Building Societies Association

Perspectives: Governance in building societies

Measuring Culture

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Introduction

The Institute of Business Ethics defines culture as the combination of factors that drive behaviour within an organisation – it's 'how things are done around here'.

However, as recent business scandals illustrate, an organisation's culture can be working against the very ethical values the company declares in its corporate communications - the say/do gap – where a company says one thing, but does another. Corporate culture can be open, aspirational, ethical, but it also can be rotten, toxic or self-destructive.

The focus by the UK Government and the Financial Reporting Council[1] on corporate culture is an example of how seriously this is being taken. Improving corporate culture is seen as essential in order for business to regain its standing in society so that companies can secure their long-term franchise and their right to be heard in the debate on public policy.

But while everyone agrees that culture is important, it is hard to define and cannot easily be measured. However, boards can and do have access to a range of information that will shed light on the drivers of behaviour within their organisation and help them to shape it.

[1] FRC (2018) *The UK Corporate Governance Code*

According to an IBE survey,[2] boards do discuss culture and receive a lot of relevant information. However, this is not necessarily presented systematically so boards may find it difficult to make connections and draw conclusions about culture. The IBE survey suggests that, while boards are driven very much by indicators that matter to the public like diversity and taxation policy, many show a striking lack of curiosity towards other indicators that also have an important bearing on culture. These neglected indicators include customer complaints, staff turnover, supplier issues and social media impact.

Values and purpose

“Across the whole bank [Barclays], there were no clearly articulated and understood shared values – so there could hardly be much consensus among employees as to what the values were and what should guide everyday behaviours. And as a result there was no consistency to the development of a desired culture” – Anthony Salz [3]

There can be no effective oversight of corporate culture unless boards have first set and promulgated a statement of values and purpose against which expected behaviours can be defined and measured.

Employees will make their own observations on whether management behaviour reflects the company’s stated values. The example set by the management, and particularly the chief executive, speaks volumes. The expectations that arise from a given set of values will serve as a basis for judging where the company is living up to those values or it is running hidden risks.

This requires directors to identify the key values that the board would like the company to have and then to reflect on the possible sources of feedback that will show the extent to which these values are found in practice. The board cannot anticipate all the decisions it will make in the course of its work, but it can do much to shape the culture that drives those decisions.

Measuring culture

"If you cannot measure it, you cannot improve it." Lord Kelvin

Numbers can form part of our understanding of culture but they often need interpreting, which requires judgement. Directors need both quantitative and qualitative data. Where KPIs are concerned, they need to look beyond the raw figures to understand the underlying

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[2] See IBE (2018) *Board Briefing: Culture Indicators: understanding corporate behaviour*

[3] Salz Review An Independent Review of Barclays’ Business Practices

message and compare the results with other indicators to see whether they confirm the picture. Evaluating culture involves monitoring process as well as data.

Critical indicators might be based on the expectations of key stakeholders i.e. groups that the company cannot afford to alienate. Directors also need to consider factors that will inform them about morale and motivation among staff, suppliers and customers, as well as levels of operational stress that might lead to conduct and other types of risk.

Consideration of the various indicators of culture need to be joined up. When alarm signals are ringing in several different places at once, there really is a problem. In each case it is also necessary to ask the question about what the figures really mean.

A dashboard approach

Boards are rightly worried about being drowned in information. Many seek to address this by channelling more detailed work through committees and tailoring the information flows they receive to suit their particular needs.

Boards may find it helpful to draw up their own bespoke dashboard of indicators based on what they see as the critical behavioural factors for their company and sector and the most important concerns of their main stakeholders – employees, suppliers and customers.

For this boards need Key Performance Indicators (KPIs) covering a wide range of data from different sources, including human resources, commercial, operational and financial information. This will allow them to clearly see where patterns are emerging and check one indicator against another. Large companies face a particular challenge because group-wide KPI's will not differentiate between what is happening in different parts of the business. Group boards need to be able to disaggregate the information sufficiently to know where there are pockets of poor culture that might cause a risk to the whole concern.

Thus a dashboard approach may comprise a limited number of indicators that can be tracked closely and are chosen to reflect the company's values, business model and key stakeholder relationships. Since culture is a key determinant of corporate reputation, companies may find it helpful to consider what is important to their key stakeholders when setting criteria for assessing culture.

Drawing on a wide-ranging set of indicators also means that not all the information comes to the board from one source. Compliance, internal audit and human resources all have their part to play. Whereas one of these groups might seek to massage the data, it is less likely that all of them will do so at once.

The dashboard approach makes the task of monitoring culture both more manageable and relevant to the perceived situation of the company. A traffic light system should give early warning and enable pre-emptive action to be taken.

Leading indicators

The best indicators for a dashboard approach are those that look forward rather than backwards – leading rather than lagging indicators. These sharpen the board's understanding of risk.

Boards need to look not just at what has already happened, but also at what may happen next. A better indicator of future risk is the incidence of 'near miss' events that might have caused serious problems but did not. These are important even if no harm was done because they say more about what might happen. For example, critical equipment failure is a forward-looking indicator. Put crudely, repeated failure may reveal that, although the server has not failed yet, there is a high risk that it will at some stage. Looking at predictive indicators can help boards and management take pre-emptive action.

Below are some examples of how culture might be measured across a range of indicators: health and safety, employee surveys, Speak Up, codes of ethics, staff turnover, stakeholder engagement and customer satisfaction. For a fuller exploration of indicators, what boards should consider and how to report authentically, please take a look at the IBE's Board Briefing *Culture Indicators: understanding corporate behaviour.*[4]

[4] https://www.ibe.org.uk/List-of-Publications/67/47#pub3340

Culture Indicators

These examples illustrate in their different ways the complexity of many of the indicators of culture and the type of questions that boards need to ask. The challenge is to make what is inherently subjective as objective as possible, while accepting that there is almost always a need for qualitative judgement.

Customer satisfaction

"Your most unhappy customers are your greatest source of learning."

– Bill Gates, Microsoft

Customer satisfaction is critical to corporate survival. A company that consistently disappoints its customers is unlikely to receive repeat business and, unless it is a monopoly, will almost certainly start to lose market share. And yet the IBE survey shows that two fifths of boards do not receive information on customer satisfaction.

The Institute of Customer Service (ICS) has established a clear connection between customer satisfaction and financial performance. Its 2017 index[5] shows, for example, the highest scoring current account providers (Nationwide Building Society, TSB, Santander, Halifax and Natwest) added a net 20,016 current accounts, while the lowest scoring banks saw an average net loss of 9,017 accounts.

It follows that boards have a strong interest in customer satisfaction, which is also part of the culture picture. The ICS has found that employee engagement is critical to customer satisfaction.[6] Just 11 percent of customers would repurchase from an organisation following a bad experience with an employee, while 43 percent of customers would also actively warn others against using the organisation. For every one point increase in employee engagement, customer satisfaction rises by 0.41 points.

Among the possible indicators for customer satisfaction are:

- Net Promoter Scores, popular with retail-facing companies – to measure how likely a customer would be to recommend a company/ its products to friends and family
- Customer survey data
- Call centre records on resolving customer queries
- Complaints, including the success with which they were resolved
- Market share

[5] ICS (2017) *Op cit*
[6] ICS (21 November 2016) *Disengaged workforce push customers away*

Stakeholder engagement

Good relations with stakeholders are important if the company is to preserve and strengthen its social licence to operate. Boards therefore need to understand which stakeholders matter most to the company and need to be familiar with stakeholder concerns and expectations.

For example, supplier payments record is a potentially important culture indicator. Though most companies have clear policies on the scheduling of payments to suppliers and government expectations in this area have tightened up in recent years, fair treatment of suppliers is part of a positive culture and a habit of late payments can be a significant reputation issue as well as an indicator of financial stress.

In terms of raw data, it helps for boards to know that the executive is engaging with a range of stakeholders, and also to have some broad idea of content. Directors need to probe, especially when the stakeholder is significant. For example, the chairman of a regulated company may wish to meet his or her counterpart at the regulator to ensure that the two sides are working together well at the executive level. The board can then help to iron out problems in the relationship. This is different from running a parallel engagement.

It also follows from Section 172 of the Companies Act that the impact on stakeholders should be part of all major board decisions.[7] Boards should insist that all board proposals contain an analysis of stakeholder impact.[8]

Employee surveys

Employee surveys are one of the most widely used indicators. Yet their value may be limited if they are not used carefully. The characteristics of a good survey include:

- An independent approach to setting the questions so they cannot easily be 'gamed' to provide the desired answer. This might include periodic use of an external provider to reinforce confidence in the process. Employees often respond differently if they know that responses are to an independent organisation
- Effective safeguards that will give employees the confidence to respond honestly
- A link between the questions and the organisation's values as well as the inclusion of questions relating to ethical behaviour
- Consistency that enables trends to be discerned
- Commitment by company leadership, including evidence of responding to issues raised by employees. This helps to convince employees that the survey is taken seriously

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[7] See the Corporate Governance reporting requirements (June 2018) https://www.gov.uk/government/publications/corporate-governance-new-reporting-regulations

[8] For further information, see IBE (2016) *Stakeholder Engagement: values, business culture and society*

- Reliable analysis, which demonstrates that data has not been massaged by those with a vested interest in providing a favourable result
- Breakdown of results, which enables directors to see where any particular problems have arisen and whether there is a serious gap between an optimistic management view and scepticism in the broader employee base.

The questions in the survey are critical. One particular question can give valuable insight: does the respondent believe their line manager complies with the company's code of ethics and what is the evidence for this response? A significant number of negative answers suggests a serious problem, especially when the management says it believes that there is no gap between its expectations and reality.

Even a well-constructed survey, however, is only conducted periodically and will only give a lagged response to changes in morale. Some companies undertake more frequent 'pulse' surveys on specific issues as they arise. This gives a more timely view of employee opinion, but is at the cost of the consistency that enables the board to discern key trends.

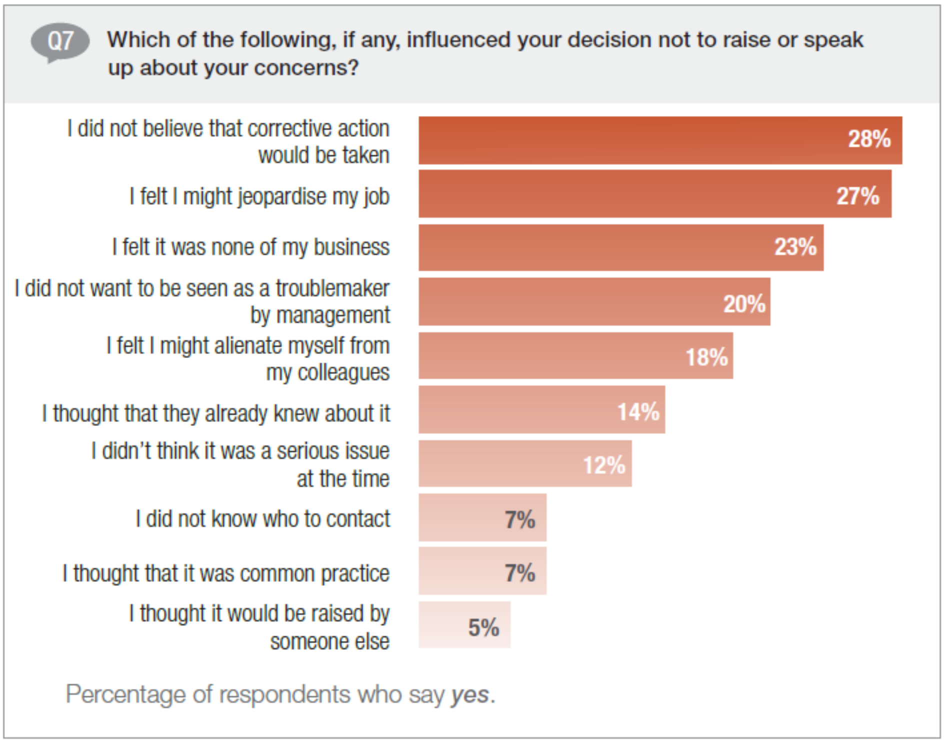
In analysing the results of the employee survey, it is useful to triangulate the message with other data. In the human resources sphere, other indicators may include staff turnover, exit interviews and absenteeism rates.

Speak Up arrangements

Reliable Speak Up arrangements[9] are an important support for a board and senior management. However, it is not always easy to tell whether the arrangements are effective. In terms of raw data, the numbers of calls to the system may fluctuate for a number of reasons. Increased anxiety by employees that they may face reprisals for speaking up will cause the volume of calls to fall, but the same effect might be felt as a result of a more open culture in which employees did not feel the need to call the hotline. Alternatively, the volume of calls may fluctuate in line with employee familiarity with and confidence in the process.

The IBE's *2018 Ethics at Work*[10] survey illustrates how fragile employee confidence in Speak Up procedures can be. A third of European respondents who had witnessed misconduct in the past year were asked whether they had raised their concern. The 43% who had not raised concerns were asked what those barriers to speaking up were.

[9] For further information, see IBE (2017) *Encouraging a Speak Up Culture*
[10] IBE (2018) *Ethics at Work: 2018 Survey of Employees: Europe*



As with most indicators of culture, it is important to look behind the figures. Key questions for boards relate to how Speak Up arrangements are organised and managed, as well as the use being made of them.

To be effective, Speak Up arrangements must:

- Provide confidence to the employee that their identity will be protected
- Ensure that those who speak up are listened to and as far as possible are informed of action taken as a result of their initiative
- Ensure that employees who speak up are protected against reprisals

Codes of ethics

Companies are increasingly introducing codes of ethics, which set out what they expect of their employees and offer guidance in decision-making in line with the company's ethical values.[11]

It can be hard for boards to judge whether their code of ethics is effective. Having a code, however carefully designed, will make little difference if employees are scarcely aware of its existence or no effort is made to keep it alive.

[11] For further information, see IBE (2016) *Codes of Business Ethics: a guide to developing and implementing an effective code*

Boards need to understand how to implement and embed a code. Some questions include:

- How frequently are employees asked to confirm that they have read the code and are aware of its contents?
- How frequently are employees trained in the code and its expectations? Does the senior management receive such training? Does the board receive it? Training the board provides a good example to employees and keeps board members in touch
- Is compliance with the code a part of each employee's annual appraisal? Is promotion of the code a part of each manager's and line manager's annual appraisal? This can reveal how well knowledge of the code is cascading down and which managers are failing to deliver
- Is there a question on the code in the employee survey?
- How many employees have been disciplined or fired for non-compliance with the code? Note that the answer to this needs careful interpretation. No disciplinary action at all is scarcely credible for a large group. A lot suggests the code is not working properly.

Staff turnover rates

Staff turnover rates have attracted increasing attention in recent years. Academic authors such as Alex Edmans of the London Business School[12] have shown how a happy workforce can produce higher financial returns over time. Shareholders have also become interested, both as part of their quest for sustainable long-term returns and because of the reputational damage – and therefore loss of value – that can accrue to companies where staff are poorly treated.

Once again, however, the raw data may not mean very much. In some companies, especially those employing large quantities of unskilled labour, a high staff turnover may be normal and expected. There may also be specific reasons why large numbers of employees may be leaving, for example a restructuring or decision to outsource. Data on staff turnover is useful but needs to be seen in context. It also helps to triangulate it with other data, such as:

- Comments on social media sites such as Glassdoor
- Absenteeism rates
- Exit interviews
- Grievances and disputes leading to tribunals
- Industrial disputes.

[12] See European Corporate Governance Institute (2014) *Employee Satisfaction, Labour Market Flexibility and Stock Returns around the World*

Some work here could usefully be performed by internal audit.[13] There are mixed views on the value of exit interviews, for example, and much depends on the way in which they are conducted. Some companies find them useful, even though the IBE's survey data shows that boards do not currently pay much attention to them.

Finally, a particular risk arises when a company decides to outsource activities or employ a lot of casual labour or people on zero-hours contracts. Boards need to monitor this closely because of the reputational damage that can arise when workers are felt to be have been treated unfairly.

Health and safety

For many companies, health and safety is a critical indicator. The leadership wants to protect its employees from harm and the reputational damage of not looking after them can be very great, even more so where customers run the risk of harm. Besides, a caring attitude is critical to a good culture. Health and safety is less important in some sectors, for example in the financial sector where employees may not be much exposed to physical risk. In this sector the focus may be on conduct risk, but health and safety still cannot be neglected. The incidence of mental health problems, work-related stress or even suicide in high-pressure financial firms needs to be watched.

Board discussion about health and safety needs to do more than chart the number of incidents. The issue is not just about what has happened but why, and whether sufficient safeguards are in place. Questions around this include:

- Is the board informed of all fatalities and is each one investigated at board level?
- Is the board informed of all incidents that might have led to fatality and/or serious injury? How does the board respond when confronted by a negative trend?
- Does the board monitor the company's performance compared with its peers, bearing in mind potential differences in the calculation of data?[14]
- Does internal audit monitor the reporting of incidents to ensure that they are timely and complete?
- Do directors and senior managers set an example by visibly conforming to safety standards, for example, by wearing hard hats when 'on site'?
- Does the senior management monitor breaches of health and safety procedures? How are they dealt with?

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[13] See IBE (2015) *Checking Culture: a new role for Internal Audit*

[14] UK companies report on health and safety according to Incidence Rates (including RIDDOR rates) and/or Frequency Rates. This means that data is not necessarily comparable between different companies or sectors. The UK Health and Safety Executive (HSE) provides full explanations of each type of metric at www.hse.gov.uk.

- Are the board monitoring the trend of instances and responding accordingly?

Boards have to strike the right balance, bearing in mind that a ‘no blame’ culture can be helpful for those who do acknowledge mistakes. There is a connection here with Speak Up and whistleblowing. Ideally, employees should feel confident enough to raise health and safety issues they have encountered in the workplace. If this is not the case, employees need access to Speak Up arrangements they can trust.

Summary

The level and direction of debate over the last couple of years leaves little doubt that culture matters to companies. The way employees behave and the way the company relates to the outside world can have a profound bearing on its reputation and thus on its franchise.

Monitoring culture frequently involves oversight of processes. For example, boards need to know if their Speak Up or whistleblowing arrangements are fit for purpose and whether they are operating in the intended way. This involves a qualitative judgement as well as a selection of quantitative indicators. Directors need periodically to gain some first-hand experience as part of their site visits and other familiarisation exercises. Without that, it is very difficult to judge the data the board receives. A real sense of ownership by the executive – manifested by a personal approach to presenting the papers – is a sign of a positive culture. If the executive is distant from the board, it is likely to be distant from employees and other stakeholders as well.

An important part of board oversight of culture involves assessment from first-hand observation. The demeanour of the chief executive, the degree to which they embody the desired values, and the way in which the management engages with the board, speaks volumes. Equally, the board needs to get out and about within the company to test how culture is being embedded further down the organisation.