tomorrow's good governance forum

Culture and opportunity aversion

Notes from 28th September Good Governance Forum. 4-7.15pm, Korn Ferry.

In the first session the group discussed the overlap between the recent work on culture and the GGF's 2016 theme of overcoming opportunity aversion. The discussion focused on how boards can support the creation of a culture that embraces innovation. The second session was on employee representatives on boards that is written up separately.

Questions to consider

- Is the board clear in which divisions of the organisation it wishes to encourage greater innovation, idea generation and risk taking?
- In these divisions, how is the board helping employees receive the support and trust needed to challenge the status quo?
- How are behaviours of challenge and idea generation being recognised and rewarded?
- Is the board and executives sending a clear message of commitment to a purpose that gives credibility to the support for innovation?
- Has the board secured the buy-in from key stakeholders, including shareholders, to pursue a long-term purpose?
- Do boardroom dynamics lead to a healthy balance between the short and long term? For example, if the CFO advocates the need for new projects to deliver a short-term return, who on the board balances this by advocating the long-term?

Background

The focus for the Good Governance Forum in 2016 is on opportunity aversion in the boardroom and how this can be overcome. There is a growing concern that boards too often focus on mitigating risk and avoiding downsides, rather than embracing the risk necessary to capture opportunities. So far in 2016 the GGF has looked at issues from time allocation to information. See the event summaries for more detail. GGF Summary April 2016, GGF Presentation April 2016, GGF Summary July 2016, Interview with Antony Jenkins

The focus for this session was on the overlap between opportunity aversion and the work of the FRC's culture coalition, which included the practical guide co-produced by Tomorrow's Company – Governing Culture: Risk & Opportunity. Below are a selection of conclusions from the recent array of reports on culture.

- Culture is important to business success.
- All cultures are different.
- Companies don't have one culture; they have a collection of sub-cultures.
- Having a statement of values does not mean a company has a good culture.
- Culture can be quite abstract, instead focusing on employee behaviours can make it more tangible.
- Culture cannot be dealt with in separation, it comes into all decisions, and to some extent is the aggregate of all decisions.
- Ultimate responsibility for culture lies with the CEO and other executives. The role of NEDs is to encourage, support and monitor.
- Boards need to actively monitor the culture, and NEDs spending time in the business is critical in achieving this.

There is also a longstanding literature on what it takes to create an innovative culture. Some common themes are highlighted below.

- Decentralised and flatter hierarchies, enabling quicker decisions and geater employee autonomy.
- Reward and recognise employees for innovating and generating new ideas. Make employees feel like owners.

- Hire innovative individuals.
- A balanced approach to failure. Reward failures where it was a worthwhile risk that was executed well.
- Relentless focus on the customer.
- Encourage collaboration across departments.
- Lead by example.

The discussion focused on the overlap between the recent work on culture and the issue of opportunity aversion in many boardrooms. For example, has culture been too narrowly interpretted as encouraging employees to do the right thing, rather than innovation? Is an innovative culture critical in generating ideas that can lead the board to take investment decisions?

Discussion summary

Founder led companies often have a clear purpose and goal that enables a more innovative approach. They have a relentless focus on achieving their goal, even if it means sacrificing short-term profit. This is supported by many entrepreneurs having a naturally high tolerance for risk. Then as companies grow and mature they become more cautious and risk averse.

This is partly desirable as we woud not want all companies and employees to have the risk profile of a start-up. In all organisations there is a valuable role for individuals focused on ensuring that behaviours meet regulations and ethical expectations. However, the evidence suggests that, in general, large established companies would benefit from an increased focus on innovation and embracing opportunity.

It was noted that a significant barrier to investment is the current high level of uncertainty, but also that companies may need to adjust to investing in a more uncertain world.

There was also agreement that culture is in many ways an unhelpful term, as it is too broad. It can be more productive to focus on purpose, values, behaviours and the alignment with strategy. Culture being the result of all decisions and not something that can be managed separately. Some values may be unchanging through time and across business units, while others may vary significantly. For example, values and behavoirs built on integrity should always apply, but initiative and risk taking may only be desirable in certain circumstances.

The discussion then focused on how a board and company can support and create an innovative culture.

The behavioural side to innovation – support, trust and confidence
Innovation and new ideas are naturaly threatening to the status quo. This can be hard as people become tied into a certain narrative they have become associated with. Accepting a change to this narrative can be hard for people, most people are happy with the status quo.

Therefore at a behavioural level people need trust and support to put new ideas forward. This applies to employees pitching new ideas to their manager, executives presenting to the board, and the broad communicating with shareholders. At each level there needs to be support, trust and confidence to take new ideas forward, or the status quo will naturally prevail.

One barrier to building this confidence is that there is a tendenancy, across these three levels, to punish failure more than we reward success.

Reward and recognition for values and the long-term
To achieve this at the employee level, companies can recognise and reward the behaviour they want to see. This could involve incorporating a discussion of the companies values in the annual appraisal process or award schemes for innovative ideas.

Another important aspect is to have rewards and recognition that encourage employees to focus on the long-term. For example, through the use of a balanced scorecard. Though this needs to be combined with the need for short-term performance assessment that creates the pressure to perform.

Purpose and leadership

To increase the credibility of such rewards CEOs can publicly recognise examples of the values in action, and hence in this context for innovative ideas. This can be greatly enhanced by having a clear purpose, similar to many start-ups and entrepreneurs. It was noted that when a CEO is clearly driven by a purpose, everyone feels it in the organisation. This can be a key mechanism to give people the confidence throughout the organisation to challenge the status quo and put new ideas forward.

Support from shareholders and other stakeholders

All individuals seeking to put new ideas forward need the support of key stakeholders. This is especially relevant for how the board communicates to shareholders. The ability of a board to puruse a long-term purpose is enhanced when they are clear with shareholders about the long-term plan and how this will involve short-term uncertainty. Building the support for a long-term purpose from key stakeholders can help provide the freedom needed in the short-term to innovate.

One example given was Alex Ferguson, who on becoming manager of Manchester United told the board not to expect any silverware in 3 years as he needed time to build the team. He secured the buy-in from the board for this plan, which gave him the freedom to innovate and plan long-term.

While shareholders can often apply short-term pressure on companies, they can also buy-into a long-term vision where a compelling case is made by management.

Boardroom conversations and dynamics

Creating the right boardroom conversations is also important. Too often executives view the board as a barrier to pursuing new ideas, rather than as a venue to discuss problems. Some executives think they can only present a board with a solution for approval, rather than a problem to be discussed. This can be helped by having time for free discussion.

Another aspect of boardroom conversations is the dynamic between the short and long term. The CFO often advocates that projects need to deliver a short-term return. This case often has a compelling logic that can be hard to argue against. However, there is a benefit to having a counter-balance who advocates the case for the long-term.

Innovation process

Companies could also benefit from thoroughly examining their innovation process. Too often individuals are not rewarded by generating new ideas right through the hierachy up to the boardroom. One role that is increasingly playing an important role in innovation is the sustainability director. They often have a wider view, and are close to the CEO and chairman.

Board diversity

Lastly, it was noted that boardroom diversity was critical in capturing a broader range of ideas and hence enabling innovation.

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