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# Board Perspectives:
*Risk Oversight*

## Board Oversight of Organisational Culture

*The concept of culture oversight is gaining traction in the boardroom. More than ever, directors are acutely aware that culture plays a role in delivering outcomes — both good and bad — for the companies they serve.*

Every director has read stories of companies behaving badly and asked themselves, "What were they thinking?" Perhaps he or she has also pondered, "Can that happen at my company?" On the flip side, many directors have also observed successful companies they admire and wondered, "What makes them tick?"

As author Peter Drucker famously pointed out, "Culture eats strategy for breakfast." Like everything else that has a demonstrable impact on an enterprise's success in creating and protecting enterprise value, culture warrants a proactive agenda from directors and senior executives to understand, measure and reinforce it continuously and improve it as circumstances warrant.

### Key Considerations

In the most recent Protiviti and North Carolina State University ERM Initiative global survey of board members and C-suite executives,[1] respondents cited resistance to change as the number two risk for 2018 — a significant matter given that the number one risk points to concern over the implications of disruptive change to the business model. Our results also indicated that board members and management are concerned about the risk that important information is not flowing up to them promptly. These risks relate to culture. Also, the results of a National Association of Corporate Directors (NACD) survey noted that the board's understanding of corporate culture doesn't extend beyond the tone at the top, creating a risky disconnect between the tones in the middle and at the top.[2]

1 *Executive Perspectives on Top Risks for 2018*, Protiviti and North Carolina State University ERM Initiative, December 2017, available at www.protiviti.com/US-en/insights/protiviti-top-risks-survey.

2 *2017-2018 NACD Public Company Governance Survey*, November 2017, complimentary executive summary available at www.nacdonline.org/Resources/Article.cfm?ItemNumber=50360.

Thus, culture is being elevated as a priority issue in the boardroom, as it is unquestionably a vital enterprise asset that must be cultivated, nurtured and maintained. In June 2018, Protiviti met with 15 active directors during a dinner roundtable at an NACD event to discuss the board's oversight of organisational culture. The conversation revealed several key themes related to culture that boards must understand.

**Culture must be nurtured in a changing environment.** Culture means different things to different people throughout the organisation, from the board down. In some companies, it represents strategy, particularly in smaller companies with an entrepreneurial focus on growth, passionate and hands-on leaders, and an easier-to-manage size and scope. As such organisations scale and grow, gain visibility in the market, and experience an infusion of new talent, the inevitable blending of styles may create conflict — and the culture often changes, and not necessarily for the better.

As discussed further below, some directors relate culture to values, mindset and behaviours. A useful general definition of culture is as follows:

> *The behaviours that people experience when they work for or interact with the enterprise's management team and other representatives, as manifested through their decision-making, attitudes and actions day to day.*[3]

Note that the focus is not on what leaders and key employees say, but on what they do. Whatever the belief systems are, they manifest themselves through the enterprise's actions.

The group at the roundtable discussed the intricacies of understanding a company's "subcultures." Innovation culture is a subculture, for example. Other subcultures may include a quality-committed culture, a sales culture, a safety-conscious culture, a risk culture, and a diverse, inclusive culture. Organisations should pay attention to their subcultures to ensure they are aligned.

As the company expands, cultures within it may develop to the point where they vary across the entity at different locations, in different functions and departments, and, of course, in different countries and regions. For example, a significant acquisition often results in management having to address distinctively different cultures in the merging entities. And digital transformations often require hybrid talent models that combine employees who grew up during the analog, physical age with new employees armed with digital expertise and fresh ideas for deploying it. The influx of digital talent can bring with it different views and perspectives as to how the company should operate. These cultural distinctions across the enterprise must be understood and managed.

In some organisations, especially in the technology industry, there can be the dominant personality of the founder or founders; such companies may lack a healthy, open, transparent and speak-up culture. They run into trouble if these individuals drift away from the company's values or acceptable societal norms through their behaviour and examples. All of these aspects of culture can create friction across the organisation that should be understood and managed.

Ultimately, as a company's leaders manage changes in processes, people and technologies to align the business model with shifting market realities, they must do it in a way that ensures a healthy, vibrant corporate culture remains intact. That is why the board needs to ensure that periodically management assesses the alignment of culture with the enterprise's vision and values. If the culture is flawed or dysfunctional, for whatever reason, necessary actions should be taken to fix it.

**The board has an important role in understanding and monitoring culture.** Any time a leader's actions stray from the entity's mission, vision and values, the board should note the change as a red flag. When developments stemming from a flawed culture adversely affect an organisation's reputation and brand, the question arises as to whether there were early "red flag" alerts to directors. Sometimes these signals are subtle. For example, can the board connect the dots between sales incentive practices and the subculture these practices create when the narrative around cross-selling makes sense from a growth standpoint and compensation consultants assure the board that other industry players are doing the same thing? If base compensation is lower than industry standards and the difference must be made up through incentive compensation, what does that tell the board?

[3] "Corporate Culture: Are You Curious Enough?" *The Bulletin*, Vol. 6, Issue 12, Protiviti, June 2018, available at www.protiviti.com/US-en/insights/bulletin-vol6-issue12.

Similar issues arise with respect to demanding cost and schedule metrics vis-à-vis safety standards in situations that are environmentally sensitive or involve potential threats to the public interest. Yes, the tone at the top is critical in driving behaviour in areas like safety, but so is the tone in the middle; the two must be aligned so that behaviours match the words. Safety is more than just issuing policies and instituting appropriate procedures and practices. It is also a mindset and something that must be practised and reinforced at all times — at the top and in the middle — so that the tone at the bottom fosters the desired behaviours. When there is a conflict of metrics that places at risk the focus on safety at a crucial moment, the matter should be escalated to the appropriate level.

The roundtable discussion raises two fundamental questions: How do board members know what they need to know regarding culture? More importantly, is their understanding representative of the entire organisation or just in certain areas? Following are two ways to address these questions:

- Board members should engage directly with operating personnel through site visits. Because culture can break down anywhere in the company, it is important to experience firsthand the real-world culture rather than rely solely on boardroom discussions. During these visits, directors can directly observe the culture, interact with employees, experience how people communicate with customers and each other, and see what their priorities are in relation to the core values espoused by executive management. These observations can help directors formulate their own informed views.
- Directors should focus additional "eyes and ears" on culture. They should insist on observations regarding culture from the chief risk officer, chief compliance officer, chief information security officer, and human resources and environment, health and safety personnel, as well as other independent second line-of-defence functions. These functions should have a unique viewpoint, as they assist business unit leaders and process owners with assessing culture in their respective areas of responsibility. The third line of defence — internal audit — may also perform a culture audit, evaluating the processes used across the entity by first- and second-line personnel to assess culture. With everyone having a stake in evaluating the enterprise's culture, the board should be privy to the results of their evaluations — particularly from independent second-line functions and internal audit.

**Culture should be measured.** A view shared by several board members during the discussion (though not unanimous) is this: Culture is not intangible and can be measured. Keys to consider tracking are values, mindset and the behaviours that follow. If these align during the organisation's recruiting, onboarding and training, a strong culture will exist. Values are one thing. Behaviours are another. Simply having values doesn't mean that they are being practised. Energy company Enron had a world-class code of ethics, but its day-to-day behaviours reduced that code to a mockery. As mindset, or attitudes, can be decisively influential in driving behaviour, the board needs to ascertain if management is assessing behaviours and challenge whether values are being practised and reinforced.

Metrics focus attention on what matters and clarify management's priorities, and may include mission and values alignment, innovation, resiliency, collaboration, and employee satisfaction. Employee satisfaction, for instance, might be addressed through tracking employee retention rates and feedback from anonymous employee surveys and exit interviews.

The point is, culture *can* be measured. So, the question then becomes: *Is it being measured?* Methodologies exist for companies to benchmark their culture against leading organisations. For example, Ethisphere offers a benchmarking survey tool to measure culture around eight pillars of corporate culture.[4]

[4] See Ethisphere's "8 Pillars of Corporate Culture," available at https://ethisphere.com/what-we-do/culture-assessment/.

The key is to define the organisation's values and the behaviours that demonstrate them. But how do directors move beyond the senior executive suite to understand behaviours in the organisation? This circles back to the importance of direct access to the organisation's operations and employees, as discussed earlier. Also, the board needs to inquire of executive management how they know the tone in the middle is aligned with the tone at the top. If it isn't aligned, front-line and back room employees may be getting a different message from their superiors than the one they hear from the CEO and executive team. Ultimately, directors and senior management need insight into the behaviours happening day-to-day at all levels of the organisation.

**Directors need to be curious enough to probe on cultural issues.** The board must *want* to know whether there are any concerns pertaining to culture warranting its attention. In the context of understanding and measuring culture, are board members curious enough? How about executive management, or the executives supporting the board's oversight activities? For board members at companies that have experienced scandals related to a toxic culture in recent years, another question arises: *How did this happen, and why didn't we know?* In light of recent events and the attention that they have drawn to culture oversight, it is imperative that the board and management are inquisitive — plausible deniability regarding a flawed culture carries little weight.

For example, is management investing in monitoring social media and message boards to get a sense of the ongoing dialogue about the company and its processes, products and services? Such monitoring may pick up subtle signs of emerging or potential issues in the organisation. One might discern that a "get along, go along" culture is in place, for instance. Admittedly, online sources often contain vague, disparate pieces of information, much of which may be deemed unreliable. But nuggets of informative insights may be discovered. One possible solution for capturing insights is artificial intelligence (AI). Consider what this research exercise might look like five years from now with the use of AI to deliver insights about the organisation from online sources.

Directors should insist that executive management have effective processes for escalating concerns and, as noted earlier, second and third line-of-defence functions focused on identifying early warning signs and red flags regarding cultural dysfunction. In addition, useful insights about patterns that suggest potential issues can be obtained from independent, confidential surveys, and opportunities for public commentary on culture, such as Glassdoor. Executive management can also provide ongoing research to board members, offering insights on how market perceptions are trending with respect to the organisation and the customer experience it delivers.

## Questions for Boards

Following are some suggested questions that boards of directors may consider, based on the risks inherent in the entity's operations:

- Can the board and CEO agree on the state of the current culture and whether it is aligned with the enterprise's strategy and core values? Is the mood in the middle aligned with the tone at the top? Are there any gaps between the current culture and desired culture?
- Does the entity measure culture? Does it monitor and improve its culture over time as needed? Does the board have transparency into how well the culture is functioning? For example, how does culture impact employee performance, productivity, recruiting and retention?
- Are there subcultures that are in conflict with each other? If so, do they present exposure to organisational dysfunction (e.g., excessive risk-taking, off-strategy decisions, or unethical and irresponsible business behaviour)?
- Is the board's culture fit for purpose in today's environment? Are diversity and inclusion considered by the nominating committee when evaluating candidates for the board?

## How Protiviti Can Help

Protiviti assists boards and executive management in public and private companies in identifying and managing the organisation's key risks. We work closely with companies to assess the entity-level control environment, organisational structure and cultural issues that can impact their performance. We offer an experienced, unbiased perspective on issues separate from those of company insiders and an analytical assessment approach that focuses on strengthening the organisation's culture.

### Is It Time for Your Board to Evaluate Its Risk Oversight Process?

*The TBI Protiviti Board Risk Oversight Meter™ provides boards with an opportunity to refresh their risk oversight process to ensure it's focused sharply on the opportunities and risks that truly matter. Protiviti's commitment to facilitating continuous process improvement to enable companies to confidently face the future is why we collaborated with The Board Institute, Inc. (TBI) to offer the director community a flexible, cost-effective tool that assists boards in their periodic self-evaluation of the board's risk oversight and mirrors the way many directors prefer to conduct self-evaluations. Boards interested in using this evaluation tool should visit the TBI website at http://theboardinstitute.com/board-risk-meter/.*

**Learn more at**
www.protiviti.com/boardriskoversightmeter



Protiviti partners with the National Association of Corporate Directors (NACD) to publish articles of interest to boardroom executives related to effective or emerging practices on the many aspects of risk oversight. As of January 2013, NACD has been publishing online contributed articles from Protiviti, with the content featured on https://blog.nacdonline.org/authors/42. Twice per year, the six most recent issues of *Board Perspectives: Risk Oversight* are consolidated into a printed booklet that is co-branded with NACD. Protiviti also posts these articles at protiviti.com.