culture

purpose

strategy

THE CULTURE IMPERATIVE

Institute of Corporate Directors
Institut des administrateurs de sociétés

THE CULTURE IMPERATIVE

An organization's culture is inextricably linked to its purpose and the successful execution of its strategic plan. In short, if strategy is what you are going to do, then culture is how you are going to do it.

Given the board's critical role in approving and overseeing a strategy that benefits their organization's long-term viability, directors must also understand and oversee the culture driving (or stalling) their organization.

Indeed, the risk of underestimating the importance of cultural oversight can be significant. Think of the reputational damage caused by tainted cultures in the Wells Fargo sales scandal, the VW emissions fiasco and the Boeing 737 Max 8 disasters. Each of these were largely the outcome of cultures misaligned with the ongoing interests of their respective firms.
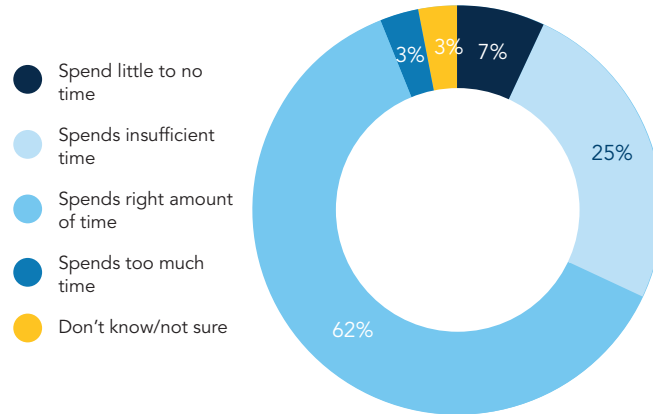
Directors also need to appreciate the long-term benefits of aligning culture with strategy. In the war for talent, younger and highly mobile workers increasingly want to be associated with organizations whose cultures they respect and that reflect their values. An organization with a defined, transparent and lived culture aligned with its strategy will face less resistance in fulfilling its purpose.

Unfortunately, the importance of the board's role in overseeing culture may not be apparent to many directors. For example, the ICD's Spring 2019 Director Lens Survey found that while 62 percent of respondents say that they are spending the right amount of time discussing organizational culture, only 34 percent indicate that they have agreed on oversight measures and discuss them frequently.

> "If you're really doing strategy, culture is a fundamental element of that. If you're not focusing on culture (…) then you're not actually covering strategy."
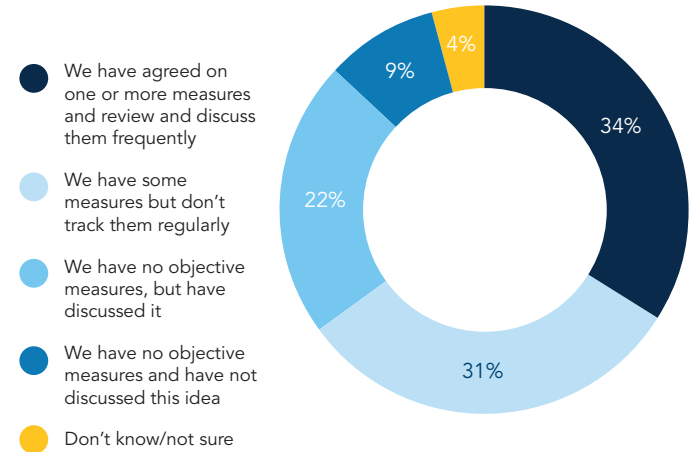
Robert McFarlane
Director, Entertainment One Ltd.

Which of the following reflects the amount of time you feel your board is spending on the oversight of organizational culture right now?

- Spend little to no time
- Spends insufficient time
- Spends right amount of time
- Spends too much time
- Don't know/not sure

3% 3% 7%
25%
62%

What approach best describes your board's ability to measure the health of organizational culture?

- We have agreed on one or more measures and review and discuss them frequently
- We have some measures but don't track them regularly
- We have no objective measures, but have discussed it
- We have no objective measures and have not discussed this idea
- Don't know/not sure

4%
9%
22%
34%
31%

Advisory Committees on the board's oversight of culture

In spring 2019, the Institute of Corporate Directors (ICD), in collaboration with the Governance Professionals of Canada, Mobilis Strategic Advisors and The David and Sharon Johnston Centre for Corporate Governance Innovation, hosted four Advisory Committees on the Oversight of Corporate Culture. Experienced corporate directors and governance professionals met in Montreal, Toronto, Calgary and Vancouver to discuss issues related to corporate cultural oversight and to craft guidance for Canada's directors on how they can more effectively monitor and measure culture.

The Advisory Committees agreed that the notion of "noses in, fingers out" is evolving to demand deeper questioning by directors around the values and behaviours that drive organizational results. To help guide directors in this evolution, they offered their insights on three aspects of cultural oversight that demand greater understanding:

- The interdependence of culture and strategy;
- Understanding your organization's culture and;
- Measuring and governing culture for effective ongoing oversight.

WHAT IS CULTURE?

Culture is the expression of those behaviours, expectations and interactions that either allow for or impede the execution of an organization's strategy and the manifestation of its purpose.

The interdependence of **culture and strategy**

Directors have the responsibility to ensure the long-term viability of their organizations. As such, one of the board's most critical roles is to approve the organization's strategy. Increasingly, board members are invited – or expected – to also advise on and test strategic options.

This then begs the question, "how can a board test and approve a strategy without a strong understanding of how it will be accomplished?" The answer is "not effectively". As Robert McFarlane, director, Entertainment One Ltd., noted, "if you're really doing strategy, culture is a fundamental element of that. If you're not focusing on culture (…) then you're not actually covering strategy."

And when focusing on culture in its strategic context, it is critical to understand that each organization will have a unique culture that reflects their activities (or doesn't). As Mary Jordan, director, Superior Plus Corp., observed "there is no such thing as good and bad culture – there's only culture that supports your strategy or doesn't (…) If you say, 'we want to be innovative' but then the data comes back and says, it's not safe to fail in this company (…) it's just not going to work."

The association with culture becomes even more apparent when strategic change is needed. It is at these moments when an organization's culture may be most tested and need to adapt. Directors need to understand the strategic transformations the CEO is looking to accomplish and what modifications to the culture will be necessary to facilitate them. As Don Charter, chair, IAMGOLD Corp., put it, "you have to pick your culture for what you are doing."

Values, purpose and human capital

Having a clear set of organizational values can provide a framework for shaping the appropriate culture. When describing a strategic shift she had lived through, Andrea Bolger, director, Genworth MI Canada Inc., recalled that on one her boards we "went back to our values […] they remained the same but our culture had to change in order to accomplish a strategic change."

Falling back then on the organization's "core values" provides the board – and management – the context it needs to adjust the organization's culture to fit strategy.

The role of culture in supporting an organization's overall purpose is also an important consideration for boards. According to Isabelle Courville, chair, CP Rail Ltd., a purpose, the raison d'etre of the company, is tied to its culture and strategy. Courville says that "a purpose articulates why an organization exists, and how, for the benefit of all of its stakeholders."

Boards need to understand the connections between why a company exists (its purpose), its desired end state (vision), the path it chooses to get there (strategy) and how it chooses to travel that path (culture). The rationale for doing so lies in the growing belief that many of the companies that have been successful over a long period of time have a "purpose" beyond profit. The leadership of such organizations have worked hard to think through the values and sense of meaning that underlie their strategies and supporting behaviours.

Many Advisory Committee members also agreed that meaningful purpose, supported by robust strategy and strong operating cultures, led to better motivation and engagement, more satisfied customers, greater attention to risk factors, stronger leadership and more focus on achieving business goals.

DIRECTORLENS

1. Strategic discussions are opportunities to discuss culture. Don't just ask "what are we going to accomplish"? also ask "how are we going to accomplish it"?

2. Work as a board to help management develop your organization's overall purpose and "core values". This will provide the context necessary to recruit and work with your CEO and to define a culture aligned with your strategy even through change.

3. Increasingly employees want to belong to something meaningful. As such, a culture aligned with your organization's purpose can be a competitive advantage in the war for talent.

4. Place discussions about cultural oversight within the context of risk management. Boards should ask, "what are the risks of not understanding and effectively overseeing our culture?"

"If we don't have a culture that's going to attract people with the right kinds of skills and values, you will not be able to hire the talent you need. And that's a huge risk to the future sustainability of the organization."

Mary Jordan
Director, Superior Plus Corp.

Advisory Committee members also discussed the link between culture, purpose and the successful attraction and retention of talent. Maryse Bertrand, director, METRO Inc., noted that culture plays a critical role in shaping an effective human capital strategy. The failure to attract and retain the appropriate human capital puts any firm's growth and success in jeopardy. Mary Jordan reinforced this and observed, "understanding what's important to a younger generation is really critical and it ties back to culture. If we don't have a culture that's going to attract people with the right kinds of skills and values, you will not be able to hire the talent you need. And that's a huge risk to the future sustainability of the organization."

Risk

As much as boards need to understand that a strategically aligned culture can help build a thriving and sustainable organization, so too can a misaligned or poor culture damage an organization's reputation and threaten its long-term viability.

Consider the case of Boeing where the 737 Max 8 aircraft represented a significant strategic initiative but where the safety culture risks may not have been properly considered and mitigated by management or the board. As one of our Advisory Committee members asked, when managers decided to use a different development schedule for the aircraft, or different design, did the Boeing board ask what trade-offs were being made to speed up the production or change the design? The long-term impact on the firm is hard to gauge but it is fair to say this is probably the worst crisis in the company's history. It is also fair to ask if it could have been avoided or mitigated by more effective oversight.

Another Advisory Committee member noted that safety - not financial performance - needs to be the number one priority for companies like Boeing. But measurement around safety needs to be done carefully so as to not pressure managers to underreport incidents. Small changes in how safety is addressed can also be very meaningful. One of our Advisory Committee members described how, in one company, the board and management team stopped referring to "fatalities" and only referred to those who died by name. This change humanized the incidents and made real the consequences of not adequately governing safety.

Surveying culture through a risk lens - whether it be safety-related or not - may be an effective means by which to prioritize critical items of employee or team conduct. Don Charter suggested that cultural measures could be defined by the board and then incorporated into the organization's overall enterprise risk management framework, which would allow cultural measures to be tracked and reported along with other key risk indicators.

Challenges in understanding **your organization's culture**

A common challenge in understanding an organization's culture is a lack of conviction that culture is "the board's job". As Heather Laxton, chief governance officer and corporate secretary, Wesdome Gold Mines, pointed out, it can be difficult for directors to make the straight-line connection between strategy, which is measurable, and culture, which can sometimes be interpreted as intangible. "Everything else we do is quantitative," she said. "It's fairly black and white but this is something that a lot of boards can't or won't embrace as part of their oversight responsibility."

While making the connection for boards to their cultural oversight responsibility may be made easier by clearly associating culture to strategy (the "how" to the "what"), other considerable governance challenges continue to exist.

A point that was repeated at many of the Advisory Committee meetings is that most organizations typically will not have only one culture. The lived experience of employees may not reflect the experience being reported on by senior management to the board. Jim Goodfellow, director, Canadian Tire Corp. Ltd., made the point that an organization's culture has a visible component and an invisible component. "Like an iceberg, beneath the surface is the invisible component - the values, feelings, beliefs,

assumptions, and cultural norms that drive the visible behaviours and the corporate culture".

Understanding the invisible culture of the organization will help the board to effectively govern but to do so they must get accurate and reliable information and better understand why and how staff is incentivized.

Transparency of information

Perhaps the greatest obstacle for boards in understanding their organization's culture is gaining insight into the day-to-day experience of employees. Some challenges are obvious: directors do not run the organization and likely do not spend significant time with staff below the senior management levels. Others, such as trust and transparency issues between the board and management, may themselves underscore cultural difficulties.

Susan Wolburgh Jenah, director, Aecon Group Inc., remarked that "boards need to be vigilant to signs they are getting the information they need" and, if not, to ask themselves whether they even have the right team in place giving them the right information. As Josée Turcotte, Corporate Secretary and Head of Governance, HSBC Bank Canada, asked, "does the board have the operational reports to know what's happening on the ground?" If not, there may be trust issues between the board and senior

DIRECTORLENS

1. Directors should seek out opportunities to understand the "lived" cultures in their organizations by "asking the same questions" about culture across different levels of the organization to see if the answers are consistent.

2. Boards can encourage committees and chairs to develop strong relationships with the appropriate senior executive to improve information transparency.

3. Boards should understand compensation structures below senior management and how they align desired behaviours with the strategy.

INTEGRAL FACTOR UNDERPINNING CULTURE: **BOARD CULTURE**

Boards need to understand their own culture and pay attention to its importance. The oft-used "tone from the top" is particularly salient here and it is important for directors to ask, "is my board's culture functional and effective so as to provide the appropriate level of oversight over the organization's culture? Robust board evaluations, including peer reviews can help surface any underlying issues that may be impeding an effective culture. A strong board chair can also help ensure that boards are operating optimally.

It is expected that boards will model the behaviours, values and expectations they have for the broader organization. According to Susan Wolburgh Jenah, "if some threat to the company's reputation emerges, and we don't respond effectively to it, what signal are we sending to stakeholders, including employees? That it is all right for things to happen as long as you get results? As a board, you need to be careful about the messages you are sending." According to Sarah Raiss, director, Loblaw Companies Ltd., once the culture has been defined and aligned with strategy, the board should be measured on the same values and behaviours through its board evaluation. The board and senior management also need to act as role models for the "how" in the culture through its hiring, promotion, development, training, succession and other decision processes.

> "For the board, "it's a matter of making sure you recruit [a] CEO that understands that cultural dipstick."
>
> **Jim Dinning**
> Chair, Russel Metals Inc.

management and she further emphasised that "the board has to have this information so that it can ask the [right] questions."

An atmosphere lacking in trust and transparency can make the board's job more complicated. To better inform itself on how the business is operating, Linda Hohol, chair, Institute of Corporate Directors and director, Canadian Western Bank, advocated that the board "ask the same question at different levels in the organization and see if you get the same answers. "

Elizabeth Watson, founder, Watson Inc. and Chair, Shad Canada, agreed and pointed out that "when you talk lower down, people know what's going on (and) you can see quite quickly whether there's a consistency in how things are and what is said."

Misaligned incentives

Another important challenge in achieving a culture that supports strategy relates to the behaviours and outcomes that are rewarded. This is where an organization's "invisible culture" is most prevalent including in its hiring and promotion practices, organizational structure, succession planning, performance evaluations and, critically, compensation.

Robert McFarlane used the example of Wells Fargo where employees were incentivized to sell multiple products regardless of whether customers wanted or agreed to them. "It really comes back to the cultural aspect of a compensation system and culture that rewarded performance. What were thought to be the best managed types of boards and organizations can be exposed because they really didn't have an understanding of how and what was being incented in the organization."

In this instance, more than a culture problem, misaligned incentives posed a serious business continuity risk. As Maryse Bertrand emphasised, "there has to be a compensation system that encourages the right behaviours to make sure we 'walk the talk'".

DIRECTORLENS TOOLS

🔧 Cultural dashboards may be a useful mechanism for collecting and reporting on cultural attributes the board has decided are important. For organizations where a dashboard may not be feasible, some form of integrated reporting of cultural information should be undertaken to give board members a holistic view of organizational culture.

🔧 Assign board and committee chairs the task of forming a deeper working relationship with relevant senior executives. Also consider assigning a board committee the task of analyzing employee engagement reports.

Measuring and governing **culture for effective ongoing oversight**

While Advisory Committee members agreed that measuring the current state of the culture—and then tracking it over time—was a priority, they also agreed that there is no "one-size-fits-all" approach to measuring cultural attributes. Each organization needs to decide which traits are important to their organization and then determine how to measure them. As Don Charter pointed out, "you need to identify what part of your business is dependent on cultural issues and then decide how to measure it. Once you have the metrics, you can then determine if the culture is helping or hurting you, and, if necessary, what you need to change and, finally, how you go about changing it."

Jim Goodfellow noted that the following questions would be helpful to boards in determining if they are effectively monitoring their organization's culture:

❏ What cultural component does senior management monitor and assess (if any)—and how often?

❏ Does management focus on the cultural components that are easiest to measure or on what is most meaningful? At what levels and in what depth of detail is it measured?

❏ Has the board determined what culture-related information they need from management? Do they get it? And what culture-related information can boards and committees get directly on their own?

Tools to measure culture

There are many tools to measure an organization's culture and the metrics selected will largely depend on the organization and what it has identified as its strategic priorities. Advisory Committee members identified several measures they felt were significant:

Employee engagement surveys

Employee engagement surveys are a popular tool to measure culture. However, some participants pointed out that culture and engagement—while related—are not equivalent. Engagement measures an individual's emotional and intellectual connection and commitment to the company, while culture represents shared beliefs, values and ways of doing things. Robert McFarlane advised that "you really need to have transparent disclosure of the employee engagement surveys. It's not just the surveys but also the questions that are being asked. Are they being asked in a format that would get at the core issues?"

Andrea Bolger also noted that engagement alone isn't enough. She said "I have been on boards where employee engagement was super high but we weren't achieving what we wanted to achieve – engagement needs to be in balance with fulfilling the organization's strategy." Sharon Sallows, director, Home Capital Group Inc., also noted that a committee can be a good place to have deeper discussions about the results of the employee engagement survey.

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>
> **Don Charter**
> Chair, IAMGOLD Corp.

🔧 Create - and insist on - opportunities for the board to interact with non-management employees and to ask questions about the organization's culture.

🔧 Ensure reports on whistleblower hotlines, the issues being reported on and how they are being resolved are provided to the board on a regular basis.

🔧 Request exit interview feedback and employee engagement survey results from management in order to uncover persistent themes or to investigate troubling turnover trends.

INTEGRAL FACTOR UNDERPINNING CULTURE: **WORKING WITH THE CEO**

Just as the responsibility of creating the organization's strategy falls to the CEO, so too should the duty of driving the desired culture. In both cases though, input and oversight from the board strongly benefits the process.

While Robert Tessier underscored the importance of transparency between the CEO (and the rest of senior management), the chair and the board, Jim Goodfellow noted that the board should work with the CEO to develop and agree on the organization's core values and desired culture. He also argued that having "purpose beyond profit" helps to develop the kind of culture that attracts top talent, motivates people, and creates a powerful force for meaningful performance.

The view that good governance starts with people was echoed by Elizabeth Watson, who remarked that there "is a clear need for alignment on strategy and values". Moreover, she argued, "the board needs a philosophy on what success around this alignment looks like". This alignment can also be envisaged as a "cultural dipstick" that directors can use to understand – and then help to calibrate – the firm's culture at any given moment. As Jim Dinning, chair, Russel Metals Inc., put it, for the board, "it's a matter of making sure you recruit [a] CEO that understands that cultural dipstick."

A committee may be able to spend more time on the issue, ask for more information, ask more probing questions and then elevate any issues to the full board for discussion as required.

Leveraging board committees

Board committees can also play an effective role in increasing transparency. Robert Tessier, chair, Caisse de Depot et Placement du Québec, argued that governance, risk, audit, and HR committees and chairs can act as integrators with the relevant senior managers in the organization. This may have the impact of improving relationships and information-sharing between certain directors and senior managers. Kate Stevenson, director, CIBC, suggested that senior managers and board members can even be teamed up to work on specific projects together – this gives both directors and management team members the opportunity to get to know each other better and helps directors gain a deeper understanding of a key part of the business.

Site visits

Many of our Advisory Committee participants recommended that board members find opportunities to interact with employees including site visits to operational facilities. It was also suggested that 1-2 directors conducting a site visit may be more effective at gathering intelligence than a visit by the whole board where it may be more of a "dog and pony show". Linda Hohol noted that it's important that the board "have unfettered

access to job sites, locations and social events with non-management." In addition, exposure to high potential talent is helpful. Board members may also consider attendance at customer events, investor days and chatting with external auditors and suppliers.

Whistleblower hotlines

Advisory Committee members recommended that every organization have a third-party operating a whistleblowing hotline. Tonya Fleming, Vice President and General Counsel and Corporate Secretary, Painted Pony Energy Ltd., recommended that even anonymous whistleblower complaints be investigated. "When we investigate, we typically find there's some truth to it. And then we put a process in place and change it," she noted.

Exit interviews

Exit interviews can provide excellent insight into the culture of the organization and reveal underlying issues that may not be visible to the board. Several Advisory Committee members indicated that exit interview feedback was something the board may want to consider requesting from management to uncover problems and to determine if consistent themes exist.

While the results of exit interviews have not traditionally been reported to the board, many felt it was information they would like to obtain in order to have a more complete understanding of the reasons for employee turnover.

Cultural dashboards/ standardized reporting

Several participants recommended the use of cultural dashboards to help boards monitor culture. Neil Puddicombe, Associate General Counsel, Bank Board Governance, BMO Financial Group, noted that "one of the things that we've been working on is a standalone culture and conduct report. We pull the cultural measures together for the board in one report, have someone responsible for producing the report and then have that person come and explain it to the board – these are what the numbers are, this is how it compares to last quarter, this is what it means and this is what we need to do." Robert McFarlane, echoed the benefit of a cultural dashboard. He noted that, "one of the values that I'm seeing in terms of having a culture dashboard developed is the brainstorming around the measures (…) If you pull all the metrics, you can create one integrated view and then you start to see some themes developing."

Some culture dashboard metrics might include:

❏ Turnover rates (broken down by department/ business/geography, age, and high potential loss)
❏ Audit trends and issues
❏ Grievance reports and employee helpline reports
❏ Glassdoor reports
❏ Absenteeism
❏ Customer feedback
❏ Health and safety reports
❏ Net promoter score (NPS)

Summary

To help guide directors in their role overseeing corporate culture, the Institute of Corporate directors convened four Advisory Committee meetings across Canada with experienced board members. Several key insights were gathered from the roundtable discussions and are presented here on three important aspects of cultural oversight:

THE INTERDEPENDENCE OF CULTURE AND STRATEGY

- Strategic discussions are opportunities to discuss culture. Don't just ask "what are we going to accomplish"? also ask "how are we going to accomplish it"?

- Work as a board to help management develop your organization's overall purpose and "core values". This will provide the context necessary to recruit and work with your CEO and to define a culture aligned with your strategy even through change.

- Increasingly employees want to belong to something meaningful. As such, a culture aligned with your organization's purpose can be a competitive advantage in the war for talent

- Place discussions about cultural oversight within the context of risk management. Boards should ask, "what are the risks of not understanding and driving our culture?"

UNDERSTANDING YOUR ORGANIZATION'S CULTURE

- Directors should seek out opportunities to understand the "lived" cultures in their organizations by "asking the same questions" about culture across different levels of the organization to see if the answers are consistent.

- Boards can encourage committees and chairs to develop strong relationships with the appropriate senior executive to improve information transparency.

- Boards should understand compensation structures below senior management and how they align desired behaviours with the strategy.

MEASURING AND GOVERNING CULTURE FOR EFFECTIVE ONGOING OVERSIGHT

- Cultural dashboards may be a useful mechanism for collecting and reporting on cultural attributes the board has decided are important. For organizations where a dashboard may not be feasible, some form of integrated reporting of cultural information should be undertaken to give board members a holistic view of organizational culture.

- Assign board and committee chairs the task of forming a deeper working relationship with relevant senior executives. Also consider assigning a board committee the task of analyzing employee engagement reports.

- Create - and insist on - opportunities for the board to interact with non-management employees and to ask questions about the organization's culture.

- Ensure reports on whistleblower hotlines, the issues being reported on and how they are being resolved are provided to the board on a regular basis.

- Request exit interview feedback and employee engagement survey results from management in order to uncover persistent themes or to investigate troubling turnover trends.

Conclusion

The state of an organization's culture can have far-reaching impacts on the effective implementation of its strategy and on related outcomes, including employee engagement, stakeholder satisfaction and, ultimately, on long-term viability.

Culture drives engagement, the attraction of talent, the efficiency of decision-making and many other factors that play a significant role in shorter and longer-term organizational success. As companies evolve, more of their value will be found in intangible assets such as human capital where culture is likely to have a greater impact. Because of this growing importance, the role of the board in providing effective oversight of corporate culture is critical.

As Hubert Lacroix, chair, Stornoway Diamond Corp., explained "culture is not just a board agenda item. It is everywhere and connects everything in every action."

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Acknowledgements

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