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This article explores how leadership exerts a fundamental influence on the corporate culture of an organization, and how that influence sets the tone for the way the organization conducts business. It also explores the respective role of the Board, the Chief Executive Officer (CEO) and the Chief Compliance Officer (CCO). “Tone at the top” describes how the leadership culture pervades and cascades throughout the organization, and the example set by the Board and senior management on corporate behaviour.

**Setting the Tone at the Top**

The term is used to describe an organization’s general ethical climate, as established by its board of directors, audit committee, and senior management. The term was popularized following a series of major accounting failures such as Enron, Arthur Andersen, and the U.S. Federal National Mortgage Association.

When we think of the “tone” set by the leadership, we construe it widely to cover all aspects of the organization’s operations. It refers to an organization’s guiding values and ethical climate, and management’s style of leadership and
commitment towards openness, honesty, integrity, transparency and ethical conduct.

How management and business leaders behave will set the tone for the way the employees behave. Is it a Code of Conduct? Arguably yes, but it is much wider than that. The former is a written statement of rules and expectations. Tone at the top is an unwritten proposition that defines attitudes and values that business leaders are expected to support as role models. Leaders that fail to live the values they espouse will be quickly discovered and lose credibility.

The Price of Reputation

Reputational risks are now considered as great as strategic, operating and financial risks, according to a recent survey conducted by Deloitte. Accordingly, some companies will seek to enforce the tone at the top to protect their reputation.

For example, when a Google engineer wrote a controversial memorandum that suggested men and women have underlying psychological and biological differences that make them suited to different types of work, the company acted quickly to distance itself from his views. The company responded decisively by describing the memorandum as offensive. The engineer was quickly fired for lighting a firestorm that, if handled badly, could severely tarnish Google’s reputation as an inclusive employer that embraces diversity.

The Onset of Social Media and Implications for Business

The Google incident highlights the modern pitfalls for organizations in the social media age. Carefully nurtured reputations that have taken years to foster can be destroyed overnight by an incident or scandal that goes viral.

Through social media and mobile technologies, a leader’s words and actions can go viral in a nanosecond. Once the damaging content is out there, the genie is out of the bottle. The future reputation of the organization is at stake, based on how it responds. The timing of the response is critical too. Wait too long and the more likely the response you give will be perceived as lacking in genuine intent.

For example, when a United Airlines passenger was dragged from an overbooked flight, sustaining facial injuries, the incident was filmed by a fellow passenger. That footage went viral and the resulting media frenzy threatened to engulf the company. Yet Oscar Munoz, the CEO, failed to respond for several days and then he accused the injured passenger of being disruptive and belligerent in resisting. He only apologized following a huge online petition demanding his resignation. Few treated his apology as genuine, and more as an attempt to protect his position. In the immediate aftermath, over $1 Billion value was wiped from the airline’s stock price.

The Board’s Role

The starting point for setting the tone begins with the organization’s governing authority; the Board. They are expected to appreciate that a healthy corporate culture is a valuable asset, a source of competitive advantage and vital to the creation and protection of long-term value. The preface to the UK Corporate Governance Code 2016 summarizes it succinctly:

“One of the key roles for the board includes establishing the culture, values and ethics of the company. It is important that the board sets the correct “tone at the top.” The directors should lead by example and ensure that good standards of behaviour permeate throughout all levels of the organization. This will help prevent misconduct, unethical practices and support the delivery of long-term success.”

Reinforcing this, the GC100, which represents FTSE 100 general counsels and corporate secretaries, recently provided guidance on the
interpretation of Section 172 of the UK Companies Act 2006. This section imposes a general duty on directors to consider the impact of their decisions on stakeholders such as employees, the wider community and the environment. The key principle behind the guidance is around the culture of the company. It recommends that directors should embed in the habits and behaviour of the board, management and employees, a culture which is consistent with the company’s goals. Installing culture as a director duty in this way represents a potentially significant shift in director thinking.

The Board needs to establish the appropriate tone by cultivating a culture that gives high priority to ethical standards, principles of fair dealing, professionalism, integrity, full compliance with legal requirements and ethically sound strategic goals. How can the Board achieve this?

- Firstly they must lead by example – that means working with the appropriate level of integrity and honesty; communicating their decisions in a transparent fashion.

- The composition of the board is critical. It should have sufficient expertise related to human resources and leadership development – important ingredients in shaping culture. Board training often focuses on compliance but should also include ethics and culture.

- Employee surveys can be useful tools to provide valuable insight into the state of the organization's culture.

- Compensation decisions made by the board send powerful signals throughout the organization’s culture about what is valued.

- The Board needs to ask the hard questions to satisfy themselves that management has adopted the appropriate culture and is maintaining it. They can ask about the company’s policies on whistleblowing; the company’s interaction and relationship with regulators; policies relating to disclosure and transparency etc.

It is important for the Board to be in touch with and understand employee morale and sentiment, including through updates from management, and in turn flow the corporate culture down through all levels of the organization.

**The CEO's Role**

The influence of the CEO cannot be overstated. Internally, the CEO is the face of the organization and the figurehead to whom employees ultimately look for vision, guidance and leadership. Externally, establishing the right tone can serve to fortify the organization’s reputation and its relationship with shareholders. The CEO needs to be a trusted figure within the organization by connecting with people inside and out of the organization. It requires regular, transparent communication through the most effective channels, and for the CEO to consistently exhibit his/her core values and standards. This also means developing reward systems whereby behaviour that reflects the values are rewarded, and equally behaviour that conflicts with the values be disciplined. Clear rules and consistent enforcement will ensure that the values become deeply embedded within the organization. People will know the CEO’s expectations and where they stand if they do not meet them.
The Chief Compliance Officer

The CCO has a critical part to play in setting and reinforcing the tone at the top. He/she must be beyond reproach, someone whose integrity is clear and who can earn the respect of personnel at all levels of the organization. In the world of globalization and increased competition, ever more complex international laws and standards, and onerous regulatory regimes, the role of the CCO is arguably more critical than ever. Ensuring that business is conducted diligently, ethically and in compliance with accepted business practices is one aspect. Many perceive the role of the CCO as the key person to identify and manage legal and reputational risks. Critical elements of the CCO’s mission is to raise awareness of risk; to develop training programs to address risks and to support the creation of the right culture; to act as an adviser to senior management and the board on the organization’s commitment to ethics and compliance.

The CCO contributes to tone at the top both directly and indirectly. He/she has a built-in platform for reinforcing the organization’s values, often having oversight for the Code of Conduct and the training that supports it. The CCO should also be the leader that employees can turn to for advice on ethical concerns. They are instrumental in creating a culture where employees can express their views without fear of adverse consequences, an essential element to creating a strong ethical tone.

The Business Case for the Right Tone at the Top

Why is it so important to adopt a strong ethical tone at the top? The more useful question is: What are the implications for an organization that does not adopt an ethical tone at the top? One only has to study Enron, Wells Fargo or Lehman Bros in the U.S., Danske Bank and Carillion in Europe, Toshiba and Samsung in Asia, or even Mobily in the MENA region. Below are some key benefits of adopting the right tone. These are not exhaustive.

- Stronger risk culture. An organization’s culture has a huge impact on its ability to prevent the occurrence of unacceptable risks and identify new and emerging risks in a changing operating environment. It can highlight weakness in internal controls or organizational blind spots.
• It is critical to building trust and value with shareholders, employees, customers and business partners. An organization that engenders trust and builds a reputation for ethical and fair treatment of all its stakeholders will enjoy a competitive advantage, attract shareholder investment and develop its client base. In an uncertain world, people want to deal with organizations they can trust.

• People are happiest and most productive working for companies whose values align with their own. The attraction of talent is a key priority for business leaders. In the social media world of today, many decisions are based on perceptions of an organization, and the recruitment process is becoming driven more and more by culture and reputation. Candidates want to find out what the culture is like, the opportunities for development and rewards, and the effectiveness of the leadership.

• There is a correlation between strong ethical values and improved financial performance. An ethical company can attract and retain a loyal workforce, is able to optimize its reputation, reduce its cost of equity, enhance supplier relations, and mitigate litigation and associated costs. It is a virtuous circle of “caring capitalism” whereby improved social performance leads to improved financial performance.

How Can a Company Create and Maintain an Ethical Culture and Strong Tone at the Top?

In conclusion, here are some pointers on how to develop and more importantly maintain the right ethical culture for your organization:

• It has to come from the very top. Consistent and visible executive sponsorship for ethics and compliance-related issues is mandatory to influence a change of culture;

• A culture change does not happen overnight. It needs patience. Understand the prevailing culture first before attempting to make any wide-sweeping changes. Communicate the change message clearly to inform and drive the new culture before implementing change;

• Leaders are the agents of change, the role models. It has to be action based. Leaders must consistently ‘do as they say’, to behave and conduct business in a way that is aligned to and enforces the values and ethical standards of the business. Only that way can it cascade through each level of the business;

• There should be systems that recognize and reward behaviour consistent with the values;

• Similarly misaligned behaviour must be acted upon and necessary action undertaken, openly and transparently. This may involve developing whistle-blowing procedures, but also sophisticated internal control systems that monitor and test compliance;

• Embedding systems and processes to support the tone from the top as ‘business as usual’ will help shape the organizational culture and measure the effectiveness of leadership actions and behaviours over a period of time.

Adopting the right tone at the top is a business imperative. The cost of failure to do so in this highly regulated, social media world is crippling fines, lost business and a reputation destroyed overnight that will take years to win back.