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Think Ahead ACCA

# Aligning Corporate Governance and culture: What's in it for the board?"

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**DRAFT REPORT**


On 11 January 2017, ACCA (the Association of Chartered Certified Accountants) and ecoDa jointly organised a conference called **Aligning Corporate Governance and culture: What's in it for the board?** to share best practices and real life examples of how companies successfully achieved a culture change and how it works in reality.

**Turid Elisabeth Solvang**, Chair of ecoDa & Co-Founder of the Norwegian Institute of Directors, and **Cora van Nieuwenhuizen**, MEP, gave keynote speeches. The panel discussion was moderated by **Maija Laurila**, Head of unit, Company Law, DG JUST, European Commission, and comprised of **Matthieu Leclercq**, President, Decathlon, **Peter Montagnon**, associate director, Institute of Business Ethics, **Will Oulton**, Chairman, Eurosif, and **Jo Iwasaki**, Head of Corporate Governance, ACCA.

The debate revealed that

- In order to change people's attitudes and behaviours, the issue of corporate culture needs to be addressed. Change starts with "tone from the top", but equally important is "behaviour at the top" - action, not just words.
- There is increasing evidence and acceptance that a link exists between the corporate governance and culture of organisations, as unfortunately highlighted by recent examples of corporate dysfunction. There is no « one size fits all >> in corporate governance matters, and corporate culture – as well as nurturing a healthy one - is a challenge to everyone. But the good news is that evidence is building with examples of culture facilitating better performance and building harmonious teams.
- Prescriptive regulation trying to address corporate culture change is not a silver bullet to help organisations, team and individuals progress. Culture relates to the quality of behaviour, and passing legislation requiring people to behave better is a challenge. Tone from the top matters and stewardship is critical for change, but this is not enough, with companies needing a systematic approach to embedding their values.
- The purpose of companies is not just to generate short-term profits for their shareholders. Corporate leaders need to be aware of the impact of their company on society and also how the values they have espoused are shaping the behaviour of their employees if they were to deliver sustainable prosperity. It was stressed that this might suggest a greater focus on disclosure. Part of this could involve developing and promoting new indicators such as customer satisfaction and staff turnover.

## Main highlights

**Turid Elisabeth Solvang**, Chair of ecoDa & Co-Founder of the Norwegian Institute of Directors

- The 4th Industrial Revolution is thundering forward, faster and faster – whether you like it or not; whether you want to be on board or not. Artificial intelligence and robots are taking over the jobs we don't want – and also the jobs we want.
- The fact is, the 4th Industrial Revolution affects us all – how we spend our time; the products and services we make and use; where and how we work, how (and if) we get there. The changes will be massive and rapid, and we will all be affected, including boards of directors.
- But technology also affects how business is done – and companies' license and freedom to operate. While companies aren't necessarily misbehaving more than previously, the odds that customers and the general public will find out about corporate misconduct or product failures are much greater – or "better" – than before. The global accessibility of digital information and social media means that people do find out – quickly – and they make informed decisions based on their knowledge.
- If 2016 taught us anything, it would be that strange and unpredictable things happen when people lose faith in authorities – be it government or highly esteemed companies or products – when their points of reference no longer provide hope or meaningful direction. Add geopolitical unrest, Brexit and Trump, corporate scandals, and climate concerns to a disconcerted population, who are showing signs that they are "mad as hell, and just aren't going to take it anymore", and you have a highly volatile cocktail indeed.
- Many are turning their lime-lights on the actions of boards of directors and C-suites, and are eagerly listening for a new tone from the top. Among those requesting change, is the British Prime Minister. "I want to see changes in the way that big business is governed. The people who run big businesses are supposed to be accountable to outsiders," May said in July. "In practice, they are drawn from the same narrow social and professional circles as the executive team."
- As we are all familiar with, the EU is responding in its own language – regulation: Digital Single Market; Audit reform; Non-Financial Directive; Shareholders Rights Directive; Gender directive.
- Regulations, directives and reforms supporting the EU 2020 strategy for a "Smart, inclusive and sustainable growth", and that also in many ways express the authorities' frustration with a business sector that is seen as unwilling to change and incapable of self-regulation.
- But companies that want to be sustainable and socially responsible need to understand the role they play in people's lives. They need to take their stakeholders along on their journey. And the winds are indeed shifting. As an example, the topic for the World Economic Forum is "Responsive and responsible leadership".
- While the concept of a "triple bottom line" has been around for a while, it now seems to be taking hold. We increasingly find ourselves talking about the company's role in society – and understand that a discussion about purpose and values no longer stops at profit.
- The acknowledgement that good corporate governance goes far beyond compliance is spreading. The global governance discussion increasingly pivots around culture and values, and the board's role and responsibility in making sure that a healthy corporate culture is nurtured, and that the company's set of values permeate every aspect of its operations. Regulations are not enough to achieve lasting change. To

really change people's attitudes and behaviour, we have to address culture. Because we all know - in the quote usually attributed to Peter Drucker - 'culture eats strategy for breakfast'.

**Cora van Nieuwenhuizen**, MEP

- The importance of corporate governance is more and more on the political agenda of the European Parliament. Unfortunately the reason for that is the recent scandals, such as Panama Papers or Lux Leaks. We should instead try to set the agenda before something goes wrong, which is something that the general public is asking for – politicians to be proactive.
- Bitcoin is growing but not necessarily for the right reasons. It sometimes can enable new money-laundering opportunities. It tells us a lot about our culture
- Corporate culture concerns not only big multinational companies, it is also very important for SMEs. Therefore, much broader discussion with multiple stakeholders is needed. Let's not wait for a new scandal to do that.
- Corporate culture starts with the tone at the top and it takes time. Having awareness in the company about possible risks and creating incentives helps.
- It is often not about what's being said but rather about the actual behaviour. Making statements doesn't make a difference. People tend to follow examples, not rules. Having the right attitude and being open is crucial.
- Regulation needs to be principle-based. Box-ticking exercises create fake security – there is no such thing as risk-free society. There needs to be an on-going discussion about values and risks.
- Developing corporate governance should be an incremental process – every little improvement should be appreciated. There shouldn't be a deadline to reach the final destination – the journey is more important.
- Integrated reporting should be supported; however, it is mostly about sustainability and people. Taxation is often forgotten. Companies should provide information about the amount of taxes they are paying and in which countries they are doing so.

**Matthieu Leclercq**, President, Decathlon

- It is important to honour the past and invent the future. Companies have no choice but to change, yet it is essential to look where they come from and what are the experiences they have. You must change to be better who you are – this is true for individuals but also for companies.
- Tone in the company comes from the chairman and CEO – it is not the case where everyone speaks to everyone.
- Decathlon uses the metaphor of spinal cord which defines the responsibilities of the team members. The Chairman is responsible for best practices, values and purpose; CEO is in charge of business model, vision and strategic objectives; business unit leaders take care of profitability, users, process and team members.
- The main responsibility of board members is to appoint the chairman; the main responsibility of a chairman is to appoint the CEO. If board members would get involved with the management, there would be a risk of cacophony. Bigger involvement of a board member with the chairman can lead to difficulties in removing the chairman from the position.
- People need to understand their roles and the company tone, and then take decisions appropriate for their position locally. Adapting to situations is very important and actions always need to make sense locally (what makes sense in Sri Lanka

might not make sense in London)– employees need first to act locally - and only then think globally. If it doesn't work locally – change is required. Confidence is an important element that allows people to take action.

- Company needs to define its identity and where it is going: does it want to differentiate itself from the competitors, focus on cost and price, increase the production etc. The role of the chairman is to define where the company stands. Strategy means defining the territory you want to conquer. For example, Decathlon is focused on reducing the cost which leads to lowering the price and giving people better value for their money. It is a cost-driven business which does not mean that Decathlon has not developed strong values.
- Good judgement comes from experience. Unfortunately, experience comes from bad judgement. Making mistakes is normal and it should be encouraged to acknowledge them. Being afraid of making mistakes shouldn't be a part of the culture (it is only when you repeat mistakes that they are becoming faults).
- Family businesses usually perform better but they are more complex. Salary is often a big part of this complexity.
- At Decathlon, 90% of CEO have started as employee – internal promotion is important.
- If you highlight the behaviours you want and if you reinforce them, the culture will change. That's the proper way of designing the future.

**Peter Montagnon**, associate director, Institute of Business Ethics

- It is important to nurture the good things in corporate governance.
- We are at an inflexion point in governance as our understanding of the role of boards is changing.
- There is not a lot that prescriptive regulation can do to take us on to the next stage, as we are talking about the quality of behaviour and you can't legislate for that.
- Values matter – a lesson we still struggle to learn even after the banking crisis.
- The public view of the corporation is changing in the wake of the banking crisis and other corporate scandals such as those at Tesco and Volkswagen. These have taught us to reject the idea that companies are simply there to make money for the shareholders in the short-term. The corporate world has to adjust to the new reality. That means that boards have a slightly different task than before.
- When it comes to corporate governance, we have been thinking a lot about the process and it has been very inward-looking in the way we organise the board, what committees we have etc.
- Nowadays corporate leaders need to be aware of the impact of their company on society and also how the values they have espoused are shaping the behaviour of their employees. Will the workforce make good choices under stress, or will they cheat as those at VW did? If so, will their behaviour put the whole company at risk?
- The key starting point is values. All companies have them even if they don't know what they are. But they can also change and develop. Boards have to work out what values they want and then how to ensure that the values they have chosen are what actually drive behaviour.
- Some values are more commercial in nature. For example a company may prize innovation. Some have a highly ethical content built around delivering real value to the customers, respect for stakeholders, honesty, openness and reliability.
- Obviously a company with positive values is more likely to endure than one whose business model is based on dishonesty and lack of reliability. It is critical for companies to have a sense of purpose. They must understand what they are here for – not just to make money, but if they are to deserve their franchise, to deliver something that society wants and values.

- Then there is a big challenge for boards and company leadership in understanding, shaping and assessing what drives behaviour in their business.
- We talk a lot about tone from the top, and it is indeed true that this matters. In particular people will look to the Chief Executive to display the firm's values in the way he or she behaves. Even he or she is successful, a CEO has to be dismissed if he/she does not act in line with the companies' values.
- At the moment at the IBE we are quietly cross with Prime Minister Theresa May because she refuses to wear a hard hat on factory visits. Her argument is that she is not likely to suffer an accident, but we know that the signal she is actually sending is that it does not really matter whether you wear a hard hat or not. This just makes it harder for those concerned with high overall standards of safety.
- The correct response, by the way, to chief executives who do not display the required values is to fire them, but I will leave you to your own conclusions about whether and how this should apply in the political context.
- The more important point is that tone from the top is not enough. Companies need a systematic approach to embedding their values. This can be done through internal codes of conduct, but these have to be very carefully constructed and monitored, and it requires a large effort to keep them alive, and boards have to monitor carefully to ensure that what they've got is what they want.
- As regards to regulatory framework, because we are talking about the quality of behaviour, you simply can't pass legislation requiring people to behave better. All that regulators and policy-makers can do, once the basic framework of rules is in place, is to encourage and facilitate. It is about building trust which is opposite of regulation (you don't regulate people that you trust). In the Netherlands companies are now obliged to have a code of ethics.
- This might suggest a greater focus on disclosure. We need, perhaps a serious review of where we have got to with narrative reporting designed to do away with some of the less helpful disclosures and to make it come alive. Part of this would involve developing and promoting new indicators such as customer satisfaction and staff turnover which rarely get reported and doing away with indicators that must be reported but receive little attention.
- As regards to remuneration, it is an area where things need to change. The incentives that we have now are too much focused on short-term and too specific.
- Britain has made a mistake in making the disclosure legislation around patching up an existing system which isn't fit for purpose and is far too complicated. Remuneration policies need a radical fresh thinking. We should cut out options, share schemes and largely remove bonuses. It would allow running the company for a sustainable and growing cash flow.
- Instead of culture, it should be about behaviour and what drives it in the organisation. Important thing to understand is that we act differently when we are on our own than we do in a group. The real question is how to make people behave so it is right for the organisation. Values are the starting point as drivers of behaviours.

**Will Oulton**, Chairman, Eurosif

- Research has shown that the costs of intermediation in the finance industry have been accelerating over time. To some degree we can understand that because of technology. However, it has been noticed that the costs are greater not because of greater efficiency but because the costs are being extracted by intermediaries in terms of bonuses, salaries and costs. In the US market alone that amount is estimated to amount to around 9% of GDP going out of the system.

- This is a system where people are paying for activity and not outcomes. It is a big weakness in the financial services sector. We have encouraged a culture of entitlement.
- The CFA Institute, together with State Street bank, published research on the purpose, habits and incentives (PHI) of 7000 investment professionals from 20 countries around the world. The research came up with variable "phi" which derived from the motivational forces of purpose, habits and incentives that govern behaviours and actions.
- The results show that the majority of investment professionals believe that if they underperform for period of 18 months, they will get fired. 28% of participants remain in the industry to help service their clients, which means that 72% have different, non client orientated motivations for working in the industry.
- Pressure to meet short-term incentive driven goals is creating high levels stress and is moving people away from a focus of meeting long-term client-beneficial goals.
- The research shows that millennials have much higher phi rating which rises again when people turn 51.
- Since the global financial crisis, biggest banks paid around 275 billion US dollars in terms of settlements. That is a phenomenal amount of money that is going out of the banks which could be used to train, support and develop staff and to service the real economy. Such malpractices has created a flawed and unsustainable business model.
- Regulating for good culture doesn't work because you are talking about people's innate behaviours.
- There is clearly a problem of short-termism. There is no real consensus on how to deal with it and how to incentivise investors to be more long-term focused. Eurosif has done some work in this area in measuring practices across Europe
- Investors have a key role to play. Some codes help in the process and encourage change in behaviour. However, we need to tackle the incentives issue in order to make a difference. The levels of executives' compensation packages which are increasingly complicated needs to be addressed.
- Daniel Godfrey, the former CEO of the UK Investment Management Association has set up The People's Trust – a new and different kind of investment fund. It will be owned 100% by customers and will have a structure that ensures independency of any external commercial interests. Daniel Godfrey went to crowd funding to get money for the launch of the project and reached the target of £100K in only 2 to 3 weeks. This might be one of the disruptors that could make larger organisations think harder about clients frustrations in the outcomes and costs of the service they get from the industry.

**Jo Iwasaki**, Head of Corporate Governance, ACCA

- Many processes and procedures that people see and experience in their professional lives represent what we call 'corporate culture'. In other words, we would try to understand the organisational culture based on processes, procedures and behaviour – mixture of tangible and intangible things – and adjust our behaviour to align. Crucially, many of processes and procedures are largely set out or influenced by decisions made at the top.
- Corporate leadership has the powers and the responsibility to nurture a culture that promotes behaviours consistent with organisational objectives. These are particularly in the areas of tone-setting, mission, performance (including risk) management, and communication. ACCA has looked at traditional governance responsibilities of corporate leadership and analysed what processes and procedures are closely related. Culture is not made up of intangible, abstract, ideas. It is a mixture of hard and solid elements such as salary structure, promotion opportunities, training that

employees get, if rules are written down and what happens if people don't follow, what responses we get when we ask for resources or help, or when we report failure.

- ACCA has recently developed a new culture-governance tool. The tool is addressed to anyone, but particularly to leadership at all levels of the organisation. It can help them systematically approach and understand how the culture set at the board reflects the organisation's value and mission. It also helps the areas of inconsistencies that require addressing. The outcome of review and action points can be revisited periodically to assess progresses.
- It can be used at group, branch, department, and subsidiary levels to do a focused review. The tool can be used at the time of change, for example when an organisation is going through rapid growth, a family business planning a succession, merger, or bringing in new funders. The tool helps businesses to develop a structured narrative and to enrich the conversation with investors.
- The tool was developed based on the findings from ACCA's research commenced in 2012. ACCA has carried out a series of roundtables and global member survey to deepen understanding of corporate governance and culture.
- ACCA wants to help companies that are interested in culture change. It intends to organise a series of events and share real-life examples and best practices of improving culture. For example, it is important to focus on culture and risk interaction, how organisations can better embed risk sensitivity and awareness in everyone's day to day responsibilities.
- If an organisation wants to be well-integrated, the main message needs to be communicated from the leadership level. In this way, the organisation has clarity and, makes it easier for anyone to challenge which in turn helps it identify and address internal inconsistencies.
- Sometimes there are certain situations that conflict with the objectives or the objectives are applied in a wrong way. In well-working organisations, values will be changed if they are outdated; what matters is how the organisations communicate and deal with them. Organisations that don't respond to these kinds of concerns or new opportunities are going to be static.
- Personal and professional values can be two different things. If there are inconsistencies between the two, organisations' job is to make them as small as possible. While it is not always possible for everyone to work in an organisation where their personal values agree with the those of the organisation, at least they can identify organisations with which they can better fit, and manage their idea about what professional behaviour is expected of them.

**Maija Laurila**, Head of unit, Company Law, DG JUST, European Commission

- It was an interactive event with great participation and many inspiring insights. As a brief concluding remark, if there is a change to be made in aligning corporate governance and culture, it is a journey. Many speakers referred to processes, tools and discussions on values, and it is not something that happens overnight. There is consensus that the better you have defined where you want to get, the better are the chances to actually get there.