



MARSH & McLENNAN
INSIGHTS



WomenCorporateDirectors
A Foundation Inspiring Visionary Boards Worldwide

IDENTIFYING AND RESPONDING TO A DYSFUNCTIONAL CULTURE

Key Actions for Boards

GLOBAL GOVERNANCE INSIGHTS ON EMERGING RISKS

A NOTE FROM WOMENCORPORATEDIRECTORS

For the past year, headlines have screamed with incidents of cultural missteps and almost weekly reports of CEO or executive dismissals from infractions. Boards are asking themselves – could this be a potential issue within my organization, and if so, how do we detect it and respond?

An organization’s culture is recognized as a critical element for success and differentiation and it can be the rocket fuel for delivering value to stakeholders. However, a dysfunctional or toxic culture creates inefficiencies and daily instances of under-performance across the organization. At its worst, cultural blow-ups can damage a company’s reputation with negative media coverage, put the organization in breach of laws and regulations, lower productivity, a failure to deliver on strategies, and be very costly to resolve. What makes for a dysfunctional culture? What is the role of the board in guiding culture and what are the warning signs of an inappropriate culture? What levers can the board apply to steer culture?

There is a significant body of research on the importance of culture in driving organizational success, the core building blocks of organizational culture, as well as guidance for boards in their role in oversight of organizational culture. Despite this, our research suggests that in many boardrooms, culture is not yet a regularly scheduled agenda item or there may be limited regular updates on the organization’s culture. This paper arms directors with the right questions to ask management and what data, incidents, and trends to track to draw out a real picture of the organization’s culture.

At WCD, we are committed to bringing directors the most up-to-date insights around governance and strategy, enabling them to serve as highly effective corporate stewards. This valuable research with Marsh & McLennan Insights is something every director should read and keep on-hand to support meaningful discussions on corporate culture and its alignment with organizational strategy.



Susan C. Keating,
Chief Executive Officer
WomenCorporateDirectors

SNAPSHOT

IDENTIFYING AND RESPONDING TO A DYSFUNCTIONAL CULTURE

10 CULTURAL WARNING SIGNS

- 1 No clear organizational vision or set of values
- 2 All information to the board runs through the CEO
- 3 Fighting amongst leadership
- 4 Debate and challenge are not encouraged
- 5 Limited transparency into organizational decision making
- 6 Complacency and resistance to discuss culture
- 7 Bad news is not shared and employees do not feel comfortable reporting incidents
- 8 Strong focus on individual results or a "get it done at all costs" attitude
- 9 High employee turnover rates by business unit, race, age, gender, function, etc.
- 10 Limited transparency on factors for promotion or success

10 Actions Inside the Boardroom

Full Board

- Consider cultural issues in CEO selection
- Capture a comprehensive range of information relating to corporate culture
- Ensure culture is a regularly scheduled board agenda item

Compensation Committee

- Ensure compensation structure supports desired culture and ethical behavior
- Consider how culture-related elements are factors of executive compensation

Audit Committee

- Review compliance updates
- Review whistleblower hotline reports
- Examine deep-dive data from employee surveys

Nominating/Governance Committee

- Consider culture in director selection and diversity of boards
- Review succession planning and process for senior executive officers

5 Actions Outside the Boardroom

Diagnose the culture

- Explore cultural issues when onboarding
- Visit sites to better understand day-to-day operations
- Build relationships beyond C-suite to get honest feedback
- Review external feedback on the organization (eg., social media)
- Apply experience and judgement to be attuned to culture "warning signs"

ORGANIZATIONAL CULTURE: THE VALUE, RISKS, AND ESCALATION OF ITS IMPACT

Culture is central to an organization's performance. Successful businesses show time and again that possessing the right culture can prove to be a source of competitive advantage, but culture can also cripple success. For example, a study revealed that 43 percent of M&A transactions worldwide were delayed, terminated, or negatively impacted because of culture-related issues and 30 percent of deals fail to achieve financial targets due to culture-related matters.¹

There are often also sub-cultures across organizations, its geographic footprint, and within departments. Across the spectrum, an organization can have the "right" culture for its goals and strategies, a misaligned culture, or a dysfunctional or even toxic culture.

There is no single right or effective culture or an individual recipe for developing or maintaining such. Every organization is unique, and the effective culture for an organization should match its strategic intent,² such as aggressive targets, high standards, or a highly competitive and demanding environment, particularly at times of rapid growth in a company's lifecycle.

A misaligned culture can be understood as one that is not supportive of the organization's desired goals and strategies. For example, if the strategy is geared to social engagement in the community, but the culture is highly-focused on the bottom-line, there may be a disconnect.

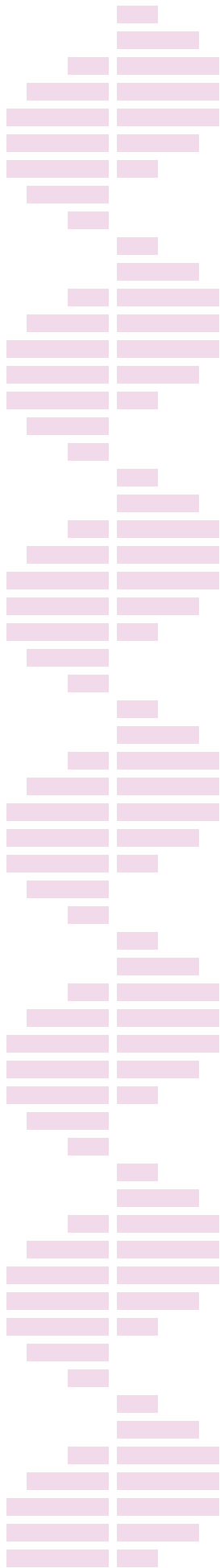
As part of this study, many directors noted the important distinction between a misaligned culture and a dysfunctional culture. Dysfunctional cultures enable a permeation of uncivil or offensive behavior, unethical and/or even illegal behavior and can also be described as toxic. Ultimately, Davia Temin said, "No matter what else the corporate culture is, it bifurcates into functional and dysfunctional." Molly Coye also noted, "A dysfunctional culture impedes the organization from reaching its goals."

ORGANIZATIONAL CULTURE DEFINED

Organizational culture can be defined as the shared and experienced values, beliefs, and behaviors. Pragmatically, it can be understood as the organization's operating environment. It is what people say and what people do day-in and day-out and is revealed in individual actions that deliver business outcomes and also in an organization's norms, working language, systems, and symbols. From a business context, culture should align with the strategy of the organization as well as market and regulatory factors. From an organizational context, culture is reflected in policy and procedures, and every level of the governance structure should buy into and live the culture. From a people context, the culture enables people to do their jobs, supporting talent acquisition and team effectiveness.

1 Is Your Organization Ready to Mitigate Culture Risk in M&A Deals? Jeff Cox, Mercer, www.Brinknews.com, October 25, 2018

2 Achieving Culture Change: How to Seize the Moments that Matter Each and Every Day, Oliver Wyman, 2018



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Davia Temin

Boards of directors, at the top of the organization, play a key role in assessing and guiding culture and are increasingly being held to account, especially in instances of cultural dysfunction. For example, recent headlines include claims that Lululemon's board breached their fiduciary duties to shareholders by not adequately addressing the toxic culture of sexual harassment and bullying created by its ex-CEO which led to reputational and financial damage to the company.³ In another example, the board of a UK-fashion retailer was asked to respond after 2,500 current and former employees signed an online petition calling for an end to the CEO's style of forced hugging, describing it as "part of a culture that leaves harassment unchallenged." Finally, in reporting on a review of an investigation to allegations of sexual misconduct by the CEO at US media company CBS, the New York Times highlighted what it described as an "epic failure of corporate governance."⁴

CULTURE IN THE SPOTLIGHT

There is rising board focus on culture and how the organization operates and achieves its goals. "It now is becoming more of a board agenda item. Before culture was only discussed at most once a year if the results of an employee survey indicated an issue with the culture," commented Nilsa Mahon. Reinforcing this heightened focus by boards on culture, a recent Australian survey found 89 percent of directors said their board is trying to effect change in culture within their organization.⁵

Three trends are driving the focus on culture:

9. **Increased focus on environmental, social and governance factors (ESG).** An overall increased focus on ESG by stakeholders and investors is emphasizing how organizations treat their employees. Also, investors are paying greater attention to culture-related performance metrics.
10. **Acceleration of the #MeToo movement.** The #MeToo movement sparked a new focus on culture, with more than 400 prominent executives and employees (and counting)

facing dismissal due to complaints of sexual assault and harassment. The pace and extent of these events have pushed the cultural issue to the forefront of directors' minds.⁶ The movement, and the often associated boiling over of a long-simmering workplace issue, reinforces to boards that they can no longer afford a reactionary approach to monitoring corporate culture.

11. **Amplifying effects of social media.** Social media and websites that include company reviews by employees (such as Vault, Glassdoor, etc.), or customer review sites (such as Yelp) have changed the pace and impact of cultural transgressions. Social media increases the transparency into an organization's culture, and activities and technology change the timeline of traditional procedures. Liz Coutts noted, "What's new is the fast-paced nature of reacting to culture."

Events trending on social media can be escalated quickly to the board level, and directors face rising expectations to respond almost immediately to reports of corporate cultures gone wrong or leadership missteps that suggest tolerance of inappropriate corporate culture. Social media pressure does vary by geographic region. Boards in the US often face significant media pressure to respond rapidly. In other locations where social media is less pervasive, such as Peru, Vietnam and India,⁷ companies may face less pressure. Across interviews, directors stressed that even in this intense climate, boards must take the appropriate time to make sure they are comprehensive in their considerations.

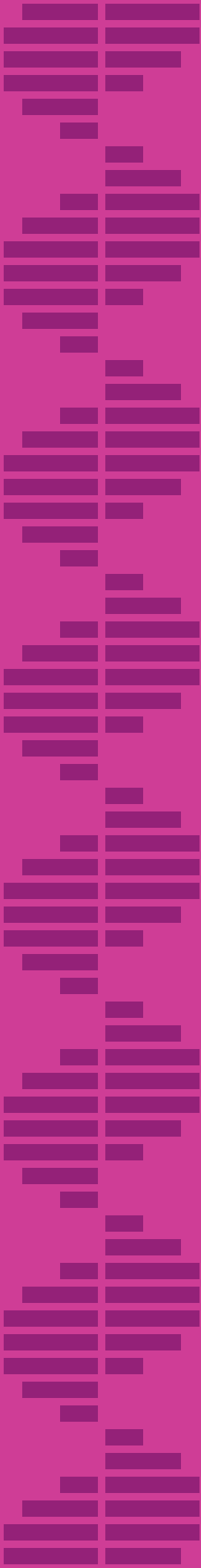
3 <https://www.law360.com/articles/1105987/lululemon-board-ignored-toxic-work-culture-investor-says>

4 <https://www.nytimes.com/2018/12/04/business/leslie-moonves-cbs-board.html>

5 Australian Institute of Company Directors sentiment poll, October 2018

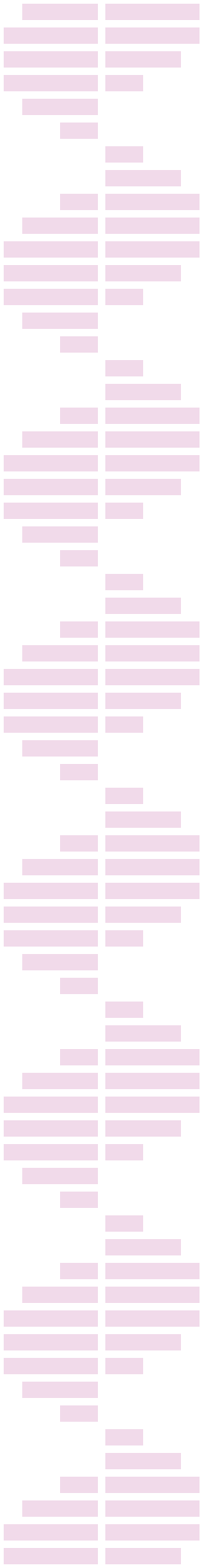
6 <http://boardmember.com/directors-place-culture-front-center/>

7 <http://www.pewglobal.org/2018/06/19/social-media-use-continues-to-rise-in-developing-countries-but-plateaus-across-developed-ones/>



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Nilsa Mahon



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Susana Elespuru

THE COSTS OF DYSFUNCTION

A dysfunctional culture can be marked by an atmosphere of sexual harassment, racial or gender harassment, overt or passive bullying behaviors, or general incivility such as yelling or name calling. It can have negative consequences on customers, employees, and the overall success of the firm. Impacts may include:

1. **Employee disengagement and under-performance.** Employees are the biggest asset in a company, and if they disengage due to a toxic or dysfunctional culture, the company will suffer the consequences of underperformance or defection of critical talent. For example, an estimated 80 percent of women who report sexual harassment change jobs within two years⁸ and research indicates that companies with more than 23,000 employees lose \$14 million annually due to lost productivity, absenteeism, and turnover as a consequence of sexual harassment.⁹ Nilsa Mahon stressed, “If the employees aren’t protected and supported by the culture, nothing else is going to work.” Some studies suggest that even workplace incivility can have an average cost of \$14,000 per employee per year due to lost production and work time.¹⁰
2. **Reputational risks.** A dysfunctional culture can lead to unethical or criminal behavior and create severe reputational risks for the organization. For example, GM has been subject to a lawsuit accusing the automaker of allowing violent levels of racism in an Ohio manufacturing plant. This incident captures 720,000 hits in a quick internet search on the company. Directors are particularly sensitive to reputational risks and potential impacts on valuation that can come from a culture gone awry.¹¹ Phyllis Campbell commented, “Reputational equity is a precious asset that

is tied to long-term shareholder value. The end doesn’t justify the means if it damages reputation or shareholder value, as a dysfunctional corporate culture can.”

Reputation loss can have significant financial impacts. Amid allegations of an atmosphere permitting sexual harassment, investors devalued Uber’s stocks by as much as 15 percent.¹²

3. **Diminished customer service, reliability and stakeholder engagement.** A poor culture can lead individuals to make decisions and interact with external stakeholders in ways that may cause stakeholders to question the credibility, reliability, and integrity of the organization, ultimately undermining the social license to operate.¹³

The fallout from executives behaving badly, but not unlawfully, can be significant and lasting. In one recent study of 38 incidents, each garnered on averaged 250 news stories with media attention lasting 4.9 years. In a third of the cases, firms faced further damage, including loss of major clients, federal investigations, shareholder lawsuits, or proxy battles.¹⁴

8 <https://hbr.org/2017/11/the-insidious-economic-impact-of-sexual-harassment>

9 <https://www.ineteconomics.org/research/research-papers/metoo-the-economic-cost-of-sexual-harassment>

10 Dysfunctional, Abusive Behavior in the Workplace, The Conference Board, 2018

11 Reputation risk is generally defined as the risk to the institution from changes of perceptions by key stakeholders, including customers, investors, and regulators and is driven by the belief that the future ability of an organization to deliver on stated goals and performance targets will be worse than previously expected, given the new information that has come to light. Thus, reputation risk is a multiplier that amplifies the direct impact of an event through the loss of future revenue due to the reputational impact of the event. See: “The Hidden Cost of Reputation Risk,” Oliver Wyman, 2018

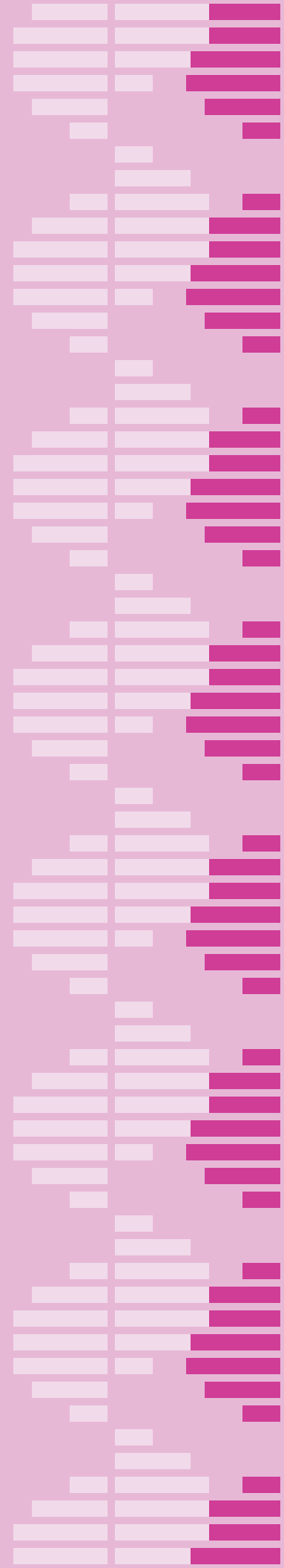
12 Unhappy Uber investors marked down the value of the scandal-ridden ride-sharing company. Independent. August 23, 2017.


13 Maintaining the social license to operate, 2018 KPMG – Australian Institute of Company Directors Trust Survey

14 More misbehaving American executives get the boot, The Economist, July 27, 2018.

**THE WHOLE OF THE
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Joanna Perry





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Phyllis Campbell

CULTURE AND DIRECTOR & OFFICER LIABILITIES

Director & Officer (D&O) insurance can help mitigate or transfer the risks associated with corporate level litigation, investigations, and losses arising out of corporate cultural issues. Corporate claims arising out of cultural issues expose companies to enormous costs including, amongst other things, drops in market capitalization and legal expenses for internal investigations, government proceedings, employment lawsuits, securities class actions, and shareholder derivative suits.

D&O insurance is often referred to as the last line of defense for directors and officers. It is a form of personal asset protection. Public company D&O insurance typically contains three coverages:

- **Side-A coverage** provides direct insurance for directors and officers and coverage is triggered if the company refuses or is legally unable to indemnify its directors and officers. Directors and officers typically require that the company buy this insurance.
- **Side-B coverage** reimburses the company for any costs it pays on behalf of a director or officer by way of its indemnification obligations. These are typically legal defense costs, settlements, or judgments.
- **Side-C coverage** protects the company itself in connection with a covered claim. While D&O insurance is important for public and private companies and non-profit organizations, the breadth of coverage for the company or organization varies. For public companies, entity coverage is traditionally limited to coverage in connection with a securities claim.

While the entity coverage associated with private and non-profit company D&O insurance can vary from the coverage offered to public companies, the Side-A coverage (coverage that protects the directors and officers for non-indemnified loss) is equally as relevant for directors sitting on boards of private companies and non-profit organizations as it is for public companies.

As the corporate and director-level exposures continue to increase because of issues arising out of allegations of dysfunctional organization culture, having a robust D&O liability insurance program in place could prove to be the best form of risk transfer.

THE ROLE OF BOARDS IN CORPORATE CULTURE OVERSIGHT

As part of this study, in addition to extensive research, directors were interviewed on the role of the board in overseeing an organization's culture, and how to assess and respond to a potentially dysfunctional culture within an organization. It is generally recognized that the board is responsible, alongside management, for setting the "tone at the top" and overseeing management's strategy to promote a culture of integrity.¹⁵ Indeed, the 2018 UK Corporate Governance Code puts a renewed emphasis on culture, calling on boards to "...assess and monitor culture. Where it is not satisfied that policy, practices or behaviour throughout the business are aligned with the company's purpose, values and strategy, it should seek assurance that management has taken corrective action."¹⁶

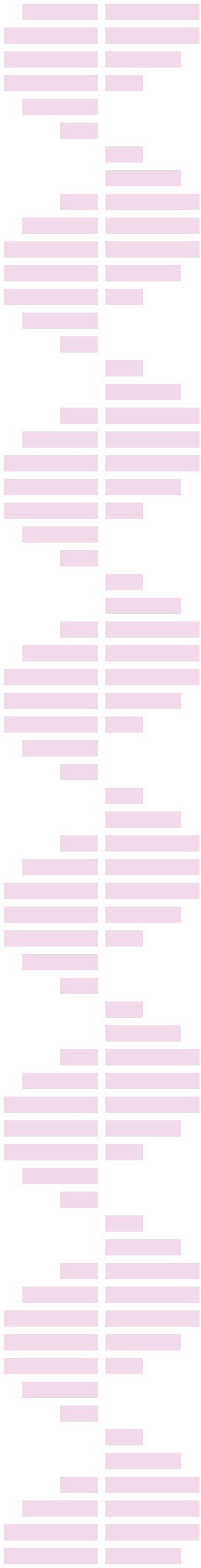
This responsibility aligns with the board's role for risk oversight. To the extent that the directors are representing the interest of shareholders, then the means to the end (such as profitability and shareholder returns) are just as critical as the end. Susana Elespuru stated, "If you are not making sure that your employees are following healthy, ethical and straight ways to deliver the results, sooner or later it will fall apart."

While boards have an oversight role for culture, the reality is that boards cannot lead the culture. As the WCD 2017 Visionary Report noted, there is a difference between guiding culture and defining the culture.¹⁷ Directors echo this view noting that driving and aligning culture is management's prerogative. "The whole of the organization and the executives create the culture. They are the ones who are living and breathing the culture every day," noted Joanna Perry.

¹⁵ Culture as a Corporate Asset, National Association of Corporate Directors, 2017

¹⁶ The UK Corporate Governance Code, Financial Reporting Council, July 2018

¹⁷ The Visionary Board at Work: Developing a Culture of Leadership, WCD, 2017



THE BOARD'S MAIN INSTRUMENT BY WHICH THEY CAN INFLUENCE CULTURE IS THROUGH THE SELECTION OF THE CEO, AND IN TURN, THE TEAM THE CEO DEVELOPS.

Liz Coutts

With the emerging, heightened focus on culture, Phyllis Campbell said, “Five years ago, boards would say, ‘nose in, fingers out.’ Now, it’s still ‘fingers out,’ but it’s ‘nose in, nose in, nose in’”. While the role of the board is oversight (i.e., fingers out), it’s up to boards to look deeper, ask questions, and probe for details (i.e., nose in) when something seems amiss.

The mechanisms by which boards capture insights on culture, either in their committees or as a full board, how directors engage on the issue, and how they engage management will all serve as levers that influence culture and how management prioritizes culture. As Ana Paula Pessoa commented, “Getting to the bottom of culture is all about asking questions.”

CULTURAL INDICATORS AND LEVERS FOR CHANGE

Below are a set of actions boards can take to detect, influence and realign a dysfunctional culture.

AT THE FULL BOARD LEVEL

CEO SELECTION

“The Board’s main instrument by which they can influence culture is through the selection of the CEO, and in turn, the team the CEO develops,” advised Liz Coutts. Across the interviews, directors agreed that the CEO is the board’s main conduit into the company and it is the board’s job to hold the CEO accountable. When boards want to take drastic action to reinvent the company culture, it is often the CEO position that is the pivotal role for success or failure.

In a recent report by the Australian Institute of Company Directors, the CEO was highlighted as the “Chief Culture Officer.” The tone of the organization is set at the top. It is for this reason that boards need to be particularly careful in choosing a CEO and then assessing the CEO’s alignment to the culture. Less than 40 percent of US boards have formally evaluated the CEO as a leader

of the organization’s culture over the past year.¹⁸ Jill Kanin-Lovers suggested, “The CEO can have a 360-degree assessment done by an outside party that is then presented back to the board.”

Many directors also commented that effective succession planning is an integral way to influence corporate culture, and as Avanthi Shah advised, “If you’re hiring someone, you need to make sure that person is aligned with the values of the organization.”

Succession planning discussions, as well as performance review discussions, reveal how upper management defines and guides culture. For instance, it is a balance between financial results and how those results are achieved. “The CEO should be able to indicate the leadership qualities of the individuals in the management team and how they align with the goals and culture of the organization,” Jill Kanin-Lovers also noted.

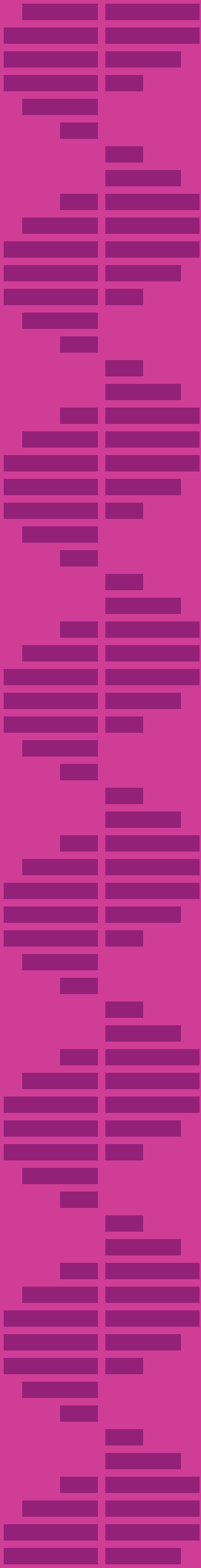
EXECUTIVE MANAGEMENT TEAMS

Beyond the CEO, the executive management team and country or business unit leaders in global firms are critical. Boards can examine how the whole executive team, not just the CEO, views culture and sets the tone for the organization.¹⁹ This includes examining the management team that the CEO develops, and how each member of the management in turn develops and manages their team and culture, and how this cascades down. (See section on Nominating and Governance Committee.)

Culture can vary by geographic location, department, and stage of development, but it is essential that all leaders buy-in and behave in a way that supports the desired culture. As Kay Dryden observed, “What executives do, as opposed to what they say, is influential. Culture has a way of trickling down and bypassing policies.”

¹⁸ 2018–2019 Public Company Governance Survey, National Association of Corporate Directors, 2018

¹⁹ Organization culture fallout from the APRA report. Australian Institute of Company Directors. June 15, 2018



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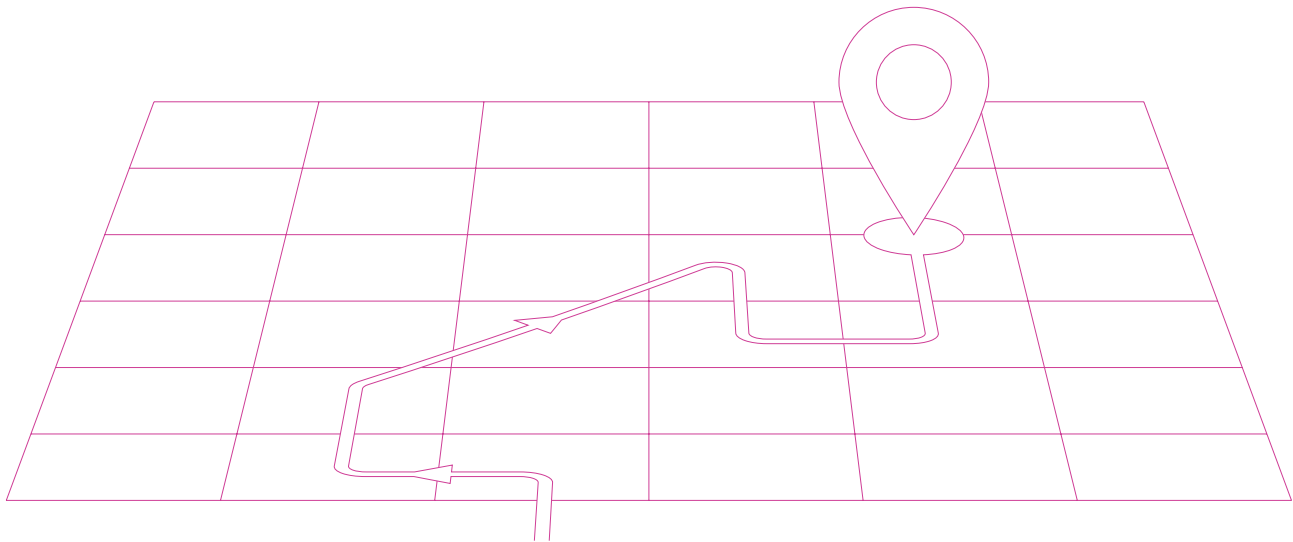
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Kay Dryden

| C A S E S T U D Y |

THE TECH INDUSTRY AND DYSFUNCTIONAL OR TOXIC CULTURES



Tech companies and Silicon Valley have long been admired for the agility, dynamism, and inventiveness. Recently, whenever a dysfunctional or toxic culture is discussed, it seems that “tech” or “Silicon Valley” follows right after. A November 2018 survey on Blind, a community app for the workplace, found that half of the 12,000-plus tech workers responding thought the workplace culture was unhealthy.¹ In November 2018, about 20,000 Google employees worldwide walked off the job in protest of the work environment and forced arbitration in cases of sexual misconduct.²

This raises the question: are the cultural challenges greater in this sector, and if so, is it due to the industry itself, or the types of businesses in the field – especially startups – or the limited diversity, including gender or race?

Directors noted the culture at technology companies, often originating as small startups, faces some distinct challenges. Individuals with specific and unique skills sets can take on an outsized organizational role in their influence and decision making, creating a challenge to counter or dismiss it in the case of inappropriate behavior. Early success by a startup can create hubris and unwillingness for self-examination. Small organizations

are also particularly influenced by the CEO. The CEO is instrumental in setting the culture, even as the organization grows larger, and in the presence of underdeveloped governance mechanisms in young or inexperienced organizations, dysfunctionality can become pervasive.³

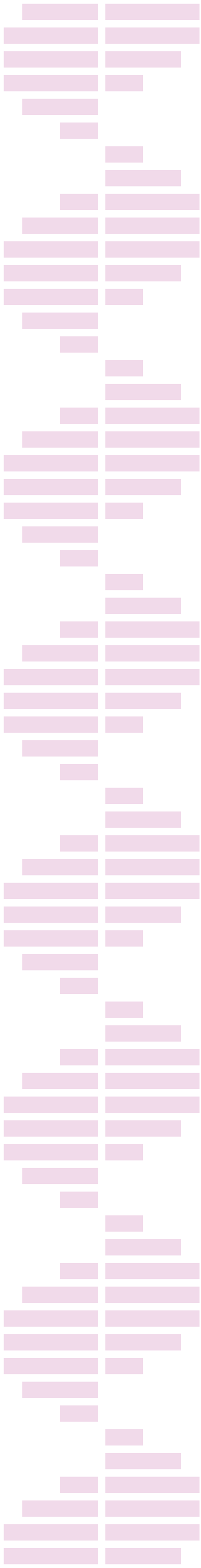
One example of this influence is Uber. After a blog post detailing the culture one female engineer faced, this organization’s culture soon became a household topic of conversation. Investigations by the company pointed back to a culture enabled by the CEO’s management style.

Our interviews with the directors highlighted the importance of defining the vision and values of the organization as a board and with the management team. This is particularly essential for startups and small companies. Fundamentally, as Vuyiswa M’Cwabeni noted, “determining the purpose of the company is the prerequisite to identifying and shaping the right culture.” This view is also reflected in the 2018 UK Corporate Governance Code that noted, “the board should establish the company’s purpose, values and strategy, and satisfy itself that these and its culture are aligned.”

1 TeamBlind; <http://blog.teamblind.com/index.php/2018/11/28/52-percent-of-tech-employees-believe-their-work-environment-is-toxic/>

2 <https://www.theguardian.com/technology/2018/nov/01/google-walkout-global-protests-employees-sexual-harassment-scandals>

3 Banking Conduct and Culture: A Permanent Mindset Change, Group of Thirty, November 2018



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Molly Coye



COMPLACENCY CAN BE A BREEDING GROUND FOR CULTURAL DYSFUNCTION.

Liselotte Engstam

REGULARLY SCHEDULE CULTURE AS A BOARD AGENDA ITEM

The second most important action boards can take is to include culture as a standing and consistent board agenda item. Bonny Simi advised, “Simply getting culture on the agenda is a great way to start the discussion.” But as Kathleen Crampton pointed out, “Talent management and human resource factors are often not taken all that seriously. That is a mistake on the board’s part.”

Research supports that comment. A 2017 survey showed that just 27 percent of US boards discuss culture or ethic risks at each board meeting, and an Australian survey found that 50 percent of organizations did not have culture on their board agenda even once in the year.²⁰ As Joanna Perry observed, “I am not sure that it is ingrained in a board’s psyche to regularly talk about culture or to consider the culture as part of these meetings.”

Ingraining culture discussions with a clear, structured framework takes work. It involves actively talking about culture, examining whether the organization’s mission, values, and operating model support the desired culture, looking at attitudes within the company, and analyzing how decisions are made. As part of that process, the board should review the company code of conduct and the processes to ensure organization-wide awareness and knowledge of the code. A number of directors noted that participating in organizational conduct training or e-training is also very valuable in prompting cultural discussions.

In addition, there may not be boardroom consensus on the desired culture. For example, a 2017 INSEAD report found that half of the surveyed directors are “reasonably clear” on the desired culture of their business, but only a fifth said that their boards fully consider the desired culture of the business. Almost one-third are not clear or said there is no discussion at the board level about the desired culture of the business.²¹

If there are concerns about the culture, getting the board to agree to the need for a cultural change can

be challenging. Liselotte Engstam advised, “The board needs to first agree that there is a problem to address and there may not be consensus on that.” Molly Coye noted, “The board’s own reaction, when confronted with information about internal cultural problems, is very telling - and largely determines how it will respond.”

Directors recognized that making culture a priority requires a significant amount of effort. As Susana Elespuru said, “Culture requires a lot of participation from executives, the CEO, and the management team.” All too often, culture change, far from being strategically driven, degenerates into a set of PowerPoint slides or posters, rarely discussed at length.²² To increase the consistency of cultural discussions, boards may find it useful to have management present a regularly updated culture dashboard – a set of statistics and measures that are routinely updated and discussed at meetings. A culture dashboard with regular tracking shifts the discussion from episodic, one-off discussions - that when introduced by the board could make management feel blindsided - to a natural, standing topic of discussion.

By prioritizing culture discussions, the board can help the CEO and management team uncover issues and give suggestions on how management could drive changes. Indeed, a unique strength of the board is its distance from the organization. By being away from the day-to-day operations, boards may see changes that people in the organization may not recognize.

Many boards tend to get more involved in culture in reaction to a crisis of some sort or when prompted by a change in the organization, such as a merger or acquisition. However, interviewees reported that discussing culture can be more challenging in periods of strong financial performance. Liselotte Engstam stressed, “Complacency can be a breeding ground for cultural dysfunction.”

If boards find that the culture needs to be changed, open conversations need to be had within the board about who is buying into the culture. That means evaluating fit at the board,

²⁰ What Directors Think, 2017, Corporate Board Member / Spencer Stuart Survey, 2017, and Maintaining the Social Licence to Operate, 2018 KPMG – Australian Institute of Corporate Directors Trust Survey, 2018

²¹ Board Leadership in Corporate Culture, European Report 2017, Mazars/ INSEAD, 2017

²² Achieving culture change, Oliver Wyman, 2018

CEO, management, and employee levels. Kathleen Crampton noted, "Culture is an index for underlying issues and it's critical to have a culture that values feedback."

LEVERAGE COMPREHENSIVE INFORMATION SOURCES

Boards primarily rely on the CEO for insights on the culture. For example, the recent Global Network of Director Institutes survey indicated that 89 percent of employees engage with the board through the CEO or managing director – meaning that the board rarely receives an unfiltered employee perspective.²³

Given this, directors can encourage candid and regularly-scheduled discussions, as well as hold informal, executive-session discussions, on both the positive and negative aspects of the culture. This helps to hold the CEO and management team accountable and gives the board insight into

whether upper management understands the culture of the company.

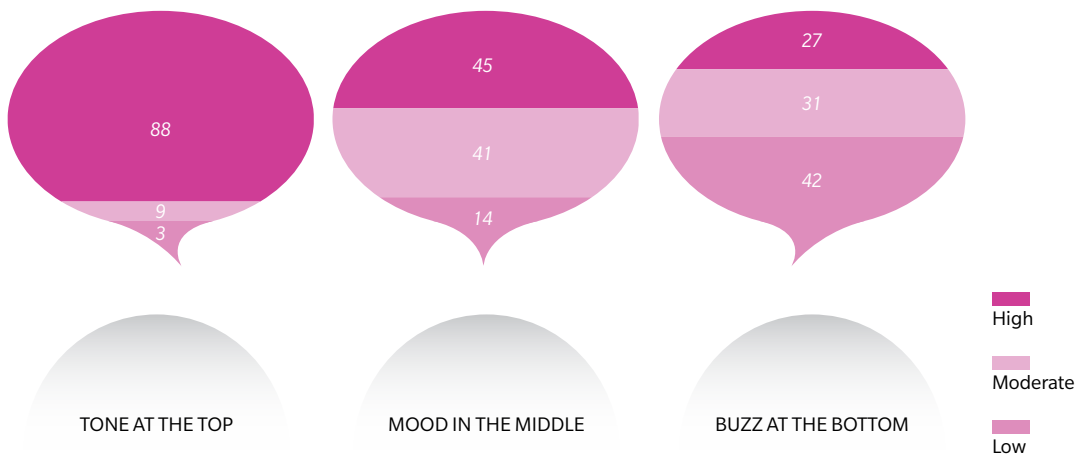
One survey found that nearly two-thirds of directors go with a "gut feeling" from management interactions to gauge culture.²⁴ This reveals that few boards have deep insights to their organizations' culture beyond the upper layers of the management team. (See Figure 1.)²⁵

TAKE A DEEP DIVE INTO THE DATA

A range of information sources can be used for insights into the organization's culture. Culture cannot be explicitly measured but the behaviors and outcomes that culture drives can be measured. Culture is constantly changing, and it will evolve over time and be influenced by many factors including company strategy, hiring, growth, acquisitions, and external drivers such as evolving customer needs and technology advancements.²⁶

Figure 1: Boards' insights to organizational culture

BOARDS' UNDERSTANDING OF ORGANIZATIONAL CULTURE AT VARIOUS LEVELS (%)



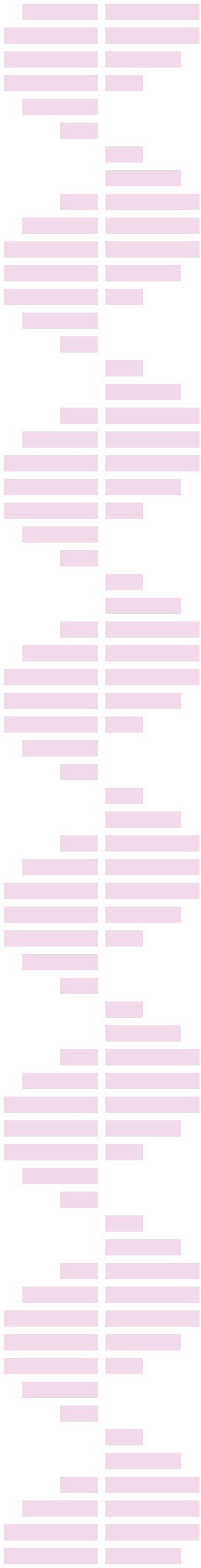
Source: NACD 2018-2019 Public Company Governance Survey

²³ Global Network of Director Institutes, Global Director Survey, September 2018

²⁴ PwC's 2018 Annual Corporate Directors Survey

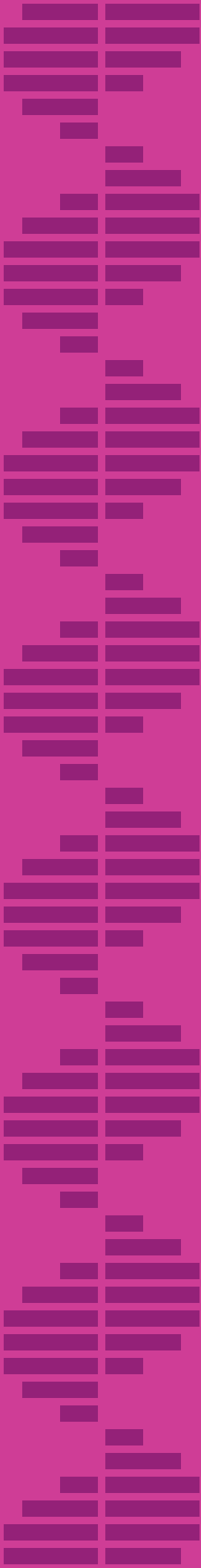
²⁵ 2016-2017 Public Company Governance Survey, National Association of Corporate Director, 2016

²⁶ Measuring Conduct and Culture A How-To Guide for Executives, Oliver Wyman, 2018



**MIDDLE
MANAGEMENT IS A
POWERFUL LAYER
IN SETTING
ORGANIZATIONAL
SUB-CULTURES,
ESPECIALLY IN
LARGE GLOBAL
ORGANIZATIONS.**

Vuyiswa M'Cwabeni



YOU SHOULD INSPECT WHAT YOU EXPECT.

Paula Lupriore

Measures to track culture can be regularly refreshed and brought to the board to assess and include a mixture of leading and lagging indicators (see Figure 2). Also, boards can ask management to provide data on factors that could indicate potential pockets of dysfunctional or toxic cultures.

To better understand and identify potential cultural issues, boards can use a variety of channels and tools, for example, employee exit debriefs, HR reports, employee engagement data, and surveys.

There is no single key performance indicator (KPI) for culture to detect an environment that is fostering dysfunction. However, employee surveys, conducted frequently, can provide practical and useful information and capture a sentiment of the workplace across different areas. Anonymous surveys are likely to attract more participants, and short, well thought out surveys can help companies target areas of immediate concern or high-risk areas. Relying only on surveys is likely to not provide a comprehensive picture of the situation, as many people do not report incidents. A survey also provides ancillary benefits, such as improving transparency and accountability, demonstrating a commitment to recognizing and addressing

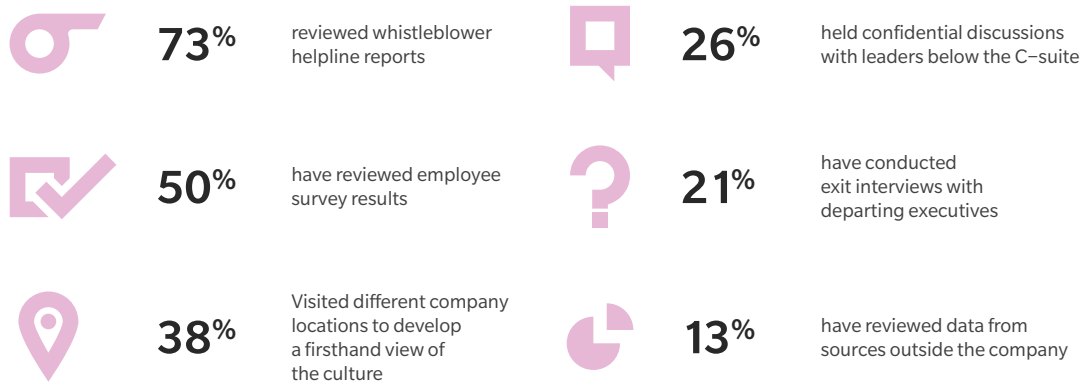
harassments, and assessing the impact of any remediation policy put in place.

However, it is important that boards explore beyond summary reports to do a deep dive into the data to help identify regions or departments within the organization that are at risk for dysfunctional or toxic behaviors. (see: "Data points to analyze to detect cultural issues") This can help determine if the "tone at the top" is also the "tone from above" – that is, the culture set by a manager or supervisor. Cultural norms are felt and transmitted most directly by a worker's immediate supervisor, especially in large, geographically diverse organizations.²⁷ As Vuyiswa M'Cwabeni, highlighted, "Middle management is a powerful layer in setting organizational sub-cultures, especially in large global organizations."

Some organizations have an ombudsman who serves as a third-party to whom people in the organization can report issues. This mechanism was viewed as quite effective by several directors.

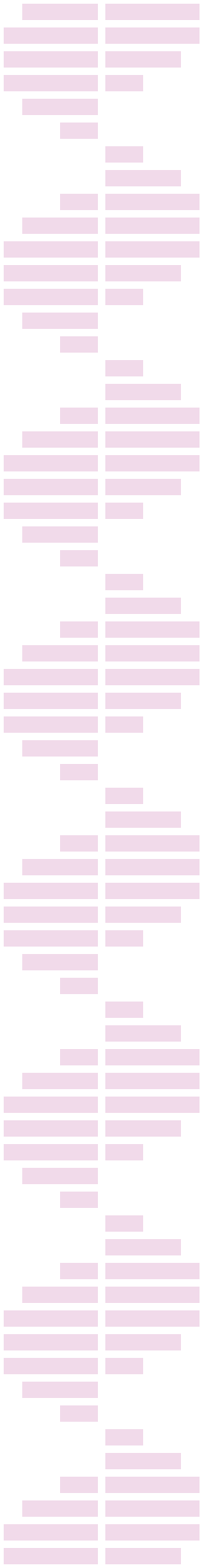
Boards may also want to hire external consultants or conduct a 360-degree assessment of the CEO and management to gain a deeper understanding of the organization.

Figure 2: Practices performed by the board to assess the organizational culture within the past 12 months



Source: NACD 2018-2019 Public Company Governance Survey

²⁷ Banking Conduct and Culture: A Permanent Mindset Change, Group of Thirty, November 2018



**MEETING GOALS
HAS LONG BEEN A
PART OF EXECUTIVE
PAY – AND
CULTURAL GOALS
CAN ALSO
BE INCLUDED.**

Avanthi Shah

BOARD COMMITTEES

AUDIT COMMITTEE

The audit committee is at the crux of data that could indicate dysfunctional issues within the organizational culture. As such, the committee members may approach their responsibilities while keeping the values of the organization in mind. Internal audit teams and external audit teams can also provide critical insights to the audit committee.

ANALYZE COMPLIANCE DATA

Regarding compliance updates, incidents can point to issues within the organization. For example, a cluster of incidents within a particular business group, function, or level of employees.

However, when collecting this data it is essential to dig deeper. Directors noted that summary information is no longer sufficient and audit committees have a broader requirement to go into corporate culture. Compliance performance and incident information can be assessed by various filters to provide insights. This can help the board ask: How do we know if there's a problem? What types of training systems are in place for the employees? Does the company have a "speak up" culture?

TRACK AND MONITOR EMPLOYEE DATA

Regarding measuring culture and conduct, many organizations focus their efforts on misconduct: intentional actions that are clear breaches of policies. However, to provide a truly comprehensive and balanced view of company culture and conduct, the scope of measurement can be expanded to cover positive conduct and associated indicators such as employee volunteer hours, employee satisfaction survey results, sustainability efforts, and social impact investments.²⁸ These indicators are critical data points the board can reference when trying to assess the current culture.

The audit committee can also track critical performance metrics and employee data. (see: "Data points to analyze to detect cultural issues") Other indicators can include elements like

DATA POINTS TO ANALYZE AND DETECT CULTURAL ISSUES

Employee metrics and data can be monitored to gain deep insights on whether there may be a discrepancy in employee engagement and treatment across gender, race, age, division, geography, business unit, tenure, or employment level. These discrepancies could indicate a dysfunctional culture.¹ Such metrics include:

1. Representation by gender, age and race, and career level
2. Hiring, performance ratings curves, pay increases, promotions, and turnover reports rates by gender, age, race, and career level
3. Pay data by gender, age, race, and role
4. Health data by gender (e.g., availability of women's health benefits)
5. Employee engagement surveys by gender (e.g., look for patterned differences between men and women's responses)
6. Employee absence data and variations across business units, role and gender
7. Number of sexual harassment claims
8. Organizational climate data by gender (e.g., work climate, employee voice)

These indicators can be reported to the audit committee but in some instances, the compensation or a corporate social responsibility/Sustainability committee may be chartered to provide oversight of these issues.

²⁸ Measuring Conduct and Culture A How-To Guide for Executives, Oliver Wyman, 2018

¹ Patricia Milligan, Metrics for Gender Inclusion that Every Board Should Monitor, Directorship, September 2018

overtime hours or health and safety reports which can reveal insights into the “tone from above” across the organization. These indicators allow a board to ask: How are people promoted? Where are they coming from? Are executives comfortable grooming successors? Who is put forward for promotion?

TRACK WHISTLEBLOWER INFORMATION

Whistleblower information and the organization’s process for reviewing whistleblower hotline data is another important source of information for the audit committee. The escalation process needs to be effective and expedient as well. As noted by Kapila Anand, “If the board and management don’t know about the types and trends of whistleblower incidents such as repeat incidents or geographic concentration there’s not much they can do.”

Directors acknowledged that hotlines can capture both trivial episodic events as well as reports of critical issues. Davia Temin recommended, “You investigate everything, but you investigate with great vigor the things that could be a large problem for the organization.” Indeed, research found that companies that provide employees with whistleblower channels – and have effective follow-up systems in place – earn a greater return on assets than businesses with underdeveloped whistleblowing platforms. Whistleblowers play a vital role in cleaning up a company’s corporate culture and can even help them achieve profitability goals.²⁹

If the audit committee is getting whistleblower information, human resources also need to be aware of the information. It is essential to open channels of communication between the audit committee and compensation committee.

COMPENSATION COMMITTEE

The compensation committee, which can also be known as the remuneration committee and sometimes HR and remuneration, can take an active role in increasing the importance of culture to an organization through its review of the design

of thoughtful and holistic compensation schemes.³⁰ If executive members’ pay is at least in some part reflective of how cultural targets are being met, executives are much more likely to pay attention to culture. Paula Lupriore observed, “When your pay depends on meeting certain metrics, you’re going to make sure it happens.”

The committee can review that the compensation structure aligns with the desired culture. For example, if the goals include increasing diversity, metrics on diversity in hiring could be included in the compensation structure. Board members can also consider having culture-related elements as explicit factors of executive compensation. “Meeting goals has long been a part of executive pay – and cultural goals can also be included,” said Avanthi Shah.

The compensation committee may want to reserve a certain percentage of annual awards or retention awards to recognize nonfinancial achievements such as effective leadership, teamwork, communication, and initiative. One survey showed that 24 percent of companies used “measures related to the health of the firm’s culture” as key non-financial metrics in setting CEO pay.³¹

However, there are challenges in incorporating non-financial metrics into executive compensation schemes. Incentive plans often rely on predetermined financial targets that can be objectively measured. An organization’s culture is difficult to quantify and setting specific goals and tracking progress is challenging. In addition, shareholder and proxy advisors have increasingly voiced concerns that discretionary bonus plans do not demonstrate a link between pay and performance. One solution to the difficulty of weighting financial and non-financial metrics is to create a balanced scorecard with relative weightings for various metrics and incorporating a discretionary component.

²⁹ Evidence on the Use and Efficacy of Internal Whistleblowing Systems, Stephen Stubben, University of Utah and Kyle T. Welch, George Washington University - School of Business, December 2018.

³⁰ Board Oversight of Executive Pay: Compensation Committee Basics, Marsh & McLennan Companies and NACD, 2018

³¹ 2017–2018 Public Company Governance Survey, National Association of Corporate Directors, 2017



**WITHOUT A
DIVERSE BOARD,
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NOT ENOUGH
ON MEASURES
SUCH AS CULTURE
AND TALENT.**

Bonny Simi

NOMINATING AND GOVERNANCE COMMITTEE

INCREASE BOARD DIVERSITY

Diversity in experience and thought – such as having former HR executives on the board – can better support open discussions on cultural issues. “Without a diverse board, boards can find themselves too heavily focused on financial metrics, and not enough on measures such as culture and talent, said Bonny Simi. A recent Global Network of Directors Institute survey recommended, “Building a board that considers diverse perspectives in discussion and decision making adds value to the organization, helps combat groupthink, and is core to effective governance.”³²

Directors can also consider potential culture indicators within the boardroom and how effectively the board can respond to cultural issues. As Kay Dryden, commented, “If there are only one or two women in the boardroom, it can be difficult to raise what are viewed as ‘soft’ issues.” If the board’s own culture aligns with the organization’s culture, it may be particularly difficult to spot indicators of cultural dysfunction as doing so would take a sense of self-awareness that not all organizations have. If the board has a toxic culture, can it spot a toxic culture within the management team?³³

A lack of diversity is cause for concern. For example, can a board without women address #MeToo related complaints and issues? Can a nondiverse board, considering all aspects of diversity, be aware of signs of cultural dysfunction? Data shows that over the past two years, only 37 percent of boards have discussed how diversity, or the lack thereof, impacts company culture.³⁴

Simply, as was noted by many of the directors interviewed, “Diversity changes everything.”

DEEPENING THE UNDERSTANDING OF AN ORGANIZATION’S CULTURE AND IDENTIFYING WARNING SIGNS

Beyond the specific board structures and mechanisms, there are several approaches that directors can leverage to capture a sense of the culture. Board members, as a team, in committees, or as individuals can play an active role in diagnosing an organization’s culture and spotting warning signs.

DIAGNOSING CULTURE

Many directors noted that employees don’t feel comfortable sharing honest opinions with the board during scheduled board meetings. To open channels of communication, board members can take actions to gain a deeper understanding of the organization. Paula Lupriore suggested, “You should inspect what you expect.”

VISIT THE ORGANIZATION

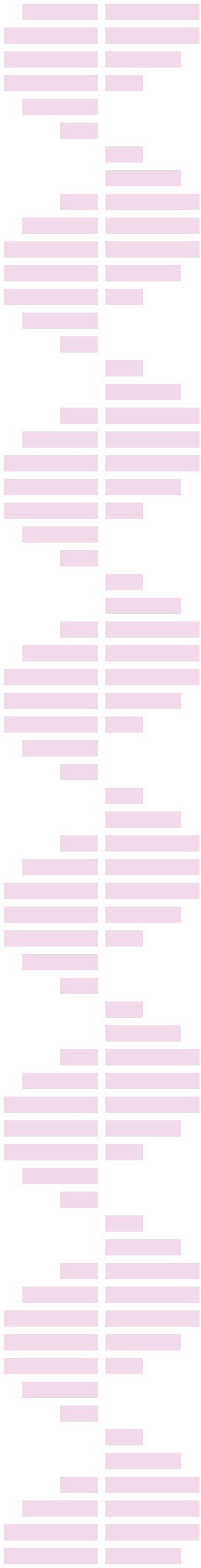
Instead of bringing employees into the boardroom, directors will get more out of meeting employees on their own turf. Time and time again, directors mentioned that site visits and walking the hallways of the organization are critical. This process provides directors with a sense of the organization, the degree of transparency in the culture, and what drives employees.

Organizations with a healthy, robust culture would likely be confident with directors conducting site visits. Kapila Anand stressed, “It’s a red flag if anyone says you can’t walk through the accounting department and talk to management outside of the boardroom.” Other directors agreed with encouraging sitting and talking with people who aren’t the top executives. At the same time, directors acknowledged that it is hard for them to pass as incognito.

³² Global Network of Director Institutes, Director Survey, September 2018

³³ Kador, John. A little rudeness has big impacts on corporate culture. <http://boardmember.com/little-rudeness-big-impacts-corporate-culture/>

³⁴ 2018–2019 Public Company Governance Survey, National Association of Corporate Directors, 2018



**MEETING IN A
BOARDROOM EVERY
FEW MONTHS
DOES NOT EQUATE
WITH HAVING
AN IDEA OF THE
ORGANIZATIONAL
CULTURE.**

Ana Paula Pessoa

GET TO KNOW THE ORGANIZATION

“Meeting in a boardroom every few months does not equate with having an idea of the culture,” noted Ana Paula Pessoa. Board members need to find time aside from scheduled meetings to spend time with executive leaders and non-executive team members to enable free-flowing conversation. With management, boards can schedule executive sessions with the CEO or others in the C-suite to enable frank discussions.

Board members can also build relationships with members of the organization beyond the C-suite. For example, one director noted she likes to reach out with a request such as, “I’m going to come in a day earlier, tell me about X over lunch.” Informal, less structured meetings can be useful since people who present to the board are highly-briefed and organized, so it will take some time to get to know the culture and delay the information.

The process of getting to know the organization and its culture is particularly important when a director is being onboarded (or if the organization has a poor onboarding process, actions the director can take to onboard him/herself and understand the organization). Directors need to take steps to visit and learn the organization. One director said that she likes to sit in on client meetings to get a sense of the interactions. This process of deeply considering culture during onboarding gives directors the chance to ask themselves “If this culture doesn’t fit with me, should I even be a board member?”

REVIEW SOCIAL MEDIA TO SEE HOW THE ORGANIZATION IS VIEWED

Social media is an increasingly valuable tool for insights on corporate culture. Twitter, LinkedIn, Yelp, or recruitment sites such as Vault or Glassdoor can provide a window into understanding the corporate culture. A few directors commented that using social media as a tool and taking it seriously is a new development for boards. However, in a recent survey, boards that report a better understanding of culture lower down in the organization are four to five times more likely to review data from outside of the company, such as social media commentary or job review sites.³⁵

Individual directors may find it useful to scan social media sites and review external feedback on the organization to gain a better understanding of what is being said by others about the organization. The board can also ask for summaries of social media profiles from external resources or ask management to provide summaries of the organization’s ratings on social media sites.

FLEX JUDGMENT AND EXPERIENCE

Finally, one of the biggest strengths that individual board members have is their judgment and experience. Being aware of body language and communication, such as if the CEO averts his/her eyes when discussing certain topics, can help clue board members into potential warning signs. Boards can also look at the language the organization uses in communications. The tone from the top, and the nuances of the language and words that executives use to communicate with employees, provides relevant cultural indicators.

THE WARNING SIGNS OF A DYSFUNCTIONAL CULTURE

Directors noted a range of warning signs of dysfunctional or toxic cultures. (see “Snapshot”) For example, statements that “the company does not have HR issues,” should be questioned. Every company has at least minor HR issues of which to be aware. Furthermore, there are multiple triggers associated with the CEO as that role is so instrumental to the culture. For example, one sign of concern is if the CEO that says that all board reports must run through him/her.

Boards can also consider if anyone other than the executive team presents to the board as too much distance between the board and the company is a warning sign. Also, while a strong CEO or charismatic leader is often seen as an asset to the firm, this personality style, when overly used, could contribute to a toxic culture by stifling dissent or open discussions. A CEO needs to be open to bad news as well as good news and avoid a culture of sweeping things under the rug.

³⁵ 2018–2019 Public Company Governance Survey, National Association of Corporate Directors, 2018



**IT'S A RED FLAG
IF ANYONE SAYS
YOU CAN'T TALK
TO MANAGEMENT
OUTSIDE OF
THE BOARDROOM.**

Kapila Anand

Directors also pointed to some other factors which could initially show signs of a dysfunctional culture such as strong agreement amongst management teams or an attitude of getting the results “no matter what it takes.” For example, a lack of disagreement amongst senior management could be indicative of infighting underneath the surface.

CONCLUSION: TAKE ACTION

Recent headlines have driven a greater focus on organizational culture and the impacts that a dysfunctional or toxic culture can have on the performance of the organization.

Boards must be attuned to the potential warning signs within their organization. To do this, they can tap into various information sources – from employee surveys to culture dashboards – to glean

insights on culture within the company. While directors agree that the board’s role is largely to oversee culture, boards now face greater pressure to dig deeper on culture and ensure that there are processes in place to capture insights and report these out to the board. The board can apply these levers to support management in evolving an organization’s culture where necessary, and consistently track critical data to identify what needs to be regularly reviewed properly.

If there are cultural issues that need to be addressed, boards are increasingly pressured by stakeholders to take action, act quickly, and remediate any potential reputational effects. By tracking cultural indicators, increasing cultural awareness in the company, and proactively applying levers of change where necessary, boards can help steer the culture – creating greater alignment of the entire workforce to the vision of the organization.

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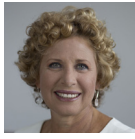
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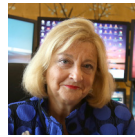
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