

## Corporate culture. Why the sudden interest?

by Peter Parry

Having noted that cultural issues have been at the bottom of many corporate reporting scandals in recent years, the Financial Reporting Council (FRC) has initiated a debate about whether companies and their auditors should provide investors with more information about culture within organisations. In July the FRC published its report, 'Corporate Culture and the Role of Boards' This article, therefore, looks at how the debate is currently developing based on some of the research that has recently been completed.

The audit firms have a central place in the debate. Investigations into a number of high-profile corporate scandals have identified shortcomings in audit and reporting standards. Alongside this, there is a view emerging that some of the content that appears on a routine basis in the annual report is not of much use to investors while other information which could be of more use is absent. Reporting on corporate culture falls into the latter category and external auditors are seen as the independent third-party who should be providing oversight and feedback to investors. While there is plenty to support the view that the auditors should play a role in this area, some members of the profession are uneasy about the practical implications. Culture is not easy to pin down; it means different things to different people, has somewhat 'fluffy' connotations and can be very hard to measure.

### **An interesting topic for debate, but how do you define 'culture'?**

In order to consider what is to be achieved in any proposal for reporting on 'corporate culture' it is important to define what the term means. This is how the FRC defines it in its report:

*Culture in a corporate context can be defined as a combination of the values, attitudes and behaviours manifested by a company in its operations and relations with its stakeholders. These stakeholders include shareholders, employees, customers, suppliers and the wider community and environment which are affected by a company's conduct'.*

This is a starting point but it is too superficial to be of much help. There are plenty of verbatim comments from chief executives in the report but many fall into the easy 'sound-bites' category (*'War stories are a useful way to get the culture solidified' – Jeremy Darroch, CEO Sky*). There is plenty of comment on ethics and conduct, building trust with customers and suppliers, the role of the human resources function, internal audit and so on but little that shows how this mass of ideas and observations can be pulled together to develop a coherent and practical approach to managing corporate culture. There is, however, a recognition that sound governance is an essential prerequisite for establishing and managing culture. Recent revelations at Sports Direct are a good example of how governance systems (or the lack of them) affect cultural norms.



**Peter Parry**

### **What else are people saying about the importance of corporate culture?**

The audit firm Ernst and Young (EY) has also carried out research into corporate views of culture within businesses. Its research involved 100 board members of FTSE 350 companies. Its report, 'Is your Board yet to realise the true value of culture?', takes a different approach to defining 'culture':

*'Corporate culture encompasses a company's values and purpose, the beliefs, behaviour and attitudes of employees, and the way things are done and managed.'*

It goes on to identify four organisational pillars that shape culture - Political architecture, Social architecture, Performance architecture and Operational architecture and it notes that that:

*'...all large organisations will have local sub-cultures within teams and different locations'*

*that reflect local approaches to business and the styles and beliefs of team managers.'*

As a starting point for identifying the complex mix of components that go to make up corporate culture this not a bad analysis.

As with the FRC research, the verbatim comments from CEOs and others seem to confirm that everyone thinks that corporate culture is a vitally important issue: 86% of respondents said that culture was 'fundamental to' or 'very important to' the company's strategy and performance. A major strength of EY's research is that it seeks to test some of these claims and finds them to be wanting. It turns out that in only 19% of cases is the board currently seen as being primarily accountable for culture. Nearly a third of respondents did not believe that they, as board members, had a leading role to play in shaping or managing the culture of their organisations. Only 24% of respondents said that culture was on the agenda at every board meeting. Only 53% said that there was full consensus on culture among board members. The latter might not be so bad if it meant that there was serious debate and challenging of cultural issues by board members. However, the fact that in the majority of cases culture is not on the agenda at board meetings suggest that dissent is seen as a fact of life that is just accepted.

### **What are the main conclusions so far?**

The EY report concludes that:

*'Many companies lack the tools and structure necessary for assessing and managing culture effectively, do not fully understand what drives culture and do not fully appreciate the breadth of the benefits of investing in culture.'*

The EY report makes an interesting observation from an investor point of view: at a recent EY 'Dialogue with Investors' event, an audience poll of the investors attending found that 81% said they believe that companies do not provide information that allows investors to assess corporate culture, while 85% said they believe they had a role to play in the culture of companies in which they invest. Many of those who attend the Dialogue with Investors' events are representatives of large investors and fund managers – although organisa-

tions like UKSA are there as well. As this feedback is skewed by the predominance of large investors, it would be interesting to know what UKSA members think about the issue of corporate culture and its impact on business performance.

### **So where do we go from here?**

The FRC's report on corporate culture is being followed up with a conference – 'Culture to Capital: aligning corporate behaviour with long term performance'. This will be taking place on 21<sup>st</sup> September and I shall attend on behalf of UKSA and will be promoting UKSA's cause with the delegates there. It promises to be an interesting event on which I shall report back in the next edition of TPI.

In the meantime, it is worth noting that UKSA members do have one important means of assessing culture that is not open to most others small investors. They can attend the company visits which provide an unique opportunity to meet the management and see how they respond under close questioning.

*Peter Parry*