

Governing Culture

Risk & Opportunity?

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A GUIDE TO BOARD LEADERSHIP IN PURPOSE, VALUES AND CULTURE

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VALUES AND CULTURE



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Foreword

Culture is a critical element in the long-term success of any business. It is both a risk and an opportunity – a healthy culture which is consistently nurtured and developed can protect and enhance the value of an organisation and help differentiate it from its rivals. As we have seen all too often, if culture is neglected this can lead to a destruction of value.

In all of this boards have a leadership role to play and are accountable for the governance of culture.

Purpose and values embrace both strategy and behaviour. If clearly defined they can help the organisation to set a template for ethical behaviours and to embed a culture of ‘this is how we do things around here’. Clarity of purpose and clearly defined values I believe are critical to the success and sustainability of any major enterprise today.

Every organisation will have its own approach to this important topic and appropriately it is not the purpose of this guide to be prescriptive as to outcomes. It does however offer a practical agenda and roadmap to help boards to assess where their organisation stands in relation to their accountability for culture, to evaluate areas for priority action and periodically to assess progress.

Sir Win Bischoff

Chairman of the Financial Reporting Council



Sir Win Bischoff

Introduction



Sir Roger Carr

Culture is about behaviour which reflects the values, beliefs and ethics of a business and ensures that it is understood that how a business makes money is as important as how much money it makes.

For a company to be both economically successful and socially acceptable in the wider community, it must be performance driven, but values led. The culture of an organisation which aims to strike this balance is created in the boardroom.

Implementation, however, requires its absorption into the DNA of the business to ensure it is instinctively adopted by employees rather than driven by management instruction.

Culture should have no geographic boundaries or be subject to management interpretation. The definition of doing the right thing should never change at a border crossing or adjusted at an executive meeting. Culture should be the bedrock on which good business delivers great performance.

This guide is intended to help in identifying why culture matters, who drives the agenda, what good looks like and how it is delivered.

In today's world, where society increasingly believes that business is a vehicle for satisfying the greed of the few rather than creating wealth for the many, culture and values have never mattered more.

Sir Roger Carr

Chairman of BAE Systems plc

A board summary

Culture is both a risk and an opportunity. If not taken seriously by the board it can lead to the destruction of value. It is a key organisational capability and fundamental to an organisation's long-term sustainable success. It helps distinguish an organisation from its competitors and is crucial to the achievement of its strategic goals.

Organisational culture is the sum of the shared assumptions, values and beliefs that create the unique character of an organisation. The purpose and values of an organisation therefore shape culture. In successful organisations, culture governs behaviour in relationships. It defines the appropriate behaviour for any given situation – 'the way we do things around here'. It governs the interaction with customers and other stakeholders and also affects how employees identify with an organisation.

Value is created through networks of relationships that can span the globe – the organisation's 'ecosystem'. Since culture governs behaviour, it impacts on every interaction within these relationships and therefore on the value created. In the extended supplier relationships that now exist, the importance of aligned purpose, values and culture becomes crucial.

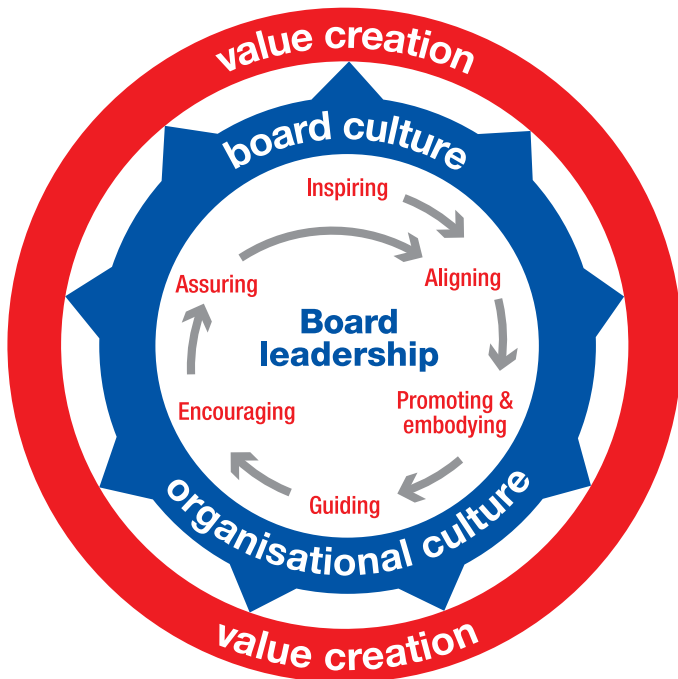
Creating a desired and consistent organisational culture is not easy especially in a global organisation. The national culture of the societies in which an organisation operates have an influence and employees bring their own values into the organisation. But the benefit of establishing common values and expectations of behaviour among employees is that this encourages consistent behaviour. This results in higher employee engagement and enhanced performance.

The desired culture that will enable success needs regular attention and nurturing. Leaders have a crucial role to play in influencing culture through what and how they communicate, their behaviours, how they reward and sanction the behaviours of others, what they measure and how they apply processes and practices. If these are not aligned, then a gap between the desired culture and the actual culture will develop.

Boards have a dual leadership role – accountability and assurance. They are accountable for ensuring that there is no ambiguity about purpose and values and for embodying the behaviours needed to deliver their strategic goals. They also need to assure themselves that the culture of the board is the desired culture and that the executive is taking the appropriate action to achieve and maintain the desired culture throughout the organisation.

"In particular an effective board... demonstrates ethical leadership, displaying – and promoting throughout the company – behaviours consistent with the culture and values it has defined for the organisation".

The Financial Reporting Council, Guidance on Board Effectiveness



The findings from our research indicate that boards which fulfil this dual role well, focus on the following six 'pillars' of success:

- **INSPIRING** purpose and set of values
- **ALIGNING** purpose, values, strategy and capability
- **PROMOTING AND EMBODYING** purpose and values
- **GUIDING** decisions using purpose and values
- **ENCOURAGING** desired behaviours
- **ASSURING** progress is being achieved.

These work together to form a cycle of review and action. We recommend that boards take time every year to review and discuss progress towards achieving the desired culture, its maintenance and development.

To assist such a discussion, we have provided two tools which are provided as separate documents within this guide:

- an 'agenda' for the board's discussion, taking each of the six pillars above and providing the core questions a board might ask of itself and the executive team
- a 'roadmap for boards' showing the behaviours boards should expect to see that address the questions in the 'agenda for boards'. The roadmap shows three stages of a journey. Boards can review where they are now and agree where they want to be. Each board will prioritise differently.

Perspectives

“A clear, inspiring purpose supported by the right culture helps to knit together companies in the same group or value chain. Purpose and culture liberate energy and innovation, both in what we do for our customers and how we do it.”

Sir Ian Cheshire, Chairman, Debenhams plc

“In the twenty-first century, free market capitalism is being tested as never before – and some of that challenge is legitimate. Yet for those organisations that can define a vision and sustain a culture that supports it, there are great opportunities if this is embedded in their products, services, client interactions and, therefore, their brand.”

Elizabeth Corley, Vice-Chair, Allianz Global Investors; Non-executive Director, Financial Reporting Council.

“In Greggs we have a set of values and apply them to every decision that’s made in the business. This culture has taken a long time to develop, and as the business faces new challenges, we are constantly testing the applicability of our values against management decisions.”

Ian Durant, Chairman, Greggs plc and Capital & Counties Properties plc

“Culture is the glue that binds an organisation together. It has a very significant impact on the firm’s effectiveness, ethics and governance. How could a board not have a view on the fitness for purpose of the firm’s culture?”

Sir Adrian Montague, Chairman, Aviva plc

“Culture is not just an accidental function of executive action: it is fundamental to the character of any charity (indeed of any organisation). And it can be changed through conscious, deliberate action. Hence culture is a legitimate topic for trustees. This does not give trustees carte blanche to step over the divide into executive territory without let or hindrance. But it does mean that, to take one example, trustees are the ultimate custodians of organisational values. And if those values are not being followed in practice, that is a proper prompt for them to ask why not.”

Andrew McDonald, Chairman, Scope

“This is an important and timely report. It is straightforward and practical and will enable boards to get to grips with an area of their remit which has been overlooked for too long and at significant cost to the organisations they govern. The inclusion of a ‘roadmap’ and the explanatory pillars succeed in making the illusory concept of organisational culture and values real and tangible. This report should be required homework for boards across all sectors.”

Catherine Devitt, CEO, Meyler Campbell

“There is an urgent need to restore the public’s trust in business; the decisions we make and the way we behave will play a crucial role in accomplishing this. I believe that commercial success and values not only coexist, but are interdependent and we need to constantly reiterate this message. Having strong values and purpose is also critical if we are to attract the next generation of talent. Millennials want a career with meaning, and to work for a firm that shares their own ethics and moral boundaries: they are prepared to sacrifice financial reward to do so. This is a wake-up call for business.”

Simon Collins, Chairman, KPMG UK

“Do the very top people in the organisation – the chairman and the chief executive – make clear how important they think the values are? If they really believe it, you can get the board to buy into it and you can get the senior management to buy into it. But if you don’t really believe it yourselves, you’re not going to make that much difference.”

Sir Peter Gershon, Chairman, National Grid plc and Tate & Lyle plc

“In my work with boards this is an absolutely brilliant guide, I will use it tomorrow! Why? It is unique in translating the Why into the What and the How. Typically, a resource like this leaves you with feeling “these are wonderful ideas, but what do we do? We have an organisation to run!” If followed, the guide will lead to a high-integrity, high-performing organisation that is good for its people, mission, and hopefully the planet.”

Carol Kauffman, Assistant Professor, Harvard Medical School and Founder/Executive Director, Institute of Coaching

The board's role

The rest of this guide explores in more detail what board leadership of purpose, values and culture means in practice.

It describes each of the six key pillars in more detail and gives examples of what the best boards do. It also shows, for each pillar, the relevant section from the 'agenda for boards' differentiating between the questions for the board to ask of itself and those it might ask of the executive team, along with the relevant part of the 'roadmap'.

Case studies are also provided in the section 'In practice...'

Why purpose, values and culture matter

In the wake of the financial crisis much has been said about the critical importance of culture, values, the need for leadership, integrity and setting the right ‘tone from the top’. Culture helps distinguish an organisation from its competitors. It is crucial to the achievement of its strategic goals. It can be an enabler or barrier to success – a capability or a disability.

There is often confusion between the use of the words culture, values and behaviours. For the purpose of this guide we define culture as being ‘the way we do things around here’. It is the sum of the shared assumptions, values and beliefs that create the unique character of an organisation. If culture is left to chance, it can absorb precious energy and put the handbrake on the organisation achieving its purpose and strategic goals. But if led and managed well culture is the rocket fuel for delivering value to stakeholders.

Purpose is an expression of why the organisation exists, beyond financial gain. It states the impact it wants to have on the lives of everyone it wishes to serve. If expressed well, purpose should inspire people so they want to work for the organisation. The set of organisational values support the achievement of this purpose.

Together, purpose and values shape an organisation’s culture. Their collective impact manifests itself through the behaviours of all those in the organisation and in the ecosystem of relationships on which it relies to create value. When the purpose is inspiring, and the values are lived by everyone and used to inform every decision made, then the organisation creates greater value for all its key relationships.

Boards are the ultimate custodians of an organisation’s purpose, values and culture. The board’s role, led by the chair, is to:

- ensure the organisation is delivering its purpose
- ensure alignment between the purpose, values, strategic goals and capability, including culture
- assure itself that the purpose and values are embedded and lived at board level and throughout the organisation and the desired culture is being achieved and maintained.

Board leadership of purpose, values and culture is a dynamic process. Boards need to be alive to the changing expectations of the organisation’s key relationships, and to the pressures of those expectations on the behaviours and decisions of people on the front line. It is also a journey. Our research shows that, while many organisations recognise the importance of these to their success, most still have progress to make in terms of governing these well.

The six pillars

Pillar 1: INSPIRING purpose and values

The best organisations are clear about their purpose, their values, their key relationships and the reciprocal value created through those relationships.

Purpose and values equip the organisation to be focused and consistent while also being adaptable. They shape its view of success, and underpin its approach to engaging in all its relationships.

Every organisation has a unique purpose – its reason for being. From this a set of values will flow that are necessary to achieve this purpose. Together they act to inspire everyone in the organisation to make the right choices and decisions.

Not only do boards need to be clear about purpose and values, they need clarity about who they value – their key relationships such as customers, employees, suppliers, investors, regulators and the communities and wider society in which the organisation operates.

Relationships are reciprocal. Each of these relationships has value to the organisation and the value that the organisation promises for each relationship needs to be made clear in return. Boards have been excellent at being sensitive and responsive to the changing expectations of investors. They now need to apply the same sensitivity to the expectations of other key stakeholders.

It is this reciprocal value created through each key relationship that differentiates an organisation from its competitors. When boards do not provide sufficient clarity about who and how this value is created, employees on the front line will find it difficult to know what behaviours are expected and to act consistently in these relationships.

Once defined, the purpose and values of an organisation tend to be long lasting and only need to be reviewed if there is a significant reason to do so. However, the reciprocal value from each key relationship may need more frequent review as stakeholders' expectations change. Mergers and acquisitions can substantially change the business model. Changing stakeholder expectations constantly shift the line that separates what wider society considers morally acceptable or not. An example is the adverse public reaction to what is seen as tax evasion.

An agenda for boards

Questions for boards to ask themselves

- What is our shared understanding about our purpose and values and the culture they inspire?
- To what extent does our purpose adequately describe the way we wish to create value for our key stakeholders including wider society?

Questions for boards to ask the executive team

- How inspiring are our purpose and values to our people and other key stakeholders, including society at large?
- How are the changing expectations of our key stakeholders being monitored in order to inform our purpose, values and strategic goals?

Stages of the journey

Level 1	Level 2	Level 3
<p>The board has a clear and shared understanding of the corporate purpose and values.</p> <p>Values are inspiring and are revisited by the board when required.</p> <p>The board has discussed and articulated the reciprocal value the organisation creates in its key relationships and the expected behaviours.</p> <p>Progress towards intended value creation against purpose is checked annually.</p>	<p>Purpose and values have been communicated to all employees at the front line in a way that resonates with them, leading to the values being more closely reflected in behaviours.</p> <p>The board receives an annual update of trends in the expectations of key stakeholders.</p> <p>The board clearly prioritises the value that the organisation creates for key stakeholders on the basis of mutuality and sustainability.</p> <p>The behaviour of all employees is aligned with and reflects the corporate values.</p> <p>The board understands the current culture in the board, the organisation and its ecosystem.</p>	<p>The board publishes what value key stakeholders can expect from the organisation.</p> <p>Members of the board meet regularly with representatives of each key stakeholder group both formally and informally.</p> <p>The value created for each key relationship is measured and reported to the board and published externally.</p> <p>The board receives a 'social value report' each year.</p>

Pillar 2: ALIGNING purpose, values, strategy and capability

Boards see strategy as a galvanising force for everyone to achieve the organisation's purpose and commercial goals, and unlock the reciprocal value that lies in all its key relationships. The strategy also sends a strong message about what senior leaders value and prioritise.

The strategy will only succeed if it is supported by the organisation's culture shaped by its purpose and values and manifested through behaviours.

The board's role is to challenge the corporate strategy and satisfy itself that the organisation has the capability to deliver it.

By capability we mean:

- financial capability: what additional investment may be required (for example in technology, new products and services, new distribution or supply networks)
- people capability: whether the people in the organisation and throughout the ecosystem of relationships on which it relies, have the skills to deliver their objectives in a way that is consistent with the stated values
- cultural capability: whether the ensuing culture is enabling or acting as a barrier to achieving the strategic goals.

Sustainable strategies of the best companies include value creation for all key stakeholders.

Purpose and values should be embedded in the business model. The business model includes not only how value is defined, but also the means by which value is created for each key stakeholder and how that value will be delivered in a consistent way, including the investment costs required to develop the organisational capability to deliver the value.

An agenda for boards

Questions for boards to ask themselves

- How well does our current business model deliver our purpose consistent with our values? What might we need to change?
- How effective is the fit between our purpose, values, culture and strategic goals? What are the barriers, enablers, risks and opportunities?

Questions for boards to ask the executive team

- What is our current versus our desired culture? What is being done to close any gap?
- To what degree does our organisation and the key relationships on which we rely to create value have the capability, including culture, to deliver our strategic goals in a way that is consistent with our purpose and values?

Stages of the journey

Level 1	Level 2	Level 3
<p>Alignment of strategy, values and behaviours is a regular board conversation.</p> <p>All human resource processes take into account values and expected behaviours.</p> <p>The board has identified suitable accreditations for the organisation and employees to help embed values.</p>	<p>The tension between purpose, values and commercial value is explicit in strategic goals and execution.</p> <p>The board regularly reviews the risks of not embedding appropriate behaviours consistent with values.</p> <p>The board ensures that the recruitment and selection of board members and key senior executives assesses their values and behaviours as well as their professional competence.</p> <p>The business model is reviewed by the board on a regular basis to ensure that it is delivering the purpose consistent with values.</p>	<p>Strategy exploits values and consistent behaviours as a differentiator or sector game changer.</p> <p>Business model goes beyond profit generated for investors to include the investment costs needed to develop organisational capability and consistent behaviours.</p> <p>Suppliers and all those in the ecosystem are required to behave consistently with values.</p>

Pillar 3: PROMOTING AND EMBODYING purpose and values

The purpose and values of an organisation shape culture and culture governs behaviour. It governs the way people and groups interact with each other, with customers and clients and other stakeholders and how much employees identify with an organisation. It defines the appropriate behaviour for any given situation – ‘the way we do things around here’.

Promoting and embodying the purpose and values of the organisation is vital. Everyone watches what the leaders of companies do. Whether speaking in public at parliamentary select committees or in private discussions in far flung corners of the organisation, employees, customers and society at large pay very close attention to what board members say and do.

The board’s role is to ensure that its own behaviour is in line with the organisation’s purpose and values and to assure itself that all leaders are doing the same.

Some boards seem almost complacent and take for granted that the published values are being lived. In some cases, these are the lucky ones where values and behaviours have been lived consistently since the organisation was founded. In today’s world even these companies need to be explicit about their purpose and values, ensure they are communicated and understood and reflected in everyone’s behaviour.

Part of this is being unambiguous about the relative priority of financial performance, reputation and values. The interests of key stakeholders are frequently in conflict with each other or with the purpose and values of the organisation. In these situations, boards send a strong signal to the rest of the organisation when they make decisions that are consistent with the organisation’s purpose and values, especially where the commercial benefits may not be immediately apparent.

Dealing with such dilemmas takes strength of character. Board members need to be seen to stand up for their beliefs and step forward in the face of serious challenge. The chair has an important role to play in ensuring that the culture of the board encourages the right behaviours. He/she can enable the board to show this kind of leadership by creating a safe space for constructive challenge and for different ideas to be aired within the boardroom. For example, by ensuring that any of the CEO’s direct reports can raise an issue with the board where they have a contrary view to the CEO. A skilful chair will be able to draw these issues out and encourage discussion. Effective use of board evaluation can be helpful.

An agenda for boards

Questions for boards to ask themselves

- What are the board behaviours we wish to encourage?
- How do we embody the purpose and values, individually and collectively, inside and outside the boardroom? What can we do to improve this?
- To what degree does our board culture encourage constructive challenge about behaviours that are inconsistent with our purpose and values?
- What more can we do as a board to communicate the behaviours we want to see of everyone who affects our reputation?

Questions for boards to ask the executive team

- How are we assuring ourselves that all leaders in our organisation promote and embody our purpose and values?

Stages of the journey

Level 1	Level 2	Level 3
<p>Leadership behaviours that role-model the values and reinforce the aspirational culture are clearly described and agreed.</p> <p>Board members and executives demonstrate purpose and values through their behaviours.</p>	<p>Board members live and breathe values, through all communications.</p> <p>Board members are selected for character and ability to promote values across the organisation and are role models for the values and culture.</p> <p>The chair includes values-led behaviour, when assessing the performance of board members.</p> <p>The performance of the chair is judged against the extent to which they live and promote the values.</p>	<p>Board members regularly visit operational sites/branches, hold town halls and meet with individuals to promote values and behaviours.</p> <p>Boardroom culture is open and self-critical. It is a safe space for concerns to be raised and discussed.</p> <p>The board has a team coach who focuses on values and culture, recognising the need for continuous development.</p>

Pillar 4: GUIDING decisions using purpose and values

Decisions, large or small, can quickly make or break an organisation's reputation. For example, the decisions taken by Volkswagen in respect of the devices monitoring emissions in their diesel vehicles.

Boards need to be clear which decisions are most critical to their organisation's reputation and success. For example, protecting the health and safety of employees, customers and society is critical to an oil and gas company. For a bank, protecting customers' deposits is a priority. The tricky decisions are those that involve balancing the competing interests of key stakeholders, such as returning profits to investors versus customer service versus employee work life balance versus value to society. Boards that are clear about the two or three most important priorities to the organisation and review these regularly will find it easier to govern culture.

Once these key priorities have been identified, the best organisations put in place a decision-making framework, supported by learning and development, to help ensure that decisions taken anywhere in the organisation reflect the purpose and stated values. This could be in the form of principles, a code of conduct or a 'mantra' that everyone in the organisation knows and which guides their decisions and behaviour – such as the 'triple bottom line' or 'doing the right thing'.

Good decision-making also means being clear about responsibilities and delegated authority, particularly in matrix organisations.

One way to judge if the decision-making framework is effective is whether the chair and board members talk about using the decision-making framework in the same language as their employees.

A parallel can be drawn with risk appetite. The litmus test for whether a board has articulated the risk appetite well is whether the chair can go to the most junior employee and find that they are able to explain what the major risks around their job are. A similar test might be applied to values. Can employees describe the major dilemmas they face or are likely to face around their job? Can they give examples of scenarios they have observed where the values are working and where they are not working? Can they give examples where decisions have been taken that are not aligned to the organisation's purpose?

An agenda for boards

Questions for boards to ask themselves

- How do we ensure that board decisions are consistent with our purpose and values?

Questions for boards to ask the executive team

- How are we ensuring that critical decisions are being taken across the organisation at the right level, by the right people, at the right time and in a way that is consistent with our purpose and values?
- What support and learning and development are being provided to help everyone we rely on to create value to take these decisions consistently with the purpose, values and strategic goals?

Stages of the journey

Level 1	Level 2	Level 3
<p>Principles-based decision-making is the norm at the board.</p> <p>Product/service alignment with purpose and values is part of the approval process for research and development and marketing.</p> <p>It is acceptable for everyone in the organisation to challenge decisions and actions that are inconsistent with the purpose and values.</p>	<p>The board has a clear decision-making framework that seeks to ensure decisions and behaviours are consistent with values.</p> <p>The values component of reputational risk is an element of all strategic decisions and is reported to the board.</p> <p>Data on the alignment of values and behaviours is collected and used in strategic decision-making.</p> <p>Everyone in the organisation is trained and supported to understand and apply the corporate values in their daily decision-making.</p> <p>The consistency with which values are expressed across the organisation is measured and monitored.</p>	<p>Values are always considered in every decision made throughout the organisation.</p> <p>Strategic discussions are accompanied by a conversation about the reciprocal value for each key relationship and the business model.</p> <p>The board regularly reviews and challenges whether it is meeting society's expectations – its 'licence to operate' – in all the countries where it does business.</p>

Pillar 5: ENCOURAGING desired behaviours

Achieving a desired and consistent culture is necessary to achieve the organisation's purpose and strategic goals. The board's role is to encourage the desired behaviours among themselves, the executive team and throughout the organisation and its ecosystem. Communication and incentives have an important part to play.

When discussing incentives, there is a tendency to consider these only in monetary terms. Yet there are other important motivators that can influence behaviour and therefore culture such as:

- moral: the drive to do what is 'right' – which is why purpose is increasingly important
- personal: the satisfaction of individual needs such as status, reputation, autonomy, achievement, self-esteem, pride in the organisation and/or its products and services
- outside forces such as regulation, public opinion, peer pressure.

These categories are not mutually exclusive. Neither do individuals exist in a vacuum – they are subject to the influence of others' beliefs, motivations and actions driven by their own incentives.

While the board should not involve itself in the details of management, it should regularly question the executive team about whether the organisation's systems and processes are encouraging the right behaviours. Remuneration, recruitment, learning and development, performance and recognition are all important but so too is how inappropriate behaviour is dealt with – what sanctions are used and in what circumstances.

There are many ways to tie values into incentive structures. For example, remuneration can be tied to non-financial metrics such as customer service and employee engagement. 'Gating systems' can be introduced, where managers are not considered for a bonus or promotion without meeting certain values targets.

All communication, both internal and external and to all stakeholders, should reflect the organisation's purpose and values.

An agenda for boards

Questions for boards to ask themselves

- What are the board behaviours we wish to encourage and how do we encourage them? How do we deal with behaviours that do not support our purpose and values?
- How do we ensure that we practice what we preach in the appointment, promotion and dismissal of the executive team?

Questions for boards to ask the executive team

- How are we rewarding and recognising the behaviours of the executive team, individually and collectively, to ensure they embody and promote our purpose and values across the whole organisation?
- How do we ensure that the incentives, processes and practices adopted inside the organisation and in our value chain are driving the right behaviours?

Stages of the journey

Level 1	Level 2	Level 3
<p>Reward is tied to demonstrated behaviour.</p> <p>The remuneration committee receives reports on individual behaviours with all submissions for pay, bonus and promotion.</p> <p>Senior leaders are rewarded/sanctioned for performance against 3 or 4 'bottom lines' e.g. finance, customers, employees, society including environmental issues.</p> <p>Senior leaders are encouraged to talk about purpose and values and expected behaviour in their routine communications.</p> <p>The board regularly reviews communications through the lens of values and behaviour.</p>	<p>There is automatic bonus reduction for senior leaders, or their teams, that do not demonstrate expected behaviours and values</p> <p>Board members and senior leaders who do not behave in line with values are sanctioned or exited.</p> <p>The board regularly considers communications strategies to encourage and reinforce purpose, values, culture and behaviour.</p> <p>Stories/examples that reinforce and encourage the desired culture are collected and widely shared.</p> <p>Employee recognition programmes encourage behaviour in line with purpose and values.</p>	<p>Board members who do not demonstrate the expected behaviours are sanctioned.</p> <p>Senior leaders are valued and recognised for consistent behaviour in line with purpose and values.</p> <p>The board receives a report which describes the level to which reward and recognition are aligned with the purpose and values in both the organisation and its ecosystem.</p> <p>Stories/examples of misaligned behaviour and the resultant action are made widely known.</p>

Pillar 6: ASSURING progress is being achieved

At any moment someone, somewhere, in every organisation will be doing something that is not consistent with the purpose and values. But boards of large companies cannot monitor how every individual is behaving. What they can do is examine and review their own behaviour and insist that management has a strategy for achieving the desired culture and develops ways to measure the behaviours that drive its culture to success.

Measuring behaviours and culture is difficult and approaches are still being developed. What is being sought is objective evidence of how behaviours have been applied in arriving at an outcome. There are three main ways board members can assess and measure behaviours:

- **observation** – while not an objective measure, observation can be useful. For example, observing how people behave in the boardroom, board members spending a day listening to calls at a call-centre or talking with those at the front line. Informal evidence can also be collected from those conducting internal reviews and audits, risk and legal teams and feedback obtained from external auditors
- **structured subjective measures** – these are the most commonly used and are helpful in terms of identifying trends. For example, reports on misdemeanours, performance management, whistle blowing, internal audit and risk reviews. In addition to trend identification, employee engagement and customer satisfaction data can give some indication of potential systemic or exceptional issues or problems
- **objective measures** – this is the ‘holy grail’. These measures focus on the outcomes of behaviours being measured in practice by using evidence about key decision-making moments to determine whether such decisions have been taken in line with the purpose and values of the organisation. Exploiting ‘big data’ within the organisation to analyse culture and values is a developing science.

Boards should consider the best way to assure themselves that the culture of the board is the desired culture and cultural issues across the organisation are being monitored and reported to the board depending on the structure of the organisation. There are differing views, but we believe there is value in having a non-executive director who leads on culture.

Over time, independent internal and/or external assurance may be possible in much the same way as companies have moved from reporting only on financial performance to including performance in some non-financial areas.

An agenda for boards

Questions for boards to ask themselves

- How are we ensuring that all the people on whom we rely to create value, inside and outside the organisation, are behaving and making decisions in line with our purpose and values?
- In what ways do we monitor whether the desired culture is being achieved at board and executive levels and across the organisation as whole?

Questions for boards to ask the executive team

- Where insufficient progress is being made, how will this be addressed by the executive team?
- Where there is misalignment, how do we assure ourselves that cultural risk is being mitigated effectively?

Stages of the journey

Level 1	Level 2	Level 3
<p>The board has ways of measuring values, behaviours and culture in the organisation (e.g. results of key stakeholder surveys such as employee engagement, customer satisfaction, regulator reports and internal reviews and audit reports).</p> <p>Internal audits cover values and behaviours contained in the above processes.</p> <p>The board receives regular 'misdemeanor' reports.</p> <p>Cultural risk is a specific risk agenda item.</p>	<p>The board agrees key values-based metrics for customers, employees and other key stakeholders and monitors regularly.</p> <p>The board has agreed ways to test whether the values resonate with the people at the front line of the organisation.</p> <p>The board receives an annual report on values and behaviours – distilled from key performance indicators (KPIs), surveys, internal audit, HR and other sources – to assure themselves that the values are being demonstrated throughout the organisation.</p> <p>The board receives an annual report on the alignment of actual and aspired culture.</p>	<p>The board publishes performance against values and behaviours with objectives and metrics in the annual report.</p> <p>The board has an independent team that measures and reviews values and expected behaviours throughout its ecosystem on a regular basis.</p> <p>The board evaluation processes always include the behaviour of board members and board culture.</p> <p>There is a non-executive director who leads on culture.</p>

In practice...

Prof. Dr. Christof E. Ehrhart

Head of Corporate Communications and Responsibility,
Deutsche Post DHL Group

Happy workers make happy customers make happy investors

That is the simple message which the board drives throughout the organisation. It can be easily understood by the managers as well as the staff in our team of more than 470.000 employees and is consistently communicated through all internal channels – from posters on blackboards to blogs in the intranet.

A Guiding Principle (Respect & Results) as well as a Customer Promise (Simplifying Services & Sustainable Solutions) have been defined to make this message even more tangible and give concrete guidance for the employees. The three bottom lines have been added with a fourth one: under the brand of Living Responsibility the Group engages in environmental protection, disaster management and education in order to make a positive contribution to our natural and societal environment.

The progress in delivering against those bottom lines – beyond the financial result and the stock market performance – is constantly measured via tools such as the yearly Employee Opinion Survey, a range of comprehensive Customer Surveys and a sophisticated Carbon Accounting that captures or CO₂ footprint against an ambitious reduction target (30% by 2020 compared to 2007). Improvement targets related to the multiple bottom lines are derived for all managers including the board.

A key instrument for creating a culture which ensures that the company lives up to the standards defined by the Guiding Principle as well as the Customer Promise is continuous leadership communication and training. Based upon the principle of whole leadership which encourages management to use mental, emotional and intuitional capacities (“head, heart and guts”) when being faced with dilemma situations, a dedicated leadership philosophy has been developed and promoted. Leaders from top management level through to middle management have been provided with insights on their given leadership profiles e.g. via upward feedback sessions with their teams and encouraged to share the learnings with their direct reports as well as peers. This process of openly addressing individual values and strengths but also weaknesses has been exemplified by the Corporate Board including the CEO. Dedicated leadership competencies which are related to the whole leadership principle form the measure which is applied to all managers during their annual appraisal.

Paul Feeney

Chief Executive Officer, Old Mutual Wealth

Enabling positive futures

In 2012, following the appointment of a new CEO, the Old Mutual Wealth Management board agreed a revised definition of their corporate purpose. They defined it at that time as to ***“provide the best investment and retirement solutions in the market, in the most flexible manner, with unparalleled service to our customers at great value”***.

Given a mandate to pursue this vision, the executive team started by going back to basics. They asked why does the company exist? What is the social value the company adds? Having set their purpose they asked how are we going to implement it? What does it mean for our strategy? What are we going to do about it? The common purpose they arrived at for the company was ***“To enable positive futures”***.

Within 12 months, 90% of their UK and European insurance books were closed to new business and replaced by new products that were aligned to the board’s vision. Having communicated the new strategy for Old Mutual Wealth Management to the market Old Mutual collected and reviewed their broker reports. All but one (out of around 30) were supportive and bumped the share price.

The change was also reinforced by creating an aligned culture in which everyone across the business took responsibility for their decisions. A part of this was ruthless honesty and blameless communication within the organisation. The culture was one where if you have made a mistake and have bad news you should speak up. This started with the CEO who made clear that nobody gets blamed for giving him bad news. The approach also meant that executives do not ‘gild the lily’, which helps to ensure that information coming to the board was truthful, and so provided a basis on which to take sound decisions.

(In March 2016, Old Mutual announced its plans to separate the group into four stand-alone businesses. Consequently, the Old Mutual Wealth culture and behaviours will evolve again to reflect its new role as a standalone entity. This is an historical case study, drawn from 2012-13, reflecting the position at that time.)

Barbara Frost

Chief Executive, WaterAid

An integrated approach

Creating and maintaining the culture needed to deliver our vision and strategy requires effective governance, management, communication and engagement. All need to be working together effectively and in an integrated and consistent way.

When I took over as CE at WaterAid in 2005, we worked in 15 countries and had an income of £27 million. Today, we operate in 38 countries and our annual income is £83 million. This success comes from being clear about what and who we are and what we and are our partners are seeking to achieve. Our vision is of a world where everyone has access to safe water and sanitation. This vision is something that resonates with and inspires all those who work for and with us and we keep this vision front and centre in all the decisions we take.

We are also driven by our values – respect, collaboration, accountability, integrity, courage and innovation. And we have fun, not just in terms of how we work together and celebrate our successes but we also use humour to drill home important messages about health and sanitation. We take our purpose very seriously but not ourselves.

The combination of having such an inspiring vision and our commitment to our values also means that we have highly engaged and passionate teams, partners, volunteers and supporters. But we can't rely on this always being the case. Maintaining this engagement and support requires constant communication, removing any silos and it requires the right leaders with the right attitude and behaviours at all levels across the organisation. Everyone who touches the organisation has to experience the same behaviours whether at the UN or in a local community in Mozambique.

We therefore invest in our selection, appraisal, development and reward processes to ensure that our performance is aligned to our values. This applies equally to our board of trustees. All our trustees are carefully selected and appraised, on a light touch but structured basis, after their first term. The board takes the time to have conversations about the changing context of our work and what this means for our achieving our vision and strategy. These conversations take place with both the board and the directors, some with just the chair and trustees and some with the board and staff during seminars on a particular issue.

And there is a simple 'back to basics' approach we all use... we ask ourselves of every decision: "so how is this going to get more people access to safe water and sanitation?"

Sir Roger Carr

Chairman, BAE Systems plc

Building an ethical business culture

At BAE Systems we have tried to develop a culture within which the company's core ethical values are taken into account in every decision our people take.

The desire to create this environment is driven by the belief that the only way to meet the ever changing demands placed on a company to maintain its licence to operate is through having a shared set of values that are applied consistently worldwide, and which are continually reinforced and improved over time throughout the organisation.

We see this boiling down to two things. First, a recognition that an ethical business culture is vital: there is no alternative. And second, that building that culture is not a single step that can be taken and then forgotten about but an on-going voyage where the destination is always just over the horizon.

The Board is clear that we should be judged not simply on how much money we make but how we make money. This belief must be anchored in the DNA of the company to ensure that doing the right thing is achieved by instinct rather than instruction. The business, at all times, must be performance driven, but values led.

In 2007, before the Woolf Review, BAE Systems rewrote the contracts for all third-party advisers worldwide and submitted each of them to a new and more rigorous approval process, including scrutiny by a panel of external experts. The process was demanding and the Woolf Report described it as being leading edge in managing ethical and reputational risks.

When the process was introduced many observed that it would be detrimental to the company as it would mean actively turning down contracts that might cause BAE Systems to breach their ethical code. In practice it has proven beneficial as customers across the globe have shown that they want to deal with providers who behave ethically. By 2012 BAE Systems' order book had doubled in size compared with the previous year and has remained strong thereafter.

Matt Peacock

Group Director of Corporate Affairs, Vodafone

A culture that prizes trust, integrity and transparency

Vodafone's vision is to deliver connectivity and innovative services to improve people's livelihoods and quality of life. Central to this is our commitment to work in the 'The Vodafone Way' with values based on speed and trust. Speed means that we focus on being quick to improve, innovate and solve problems. Simplicity means that we try to make things easy for customers, partners and ourselves by offering simple answers to complex problems and by removing obstacles that create unnecessary complexity. Trust is the oxygen of Vodafone: it means acting with honesty, integrity and fairness at all times, being reliable and transparent and cherishing the confidence that people place in us as a company.

In recent years, we have faced two potential crises which have both been averted by practising what we preach. Trust relies on transparency; and transparency relies on information and facts – digging deep in the organisation and asking hard questions to illuminate difficult issues.

At the height of the global financial crisis in 2010, Vodafone was accused of tax evasion by a protest group. Their allegations quickly gained traction in the media and in politics. What had often been seen as a rather dry and dull accounting matter suddenly came to life as an acute societal issue. Our response was to publish the first-ever tax transparency report in the global telecoms and technology industry setting out our contribution to public finances in all the countries in which we operate, using simple and accessible language to demystify complex accounting rules for the lay reader. It was also groundbreaking in giving a breakdown of our contribution to governments in each of our countries of operation on an actual cash-paid basis. Two years later, Vodafone and other UK telecoms operators were accused of illegal collusion with UK intelligence agencies. Those allegations were potentially damaging to our reputation and from a commercial perspective as customers in a number of countries worried that their communications on our networks could be compromised. We adopted the same playbook that we'd used with tax: to focus on the facts and create a report. The result was what is now considered to be the world's most comprehensive transparency report focused on law enforcement and intelligence agency powers and practices. Both these reports are updated annually and both have fundamentally reshaped our stakeholder relationships for the better.

Our response to both of these issues required integrity and – often – quite a lot of courage. I think we were only able to pursue this course because of the board's and executive committee's strong commitment to trust and honesty. It also meant that all of us involved felt strongly that shining a bright light in response to those external threats – rather than hiding from them – was absolutely in line with the company's core mission and values.

Karen Bassett

Chief Internal Auditor, Leeds Building Society

Internal culture audit

Leeds Building Society was established in 1875 to help people save money and have the home they want and this is still its core purpose.

As a result of the Financial Conduct Authority's Risk Outlook 2014, which identified culture as a key issue for the sector, Leeds Building Society undertook a culture audit because they thought it was the right thing to do.

The audit was based on six themes in a Culture Cluster, setting the scope and approach for each theme was conducted as an audit in its own right while leveraging other audit plan deliverables wherever possible. The themes were: tone at the top, risk culture, governance, member value, aspirational values, and colleague advocacy.

Expected and actual controls for each theme were categorised into three types: enablers – the processes and frameworks in place to support the desired culture; drivers – the incentives to encourage the right behaviours, such as recruiting the right people, reward and performance management; and belief – focused on what colleagues actually felt and believed in. Experienced senior auditors were trained to ensure consistency and get to the core of colleagues' beliefs. The responses were scored by colleagues on a scale of 1-6.

In order to benchmark the results of the audit and describe the existing culture, the internal audit team developed a Culture Maturity Path. Colleagues were requested to score their assessment of culture and board members were asked for their views for comparison.

The results from the review were assessed to identify key themes for improvement. Internal audit reported these results to the board in 2015 and the chief executive has initiated a programme to implement changes. The results and planned actions were shared via the Society's intranet.

To continue their review of culture the audit team are developing cultural indicators to consider as part of audits in 2016 and to be reported to the audit committee and board.

(This case study appears in the report Corporate Culture and the Role of Boards: Report of Observations and is reproduced here by kind permission of the Financial Reporting Council, the Chartered Institute of Internal Auditors and Leeds Building Society. See Other Useful Resources at page 29 for website references.)

Other useful resources

This report forms part of the findings of the Culture Coalition initiated by the Financial Reporting Council – a market-led initiative to gather insight into corporate culture and the role of boards; to understand how boards can shape, embed and assess culture; and to identify and promote good practice.

The reports that have been produced by the other partners in this project are:

Financial Reporting Council, July 2016. Corporate culture and the role of boards. Report of Observations. Available at: <https://www.frc.org.uk/Our-Work/Corporate-Governance-Reporting/Corporate-governance/Corporate-Culture-and-the-Role-of-Boards.aspx>

Chartered Institute of Management Accountants, 2016. Financial Management – Rethinking the business model. Available at: <http://www.cimaglobal.com/Thought-leadership/Research-topics/Budgeting-and-planning/Rethinking-the-business-model/>

Chartered Institute of Personnel and Development, 2016. A duty to care? Evidence of the importance of organisational culture to effective governance and leadership. Available at: <http://www.cipd.co.uk/hr-resources/research/duty-care-evidence-organisational-culture.aspx>

The Institute of Business Ethics, 2016. Stakeholder engagement – values, business culture and society. Available at: <http://www.ibe.org.uk/list-ofpublications/67/47>

Chartered Institute of Internal Auditors, 2016. Organisational culture: Evolving approaches to embedding and assurance. Available at: <https://www.iaa.org.uk/policy/publications/culture-evolving-approaches-to-embedding-and-assurance-board-briefing/>

In addition, readers may find the following helpful...

Blueprint for Better Business

Blueprint helps businesses realise their true long-term potential: to serve society, respect people, rediscover their purpose, and thereby earn a fair and sustainable return for investors. Blueprint's approach is rooted in intellectual rigour drawn from research and the collective wisdom of a number of traditions, disciplines and initiatives. It offers particular insights into the constituents of good corporate purpose founded on a more realistic view of the human person.

The tools developed by Blueprint require a shift in assumptions about the human person and their motivations. The shift is from an assumption of self-interest and extrinsic motivation (notably a strong command and control environment and financial incentives) to one of collaboration and co-creation supported by intrinsic incentives (creating a sense of meaning in what the organisation produces and the work done to produce it). This gives a distinctive meaning to what is needed to make purpose a practical contribution to the sustainable success of a company.

At the core of Blueprint's approach are the ***“Five Principles of a Purpose Driven business”***. Within the key pillars of this Guide, particularly Pillar 1, these can be used by boards as a proxy from society, a call to action and a summary of the actions and behaviours an organisation may commit to. The essence is a commitment to deliver value through explicit purpose that serves society and the quality of the human relationships nurtured internally and externally.

The ***Blueprint Framework*** which accompanies the Five Principles is a vital tool in enabling this to happen as it assists and nurtures the mindset change required.

Companies which have engaged with Blueprint recognise that those with a real purpose which delivers benefits to society, and which society acknowledges and recognises are genuine and long-term in their aspirations, build stronger relationships with those who contribute to the sustainable success of the company, including customers, suppliers, employees, communities and investors.

For further information visit www.blueprintforbusiness.org

...as well as earlier work by:

The City Values Forum with Tomorrow's Company, 2013. *Governing values: a guide for boards of financial services companies*. Available at:

<http://www.cityvaluesforum.org.uk/1.%20GOVERNING%20VALUES%20A%20GUIDE%20FOR%20BOARDS%20OF%20FINANCIAL%20SERVICES%20COMPANIES.pdf>

The **Tomorrow's Good Governance Forum, convened by Tomorrow's Company**, which brings together a number of key businesses, organisations and individuals to explore what good governance means and to make practical recommendations to company boards and policy makers. It has produced a set of guides and toolkits for use by chairmen, boards and advisors, to help achieve practical change:

- **'*The case for the Board Mandate***' advocates the creation of a formal mandate by boards as a useful framework for internal strategic decision-making and subsequent communication.
- **'*Improving the quality of boardroom conversations***' focuses on the importance of, and how to get the right level of engagement in board conversations to get the very best from the skills and abilities around the board table.
- **'*The boardroom and risk***' highlights powerful evidence to suggest that there is a serious gap in the way that many boards identify and address significant risk issues and discusses how boards can achieve a greater understanding and control over these strategically important risk exposures.
- **'*Tomorrow's Risk Leadership: delivering risk resilience and business performance***' puts forward the case for all organisations to rethink their risk leadership and consider the value of a dedicated executive risk leadership role.
- **'*Tomorrow's Chairman***' explores what makes for a great chairman now and in the future. It uses the format of a series of letters to a new chairman to offer advice and experience from a range of stakeholders.
- **'*Improving board evaluation for greater board effectiveness***' was produced in partnership with The Chairmen's Forum and provides insights, ideas and examples of 'what good looks like' when undertaking board evaluation reviews.

For further information visit: <http://tomorrowscompany.com/our-work/governance/>

Acknowledgements

Governing Culture: a guide to board leadership in purpose, values and culture arrives at a critical time in the development of thinking about the importance of culture to the long-term sustainable success of any business and, importantly it “does what it says on the tin”.

It provides chairmen and boards with an approach to framing the conversation which they will need to have about the whole topic and, without being prescriptive, enables them to determine what they feel is right for their business at each stage of development.

It contains much in the way of hard won experience and insights as well as illustrations of what good looks like and where best practice sits at each step of the way. It also offers a framework against which boards may determine the level of depth or intensity deemed appropriate for particular aspects of the programme at different stages of their development.

In short it is a flexible and resourceful guide which enables boards to take an informed and professional view of where they stand against three levels of depth, maturity and sophistication on each of the principal issues they will need to address and helps them to define a coherent policy and plan for further review and development.

Building on the work which we undertook previously on Governing Values which focused on the need to restore purpose and values within the financial services sector, Governing Culture includes wider work pertinent to a broader FTSE 350 business segment and a range of organisations.

There has been much spoken and written on the topic of corporate culture but little has focused hitherto on enabling the board to determine its own policy thinking for implementation by the executive management team. That Governing Culture is so comprehensive in its approach to each aspect of purpose, values and culture is testament to the breadth of experience brought to this work by Oonagh Harpur who has advised throughout its preparation and also to Richard Finn who also joined the team at the outset of this Lord Mayor’s Initiative in 2011 working together and with Venetia Howes. Together with our skilful, intelligent and extraordinarily patient editor Patricia Cleverly and Yolanda Villafuerte Abrego at Tomorrow’s Company they have produced what we think you will agree is an engaging and comprehensive approach to an important and multi-faceted aspect of corporate policy.

The Governing Culture team has also benefited enormously from the collaboration between the Tomorrow's Company Good Governance Forum and The Chairmen's Forum and from engagement with the Financial Reporting Council team and our partners in the FRC Culture Coalition Steering Group. Our thanks go to this group that comprises of the Institute of Business Ethics, the Chartered Institute of Personnel and Development, the Chartered Institute of Internal Auditors and the Chartered Institute of Management Accountants. Also particular thanks to Tony Manwaring who has been involved in the City Values Forum from the outset.

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Richard Sermon MBE
Chairman
The City Values Forum



Mark Goyder
Founder and Chief Executive
Tomorrow's Company

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About the City Values Forum

The City Values Forum works to embed the principles of trust and integrity in the financial and business services communities and the corporate sector and to improve cultures and behaviours.

Formed in 2011 to deliver the recommendations of The Lord Mayor's Initiative 'Restoring Trust in the City', the Forum is constituted as an informal working group reporting to The Lord Mayor.

The City Values Forum continues to work across a broad front with City institutions, corporate entities, regulators, professional and trade bodies, think tanks and academic institutions to strengthen standards of integrity in the City and corporate communities.

This work, *Governing Culture: Risk and Opportunity?* – a guide to board leadership in purpose, values and culture, is the latest in an occasional series of initiatives addressing standards of corporate governance, professional competence and the development and sharing of best practice – each aimed at improving business culture and behaviour.

No single initiative can remedy the failures of integrity revealed in recent years, but by acting with the support of many organisations, working throughout the financial, business services and corporate sectors, we aim to reassert the City's long-standing reputation for fair dealing and to encourage the development of healthy business cultures and behaviours in UK corporate life.

If we succeed together we will inspire customers and clients to entrust us with their business and earn society's endorsement of our economic role.

About Tomorrow's Company

Tomorrow's Company is a London-based globally focused agenda-setting not-for-profit think tank whose purpose is to inspire and enable companies to be a force for good in society.

It champions a practical agenda for better leadership, governance and investor stewardship.

Tomorrow's Company believes that adopting an approach that focuses on purpose, values, relationships and the long term is the key to enduring business success. It promotes this approach by engaging business leaders, investors, policymakers and NGOs in a uniquely thoughtful process which sets new agendas.

Tomorrow's Company developed the concept of the business licence to operate and redefined the concept of corporate social responsibility in the 1990s. Its work on investor stewardship and capital markets stimulated the emergence of the UN Principles of Responsible Investment and the UK's Stewardship Code.

More recently it has championed integrated reporting and a new agenda for governance and stewardship. It has significantly influenced the direction of corporate governance, including defining the inclusive duties of directors for the UK's Companies Act 2006 and influencing the King III report in South Africa.

CITY
VALUES
FORUM



45 Andrewes House
Barbican
London EC2Y 8AX

tomorrow's
company

Centre for Tomorrow's Company
Charity registration number 1055908.
Registered office: 33 Cannon Street,
London EC4M 5SB

'The City Values Forum – embedding integrity and building trust'

www.cityvaluesforum.org.uk

