Defining Corporate Culture

Directors should understand the role of culture in business performance and whether culture and company strategy are aligned.

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In the past decade, corporate boards have recognized the need to improve their 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, an unhealthy or misaligned culture can impede strategic outcomes, erode business performance, diminish customer satisfaction and loyalty, and discourage employee engagement.

If "culture eats strategy for lunch," as the saying goes, then why then are boards not more actively engaged in its oversight? There are several reasons:

- **Lack of board ownership.** The CEO and management team own the 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.** 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. To this end, boards should understand the cultural fluency of the CEO and the executive team, and consider whether to include executives' ability to manage culture as part of performance reviews and succession planning.

Assessing Attitudes

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.

A 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.** Organizations open to change are flexible, innovative, and inquisitive versus those that prefer to manage change, which are stable, have proven processes, and like control.
- **Attitude about people.** An organization may value dependent individuals—those with initiative who are also self-empowered, or it may value interdependent people—those who are collaborative and thrive on group engagement and interactivity.

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 with the right culture model and diagnostic tools helps companies understand their current culture, identify the cultural styles that support its strategic imperatives, and diagnose how the culture may need to evolve to align with strategy.

A Critical Value Lever

Just as boards evaluate the soundness of the business strategy and challenge its underlying assumptions, they should be willing to spark discussion about the need for culture change when necessary. A framework for understanding organizational culture is critical to this effort. Finally, directors should consider whether their own actions and behaviors are modeling the desired behaviors.

Corporate culture is one of several critical levers for creating shareholder value—one that many companies underutilize. Boards can do more to understand whether 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.

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How to Understand Culture

What is the current culture of the organization? Culture is the culmination of the shared values, beliefs, and assumptions that shape the behavior of the organization—the "unwritten rules" that guide the thousands of decisions employees make throughout the company every day. Boards should ask: What are those unwritten rules that everyone knows but can't necessarily articulate?

How well aligned is corporate culture with strategy? A high-performing organization with a strong alignment between culture and strategy produces more financial growth and better employee engagement. Boards can probe on the health and alignment of the culture by asking questions such as: What organizational behaviors are required to achieve our strategy? How well do we demonstrate those behaviors today? What do we measure to understand the extent to which those behaviors are happening? What do these findings tell us about our culture relative to our strategy?

What is the difference between the current and ideal corporate culture? Effective leaders can describe both the culture as it currently exists and the culture to which the organization aspires, an ability sometimes called "cultural fluency." Boards can assess management's cultural fluency with questions such as: What is the difference between our current and ideal culture? Where do our most influential people, those who "get" our ideal culture, reside within the organization? Are they being deployed effectively?

How well do the organization's structure and practices support the 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. Lack of alignment can become most apparent when a company is changing its organizational structure or processes. For example, a company creating a new role for an "innovation leader" will likely encounter cultural roadblocks in an organization characterized by order and stability. Boards can better understand the cultural impact of organizational factors by asking questions such as: When a necessary and thoughtfully planned organizational change is not going well, what aspects of the culture might 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. Therefore, boards will want to understand how talent management systems, employee evaluations, and executive recruiting are likely to shape the future culture of the company. 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 that, 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? 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 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 (e.g., the arrival of a new CEO, a crisis, a new strategy, or a merger) that could influence our values and culture?