

Corporate culture and the role of boards

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Financial Reporting Council

Who we are and what we do



Financial Reporting Council

UK Corporate Governance Code

- Applies to all premium listed companies on a 'comply or explain' basis
- Five sections covering:
 - A. Board leadership and composition
 - B. Board effectiveness
 - C. Reporting and risk management
 - D. Remuneration
 - E. Relations with shareholders
- Additional guidance, e.g. audit committees and risk management



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

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Sir Winfried Bischoff
Chairman
Financial Reporting
Council



‘Culture in a corporate context can be defined as a combination of the values, attitudes and behaviours manifested by a company in its operations and relations with its stakeholders. These stakeholders include shareholders, employees, customers, suppliers and the wider community and environment which are affected by a company’s conduct.’

FRC, 2016. Corporate culture and the role of boards



Methodology

Meetings

300

Interviews

23

FTSE chief executives

58

FTSE chairmen

Surveys

44

FTSE chairmen



Coalition partners



Chartered Institute of
Management Accountants



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Key observations

- Recognise the value of culture
- Demonstrate leadership
- Be open and accountable
- Embed and integrate
- Align values and incentives
- Assess, measure and engage
- Exercise stewardship

RECOGNISE THE VALUE OF CULTURE

A healthy corporate culture is a valuable asset, a source of competitive advantage and vital to the creation and protection of long-term value. It is the board's role to determine the purpose of the company and ensure that the company's values, strategy and business model are aligned to it. Directors should not wait for a crisis before they focus on company culture.



Questions on values

Are we clear about the values and behaviours we expect when recruiting new executives?

Do we hold the chief executive to account where we see misalignment?

Are we discussing culture in sufficient depth at board meetings?

How are we taking account of culture in our board effectiveness reviews?

How can we ensure we consider the impact on culture in all the decisions we take?

Do the committees support the board on culture?

Is there a need for a specific conduct, ethics or culture committee?

What is the company telling the outside world about what it stands for and how it conducts business?

ALIGN VALUES AND INCENTIVES

The performance management and reward system should support and encourage behaviours consistent with the company's purpose, values, strategy and business model. The board is responsible for explaining this alignment clearly to shareholders, employees and other stakeholders.



Questions on incentives

How well are our values and expected behaviours embedded in all our HR processes from recruitment to exit interviews?

How is corporate reputational risk considered in the setting of incentives?

Does the balance between financial and non-financial incentives support the desired culture?

Are behavioural objectives included in leadership and employee goals and are behaviours formally assessed as part of performance review activity?

Have we considered whether top tier executive pay awards and those of other employees could undermine culture?

EXERCISE STEWARDSHIP

Effective stewardship should include engagement about culture and encourage better reporting. Investors should challenge themselves about the behaviours they are encouraging in companies and to reflect on their own culture.



Questions for investors

Do the board and senior management seem to have a clear idea of the company's purpose?

Do the company's values seem to be aligned to its business model or models?

What first-hand experience do NEDs have of conditions in the operating parts of the business?

How is the board assessing culture and how does it hold the executive to account?

How does the board take account of culture when structuring remuneration?

How does the board ensure incentives do not encourage undesirable behaviour?

How does the company deal with employees who are in breach of company rules or codes of conduct?

What actions has the company taken in the last year to reinforce culture?

Internal sources

Compliance and control indicators of culture

Health and safety record, including near-miss reporting

Whistleblowing/speak up incidents

Promptness of payments to suppliers

Control failures and instances of poor compliance

Fines/regulatory breaches

Expense claims

Breaches of the code of ethics/conduct

HR sources of insights into culture

Responses to employee surveys, especially those shedding light on middle and senior management attitudes

Succession plans

Staff turnover and absenteeism rates

Workforce diversity

Staff training data

Recruitment policies and practices

Promotion decisions

External sources

External sources of insights into culture

Customer complaints

Customer satisfaction data

Supplier feedback

Social media, for example, Glassdoor

Conclusions

- Connect purpose and strategy to culture
- Don't wait for a crisis
- Take account of stakeholders other than shareholders
- Align values and incentives
- Assess and measure

Next steps UK Governance

- Encourage others to develop practical support
- Consider *culture* in context of other CG developments
- 2017 consultation on Code and supporting *Guidance* expected
- Changes to primary or secondary legislation?