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Corporate culture: The root of good and poor governance

Setting the tone with the right values, attitudes and behaviours must start with the top leadership. BY MAK YUEN TEEN

IN HIS opening address at the Sias Corporate Governance Conference on Nov 6, Monetary Authority of Singapore managing director Ravi Menon said that Singapore will assess if it should introduce a new provision in its corporate governance code to promote good company culture.

Coincidentally, I had accepted an invitation to speak at the Annual Directors Summit organised by the Vietnam Independent Directors Association the following week on the topic of ethical leadership and corporate culture.

I was asked to cover three main issues: why ethical leadership matters especially in the current economic context, the relationship between ethical leadership and corporate culture, and empirical evidence on the relationship between having an ethical leadership and corporate value.

I did not have a problem speaking about the first two issues, but I was uncomfortable talking about the third. I could easily have said there is a relationship, as some other academics have asserted, and proceeded to highlight research that claims to have found such a relationship.

However, I took a different tack for two main reasons.

First, I do not think one should do the right thing only if it increases corporate value. Second, especially in the social sciences, nothing can be proven conclusively and few relationships can even be said to be supported by evidence with a high degree of confidence.

I put the third issue to rest by sharing one of my favourite quotes on ethics by Peter Forstmoser, former chairman of the board of directors of Swiss Re, who said: "To be ethical is profitable, but to be ethical because it is profitable is not ethical. And, one might add, it is also not profitable in the long run."

I then shared examples of some international and Singaporean companies that I believe behave ethically, and how that has helped them survive, thrive and gain stakeholder trust, even though like all businesses, they have gone through some challenging times. It is not merely about whether they have a code of conduct or a whistleblowing policy or claim to have zero tolerance for misconduct. It's about their actions, including how they treat employees, minority investors and other stakeholders. The real test of ethical leadership is often when a company is facing difficulties or a difficult economic environment.

In my workshops with directors, I ask for examples of how their companies walk the talk. Are employees recognised for ethical conduct, or only for achieving sales or profit targets? One participant shared that in a company where she was a director, the CEO hung framed write-ups along the wall of the corporate headquarters describing how certain employees had through their ethical actions helped the company. Another shared that they gave recognition to whistleblowers (anonymously) and employees who have acted ethically, and announced such recognition to employees.

Ethics and corporate culture

Using a tree as an analogy, ethics is the seed; corporate culture is the root; corporate governance is the trunk; business strategies, risk management and reward systems are branches; policies and operations are leaves; and profit is the fruit.

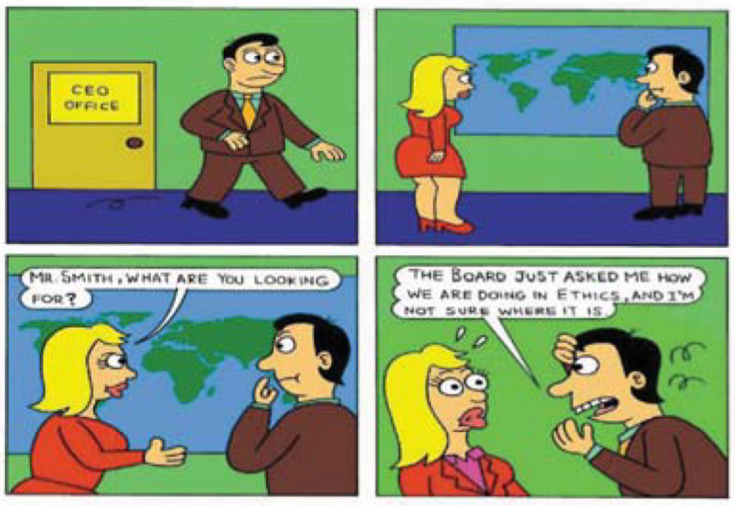
The renowned management expert Peter Drucker said "culture eats strategy for breakfast". I would add that it eats governance and risk management for lunch and dinner too.

According to Winfried Bischoff, former chair of the UK Financial Reporting Council (FRC), "A healthy culture both protects and generates value. It is therefore important to have a continuous focus on culture, rather than wait for a crisis."

Companies such as the Tata Group in India, Ayala Group in the Philippines and Berkshire Hathaway in the United States have survived and thrived over very long periods. A strong corporate culture underpinned by ethics is key to their success.

Conversely, there are many companies that have been hurt by poor corporate culture. Based on the nearly 250 case studies that I have edited or written about companies that have been involved in corporate governance or accounting scandals, I would say that poor corporate culture, followed by ineffective boards and failure of the three lines of defence are the top three contributors – with corporate culture as the first-order contributor.

The UK FRC defines culture in a corporate context as "a combination of the values, attitudes and behaviours manifested by a company in its operations and relations with its stakeholders".



SOURCE: MAK YUEN TEEN AND CHRIS BENNETT, 'DIRECTORS DAZE: THE LIGHTER SIDE OF CORPORATE GOVERNANCE', 2014

An ethical culture is at the heart of corporate culture but corporate culture also encompasses a risk culture, performance culture, focus on customers, and responsibility to society.

Board's role in corporate culture

It is important that the board is involved not only in developing the corporate culture, but also ensuring that it is cascaded throughout the organisation. The board needs to work with the management in doing so. Picking the right chief executive officer who is ethical is crucial.

A good corporate culture starts with the board setting the right tone by ensuring that each director subscribes to high standards of conduct, and that issues relating to values, standards and ethics are discussed with the management and are considered in setting strategic objectives and decision-making.

Directors also need to show respect for the management. In one organisation, the chairman openly criticised the CEO, not only in board meetings with the CEO present, but also in the presence of outsiders. While there were performance issues with the CEO, such behaviour is unacceptable and sets a bad example for the management. If the board treats the CEO this way, the CEO may do the same with employees.

The board should also monitor the corporate culture. The *Guidance on Board Effectiveness* published by the UK FRC in 2018 suggests the following sources that can provide insights into corporate culture: turnover and absenteeism rates; training data; recruitment, reward and promotion decisions; whistleblowing, grievance and "speak-up" data; employee surveys; board interaction with senior management and workforce; health and safety data, including near misses; promptness of payments to suppliers; attitudes to regulators, internal audit; and exit interviews.

When discussing remuneration policies with directors, I ask if they evaluate whether employees who demonstrate the appropriate values are recognised in reward and promotion decisions. For example, are the employees who gain the fastest promotions and highest rewards consistently the ones who did best on financial performance measures, such as sales and profits? If so, messages about values and ethics may be no more than lip service.

The UK FRC guidance also provides useful indicators of a good corporate culture, such as honesty, openness, respect; adaptability, reliability; recognition; acceptance of challenge; accountability; and a sense of shared purpose.

It also suggests possible signs of problems with corporate culture that directors should watch out for. These include silo thinking; dominant/arrogant leadership; pressure to meet the numbers/overambitious targets; lack of access to information; low levels of meaningful engagement between leadership and employees; lack of openness to different views; tolerance of regulatory or code-of-ethics breaches; short-term focus; and misaligned incentives.

On silo thinking, a country CEO once shared with me his experience working in a company that had imploded in a scandal. He said that the founder and group CEO did not allow him access to the subsidiary's product development department in the country he was responsible for. A highly compartmentalised approach to management was also practised at Satyam Computer Services, which saw one of India's biggest corporate frauds.

Directors need to be observant rather than rely solely on information from the management in monitoring corporate culture. In one organisation, a director habitually arrived early and chatted with employees in the corporate headquarters. He noticed that there were often new faces, suggesting a high turnover. He proposed that the management start providing employee-turnover information in management reports to the board, and that an independent employee-engagement survey be undertaken. There could be various reasons why turnover is high, but, in this case, it turned out that it was an issue with the management style that was driving employees away.

More box-ticking?

Singapore does not have fit-and-proper tests for directors and management beyond basic statutory requirements and loose listing-rule requirements on character and integrity. These requirements have not stopped highly questionable individuals from being appointed as directors and senior management of Singapore Exchange-listed issuers. Unless we see changes starting from the top of companies, including the adoption of more stringent fit-and-proper requirements for directors and the management, adding a new provision on corporate culture in the code could become just another meaningless box for companies to tick.

The writer is professor (practice) of accounting at NUS Business School, where he specialises in corporate governance. He is also the founding director of the new Centre for Investor Protection at the school. This article is partly based on a keynote speech at the Annual Directors Summit organised by the Vietnam Independent Directors Association in November 2023.