TMS Academy
TEMASEK MANAGEMENT SERVICES

DIRECTORS IN DIALOGUE

Highlights of presentations and discussions at TMS Academy's Directors-in-Dialogue Forum on

16 November 2015

Culture Eats Strategy for Breakfast: Are Boards Paying Enough Attention to It?

Insights for Leaders

CULTURE EATS STRATEGY FOR BREAKFAST: ARE BOARDS PAYING ENOUGH ATTENTION TO IT?

Over the long term, a company's success or failure is determined not so much by its strategy as by its culture. The November 2015 session of TMS Academy's Directors-in-Dialogue series examined the idea that boards play an important role in shaping not just strategy, but culture. The session was facilitated by Professor Jean-François Manzoni, Professor of Management Practice at INSEAD, where he holds the Shell Chair in Human Resources and Organisational Development and co-directs the *International Directors Programme*. This white paper includes a summary of the presentations by Professor Manzoni, as well as the ensuing discussions at the forum.

The What, Why and How of Corporate Culture

Culture is a common way of thinking that drives a prevalent way of acting. It goes beyond surface aspects such as the corporate environment, norms and values: it influences the way people think, behave and interact with others. In essence, it is what people do when no one is watching.

Business leaders need to pay attention to and take responsibility for corporate culture because over the long term, a company's culture will determine its success or failure. And a sustainable culture is not something that happens spontaneously or overnight: it requires building and maintenance, not just from the board, the CEO and other top management, but from the rest of the organisation as well.

Successful companies consider culture to be a unifying force and a legacy to be preserved and passed down through the generations. Many well-known companies, including Google, have appointed chief culture officers who are tasked with developing and maintaining aspects of culture that will positively affect the company's performance.

On the other hand, organisations need to be aware that corporate culture can hit diminishing returns. A strong organisational culture is usually indicative of employees being fully aligned with the organisation's values, beliefs and thinking. The cohesive nature of such a strong culture, however, may result in groupthink, which could inhibit the organisation's ability to process differences and adapt to changes in the environment.

Aspects of Culture that Support Performance

Management and the board need to be aware of how the corporate culture affects organisational performance. The culture needs to support the brand promise, that is if the organisation brands itself as offering efficiency and good service, then its culture needs to emphasise and reward qualities such as timeliness and responsiveness.

Some aspects of culture that can impact an organisation's performance are:

- Ethics and compliance: how do people look at rules, regulations and "doing the right thing"?
- Reliability: how likely people, teams and the entire organisation itself is to keep promises
- Innovation capability: ideation and experimentation vs. disciplined ramp-up
- Conflict resolution: how differences of opinion are handled
- Areas of zero tolerance: where the line is drawn
- Performance intensity: whether performance is evaluated based on effort or outcome
- Stakeholder prioritisation: which groups of stakeholders are given greater importance and attention
- How mistakes are handled: the degree of positivity or negativity with which mistakes or failures are received
- Power distance: the extent to which people in the organisation look to top management for answers and decisions
- Cooperativeness: whether the organisation is willing to work with outsiders, or whether it focuses only on local goals
- Insularity: how open the organisation is to external ideas

Reshaping An Organisation's Culture

Often, organisations find a discrepancy between the culture they aspire to establish and their actual culture. This is not always a bad thing, as it offers room for growth and development. On the other hand, organisations must be mindful of discrepancies between their self-described and actual cultures, as these can often be a blind spot.

Reshaping an organisation's culture involves changing the way people think. This involves first changing the way they behave, because people act their way into new attitudes. The main tool for doing so is key performance indicators (KPIs). Other tools for shaping culture include setting up reward and recognition systems or setting up physical facilities to facilitate related discussions. For example, French cosmetics and beauty company L'Oreal is known to set aside a "confrontation room" in its offices where staff can work out issues rather than keep silent about problems.

At the same time, the organisation's leaders must demonstrate the desired behaviour themselves. They need to send strong, persistent and aligned signals. For example, management needs to be judicious in promoting or otherwise rewarding individuals who lack desired values but perform well in other aspects.

Sometimes, making changes is not about the culture but about how the business is defined. One Chinese company, for example, maintained very high performance and quality standards by using disincentives such as negative bonuses and mandatory training. However, such practices are considered illegal in the US. Hence, when the company expanded into that market, it had to change its practices. For instance, it re-set its minimum bonus to zero, in compliance with the local laws. The company identified its principles, which are performance driven and continuous improvement, and retained them, but changed the way it implemented these principles in different countries.

Culture, Risk and Ethics and Compliance

A company's risk management, the ethicality of its employees' behaviour and the level to which it complies with the law are affected by its culture. This can happen in both positive and negative ways. A well-known positive example is the Tata Group, which emphasises doing the right thing even if this means passing up an opportunity for profit.

The opposite (negative) end is best exemplified by Enron Corporation, whose reckless behaviour and low regard for regulations contributed to the scandal which caused its subsequent collapse. Such a corporate culture was contrary to its otherwise stated values of communication, respect, integrity and excellence.

Other factors may also affect ethics and compliance. Sometimes, a company's continued success, especially if it is considered too big to fail, may lead to complacency and decreased vigilance about its ethical and risk management behaviour.

Incentivising Ethical Behaviour

A successful company understands that the drivers of business are long term and not short term. It focuses on customer-employee relationships and uses these as the basis for its competitive advantage. Most importantly, all decision making in the company, cascading down from the board, is guided by its values and ethics.

To propagate an ethical culture, companies must consciously recruit for it, train for it, and evaluate performance for it. Some companies, such as Zappos and Amazon, have gone a step further and implemented a cultural adjustment programme under which employees who do not fit into the corporate culture are paid to leave.

Companies also need to make the workplace environment and processes conducive to ethical behaviour. One way of doing this is to encourage speaking up, either through a whistleblowing mechanism that allows people to voice their reservations, or through access at board level, where independent directors can speak to people in the company and seek their feedback.

In addition, the root causes of transgressive behaviour should be addressed. Conscious transgressions tend to stem from fear and greed when staff gives in to often self-imposed fears of loss of reputation, money or promotion, after which they actively rationalise their actions by minimising the magnitude of the breach. They might also compare their actions to other offenders or attribute their breaches to an unavoidable cause or a higher purpose. Broadly speaking, transgressions arise from three aspects: incentive, opportunity and rationalisation, and removing at least one of these will reduce the likelihood of unethical behaviour.

Typically, organisations try to reduce opportunity by increasing monitoring and putting disincentives in place. However, this often shifts people's mindset towards "how to get away with the act" versus having considerations of whether something is ethically correct.

Sometimes, people may not realise that they are transgressing. This is more likely to happen in an environment where the ethical aspect is de-emphasised. Some indicators of such an environment include:

- Business implications are emphasised over ethical implications
- Potential victims are numerous or anonymous, or when there is no identifiable victim
- Language euphemisms are used
- Rules are considered more important than principles
- Small financial penalties are imposed for transgressions

The Role of Top Management

Culture is imposed from the top down: when many employees persistently misbehave, they are most likely taking cues from those at the top. The Deepwater Horizon explosion, for example, was found to be the result of a long-running, insidious trend whereby senior personnel discounted problems and junior personnel followed that lead.

The CEO, with the support of the board, is usually considered a driver of the company's culture. Processes that the CEO implements, and the hiring and firing decisions that the CEO makes, all these send strong signals to the rest of the organisation about what behaviour is encouraged or discouraged.

A company's culture may be affected when its CEO changes. It may lose focus on important aspects of the culture that were driven by the outgoing CEO but have not yet been internalised when the CEO changes. Stability in top management is very important for nurturing and developing a strong corporate culture.

Conversely speaking, changes made by the new CEO are also a potential issue. Large corporations such as HP have experienced the downside of a CEO whose policies were ultimately detrimental to the company's culture and thereby its performance.

Ultimately, the board needs to define the CEO's mandate and set clear limits on what can and cannot be changed for the benefit of the organisation.

Reinforcing Core Values with Key Performance Indicators

Companies can use their KPIs to better manage corporate culture and reinforce core values. To do so successfully, the KPIs must be formulated such that they cover all the company's operations, and supported such that everyone in the company, from top decision makers to front line staff, understands their importance. For example, promotions should be given based not only on financial targets, but also whether the person is meeting non-financial targets such as mentoring and coaching others, or promoting the organisation outside their duties.

One way of developing KPIs that are well aligned to core values is to begin with the company's basic purpose, then extend it increasingly to wider circles of stakeholders. From there, the company can develop its strategy, processes, and finally specific goals that will become its KPIs.

Culture, Strategy and M&As

When two companies come together in a business venture, their success hinges on the compatibility of their cultures. Hence, it is crucial that a company can respect and co-exist with another organisation that functions on a completely different mode.

How Culture Affects M&A Activities

Culture has a profound impact on merger and acquisition (M&A) activities. Some key differences between corporate cultures can be seen in:

- Leadership and its tone at the top
- Power distance and other aspects of how the company is run
- Types of diversity embraced
- Types of clients, customers, suppliers and other business partners
- Attitude towards risk

If these differences are great, the merger becomes significantly more difficult and may even be compromised. In one example, two large professional

services firms which operated in similar fields merged. Both companies recruited their talent from the same pool and even the same educational institutions, yet their cultures were completely different and would take years to reconcile. The differences were further exacerbated because professional services firms place a heavy emphasis on people.

The integration of two different companies involves detailed processes. Each company must be able to identify aspects of its culture that are non-negotiable, and be clear on what value it should get out of the merger. If certain aspects of their respective cultures clash, they will have to invest time and resources into finding a middle ground.

Most importantly, the companies involved need to focus on the positive aspects of the merger rather than the negative. It is helpful to assemble a post-integration team comprising representatives from both companies to address cultural issues, if necessary.

"M&A activities are more likely to be successful if the culture resonates, the values resonate, there is a strong feeling of inclusiveness, and a feeling that the other firm's culture will value you."

LEE SUET-FERN

The International Aspect of Culture

Cultural impediments to M&A activities emerge with the greatest intensity when the merger is cross-border. Often, the image or stereotype of a country's culture will affect how well the merger is accepted. Whilst Singapore's own culture is internationally perceived as being straightforward and trustworthy, with the ability to get things done, it is not necessarily the same in other cultures.

In one example, a Chinese company attempted to merge with a US company, but it turned out that the Chinese staff were not enthusiastic about working with Americans. They indicated that they would rather work with Europeans, whom they perceived to be more technically minded and efficient in getting things done.

At other times, certain cultural characteristics affect communications among co-workers and even decision makers. American directors, for example, take a very forthright approach and are willing to ask difficult questions and probe hard into issues that they feel are of concern. In contrast, directors from many Asian cultures tend not to publicly agree or disagree and will only give their feedback in private, after the board meeting. Either approach can drastically change the board's dynamics.

Language is another potential issue. Some directors may be reluctant to speak up because of a language barrier, which makes their position appear ambivalent. While facility with English is a criterion for many corporate boards today, this also limits choices in countries where English is not a primary language. A possible solution is to have translators present at board meetings.

The key to addressing cross-border cultural issues is to practise empathy and open-mindedness. It is necessary to understand why someone in a certain environment behaves in a certain way. This can be achieved through exposure: for example, one international firm moved individuals with high managerial potential between its offices, both as culture carriers and to give them experience working in different cultural environments.

"We need to understand why someone in Tokyo or Mumbai is behaving in a certain way, how their culture affects them. There has to be a certain empathy for the individual."

GAUTAM BANERJEE

Companies also need to lay out ground rules for communication, as this can affect the quality of decision making. At the board level, the chairman must actively engage people and ensure that all views are articulated. If necessary, the chairman may even coach board members on how to put their views forward in a way acceptable to their colleagues.

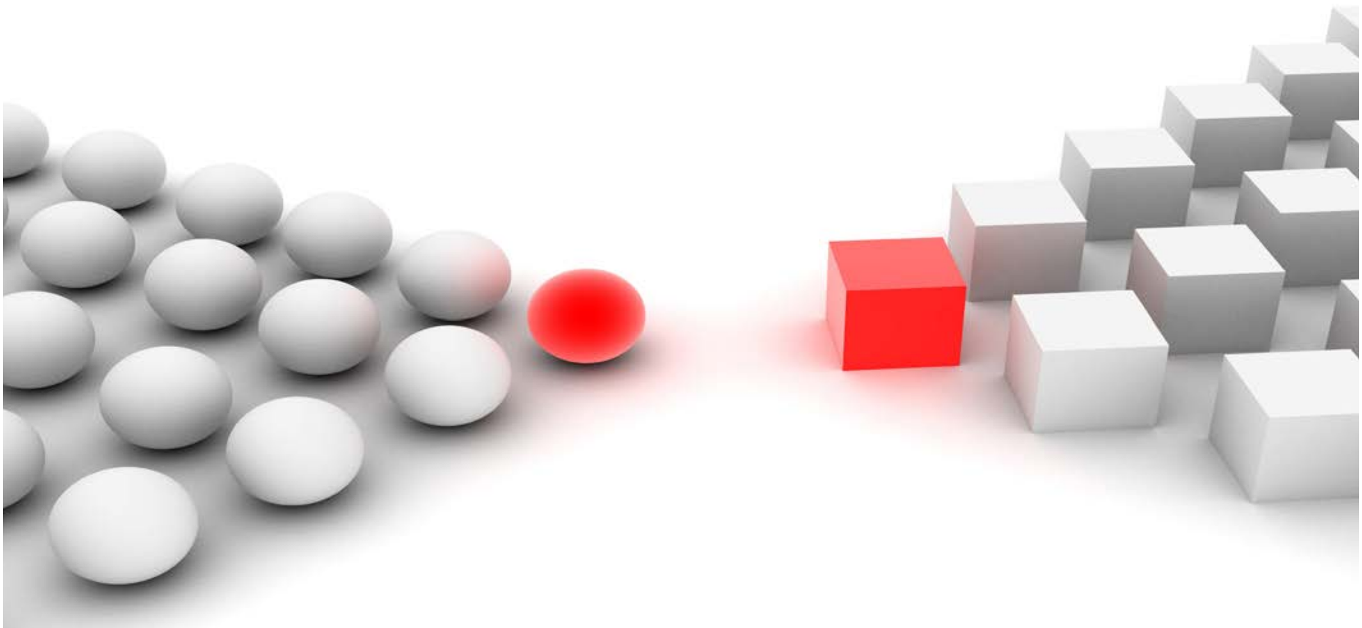
"When you buy an organisation, it is important not to destroy the value of the people. If you buy them for innovation and creative thinking, then you must give them an appropriate environment to work in."

CHALY MAH

Managing Sub-Cultures

Occasionally, cultural integration is undesirable, especially in innovation-based industries where autonomy produces the best performance and integration destroys value rather than create it. In one example, a professional services firm bought a digital practice but found that the newly acquired staff did not fit in at all: they dressed informally, made decisions independently and on the go, and sometimes valued the success of individual "stars" over teamwork. The firm eventually created a separate entrance to the office for this group of staff, so that they would not need to interact with clients whose expectations differed.

The solution to managing sub-cultures, however, goes beyond the physical environment. The company needs to manage the expectations of not only clients, but others within the main culture. While the company needs to appreciate the value of a sub-culture's difference and embrace it rather than trying to make it fit in, it must also retain its own non-negotiable values. It has to be clear that the sub-culture needs to respect the overall corporate mission. Disparities in pay structures and KPIs need particularly careful management and must be supported by observable differences between the sub-culture and the rest of the organisation.



TMS Academy

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Temasek Management Services Pte Ltd
A member of the Temasek Holdings Group

60B Orchard Road #06-18 Tower 2
The Atrium@Orchard
Singapore 238891

www.temasekmanagementservices.com.sg

For enquiries, please contact:
KNOWLEDGE CENTRE CO-ORDINATOR
programmes@tmsacademy.com.sg