



WHAT DO BOARDS NEED TO KNOW ABOUT CORPORATE CULTURE?

- Boards can help foster long-term shareholder value by deepening their understanding of their company’s culture, placing it on the board agenda and ensuring management is forging a culture aligned with the business strategy.

Corporate boards continue to become more engaged, independent and effective stewards of business performance and shareholder value. In the past decade, boards have recognized the need for greater board oversight of critical levers of business performance such as strategy, risk, major transactions and “people” — including succession planning and executive compensation. And they have adopted more rigorous and transparent processes around these levers.

One lever of performance, however, rarely appears on board agendas: culture. Despite its sizable contribution to business results, few boards oversee culture with anything like the rigor they do strategy, risk or CEO succession planning.

A company’s culture can make or break even the most insightful strategy or the most experienced executives. Cultural patterns can produce innovation, growth, market leadership, ethical behavior and customer satisfaction. On the other hand, a damaged culture can impede strategic outcomes, erode business performance, diminish customer satisfaction and loyalty, and discourage employee engagement.

If “culture eats strategy for breakfast,” as the saying goes, why then are boards not more actively engaged in its oversight? We see several reasons for this:

- > **Lack of board ownership.** No one exerts more influence over corporate culture than the company’s leaders. The CEO and management team own culture, not the board. As a result, boards tend to give the issue of culture a wide berth, expecting the CEO to raise cultural issues when needed.
- > **Lack of board visibility into the culture.** Directors rely on the management team to bring information about corporate culture to the board. Distant from the day-to-day activities of the organization, it’s not easy for directors to gain a clear perspective on the company’s culture.
- > **Lack of a defined board role.** The board’s role in cultural oversight is not as clearly defined — by rule or practice — as areas such as executive compensation or risk oversight.
- > **Lack of a shared vocabulary.** Without a shared language or framework to discuss culture — or data about the health of the culture — directors and executives don’t know where to start or how to have a productive conversation about it.

Nonetheless, boards can help foster long-term shareholder value by deepening their understanding of culture, placing it on the board agenda and ensuring management is forging a culture that is aligned with the business strategy. Boards that want to improve their oversight of this important performance lever can work with the management team to define the current culture and understand how it does and does not support the strategy.

In our work with boards, we have found that having a framework for understanding organizational culture is critical to this effort. Boards can ensure that the CEO and executive team have the cultural fluency needed to define culture, and that they are attentive to culture and its impact on business performance. To this end, boards may decide to consider an executive’s ability to manage culture as part of individual performance reviews and the succession planning process. Just as they evaluate the soundness of the business strategy and challenge its underlying assumptions, boards should be willing to spark discussion about the need for culture change when necessary. Finally, directors should consider how their own actions and behaviors contribute to the culture and whether they are modeling the desired behaviors.

Spencer Stuart has found the following questions to be powerful in helping directors better understand culture and ensure the company is on the right path when it comes to culture.

What IS the current culture of the organization?

Culture is not the aspirational values posted on the break room wall. Culture is the culmination of the shared values, beliefs and assumptions that shape the behavior of the organization. These “unwritten rules” guide the thousands of decisions employees throughout the company make every day. Boards should ask: What ARE those unwritten rules that everyone just knows but can’t necessarily articulate clearly?

How well-aligned is our corporate culture with our strategy?

A high-performing organization with a strong alignment between culture and strategy produces more financial growth and better employee engagement. By contrast, a troubled or misaligned culture can result in prolonged underperformance by the business or specific business units, low levels of customer satisfaction and loyalty, internal conflicts and poor employee engagement. Boards can probe on the health of the culture by asking questions such as: What organizational behaviors are required to achieve our strategy — keeping in mind that culture guides employee behavior? How well do we demonstrate those behaviors today? What do we measure to understand the extent to which those behaviors are happening — for example, where product innovation and a learning culture are keys to the strategy, is a larger percentage of revenue coming from new products? What do these findings tell us about our culture relative to our strategy? Where do organizational behaviors open us up to risk?

What is the difference between our current and ideal corporate culture?

Effective leaders can describe both the culture as it currently exists and the culture to which the organization aspires. This ability is sometimes called “cultural fluency,” and it is a critical skill for leading on culture. Board can assess management’s cultural fluency with questions such as: What is the difference between our current and ideal culture? What cultural impediments do we face and how will we overcome them? Where do our most influential people, those who “get” our ideal culture, reside within the organization? Are they being deployed effectively?

How well do our organizational structure and practices support our ideal culture?

Structures, processes and practices exert significant influence on shared behaviors, and business success can be impeded when these are not aligned with the ideal culture. This lack of alignment can become most

apparent when a company is making a change to its organizational structure or processes. For example, a company seeking to centralize core functions in a culture characterized by autonomy, will be at risk. Similarly, a company creating a new role for an “innovation leader” will encounter cultural roadblocks in an organization characterized by order and stability. Boards can better understand the cultural impact of these organizational factors by asking questions such as: When a necessary and thoughtfully planned organization change is not going well, what aspects of the culture could be getting in the way? How might different compensation structures help shape different types of organizational culture over time?

How do we consider culture in our succession plans?

Culture evolves over time. The next set of leaders will drive performance in a cultural context that may not yet exist, and today’s talent management systems, employee evaluations and executive recruiting may or may not contribute to the future corporate culture. Therefore, boards will want to understand how these processes are likely to shape the future culture of the company. In succession planning discussions, directors can ask: To what extent do individuals’ leadership styles contribute to the culture we strive to achieve? Where are there gaps in our leadership capabilities and how will we close them? How does our talent development process advance our ideal culture?

How can we contribute to the right tone at the top?

While board behaviors have less influence on culture than those of the CEO and management team, boards do set a tone at the top which, in turn, has an impact on the company’s culture. Boards should be aware of what the tone is and how they contribute to it. They can ask themselves: How do our boardroom behaviors advance the right tone at the top? What changes would we like to make in our behavior or composition to enhance our contribution to setting the right tone for the company?

Where in the board agenda should we put questions about culture?

As expectations on boards continue to grow, so has the board agenda. Given their current demands, boards are unlikely to tackle questions about company culture unless the issue is explicitly part of the agenda. Because of the importance of aligning culture and strategy, the annual strategy retreat or strategy review may be the right time to discuss culture. To make sure culture is on the agenda, boards can ask: Where on the annual board calendar should culture fall? What culture models or frameworks could be useful to adopt? Are we embarking on a period of change — the arrival of a new CEO, a crisis, a new strategy or a merger — that could influence our values and culture?

A FRAMEWORK FOR THINKING ABOUT CULTURE

What role does culture play in the performance — or underperformance — of a business? Whether the goal is to sustain company performance or implement transformational change, the company culture must be aligned with the strategy, the organizational structure and operational practices. Otherwise, performance is likely to suffer and strategic goals will be unmet.

Consider the example of a private-equity-backed global manufacturer of specialized consumer products. Two years into the firm's five-year investment, the company was plagued by stagnant performance and an uncertain identity and struggled with a leadership transition. Although the company strategy emphasized growth through product innovation, our assessment revealed that the company had a culture built around results and stability, more in keeping with a sales and distribution company than an innovative products company. By fine-tuning the strategy, reassigning a few executives as part of a larger organizational restructuring, and promoting a culture that emphasized learning and experimentation, the company got back on track.

Spencer Stuart's framework for assessing organizational culture is rooted in the insight that a surprisingly limited set of rules can result in highly complex and diverse behavioral patterns. Every organization, and every executive, must address the inherent tension between two critical dimensions of organizational dynamics:

- > **Attitude toward change:** Open to change (flexibility, innovation, enquiry) versus manage change (stability, proven processes, control)
- > **Attitude about people:** Independent (individual initiative, self-empowerment, act) versus interdependent (collaboration, power through groups, interact)

A company's culture is defined by WHERE an organization falls on these two dimensions, and this reflects HOW thousands of employees make individual decisions to manage the costs and benefits associated with those tensions over time. Individuals come "pre-wired" for how they deal with other people and with change (e.g., "approach or avoid," "fight or flight").

Applying this insight, our culture model and diagnostic tools help companies understand their current culture, identify the cultural styles that support its strategic imperatives and diagnose how the culture may need to evolve in order to align with strategy.

Conclusion

Corporate culture is one of several critical levers for creating shareholder value — one that many companies underutilize. Boards can do more to help ensure that senior management is effectively monitoring and guiding corporate culture and making the most of this important contributor to business performance. By placing culture on the board agenda and asking the right questions, boards can help to ensure that culture supports business strategy, while preserving the boundary between governance and management.

About the authors

George M. Anderson is a member of Spencer Stuart's Board Practice.

Michael J. Anderson heads Spencer Stuart's Leadership Advisory Services and is a member of the Board Practice.

Jeremiah B. Lee is an expert on organizational culture and is a member of the firm's Leadership Advisory Services group.

Spencer Stuart Board Services

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