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Comment: How nurturing a good conduct culture can actively reduce business risk

decision-making if they truly want to reduce the risk of a Volkswagen-scale scandal

With the Financial Reporting Council (FRC) proposing a significantly increased focus on company culture in its recent consultation on the Corporate Governance Code, the issue of culture has become something of a hot topic around the board-room table.

And yet, while the vast majority of directors already consider culture to be very important or fundamental to their company's performance, only 12% of organizations provide detailed information on culture in their public filings and annual reports, according to a survey of FTSE 350 board directors.

The result is that the abundance of culture buzzwords in the annual reports of FTSE companies often 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 values that underpin their culture.

This goes against the recommendations of the FRC, which stated in its 2016 report, Corporate Culture and the Role of Boards, that directors should not only understand its importance, but also "devote sufficient resources to evaluating culture".

> **According to the FRC, poor culture is a significant business risk in itself**

Company culture touches on all areas of business operation, determining everything from executive pay to 'borrowing' of company property. It can dictate both the type of employee the organization attracts, and how long they are likely to stay.

It is linked to both values and purpose and can underpin

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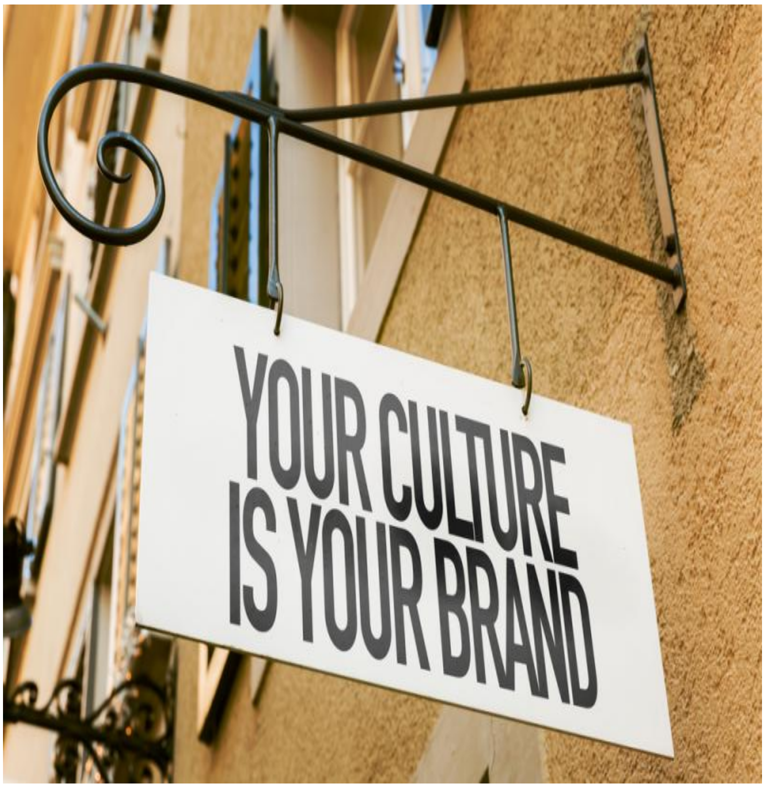
As countless headlines have shown, it is often the ethical aspects of a company's culture that lead to reputation-damaging scandals that devastate shareholder value and, with it, the company's chances of long-term success. Indeed, in its consultation on the Corporate Governance Code, the FRC states that poor culture is a significant business risk in itself.



Company culture affects all areas of a business's operation. (Credit: ESB Professional/Shutterstock)

Volkswagen is a case in point. Although feedback from employees on the workplace review site Glassdoor showed that Volkswagen was similar to other car companies at the time, the survey failed to explore attitudes towards company values or probe into the type of behaviour or decision-making that would ultimately lead to the "diesel-gate" scandal.

By contrast, an analysis of the ethical characteristics

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and blood feuds".

This kind of culture, which Fortune said "mandated success at all costs", ultimately cost the company dearly. The Volkswagen share price collapsed once the emissions cheating came to light and remained at roughly half its pre-crisis peak two years later, albeit now recovering.

> **Businesses need to ensure that they actively promote ethical decision-making and conduct**

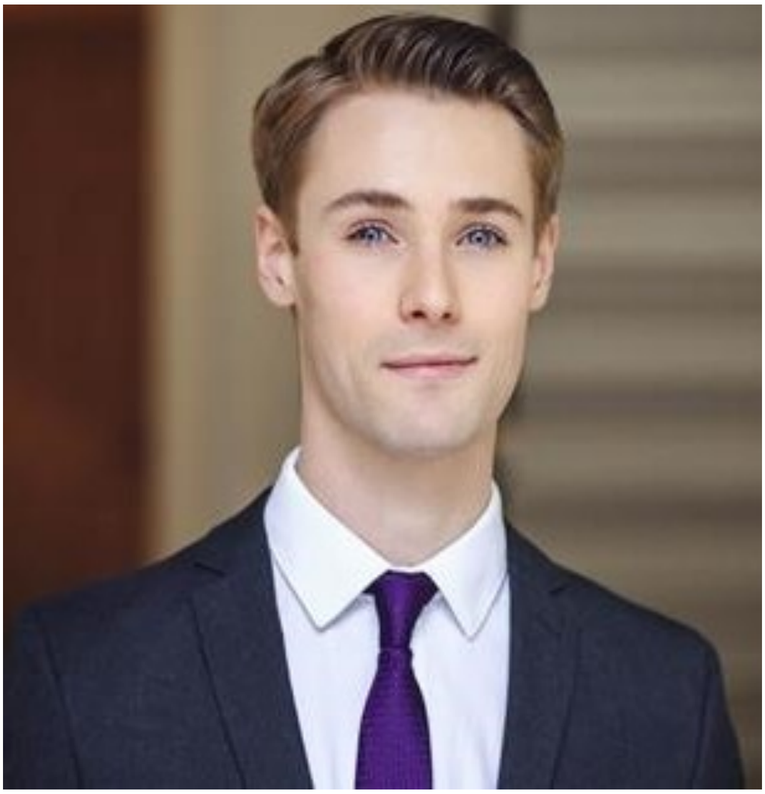
Companies are therefore increasingly at risk from financial failure because of poor ethical behaviour. The decision-making behind every objective, the 'how' behind the 'what', must therefore be supported by a culture that promotes the right kinds of behaviour.

While the FRC is pushing companies to monitor and assess company culture in order to "satisfy itself that the behaviour throughout the business is aligned with the company's values", to reduce the risk of scandal and safeguard long-term success, businesses need to ensure that the behaviours they promote are not just aligned with company values but actively promote ethical decision-making and conduct.

In our response to the Consultation on the Revised Corporate Governance Code we welcomed the FRC's increased focus on company culture but also specified that boards should devote particular attention to the core ethical behaviours needed to underpin a culture that mitigates a company's risk of scandal.

These core ethical behaviours should be defined and assessed in a way that draws on the experiences of the company's key stakeholders. They should then be monitored to show that they support good decision

We believe that by engaging with their stakeholders in this way to define, measure and monitor the key ethical drivers of a healthy company culture, boards will receive the metrics they need to ensure theirs is a culture designed to mitigate the risk of scandal and, ultimately, safeguard long-term success.



Michael Pollitt's work at GoodCorporation focuses on assessment and consultancy services in the areas of business ethics, human rights and ethical culture. GoodCorporation is a leading advisor in business ethics, compliance and corporate responsibility.

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