate how important it is for NEDs’ understanding. Many of them, however, favour providing NEDs with “structured opportunities” to go on visits – which is contrary to the majority chairman view that informality is best. CEOs do not like to lose control so this is likely to be a continuing source of tension which needs to be managed by the Chairman – and alleviated by the NEDs showing they can be trusted off the leash.

“I’m not a fan of discussions about values. You just end up with another poster replacing the ones peeling off the wall from last time. It’s no good looking at culture in theory, you need to experience behaviour in practice.”

Adam Crozier, CEO, ITV

“The board should be aware as far as possible of the culture(s). They clearly have to reinforce the standards that have been set. The board needs to set the mood. However, the board should not interfere, as this may risk causing discontinuities and problems. Their involvement has to be very balanced. If the board feels that it is not working, they need to get rid of the CEO.”

Sir Martin Sorrell, CEO, WPP

“I expect the Board to be holding my feet to the fire over culture.”

Robert Noel, CEO, Land Securities
“There is a real danger in trying to over-codify what you do on culture. You would end up stifling innovation and creativity, and drive people to avoid risk altogether. You have to recognise that ‘professionalism’ is about common sense and judgement.”
Richard Solomons, CEO, IHG

“They say a fish rots from the head but it can rot from the Finance Department in corporate life, if they forget that their job is to make sure that management and owners understand the truth and know what is going on. Culture goes wrong when people are more interested in what they would like the truth to be, rather than in what it is.”
Rupert Soames, CEO, Serco

“The Chairman must be absolutely involved. The remainder of the board should speak up if they feel the need to but hold the CEO accountable – much more would be straying into executive territory.”
Robert Noel, CEO, Land Securities

“Executives are always going to know more than the board – that needs to be remembered and it’s why boards need CEOs to be transparent about the performance of the company, good and bad.”
Adam Crozier, CEO, ITV

**Elements of effective communication by CEOs**

- **Simplicity**
  - Get the message across

- **Consistency**
  - Do what you say

- **Honesty**
  - Don’t be evasive, admit what you don’t know and don’t hide bad news

- **Visibility**
  - Be out in the business continually in order to listen

- **Clarity**
  - Make clear what you are not willing to compromise in order to achieve high performance

- **Approachability**
  - Make it easy for people to speak to you, or to write you an email

**Things to think about: NEDs out and about**

1. **Being clear about what NEDs are doing**
   - CEOs feel that NEDs should be clear about their aims when they go on visits. It should be to gain an impression and understanding of the culture (along with other aspects of the business), both for their own benefit and so they can feed back to executives and other NEDs on what they’ve observed. CEOs welcome this independent perspective.

2. **Being clear about what they’re not doing**
   - What they do not welcome is when NEDs try to send explicit messages in the business – that’s straying into management territory (although the NEDs will of course be signalling what matters through their own behaviour). NEDs should keep the CEO informed about their visits, and they should be wary of returning from a limited visit ready to tell the CEO what he needs to be doing on the culture (or indeed any other aspect of the business). CEOs see themselves as the ones who must develop coherent plans based on their greater knowledge, which they then put to the NEDs rather than vice versa.

**Our view?**
   - There is no doubt which way the regulatory tide is flowing around the expectations of the Board for promoting the culture agenda, raising questions and concerns, and generally being more engaged and better informed. CEOs might feel the temptation to push back on this, but they have better things to do than play Canute. Making the most of the NED’s engagement with the business, while agreeing sensible ground rules to minimise tension, is the best approach.
In this report, we have distilled the thoughts of many chairmen and CEOs as to who should be doing what and how. But there will never be a simple answer. The board will always have to exercise judgement when asking themselves the question – are we on top of culture? But then, exercising judgement on difficult matters is what boards do...
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We help boards review the effectiveness of internal and external audit, risk governance and internal control.

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