Governing organisational culture

An organisation's culture – collective behaviours driven by a set of norms and values that directly impact decision making – is central to the quality of contemporary governance. It's inextricably linked to questions of right and wrong and reframes compliance-oriented "can we?" questions into ethically-weighted "should we?" questions.

In Australia, regulators such as the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) highlight the significance of organisational culture, including the role it plays in shaping governance frameworks and outcomes.

The Australian Institute of Company Directors has developed this director tool to help shape the approach to governing organisational culture:

Part A considers the role of the board in governing culture;

Part B offers insights to assist directors in discharging their important responsibilities in this area, including a list of themed questions to assist in framing their organisation's unique culture.

This suggested approach, applicable to all sectors, is not about adding another prescriptive element to already significant oversight obligations. It should be noted that, by nature, culture is complex and organisations are dynamic and this makes the practice of governing organisational culture too complicated for simple prescription. Rather this approach recognises that despite the complexity, culture is critical to an organisation's sustainable performance, and that cultural change must be driven by, supported by, and modelled by the leadership of the organisation, and integrated within the board's overall governance role.

PART A
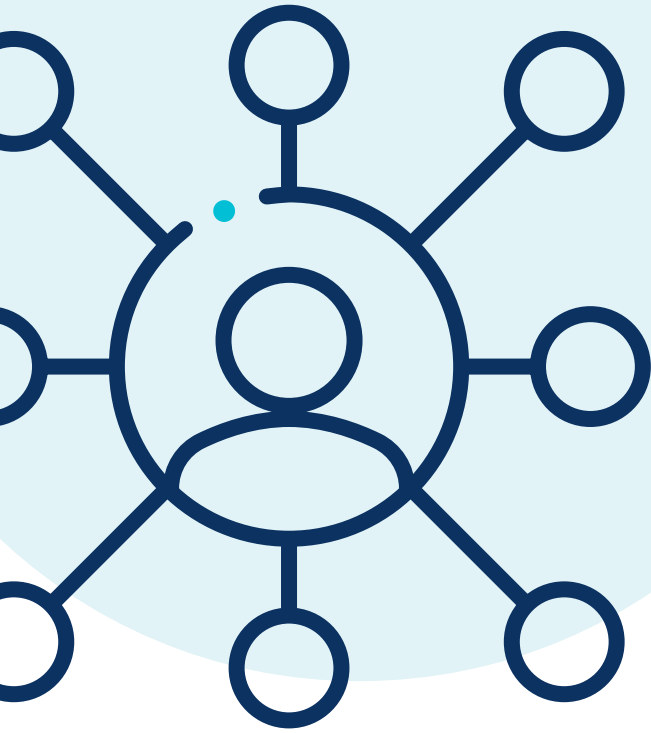
Culture and the role of the board

What leaders do and say set the tone for the rest of the organisation. As the board takes the highest leadership role in the organisation, how directors behave (for example, the quality and character of their discourse) and the decisions they make in the boardroom (for example, strategic directions, risk appetites and remuneration frameworks) directly affect how the CEO and senior management perceive and embody their roles, and how they influence the organisation's overall culture.

Effective governance identifies culture as an important lever to create value. Organisations with a stronger, positive culture may not only face lower risk (for example, from misconduct) but may also exhibit greater resilience overall, higher customer satisfaction, better employee morale and well-being, and enhanced productivity and performance against strategy over the long term.

In this strategic context, the role of the board is to provide ongoing and effective cultural stewardship and oversight. As part of this role, it is important that directors take proactive steps to understand and assess the systems of culture (both formal and informal) in their organisation and work with management to leverage opportunities and implement changes where necessary.

Three key dimensions of governing culture

To effectively govern culture[1], it's important for the board to consider its own function across three dimensions.

Firstly, the board needs to set clear cultural direction and expectations around behaviours and decision making. Good organisational governance sets expectations for both formal and informal behaviours that shape culture. These expectations serve to create a link between the organisation's purpose (why it exists) and its strategic goals by expressing the behaviours it expects from its people.

Secondly, the board needs to align the levers at its disposal to reinforce these expectations. Expectations are reinforced if they are embedded in the organisation's policies, systems and processes and carried out in the behaviours and decisions of employees. Strong cultures are those where there is clear alignment between

expectations and the structures used to reinforce them. This alignment delivers a circularity where expectations shape policies that define processes and where processes shape desired behaviours and decisions that in turn reinforce expectations.

Thirdly, the board needs to regularly test that these expectations are being met. Boards should test that expectations are being met through both reported metrics (formal) and observed enacted behaviours (informal). Contradictions and inconsistencies (for example, informal rules around complacency, insularity and collegiality) can undermine board efforts to govern culture effectively.

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[1] The Australian Institute of Company Directors' Board Advisory practice offers independent evaluations and specialist expertise in the field of governing culture. Contact our Board Advisory practice at https://aicd.companydirectors.com.au/advisory to find out more.

PART B
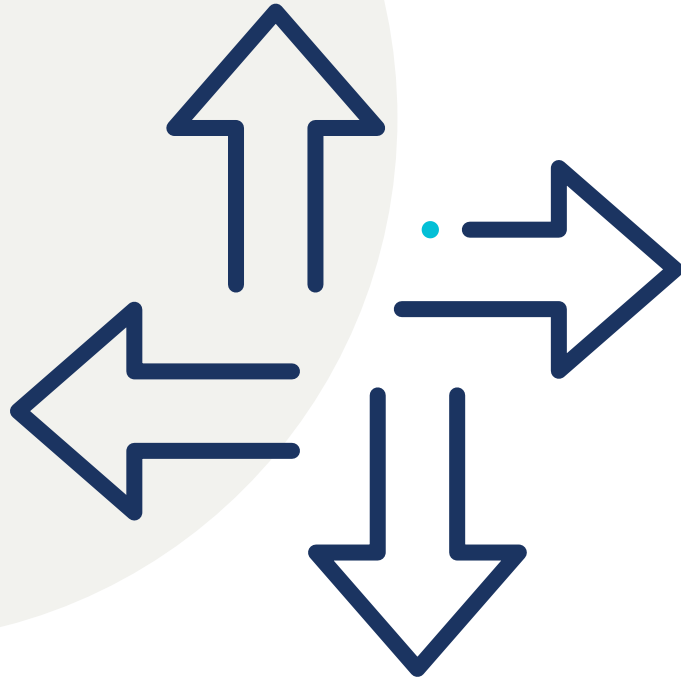
Governing culture in practice

Governing culture at a board level is complex because it reflects a higher order dynamic than a checklist world of systems and process. The four quadrant approach outlined in this section tasks directors with pursuing a better understanding of broad formal and informal systems and processes that determine culture in their organisation (refer to Figure 1: Governing Culture in Practice). It is designed to guide director thinking and questioning, and to stimulate curiosity and make new connections regarding culture both inside and outside the boardroom.

Appointing the CEO and holding them accountable is one of the most significant influences the board has on culture, and an alignment with values should be given appropriate weight during the CEO recruitment process and succession planning.

Directors cannot delegate all responsibility for organisational culture to management. Similarly, they cannot rely solely on discrete, formal sources of data for culture insight and oversight. Rather there is a need for directors to discuss a framework for constructive challenge with management, so that both the board and management are clear and so that the constructive component is maintained.
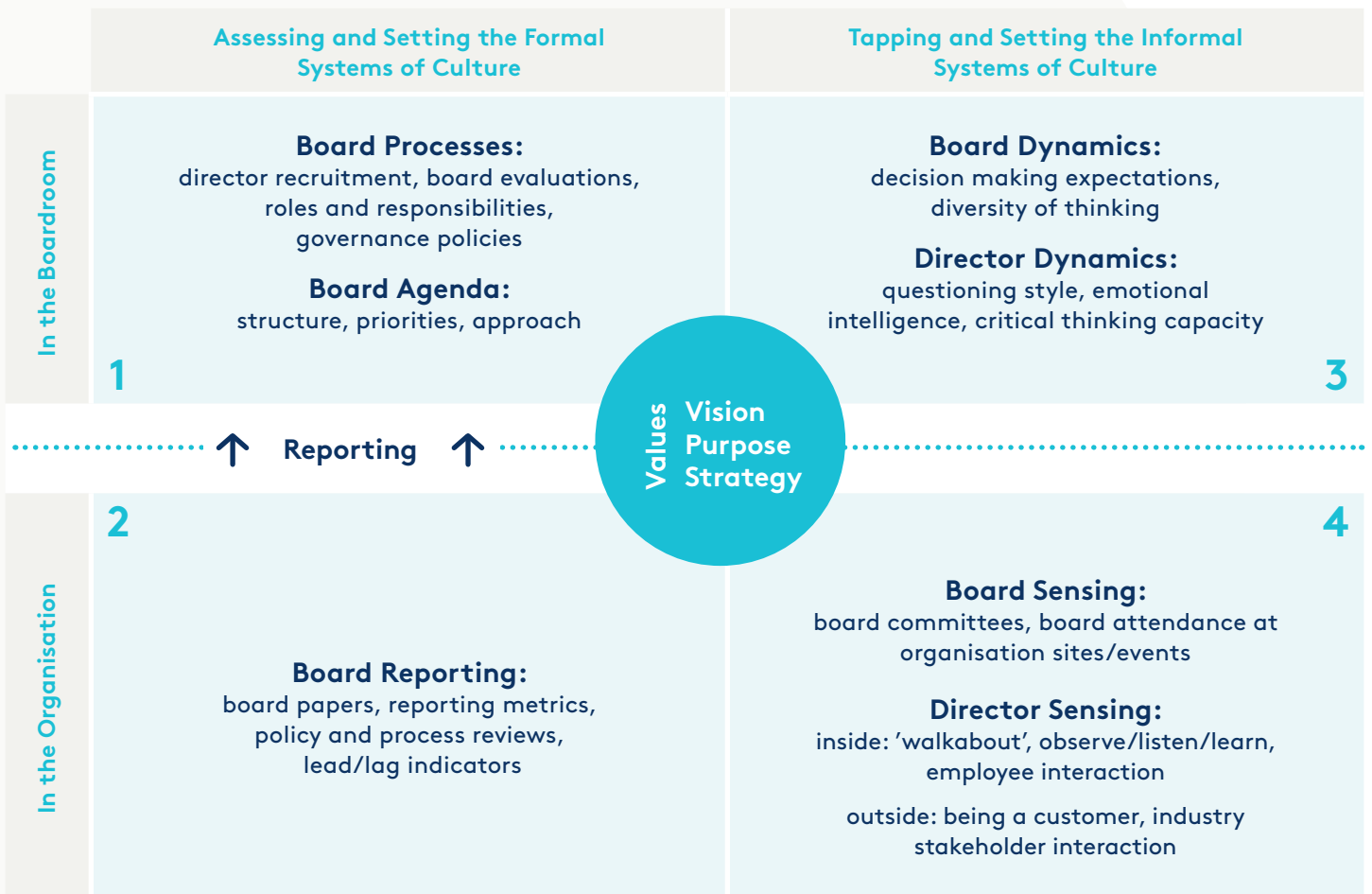
Directors must also regularly test the trust they necessarily place in the CEO (and other senior executives), and experience first-hand what is happening in the organisation.

While holding their organisation's agreed vision, purpose and strategy at the centre, directors might use the insights that surface from the approach suggested below to understand, evaluate and influence their organisation's formal and informal systems of culture. This approach helps determine the strength of their culture and its alignment to current strategy. Importantly, this approach also helps identify red flags.

The board's ability to both assess and set their organisation's formal systems of culture rests with the tools directors use to make decisions in the boardroom and how they interact with the organisation via board reports.

On the other hand, but equally important, the board's ability to influence and tap into their organisation's informal systems of culture rests with how directors behave in the boardroom and what behaviours they directly observe inside and outside the organisation.

Figure 1: Governing Culture in Practice

	Assessing and Setting the Formal Systems of Culture	Tapping and Setting the Informal Systems of Culture
In the Boardroom	**Board Processes:** director recruitment, board evaluations, roles and responsibilities, governance policies **Board Agenda:** structure, priorities, approach **1**	**Board Dynamics:** decision making expectations, diversity of thinking **Director Dynamics:** questioning style, emotional intelligence, critical thinking capacity **3**
	↑ Reporting ↑	Values · Vision Purpose Strategy
In the Organisation	**2** **Board Reporting:** board papers, reporting metrics, policy and process reviews, lead/lag indicators	**4** **Board Sensing:** board committees, board attendance at organisation sites/events **Director Sensing:** inside: 'walkabout', observe/listen/learn, employee interaction outside: being a customer, industry stakeholder interaction

QUADRANT 1:

Board Processes and Board Agenda

In assessing and setting an organisation's formal systems of culture, boards should review in-boardroom activity: from how the appointment of directors and board-level processes and policies are approached, to the design and priorities of the board agenda.

Processes in the boardroom

- Director recruitment 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.

  Board appointment letters, director induction and ongoing development opportunities should reflect organisational values.

- Board and individual director evaluations can support directors in understanding and constantly improving boardroom culture. Undertaking 360° feedback reviews as part of board evaluations can help to identify development needs of directors. Being an effective role model requires an understanding of others' perceptions and an open mind about things that can be done differently.

- Board-level governance policies, systems and processes, as well as human resources and people policies, play an important role in shaping culture, and should be closely reviewed for alignment to the desired culture.

  For example, ensuring there are no conflicted remuneration arrangements is likely to support positive conduct and culture.

- Clear and documented roles and responsibilities support effective articulation of delegations, efficient yet rigorous decision making and accountability.

  Boards can demonstrate cultural alignment by calibrating decisions against the strategy, values and risk appetite.

The board agenda

- How agenda priorities are determined can reflect and drive culture in the boardroom and also throughout the organisation.

  For example, a board agenda that is structured to allocate time for discussion of culture and exploration of ideas sends a message about a cultural expectation of agility and generative input.

Cultural red flags in this quadrant include:

- Low/outdated skills level
- Homogeneous director profiles
- Little succession planning
- Poor understanding of risk
- A checklist approach to policies
- Unclear board and committee accountabilities
- Rushed board meetings
- Inflexible standing agendas

QUADRANT 2:

Board Reporting

Management should be tasked with supporting the board in understanding the organisational culture, both through formal survey processes and through the board reports on relevant data and culture metrics on an ongoing basis.

- Board papers should deliver rigorously analysed data that provides insights for the board and supports them in discharging their responsibilities.

  Management should be clear on the purpose of each board paper and the action desired from the board.

  Reporting should identify clearly what problems/opportunities are being addressed and provide clear options, not just a favoured recommendation.

- Boards must see that they have access to instruments to monitor culture and facilitate transformation, if required. Formal cultural surveys can assist, but they are not enough. Management should be tasked with reporting non-financial metrics to the board that help reveal the cultural dimensions of an organisation.

  These may include employee survey results, customer and supplier feedback, action taken on identified risks or breaches, internal audit reports, reward and performance management systems, and organisational measurement systems.

- Boards should consider the alignment of the metrics to the desired culture.

  If the desired culture espouses that employees are the company's most valuable asset, questions could include: Are staff development costs allocated as an expense or investment? Do percentages of staff providing feedback indicate that staff feel 'safe' and can trust the system/organisation? What is the number and pattern of hires who resigned within 12 months of starting?

  If innovation is a priority: What metrics reflect pipelines, experimentation, speed to market and importantly, lessons learned?

  If the organisation promotes itself as customer centric: How is customer feedback tracked? How is complaints data aggregated and handled? How and what are the social media trends and commentary?

- Measuring culture is challenging as it is a composite of both the visible and the invisible. Historically, there has been a tendency to concentrate on results, tangible outputs and outcomes because they are easy to measure. These are lag indicators - an after-the-event measurement, essential for charting progress but of less value when attempting to capture culture.

- To better capture culture and influence the future, a different type of in-process measurement is required. This can be achieved through lead indicators, which are predictive and often more qualitative.

  For example, if it's important to enhance reputation for customer care, a predictive measure for better performance would be the number of referrals from satisfied customers or favourable reviews on social media.

- Lead indicators are more difficult to determine than lag indicators. However, a combination of lead and lag indicators that capture both qualitative and quantitative data about culture will provide early signals about organisational reputation and, in turn, contribute to delivering performance.

Cultural red flags in this quadrant include:

- Low goal achievement and poor bad news flow

- A focus on 'what are the outcomes' without regard to how they were achieved

- A focus on the strict letter of the law

- High turnover and exit rationales not being reported

- Absence of raw data on whistleblowers

- High-performer preferential treatment

- Cross-silo failure

- Dominance of short-term business decisions

- Actions discussed in the boardroom not being recorded or taken

- Poor board papers (for example, unclear, overly technical and complex, and operationally focussed)

- Management being absent from the boardroom

QUADRANT 3:

Board Dynamics and Director Dynamics

Whatever the organisation's formally espoused systems of culture, it is what is enacted around the board table – the dynamics of director decision making and discussions, their expectations and priorities, and how they hold management to account - that influences the culture that flows through the organisation.

Directors shouldn't underestimate their role in setting culture through what they do and say, and what they attend to and don't attend to, around the board table.

Collective boardroom conduct

· Room for discussion and questioning is important. How the board responds to objective challenges and people, what it wants in reports and how it interacts with what is presented, implicitly and explicitly drive culture in the organisation.

· Efficient decision making may not leave room for questioning assumptions. Is it normal practice for everyone to take the role of (constructive) critic and in so doing normalize and make safe the voice of challenge? Does everyone hold each other to account to demonstrate the organisation's values as they interact with what is presented? Is management treated with respect and equally held to account if they do not behave in alignment with the culture?

When behaviour fails in delivering and supporting the company's culture, or behaviour contradicts the values and ethos, does the board challenge the CEO?

· Management as well as the board are individually and collectively well served with a 'growth' mindset.

· Boards that operate to their potential are characterised by constructive challenge, coupled with mutual respect between management and directors. Constructive debate improves decision making. However, as productive debate is a form of conflict, it is important that time is devoted to building trust and giving permission to dissent, irrespective of the organisational hierarchy in the room.

Individual conduct

· The nature of each individuals' questioning style, critical thinking and level of emotional intelligence, including self-reflection, creates a whole that is greater than the sum of individual inputs and sets the tone for the rest of the organisation.

· It is important that board members role model personal courage, hold each other to account and remain ever curious as they ask challenging yet constructive questions of themselves as well as others.

Cultural red flags in this quadrant include:

· Excessive collegiality and relationship prioritisation (especially between the chair and the CEO)

· Short termism

· Tolerance of small breaches of rules

· Complacency

· Risk reaction rather than risk preemption

· Uneven influence of the risk function

· Groupthink

· Insufficient constructive challenge

· A boardroom that feels 'comfortable'

· More priorities being driven by management than the board

QUADRANT 4:

Board Sensing and Director Sensing

In addition to formal board reporting, a parallel source of input to the board comes from informal cultural data gathered by directors individually and collectively. This 'sensing' of the culture is not intended as a rigorous data gathering process, nor does it undermine the need for boards to respect management authority. Rather, it is a qualitative, and purposefully informal, activity.

This fourth quadrant – of informally observing the organisation outside the boardroom, and from outside the organisation – balances the range of cultural insights and levers available to directors and delivers a more holistic approach to their role in effectively governing culture.

What can the board do collectively?

- Scheduling board meetings at different sites rather than only the head office boardroom can help directors get to know the organisation's operational circumstances first hand.

  It also provides the opportunity to interact before and after board meetings with employees, and possibly customers and other stakeholders.

- Attending events and employee celebratory functions when appropriate can demonstrate the value that is placed on employees, whilst also providing an opportunity to read the culture.

  It is also valuable to understand why people join the company and what keeps them in the company. Identifying the sources of emotional energy and pride driving employees can be important foundations to build on.

- The observable functions and behaviours of board committees are a valuable way for the board to monitor (and influence) culture.

  The aspects of culture the committee is responsible for should be articulated along with how cultural oversight will be embedded in the ongoing work of the board.

  The committee activity is also a valuable opportunity to see culture enacted in the interactions with staff.

  For example, the remuneration committee may consider the impact of pay plans on culture at all levels in the organisation, identifying those that could encourage high-risk behaviour or discourage innovation or impede achieving a strategically aligned culture.

  The audit committee could discuss culture-related aspects of internal and external audits, compliance reviews, whistleblower systems and regulatory reviews.

  Together these provide insight into the ethics and attitudes toward risk and compliance that can reinforce or otherwise the company's desired culture.

What can directors do individually?

- Directors can observe, listen and learn, while ensuring that 'hands are out of operational management' and they do not blur the boundaries between the board and management roles.

- Valuable information about enacted culture comes from observational activities such as 'walking about', being a customer, sitting at a hot desk in the open plan office, calling the help line.

- What are the attitudes of staff towards customers, policies, the organisation's sustainability

and reputation? Observing the conditions that employees work under, their level of resourcing, their willingness and opportunities to speak up, and seeing firsthand how managers treat staff and role model values is invaluable input for directors to calibrate against the stated values.

- Beyond the organisation, individual directors can triangulate data to understand how others see the enacted culture as they talk informally to non-customers, investors and other stakeholders such as regulators, community groups and employee representatives. Directors can visit suppliers, regulators and industry peers to assess how the organisation is regarded.

Cultural red flags in this quadrant include:

- Low culture references in committee work

- Excessive or deficient collegiality

- Poor bad news flow, concealment

- Relationship prioritisation,

- A poor work/life balance environment

- Reluctance to challenge the status quo

- Lack of awareness of the organisation's values, vision and purpose through different organisational levels

The governing culture mindset

The following questions are designed to assist directors to reflect on metrics that might be relevant to their circumstances in the context of governing culture. It is not a complete or prescriptive list and relevant aspects may vary over time and will depend on factors such as an organisation's size, industry sector and lifecycle position.

Questions on the board-management relationship

- Does the board trust in management but continually test that trust?

- Does the conduct of the CEO and senior management team align with the organisation's espoused values and desired public reputation?

- Do key stakeholders, including regulators, employees and customers, share the board's view of management performance?

- Does the board interact with a range of employees beyond just the CEO and senior executive?

- How often are management proposals rejected or substantially revised by the board?

- What is the nature of the chair-CEO relationship and is it too close or too distant?

- Does the board receive appropriate information flows in order to challenge management effectively?

Questions on people and risk

- 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?

- Are robust whistleblowing policies in place that encourage a 'speak up' culture, are they utilised, and do they provide the board with clear visibility?

- Are there functioning degrees of 'speaking up' that surface concerns prior to relying on a whistleblowing policy?

- What do the risk, legal and compliance reports say?

- What is the organisation's framework for understanding and managing non-financial risks?

- Are the risk, legal and compliance functions adequately resourced and empowered within the organisation?

- Does the board receive regular reporting and analysis of customer metrics including raw complaints data?

- Are individuals held accountable for serious risk, legal or compliance failings?

- Do staff refer family and friends to join the organisation?

Questions on innovation

- What percentage of revenue is devoted to research and development and how does that compare with industry and global standards?

- When was the last time the organisation produced a new-to-world or new-to-market product or service?

- How concentrated is decision making within the organisation? And how long does it take for a decision to be made and implemented?

- Does the organisation have a sufficient diversity of skillset, experience and background in its workforce to remain competitive?

- What investment in staff is needed to promote innovation?

Questions on remuneration

- Does the organisation's remuneration framework align with the organisation's values, desired culture, and agreed risk appetite?

- Does the board include non-financial metrics in decisions on CEO variable remuneration if applicable?

- 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? ▶

Questions on workplace health and safety

· What does WHS reporting (including incidents and near misses) tell the board regarding the overall safety culture within the organisation?

· Are employees provided with adequate training and support to carry out their jobs safely and effectively?

· What measures are taken to promote work-life balance and employee wellbeing, including handling of mental health issues?

Questions on intra-board dynamics

· Does the chair effectively manage the board agenda and encourage constructive debate by all directors?

· Does the board defer to the committee chair on issues, or does it engage in robust debate?

· Does the board carry out regular, external reviews of individual and collective performance?

· Is the board cohesive or is it fragmented into cliques or factions?

· How many directors sit on boards with other fellow directors, and does that impact the quality of boardroom discussion?

About the Author

Judith S. MacCormick FAICD, PhD and MBA (USyd and UNSW), Grad Dip Sci (ANU), BA advises leading public, private and NFP organisations across the globe on issues of strategic corporate governance, and board development and effectiveness. Judith is a faculty advisor, senior facilitator, and writer for the Australian Institute of Company Directors.

About us

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 44,000 includes directors and senior leaders from business, government and the not-for-profit (NFP) sectors.

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