goodcorporation

Measuring Ethical Culture

Contents

Introduction

The culture of an organisation or group consists of the habits of the people in it and the way they behave. [1]

For corporates, therefore, culture can dictate how they operate, who they attract to work for them and how they set out to achieve their objectives. While a good culture can help build a successful organisation, a bad culture can lead to unethical behaviour, regulatory breaches and reputational damage with potentially serious consequences for the company as a whole, the individuals within it and other key stakeholders.

Corporate culture is, therefore, a crucial if intangible asset, one that can effectively determine a company's long-term sustainability, and should be the focus of board attention. Yet very few boards regularly take responsibility for reviewing or assessing their corporate culture, let alone determining whether or not it promotes the right behaviours. This is reflected in a recent survey of FTSE 350 board directors, only 19 per cent of whom felt that the primary accountability for their company's culture sat with them.[2]

> "Directors should lead by example and ensure that good standards of behaviour permeate throughout all levels of the organisation

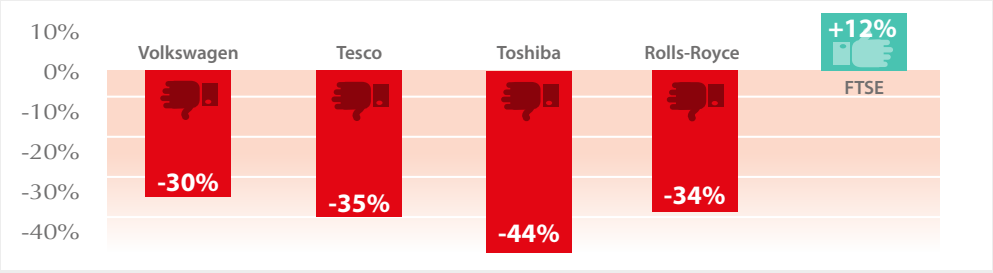
This goes against the UK Corporate Governance Code 2016 which states that "One of the key roles for the board includes establishing the culture, values and ethics of the company [...] The directors should lead by example and ensure that good standards of behaviour permeate throughout all levels of the organisation. This will help prevent misconduct, unethical practices and support the delivery of long-term success."[3] In its 2016 report, *Corporate Culture and the Role of Boards*, the Financial Reporting Council (FRC) goes one step further, arguing that "boards should devote sufficient resource to evaluating culture and consider how they report on it."[4]

In evaluating culture, boards need to consider a number of factors. First, what is the nature of the organisation's culture? This should take account of mission, values, goals, work environment, communication, collaboration, hierarchy and so on. The board should also ask if that culture is ethical. How do people behave? Do the decisions taken promote good and responsible corporate conduct? And, of prime importance, does the culture support the business's objectives?

The link between unethical culture and commercial failure has never been more apparent. Volkswagen's 'diesel-gate' scandal is undoubtedly one of the most high-profile examples, but Tesco, Toshiba and Rolls-Royce have also been exposed for unethical conduct in the last five years. In addition to fines and reputational damage, the long-term impact on share price shows that shareholders can be the biggest losers when corporate culture fails.

The graph below illustrates this reduction in share price compared to the pre-crisis peak, well below the index which saw a rise of 15 per cent over the comparable period.

Reduction in share price - pre-scandal peak to May 1st 2018



In our view, the ethical component of corporate culture is vital. An analysis of the Volkswagen scandal published in *Fortune* magazine in 2016 argued that "VW is driven by a ruthless, overweening culture […] the company was run like an empire, with overwhelming control vested in a few hands, marked by a high-octane mix of ambition and arrogance—and micromanagement—all set against a volatile backdrop of epic family power plays, liaisons, and blood feuds. It's a culture that mandated success at all costs." [5]

The danger is that a culture that focuses on 'success' at all costs, might in fact be planting the seeds for its longer-term failure. Long-term business success is, in fact, much more dependent on the organisation's underlying ethical culture. There is no question that some organisations are able to do very well financially for long periods of time, with a poor culture. However, the risks for shareholders are obvious. In the end, long-term success cannot be guaranteed where culture is poor.

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As Mark Carney, Governor of the Bank of England, said of the banking sector in 2014,

"the succession of scandals means that it is simply untenable now to argue that the problem is one of a few bad apples. The issue is with the barrels in which they are stored."[6]

Despite this, companies are still failing to measure and report on culture.

A recent survey of FTSE 350 companies found that 88% of organisations did not provide detailed information on culture in public filings or annual reports.[7]

It seems hardly surprising, therefore, that 81% of investors at a recent Ernst & Young event said they did not believe companies provided sufficient information for them to be able to assess their corporate culture.[8]

Reporting on culture

> Boards should seek assurances about the health of the culture by taking the temperature of the organisation on a regular basis

Building on the conclusions of its 2016 *Corporate Culture* report, the FRC argued in its recent consultation on the Corporate Governance Code that 'in order to establish an appropriate culture', the board must 'consider the type of behaviours it wishes to promote'. [9]

Appendix B of the consultation states that "boards should seek assurances about the health of the culture by taking the temperature of the organisation on a regular basis. This means gathering evidence by monitoring chosen indicators [...] to gain insights into the overall culture". [10]

This chimes with the growing demand from shareholders for corporates to provide evidence of long-term sustainability in their public reporting. With poor culture perceived to be a business risk in itself, it seems clear that the demand for effective reporting on culture will only grow. A common reporting framework is yet to be developed, despite board recognition that culture is important to long-term business success. To meet the likely new reporting requirements and the demands of shareholders, a methodology for reporting on culture needs to evolve. This raises a critical question.

Can culture be measured?

As the Institute of Business Ethics (IBE) acknowledged in its recent Board Briefing *Culture Indicators: Understanding corporate behaviour*[11], culture cannot easily be measured. However, boards do have access to a range of information that can shed light on the culture of their organisations. In its briefing, the IBE outlines the existing data that are indicators of culture and how to interpret them in order to produce an authentic picture.

They are not the first to suggest that culture can be measured. In 1998, Linda Treviño, Kenneth Butterfield and Donald McCabe established a framework against which the ethical culture of an organisation could be measured.[12] They developed a 14-item measure of a company's overall "ethical environment", including its culture, but concluded that more research was required "to refine the ethical culture measure, to make it more applicable".[13]

Muel Kaptein established an eight-point "Corporate Ethical Virtues Model" for the measurement of an organisation's ethical culture, with a corresponding 58-item self-reporting questionnaire, in 2007.[14] However, this model was intended mainly as a research tool for further study and self-audit, rather than for objective, third-party analysis.[15]

Employee surveys

Many large businesses choose to undertake employee surveys to measure culture. This approach may be tailored to the company or use a publicly recognised accreditation format, such as the Great Place to Work Survey, which compares surveys of management style with surveys of employee perception,[16] or the "Best Companies to Work For" lists published by *The Sunday Times*.[17]

Other approaches use a non-accreditation-based employee survey format such as PwC's Culture Surveys and Assessment or Ethisphere's Ethical Culture & Perceptions Assessment.[18]

Others favour entirely online canvassing and training, such as the Ethical Systems Culture Measurement Tool which uses a collection of online 'modules' vetted by social and behavioural scientists.[19]

Some provide more traditional confidential whistleblowing services but combine these with action planning designed to improve the cultures which give rise to complaints, such as the RiskClarity tool developed by Corporate Executive Board (CEB), now Gartner.[20]

These surveys certainly touch on elements of ethical culture, but their focus tends to be on how employees are treated. While this may provide a view on whether or not the organisation is a good place to work, such surveys do not focus sufficiently on ethics issues that affect other stakeholders or the organisation's decision-making.

"These surveys certainly touch on elements of ethical culture, but their focus tends to be on how employees are treated . . . and do not focus sufficiently on ethics issues that affect other stakeholders or the organisation's decision-making

As such, they are less useful for shareholders and boards as indicators of potential ethical failure and/or risk to the business. An organisation, could have very good employee engagement scores from surveys while at the same time playing host to underlying cultures that do not promote ethical behaviour. For example, employee reviews on the workplace review site *Glassdoor* described VW as similar to other car companies at the time of the diesel-gate problem, illustrating that this type of feedback may not be good enough if a board is trying to identify a cultural problem.[21]

Employee net promoter scores (eNPS) - building on the measurement system more commonly used for brand loyalty - are also used to measure the willingness of employees to recommend their employer to friends and family. Again, this is a useful indicator and boards should consider reporting this metric if it is available. However, it lacks direct measurement of ethical issues.

The Ethical Culture Healthcheck

> According to a study published last year, only 23% of FTSE 100 companies provide shareholders and other stakeholders with a measure of their ethical standards

While this range of approaches is still developing, it is clear that to date no definitive methodology has emerged that is widely recognised as a reliable measure of business culture.

Perhaps for this reason, the abundance of culture 'buzz-words' in the annual reports of the FTSE 100 companies stands in stark contrast, not only to the ethical scandals some of these companies suffer within the same year, but also to their lack of any concrete system for measuring the ethics of their culture. According to a study published in 2017, only 23 per cent of FTSE 100 companies provide shareholders and other stakeholders with a measure of their ethical standards, despite 94 per cent stating a commitment to high ethical standards in their annual reports.[22] A review of how these companies have undertaken the task of measuring ethical standards reveals that many are reporting on code of conduct training and similar metrics, which are poor indicators of ethical culture and unlikely to help the board to spot an emerging serious issue.

Although many of the approaches described above acknowledge that stakeholder feedback is critical to culture measurement, they do not provide a consistent measurement of whether or not a company's culture is ethical.

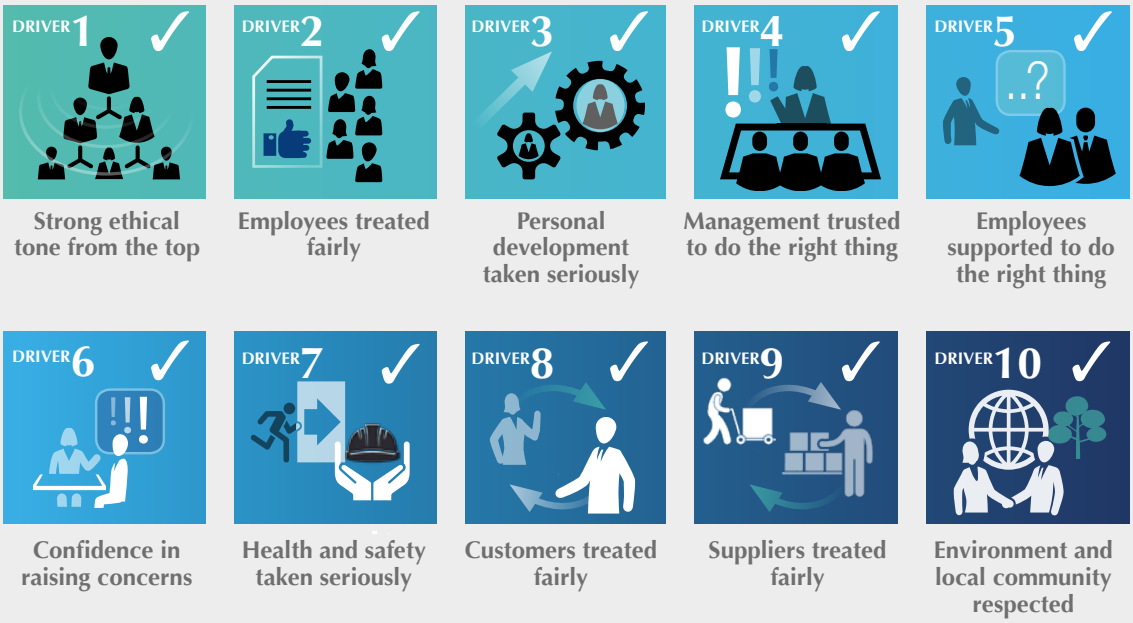
Unless culture measurement analyses behaviour on the ground, the values, conduct and ethics of the organisation, it will not help boards or investors understand how an organisation conducts its business. Nor will it provide an indication of the likely risk of scandal or misconduct.

GoodCorporation has developed an approach to ethical culture measurement that provides organisations with key performance indicators of a robust ethical culture that can help predict the kind of ethical scandal which could damage their reputation and their bottom line.

Established in 2000 with the aim of driving up standards of behaviour in business, our expertise lies in checking and measuring corporate behaviour. Since our foundation, GoodCorporation has conducted tens of thousands of stakeholder interviews as part of our assessments of ethical and responsible corporate behaviour. These interviews have mostly been conducted face-to-face as part of over 600 assessments for hundreds of companies in over 70 countries. We have used this experience to identify **ten key drivers** which determine ethical behaviour and underpin sustainable success.

> GoodCorporation has conducted tens of thousands of stakeholder interviews as part of our assessments of ethical and responsible corporate behaviour

The ten key drivers



From these drivers we have identified 25 key culture statements which are used to undertake an **Ethical Culture Healthcheck.**

Face-to-face interviews are carried out with batches of 50 to 100 employees, depending on the size and complexity of the organisation.

At the start of the interview, employees are asked to complete a short questionnaire, giving one of five possible responses to the 25 statements (strongly agree, agree, don't know, disagree, strongly disagree). This produces the quantifiable data.

The answers are explored in depth during the interview to obtain a more detailed understanding of the employee's perspective. This provides the qualitative analysis.

This approach provides both a practical insight into how a company operates and a means by which possible ethical failures can be identified and prevented.

Our experience suggests that this type of surveying is best done face-to-face and not simply by online polling. The reasons for this are twofold. While most people instinctively believe that online polling is cheap and efficient, our experience is that in many large organisations a face-to-face survey is more cost-effective and significantly faster to deploy. Organisations are often survey weary, with many stakeholders needing to sign off any new polling effort, leading to long delays in launching surveys and obtaining survey feedback. The second crucial reason is that a trained assessor can probe for reasons behind each answer and make a much more comprehensive report to management about how to respond to any negative results.

The quantitative data set resulting from the surveys is analysed to provide a Net Ethical Culture (NEC) score. This is calculated by averaging the answers to the 25 questions to get an overall percentage of 'agree' and 'disagree' responses. The overall 'disagree' score is then subtracted from the overall 'agree' score to calculate the NEC score.

To create a benchmark [23] against which companies can measure their ethical culture, we have conducted a nationwide study with the polling company Opinium, surveying UK workers on their perceptions of their workplace culture.

Methodology of surveying and analysis

Two thousand employees across all levels of seniority, and from a representative sample of the British workforce, were surveyed.

Questions were developed based on our 25 culture statements and answered using a five-point scale. The analysis below aggregates the two positive responses (strongly agree and agree) and contrasts them with the two negative responses (strongly disagree and disagree). We have also calculated a net ethical culture score. The middle response, 'don't know', has been omitted for the purposes of this report.

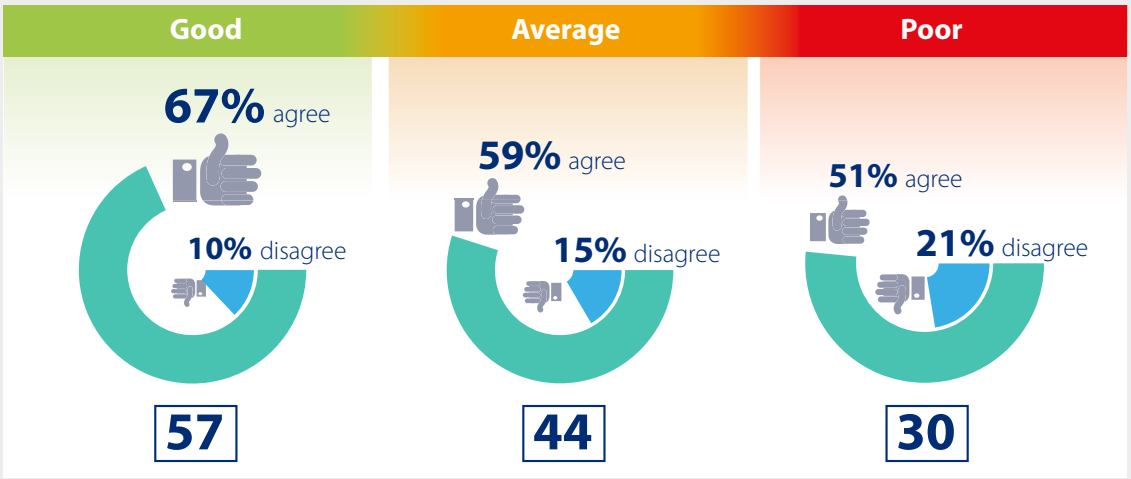
For UK businesses as a whole, the net agree score is 59% and the net disagree score is 15%, giving an NEC score of 44. This type of nationwide survey can be easily repeated for other countries to provide a clear culture benchmark for each country in which an organisation is working.

Calculating the UK's net ethical culture (NEC) score

Adding up ethical culture

By analysing the survey results, we have created a benchmark against which a company's ethical culture can be judged good, average or poor.

UK businesses – corporate culture benchmark



As shown in the chart above, the average across all of the 25 questions shows 15% 'disagree' and 59% 'agree'. We have assumed a normal distribution for these results and taken a standard deviation of these answers both 'up' and 'down' to give the good culture and poor culture charts above. A 'good culture', for the purposes of our benchmark, would have an average 'agree' response of 67% and an average 'disagree' response of 10% in relation to our 25 supporting statements. A 'poor' culture would be one in which only 51% of employees 'agree' with these statements and 21% disagree.

Any organisation following this methodology would be able to benchmark their own culture against these scores, providing a meaningful measurement for a board or senior management team.

UK ethical culture survey results

There are a number of indicators to suggest that many workers feel a strong ethical culture is embedded in their workplace. However there are also a number of areas that give cause for concern.

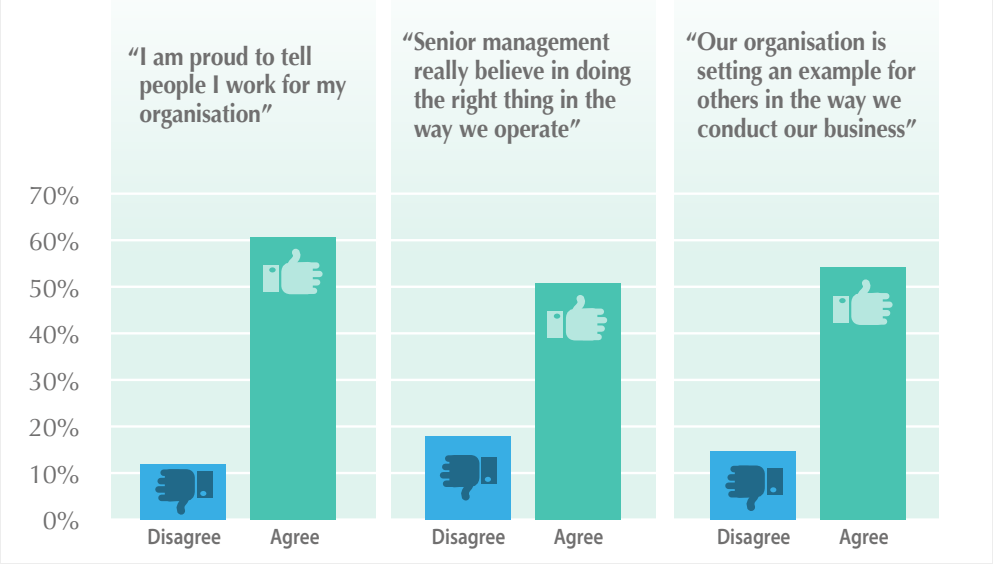
Strong ethical culture led from the top

Three fifths of UK workers think their organisation has a strong ethical culture (59%) and are proud to tell people who they work for (60%).

This sentiment is stronger among 18-34 year-olds, 63% of whom feel that their organisation has a strong ethical culture. Workers in not-for-profit organisations had the strongest sense of an ethical culture at 75%. Similarly, 66% of younger workers (18-34 years old) say that they are proud of their organisation compared to 59% of employees over 55 years old.

Younger employees are more likely to believe that their organisation sets an example in terms of good conduct (58% compared to 50% of employees over 55 years old).

Tone from the top



However, while these figures may be encouraging, the survey also found that a fifth of employees in the UK feel their organisation does not value their opinions and would not actively seek them. This is even higher when it comes to unskilled workers, with 40% saying their views are not actively sought.

Doing the right thing

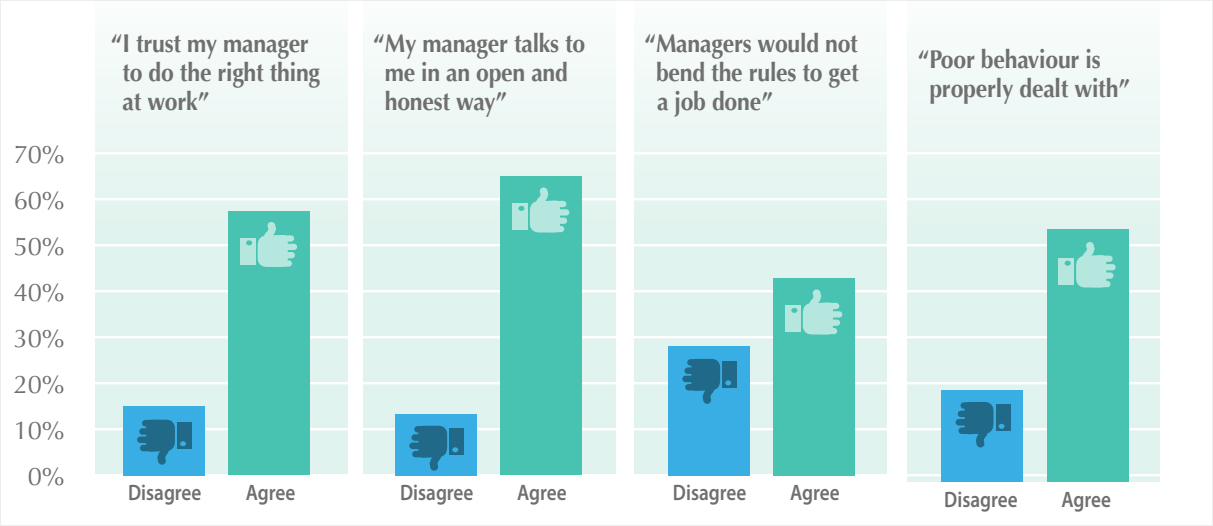
While almost two thirds (64%) feel that their managers communicate in an open and honest way, it is of some concern that only half the respondents felt that senior managers really believe in doing the right thing, with 18% disagreeing. Of equal concern is the fact that over a quarter (27%) think that managers would bend the rules to get a job done.

There is a contrast between older and younger workers. For example, 63% of younger workers (18-34 years old) trust their managers to do the right thing compared to only 53% for the over 55s. Younger workers also report that managers talk in an open and honest way (69% compared to 58% for older workers).

Similarly interesting is the finding that 20% of the UK workforce disagree that 'poor behaviour is properly dealt with'. This finding corresponds with our face-to-face fieldwork. We find that, in many companies, one of the areas of greatest frustration is the existence of rules which are inconsistently enforced, leaving employees uncertain about what is and is not really permitted.

Women are more likely to report that their manager talks to them in an open and honest way (67% agreeing compared to 62% for men).

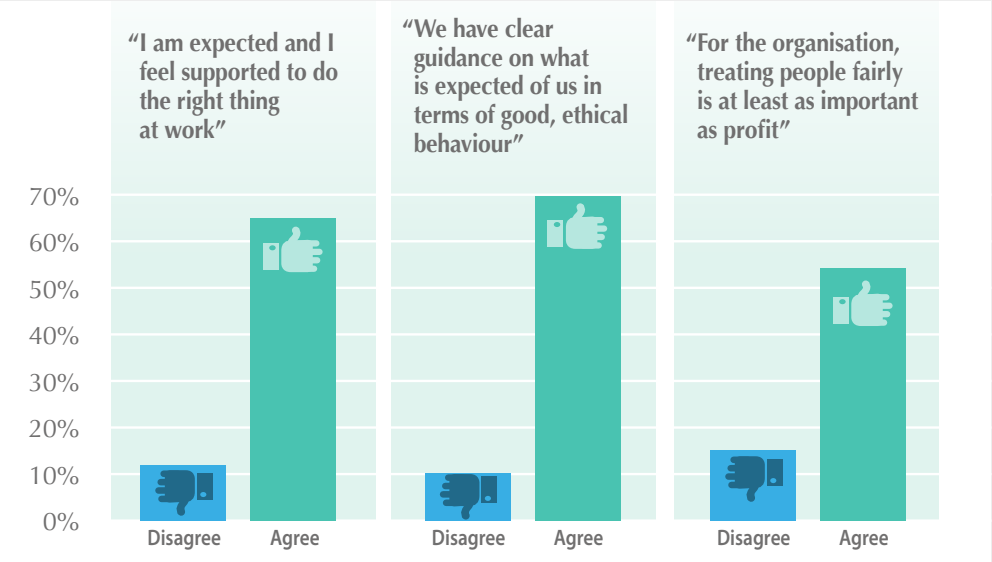
Trust in managers to do the right thing



Employees supported to do the right thing

Employees generally felt well supported to do the right thing, with 70% agreeing that clear guidance is provided in terms of expected conduct and behaviour and 60% agreeing that they are supported to do the right thing at work. The flip side is that there remains a significant minority of employees who disagree with these views and our face-to-face survey work confirms this. We often find that a minority in many organisations report that when they have tried to do the right thing, for example by raising an alert, they are treated poorly as a result or have faced outright retaliation.

Feeling supported to do the right thing



Interestingly, there is a notable difference between men and women in terms of feeling supported to do the right thing at work, with 70% of women agreeing with this statement, compared with 63% of men.

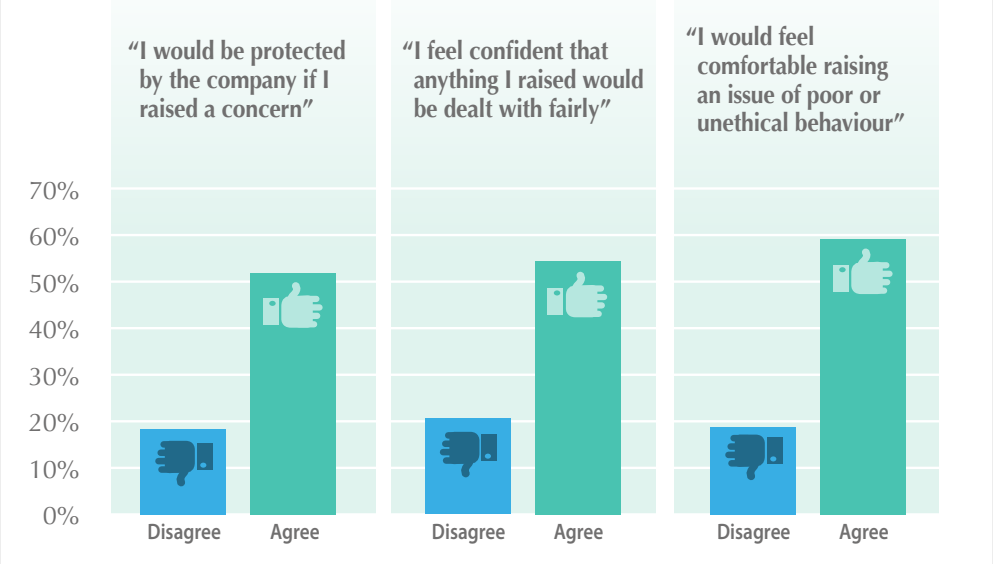
Raising concerns

Indeed, one of the best indicators of a strong ethical culture is the extent to which staff feel able to raise concerns. Organisations with a real commitment to encouraging staff to speak up are more likely to learn of problems early and fix them before they become scandals. While the majority of workers felt able to raise concerns about poor ethical behaviour, this was still only six out of ten (59%). Even more concerning is the fact that 20% of our sample felt that if they raised an issue, it would not be dealt with fairly.

Clearly employers should be looking closely at their management of whistleblowing systems to make sure that their effectiveness is well promoted and robust processes are in place to protect employees who raise a concern. As indicated earlier, in our face-to-face interviews, we find that employees often fear open hostility or subtle forms of discrimination and retaliation from managers if they raise concerns.

Just over a sixth (17%) did not feel that their company would protect them if they spoke out. Failing to handle concerns properly can lead to reputation-damaging headlines, providing very public evidence of a poor culture.

Confidence in raising any issues of concern



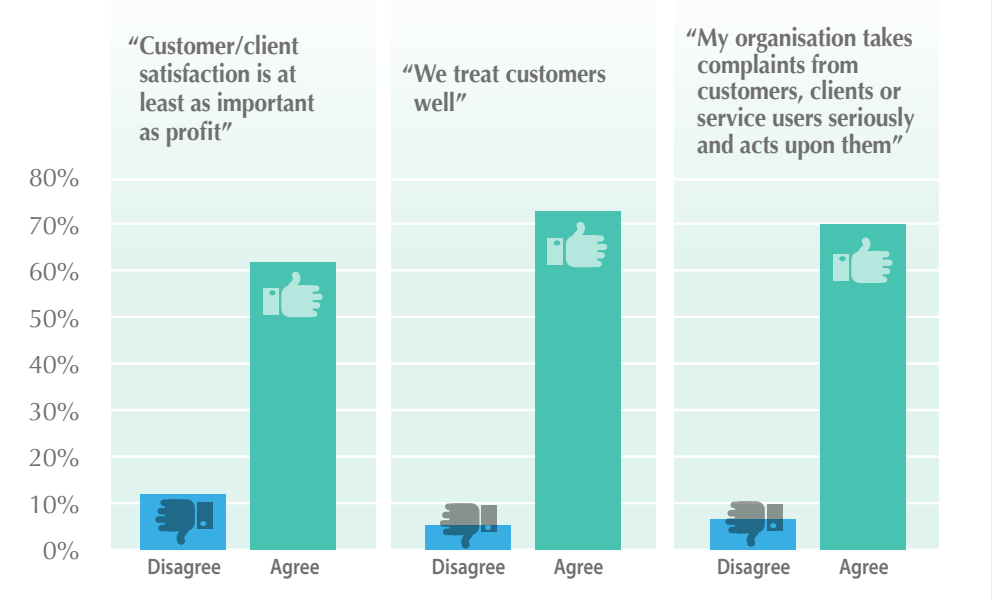
Customer care

When it comes to managing customer relations, organisations score more highly. Over 70% of the workforce agrees that their organisation treats its customers/service users well, with only 5% disagreeing. Customer satisfaction was generally felt to be at least as important as profit; those surveyed were also generally confident that customer complaints would be taken seriously and addressed.

Given the importance of sales and customer care to the bottom line, it is perhaps not surprising that this seems to be an area where organisations have already established good practice and ethical culture scores are high.

> "Over 70% of the workforce agrees that their organisation treats its customers/ service users well with only 5% disagreeing

Treating customers fairly



Community and environmental impacts

The last 25 years have seen the emergence of corporate social responsibility as a discipline with many organisations focusing formally on their community engagement. Our face-to-face interviews, conducted as part of our business ethics assessments, confirm that the inclusion of employees in community programmes is a strong motivating factor and can be an indicator of good culture.

Similarly, care for the environment and the local community matters. In our survey, nearly six out of ten (57%) felt that their organisations do care about these issues, although about 12% disagree.

There is an age-divide in this area: 62% of younger workers believe that their organisation cares about its environmental and societal impacts compared to 53% of those aged 55 or over.

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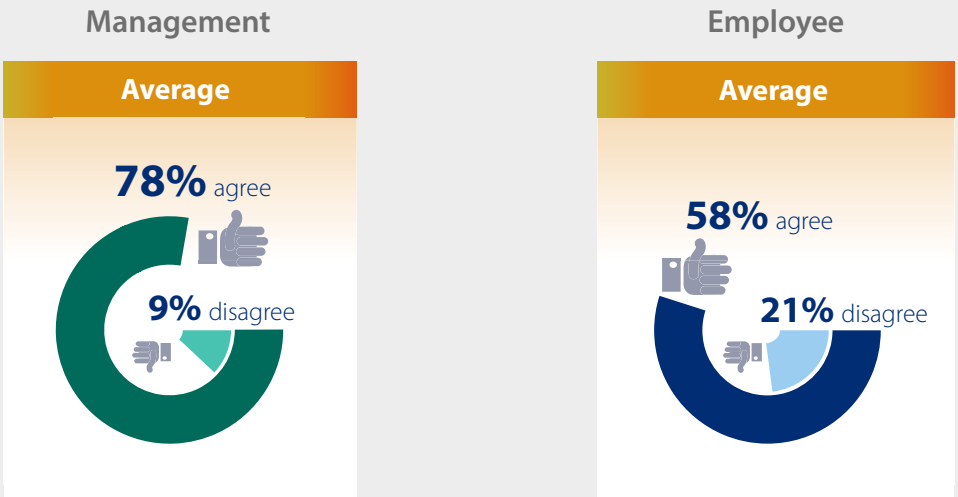
Understanding employee and management culture

One of the most striking findings was the difference in response between managers and employees. Managers display an attitude which is significantly more positive about their company's ethical culture than employees. Analysing the 308 senior management responses and those of 1,378 employees, we were able to see how perceptions of culture vary inside and outside the management level, with managers around twenty percentage points more likely to agree that their organisation has a strong ethical culture than employees.

Perception of culture



Source: UK Workforce Survey, conducted by Opinium for GoodCorporation, 2017. Agree/disagree number is the average response from the 25 key questions

We might expect some difference between the two groups, as managers would be expected to have a greater sense of corporate ownership. In our view, however, companies should be studying this gap carefully and looking at the specific areas across the 25 culture statements where these differences are largest. A strong ethical culture should permeate the whole organisation, but should be driven by management. By identifying and reducing any such gap, organisations should be able to improve their ethical culture significantly.

In our UK-wide survey, the area of largest disparity between management and employee opinion is, perhaps not surprisingly, personal development, with a much stronger 'agree' rating from management compared to employees. The second is the statement that 'treating people fairly' is at least as important as profit.

Size matters

Size also proved significant when it came to establishing an ethical culture. There are marked differences in terms of perceptions of ethical culture between large companies (with more than 5,000 employees) compared with all others. Micro organisations with up to ten employees and small companies with up to 50 employees are generally seen as having stronger cultures. For example, employees in micro (73%) and small businesses (68%) are more likely to report being proud of their organisations than large organisations (57%). Similarly, employees are more likely to report being treated with respect in micro organisations (76%) and small organisations (75%) than in large organisations (67%).

Employees are more likely to feel appreciated in micro (67%) and small organisations (66%) compared to large organisations (50%). Employees are also more likely to report being supported to do the right thing in micro organisations (76%) and small organisations (71%) than in large organisations (63%).

This pattern is repeated across all of the ten ethical drivers and most of the 25 culture statements. This suggests that larger organisations have more to do in terms of ethical culture and need to learn the lessons from smaller organisations in order to improve. This may include allowing more local decision making and autonomy to replicate the cultural strengths found in smaller organisations.

Conclusion

The results of our Opinium survey provide a benchmark against which organisations can measure the strength of their ethical culture using an Ethical Culture Healthcheck. Our measurement system enables boards to risk-assess culture in a way that enables weaknesses to be identified and progress to be measured.

By producing a net ethical culture score, we are providing organisations with data that can be used for management reporting, internal monitoring or published in annual reports or viability statements as a non-financial key performance indicator. They can also be used for benchmarking purposes with the quantitative data set analysed to provide scores for each driver and statement. This can then be used to create an ethical culture dashboard as part of a management or annual report and monitored over time.

We believe that our approach enables organisations to assess culture in a way that can strengthen and protect the business while also enabling companies to meet the growing demand for effective measurement and reporting on organisational culture.

Endnotes

1 See "culture" in *collinsdictionary.com* available online at https://www.collinsdictionary.com/dictionary/english/culture (accessed 27 October 2017)

2 Ernst & Young, *Is Your Board Yet to Realise the True Value of Culture?*, 2016, p.5

3 The UK Corporate Governance Code, 2016, p.2

4 Financial Reporting Council, *Corporate Culture and the Role of Boards: Report of Observations*, 2016, p.7

5 Geoffrey Smith and Roger Parloff, "Hoaxwagen: How the massive diesel fraud incinerated VW's reputation—and will hobble the company for years to come", *Fortune*, 7 March 2016, available online at http://fortune.com/inside-volkswagen-emissions-scandal/ (accessed 27 October 2017)

6 See Mark Carney, "The Future of Financial Reform", Monetary Authority of Singapore Lecture, 17 November 2014, p.13 in which Carney paraphrases Minouche Shafik, "Making Markets Fair and Effective", London School of Economics, 27 October 2014 and William Dudley, "Enhancing Financial Stability by Improving Culture in the Financial Services Industry", Federal Reserve Bank of New York, 20 October 2014

7 Ernst & Young, 2016, p.5

8 Idem. p.22

9 Financial Reporting Council, *Proposed Revisions to the UK Corporate Governance Code*, December 2017, Section 1, Paragraph 40, p.10

10 Idem. *Appendix B: Revised Guidance on Board Effectiveness*, p.8

11 IBE Board Briefing, *Culture Indicators: Understanding Corporate Behaviour* p.7

12 Linda Klebe Treviño, Kenneth D. Butterfield, and Donald L. McCabe, "The Ethical Context in Organisations: Influences on Employee Attitudes and Behaviours", *Business Ethics Quarterly*, Volume 8, Issue 3, 1998, p.457

13 Idem. p.472

14 See Muel Kaptein, "Developing and Testing a Measure for the Ethical Culture of Organizations: The Corporate Ethical Virtues Model", *Journal of Organisational Behaviour*, Vol. 29, No. 7 (October 2008), pp.923-947

15 See ibid. p.2 and below.

16 See http://www.greatplacetowork.co.uk/best-workplaces/about-applying-to-best-companies-lists (accessed 27 October 2017)

17 See http://appointments.thesundaytimes.co.uk/article/best100companies/ (accessed 27 October 2017)

18 See https://www.pwc.com/us/en/hr-management/people-analytics/workforce-cultural-surveys.html (accessed 27 October 2017) and https://ethisphere.com/what-we-do/culture-assessment/ (accessed 27 October 2017)

19 See http://www.ethicalsystems.org/content/ethical-systems-culture-measurement (accessed 27 October 2017)

20 See https://www.cebglobal.com/compliance-legal/risk-clarity/about-risk-clarity.html (accessed 8 November 2017)

21 GoodCorporation reviewed the Glassdoor score for each of the major car companies: Daimler scored 4.0, Ford 3.8, Renault 3.7, Jaguar LandRover 3.6, Nissan 3.4, Fiat Chrysler 3.2 - VW scored 3.7, putting it in the middle of this group of car companies.

22 See Chartered Institute of Internal Auditors, "FTSE 100 companies still fail to provide shareholders with information on ethics", 14 March 2016, available online at https://www.iia.org.uk/media-centre/news/ftse-100-companies-still-fail-to-provide-shareholders-with-information-on-ethics/ (accessed 6 November 2017)

23 Opinium, National Sample of 2000 UK Workers, 2017

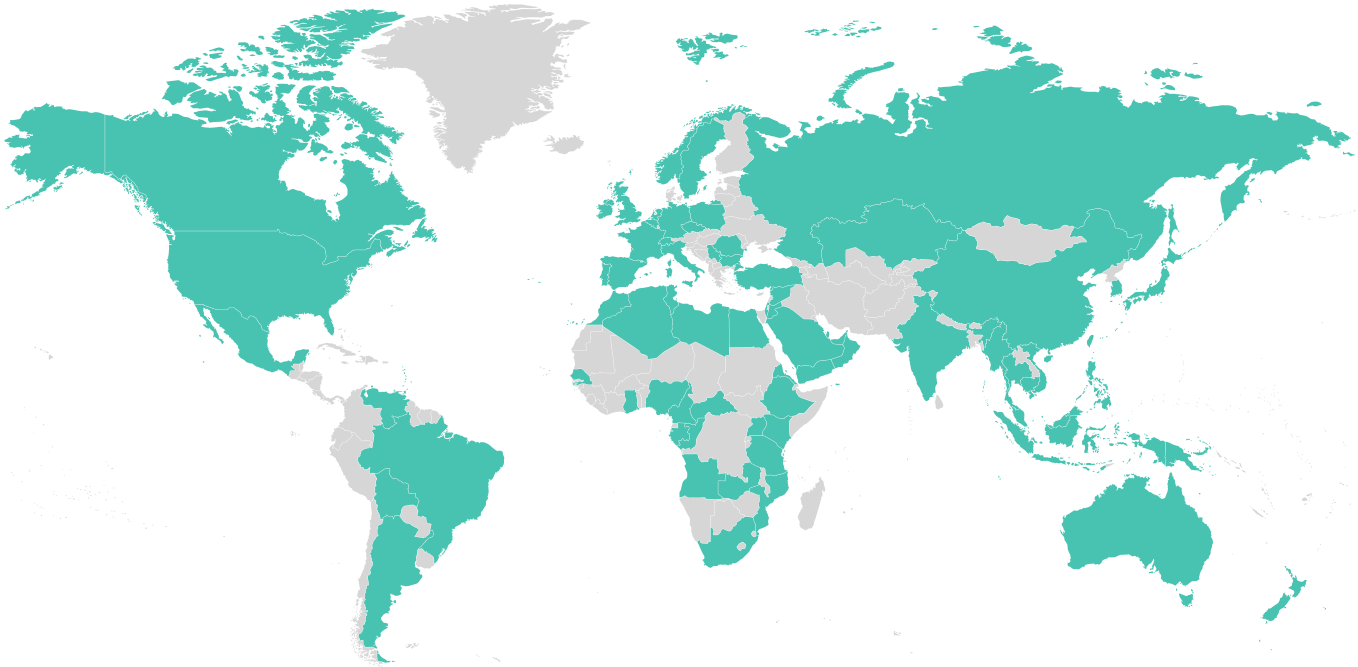
About GoodCorporation

Recognised worldwide in the field of corporate responsibility and business ethics, GoodCorporation has nearly twenty years' experience of checking and measuring corporate behaviour, including anti-corruption practices. We have over 100 clients, including FTSE 100 and CAC40 companies and have conducted more than 600 assessments in over 70 countries.

Data gathered from our assessments is used to benchmark business behaviour. This enables GoodCorporation to identify those management practices that are successfully embedded and highlight weaknesses that might leave an organisation exposed to reputational damage.

We support our clients through assessment, certification, training and advice. We also provide opportunities to share best practice and thought leadership through our Business Ethics Debate Series at the House of Lords.

Where we have worked



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Angola
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Belgium
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Brunei
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Zambia
Zimbabwe

Measuring Ethical Culture has been compiled by GoodCorporation, a leading practitioner in assessing, measuring and advising on responsible management practices. In this report we examine the importance of culture, the role of the board in setting and evaluating culture and its role in determining the long-term sustainability of a business. More specifically, we explore how culture can be measured and, in particular, how to assess whether or nor a company culture is ethical, promoting the right behaviours and decision-making. By identifying ten ethical culture drivers and 25 indicative statements, GoodCorporation has developed a methodology for an Ethical Culture Healthcheck, with a resultant net ethical culture score and benchmarked data for UK business.

Contact

For full details of the survey and more information about our **Ethical Culture Healthcheck,** please contact Debbie Ramsay at GoodCorporation.
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