# Culture and channelling corporate behaviour: summary of findings

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Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of consistent global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We work to open up the profession to people of all backgrounds and remove artificial barriers to entry, ensuring that our qualifications and their delivery meet the diverse needs of trainee professionals and their employers.

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This is part of a series of four reports that aims to assist boards in preparing to assess their corporate culture and in understanding how it can influence either functional or dysfunctional behaviour.

### IN THIS SERIES...

The four reports in this series are:

- *Culture and Channelling Corporate Behaviour: Summary of Findings,* ACCA, 2014.

- *Culture and Channelling Corporate Behaviour, Appendix 1: Review of the Academic Literature on Organisational Culture,* ACCA, 2014.

- *Culture and Channelling Corporate Behaviour, Appendix 2: Findings from the ACCA–ESRC Roundtable Discussions,* ACCA, 2014.

- *Culture and Channelling Corporate Behaviour, Appendix 3: Results from the ACCA–ESRC Member Survey,* ACCA, 2015.

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# Culture and channelling corporate behaviour

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## ACKNOWLEDGEMENTS

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# Foreword

The 2008 global financial crisis demonstrated very clearly how regulation and existing corporate governance mechanisms failed to prevent dysfunctional behaviour from spreading and seemingly thriving businesses from collapsing. Business scandals and public inquiries are repeatedly making the headlines and the LIBOR case of interbank lending rates manipulation was only one of the most striking illustrations of corporate wrongdoing. There are plenty more. Trust has been eroded across a range of sectors, from politics to the media to big business, and society now demands more accountability at board level.

For us at ACCA, we believe that a healthy culture is a prerequisite for good governance and risk management. We think it is also essential for good long-term corporate performance. Good corporate governance is about achieving long-term sustainable value creation while taking proper account of shareholders and other stakeholders' interests. Taking 'proper account of' means behaving ethically at all times; over the last ten years ACCA has published several reports which major on business ethics and of course professional ethics is at the heart of the ACCA qualification.

The present study conducted in collaboration with the UK's Economic and Social Research Council (ESRC) included roundtable discussions around the world and an ACCA members' survey. All affirmed the critical importance of tone at the top in setting the ethical compass for the organisation, hence shaping and driving a strong corporate culture that channels functional behaviour.

Boards must strive to ensure that their organisations get culture right so they get the kind of behaviour they want and avoid the sort of dysfunctional behaviour that causes accidents, destroys values and creates financial and reputational loss. Getting this right is not easy and our report will offer suggestions to make it easier.

Helen Brand
**ACCA chief executive**

# 1. Introduction

## 1.1 THE IMPORTANCE OF CULTURE AND BEHAVIOUR

In the wake of various high-profile cases of corporate misconduct in sectors and industries previously perceived to be well-governed and regulated, many observers have come to the conclusion that poor organisational culture was a significant root cause of much of the corporate wrongdoing.

Culture and the drivers of behaviour are now key issues for regulators, particularly of financial services organisations. The Financial Stability Board now expects bank supervisors around the world to assess financial services companies' risk culture, and their starting point will be boards' own assessments (FSB 2014). It is likely that boards in other sectors, private and public, will need to make similar assessments. Boards need better guidance; this study aims to assist, by identifying the leading corporate and academic thinking, and providing a practical and insightful framework to help you understand your own organisational culture.

ACCA has long considered that a key part of risk management should be the assessment of the control environment, including such aspects as culture and ethics (Davies et al. 2010).

ACCA believes that the human factor in organisations is central to understanding how they function. A firm can have what appears to be most sophisticated procedures and follow a code of governance, its success relies on the people within. People can make perfectly designed and executed systems fail but, equally, they can make poorly designed systems work actually rather well.

Functional behaviour contributes to the creation of long-term, sustainable value for the organisation, and the majority of its stakeholders.

What is it then that drives individuals' and groups' behaviour? Rules and procedures can fail to result in appropriate corporate conduct, so what is it that motivates people to behave one way rather than another? Is it all about culture?

> Functional behaviour is seen as behaviour that helps the organisation in the long-term pursuit of its objectives, while dysfunctional behaviour describes behaviour that does not, even where it may seem to help in achieving certain short-term objectives.

## 1.2 THE ACCA–ESRC PROJECT

Culture is a nebulous concept which is often misused. It is a vast subject to research and is one to which people devote a lifetime. In 2013 ACCA and the UK's Economic and Social Research Council (ESRC) launched research into this field with the overarching goal of understanding what causes dysfunctional behaviour in organisations.

This project has generated much interest and enthusiasm within the business community, from all regions of the world. Understanding the interaction between culture, behaviour and business ethics is clearly high on the corporate agenda for business leaders, senior accountants and regulators alike.

This concern is a very positive sign, but it seems driven by a widely held perspective that the largely regulation- and rules-based response to the financial crisis has somewhat missed the main problem. Many people with whom we engaged expressed despair with what they see as a general tendency to apply quick fixes and 'snake oil' to deep, complicated and often poorly understood behavioural issues.

Decades of evolution of regulation and governance did not prevent organisations from failing and there is now broad agreement that a much more holistic approach is needed; some said that the multidisciplinary format of this research might well be an essential part of finding a solution.

**Methodology**

The project's methodology and evidence included:

- looking at a body of academic literature from different social science disciplines as well as reports and investigations into various scandals and corporate failures (ACCA 2014a)

- discussions with over 150 people with expert knowledge, from business, academia and regulatory organisations on five continents in roundtables and other meetings; participants included executive directors, chairmen and non-executive directors, internal auditors, risk managers, researchers from international organisations and board information consultants (ACCA 2014b)

- an online survey from among ACCA's global membership in April 2014, with close to 2,000 respondents giving their views on culture, leadership, incentives and motivation (ACCA 2015).

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# 2. The nature of corporate culture

The conclusions of the ACCA–ESRC project all point to the elusive, idiosyncratic and influential nature of corporate culture.

## 2.1 CULTURE ISN'T SOMETHING YOU CAN GRAB

'The culture held by a group is a set of shared beliefs, norms and values that defines what is important and what is appropriate for individuals belonging to this group'.

O'REILLY AND CHATMAN 1986

A corporate culture can be associated with particular 'systems of understanding' (Alvesson 1993), or frames of reference, based on a specific set of formal and informal rules that dictate how organisational members should behave, and the choices they are expected to make.

From the series of roundtable discussions held, it emerged that 'culture' comes down to the particular way 'things get done' in a given organisation. Culture is demonstrated by what the organisation does, how it creates value, who gets hired and promoted and what sort of behaviour it rewards; it is visible in the way in which operations are managed and relations with staff, customers, suppliers and other stakeholders, are maintained.

More pragmatically, the culture of an organisation is expressed in particular dress codes, typical office hours agreed (formally or not), specific desk layouts, or activities during which employees can socialise outside the work environment.

Prominent organisational theorist Edgar Schein defined corporate culture as 'a pattern of shared basic assumptions that a given group has invented, discovered or developed in learning to cope with its problems of external adaptation and internal integration, and that have worked well enough to be considered valid and, therefore, to be taught to new members as the correct way to perceive, think and feel in relation to those problems' (Schein 1984).

Corporate culture therefore builds upon the business model of an organisation, along with the legal and technical requirements specific to the industry and the location of activity (Drucker 1994). The characteristics of leadership, the particular ownership structure (family business, state-owned enterprise, publicly listed company), and the size and complexity of the organisation will all be determining factors, hence leading every single company to shape its very own unique culture.

## 2.2 CULTURE IS BOTH UNIQUE AND DYNAMIC

Evidence from the literature review suggests that corporate culture relates to the identity and image of the organisation (Dutton and Dukerich 1991). It is usually rooted in the personality of its founders, directors or owners, which will in turn determine the specific tone set at the top. This will be a reflection of the unique values held and an indication of how organisational members should behave.

Culture is also dynamic, as it adapts in reaction to the behaviour of peers and competitors, evolving along with the need for changing skills and practices. Corporate objectives, policies and procedures, pay and reward systems, as well as performance targets and measurement, all form part of an organisation's culture and actively influence corporate behaviours on a daily basis. As these may change as the business grows, shrinks or just relocates, so does the culture of the organisation.

According to those who participated in this project, an organisation's culture should be one of its most important assets as it is heavily linked to decision making, productive capacity and its brand/image (and therefore reputational risk). Boards should strive to ensure that they understand their existing culture, and have a clear vision of what it should be, reflecting the nature and values of the organisation.

In the ACCA member survey, 57% of respondents said they worked for a multinational or multi-centred organisation and nearly 60% said they were located in a subsidiary or local centre. A growing part of business is now being conducted away from the corporate centre, in different countries, with different workforces and different national cultures, and this is reflected within an organisation's own culture.

At the level of single corporate entities, the culture for a sales team may not be one of an accounts function, so there are layers of subcultures within organisations. Nor is there a single ideal culture for an organisation; any organisation other than a small one will have multiple subcultures.

## 2.3 CULTURE CAN ACT AS A MECHANISM OF CENTRAL CONTROL

Extensive research has long been conducted on the effect of culture and group pressure, and how it decides individual choices and behaviours. British anthropologist Dame Mary Douglas, recognised for her pioneering work on cultural theory, demonstrated this with her well-known group-grid model (Douglas, 1970), showing how the greater the incorporation into a bounded unit, the more individual choice is subjected to group determination.

Studies of group pressure also gained substance with Solomon Asch's series of Harvard experiments demonstrating the degree to which an individual's own opinions are influenced by those of a majority group, particularly when the group is made up of peers – in this case a sample of Harvard students (Asch 1955). Evidence of group dynamics and the particular role of leadership in driving individual choices were made even more explicit with Yale University psychologist Stanley Milgram's series of controversial experiments. Designed to measure willingness to obey an authority figure, these experiments uncovered the surprising ease with which ordinary persons can be commanded to act destructively against an innocent individual by a 'legitimate' authority (Milgram 1974).

Individual behaviours are therefore highly determined by the signals received from above as much as by the behaviour of others around, whether at the level of a community, a team, a department or a company. Therefore, if the tone at the top has effectively permeated throughout the organisation, and the norms and values are widely shared and intensely held, then the specific culture can act as a powerful mechanism of central control that seems to enable compliance to occur without surveillance (Weick 1987).

The Salz review of Barclays' business practices tends to confirm this assumption as it says that people 'develop shared patterns of thinking, responding to and interpreting the stimuli that they encounter. These patterns become hardwired such that ways of interacting are guided by basic, unwritten, unspoken assumptions generated through years of shared social interaction and learning' (Salz 2013).

Hence the hypothesis that, if you get the culture right, there will be less need to seek control through rules and hierarchies.

# 3. How to get it right?

The growing assumption that a strong corporate culture is key to a well-functioning organisation, along with interests from regulators, has led many to argue that boards should assess their own organisational culture.

Nevertheless, research conducted for this project clearly showed that standard quantitative metrics of assessment cannot be adapted to this sort of exercise. Culture is elusive and idiosyncratic by nature.

Dan Konigsburg, managing director of corporate governance and public policy at Deloitte Touch Tohmatsu, said at one of the New York roundtables that: 'You cannot measure culture. You can only find indirect measures or proxies'.

You cannot see culture or assess it directly. It is a bit like an iceberg; most of it is out of sight.

The project suggests three steps on the path to understanding and getting culture right:

- know the culture you want

- understand the culture you have

- take actions to reconcile what exists with what is desired.

## 3.1 KNOW THE CULTURE YOU WANT

The conclusion from the ACCA and ESRC project suggests that the board should consider what sort of culture the company wants before it assesses its existing culture. Recent corporate failures have highlighted that the following considerations are basic to good corporate governance, and before proceeding to any assessment, boards should ask themselves the following questions.

- What are the goals and purposes of the organisation?

- What sort of behaviours does it wish to encourage and discourage?

- How is the 'tone at the top' set out and conveyed through the organisation?

Evidence from the research suggested that it is essential to involve staff fully and properly in any assessment of culture, and to take care to create an environment where they can participate without fear of adverse consequences if they are honest about problems. A multiple-choice staff survey will not be sufficient. Boards are advised to follow more than one approach to assessing the organisation's culture and to avoid making binary judgements about the merit or faults of that culture – at least to begin with.

To do so, the roundtables suggested 'digging into the stories' and, very often, '[this] is best done by going down to the coffee machine'. It appeared clear that some kinds of bottom-up communication mechanism and feedback flows are key to understanding what 'the people with boots on the ground really think'.

## 3.2 UNDERSTAND THE CULTURE YOU HAVE

A set of trade-offs emerged from the research. These are not to be regarded as opposites between good and bad. Rather, they form a framework for discussion to assist boards seeking to position their own culture on a continuum. One end is not necessarily better than the other and most of the time, striking an appropriate balance will be the optimum scenario.

These trade-offs are starting points to health check the culture one organisation has and should be carried out at various levels, given that different departments may have differing approaches and needs, ie in terms of control or innovation.

In the boardroom, determining the balance between leadership and followership, independence and involvement, or conformity and challenge should be the primary focus as it will determine the quality of decision-making processes, and the resulting tone to trickle down from the top, influencing behaviours in the rest of the organisation.

By using the various cultural 'trade-offs', a board-level discussion can be instigated giving board members something to compare with the actual culture prevalent in the organisation. They can then better decide where changes might needed.

## 3.3 TAKE ACTIONS TO RECONCILE WHAT EXISTS WITH WHAT IS DESIRED

Assessing culture should be seen as a journey of continuous improvement rather than an end in itself. As boards conduct a health check of the culture in their organisation, they could then take various actions to reconcile what they want or would like.

The main actions developed in the following chapters include:

- Align and embed core values at the very top.

- Watch out for the trickle-down effect and dynamics in groups.

- Track how decisions are being made.

- Be honest about the value of regulation and codes.

- Beware of unintended consequences attached to any incentives structure.

- Find out what motivates people.

- Anticipate trends.

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### CULTURAL TRADE-OFFS FOR THE BOARD TO CONSIDER

The effects of various cultural 'trade-offs' can be considered within a board-level discussion to help reconcile what exists with what is desired.

1. Values as a wealth driver versus values as a protector

2. Openness to mistakes versus zero tolerance

3. Leadership versus followership

4. Conformity versus challenge

5. Independence versus involvement

6. Enforcing versus avoiding or exploiting regulation

7. Common sense versus rules and procedures

8. Empowerment versus rules, and tight rules versus loose rules

9. Quantitative measures versus qualitative performance

10. Innovation versus control

11. Risk seeking versus risk avoiding

12. Trust versus accountability

13. Profit versus public value

14. Human capital versus human cost.

Each of these trade-offs are discussed in detail in Chapter 4.

# 4. Further steps on the path to getting it right

**The following sections detail some of the steps to take, as identified by the project. As an overarching goal, boards should aim at breaking away from pass or fail approaches and remember that there is no absolute or 'right' way to assess culture. Asking the right questions and looking at the set of trade-offs will help boards in getting to know their culture and, ultimately, drive change where most needed.**

## 4.1 ALIGN AND EMBED CORE VALUES AT THE VERY TOP

The Financial Stability Board's Guidance (FSB 2014) lists 'tone from the top' as one of four indicators of risk culture. It says 'the board and senior management are the starting point for setting the financial institution's core values and expectations for the risk culture of the institution, and their behaviour must reflect the values being espoused. A key value that should be espoused is the expectation that staff act with integrity (doing the right thing)'.

Many people in India and Dubai, but also in London, cited the importance of the example set by those at the top: that they should 'walk their talk'. Actions and values of leaders are strongly believed to be key in maintaining ethics and integrity in organisations. In the ACCA member survey run for the purpose of this research, 60% of respondents said that tone at the top has most influence on corporate behaviour; incentives (not only relating to pay) and rules came second and third.

### What most influences corporate behaviour?

| | |
|---|---|
| Tone at the top | 60.7% |
| Incentives (not only related to pay) | 20.2% |
| Rules and procedures | 10.0% |
| Personal agendas | 9.3% |

### Trade-off #1

**Values as a wealth driver versus values as a protector**
A key part of establishing the right tone from the top is promoting sound values for the organisation and making sure they become embedded. Communication from the top should be clear, concise and unambiguous. One participant in India argued that 'today's mission statements such as "to maximise shareholder returns" or "to be number one in our market" are simply not deep enough to galvanise hearts and minds of employees and the wider stakeholder community'. To influence culture, or engage in cultural change, participants suggested that organisations 'clarify the value they provide to their stakeholders' and 'understand their place within the business ecosystem'.

Boards could consider what sort of values they want to have and work with to ensure that these values are lived throughout the organisation.

## 4.2. WATCH OUT FOR THE TRICKLE-DOWN EFFECT AND DYNAMICS IN GROUPS

While survey respondents believed that the tone set and demonstrated at the top is key, some of the other roundtables suggested that it does not easily permeate down the organisation, or that it becomes distorted. For some participants, it gets muddied in the communication process and leadership' messages may not effectively trickle down and reach everyone, particularly at an organisation's extremities, for example to subcontractors working for a large multinational. It was thus suggested in New York that the whole notion of tone at the top becomes decreasingly important the more complex the organisation becomes.

The ACCA members' survey found that 60% of respondents agreed there are multiple subcultures in their organisation, while 20% disagreed; managers have their own style so the tone in one department may be very different from that in another. Large organisations feature multiple tones coming from multiple tops and boards must look at how their message translates in different part of their company.

Participating in the New York discussion, Professor Lynn Stout explained what elements of the social context participate in creating a healthy environment; as she put it, these are 'the signals you're getting from authority, which relates to tone from the top, but also and most importantly, what you think other people around you are doing – [for instance], if you think other people in the organisation are behaving ethically, you're more likely to be ethical yourself'. Many thus believed that each one of us has a tone that influences others.

At the Brussels roundtable it was pointed out that: 'if you have somebody who is making the firm a lot of money and who's breaking the rules and you let that person get away with it that teaches everybody about the culture of that organisation…because ultimately that person will drive bad behaviour'.

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**Trade-off #2**

**Openness to mistakes versus zero tolerance**

Behaviour will be influenced by what is tolerated or accepted. Boards should remember that promoting two different sets of rules, one for the top people and another for the rest of the organisation, will most certainly create resentment and promote dysfunctional behaviours.

Whether or not there is openness to mistakes or a blame culture is another leading indicator of whether or not the culture supports functional behaviour. It is clear that a culture of zero tolerance is likely to lead people to 'hush up' mistakes, while constructive criticism is more likely to foster trust and accountability.

Boards could consider whether the organisation is open to hearing about mistakes and whether staff believe there is sufficient openness.

## 4.3. TRACK DOWN HOW DECISIONS ARE BEING MADE

Individual decision-making processes are driven by the way people make sense of the reality around them: their moral compass grounded in their own values, norms and assumptions will determine intentions, emotions and reactions. This subjective conceptualisation of events can differ greatly from one person to the other, partly owing to their original culture, partly as a result of standard human cognition.

Kahneman and Tversky devoted most of their research to uncovering cognitive biases in individual's decision-making processes. They wrote that most people are systematically prone to errors in making judgements about probability. Among other things, a rooted aversion to loss, an automated mechanism for simplifying choices, and finally, the way in which information is framed will systematically influence how decisions are made (Kahneman and Tversky 1972, 1986; Kahneman 2011).

A concise and practical description of the cognitive bias in relation to how human beings misjudge risk is provided in *Behaviour Bear Bull and Lemming* (Lloyd's 2010). It summarises the main types of bias as follows.

- Representation bias: people tend to categorise new risks according to how much they resemble a more familiar risk, even when the resemblance relates to factors irrelevant to the risk.

- Availability bias: people judge risks more strongly if they can call examples to mind; hence groups using different media will respond differently to the same risks.

- Anchoring bias: people's assessment of risk depends on their starting point.

- Hindsight bias: most people believe their capacity to perceive and manage past events is higher than it really was; this diminishes the ability to learn from experience.

- Cognitive dissonance: if two ideas are conflicting people tend to alter their opinions to reduce this feeling of tension; people tend to justify their decisions after the fact.

- Confirmation bias: people tend to look for evidence that confirms their view; and will ignore conflicting evidence.

At the level of groups, these effects can multiply, leading to sturdy conformism and, at various degrees, can affect decision making negatively.

### The phenomenon of 'groupthink'

Irving Janis developed the idea of 'groupthink' when explaining many faulty foreign policy decisions in history (Janis 1972).

Groupthink would seem to explain why non-executive or outside directors sometimes do not hold executives to account, but this may be more likely to happen in bigger groups. The Brussels roundtable was aware of research suggesting that smaller boards (fewer than 10) are better at decision making but paradoxically modern corporate governance standards demands large boards with a significant majority of independent non-executive directors.

'[Groupthink refers to] an excessive form of concurrence-seeking among members of high prestige, tightly knit policy-making groups in which group members come to value the group and their being part of it more highly than anything else. This causes them to strive for a quick and painless unanimity on the issues that the group has to confront. Group members suppress personal doubts, silence dissenters and follow the group leader's suggestions. The results are a distorted view of reality, excessive optimism producing hasty and reckless policies, and a neglect of ethical issues'.

HART 1991

## Trade-off #3

**Leadership versus followership**
Diversity of thinking is widely regarded as a good thing in organisations and the ability of people to challenge decisions is considered by the FSB to be a critical indicator of a sound risk culture.

An autocratic style of leadership makes it difficult for staff to challenge decisions or offer a different view. How boards and CEOs want to lead remains a core question. How do they want managers to lead their staff? Do they encourage discussion and challenge or to what extent is conformism de rigueur?

Boards could consider their own leadership style and find out how it is perceived throughout the organisation? Do they need to change anything?

## Trade-off #4

**Conformity versus challenge**
Whether or not dissent or constructive challenge is encouraged will be a leading indicator of whether or not the culture supports functional behaviour. Cohesion is a good thing (think of team spirit in collective sports) but can become an enemy of objective and informed decision making (think of 'groupthink' and 'cliquey' atmosphere).

Governance codes require there to be constructive challenge in the boardroom and the need is now widely accepted.

Boards could consider to what degree constructive challenge is encouraged in the boardroom, find out how cohesive teams are within the organisation and whether staff are able to challenge people above them.

## Trade-off #5

**Independence versus involvement**
This is another important matter for boards. Present notions of good governance include having a majority of independent directors. This seems to have become a universal view and is being applied in the public and not-for-profit sectors and in private companies as well as listed companies. The spirit of this is to promote independence and objectivity of mind as well as a sense of concern for what the organisation does and how it does it. A diversified and concerned board is likely to make better-informed decisions.

Boards could consider whether external directors are sufficiently independent in mind and sufficiently involved or engaged, and what steps could be taken to improve genuine commitment. The size and composition of boards should also be considered in line with their actual operational and strategic requirements.

## 4.4 BE HONEST ABOUT THE VALUE OF REGULATION AND CODES

The series of roundtable discussions uncovered different attitudes towards rules; in advanced economies (Brussels, London and New York) the benefits of strict regulations for health and safety and other areas are perhaps taken for granted and compliance is rather perceived as a box-ticking exercise or a bureaucratic burden. In emerging economies (Dubai, India and Hong Kong), such standards are to be aspired to and participants believed that regulations had actually nurtured a greater sense of responsibility in business (ACCA 2014b).

At an ACCA Virtual Conference held in September 2014, Jamie Allen, Founding Secretary General of the Asian Association of Corporate Directors, restated the critical role of regulation in channelling functional corporate behaviour. Challenging the survey figures on the primacy of tone at the top, he argued that this was missing the point: that the tone itself was mainly a reflection of the very set of rules and procedures in place in the industry and country of activity of the organisation. Regulation directly feeds into the tone adopted at the top, which in turn induces either effective enforcement (ie encouraging people to abide by rules) or 'workaround' behaviour (devoting vast amount of resources to find ways around rules).

The conclusion to draw is that good regulation is needed but more regulation is not necessarily better. In some countries, regulation and the enforcement that should accompany it are underdeveloped. In other countries there may already be too much and a larger volume of regulation requires more resources to enforce, and is prone to inconsistency. It was clear from many of the discussions that too much regulation leads to cynicism, and ultimately regulation works best when those regulated want the regulations to work.

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**Trade-off #6**

**Common sense versus rules and procedures**
The number and extent of rules and procedures required will differ according to the size, sector and function of a given business. The more rules and procedures there are, however, the harder it can be for people to exercise common sense. In a crisis this could be dangerous and at the extreme fatal for individuals and for organisations.

Boards could consider how to get the right balance between allowing people to use common sense and introducing rules and procedures.

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**Trade-off #7**

**Empowerment versus rules and tight rules versus loose rules**
Discussions demonstrated that empowered staff are more innovative and more able to exercise common sense than staff who are not appropriately empowered. Staff want to be empowered and will be more motivated when they are. Good boards will want staff to react that way – provided they do the right things.

Boards could consider how much empowerment is appropriate for different groups in the organisation.

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**Trade-off #8**

**Enforcing versus avoiding or exploiting regulation**
What attitude to regulation should an organisation have? Does it want to support and work with the spirit and the letter of regulation or does it see regulation as something to be avoided or exploited for its customers' interests or its own sake?

Boards could consider where their organisations lie on this continuum and whether it is where they want it to be.

## 4.5 BEWARE OF UNINTENDED CONSEQUENCES ATTACHED TO ANY INCENTIVES STRUCTURE

Performance management involving targets has become standard practice in most organisations over the last 30 years. People working in modern organisations are driven by measures and targets imposed externally and internally. People will manage and are managed according to these measures. Inappropriate or badly applied performance targets can have a pernicious effect further down in organisations and problems arise if there is a close link between performance measures and pay or individual performance appraisal (Stout 2012). In such cases the incentive may be for individuals to come up with measures they can easily achieve – particularly if there would be repercussions for not achieving a target.

Research conducted in UK's public health sector has shown that incentives to meet performance and financial targets in many cases result in a culture where measures take primacy over patient care (Marsden et al. 2000). This was a major factor in the unnecessary suffering and deaths of hospital patients of Mid Staffordshire NHS Foundation Trust, where quality of care took second place to proxy measures such as waiting times (Francis 2010).

In a study of public service agreement targets (PSAs) set by the UK government for addressing inequalities, ACCA had already concluded that, it was not enough to measure performance in terms of an organisation's ability to meet targets, but that it was of at least equal importance to know at what cost the target had been met (Fawcett 2010).

A clear unintended consequence of target-driven cultures is the phenomenon of 'gaming', which in the world of business refers to 'subverting the intent of socially mandated or legislated "rules of the game" in order to gain advantage over rivals, maximize reported earnings, maintain high credit ratings, preserve access to capital on favourable terms, and reap personal rewards – without resorting to blatantly illegal acts' (Salter 2013).

ACCA members' views on targets and performance measurement were also sought and, while more than 50% agreed or strongly agreed that performance-related pay schemes help foster better performance, an even larger proportion (65%) also believed that such schemes may lead people to falsify or exaggerate their performance measures.

### ACCA members' views on targets and performance measurement

Performance-related pay schemes help foster best performance
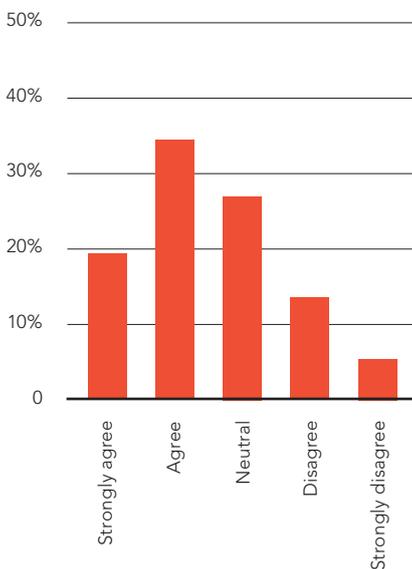


Performance-related pay schemes may lead people to falsify or exaggerate their performance measures
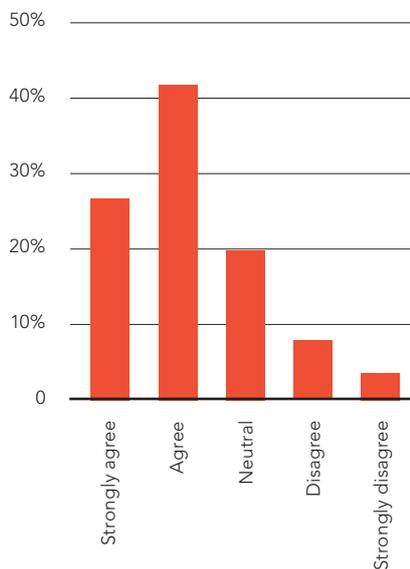
## Trade-off #9

**Quantitative measures versus qualitative performance**
The importance of selecting good measures, using them wisely, and knowing how the measures chosen can lead to unintended consequences cannot be overstated.

At the New York roundtable, Lisa French, technical director at the International Integrated Reporting Council (IIRC), claimed that non-financial measures should be used more systematically to assess performance and determine executive pay schemes. These could include 'customer satisfaction, good standing with regulators, employee morale, product quality, workplace ethnic multiples and diversity, employee turnover and so on'.

Can the board identify better measures that properly reflect the long-term aims of the organisation and use them in better ways so they do not get 'gamed'?

## Trade-off #10

**Innovation versus control**
How much innovation does an organisation need and who should be responsible for it? Without innovation accountants might still be using quill pens and paper ledgers. Innovation is a good thing but innovation involves risk, so control is required. An organisation unable to manage the potential risks inherently associated with innovation is unlikely to thrive or survive for long. Too much control, however, is likely to stifle innovation.

Boards should be aware that control can stifle innovation. The need to encourage innovation should be balanced against the need to have control; they could consider what sort of innovation they want, where it is needed, and what sort of control is appropriate.

## Trade-off #11

**Risk seeking versus risk avoiding**
An organisation that does not take risk will struggle to innovate. An organisation that struggles to innovate will find it difficult to grow. The discussion above about innovation versus control also applies to risk taking and risk avoidance. There is no point taking a risk if there is no possible benefit; also, thrill seeking has no place in a corporate environment.

How clear is the board about why its members want or allow their organisations, and the teams within them, to take risk? What is the appropriate balance between risk and reward?

## 4.6 FIND OUT WHAT MOTIVATES PEOPLE

While there is clearly more to incentives than monetary reward, in many contexts the two are regarded as synonymous. Academic thought suggests, however, that monetary reward is not a motivator, or is at least a poor one. In a study of more than 900 senior executives working for FTSE 350 companies, it appeared that 'intrinsic factors, like achievement, teamwork, status and power, are fundamentally important' even though these 'only come into play once you are at, or above, a minimum threshold for financial reward' (Pepper et al. 2012).

Many argue that extrinsic rewards such as performance-related pay have an impact on output only with very highly repetitive tasks that do not involve much cognitive effort (Herzberg 1968). Elsewhere, financial incentives are not sufficient and behavioural economics suggest that strong intrinsic motivation is associated with a strong desire for autonomy in one's work; it therefore seems that three factors are critical in determining motivation at work (Deci and Ryan 1985; Pink 2009):

- mastery involves devoting many hours of reflective practice to become truly proficient at a skill

- autonomy is about assuming moral responsibility and accountability for one's actions

- purpose is the universal desire to interact, to be connected to, and to care for others – in the sense of having a shared higher purpose with those people.

When people are motivated by intrinsic factors they perform better and more consistently than when motivated by extrinsic factors – extrinsic rewards motivate for a short time; they narrow one's focus to the immediate and obvious (Salz 2013). A recent study of a sample of 1,500 US listed firms also reveals that 'firms paying their CEO in the top 10% of excess pay actually earned negative abnormal returns over the next three years'. Cooper et al. (2014) explain that, in many cases, high pay induces overconfidence that leads CEOs to engage in 'overinvestment and value-destroying mergers and acquisitions'.

Financial incentives are often counter-productive as they encourage gaming, fraud and other dysfunctional behaviours that damage the reputation and culture of the organisation. They produce the misleading assumption that most people are selfish and self-interested, which in turn erodes trust.

The UK Code of Corporate Governance (FRC 2012) principle on remuneration initially stated that 'levels of remuneration should be sufficient to attract, retain and motivate directors of the quality required to run the company successfully but a company should avoid paying more than is necessary for this purpose'.

Following public consultation and enduring debate over executive pay, this has now been replaced by a more comprehensive principle that will hopefully give a better connection between pay and performance; it now says: 'executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied' (FRC 2014).

**Trade-off #12**

**Trust versus accountability**
In an ideal world people would always be trusted to do their best and get on with things. Society expects much more accountability, so do boards and the people to whom boards are (at least theoretically) accountable, eg shareholders (explored further in Moxey and Berendt 2014). Accountability and trust are not mutually exclusive, although attempts to increase accountability can erode trust as people who are made more accountable may feel less trusted.

Boards could consider whether existing accountability systems undermine trust and what could be done to improve trust.

## 4.7 ANTICIPATE TRENDS

In 2012, ACCA and the Institute of Management Accountants (IMA) conducted a global survey to which 2,500 professional accountants and business leaders responded, in order to identify future drivers of the changes that will affect businesses and the global accountancy professions (Chua 2012). One of the critical factors highlighted was the increasingly complex and fast-changing business environment and the resulting need to develop new mindsets and approaches to uncertainty and volatility.

Nurturing an environment that is open to external ideas and developing a capability to work with, adapt to and get the best out of a multi-location, multicultural and age-diverse workforce is a key to a successful global operating model.

The purpose of looking at culture is partly to investigate what organisations are here for. This is probably the elephant in the room for many organisations. It is worth asking whether a commercial organisation exists purely to make money or does it also exist to serve some sort of public good? Can an enterprise make more money over the long term by creating value, in the wider sense, for its stakeholders?

In Western Europe, the difficult economic climate means that the young generation of those aged 20–29 years old, have probably known nothing other than a 'national drawing of the purse strings in their adult lives' (Taggart et al. 2014): falling wages, increasing competition for jobs, rising poverty, very low interest rates, public spending cuts and a national housing crisis to name but a few of the symptoms. It is of utmost importance to consider these market trends as they will affect career choices and corporate behaviours fundamentally.

Societal expectations seem to be changing and commercial organisations now have to be more mindful of their corporate responsibilities than used to be the case. Views of what these responsibilities should be are changing. To be out of step with public opinion, even when working within a legal framework, can cause significant damage to a company's public trust and brand reputation.

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### Trade-off #13

**Profit versus public value**
Many people thrive in a results-driven environment but it does not suit everyone. Younger people, in particular, appear to want their work to have meaning. Some organisations have become very successful by focusing less on results than on inputs and what they can contribute.  Such organisations tend to have a more visionary style of leadership and one that is orientated towards some sort of higher purpose than monetary reward alone.

Boards could consider whether they think they have the right balance between making profits and contributing to public good and whether they are anticipating changing societal expectations sufficiently.

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### Trade-off #14

**Human capital versus human cost**
There is a growing suggestion that the new Generations Y (born c.1980–1990) and Z (born c.1990 onwards) will become more risk averse in their future career choices. Insecurity can also stifle aspirations and potentially alter ethical practices.

Boards may want to consider how the economic austerity that many in Generation Y and Z are facing will affect how new talents can be attracted and flourish within the organisation.

# 5. Conclusion

The first step towards assessing culture should be to determine what sort of culture an organisation wants. Attempts to understand how well its culture is working for the organisation should then inform decisions about whether changes are necessary, and help identify where potential problems may arise.

Assessing culture is difficult because it is nebulous and defies objective measurement. Culture is not something you can grab and, at best, one can only see the tip of a much bigger iceberg. Culture is a dynamic phenomenon and any attempt to measure it can result in catching only half the picture. To illustrate this, one roundtable participant referred to the Heisenberg's uncertainty principle: position and momentum of particles are two variables that cannot be measured simultaneously; in other words he said, 'the more you measure something, you pinpoint it, the less you know the direction of it', and this analogy can also be applied to culture.

Therefore, the main challenge in assessing culture is to obtain sufficient evidence and to do so one must move away from standard quantitative methods, appreciate the ambivalence of the subject, and make sensible use of a range of more subjective approaches. Asking the right questions and looking at the set of trade-offs highlighted in this study will help boards in getting to know the culture of their organisation, ultimately driving change where most needed.

A more comprehensive cultural assessment can be achieved in a variety of ways. These include surveys, meetings, seminars, workshops, interviews, audits and consultancy investigations, and each of these main approaches can be carried out in various ways. These main approaches are better used in combination than on their own. The Institute of Risk Management has published (2012) a booklet of resources for assessing risk culture, which sets out several frameworks and approaches. The Institute of Internal Auditors has published (2014) guidance on the role of internal audit in auditing culture.

It should be remembered that there is no absolutely true or 'right way' to assess culture. Attempts to manage culture themselves are difficult to prescribe – there is no guarantee that they will work, and any benefits may be slow to emerge or take root, and indeed, unintended consequences are a constant risk. It is hoped that this report will help boards and others avoid some of the potential pitfalls and help them on their journey towards evaluating and improving their own organisation's culture.

## POINTS FOR CONSIDERATION

**Align and embed core values at the very top.**
Do people who do not 'walk the talk' (act in accordance with the company's stated values) get promoted?

**Watch out for the trickle-down effect and dynamics in groups.**
What can prevent the desired tone from being established and maintained? Does the organisation have a whistle-blowing (or 'speak up') system in place that staff believe they could use without fear of retribution?

**Track how decisions are being made.**
How aware are decision-making groups, from board level downwards, of the risks of cognitive bias and groupthink? How is diversity of thinking and challenge encouraged?

**Be honest about the value of regulation and codes.**
Do management practices drive people to do things that they regard as unethical?

**Beware of unintended consequences attached to any incentives structure.**
Is it understood how incentives (deliberately created or not) work in practice? Can they be mapped and assessed in relation to the business model and organisational aims?

**Find out what motivates people.**
Are incentive structures in place actually fit for purpose? Do they promote long-term sustainable performance or do they encourage immediate self-gain only?

**Anticipate trends.**
Is the organisation open to new creative ways of thinking or is it constrained by a fear of the uncertain? How aware of global market trends are management and human resources staff?

## AREAS FOR FURTHER RESEARCH

The study reported here, alongside the other related reports in the suite, form phase one of what is intended to be a two-phase research project. The nature of the second phase has yet to be determined but will be informed by the findings of the first phase, and will delve more deeply into a particular area of this research.

The effects, positive and negative, of performance management systems and the measures used within organisations are areas worth further study.

Other areas where further insights are required include:

- the effectiveness of whistle-blowing or speak-up arrangements and whether staff believe they are safe using them

- leadership and how leaders influence the character of organisations, both positively and negatively.

There also seems to be a clear need for the business and academic communities to work together to understand how much more effectively people can be motivated in the 'real' world.

Two further areas were touched upon from time to time during the roundtables and other discussions that would seem to merit further attention. The first is about leadership and the 'personality' of organisations and the people who work in them. Organisational life has become dominated by metrics and compliance and other requirements that have to be met. The imperative is to perform or to comply or both.

The second is about time: partly thanks to the IT and internet revolutions, the pace of change in organisations is quicker than ever. The two combined help to create a mindset where there is little scope for reflective thought about the role of organisations and individuals in society.

Possible research questions include whether it is possible to have high performing cultures that are also visionary, or whether the desire to drive performance and having an inspiring vision are mutually exclusive, and whether more room should be found in organisational life for reflective thinking. Relating to this question is whether organisations which have a vision that includes playing a positive role in society can be high performing.

Research could reveal more general information about different, possibly better, ways of running organisations.

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