Governing company culture

Insights from Australian directors

December 2020

About us

Australian Council of Superannuation Investors

Established in 2001, ACSI exists to provide a strong, collective voice on environmental, social and governance (ESG) issues on behalf of our members. Our members include 37 Australian and international asset owners and institutional investors. Collectively, ACSI members own on average 10% of every ASX200 company.

Level 23, 150 Lonsdale Street
Melbourne VIC 3000
Phone: (03) 8677 3890
Email: info@acsi.org.au

Australian Institute of Company Directors

The Australian Institute of Company Directors (AICD) is committed to strengthening society through world-class governance. We aim to be the independent and trusted voice of governance, building the capability of a community of leaders for the benefit of society. Our membership of more than 45,000 includes directors and senior leaders from business, government and the not-for-profit sectors.

National Office
18 Jamison Street
Sydney NSW 2000
Phone: (02) 8248 6600
Email: contact@aicd.com.au

Foreword

Corporate culture can have a profound impact on a company's performance, governance and reputation. At the heart of many – if not all – of the high-profile governance failures over the past decade have been examples of poor company culture or sub-cultures.

Boards are as responsible for oversight of culture as they are for financial performance. It is critical that directors prioritise and embed good company culture within their organisations, and act immediately where there are instances of misconduct or unethical behaviour. Understanding the *actual* culture and devising a roadmap to the *desired* culture is crucial.

Yet despite significant commentary on why culture is important to an organisation, there has been little on how organisations, and in particular boards, should tackle this challenge. Against that backdrop, the Australian Council of Superannuation Investors (**ACSI**) and the Australian Institute of Company Directors (**AICD**) have partnered to examine how listed company directors currently oversee, assess and influence company culture. The information in this report is intended to provide practical guidance to directors about how to foster a good company culture, without being prescriptive.

Our research reveals that directors are acutely aware of the importance of culture in driving performance and good outcomes for employees, customers and stakeholders. Although we often hear that culture is difficult to oversee and assess, our interviews show that directors have access to a breadth of different metrics and can take a sophisticated approach to interrogating and synthesising this data. What has been most enlightening is the extent to which board's see their role in influencing company culture. The directors we interviewed are engaged and committed to setting the tone from the top – whether that is in their role in selecting and overseeing the CEO, to considering how their own behaviour aligns with the desired company culture.

The increased and evolving expectations on accountability, combined with the extraordinary set of circumstances created by the COVID-19 pandemic have created additional challenges in management, governance and oversight of culture. Many companies have had to make significant and rapid changes to how they operate, and faced unprecedented threats, but also opportunities. Many credit their employees and pre-existing business relationships as a key part of their ability to navigate this change. In this sense, the discussion on company culture is more important than ever.

We hope that this research will be a useful tool for all directors in their approach to examining company culture and will contribute to a baseline understanding of the board's role in overseeing, assessing and influencing culture.

Louise Davidson
Chief Executive Officer
ACSI

Angus Armour
Chief Executive Officer and
Managing Director
AICD

Table of contents

Summary

This joint report by the AICD and ACSI provides firsthand insights from the boardrooms of Australia's largest companies about how directors oversee, measure and influence culture.

The backbone of the research is a series of interviews with senior directors of ASX50 companies about the role of the board in overseeing, assessing and influencing company culture. Additional background research analysed publicly disclosed culture-related information from the ASX50 companies and existing research on the importance of strong company culture.

The information in this report is intended to provide practical guidance to directors about how to foster a healthy company culture, without being prescriptive. The complexity of corporate culture means boards will need to think deeply about what mechanisms work best for their organisation and dispassionately consider their current level of cultural understanding.

Key Findings

Culture is a priority for directors

Our interviews revealed that there has been a significant shift in the focus on culture over recent years, with it now firmly in the spotlight for directors. Directors are alert to the risks and benefits of a positive or negative culture, and many demonstrated a sophisticated approach to defining, overseeing and measuring culture. Crucial to that process is articulating in writing the desired culture. There is a strong sense that boards and senior management set 'the tone from the top' and that directors play a critical role in governing culture. Perhaps most importantly, the board should challenge actions and decisions by asking whether they are consistent with the desired culture.

Going forward, the board's oversight of culture will be tested by the ongoing impact of COVID-19, particularly as workplaces look to permanently adapt to more flexible ways of working.

Directors now use a range of tools to influence company culture

We found that senior directors of large Australian companies believe that they are able to exert significant influence over company culture. It is encouraging to see the array of practical methods directors already use to influence company culture for the better. The key methods directors use to influence culture are:

- Selecting, monitoring and (where necessary) removing the CEO
- Executive remuneration: rewarding or penalising behaviour
- Setting the tone from the top: living the desired culture by modelling desired behaviours
- Sending signals via board priorities and decision-making
- Influencing the creation and enforcement of values statements and codes of conduct.

Directors need to be curious, persistent and prepared to synthesise information from diverse sources in order to truly gauge the actual corporate culture

Data and metrics relating to culture are widely available, but in order to interpret these effectively, individual directors must be curious, persistent and willing to synthesise the many formal and informal sources of information. Directors believe strongly that the raft of metrics relating to culture are only part of the picture; individual directors must be able and willing to interrogate these data.

Fundamentally, the board must seek to address the inherent risk that management may present an overly optimistic picture of corporate culture or that directors become overly reliant on management's perspective. Boards should be seeking to understand and bridge the gap between the actual and desired cultures.

Directors see a link between company culture and long-term company performance

Our findings build on existing research, and in particular support previous studies' findings that positive company cultures are associated with better long-term company performance. Most directors interviewed see behaviours as the core of company culture, and many stressed that defining expected culture was a precursor to requiring employees to behave in line with the desired culture. All of the directors we interviewed felt that culture is extremely important to the long-term success of the company. Successful implementation of the agreed strategy relies ultimately on the prevailing culture.

Limited public disclosure on culture

Analysis shows a wide variance in public disclosure practices amongst ASX 50 companies. Investors would value greater disclosure to discern company's cultural strengths and weaknesses. For almost half of ASX 50 companies cultural outcomes did not factor into remuneration plans.

At the same time, there is a lack of market consensus regarding the most valuable and appropriate metrics to report against. This is an area where there should be further dialogue between directors and investors to seek to reach a common view.

The insights from the experienced directors and subject matter experts interviewed suggests that while the task before boards is formidable, it is not impossible. There are sources of information and techniques that can help boards to understand their organisation's culture. Indeed, a key finding of this research is that directors believe they can and should influence culture and are able to articulate methods for doing so.

Ultimately, assessing company culture is an exercise in judgment. A board comprising diverse individuals who are self-motivated, curious, inquisitive and able to ask the hard questions of fellow directors and management, is well placed to help foster a stronger culture.

Report structure

The report is structured as follows:

(i) Background information comprising a snapshot of contextual and empirical information on company culture, including an analysis of information on culture publicly reported by ASX50 companies;

(ii) An overview of how Australian directors and boards oversee, assess and influence company culture, based on in-depth interviews with experienced directors and subject matter experts; and

(iii) A summary snapshot that highlights some of the issues and questions boards should seek to explore as part of their cultural stewardship role.

Background

While company culture has always been important, it is only since the global financial crisis that it has become a significant point of discussion for regulators, companies and investors. Despite this increased focus, company culture remains very difficult to gauge 'from the outside'. This section provides some background for this research, and makes three central points:

- culture has become a priority
- culture is linked to performance
- publicly available data on culture is limited.

Together, these factors created the impetus for this research, which provides readers with perspectives on company culture 'from the inside'.

Culture has become a priority

Company culture has been in the spotlight for a number of years, with growing recognition of the importance of culture within an organisation, and its contribution to the organisation's risk profile. It is now widely recognised that weaknesses in governance, culture and accountability translate directly into financial risk.

One of the lessons learned from the global financial crisis was that behaviour and culture can significantly influence risk profile. In response to the risks revealed by the global financial crisis, the Dutch Central Bank implemented a program of supervision of behaviour and culture in the institutions within its remit.[1] Since 2011, the Dutch Central Bank has undertaken assessments, based on the principle that (among others) '*Behaviour and culture are an integral part of operational management: effective management is only feasible if organisational structure and culture go hand in hand*.'

Closer to home, in 2018, the *Final Report from the APRA Prudential Inquiry into the Commonwealth Bank of Australia* (**CBA APRA Review**) was released.[2] The CBA APRA Review examined the frameworks and practices in relation to the governance, culture and accountability within the CBA following a number of incidents that damaged the reputation and public standing of the bank. The CBA APRA Review made significant observations in respect of the bank's culture. It also made recommendations with cultural change identified as one important lever to address the issues identified. While the Inquiry was focused on CBA, the Report was studied in boardrooms around Australia, with many organisations (including those outside the financial services sector) using the Review's observations and recommendations to test their own frameworks and practices.

More recently, the Final Report from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Financial Services Royal Commission**) highlighted the importance of culture, with an entire chapter devoted to governance, culture and remuneration, which in Commissioner Hayne's words 'march together.'[3] The Final Report's Recommendation 5.6 states that financial services entities should regularly:

'Assess the entity's culture and its governance; identify any problems with that culture and governance; deal with those problems; and determine whether the changes it has made have been effective.'

This recommendation is also equally applicable across the market, regardless of sector.

[1] DeNederlandscheBank, Behaviour and Culture in the Dutch financial sector, pp. 5 and 7.
[2] The full CBA APRA Review is available at https://www.apra.gov.au/sites/default/files/CBA-Prudential-Inquiry_Final-Report_30042018.pdf.
[3] Financial Services Royal Commission (2019), p 412. https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf

In early 2019, the release of the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations Fourth Edition also saw an increased focus and recognition of the importance of entities monitoring and taking responsibility for their culture and behaviour.

Again in 2019, the Federal Government's commissioned capability review of APRA was released, also with a focus on governance, culture and accountability. The APRA Capability Review stressed that 'failures of governance, culture and accountability have often been at the heart of financial failures and systemic instability'.[4] It also noted that boards are 'struggling to identify appropriate practices' to influence culture.[5] While these comments were made in a financial services context, again they could equally apply to boards across sectors. ASIC has also turned its attention to how boards oversee non-financial risk, and has stated that one of its strategic goals is to influence culture and behaviour, including through promoting the ideas of fairness and professionalism across industry.[6] In its report on board and officer oversight of non-financial risk, ASIC noted that measures of financial risks are typically more developed and more detailed than measures of non-financial risks.[7]

The regulators' focus on culture took a backseat in 2020 in light of the COVID-19 pandemic and the need to refocus on more urgent financial stability and consumer protection issues.[8] However, as business slowly returns to normal, there is little doubt that culture will continue to be in the spotlight, particularly as attention turns to the new cultural challenges posed by remote working environments. The final chapter of this report, 'Spotlight on COVID-19 and its effect on culture', explores this further.

Culture is linked to performance

For directors and investors, company culture matters: it influences long-term company performance and impacts on employees, customers and other stakeholders. This report does not seek to provide new empirical evidence about the impact of company culture on performance, as previous studies have established clear links.

Positive cultures have been shown to improve personal effectiveness and ethical behaviours;[9] increase employee job satisfaction and performance[10]; improve human relations in the workplace;[11] and lead to better revenue growth, job creation, stock price, firm value and profitability.[12] Some aspects of culture that have been shown to enhance organisational performance include homogeneity of culture, teamwork and cooperation, and a clear mission.[13] Overall, according to the Harvard Business Review, culture may account for up to 20-30% of the differential in corporate performance.[14]

The findings from our interviews with directors provided qualitative support for this empirical evidence: consistently, directors feel that strong company culture has a positive impact on company performance.

Culture is also intrinsically linked to strategy - without the appropriate culture, the agreed strategy is unlikely to be implemented successfully.

[4] APRA Capability Review (June 2019), p xviii.
[5] APRA Capability Review (June 2019), p 86.
[6] Keynote address by ASIC Chair, James Shipton, at the Committee for Economic Development of Australia (CEDA) event (27 June 2019), available at https://asic.gov.au/about-asic/news-centre/speeches/ceda-keynote-address/
[7] ASIC Corporate Governance Taskforce Report (2019), p 2, available at https://asic.gov.au/regulatory-resources/find-a-document/reports/corporate-governance-taskforce-director-and-officer-oversight-of-non-financial-risk-report/.
[8] APRA media release, 'APRA adapts 2020 agenda to prioritise COVID-19 response' (23 March 2020), available at https://www.apra.gov.au/news-and-publications/apra-adapts-2020-agenda-to-prioritise-covid-19-response; and ASIC regulatory update 'Changes to regulatory work and priorities in response to COVID-19', available at https://asic.gov.au/regulatory-resources/find-a-document/regulatory-document-updates/changes-to-regulatory-work-and-priorities-in-response-to-covid-19/.
[9] Kouzes and Posner 2002, pp. 79-80
[10] Lund, D. B. 2003. 'Organizational culture and job satisfaction'. Journal of Business & *Industrial Marketing*, vol. 18, no. 3, pp. 219-236.
[11] Treviño, L.K., Weaver, G.R. and Reynolds, S.J. 2006. 'Behavioral ethics in organizations: A review'. *Journal of Management*, vol. 32, no. 6, pp. 951–90.
[12] Gompers, P.A., Ishii, J.L., & Metrick, A. (2003). 'Corporate Governance and Equity Prices'. *Quarterly Journal of Economics,* 118, 107-155. Gompers, P.A., Maher, M. and Thomas, A., 2000. 'Corporate Governance: Effects on Firm Performance and Economic Growth", *Convergence and Diversity of Corporate Governance Regimes and Capital Markets*, Oxford University Press.
[13] Lim, B., 1995.' Examining the organizational culture and organizational performance link'. Leadership & Organization Development Journal., 16,5. Peters and Waterman (1982), for example, held that successful organizations possess certain cultural traits of "excellence". Ouchi (1981) presented a similar relationship between corporate culture and increased productivity, while Deal and Kennedy (1982) argued for the importance of a "strong" culture in contributing towards successful organizational performance
[14] Heskett, as quoted in Coleman, J. (2013), 'Six Components of a Great Corporate Culture', *Harvard Business Review*. https://hbr.org/2013/05/six-components-of-culture

Publicly reported metrics on culture are limited

While there is a broad recognition of the importance of culture it is still very difficult for investors and other stakeholders others to assess company culture from the outside. There is also very little information in the public domain that gives investors insight into how boards assess, and how companies perform, against key measures of corporate culture.

To understand what information is already disclosed, we examined websites and most recent annual reports of ASX50 companies for words and phrases relating to culture.[15] The research encompassed both statements and actions taken by companies. In relation to codes of conduct, for example, our assessment extended to disclosures about publication, reported breaches of codes, and information about the consequences of breaches.

The data collection covered four themes:

- **Values and conduct**
- **Employees**
- **Diversity**
- **Executive pay**

Health and safety metrics can also provide insights into a company's culture. ACSI collects and reports these data separately.[16]

Overall, our analysis identified that company reporting relating to culture is inconsistent across the ASX50, with some companies reporting more widely than others. Some information is widely published, for example company values and diversity statistics. However, information generally considered more useful to investors, such as the treatment of cultural components in executive pay, and statistics relating to employees, is not as widely published.

Companies are more likely to publish information about policies and beliefs than about actions. It may be that as directors continue to amplify their focus on the governance of culture, this will in turn lead to higher quality disclosures on culture across the ASX50.

[15] Over the period December 2019 to January 2020.
[16] ACSI, Safety in numbers: safety reporting by ASX200 companies (2020). While reporting on the most material safety issues is improving, significant gaps remain: eg, 70 companies did not report any safety data in 2019, including 23 of these companies in sectors where safety issues are likely to be material. Further, ACSI's analysis identified 10 companies who linked safety performance to remuneration without disclosing any safety data or targets.

Findings from ASX50 disclosures

The word 'culture' appeared prominently in annual reports. It was included, for example, in the Chair or CEO's letter in 75 per cent of ASX50 companies.

Values and Conduct

All ASX50 companies had a code of conduct or equivalent during the period. Almost all reported the number of breaches of the code, and the majority (approximately 80 per cent) reported the consequences of breaches. While many companies provided a generic description of the consequences, some published the specific type of consequences meted out and the number and seniority of employees impacted. Financial institutions provided the most detailed information. For example, one company noted not only the number of senior leaders that had a formal consequence applied for code of conduct breaches or findings of accountability for a material event but also the proportion of the senior leader population that these individuals represented.

A range of stated corporate values were recorded for ASX50 companies. The value stated by the greatest proportion of companies was 'integrity' (40 per cent), followed by 'respect' (32 per cent) and 'excellence' (26 per cent).

Conduct-related reporting by companies included information on whistleblowing and complaints. Almost all companies reporting having a whistleblowing policy and a process for dealing with complaints from customers or communities. Only 10 per cent of companies provided information on the number of whistleblowing events occurring.

Employees

Most companies reported undertaking an employee engagement survey annually or biennially, but fewer companies (42 per cent) publicly reported participation levels or overall engagement scores. For the 42 per cent that did, engagement scores averaged around 70 per cent (with a range from 54 to 90 per cent). Some companies reported results to a key question only, such as a question relating to safety culture.

Employee turnover levels were reported by 33 per cent of companies, with some companies providing more details, such as turnover rates amongst high performers and senior leaders. Others reported turnover across cohorts with shorter and longer tenures at the company. Service tenure of employees was reported by a small minority of companies, while about 15 per cent of companies reported information relating to absenteeism.

Diversity

Almost all companies disclosed statistics relating to diversity in their annual report, corporate governance statement and/or website. This reporting focused on gender diversity, often covering the proportion of senior management roles held by women. This is unsurprising given the ASX Corporate Governance Council's Recommendations. After gender, the most frequently cited diversity-related statistics referred to Indigenous Australians and people with disabilities. Some companies disclosed targets for increasing diversity and inclusion.

Executive Pay

Just over 50% of the ASX50 explicitly included a culture-related metric in their executive remuneration plan. This is only part of the story, as boards look beyond a narrow 'culture' metric when deciding which behaviours and actions to reward. That said, the limited level of disclosure on explicit culture-related metrics provides some insight into the challenges investors and other stakeholder faces in assessing company culture from the outside.

Of those companies explicitly including a culture-related metric in their executive remuneration plan, most included a 'people and culture' target within the short-term incentive (STI) plan, normally making up between 10 to 20 per cent of the total STI plan. Some companies referred to 'culture' as part of an executive's strategic or personal objectives, or as one of the metrics making up the non-financial portion of the STI plan. In these cases, the weighting of culture within the suite of strategic, personal or non-financial metrics was generally not disclosed.

From an investor perspective, companies generally do not provide sufficiently clear guidance about how company culture is taken into account in executive pay. As with all areas of executive pay, it is easier for investors to assess disclosure that provides clear targets, and explains to what extent those targets have been met.

Insights from interviews with directors

In order to understand how Australian directors and boards oversee, assess and influence company culture, the AICD and ACSI conducted in-depth interviews with experienced directors of ASX50 companies and subject-matter experts. The interviews covered four main areas:

1. What is company culture and why does it matter to boards
2. How boards oversee company culture
3. How boards measure and assess company culture
4. How boards influence company culture.

This section explores the views of directors and experts on these points.

What is culture and why does it matter to boards?

While directors generally consider that 'you know a good company culture when you see it', most agreed that it is a difficult concept to define. There are, nonetheless, several concepts that emerged as central to the definition of culture:

- First, many directors consider that *defining* the desired culture was crucial for being able to behave in line with that culture. Even then, however, they acknowledged that culture is not always homogenous within an organisation.
- Second, most directors see *behaviours* (both individual and collective), and the mechanisms necessary to encourage certain behaviours, as the core of corporate culture.
- Third, all directors consider that, however it is defined, culture is extremely important to the long-term success of a company.

Defining desired culture is crucial

Many directors argue that companies should define their desired culture in order to be able to behave in line with it. Some stress that defining a company's culture in simple terms – for example, by keeping key requirements short and drafting in plain English – can help the message to get through. Catherine Livingstone commented:

"Keep behaviours to a vital few markers – half a dozen behaviours that boards can model – and the message gets through very quickly"

- Catherine Livingstone: Chair, Commonwealth Bank of Australia

One senior director commented that many great organisations are able to capture on a single piece of paper what the organisation stands for and what behaviours are expected.

At the same time, several directors emphasised that culture is not always homogenous within an organisation. It differs, for example, across organisational groups and geographies. Even core organisational values such as safety may be prioritised more or less in different parts of the business. Graeme Hunt commented:

"There seems to be an assumption that you need a homogenous culture; a 'one size fits all approach'. I don't think that's right or possible. There will be some commonality of key critical things – such as respect and integrity – but the culture you need in an intensive physical risk environment is very different to the culture you need in a part of the business that interfaces with the broader community."

- Graeme Hunt: Chair, AGL Energy Limited and BIS Industries Limited

Similarly, some directors are also of the view that the impact of an individual's immediate working environment is critical to his or her experience of the culture of a company. As one senior director noted:

"The most important person in any organisation is not the CEO or Chair; it's your immediate boss. If your immediate boss is a bully, that's the culture in which you operate."

- Senior director

The potential for culture to vary throughout the organisation strengthens the case for clear company statements about expected behaviour, as well more granular data regarding departmental, geographic or demographic variations. For example, materially lower staff engagement results amongst a specific cohort of employee (eg women) may indicate a more specific cultural problem to be addressed.

With this in mind, boards and management teams are strongly encouraged to examine the recent Australian Human Rights Commission's report, *Respect @ Work*, and the Male Champions of Change report, *Disrupting the System*, into preventing and responding to workplace sexual harassment.[17] These reports highlight that significant problems remain in Australian workplaces and calls for much greater attention and focus from board and management teams. As a starting point, senior leaders can send important cultural signals through requiring more detailed, periodic reporting of sexual harassment data. More importantly, a shift from a reactive, complaints-based approach to addressing sexual harassment, to one that requires victim-focused action from employers with a focus on prevention and early intervention will have clear organisational reverberations.

Behaviour, and its management, are at the heart of company culture

Directors tend to view company culture primarily in terms of behaviours, and the mechanisms necessary to encourage certain behaviours, rather than beliefs and norms. Common descriptions of culture include "the way we act or behave"; "the organisation's way of doing things"; "the way the organisation conducts itself"; "how people act when no one is looking" and "how you do things around here".[18]

Many directors explained the focus on behaviours this way: company culture is observed through the actions of people. In other words, whereas culture as a concept can be nebulous, behaviours are real and have tangible impacts on people, processes and business outcomes. Managing behaviours helps companies to shape their culture, and vice versa.

Directors stress the need to define and communicate desired behaviours, as well as behaviours that will not be tolerated. This process needs to be formal: it is vital that the promoted behaviours are supported by the right infrastructure – processes, policies and systems, conduct codes and values statements. Where this framework is not provided, problems arise. As Catherine Livingstone noted,

"If the infrastructure is not working well, people have to work around imperfect processes, policies and systems. That's when mistakes or the wrong outcomes happen. Without sufficient guidance – including clarity on roles, responsibilities and accountabilities – even if people have good intentions, it is difficult for them to get their job done."

- Catherine Livingstone: Chair, Commonwealth Bank of Australia

[17] Australian Human Rights Commission, *Respect@Work: Sexual harassment national inquiry report* (2020); Male Champions of Change, *Disrupting the System – preventing and responding to sexual harassment in the workplace* (2020).
[18] Other directors identified culture as being about relationships (e.g. how people to relate to one another and their interactions internally and with key stakeholders) while others focused on values, purpose or what a company stands for.

On the other hand, sensible processes, policies and systems can align people's actions with company purpose. As Diane Smith-Gander commented:

"Where there is a good strong culture – people are able to live the organisation's values in the way they behave, lined up with the organisation's purpose. The activities that occur are central to the organisation's purpose. You don't spend a lot of time on corrective action to get people lined up. It's a smooth effort – efficient and effective – execution against strategy is right."

- Diane Smith-Gander: Chair, Safe Work Australia; Director, AGL Energy Limited

A positive culture benefits long-term company performance

Directors unanimously consider that having a good company culture is critically important, and many stressed that a good culture benefits long-term company performance. A key message from interviews was that organisations with poor cultures are unable to maximise their potential, even if the other business fundamentals are good. The culture of the company is perhaps most important under times of stress. As Tim Poole commented:

"There are often one or two moments a year when boards and management really get tested. The way those matters are handled go to the heart of the culture of the organisation."

- Tim Poole: Chair, Aurizon Holdings

This perspective is shared by many directors, who consider that a strong company culture – and particularly a strong culture within senior management and the boardroom – is one which allows diverse views to be heard and difficult decisions to be made. In the same vein, many directors argue that a company with a good culture would cope better with adversity.

Unsurprisingly, directors emphasise the impact of culture on people. A good culture, directors note:

- motivates employees
- helps companies attract and retain talent
- can improve employee productivity
- helps to prevent misconduct
- reduces the distractions caused by having to address behavioural problems.

Directors are keen to stress the positive impact of good culture, with some noting that following both the global financial crisis and the Financial Services Royal Commission, many commentators have solely focused on the perils of poor culture. As Michael Ullmer noted:

"I would see culture as a force for good as opposed to a force for minimising the chance of bad things happening."

- Michael Ullmer: Chair, Lend Lease Group; Director, Woolworths Limited

Similarly, Ilana Atlas reflected that:

"Companies tend to focus on the negative side of culture – on everything they shouldn't be doing. Whereas the reality is you need to have really positive cultural norms to be successful as an organisation."

- Ilana Atlas: Chair, Coca-Cola Amatil; Director, Australia and New Zealand Banking Group Limited

Many directors consider that a good culture will ultimately help drive performance and shareholder value. Penny Bingham-Hall commented:

"Most businesses are all about people; how they behave, are driven to succeed and work together as a team. So a good culture is fundamental. If you have people who love going to work and love the culture, then the company can thrive. It's what makes companies great."

- Penny Bingham-Hall: Director, Bluescope; Director, Dexus Funds Management; Director, Fortescue Metals Group

At the same time, having a good company culture seems to be viewed as an efficient way to avoid trouble. Jacqueline Hey commented:

"Management can't be looking over everyone's shoulder all of the time. An organisation needs a culture that encourages people to abide by the rules, treat people fairly and do the 'right thing' when no one is looking."

- Jacqueline Hey: Chair, Bendigo and Adelaide Bank

While culture may develop organically over time, directors recognise that deliberate and persistent efforts by the board and management are necessary to develop, embed and then maintain the desired culture.

How boards oversee culture - getting a line of sight

In Australia, recent governance failures have revealed not only the significance of company culture in shaping governance frameworks and outcomes, but also the expectation that stakeholders and regulators will look to hold boards to account for failures in culture. Directors need to consider how to discharge that accountability by overseeing and seeking to positively influence the culture of their companies.

To do this, directors need a line of sight to behaviours through the layers of the company. This is difficult given the nature of a non-executive director's oversight role, and their primary engagement being with a limited pool of management. It is particularly complex in a large company or where operations (or directors) are based offshore or in remote locations.

The directors interviewed identified both formal and informal – and internal and external –mechanisms for overseeing culture, on specific and macro issues within a company. Three key points emerged from interviews:

- Effective oversight starts with motivated directors and diverse boards
- Culture belongs on the formal board agenda
- Informal oversight should complement formal oversight mechanisms.

Effective oversight starts with motivated directors and diverse boards

Many directors consider that effective oversight of culture starts with the mindset of directors as individuals and the dynamics of the board as a group. Directors who are self-motivated, curious, inquisitive and able to ask the hard questions of fellow directors and management will be better able to gain a sense of a business.

"You need directors with curious minds. The role doesn't start and stop in the boardroom; board meetings are one very small component of what we do. There are a range of things you can do – including constantly talking to people and looking at things – if you're active, interested and curious. Some people have that mindset and some don't."

- Tim Poole: Chair, Aurizon Holdings

Motivated directors

First, directors stress the individual behaviour required of directors to oversee company culture. There is a clear sense among directors that staying vigilant, being alert all the time to what's going on, observing, and listening are all very important. Directors described having their "antennae out and looking for soft signals around what's going on in the organisation". The board's first sign of a cultural problem may be "ripples" or "noises". Naturally, directors need to use their judgment to make sure the information they are receiving is credible and representative of wider-held views.

"As a director, it is important to consider whether a statement is truthful, whether it is said by someone who wants to push their own barrow, or whether it is said by someone who is angry. It is up to the director to assess that."

– Senior Director

Directors must be prepared to probe more deeply into issues at times. In some cases, this might be a regular part of reporting: for example, the board might ask to be taken through data and trends on customer complaints once a quarter (e.g. net promoter scores, number of complaints, how were they dealt with, time to resolve complaints). In other cases, some directors note that boards or relevant committees have asked for detailed reporting on individual incidents rather than being satisfied with aggregated data which may not reveal the root cause of problems. Additionally, some boards will ask to see how management has dealt with an individual complaint, incident or issue. The board can then send strong signals to the organisation about its expectations for handling any future incidents.

Example

An employee of a large organisation had engaged in misconduct involving sexual harassment. The board asked for specific details about the incident and how it was managed to be provided immediately. The board felt that management had taken too long to assess and resolve the issue and requested that management expedite their response to similar incidents in the future. This resulted in management making broader changes to the guidelines for handling such incidents, including introducing shorter timeframes. The board's insistence on immediate investigation signalled the importance the board placed on addressing sexual harassment.

Diverse boards

Diversity of thought in the boardroom is also seen as important for overseeing culture. Some directors see benefit in bringing contrarian perspectives onto the board to make sure there is a sufficient breadth of thinking and challenge. Director recruitment and ongoing development can signal and influence the desired culture, including the extent to which attributes such as emotional intelligence, resilience, moral compass and cognitive diversity are valued. Jacqueline Hey stressed the importance of both individual characteristics and group dynamics in board composition:

"What kind of people do we have on the board and how do we think? Not just what skills, but do we have rule-based, moral-based, outcome-based and process-based thinkers? People within industry and outside of it? People who are objective and fact-oriented, or big picture thinkers? People who look at things through numbers or stories? How we think, approach things, consider the facts, and who we are as inherent individuals is something for us to understand and recruit against."

- Jacqueline Hey: Chair, Bendigo and Adelaide Bank

Directors can also add value by bringing learnings from other organisations on bringing about cultural change. In some sectors such as financial services, more intensive and sophisticated monitoring of culture has eventuated following high-profile reviews and inquiries. Directors in other sectors have sought to learn from that process, with the CBA APRA Review being a key trigger point for many organisations.

Fundamentally, non-executive directors must actively encourage a boardroom culture of robust discussion and inquiry, both amongst themselves as well as with management teams. Indeed, the CBA APRA Review specifically highlighted the risk associated with an overly collegial workplace culture. The board, as the ultimate authority in an organisation, can therefore send a powerful signal through its own modelled behaviours.

Culture belongs on the formal board agenda

Directors argue that board meetings present an important opportunity for in-depth examination of company culture. Some also acknowledge the positive impact of formal reviews of company culture, and the importance of formal culture oversight systems.

Culture as a board agenda item

Culture is a regular board agenda item in many large organisations and is often part of the annual reporting schedule to the board and its committees. Directors stress the importance of including culture on the formal board agenda, both to signal its importance and to give the board time to adequately test management about company culture. As well as including culture as a specific agenda item, many directors routinely consider other issues before the board or its committees through a culture lens.

"It is the board's role to make sure culture is on the agenda and gets enough meaningful airtime at board meetings. This demonstrates to management and the organisation that it has to be taken very seriously – as seriously as you'd take strategy."

- Michael Ullmer: Chair, Lend Lease Group; Director, Woolworths Limited

Board meetings provide an opportunity for directors to formally question, and appropriately challenge, the CEO and management about company culture. It is important that the board doesn't receive an overly positive or sanitised version of events. John Mulcahy commented:

"You don't want a 'good news' executive team that doesn't surface the issues underneath. It is much harder for the board to understand what's happening."

- John Mulcahy: Chair, Mirvac Group

Some directors commented that management put their own interpretation on information presented to the board; one senior director even describing it as the need to get past 'management spin.'

Management may be more open and transparent on issues in the business where there is a relationship of trust with the board. But even then, one senior director suggested that boards should seek to validate the information they receive; that is, "trust but verify" – echoing the CBA APRA Review's mantra of "don't tell me, show me."[19]

[19] See CBA APRA Review, p 14.

"The board observes culture through different eyes and a more independent view, simply due to the fact we're not there all the time. Management and the board see different things. The melding of the way management 'live and breathe' culture every day, and the way the board understands it from afar, is very powerful."

- Jacqueline Hey: Chair, Bendigo and Adelaide Bank

Board subcommittee meetings can be a useful vehicle to get a sense of culture, particularly as subcommittees often deal with people a few levels down from the executive on specific issues. Some boards are changing their committee structures to more clearly encompass culture, for example by moving from a Remuneration Committee to a People and Remuneration Committee.

Formal culture oversight systems

Directors point to formal internal systems that have been developed to monitor company culture. In particular, in response to the Financial Services Royal Commission, some financial services organisations have developed comprehensive and advanced techniques to oversee culture, including engaging external culture experts.

Example

The board of one large financial institution recently undertook a significant exercise to define the particular values and behaviours it expects to see from employees. The board identified a number of important metrics, including behaviours in relation to risk, and also oversaw the development a specific culture survey within the internal audit function.

“The board observes culture through different eyes and a more independent view, simply due to the fact we’re not there all the time. Management and the board see different things. The melding of the way management ‘live and breathe’ culture every day, and the way the board understands it from afar, is very powerful.”

Jacqueline Hey
Chair, Bendigo and Adelaide Bank

TECHNIQUES IN THE BOARDROOM:

PRACTICAL TIPS FROM INTERVIEWEES

Observe how content is presented

What is the style of paper? How is it presented? Is management being transparent? Are they taking responsibility? Do they bring in the people who report to them and allow them to speak to the board?

Informal reporting may be revealing

A verbal update from management can often provide better insights than a lengthy written report, as it gives directors an opportunity to ask questions and test how comfortable management is with the material.

Look for gaps

What information has not been presented to the board and why?

Consider how you ask questions

Asking directors to advise the CEO of what issues/questions they would like to speak about prior to the board meeting can give management time to consider its responses (without requiring written responses in advance). It also gives the board more time to assess if responses to the issues raised have been properly thought through. At other times, questioning during the meeting can be useful to observe capability and tone.

Conduct closed sessions

This gives people the opportunity to speak freely without their colleagues in the room and can be particularly important if it relates to something concerning organisational leadership. For example, closed sessions in the Audit and Risk Committee with the Head of Audit or the Head of Risk without other management present may uncover underlying issues worthy of further examination.

Informal oversight should complement formal oversight mechanisms

"If you just attend board meetings and hear presentations, you won't understand the culture. The more you can hear on the shop floor about what's happening and interface with people, the better understanding of culture you will have."

– Elizabeth Alexander: Former Chair, Medibank Private and CSL Limited

Informal discussions with the CEO and management are an important way for boards to oversee culture. Many directors also discussed the importance of speaking to a range of employees so they have greater visibility of what is really happening in the organisation. Informal interactions also have the benefit of more candid and relaxed feedback: as Judith MacCormick observes:

"It is better to visit informally but without being a 'spy'. Everyone is on best behaviour when it's done formally."

- Judith MacCormick: Board advisor; Faculty advisor, senior facilitator and writer for the AICD

Assessment of culture through director engagement with employees can take a variety of forms. Whatever method is used, directors must bring an inquiring and probing mind to the information they receive. For example, while the employee survey is a widely used tool, there can be a number of limitations to its usefulness, such as the risk that employees will tell management what they think they want to hear in order to avoid anticipated consequences. 'Meet the board' sessions can be managed or staged. If there is no 'bad news' coming from employees up to the board, this could indicate that people do not feel they can speak up, or that management is not being transparent. Management resisting opportunities for the board to meet with employees might also raise a red flag. Working with management teams, directors should use a variety of tools and sources of information, and interrogate and synthesise these to form an overall picture of culture.

"People lie in surveys. They tell you what you want to hear. If they think management isn't trustworthy, they won't tell you anything."

– Senior director

Directors also pointed out the value in actively listening to employees, rather than just focusing on delivering a message – communication must involve a two-way exchange not just talking at staff. For companies with unionised workforces, this may also involve engaging with unions outside the more transactional interactions that might take place between management and union representatives during workplace bargaining negotiations.

CREATING OPPORTUNITIES FOR DIRECTORS TO INTERACT WITH EMPLOYEES:

PRACTICAL TIPS FROM INTERVIEWEES

Invite a wide-ranging selection of employees to meet directors

Set up a periodic rotation of randomly selected employees to meet with a board member or members.

Socialise with management and employees

The Chair of a mining company observed that while formal site visits to mines and processing plants are important, it's the afternoon teas with staff and dinners with executives that are invaluable to understand what's really going on.

Meet with all executives

A large infrastructure company has processes in place to make sure that directors have an opportunity to socialise with all the C-suite executives. For example, people move around at dinners after each course to get to know one another better.

Hold board subcommittee meetings onsite

A large energy company holds meetings on site so directors can hear directly from employees without management being present.

"We take onboard what they've said and loop back to them – in the short-term and also when we go back to the site."

Informally visit sites and offices

One senior director suggested walking the sites or sitting at a workstation, to observe how people interact with one another. Another suggested "going down to the call centre and plugging in alongside the managers to understand what the conversations are about". It would ordinarily be appropriate to inform the Chair and/or CEO first to promote trust and transparency.

Mechanisms enabling the organisation's people to raise issues freely and easily can give boards greater visibility over cultural issues when they arise. Some examples of ways that organisations do this include:

- a clear whistle-blower process that comes to the board
- confidential reporting
- career development discussions with a manager once removed.

In addition to speaking to staff members, directors can get a sense of company culture by talking and listening to external stakeholders: customers, investors, suppliers, analysts, the media, competitors, advisors and regulators. Social media or dedicated websites may also contain insightful information (e.g. Glassdoor, where employees anonymously review organisations).

Directors can also experience the culture of the organisation firsthand as customers of the business (e.g. by visiting the company's branch or store, buying and using the organisation's products, or ringing the helpline). The use of metrics to examine culture is explored in further detail in the following section.

It is important however that directors do not undertake their own cultural inquiry without first consulting with the chair as part of a deliberate and agreed board strategy. Uncoordinated attempts by NEDs to uncover cultural signals may undermine trust in the management team while not necessarily providing an accurate or comprehensive picture.

Oversight: Key insights and questions for directors

Key insights from director interviews
Include culture as a regular board agenda item.
Seek specific examples of how management has dealt with issues.
Observe how content is presented to the board.
Consider how the board interacts with and questions management, particularly on challenging issues – this implicitly and explicitly drives culture in the organisation.
Seek out a range of culture-related indicators from both internal and external sources.
Create opportunities for directors to interact with employees, both structured and informal.

Questions for directors
How does culture appear on the board agenda? What does this signal to management and the organisation about the prioritisation and approach to culture?
How is information on culture reported to the board?
Does the board interact with a range of employees beyond just the CEO and senior executive?
Does the board receive regular reporting and analysis of customer metrics including raw complaints data?
Does the board receive appropriate information flows in order to challenge management effectively?

How boards measure and assess culture

Company culture is complex and difficult to measure. Boards need to work collaboratively with management to determine whether the right things are being measured and appropriately reported to the board.

Interviews with directors revealed a wealth of different metrics (both internal and external) that a board can refer to in measuring culture.

However, reviewing metrics alone is not sufficient to form a nuanced assessment of an organisation's culture: the data must be synthesised and interrogated. Where this is done well, the data can be used by the board to compare the desired culture of the organisation with its actual culture, identify where there are gaps, and plan improvements.

Directors made three main points about the measurement and assessment of culture:

- both should use a range of internal and external metrics to assess company culture
- directors must interrogate the data and understand the context around raw metrics
- boards must synthesise information to arrive at a holistic assessment.

Boards should use a range of internal and external metrics to assess company culture

Directors referred to a range of metrics their boards use to ascertain company culture. The most common tools are internal metrics, and in particular surveys of employees. Set out below are the most common metrics referred to by directors in our interviews:

EXAMPLES OF INTERNAL METRICS

Survey-based metrics

- Employee engagement surveys
- Specific culture surveys
- 360-degree feedback on people in leadership positions
- Detailed culture review, which may be led by an independent third-party
- Employee Net Promoter Scores (eNPS), which can be benchmarked globally
- Values questions in employee performance assessments (e.g. *'Have you complied with the organisation's values?'*)

Other metrics

- Absenteeism
- Staff turnover / unexplained departures
- Employee grievances / whistle blower calls
- Misconduct
- Statistics relating to diversity
- Compliance with risk parameters (e.g. lending outside of limits)
- Compliance with internal policies (e.g. privacy, codes of conduct)
- Discrimination, harassment and bullying complaints
- Compliance training
- Service deliverability / fulfilment on time
- Interactions with regulators and breach reporting
- Behavioural aspects of internal audit reviews

EXAMPLES OF EXTERNAL METRICS

Survey-based metrics

- Customer Net Promoter Scores (NPS)
- Investor or stakeholder surveys

Other metrics

- Customer complaints and response times
- Market data (e.g. the Corporate Confidence Index)
- Glassdoor or employer review sites
- Supplier feedback

Metrics are most useful when they are used on a regular and consistent basis so that the board can track results over time – for example, comparing data to the previous year; considering which business units have struggled or made progress; and reviewing what went well across the organisation or what messages need to be reinforced.

New technological tools are also being developed to give directors greater visibility over company culture. These include artificial intelligence and tools which monitor culture in real-time, thereby enabling earlier intervention. Although these are not currently widely used, some directors believe that they are going to become an essential tool for monitoring culture. New technology comes with its own issues, particularly around privacy and trust, and boards will need to be transparent about the use of these tools.

Directors must interrogate the data and understand the context around raw metrics

Boards need to be careful about how they use and interpret metrics. Raw numbers may be misleading, so boards should interrogate and triangulate data to get a full picture and look at trends over time. For example:

- A high attrition rate may suggest a cultural problem, or it could be the consequence of the company taking a robust approach to misconduct and parting ways with employees that don't behave in line with the desired culture;
- In relation to surveys, respondents may not answer questions in the intended way if they believe their responses are not anonymous (even if told otherwise) or that people will be penalised if the survey results are bad; and
- When considering customer complaints and response times, examine management's response – are they just seeking to close the file and get rid of the complaint, or deal with the underlying issue?

Metrics can also provide a basis for boards to bring challenging and constructive questions to management and boards may opt to undertake a 'deep dive' into certain issues if something raises a red flag. This will be particularly important where there are material risks to the business from a cultural perspective, such as the possibility of sexual harassment.

Example

An organisation was accused of abusing human rights. The Board had to take a step back and deeply examine the culture of the organisation. It considered: How do we know if we have a good culture? What would we expect to see? What are the policies, processes and practices we put around it?

The board undertook an exercise where it imagined that it was writing a prospectus to bring the company to market and wanted to include a statement that the company 'does not abuse human rights'. But how would it verify that statement?

Some of the work undertaken included:

- reviewing policies and processes
- ongoing training throughout the organisation
- measuring every single incident that occurred, and looking to see what happened as a result of that measurement
- getting to the root cause of every safety event, then forming a view as to whether the consequences that management applied is going to mitigate the root cause.

18 months later the board felt it could verify the statement that the company 'does not abuse human rights'.

Some boards pre-emptively deep dive into important issues that could cause substantial harm to individuals and the organisation. It may be appropriate for the board to assure itself that these types of issues are being managed in the way the board believes and expects. Several directors mentioned safety issues; it is important to "lean well" into any incidents that occur.

"One of the real challenges as a director is how do you know what you don't know? The ability to deep dive and really question things is important. On certain topics or issues there needs to be access to a deep level of information to see how things are being managed.

The challenge for directors is to think ahead – how could that happen to us? In hindsight you think, how did we let that happen."

- Penny Bingham-Hall: Director, Bluescope; Director, Dexus Funds Management; Director, Fortescue Metals Group

Boards must synthesise information to arrive at a holistic assessment

It is a challenge for boards to synthesise the wealth of information and form an overall assessment of company culture. There is broad agreement among directors that no single data point provides the answer. It is important to consider a range of things – internal and external input – to give a full view of what is going on in the organisation. Some boards will rely on complex models to synthesise data. The aim of all of these approaches is to understand behaviours within the organisation.

"Things like employee engagement, net promoter scores, reputation monitoring etc. all play into the 'vibe' of culture. But at the end of the day, are people behaving in the way you ask and expect them to?"

- Diane Smith-Gander: Chair, Safe Work Australia; Director, AGL Energy Limited

Boards need to decide which measures are most important for the organisation. Many boards focus on measures that are most aligned with the company culture – for example, if the desired culture is customer-centric, the board may focus on customer complaints data and customer feedback; if the culture is focussed employees, the metrics may centre on staff feedback, turnover and diversity. Of course, red flags in other areas must not be ignored.

There must be a reliable basis for selecting measures; ordinarily they will be those that the organisation has learnt over time are the most important. These measures can then be used to define the desired culture of the organisation, which the board can compare with its actual culture, work out where there are gaps, and plan to make improvements.

Measurement and assessment: Key insights and questions for directors

Key insights from director interviews
Consider how metrics align to the culture – are the right things being measured and reported.
Consider whether there is consistency between what the board is hearing from management, employees and external sources; what the board is observing; and what the metrics show.
Conduct a deep dive into issues that raise a red flag, or have potential to cause substantial harm to individuals or the organisation.
Learn from other organisations: high profile culture failings at other organisations can be an opportunity to examine how the board would deal with a similar issue.
Use a variety of sources of information, both formal and informal.

Questions for directors
What stories do HR metrics (staff turnover, service tenure, exit interview data, absenteeism, employee diversity, engagement scores) tell?
Is there evidence of bullying and harassment (sexual or otherwise) within the organisation, and how quickly are incidents effectively dealt with by management?
How is performance measured, and does that align with the organisation's values, desired culture, and agreed risk appetite?
How are whistle-blowers treated and is it consistent with the desired culture?
What does workplace health and safety reporting (including incidents and near misses) tell the board regarding the overall safety culture within the organisation?
Are the company's processes and outcomes appropriately disclosed?

Tone from the top - how boards influence company culture

One of the strongest themes that came through our interviews was how boards can influence company culture through their individual and collective behaviour. As directors described their experience, the following main methods or areas of influence emerged:

- Selecting, monitoring and (where necessary) removing the CEO;
- Executive remuneration – rewarding or penalising behaviour;
- Setting the tone from the top:
- Sending signals via board priorities and decision-making; and
- Influencing the creation and enforcement of values statements and codes of conduct

Fundamentally, boards and management must be alert to the risk of hypocrisy – that is, where their words and actions do not align with the organisation's professed culture, values or purpose. Where such misalignment occurs, significant damage to credibility and culture can be done.

Selecting, monitoring and (where necessary) removing the CEO

"In my time, I've seen a culture of a CEO permeate through the whole organisation. And I've also seen when the CEO is changed, how the culture changes also."

– Senior director

Almost all directors see CEO selection as the board's 'ultimate tool' in influencing company culture, comprising three core elements:

(i) Appointing the CEO;
(ii) Guiding and monitoring the CEO's performance; and
(iii) Taking action to remove or discipline the CEO when necessary.

Starting with the recruitment of a CEO, a board may specify what kind of culture it wants to see in the company. They may question the prospective CEO on how they see those behaviours/values being generated, and how the values of the prospective CEO align with what the board believes are the right settings for the organisation (i.e. will they be a good cultural fit?). This can be more challenging where a CEO is being recruited from outside the company:

"When we are appointing a new CEO, we need to have a strong focus on their soft skills. Not just whether they delivered outstanding financials in their last job, but who are they as people? What do others really think about them? Are they genuine culture carriers? We habitually reference check with peers and superiors, customers, suppliers and competitors. But don't ignore that direct reports, and even junior executives and Executive Assistants can also give you good insights.

If someone is a good executive, but turns out to have significant negative character traits, you might want to counsel them and give them an opportunity to change. But if they can't or won't, getting them off your bus might be a very wise option."

– John M. Green: Deputy Chair, QBE Insurance; Director, Cyber Security Cooperative Research Centre; Director, Challenger Limited

It is important for the board to have a good sense of how the CEO is leading. The board can monitor and continue to test the CEO, so that it has an ongoing view as to whether they are the right person at the right time to lead the organisation. The board also has a role in guiding the CEO and, on occasion, insisting on certain things to make sure the organisation has the right culture.

Many boards have an in-camera session for non-executive directors at the end of a board meeting. That provides an opportunity to discuss the performance of the CEO and the senior management team. If these sessions are regular board agenda items, they are not considered abnormal nor do they damage the relationship between the board and CEO/management.

Where there is an issue with the company's culture or the CEO's leadership, the board is obliged to take action. While removing the CEO is ordinarily an action of last resort, it is an important board power when other strategies and disciplinary measures are not enough.

"You have no choice sometimes. You need to send a signal to the organisation that people, values and culture matter. Boards don't always get decisions right; but what you can't do is put up with something clearly wrong."

– Senior director

Some directors see the composition of senior management as another important mechanism to influence culture. While the board often does not have a formal role in the selection of the senior management team, it can have an important informal role.

Example

"We had individual or pairs of directors interface with candidates for senior management positions. Those directors then had discussions with the new CEO. We didn't take the decision away from the CEO, but the CEO got input from those directors.

Once we landed on preferred candidates, the rest of the board got to meet them before the decision was inked. The process worked well and the CEO valued the input of directors and their broad expertise."

Many directors consider that it is also important to have good visibility over the behaviours and performance of the senior management team. In some situations, it may be appropriate for the board to encourage the CEO to make changes to that team. It is important that the Chair regularly discusses dynamics and behaviours amongst the senior leadership team with the CEO. One senior director suggested:

"The Chair should sit down with the CEO and have coffee a couple of times a year and talk about what behaviours are like in the leadership team and any tensions. I think the Chair has a real obligation to make sure they're taking the pulse on the leadership team."

– Senior director

Executive remuneration – rewarding or penalising behaviour

One of the primary mechanisms that directors point to when asked how they create accountability for culture is the board's discretion on executive pay. When decisions on this are transparent, it can send a clear signal about the behaviours the board wants to see. And when things do go wrong, shareholders and the community expect to see consequences applied. In the Financial Services Royal Commission, Commissioner Hayne reflected that:

"…the remuneration arrangements of an entity show what the entity values. If the board reduces the variable remuneration of executives for their poor management of non-financial risks, and tells other staff that the variable remuneration of those who are accountable for particular events or forms of conduct has been reduced, it sends a clear message to all staff about both accountability and what kinds of conduct the board regards as unacceptable."[20]

Commissioner Hayne: Financial Services Royal Commission

Remuneration can support company culture by being aligned with appropriate KPIs – often non-financial KPIs. For example, executive pay may be modified based on a values assessment (e.g. the extent to which the executive adhered to organisational values and was a values role model). This has been an increasing focus of regulators over the past few years, particularly for financial services entities.

"You can have great business outcomes, but if you didn't achieve them in the right way you'll be penalised."

– Senior director

Yet measuring culture is not straightforward. In the context of remuneration, it becomes more challenging still, as there are a wide variety of strong views to be reconciled. The recent consultation by APRA to revise its remuneration standards highlighted some of the issues. Some were concerned by APRA's proposal to mandate a maximum weighting of financial metrics, noting that non-financial measures can be relatively immature, not as transparent and more difficult to independently verify. Others see the focus on 'non-financial' hurdles as positive, although like financial measures, hurdles must be objective, transparent and measurable, with outcomes truly at-risk.

At the same time, there is no agreed set of robust, independent verifiable measures for non-financial risk that are considered market best practice. Directors will need to make judgements on appropriate measures, taking into account the areas of focus. Entities looking for guidance on appropriate 'non-financial' targets could also look to their risk appetite and risk monitoring processes (in respect of non-financial risk) to form a basis for integration between risk, culture and remuneration.[21]

While remuneration is a useful tool, many directors also warned of the danger of inappropriate incentives, particularly if remuneration frameworks are not aligned with desired behaviours and company culture. This is important to consider throughout all layers of the organisation, from C-suite executives to frontline staff (for example, if the organisation aspires to a team-oriented culture but people are rewarded for individual sales)."Pay is overrated in terms of its capacity to do good. There is more potential to do evil. We've seen that. It's amazing what people will do to get relatively small amounts of additional money."

– Senior director

"The focus on remuneration – STI, LTI etc – is one of the reasons we have a culture problem – you get what you pay for."

– Senior director

---

[20] Page 366, https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf
[21] Recognising that incorporation of non-financial risk in risk appetite and monitoring may also be improved for example, as outlined in ASIC's Corporate Governance Taskforce report 'Director and officer oversight of non-financial risk'. officer-oversight-of-non-financial-risk-report/

“Pay is overrated in terms of its capacity to do good. There is more potential to do evil. We’ve seen that. It’s amazing what people will do to get relatively small amounts of additional money.”

Senior director

Some organisations have introduced formal processes for assessing accountability when something goes wrong. This may include a remuneration malus or clawback mechanisms or performance (including behavioural) assessment processes within the organisation. However, it should be acknowledged that the use of clawback is relatively untested given the significant practical and legal difficulties with enforcement. Development and training programs may be provided where employees fall short of expected behaviours.

If processes for reviewing and determining accountability are adopted, it is important that they are fair, and are perceived to be fair, and that the tone of the reviews is constructive. There is also a danger that certain behaviours will be 'driven underground' and not reported. Some directors feel that while it is important to encourage people to take accountability, blaming and sanctions do not necessarily lead to better cultural outcomes.

More broadly, the Financial Services Royal Commission and subsequent commentary has raised the issue of whether executives are being paid STIs merely for doing their job, rather than for high performance. In light of the complexity of remuneration structures that has materialised over recent years, and the economic contraction associated with COVID-19, some directors have indicated that the pandemic may represent an opportunity to reset current practice. With some sectors potentially facing subdued operating conditions for some time, the utility of short-term incentives and quantum of overall executive pay can be expected to face greater scrutiny from directors, employees, investors and other stakeholders.

Setting the tone from the top: modelling desired behaviours

"Do they do the stuff that's grubby? Or do they just fly around in their helicopter with their loafers on and never get out of the bus?"

– Senior director

Directors have an important role to play in modelling the right behaviours and setting the tone from the top.

The behaviours and kinds of conversations that take place in the boardroom and during committee meetings, and the way executives are treated by the board, are important in setting the tone for the culture the board expects. For example, if respect, diversity and inclusion are important tenets of company culture, then the type of questions that the board asks, and the manner in which they are asked, should reflect this.

Example

Richard Goyder, the former CEO of Wesfarmers, described the cultural change that took place when Wesfarmers purchased the Coles Group:

"We changed behaviours first and culture then followed."

The notion of authenticity is also seen as important by directors. The board can't just play lip service to culture. It should also be visible in connecting with the company and community it operates in.

"If the board doesn't 'walk the talk', management will pick up on it very quickly, and it will permeate through the organisation".

– David Gonski: Former Chair, Australia and New Zealand Banking Group; Director, Sydney Airport Corporation; Chancellor, University of New South Wales; President, Art Gallery of NSW Trust

Directors also see consistency from the board as being important when contributing to expectations and company culture.

Example

"I was involved with a company that had a separate code of conduct for the company and the board. This didn't make sense."

In particular, there cannot be lower expectations imposed on high performers or senior management. Indeed, there may well be a strong case for holding organisational leaders to a higher standard of accountability given their status and influence.

Example

"Safety is the most important value in our organisation. We've had to let go of some commercially exceptional senior people because their values around safety aren't up to scratch. They may have been exceptional at operating, and winning contracts, but if they're hurting our people or putting them at risk, that's just not acceptable."

Sending signals via board priorities

Boards can influence culture through clearly communicating the behaviours that are expected. This may be through board decisions (e.g. decisions on accountabilities) and board input into official documents such as purpose/values/conduct statements, risk appetite statements, and executive remuneration frameworks.

Boards also signal to management and the rest of the organisation what is important by focusing on or showing interest in particular issues. As Judith MacCormick commented:

"What boards do – the questions they ask management and the way the questions are asked; what they look at or don't look at; what information is asked for or not asked for; what they focus on or prioritise; and what they recognise and reward – will drive behaviours and culture through the organisation."

- Judith MacCormick: Board advisor; Faculty advisor, senior facilitator and writer for the AICD

Directors talked about a range of issues that have become important for their companies as a result, at least in part, of boards making these a priority. These included sustainability, sexual harassment, climate change and safety.

Example

"The board was very clear that it wanted action on sustainability, particularly around the use of plastics and recycling. Line managers were required to attend the board's risk and sustainability committee meetings and explain how the business is dealing with plastics and recycling.

It quickly became pretty clear within the organisation the importance placed on sustainability, what was required, and what outcomes were to be achieved."

There are various techniques that board can use to signal to management and the organisation that a topic is important. For example, if something is put on the board agenda, it receives a different treatment than if it is merely a paragraph in someone's report. The focus of questioning during board meetings also signals what is important to the board.

Example

John Mulcahy commented that when things come before the Mirvac board, the board's questioning demonstrates a commitment to culture.

"Whenever we have a project at Mirvac, the board asks a series of questions that impact on culture, like: How does this reimagine urban life? What's this project doing for the community? How will this create a better community? What are the sustainability issues?"

Another way the board can signal the importance of culture and the 'way of doing things' could be through a board ethics committee:

"An essential part of culture is questioning the ethics of what you're doing. I believe that large companies should have a board ethics committee and that management should have an ethics committee as well."

– David Gonski: Former Chair, Australia and New Zealand Banking Group; Director, Sydney Airport Corporation; Chancellor, University of New South Wales; President, Art Gallery of NSW Trust

In October 2019, the AICD and Ethics Centre released a guide to ethical decision-making that directors may wish to have reference to assist them in their role.

Influencing the creation and enforcement of values statements and codes of conduct

The board has an opportunity in formal documents, such as values statements and codes of conduct, to clearly spell out the values and behaviours they want to see in the organisation. The language and tone of these documents is important. While statements often include examples of what people should not do, it should also set out what behaviours *are* expected.

Directors broadly agree that statements of values and codes of conduct are important. Often the process of arriving at a set of agreed values and behaviours is beneficial in and of itself. Formal documents also provide employees with a framework to point to if they have concerns about something.

However, many directors believe that values statements and codes of conduct are insufficient on their own. What is relevant is how they get put into practice. To support this, it can help to include examples of situations and 'right' and 'wrong' behaviours in these types of documents. For example – what does 'integrity' mean in practice? If there is something about a 'customer focus', what is expected of an individual in the event that a customer outcome is in tension with an outcome for the company? Examples of behaviours and situations bring a values statement or code of conduct into reality, so that people can understand how they work in practice.

Example

"We had a 'Goals and Values' document that was seen as very important.

A junior colleague asked how a certain project was consistent with the 'Goals and Values' document. It caused us to pause and think about this, and we eventually came to the conclusion that it wasn't and stopped the project.

It was important that the senior person in the room listened to the junior person, and that the junior person felt free to say what she felt without fear. That was the culture."

In some companies there may be a very strong sense of what is expected of people, sometimes with less of a need to document it. This is more commonly the case in smaller, family-owned companies, but sometimes large public companies also work this way.

Example

Penny Bingham-Hall commented:

"The 'Founders' principles' are really fundamental to the way the organisation does business.

At the board level, that comes through our discussions about behaviours. We talk about values and culture all the time. It's part of the way we have conversations and it informs what we do.

We look at whether the executive team are behaving in the way we would expect them to and really driving those values through the organisation."

Generally, the larger an organisation becomes, the more important it is to clearly articulate in writing what is acceptable and what is not. Some large organisations have adopted sophisticated approaches in relation to their formal documents. One senior director commented:

"The code of conduct is a very important element. The approach we've taken is not a list of 'dos and don'ts'; we've linked the purpose of the organisation with the values, and the values with behaviours, and we've identified the core policies that everyone must be aware of. You get a line of sight from the purpose of the organisation right down to the engine room. That should be enough for people to understand what's expected of them if they come into the organisation."

- Senior director

It is important that employees receive training on values and expected conduct. This will include some form of induction when they join the company, as well as reinforcement through refresher training, and monitoring that training has happened.

Influence - Key insights and questions for directors

Key insights from director interviews	Questions for directors
Appoint a CEO who can generate the desired behaviours and culture throughout the organisation and be prepared to remove the CEO if necessary.	Does the conduct of the board and senior management team align with the organisation's espoused values and desired public reputation?
Reward the right behaviours, including through an appropriate executive remuneration framework.	Does the organisation's remuneration framework align with the organisation's values, desired culture, and agreed risk appetite?
Make sure that issues the board sees as critical but underreported are added to the agenda (for example, climate change or sexual harassment data).	How are individual and team remuneration outcomes impacted by positive or negative risk, legal or compliance outcomes?
Ensure the formal documents such as values statement and code of conduct clearly spell out desired behaviours.	Are there remuneration consequences for poor staff engagement? What steps are being taken to manage the risk of survey manipulation?
Consider establishing a board ethics committee.	What measures are taken to promote employee wellbeing, including handling of mental health issues?
	Does the chair effectively manage the board agenda and encourage constructive debate by all directors?

Spotlight on COVID-19 and its effect on culture

Undeniably, working from home has presented challenges for those organisations where it has been possible. For organisations with geographically widespread operations, travel restrictions have caused additional difficulties. Overseeing culture has become more difficult for boards. To work out what is going on, directors have had to rely on the formal indicators of culture (e.g. board reports, questioning during board meetings and metrics) rather than their observations and informal conversations.

With interviews conducted throughout August and September 2020, it was important to consider the interaction between COVID-19 and company culture.

The true cultural impact of COVID-19 has yet to be comprehensively examined; it is too early to tell its lasting effects.

There was generally a sense that COVID-19 had both positive and negative impacts. Many felt that the pandemic brought out the best in people. But there is also the risk that boards and employees will lose touch with the company culture, particularly as people continue to work remotely.

In many cases, the pandemic offered an opportunity for companies to live their values, with employees, suppliers and customers taking clear signals on priorities based on the decisions taken during this uncertain and volatile period.

Many companies have faced huge disruptions to operations, staff furloughs and redundancies, and the temporary end of face-to-face interaction.

The directors we interviewed were nonetheless heartened by the management response to the pandemic. Many organisations have heightened their focus on well-being and mental health of employees. Many had also introduced initiatives to help customers, tenants, suppliers and the community.

A director of a large financial services organisation made this observation about the period in lockdown:

"It was a tough working environment. People were putting in massive hours and we had to get everyone working from home with one week's notice. Yet employee engagement scores went through the roof. Covid-19 activated the 'care' component of our culture, and people felt they were able to deliver on what was important to them about working at the organisation."

- Director

Another senior director felt that Covid-19 has given people the legitimacy to progress proposals that are aligned to the culture and values of the organisation, without those proposals being diluted, for example, by steering committees and working groups. The director encouraged management teams to consider what factors have allowed such extraordinary achievements this year to try to retain those positive elements.

One senior director commented that Covid-19 has amplified the good and the bad of company cultures and commented:

"Cultures have been tested. If an organisation was on an upward trajectory and had a strong culture, Covid-19 may have helped to strengthen it. If things were a bit dodgy, all the gaps have become very clear."

- Senior director

Further, there is concern that the longer people continue to work remotely, the more boards and employees will lose touch with the company culture. One senior director commented:

"If we're atomising our workplace, we're atomising our culture. If you're not interacting in the workplace, how do you make sure you see what other people are doing?

It's OK for people who've been with the organisation for a long time. But if you're a new recruit, graduate, or are young and trying to learn, the whole apprenticeship model implicit and essential for developing people in organisations has gone out the window.

The sooner the atomised world finishes, the better. We have to get people back together."

- Senior director

"Culture has survived Covid-19 but it has made things harder. We now understand how important it is having people together, though there is a greater appreciation that personal lives can co-exist with our working lives."

- Jacqueline Hey: Chair, Bendigo and Adelaide Bank

Of course, there are also opportunities that come from different ways of working. It is clear from our interviews that culture will remain firmly in the spotlight for directors as they continue to navigate the impact of COVID-19 on their companies. Directors will need to remain alert to both the ongoing mental health impacts of the pandemic and periods of lockdown on employees; as well as the risks and opportunities for culture that could arise from changing workplace dynamics and more flexible ways of working.

Looking ahead, boards and management teams grappling with potentially permanent changes to how their workforce operates will need to take an evidence-based approach to the impact of greater flexibility, while developing additional ways to maintain effective cultural leadership. For those organisations which are able to do this effectively, the pandemic may well offer a once in a lifetime opportunity to affect positive cultural change and re-draw the compact between senior leadership and their workforce.

Summary snapshot: key insights and questions for directors

This guidance summarises the key insights from our interviews. It does not constitute a set of rules, but instead aims to complement and inform the good judgment that directors bring to their deliberations. It is supplemented by questions to assist directors in framing and interrogating their company's culture, largely drawn from the AICD's practical directors' tool on *Governing Organisational Culture*.

	Key insights from director interviews	Questions for directors
Oversee	• Include culture as a regular board agenda item • Seek specific examples of how management has dealt with issues • Observe how content is presented to the board • Consider how the board interacts with and questions management, particularly on challenging issues – this implicitly and explicitly drives culture in the organisation • Seek out a range of culture-related indicators from both internal and external sources • Create opportunities for directors to interact with employees, both structured and informal	• How does culture appear on the board agenda? What does this signal to management and the organisation about the prioritisation and approach to culture? • How will information on culture be reported to the board? • Does the board interact with a range of employees beyond just the CEO and senior executive? • Does the board receive regular reporting and analysis of customer metrics including raw complaints data?
Measure and assess	• Consider how metrics align to the culture – are the right things being measured and reported • Consider whether there is consistency between what the board is hearing from management, employees and external sources; what the board is observing; and what the metrics show • Conduct a deep dive into issues that raise a red flag, or have potential to cause substantial harm to individuals or the organisation • Learn from other organisations: high profile culture failings at other organisations can be an opportunity to deep dive how the board would deal with a similar issue • Use a variety of sources of information, both formal and informal	• What story do HR metrics (staff turnover, service tenure, exit interview data, absenteeism, employee diversity, engagement scores) tell? • Is there evidence of bullying and harassment (sexual or otherwise) within the organisation, and how quickly are incidents effectively dealt with by management? • How is performance measured, and does that align with the organisation's values, desired culture, and agreed risk appetite? • How are whistle-blowers treated and is it consistent with the desired culture? • What does workplace health and safety reporting (including incidents and near misses) tell the board regarding the overall safety culture within the organisation? • Are the company's processes and outcomes appropriately disclosed?
Influence	• Appoint a CEO who can generate the desired behaviours and culture throughout the organisation, and be prepared to remove the CEO if necessary • Reward the right behaviours, including through an appropriate executive remuneration framework • Make sure that issues the board sees as critical but underreported are added to the agenda (for example, sustainability or sexual harassment data) • Ensure the formal documents such as values statement and code of conduct clearly spell out desired behaviours • Consider establishing a board ethics committee	• Does the conduct of the board and senior management team align with the organisation's espoused values and desired public reputation? • Does the organisation's remuneration framework align with the organisation's values, desired culture, and agreed risk appetite? • How are individual and team remuneration outcomes impacted by positive or negative risk, legal or compliance outcomes? • Are there remuneration consequences for poor staff engagement? How can we address the risk of surveys being gamed? • What measures are taken to promote employee wellbeing, including handling of mental health issues? • Does the chair effectively manage the board agenda and encourage constructive debate by all directors?

Appendix: Interview methodology and acknowledgements

The AICD and ACSI conducted in-depth individual interviews with listed company directors operating in various sectors, and with subject matter experts on culture. Interviews lasted from 45 to 60 minutes. The discussion was framed by open-ended questions in order to best explore the experience and perspectives of the interviewees. The semi-structured interview process was used flexibly in each of the interviews where prompts were used to elicit deeper information in some of the interviews while in others, participants drove the discussion themselves.

Thank you to Louise Pocock for her assistance in conducting and analysing the interviews with directors and in preparing this report. We are also grateful to Dr. Gaia Grant for her work on a literature review that we have drawn upon for the Background section of this report.

We wish to acknowledge the following directors and contributors for their insights and reflections:

- Elizabeth Alexander AO FAICD(Life) – Former Chair, Medibank Private; Former Chair, CSL; Consultant, Ashurst
- Ilana Atlas AO MAICD – Chair, Coca-Cola Amatil; Director, Australia and New Zealand Banking Group Limited
- Penny Bingham-Hall FAICD – Director, Bluescope; Director, Dexus Funds Management; Director, Fortescue Metals Group
- Gordon L Clark FBA DSc – Professorial Fellow, Co-Director SSEE-Zurich Project, Oxford University
- Peter Collins GAICD - Director of the Vincent Fairfax Fellowship; D. Phil student at Oxford; Board member of the Walter and Eliza Hall Institute for Scientific and Medical Research (WEHI).
- David Gonski AC FAICD(Life) – Former Chair, Australia and New Zealand Banking Group; Director, Sydney Airport Corporation; Chancellor, University of New South Wales; President, Art Gallery of NSW Trust
- Richard Goyder AO FAICD – Chair, Qantas Airways Limited; Chair, Woodside Limited
- John M. Green FAICD – Deputy Chair, QBE Insurance; Director, Cyber Security Cooperative Research Centre; Director, Challenger Limited
- Peter Hay FAICD – Chair, Newcrest Mining Limited; Chair, Mutual Trust Pty Limited; Chair, Australia Pacific Airports Corporation; Director, Cormack Foundation
- Jacqueline Hey GAICD – Chair, Bendigo and Adelaide Bank; Director, Qantas Airways Limited; Director, AGL Energy Limited
- Graeme Hunt MAICD – Chair, AGL Energy Limited; Chair, BIS Industries Limited; Member, CSIRO Energy Advisory Council; Director; Future Battery Industry Collaborative Research Centre
- Graeme Liebelt FAICD FTSE FIML – Chair, Amcor PLC; Director, Australia and New Zealand Banking Group Limited; Director, Australian Foundation Investment Company Limited
- Catherine Livingstone AO FAICD FCA – Chair, Commonwealth Bank of Australia; Chancellor, University of Technology Sydney
- Dr Judith S. MacCormick FAICD – Board advisor; Faculty advisor, senior facilitator and writer for the AICD
- John Mulcahy MAICD – Chair, Mirvac Group; Director, ALS Limited; Director, The Shore Foundation Limited; Deputy Chair, GWA Group Limited; Chair, ORIX Australia Corporation Limited
- Dr Melinda Muth FAICD – Facilitator and Faculty Advisor AICD; Managing Director, Streamwise Learning; Director, Harvard Club Australia Philanthropy, Chair of CuriousWorks
- Tim Poole – Chair, Aurizon Holdings; Director, Reece Limited; Director, McMillan Shakespeare Limited
- Suneeta Sidhu, Senior Executive Leader, Governance, ASIC
- Diane Smith-Gander AO FAICD – Chair, Safe Work Australia; Director, AGL Energy Limited
- Michael Ullmer AO FAICD – Chair, Lend Lease Group; Director, Woolworths Limited; Chair, Melbourne Symphony Orchestra