

JWA Governance welcomes FRC's Culture Report

Background

The Financial Reporting Council (FRC) has today published its long-awaited report¹ on the results of an 18-month study on corporate culture in the UK, exploring the correlation between effective corporate culture and long-term success. In collaboration with the Institute of Business Ethics, the Chartered Institute of Internal Auditors, the Chartered Institute of Personnel and Development, the Chartered Institute of Management Accountants and City Values Forum, in excess of 250 leading industry experts were interviewed for the report, including CEOs and chairmen from the UK's largest companies on how corporate cultures are being defined, embedded and monitored.

The FRC noted that the "huge response rate to the study indicates companies are waking up the importance of culture, and the findings show it is climbing up their strategic agenda."

Principal findings of the report

The report 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." It makes a number of key observations. A healthy corporate culture is a valuable asset and it is the board's role to ensure that the company's values, strategy and business model are aligned to it. The report makes much of the leading role of chief executives in themselves embodying the desired culture and embedding this at all levels and in every aspect of business. Values need to be translated into a set of expected behaviours, with openness and accountability being critical. Much is said about human resources and the need for this function in particular to be empowered to drive this process and to have a clear voice in the boardroom. Reward and performance management need to be aligned in such a way as to support espoused behaviours. Crucially, boards must develop indicators and measures of corporate behaviour, in order to understand it and challenge any misalignment with the established culture and values. Finally, institutional investors should engage with culture, both in terms of the behaviours they are encouraging in companies and also to reflect their own culture.

Initial assessment of the report

JWA Governance is highly supportive of efforts to challenge FTSE Premium Listed companies in particular but also other organisations

(including public sector bodies and non-profits) through assessment and monitoring of their corporate and institutional culture and its bearing on strategy goal setting and performance². The report provides a rich diet of material and comment which should challenge all boards to refresh their thinking on how culture impacts performance, their business models and engagement with stakeholders.

The report suggests that a healthy proportion of company boards surveyed (albeit it a small sample) do in fact have ethics and culture on the agenda with relative frequency (67% consider it at least once a year, and of these the majority consider it more frequently). However, the nature of the discussion will inevitably vary. Financial services companies are probably in the vanguard here. Company culture naturally hits the agenda when there is a crisis or some unanticipated event. The report is strong on the need to embed culture and for it to inform all aspects of the strategic and operational thinking.

The report strongly reinforces the important role of the board in establishing the culture, values and ethics of the company. Culture is largely an intangible concept, embracing practices and values. It is shaped and informed by the history of the company, its business environment and competitive landscape, and may also be significantly impacted by the effect of past mergers and acquisitions.

Practical outcomes of the report

Most company boards will need to reflect deeply on the report and how they might respond. It is clear that the FRC is not seeking at this stage to amend the UK Corporate Governance Code in the light of the report. The report makes clear that while legislation, regulation and codes influence individual and corporate behaviours, they do not ultimately control it.

The most useful sections of the report (and the ones to which many company secretaries will turn) are the tables of questions for the board to ask.³ JWA Governance believes that in the near term directors will need to adopt appropriate tools for articulating their culture more clearly alongside their mission and values and, more challenging, consider how to measure the impact of culture on performance. Not only does culture need to be articulated but it needs to be shaped and changed, as circumstances dictate. As one commentator noted in the report: "Driving culture is a key part of my job. 'Driving' is the right word; the world is changing too fast just to speak about maintaining."

Cultural due diligence and review

The report notes the fact that, historically, cultural fit nearly always surfaces as a subject when acquisitions are being considered. In parallel, it is also an issue when making key hiring decisions, particularly of chief executives. JWA Governance suggests that the language of *cultural due diligence* is appropriated more widely for regular ongoing review of a company's performance and reporting. Boards should consider including material on their corporate culture in corporate governance statements in the future, setting out what steps they have taken to subject culture to external scrutiny. How has the board taken account of culture in its board effectiveness reviews, both those undertaken itself and those facilitated externally?

Conclusion and next steps

The report ends by stating its aim, which is to stimulate thinking around the role of boards in relation to culture, and encourage boards to reflect on what they are currently doing. The FRC's next steps will be to reflect on the report, update its 2011 Guidance on Board Effectiveness⁴ and continue to work with its partners to encourage debate on culture and to identify and share good practice. JWA Governance would want to share these aims in the context of its own client work. It strongly welcomes the report as a well documented next step and a resource to inform the debate going forward.

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Notes

¹ Financial Reporting Council, *Corporate culture and the role of boards: report of observations Culture project* (London: July 2016) (access via www.jwagovernance.com/publications)

² JWA Governance, *Culture: a new focus for board reviews* (Briefing Paper #4 March 2016)

³ Financial Reporting Council, *Corporate culture and the role of boards: report of observations Culture project* (London: July 2016) (see pages 19, 27 and 33)

⁴ Financial Reporting Council, *Guidance on board effectiveness* (London: March 2011)