



The route to risk reduction: better rules or better decisions?

Even the best rules won't eliminate risk where human behaviour is involved. New tools and techniques that focus on culture can help safeguard and add value to businesses driven by people.



The better the question.
The better the answer.
The better the world works.

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Introduction

Over the past several years, a seemingly endless series of scandals has rocked the business world. From banking to manufacturing to energy and beyond – during cycles of both growth and recession – numerous sectors have been impacted. Reputable organisations have made mistakes, and a range of fallouts have followed: revenues have dipped, share prices have fallen, established brands have been tarnished, customer loyalty has diminished, litigation has increased, regulators have investigated, large sums have been paid in fines and/or remediation and on some occasions executives have even been criminally charged and convicted.

Consider momentarily a business scandal that really caught your attention. Broken down to its most fundamental level, what caused it to happen? Were there warning signs? Could it have been prevented? And if so, how?

Amidst the maze of complicated facts surrounding most business scandals lies a significant commonality: they occurred despite the existence of leading edge compliance frameworks. In most cases, the transgressions were based on poor decision-making.

Rules are critical to influencing behaviours. However, they address only a part of how we behave and make decisions. Behaviours and decision-making are also influenced by culture, and the relationships and power structures that shape our work environments. Yet as regulators increase scrutiny and expand requirements, many organisations respond by modifying existing rules, and layering on additional ones, without adjusting for the role that culture plays in influencing human behaviours and decision-making. This singularly-focused, rules-dominant approach is intended to reduce risk. But in neglecting to focus on how people

apply those rules, it opens the door to unintentionally driving the opposite result.

In this paper, we explore the necessity of balancing rules with good judgement, and how organisations can apply cultural levers and leading-edge psychometric, psychoanalytical and data analytic tools to scan for risk, influence behaviours, strengthen compliance frameworks and improve performance.

Intangible assets and the value of culture

A recent study indicates that as much as 84% of a company's value may be intangible.² This is based on a comparison of companies' market capitalisation against tangible book value. When determining the value of an organisation, it is clear that investors and stakeholders consider more than just the assets on an organisation's balance sheet. Culture is an essential component in driving that value.

“Deficient corporate cultures are often the cause of the most egregious securities law violations, and directors, both directly and through the oversight of senior management, play a key role in shaping the prevailing attitude and behaviours within a company.”

Mary Jo White, Chair of the U.S. Securities and Exchange Commission¹

¹ Mary Jo White, Chair of the U.S. Securities and Exchange Commission, *A Few Things Directors Should Know About the SEC*, speech delivered to Stanford University Rock Center for Corporate Governance, Twentieth Annual Stanford Directors' College, June 23, 2014, U.S. Securities and Exchange Commission website, <http://www.sec.gov/News/Speech/Detail/Speech/1370542148863>, accessed 10 February 2016.

² 2015 Annual Study of Intangible Asset Market Value, Ocean Tomo, LLC, 3 March 2015.



Quick read

1. **Rules aren't enough to prevent scandals. While they can help guide decision-making, human behaviours are also shaped by individuals' experiences of an organisation's environment.**

There are many recent instances of leading edge compliance frameworks failing to prevent high profile scandals. Poor decision-making - heavily influenced by culture - is at the root of many of the transgressions. Culture is shaped by individuals' experiences of organisations' political, social, operational and performance architectures. By actively understanding and focussing on these areas, organisations can influence behaviours more effectively to reduce risk and drive sustainable performance.

2. **An unmonitored culture can pose a range of risks and prevent an organisation from fulfilling its potential.**

New understanding around organisational culture has highlighted often overlooked factors creating risk. Unacceptably high levels of stress, counterproductive competitiveness, constraints to knowledge sharing and fear of speaking up are but a few of the negative manifestations of undesirable cultural influences. Robotic compliance (narrowly pursuing targets without exercising judgement) is another, and can result in employees disregarding the interests of key stakeholders when making decisions. Each of these can prevent an organisation from fulfilling its true potential, and pose potentially significant risks.

3. **Leading edge psychometric, psychoanalytical and data analytic tools can offer early warnings for risk.**

The recent emergence of leading edge psychometric, psychoanalytical data analytic tools in the cultural arena offers organisations the ability to scan for potential 'hot spots,' identifying undesirable cultural indicators of risk. In many cases, the insights gained can relate to risks that may not otherwise have been detected. This enables intervention at an early stage.

4. **A wide range of business functions can derive value through better understanding their culture.**

Historically, most organisations have assessed performance based on economic measures. Understanding culture provides a new lens to look at how organisations achieve those results, and whether they are doing so in sustainable ways. This information offers new opportunities to a range of business functions to reduce risk and enhance performance objectives.

5. **The journey forward in leveraging culture, and the benefits this can bring.**

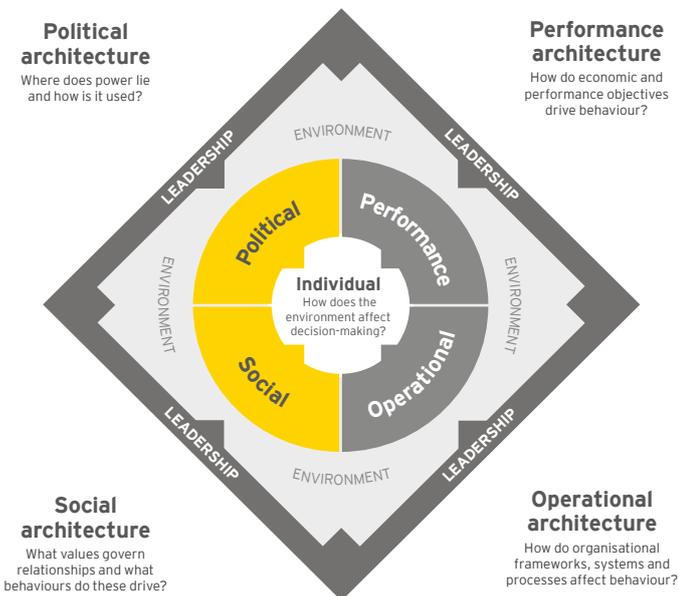
Culture offers a new approach for assessing risk. Business leaders can perform high level, non-disruptive 'temperature checks' to scan for cultural indicators of risk. Where potential issues are identified, tools and techniques adapted to assess culture on a deeper level can offer evidence-based findings that provide a roadmap for interventions and change initiatives. Combined with compliance solutions, this approach offers organisations a more holistic means of managing risk, and can lead to other benefits including more sustainable performance and increased competitive advantage.

Understanding influences on human behaviours

The architectures that drive decision-making styles

Organisations are collectives of people working together. In every team that is formed, a culture is created. This results in numerous local sub-cultures existing within a single organisation, each of which influences how employees make decisions. To successfully influence their people's behaviours, organisations need a tangible understanding of the cultural context within which people are working.

Cultures are shaped by political, social, operational and performance architectures, and the way they interact. Understanding how these architectures work and making adjustments where needed is critical to gaining confidence in how employees exercise judgement.



Historically, most organisations have focused primarily on rules to influence behaviours. That is because through operating models, policies and reporting structures, targets become tangible and performance/adherence appears measurable. However, using simplistic mechanisms, such as rules and processes, to drive human behaviours - which are inherently complex - is an incomplete approach. Recent experience shows that while rules and processes can be very effective in shaping performance and operational architectures, decision-making styles are also significantly informed by political and social architectures (i.e., the power structures and values that govern employees' relationships). These architectures are highly influenced by, and in turn define, an organisation's culture. By focussing on these architectures in addition to performance and operational architectures, organisations can create environments where teams thrive. Left unaddressed, the pulls and pressures of an organisation's political and social domains can manifest in undesirable ways.

How individuals' experiences drive business decisions and results

Culture is at the heart of influencing decision-making and behaviours. When working in tandem with well-considered rules, a culture aligned to an organisation's purpose and values helps to drive desired results. To use a simplistic example, compliance frameworks represent the rules of the road on which an organisation travels. However, rules alone don't create safe drivers. To be a safe driver, one must also exercise sound judgement when applying those rules.

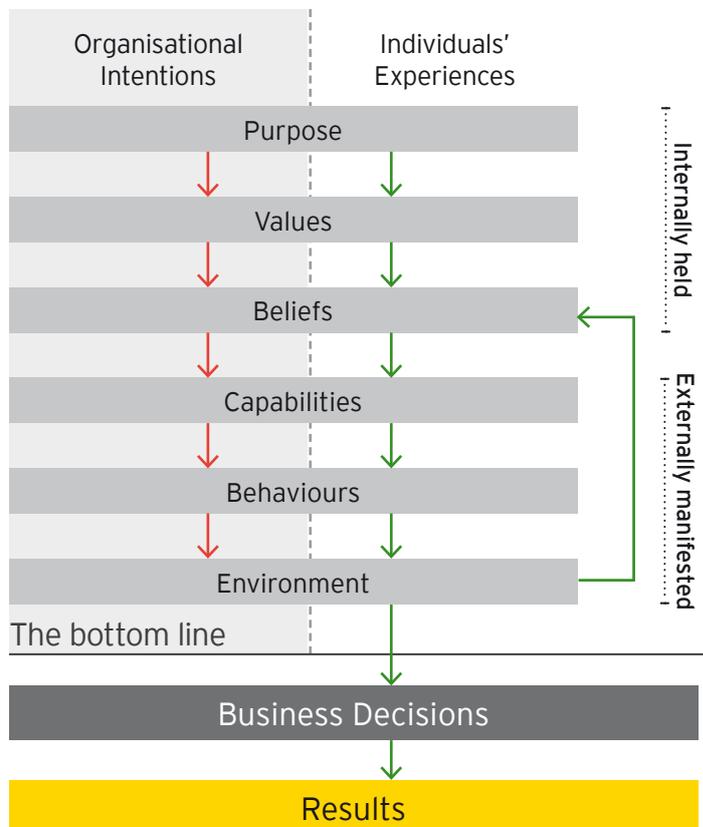
Leaders play a key role in shaping culture. They sometimes attempt to drive positive influences on culture by publishing mission statements and communicating workplace codes of ethics. However, messaging alone is rarely enough. There is often a disconnect between an organisation's stated purpose and values, and those experienced by its people. Where that disconnect exists, people's behaviours tend to be guided by what they know from their own experience. Organisations will be limited in influencing those behaviours unless they truly understand and can tap into how their people's experiences shape their views.

It is individuals' actual experiences, rather than what an organisation intends its people to experience, that drive how business decisions are made.



An individual's personal experience as to the 'real' purpose of an organisation will lead them to form their own views on what is truly valued by the organisation's leaders. These personal views crystallise as guiding beliefs, informing the individual about the capabilities they should apply and develop at work, and the behaviours that they may exhibit. Collectively, workplace behaviours are fundamental in shaping the environment in which beliefs are reinforced and within which the most trivial and most critical of business decisions are made. In this respect, what an organisation's leaders intend its decision-making environment to look like is immaterial when it conflicts with people's personal experiences of what that environment actually is.

In attempting to influence business decisions and results, most organisations focus primarily on the external manifestations of an individual's experiences (i.e., capabilities, behaviours and environment). However, that approach is incomplete as it fails to sufficiently address the internal cognitive processes that drive those actions (i.e., purpose, values and beliefs). To genuinely shift an organisation, leaders must focus not only on what individuals do, but also on the experiences that get internalised and influence how they perform their work. That is particularly the case in the context of reducing risk, where the values that guide external behaviours are critical to making good decisions.



Identifying where culture could create risk

The risk in robotic compliance

When scandals break, we often consider them in the context of rules: either that people broke existing rules or the right rules were never in place. Accordingly, it may be tempting to conclude that greater emphasis on creating a comprehensive set of well-designed rules, and closer monitoring of compliance with them, will drive desired behaviours. However, research demonstrates that a heavy focus on rules can lead individuals to suppress their human empathy at work, and become almost robotically compliant³, narrowly pursuing targets without exercising judgement. Put differently, they grow increasingly driven by an 'ethic of obedience' over an 'ethic of care' when making decisions. Importantly, research has also shown that of the three ethical philosophies that govern our decision-making (i.e., the ethics of care, reason and obedience), the ethic of obedience is the least closely associated with high performance.⁴

Targets are critical to benchmarking and achieving success in results-based sectors and industries. However, robotic compliance in the pursuit of those targets can lead to an unintended disregard of a wide range of stakeholders, including customers, suppliers and society as a whole. Organisations that encourage robotic compliance from their employees, even if unintentionally, may be discouraging those employees from considering and placing importance upon how their decisions and actions will impact those stakeholders. This is particularly significant, as when a scandal breaks public outrage typically stems from the perception that an organisation ignored those stakeholders' interests. Robotic compliance can lead to individuals 'hiding behind the rules', and failing to exercise judgement when good judgement is needed most. For many organisations, a more effective approach is to balance rules and targets with a culture that supports employees in recognising, and calling out, when pursuing the rules and targets could lead to negative outcomes.

"We have so many rules as a reaction to crises, to problems – trying to pre-empt all possible mishaps. As a result, it makes people more robotic, more blind... Too many regulations have this unintended effect of making people defensive, more risk-averse, [so they fail] to take the initiative when the initiative is warranted."

Hari Tsoukas, Professor of Organisational Studies at Warwick Business School⁵

"We have lots of targets in the NHS. Part of the job of people like me is to remind others why the targets are there. There's nothing bad about wanting patients to be treated quickly, but the key is how do we hit the targets and not miss the point?"

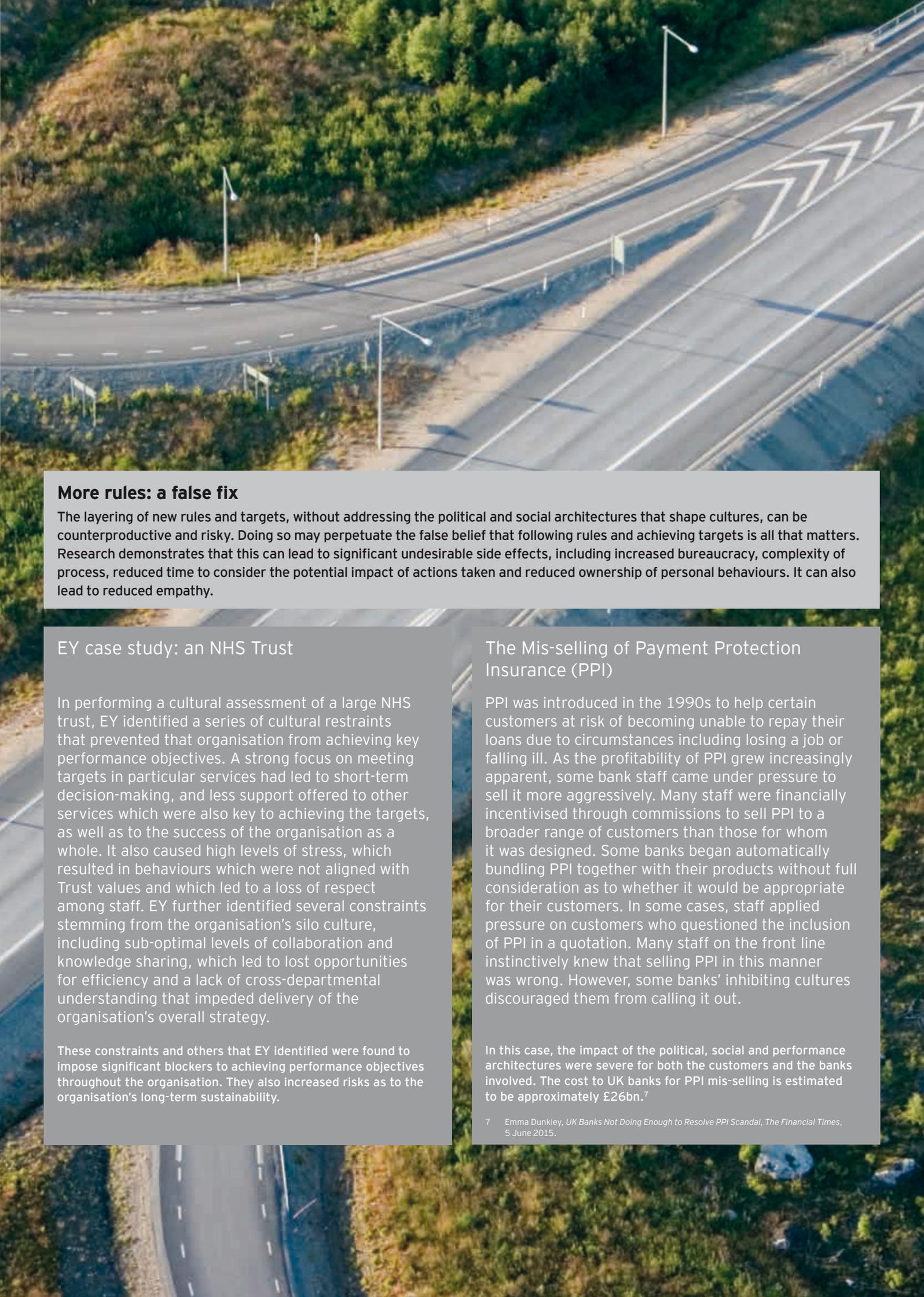
Mary Edwards, Chief Executive of Hampshire Hospitals NHS Trust (as quoted in *The Sunday Times*)⁶

3 Professor Roger Steare, Pavlos Stamboulides, Peter Neville Lewis, Lysbeth Plas, Petra Wilton and Patrick Woodman, *Managers and their MoralDNA: Better Values, Better Business*, Chartered Management Institute, March 2014.

4 Professor Roger Steare, Pavlos Stamboulides, Peter Neville Lewis, Lysbeth Plas, Petra Wilton and Patrick Woodman, *The MoralDNA of Performance: Better Values, Better Decisions, Better Outcomes*, Chartered Management Institute, October 2014.

5 Hari Tsoukas, Professor of Organisational Studies at Warwick Business School, quoted by Hannah Prevett, *We Don't Want 'Regulation Robots*, *The Sunday Times*, 28 September 2014.

6 Mary Edwards, Chief Executive of Hampshire Hospitals NHS Trust, quoted by Hannah Prevett, *We Don't Want 'Regulation Robots*, *The Sunday Times*, 28 September 2014.



More rules: a false fix

The layering of new rules and targets, without addressing the political and social architectures that shape cultures, can be counterproductive and risky. Doing so may perpetuate the false belief that following rules and achieving targets is all that matters. Research demonstrates that this can lead to significant undesirable side effects, including increased bureaucracy, complexity of process, reduced time to consider the potential impact of actions taken and reduced ownership of personal behaviours. It can also lead to reduced empathy.

EY case study: an NHS Trust

In performing a cultural assessment of a large NHS trust, EY identified a series of cultural restraints that prevented that organisation from achieving key performance objectives. A strong focus on meeting targets in particular services had led to short-term decision-making, and less support offered to other services which were also key to achieving the targets, as well as to the success of the organisation as a whole. It also caused high levels of stress, which resulted in behaviours which were not aligned with Trust values and which led to a loss of respect among staff. EY further identified several constraints stemming from the organisation's silo culture, including sub-optimal levels of collaboration and knowledge sharing, which led to lost opportunities for efficiency and a lack of cross-departmental understanding that impeded delivery of the organisation's overall strategy.

These constraints and others that EY identified were found to impose significant blockers to achieving performance objectives throughout the organisation. They also increased risks as to the organisation's long-term sustainability.

The Mis-selling of Payment Protection Insurance (PPI)

PPI was introduced in the 1990s to help certain customers at risk of becoming unable to repay their loans due to circumstances including losing a job or falling ill. As the profitability of PPI grew increasingly apparent, some bank staff came under pressure to sell it more aggressively. Many staff were financially incentivised through commissions to sell PPI to a broader range of customers than those for whom it was designed. Some banks began automatically bundling PPI together with their products without full consideration as to whether it would be appropriate for their customers. In some cases, staff applied pressure on customers who questioned the inclusion of PPI in a quotation. Many staff on the front line instinctively knew that selling PPI in this manner was wrong. However, some banks' inhibiting cultures discouraged them from calling it out.

In this case, the impact of the political, social and performance architectures were severe for both the customers and the banks involved. The cost to UK banks for PPI mis-selling is estimated to be approximately £26bn.⁷

⁷ Emma Dunkley, *UK Banks Not Doing Enough to Resolve PPI Scandal*, *The Financial Times*, 5 June 2015.

Using psychometric and psychoanalytical tools to scan for risk

Encouraging robotic compliance is but one of several ways in which an organisation's culture can unintentionally increase risk. Operating in silos and other constraints to sharing knowledge can result in sub-optimal decision-making. Competitiveness between departments and among staff can drive undesirable behaviours. Inadequate support for people speaking up can lead to misconduct going undetected. To effectively manage risk, organisations need to scan for early indicators as to where potential problems may emerge.

Innovations in psychometric, psychoanalytical and data analytics tools offer organisations the ability to perform consolidated evidence-based scans of indicators as to potential 'hot spots' where a deeper look may be warranted. Early intervention can minimise risk. One approach is to examine workers' decision-making styles. The ways people make decisions around their kitchen tables on a Sunday night often differs from how they make decisions when at their desks on a Monday morning. EY utilises a range of tools including MoralDNA™⁸, a diagnostic tool that offers insights into decision-making preferences, to assess the shift that often occurs in individuals' decision-making styles between their personal and work lives.

Based on the MoralDNA™ dataset of over 68,000 profiles⁹, we have analysed a range of sectors to identify

and contextualise the extent to which workers suppress their empathy (the ethic of care) and place greater emphasis on compliance with rules (the ethic of obedience). The shift in decision-making styles may be due to factors such as an individual's perception that compliance at work is important. It may also be due to negative leadership behaviours, which in some instances can create fear. This can manifest itself as personal fear of failure in front of colleagues, family and friends, or as high pressure environments where people believe that job security is linked to achieving challenging targets. This can override principled reason and care for the organisation, colleagues, customers and society. It can also result in individuals becoming overly focused on achieving defined performance targets, and lead to a reluctance to address undesirable behaviours where they are observed.

Additionally, when organisations are in 'survival mode', they tend to increase emphasis on hitting targets. This often leads to a tunnel vision that constrains decision-making. Target-driven cultures can also lack sufficient space and support for innovation.

⁸ MoralDNA™ is a trademark of Roger Steare Consulting Limited.

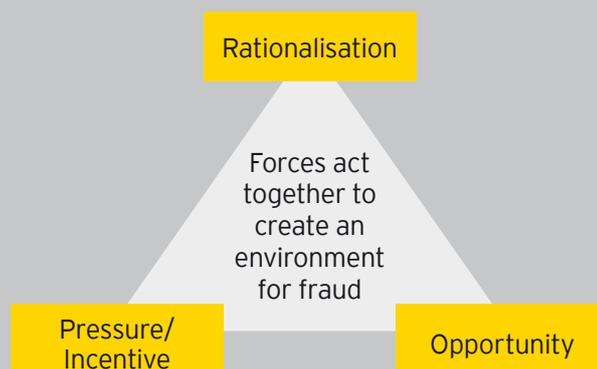
⁹ The full dataset of MoralDNA™ profiles is over 140,000, but the tool has been used to understand the difference between work and home since 2011 and thus a subset of this is relevant for the purposes of the analysis set out in this discussion paper.



The risk of fraud

Rationalisation, incentive and opportunity are commonly understood to be essential elements to enable an individual to commit fraud. Culture influences each of those components. Monitoring cultures within an organisation, and effectively addressing any red flags that are identified, can play an important part in reducing the risk of fraud.

- ▶ **Rationalisation:** Cultures where staff feel abused by leadership (e.g., overworked and under compensated) can lead individuals to rationalise committing fraudulent acts against the organisation. Similarly, people's experiences as to the unspoken desires of leadership - as communicated through the reward system or arbitrary non-enforcement of rules - may also lead employees to conclude that their transgressions don't matter.
- ▶ **Incentive:** High pressure environments where people believe that job security and/or reward is linked to achieving challenging targets can incentivise actions such as misreporting.
- ▶ **Opportunity:** Cultures of fear and blame can create situations where individuals are reluctant to speak up, resulting in misconduct going unidentified and unaddressed. Similarly, arbitrary non-enforcement of rules can provide opportunities for transgressions.

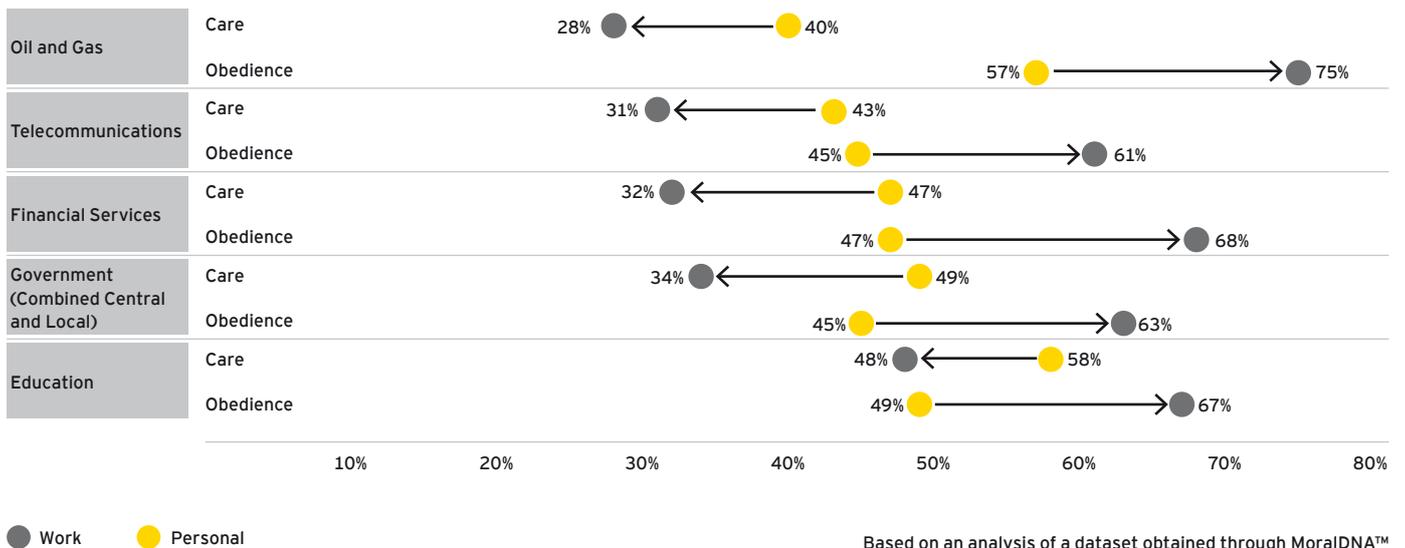


The following graph reflects the changes in decision-making styles across five different sectors: oil and gas, telecommunications, financial services, government and education. The arrows reflect the change in emphasis on the ethics of care and obedience between personal and work cultures. Where the change is greatest, and workplace care scores drop to notably low levels, there may be a greater potential for individuals to be robotically compliant, and disregard the interests of key stakeholders when making crucial decisions. Extreme shifts in decision-making styles could be the result of cultures of fear.

The analysis reflects low workplace care scores for all of the sectors reviewed, except for education. That does not mean that employees in the forementioned sectors are uncaring, but rather that their workplace decision-making styles differ from those of education sector workers, in that they appear to place comparatively less importance on how their actions impact relevant stakeholders. At the same time, they appear to have increased the emphasis they place on following the applicable rules and procedures. Where results reflect greatly decreased care scores

coupled with large workplace increases in emphasis on obedience, they may provide initial insights into the potential for robotic compliance, and therefore risk. Through MoralDNA™, organisations can drill significantly deeper, ascertaining data on decision-making styles for each level of staff or organisational division, and exploring how the data relative to an organisation stands in contrast to that of its related sector overall. Cultural circumstances – often overlooked – play a key role in shaping these decision-making styles.

Shifts in decision-making styles across various sectors



Applying data analytics to scan for risk

In recent years, multiple data analytic tools have been developed that can now be deployed in scanning for risk within a cultural context. These provide leadership with a range of evidence-based metrics and other information that highlights areas of potential concern where a deeper look may be warranted. Using these tools provides a light touch 'temperature check,' and gives business leaders a new lens on the 'cultural health' of their organisations.

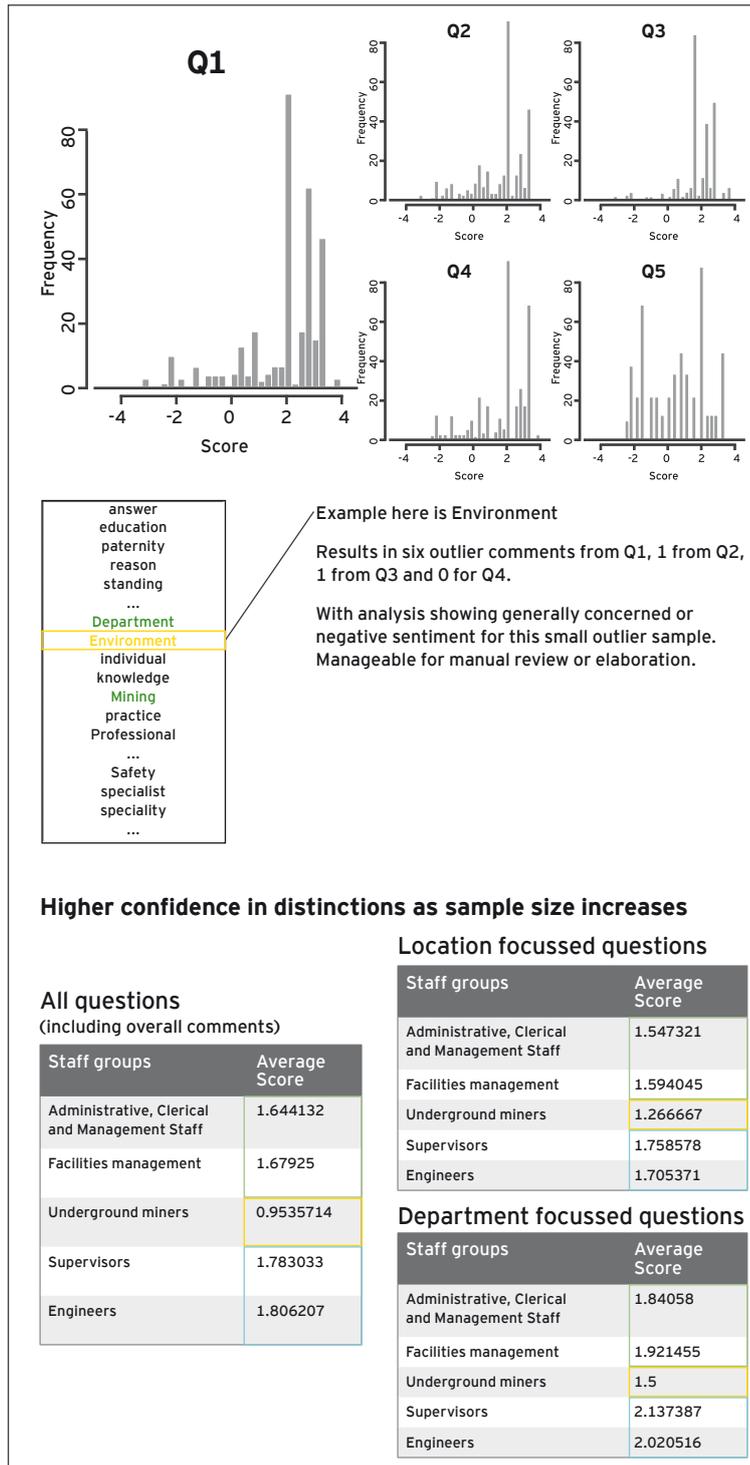
Sentiment analysis

Analysing the content of communications offers important insights into pressures, strains and issues impacting performance and decision-making. Sentiment analysis uses natural language processing, text analytics and computational linguistics to identify and extract subjective information from source materials. Employing this tool over everyday interactions/communications (e.g., emails, instant messages, social media) can help identify areas where decisions are made under high amounts of pressure and stress, or where they may be misaligned to an organisation's purpose and values. It can also help to surface issues before they are escalated through more traditional channels, providing leadership and management with an early opportunity for intervention.

Generally speaking, sentiment analysis is used to determine the attitude of a speaker or writer with respect to a certain topic or the overall context of a document. The attitude may be their judgement or evaluation, affective state or the intended emotional communication.

Sentiment analysis can be used to quickly analyse large quantities of unstructured data. The technical methodologies employed can be adjusted to scan for issues specific to an organisation or sector. Typical approaches to sentiment analysis include:

- ▶ The identification of specific, unambiguous sentiment words, e.g., happy, sad, afraid, bored
- ▶ Assessing the strength of sentiments
- ▶ Statistical probabilities based on machine learning
- ▶ Mining to extract concepts from source materials



Illustrations of sample Sentiment Analysis output



Social network analysis

Understanding human interaction is a critical component to risk reduction. It provides insights into the directions in which important information is flowing (who is receiving vs. who is broadcasting), where facilitators and blockers to information sharing exist and where unofficial seats of power and influence exist. Based on contextual information (metadata), such as the senders/receivers of an email, social network analysis can be used to build internal organisational charts by identifying reporting structures and channels, determining the strength of internal and external relationships and identifying who the most influential members of a given group or network are.

The results of the analysis can enable organisations to take steps towards significantly improving transparency and knowledge sharing, and can help mitigate risks before they materialise. Analysis results can also lead to other opportunities such as encouraging innovation by identifying and replicating patterns in high performing teams, and identifying subject matter experts and key influencers to promote important messages and initiatives.



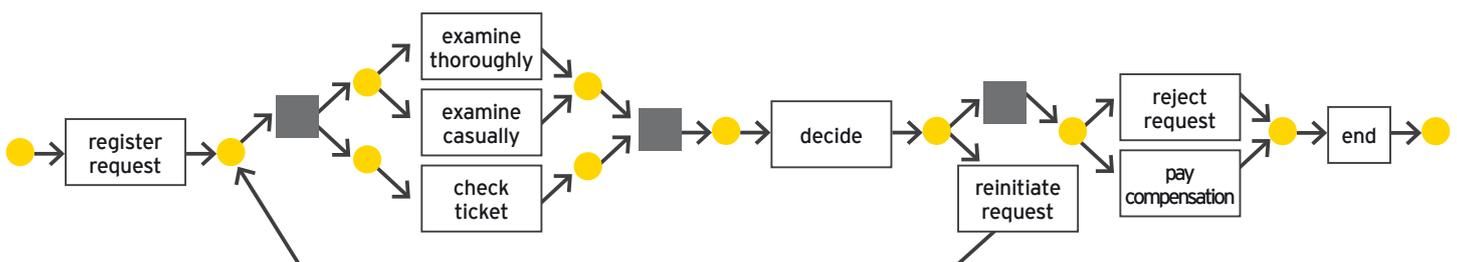


Process mining

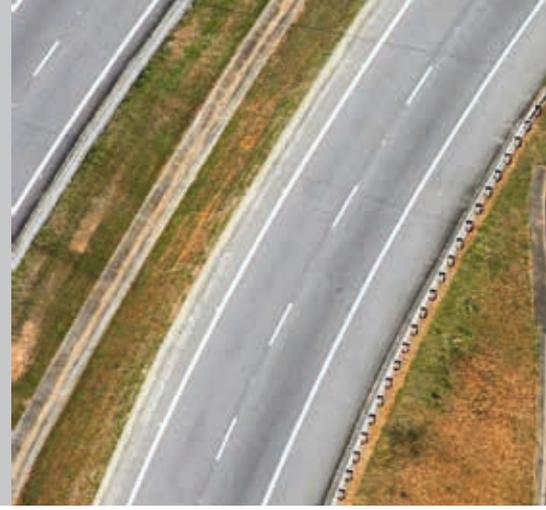
Tracing how staff handle procedural issues can provide enormous insights into the risks that well designed processes are intended to mitigate. Process mining uses event logs to track and assess case histories (e.g., customer enquiries and orders, business decisions, claims and complaints) through time. It can be applied to gain insights into unstructured processes that staff follow in order to make real-time decisions, assess conformance to existing structured processes and develop forecasts as to how changes to existing processes would play out. Through these different applications, it can be used not only to identify existing risks but also to highlight where risks may develop in the future.

Insights gained from process mining may include:

- ▶ Assessing compliance to existing structured processes
- ▶ Discovering the repeated flows and organisational habits in critical decision-making and other unstructured real-time processes
- ▶ Identifying bottlenecks and resource sinks
- ▶ Identifying de-facto worker roles and profiles
- ▶ Identifying which resources work well together, and which do not
- ▶ Enabling the development of dashboards for 'just-in-time' resource allocation and case optimisation



Connecting the dots



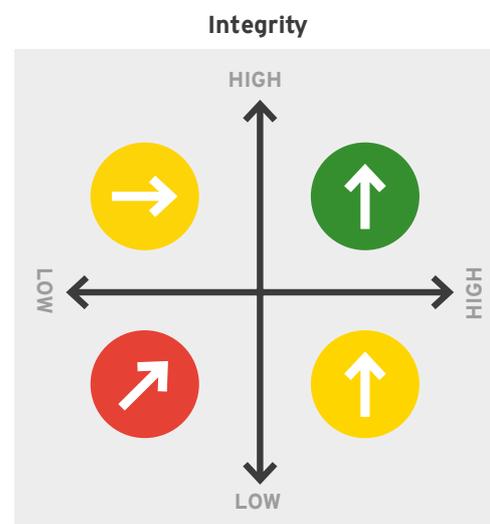
Key considerations for business leaders

By applying the right blend of cultural assessment tools, including data analytics, psychometric and psychoanalytical tools, leaders can apply a brand new lens to understanding how their organisations are operating. Importantly, whereas historically most organisations' efforts have been applied in assessing performance based on economic measures (the 'What'), these tools focus on the ways that individuals and teams achieve those results (the 'How'). In this way, they are ideally suited to identifying risks that arise from human behaviours. They can also be applied to achieve performance improvements, helping to identify areas of sustainable, high integrity performance that should be encouraged, rewarded and replicated.

There is yet a further benefit to focussing on culture:

In considering and evaluating culture, business leaders also take a significant step towards being able to measure and assign a value to it. Culture is increasingly recognised as being a fundamentally important intangible asset. As Integrated Reporting gathers momentum, it will drive a focus on the value of 'social and relationship capital' – essentially the value that is encapsulated in the strength of an organisation's relationships with its stakeholders. Culture is a primary determinant of this.

The How



The What



Questions to ask

What it means for...

CEOs

Do the cultures in the various teams across your organisation present a threat or an opportunity?

Would a better understanding of these cultures provide valuable insights into parts of the organisation that require a greater focus?

Could your culture be leveraged to improve performance and enhance delivery of your purpose and strategy?

In a merger or acquisition, are the best aspects of each culture being optimised?

Boards

Does your culture safeguard your brand?

How can you, as a board director, gain confidence that the culture of your organisation is what you think it is?

How does the board diagnose and address a problem with organisational culture?

CFOs

What role does culture play in employees' ability to rationalise non-compliant or fraudulent behaviour?

How can culture help you to gain confidence in the soundness of your financial estimates?

How could you use culture to drive efficiencies throughout your organisation?

How could earlier detection of risks support the development and delivery of a financial and operational strategy?

Audit Committee

How can understanding culture identify areas of pressure which may increase risk of financial mis-statement?

How is your external auditor considering culture in the assessment of the general control environment?

How is your internal audit department leveraging cultural tools and techniques to increase the efficiency and effectiveness of their work programme?



Questions to ask

Compliance

How does the culture of your organisation impact on the effectiveness of your compliance frameworks?

Is the extent of your compliance framework appropriate given the ability of your people to make the right decisions?

How does your compliance framework consider the root causes of non-compliance?

Risk Management

How can tapping into your culture help provide early detection of risky behaviours?

Does your culture make managing risk harder?

Would a better understanding of your organisation's culture provide valuable insights into parts of the organisation that require a greater focus?

How does your culture support or prevent your employees from raising concerns?

Legal

Would the culture of your organisation attract the attention of the regulator?

How could your culture cause significant share loss and reputational damage?

How could your culture reduce your exposure to regulatory fines and litigation?

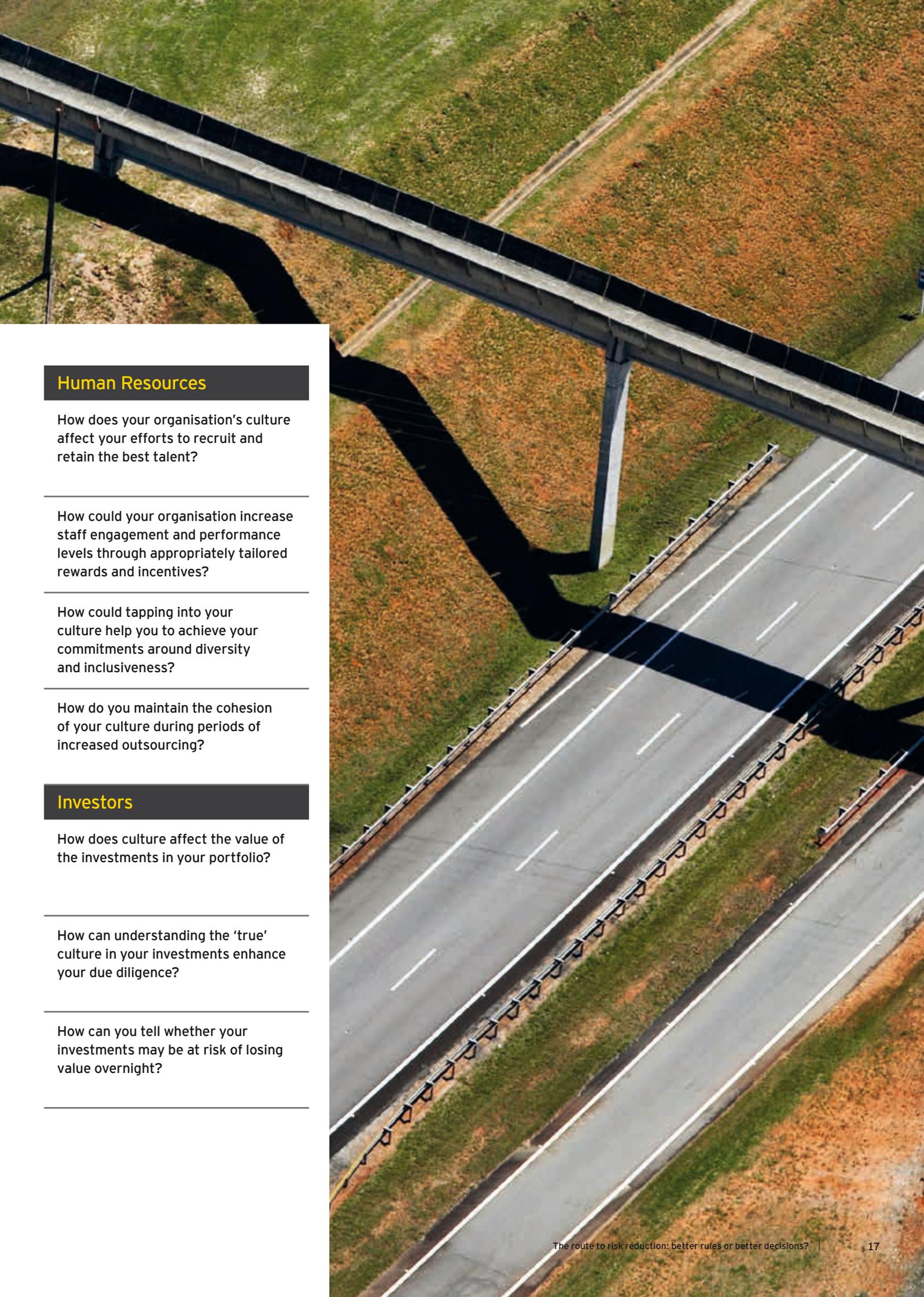
Internal Audit

What role should internal audit play in assessing the culture of your organisation?

How would an understanding of the cultures across the teams in your organisation help you to identify areas for greater focus?

How can culture help you to more effectively identify the root causes of issues and provide recommendations to address them?

Is everyone doing the right thing with your organisation's money?



Human Resources

How does your organisation's culture affect your efforts to recruit and retain the best talent?

How could your organisation increase staff engagement and performance levels through appropriately tailored rewards and incentives?

How could tapping into your culture help you to achieve your commitments around diversity and inclusiveness?

How do you maintain the cohesion of your culture during periods of increased outsourcing?

Investors

How does culture affect the value of the investments in your portfolio?

How can understanding the 'true' culture in your investments enhance your due diligence?

How can you tell whether your investments may be at risk of losing value overnight?

Assessing culture and risk: the journey

Different organisations experience different risks. The right mitigation steps for one organisation will vary from those for another. The best approach to reducing risk takes both rules and cultural influences into account. Developing evidence-based insights into an organisation's culture is key to leveraging it to achieve risk reduction and performance objectives. Business leaders can begin that journey by undertaking an incremental series of focused actions:

- ▶ Perform a high-level risk assessment using data analytics and psychometric and psychoanalytical tools to identify 'hot spots' that may warrant closer inspection. The nature of the tools means that the scan can be undertaken with limited disruption to business activity.
- ▶ If a deeper look into one or more areas is warranted, consider undertaking a more comprehensive cultural assessment of particular teams or across the organisation. An expanded variety of tools can be employed in undertaking the assessment, resulting in evidence-based findings that can support pathways forward.
- ▶ Analyse the findings of the cultural assessment to develop a deeper understanding of behaviours that may lead to risk. The findings may also provide insights as to restraints against, and drivers for, performance objectives. Develop an action plan that uses cultural levers to address the issues identified.
- ▶ Implement the action plan. Following a period of time appropriate to the organisation's circumstances (e.g., 12-18 months), perform a second cultural scan to ascertain progress.

Because cultures are not static, 'fixes' don't last forever. People come and go, and business circumstances change. By regularly focussing on culture, much like how organisations regularly focus on strategy, growth and compliance, business leaders can gain confidence not only in their holistic approach to reducing risk, but also in their ability to leverage opportunities to drive sustainable performance.

Reducing risk

In recent years, an increasing number of organisations have begun using culture to enhance compliance frameworks, and thereby reduce risk. The correlated results are highly compelling, and manifest in a wide variety of ways. Case studies reflect a strong link between investing in culture and achieving objectives such as reductions in fines imposed and litigation. Additionally, some organisations have been particularly successful in applying cultural levers to encourage speaking up and the challenging of decisions. This has contributed towards improvements including fewer costly product recalls and lower counterparty risk, including in supplier relationships.

Improving financial performance and achieving competitive advantage

Research has also shown that culture is correlated to high performance in ways beyond reducing risk.¹⁰ Achieving growth objectives, reducing costs and improving customer service are but a handful of the correlated outputs organisations have achieved following investments in their cultures. Numerous examples reflect links between organisations that actively reinforce employee commitment and those that experience an increase in profits and sales. Their culture initiatives vary from direct employee engagement by leadership, to soliciting strategy ideas from staff, to empowering employees with increased financial responsibility. In so many cases, the result of organisations' investments in their people has been their enhanced ability to get the best out of them.

Talent management is a further area where culture can lead to obtaining a competitive advantage. An independent study focussing on college graduates at US public accounting firms found that the rate at which employees voluntarily terminated their employment was significantly lower for firms with 'interpersonal' organisational cultures when compared to 'task-based' competitors.¹¹ Similarly, fostering collaborative cultures, combined with competitive perks and benefits, has been linked to the ability of organisations to attract high-calibre job applicants.

¹⁰ William G. Ouchi, *Theory Z: How American Business Can Meet the Japanese Challenge*, Addison Wesley, April 1981; Terrence E. Deal, Allan Kennedy, *Corporate Cultures: The Rites and Rituals of Corporate Life*, Basic Books (re-print edition), 15 May 2000; Thomas J. Peters, Robert H. Waterman, Jr., *In Search of Excellence: Lessons from America's Best-Run Companies*, HarperBusiness (re-print edition), 7 February 2006; HyunJeong S. Han, Ph.D., Rohit Verma, Ph.D., *The Effect of Corporate Culture and Strategic Orientation on Financial Performance: An Analysis of South Korean Upscale and Luxury Hotels*, Cornell University School of Hotel Administration, Center for Hospitality Research Publications, 2 January 2012; Jay B. Barney, *Organizational Culture: Can It Be a Source of Sustained Competitive Advantage?*, *The Academy of Management Review*, Vol. 11, No. 3, July 1986.

¹¹ John E. Sheridan, *Organisational Culture and Employee Retention*, *The Academy of Management Journal*, Vol.35, No. 5, 1 December 1992.

Conclusion

Focussing on culture can decrease risk and improve performance. However, that does not mean we can abandon rules in favour of an approach singularly focused on culture.

Recalling the safe driver example, the roads would not be safe without rules governing them. Rules are immensely important in defining the parameters within which teams and individuals should operate. But rules alone are not enough. It's whether and how they are adopted by people when making decisions that matters. Even the most well-intentioned rules can be overwhelmed by culture when it is ignored.

The key is striking the right balance to create a space where rules and culture reinforce one another. To foster the cultures that can effectively nudge people to engage in desired behaviours, organisations have to start by understanding the cultures that they currently have. It's hard, but critical work if organisations are to gain leverage over how their people exercise judgement. And judgement is at the heart of nearly every business scandal that ever occurred.

Simply put, the route to risk reduction requires better rules and better decisions. An organisation that neglects its culture is at just as much risk as one that neglects its rules.

Measuring the value of culture

Understanding culture unlocks potential not only for risk reduction, but also for more sustainable performance and competitive advantage. Because different organisations have different objectives, the ways that they measure their respective results will vary. EY is working to analyse those results so as to assign values to the return on organisations' investments in culture. Assessed across a range of organisations, this work will play a critical role in forecasting the outcomes that can be derived from targeted investment in culture.

Contact us

For more information on the topics raised in this paper and to find out more about EY's work with clients in the area of cultural assessment and culture change, please contact a member of our Corporate Integrity Team:

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