Board and management oversight of corporate culture

At their October 7, 2015, meeting in Washington, DC, Lead Director Network (LDN) members participated in a discussion with their chief legal officer and general counsel (GC) guests about how to foster a corporate culture that promotes creativity and growth while also ensuring a culture of compliance.[1] For further information about the LDN, see "About this document," on page 6. For a list of participants, see the appendix on page 7.[2]

This *ViewPoints* provides background information and synthesizes the discussion on the following three topics:[3]

- **Emphasizing culture**

- **Evaluating culture**

- **Changing culture**

Emphasizing culture

Corporate culture is an area of major interest for boards and management teams. While they recognized that there is a link between culture and compliance, lead directors and GCs said that culture is about more than merely preventing bad conduct.

Culture has become a point of emphasis for boards because it touches on nearly every topic a board must address. One GC explained culture's reach: *"Culture is the collection of written and unwritten rules that govern behavior in an organization. It is more than just a mission statement. With every action they take, senior leaders influence the organization's culture."* One lead director added, *"Culture drives the business. A company with a high level of integrity is more likely to do the right thing for its customers, employees, shareholders, and its community. A company can only succeed if everyone does the right thing."*

Lead directors and GCs also discussed the importance of a compliance-oriented culture. One GC was careful to note that compliance must be viewed as a priority, not just another program: *"When we talk about ethics and compliance, we gravitate to programs. But it is more than just establishing programs. We need to make sure that every major decision lines up with our mission and values."*

A positive culture can be a critical factor when a company faces a government investigation or an enforcement action. As Chris Wray, chair of King & Spalding's Special Matters and Government

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[1] The Lead Director Network comprises lead independent directors, presiding directors, and non-executive chairs. LDN documents use the term "lead director" to refer to all three roles unless otherwise stated. Likewise, this document uses the abbreviation GC to refer to general counsel, chief legal officers, or any other officer charged with leading a company's legal department or function.

[2] In another session of this meeting, lead directors and their guests participated in a dialogue with Andrew Ceresney, director of the SEC's Division of Enforcement. See Lead Director Network, "A Dialogue with Andrew Ceresney, Director of the SEC's Division of Enforcement," *ViewPoints*, December 7, 2015.

[3] *ViewPoints* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.

Investigations Practice Group, observed, *"When demonstrating that a company 'gets it,' prior proportional internal punishment conveys a sense of good corporate culture to the government. Things that happened in real time are worth their weight in gold during an investigation."* In a separate discussion, Andrew Ceresney, director of the SEC's Division of Enforcement, told lead directors and GCs that the SEC will credit a company that has a strong tone at the top, a meaningful ethics program, and shows signs that it values the legal and compliance functions.

Culture is broader than the company's compliance programs. As one lead director said before the meeting, *"If you think about culture only in terms of compliance, you've lost."*

Evaluating culture

It can be a challenge for directors and executives to identify and assess a company's culture. Lead directors and GCs considered what traits are critical to the success of an organization and how they can ensure those traits manifest themselves across sprawling enterprises.

Characteristics of a positive culture

Lead directors and GCs identified openness as one of the hallmarks of a positive culture. One lead director said, *"The single most important part of a company's culture is having it be all right to have real conversations without worrying about who might disagree."* One GC said, *"Our culture could be described as transparent, open, and communicative. It creates a positive, energetic environment when people are receptive to new ideas."* Along the same lines, following last year's General Motors recall scandal, CEO Mary Barra placed an emphasis on encouraging teams to be direct, transparent, and candid. She has said that the measure of a successful cultural transformation is improved results: "The ultimate proof point will be when we deliver exceptional financial results by continuing to do exceptional products and providing an exceptional customer experience."[4]

Adaptiveness is another key cultural trait. A recent study led by Stanford business professor Charles A. O'Reilly found that adaptive corporate cultures can transform companies and lead to "revenue growth, market and book value, 'most admired' ratings, employee satisfaction, and stock analysts' recommendations."[5] Cultural characteristics identified as adaptive included the willingness to experiment, personal initiative taking, fast decision making, and the ability to spot unique opportunities.[6] One lead director shared a similar sentiment: *"It is important for a company to encourage employees to have an entrepreneurial mindset. They should ask, 'How do we do things better? What is going on in the world around us that will cause us to change what we do?'"*

A critical component of culture is determining a company's risk appetite. One GC said that a culture must not dissuade risk-taking: *"A lot of good comes from taking risks. I worry about a culture that has too*

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[4] Geoff Colvin, "Mary Barra's (Unexpected) Opportunity," *Fortune*, September 18, 2014.

[5] Lisa Holton, "Charles O'Reilly: Finding a Corporate Culture That Drives Growth," *Insights by Stanford Business,* October 23, 2014.

[6] Ibid.

much of a punishment orientation. If you punish every poor risk decision, you will be in a bad situation." Marcelo Claure, Sprint's CEO, made a related observation: "The fear of failure can be so great within large organizations that many people seem to look for reasons not to do something rather than embracing a great opportunity. That is why I believe we must take calculated risks."[7]

Methods for understanding a company's culture

Independent directors do not work at the company full time, do not visit all of the company's offices and facilities in the regular course of their role, and meet with only a small fraction of the company's employees. Even senior managers, including GCs, are unable to comprehend the full scope of the culture of a large organization at all times and in all places.

But tactics are available to aid in the assessment of culture, and lead directors and GCs highlighted several oversight practices that they employ to better understand a company's culture:

- **Build relationships with many employees.** At some companies, directors and managers spend a considerable amount of time meeting personally and developing relationships with employees throughout their companies. In particular, lead directors value building relationships with employees who do not regularly present to the board. One lead director said, *"We have a mentor program where board members are paired with a member of management. The only requirement is that we see each other between board meetings. That relationship helps me get a sense of what things are like when I am not there."* Others suggested building relationships with middle management. One lead director said, *"We talk a lot about the tone at the top, but the muddy middle is really critical. When we engage with people in the middle, we learn about ways to change and energize the organization."*

- **Travel to company operations.** Lead directors said that the best way to get a sense of a company's true culture is to see the company in action. One way to do this is by holding board or committee meetings near a company operation away from headquarters. These visits often include factory tours, meals with the local management, and other opportunities to observe company leaders where they work. Directors and GCs also learn about culture by visiting company locations on their own. One GC said, *"The benefit of wandering around is that you meet people in their natural environment. Once you are out on the line you can see what is really going on."* One lead director suggested listening carefully during these visits: *"I call it a vocabulary test. Are people saying the same things about the company that the CEO is saying to the board? It is really impressive to have employees across a large, global organization use the same vocabulary."*

- **Review employee survey results.** Employee surveys are another tool directors can use to understand what is going on within an organization. Before the meeting, one lead director said, *"I am a fan of going out and doing a survey of all employees every few years. As part of the survey, the board looks for opportunities for employees to raise issues and talk about the culture. What motivates them? How do they feel about their managers? How comfortable are they about raising bad news?"*

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[7] Marcelo Claure, "Act Like an Entrepreneur to Accelerate in 2015," *Pulse*, January 5, 2015.

- **Monitor the hotline.** Public companies are required to maintain a hotline for reporting issues to the board's audit committee. Boards can often get a sense of the company's culture by evaluating issues raised in hotline calls. Lead directors also said that they can gauge culture by how management promotes the hotline and responds to hotline tips. One lead director said, *"Hotlines are really useful. Even if you get lots of little things, if you look at it consistently, you start to see patterns."*

Beyond specific practices, lead directors and GCs emphasized the importance of digging deeper when they sense a problem. One lead director said, *"If you ask good questions and provide opportunities for robust discussion, you will ultimately get a better sense of the organization's culture."*

Changing culture

Whether a company's culture requires a complete overhaul or just incremental improvement, there are a number of tools available to boards and managers to shape culture. Meanwhile, macroeconomic factors are forcing even the best, most established cultures to adapt.

Practices to shape culture

It takes considerable time for corporate culture to develop, and it often takes even more time for the culture to change. Lead directors and GCs discussed a number of ways boards can shape a company's culture:

- **Hire the right managers.** Directors said that the most obvious way for a board to shape corporate culture is by hiring the right management team. Lead directors and GCs said that when selecting new executives, it is important to consider their approach on ethics and culture.

- **Move successful leaders around the organization.** Lead directors and GCs said that one way to spread a company's culture is to place high-performing executives in new roles or new locations. One GC said, *"Our culture is spread through moving people all around the world. It is expensive, but it allows us to have one consistent culture."* Another GC added, *"There is also an opportunity to move people out of their functional discipline into another area to spread the culture and to gain exposure to all of the business units."*

- **Link a portion of compensation to culture.** Compensation is another tool that boards use to demonstrate the importance of culture. One lead director said, *"The proxy advisors like us to do compensation by metrics, but we resist buying in wholesale to that pressure and instead allow ourselves to consider things like ethics and leadership when setting the compensation for the CEO and leadership team."* A GC added, *"We have a rewards system that rewards values on the same basis as results. It reinforces the notion that culture is important."*

- **Punish bad conduct.** Lead directors and GCs said that conduct that harms the company's culture or reputation should be disciplined swiftly and decisively. Before the meeting, one lead director described a case in which several managers were terminated; the board wanted to make it very clear that the
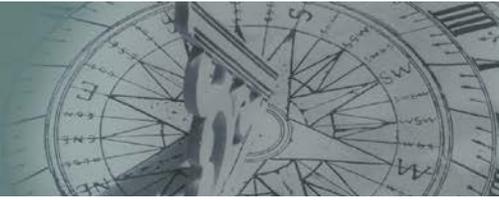
terminated employees' conduct was unacceptable: *"We publicized what we were doing and why. We usually do these things discreetly, but in this case we named names."*

▪ **Provide meaningful training.** Positive cultural characteristics are only as valuable as the organization's ability to convey them to its workforce. This often means trainings presented on site, in native languages around the world. Lead directors and GCs also discussed the benefits of virtual training. One lead director said, *"The technology that is available today is so powerful. It helps management put messages in front of people in a consistent way."* King & Spalding partner Dixie Johnson emphasized that companies must also get the message out in modes that transcend formal training programs: *"It is important to find executives in your organizations who can go out and tell the story. It helps a big workforce have a consistent culture."*

Lead directors emphasized that while the board can take steps to shape culture, it must not overstep the limits of its oversight role. However, some lead directors and GCs suggested that by its very nature, corporate culture is the sort of topic that permits the board to play a bigger role. In an earlier conversation, one GC suggested, *"It may be easier for the board to dig into culture than into operations."*

The influence of external factors on culture

Changes in the global business environment affect different companies' cultures in different ways. Lead directors and GCs identified the following external factors influencing corporate cultures:

▪ **Technological advances.** For all the benefits, technological advances also create challenges for a company's culture. Before the meeting, one lead director asked, *"How do you change a long-standing culture that has served the company well? Changes in technology, mobility, and data analytics mean that even if a company is moving faster than before, it may not be fast enough."* Another lead director added that shifts in technology have put companies *"in the middle of a talent crisis because it has become so hard to identify the skills we need."*

▪ **Demographic shifts.** Some lead directors and GCs lamented that companies are not as prepared as they should be for the cultural shift that comes with baby boomers retiring and millennials taking their place in the workforce. One lead director suggested that companies may have to focus more intently on employee training: *"Certain skills aren't being developed. People are graduating and aren't workforce ready."* A GC added that the growth in dual-income households also makes it harder for some newer workers to provide the same flexibility and loyalty as their predecessors: *"If you have a working spouse, it is hard to just pick up and move somewhere else in the world for the company."*

▪ **Diversity.** Companies continue to serve a more diverse customer base. One lead director said that this can create challenges for a company that lacks diversity: *"In the business-to-business world, customers say, 'You don't look like us. You've got to fix it.'"*
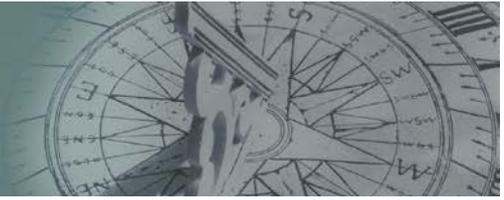
Conclusion

Lead directors and GCs agreed that setting and maintaining the right culture is critical to the success of any company, large or small. Directors and officers must overcome the challenges associated with defining and changing corporate culture to ensure that their companies, no matter how successful they might be today, are equipped with the kind of culture that can face the challenges of tomorrow. To do so requires the board to focus on ethics, values, and the tone at the top at least as much as they do on the bottom line.

About this document

The Lead Director Network (LDN) is sponsored by King & Spalding and convened by Tapestry Networks. The LDN is a group of lead independent directors, presiding directors, and non-executive chairmen drawn from America's leading corporations who are committed to improving the performance of their companies and to earning the trust of their shareholders through more effective board leadership. The views expressed in this document do not constitute the advice of network members, their companies, King & Spalding, or Tapestry Networks.
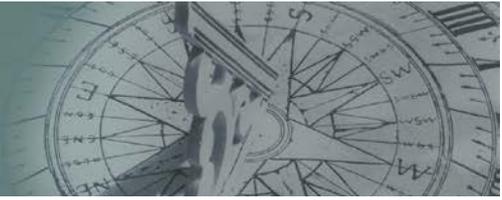
Appendix: Meeting participants

The following network members participated in the meeting:

- Sandy Cloud, Lead Trustee, Eversource Energy

- Peter Currie, Lead Director, Schlumberger and Twitter

- Ann Maynard Gray, Non-Executive Chair, Duke Energy

- Linda Fayne Levinson, Non-Executive Chair, Hertz

- Sam Nunn, Lead Director, Coca-Cola Company

- Pam Reeve, Lead Director, American Tower and Frontier Communications

- Ed Rust, Presiding Director, Caterpillar

- Tom Wajnert, Non-Executive Chair, Reynolds American

The following general counsel participated in the meeting:

- Eileen Akerson, Executive Vice President, General Counsel, and Corporate Secretary, KBR

- Sheila Cheston, Corporate Vice President and General Counsel, Northrop Grumman

- Lucy Fato, Executive Vice President and General Counsel, McGraw Hill Financial

- Cam Findlay, Senior Vice President, General Counsel, and Secretary, Archer Daniels Midland

- John Finneran, General Counsel and Corporate Secretary, Capital One

- Ed Gallagher, Acting General Counsel and Secretary, NCR

- Bernhard Goepelt, Senior Vice President and Chief Legal Counsel, Coca-Cola Company

- Barry Goldman, Senior Vice President and General Counsel, Acuity Brands

- Mark Holton, Executive Vice President, General Counsel, and Assistant Secretary, Reynolds American

- Alex Juden, Secretary and General Counsel, Schlumberger

- Mark Nielsen, Executive Vice President, General Counsel, and Secretary, Frontier Communications

- Tom Sabatino, Senior Executive Vice President, Chief Administrative Officer, and General Counsel, Hertz

The following network members took part in pre- or post-meeting discussions:

- Dick Auchinleck, Lead Director, ConocoPhillips

- Peter Browning, Lead Director, Acuity Brands

- Loren Carroll, Non-Executive Chair, KBR

- Don Felsinger, Lead Director, Archer Daniels Midland and Northrop Grumman

- Ed Kangas, Non-Executive Chair, Tenet Healthcare and United Technologies

- Doug Steenland, Non-Executive Chair, AIG

The following general counsel took part in pre- or post-meeting discussions:

- Kevin McCarthy, Senior Executive Vice President and General Counsel, Bank of New York Mellon

The following King & Spalding attorneys participated in all or part of the meeting:

- Jeff Bucholtz, Partner; National Appellate Practice Group

- Dixie Johnson, Partner; Special Matters and Government Investigations Practice Group

- Carmen Lawrence, Partner; Special Matters and Government Investigations Practice Group

- John Richter, Partner; Special Matters and Government Investigations Practice Group

- Cal Smith, Partner; Corporate Practice Group

- Michael Smith, Partner; Co-Chair, Securities Litigation Practice Group

- Chris Wray, Partner; Chair, Special Matters and Government Investigations Practice Group