SINGAPORE INSTITUTE OF DIRECTORS

STATEMENT OF GOOD PRACTICE

BOARDS AND CORPORATE CULTURE

1. Introduction

Corporate culture refers to the values, ethics, attitudes and behaviours that shape how a company's employees and management interact. It is rooted in an organisation's structure, goals and strategy, and impacts how the company conducts its business and engages with stakeholders, including employees, customers, investors, suppliers, partners and the wider community.

In recent years, many significant failures in company performance can be traced back to a corporate culture which had become corrupted. These failures were most apparent in banks but there were also notorious scandals outside of finance. With such failures in mind, boards are challenged to ensure that the culture within their companies is fit for purpose.

The 2018 Code of Corporate Governance Provision 1.1 states: "The Board puts in place a code of conduct and ethics, sets appropriate tone-from-the-top and desired organisational culture, and ensures proper accountability within the company."

The associated Practice Guidance gives further reinforcement with "The Board's role is to…. instil an ethical corporate culture and ensure that the company's values, standards, policies and practices are consistent with the culture."

The question then is how can boards fulfil this particular responsibility?

2. Corporate culture

Corporate culture can be expressed as "the way things are done here". The desired organisational culture should be one which is closely aligned to the company's purpose, values and strategy.

A crisis, as has been experienced with Covid-19, does not, in itself, change culture. What a crisis does is to amplify cultural traits and uncover what the true values of a company actually are as opposed to what is written in public statements. Actions taken in a crisis will often reflect the relative importance of various stakeholder groups; customers, suppliers, shareholders, employees, executive leaders, etc. thereby demonstrating how the culture values different groups.

3. Monitoring and questioning

The board of directors – especially independent directors – cannot directly manage culture. However, their collective effort is need to gain an understanding of the company's culture through establishing monitoring and reporting systems, questioning management and then directing specific actions and interventions.
A monitoring system should use various information and indicators, including the following.

- Employee engagement survey results, especially responses to those questions which relate to ethics, values and behaviours. The level of "trust" in leadership is an indicator of whether those leaders are actually displaying the stated values.
- Site visits to see operations first-hand. Directors should look for relevant cultural indicators, for example: Has maintenance been conducted on schedule? Is it apparent that safety regulations are being followed? Is the facility clean and tidy?
- Conversations with employees to gain an understanding of the behaviours expected of them, and understanding what makes a "high-performing" employee.
- Interviews with internal and external auditors on their perceptions of the prevailing culture.
- Review of exit interviews, whistleblowing reports and complaints from customers and suppliers, to see if there are any consistent themes.
- Monitoring mainstream and social media. Specific job sites, such as vault.com or glassdoor.sg, can be a good source of unfiltered employee views.

Information can be organised into a reporting structure such as a dashboard. As with any dashboard, it is better to select a small number of significant measures so as to focus attention on the most meaningful. However, boards should be alert to potential failures of "information aggregation", where averages mask meaningful outliers. Large companies, particular those operating in diverse countries or formed from mergers, are likely to have a variety of subcultures within the business. Significant cultural problems can often arise from smaller operations which act with a level of independence.

A key role for independent directors is to ask probing questions that can reveal deeper issues. Directors should regularly question executives on their organisation's culture, for example:

- What are the behavioural risks in the core processes? What might people do in order to hit their targets?
- What standards have been set in order to mitigate behavioural risks?
- What happens if someone steps outside the behavioural boundaries?
- How are the company's values communicated and reinforced? How regularly is this done?
- What behaviours are needed to support strategy, especially when strategies are changing?

4. Actions

Once a board has a clear view on the company's culture, it can then start taking steps to address any misalignment. The necessary first step must be to ensure that the company has a clearly articulated statement of values which the board and senior executives believe in. Values should not be "boilerplate" but reflect what is important to each company.

The board, as a whole, needs to be aware as to whether its own decisions are aligned with the desired culture. Further, independent directors need to hold executives true to the agreed values. If the "tone from the top" is confused, there will be little chance of creating the right culture at lower levels.

Employees cannot be expected to guess what behaviours are expected of them, and which are not going to be tolerated. An effective training programme explaining key ethical principles, values and behaviours is critical. The board can have input into the design of the training programme and should have management certification that relevant employees have completed training. Where there are strict rules on ethics, the compliance function will be used to support enforcement.

Remuneration committees need to establish pay systems that recognise strategic imperatives and also culture and risk. For senior executives, it is important to establish performance measures (or key performance indicators) which align strategy. The link between performance and reward will then incentivise certain behaviours. The remuneration committee needs to assess the extent to which those behaviours will support or detract from the desired culture and reduce or exacerbate risks. Mitigating measures need to be put in place as necessary.

For example, if bonuses are entirely based on profits, then that is what executives will be incentivised to produce. One of the behaviours which is being encouraged is to reduce expenses. This might be a problem if critical expenditure is curtailed, for example maintenance, training, compliance, etc. The board would need to have processes in place to ensure that cost reductions are directed at the appropriate areas.

Ideally, a culture component should be included in the remuneration system. If not, there should be clear mechanisms to reduce bonuses if measured performance has come through unacceptable behaviours.

Other human resource processes can be more nuanced than the reward system. Promotion decisions, recruitment interviews, induction processes and performance management systems (including deciding when someone should leave the company) can all be used to reinforce values and ethics and so influence culture.

One of a board's key responsibilities is the management of the CEO including succession plans. A change in CEO will, inevitably, have some impact on culture. The board will need to determine the inherent cultural traits of a prospective CEO and assess whether these are suitable for the desired culture. This is particularly important when one the reasons for changing CEO is to bring about a change in culture.

5. Board organisation and reporting

Whilst managing culture is important, most boards would not have enough time to give this proper attention. As such, culture management could be delegated to the board risk committee (if the board has one) because culture is clearly a risk issue. However, the processes for managing culture are mostly related to managing people. Many board remuneration committees have a broader human resource charter which could be extended to include culture monitoring and management.

There is no requirement to report on company culture to stakeholders and hence this is typically not found in Singapore companies' annual reports. However, with the growing emphasis on sustainability reporting, the focus on organisational culture and meaningful stakeholder engagement is likely to sharpen.

Including information on corporate culture in an annual report is not just a play from the public relations handbook. Where a major component of strategy or transformation is culture change, then it is relevant to include progress and challenges in public reports.

6. Conclusions

Getting to the desired organisational culture is a challenging task requiring commitment and perseverance. Boards should explicitly face this challenge, dedicating a reasonable amount of their time to ensure that "the company's values, standards, policies and practices are consistent with the culture."