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Managing corporate culture

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Corporate culture – why does it matter?

In December 2017, a practical guide titled "Managing Culture - A Good Practice Guide" (**Guide**) was jointly produced by the Institute of Internal Auditors Australia, The Ethics Centre, the Chartered Accountants Australia & New Zealand and the Governance Institute of Australia.[1] In light of the heightened regulatory focus on corporate culture and conduct, this timely publication provides helpful and practical insights for all organisations on building and maintaining a sound corporate culture.

KEY TAKEAWAYS

There has been an increased focus on corporate culture and conduct by regulators around the world.

Culture plays a key role in the success of a business in terms of financial performance and ability to meet its business objectives.

An ethical framework which is underpinned by the organisation's purpose is a practical way to guide decision-making at all levels.

The board, management, human resources, internal auditors and external auditors of an organisation all play separate and important roles in setting a clear ethical framework and embedding it effectively within the organisation.

Regulatory landscape

Recent years have seen a noticeable decline in public confidence in financial institutions and an intensified regulatory focus on conduct issues. Most recently, a Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry was established, whereby the conduct, practices and behaviour of financial institutions will be scrutinised.

The Banking Executive Accountability Regime, proposed to commence on 1 July 2018, further demonstrates the federal government's efforts in addressing community concerns around corporate culture in the financial services sector.

The Australian Securities and Investments Commission (**ASIC**) has identified, as key risks in 2017-2018, culture and conduct in financial services resulting in poor outcomes for investors and consumers.[2] ASIC considers that poor culture can drive poor conduct. In its regulation of "risk culture", the Australian Prudential Regulation Authority (**APRA**) places certain requirements on the boards of APRA-regulated institutions which include authorised deposit-taking institutions and general insurers.[3] For instance, boards are effectively required to formulate the entity's risk appetite, form a view of its risk culture, identify any desirable changes to the risk culture and ensure those changes are addressed. Boards are also directed to ensure that senior management "monitor and manage all material risks consistent with the strategic objectives, risk appetite statement and policies approved by the board".

With the increased regulatory focus on culture and governance practices, it is important not only for financial institutions but all entities to establish and maintain a sound corporate culture.

1 Full text of the publication is available at http://iia.org.au/sf_docs/default-source/default-document-library/424_managing-culture-a-good-practice-guide_v8.pdf?sfvrsn=2.

2 Australian Securities and Investments Commission, 'ASIC's Corporate Plan 2017-18 to 2020-21', August 2017. <http://download.asic.gov.au/media/4439405/corporate-plan-2017-published-31-august-2017-1.pdf>

3 Australian Prudential Regulation Authority, 'Prudential Standard CPS 220 Risk Management', July 2017.

Culture – what is good and what is bad?

Culture generally encompasses an organisation's shared values, principles and behaviours. It can be discerned from its main instruments such as policies, work processes, risk frameworks and organisational structure, its espoused values and principles and its day-to-day practices.

It is important to recognise that all roles and individuals within an organisation contribute to corporate culture. Culture is not merely shaped by the board and/or senior management, but is influenced by the character of the individuals who make up the organisation.

Drivers of good culture include:[4]

- tone from the top;
- cascading values to the rest of the organisation;
- translating values into business practice;
- accountability;
- effective communication and challenge;
- recruitment, training and rewards; and
- governance and control.

Indicators of culture failings include:[5]

- pursuing short-term financial interests with little or no consideration of customer interests;
- treating risk management processes and/or controls as inconveniences which can be disregarded when it is expedient to do so;
- poorly defining management accountability for risks;
- failing to take timely actions to mitigate significant risks; and
- concealing problems rather than resolving the underlying causes of the problems.

Impact of corporate culture on business performance

Any business should be concerned with culture because it translates into tangible financial benefits through customer brand loyalty, increases shareholder value and can mitigate against conduct risks. Culture is also critical to an organisation's overall ability to achieve its objectives. Preliminary results of a current study being undertaken of ASX200 companies over the last 5 years suggest a "clear correlation between conduct and share price".[6]

As corporate culture inevitably shapes the day-to-day conduct of companies, directors' duties under the *Corporations Act 2001 (Cth)* may require the engagement of directors on issues of corporate culture.[7]

4 'Why culture matters', a speech by Greg Medcraft, Chairman, ASIC at BNP Paribas Conduct Month (Sydney, Australia), 24 May 2016

5 Australian Prudential Regulation Authority, 'Information Paper – Risk Culture', October 2016.

6 Durkin, Patrick, 'ASIC's culture crackdown puts boards on high alert', Australian Financial Review, 11 January 2018.

7 For example, see ss 180, 181, 182 and 183 of the *Corporations Act 2001 (Cth)*.

Steps to build a sound corporate culture

The Guide recommends an ethical framework that serves as a point of reference in decision-making, rather than prescriptive rules (e.g. in the form of a code of conduct) that will not cover every possible scenario. The framework, reflecting the entity's purpose, values and principles, will then give shape to its organisational culture.

The Guide offers useful insights on building a sound corporate culture:

1. Identify the organisation's desired culture and formulate an ethical framework to guide decision-making at all levels. This framework should align with the defined purpose of the organisation and be core to the governance framework. It should also be practical, authentic, stable and comprehensible to those required to actually apply the framework.

2. Assess all aspects of the organisation to ensure alignment with the framework by way of surveys, dashboards, interviews, focus groups and/or an in-depth review of policies and procedures. Any misalignment requires sound justification and approval.

3. Embed the ethical framework throughout the organisation so that it is reflected in its business strategy and model, policies, procedures and practices. The diagram below shows how each of the following roles can assist in translating the desired culture set at the top into actual practices of the business:

The board/directors

Set the right tone and retain oversight of how it is being implemented in practice.

Management

Design and implement the desired framework as well as conduct regular monitoring. This may involve running training programs, conducting due diligence, measuring and reporting back to the board.

Human resources

Ensure consistent communication of the desired culture throughout the organisation and formulate appropriate remuneration plans that take into account productivity and output as well as alignment to desired behavioural aspects.

Internal audit

Assess objectively and independently whether the desired culture is being clearly articulated and communicated within the organisation, whether it has been embedded into all business units, how culture is being monitored and whether there are any misalignments between the desired culture and the actual culture.

External audit

While external auditors are not generally required to assess culture, an understanding of the entity's culture is likely to form part of their audit work in terms of assessing the risk of fraud. Given their unique perspective, it is suggested that they collaborate with the board, human resources, internal audit and risk management personnel to identify misalignments on cultural aspects before they cause any significant impact on the entity's viability.

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