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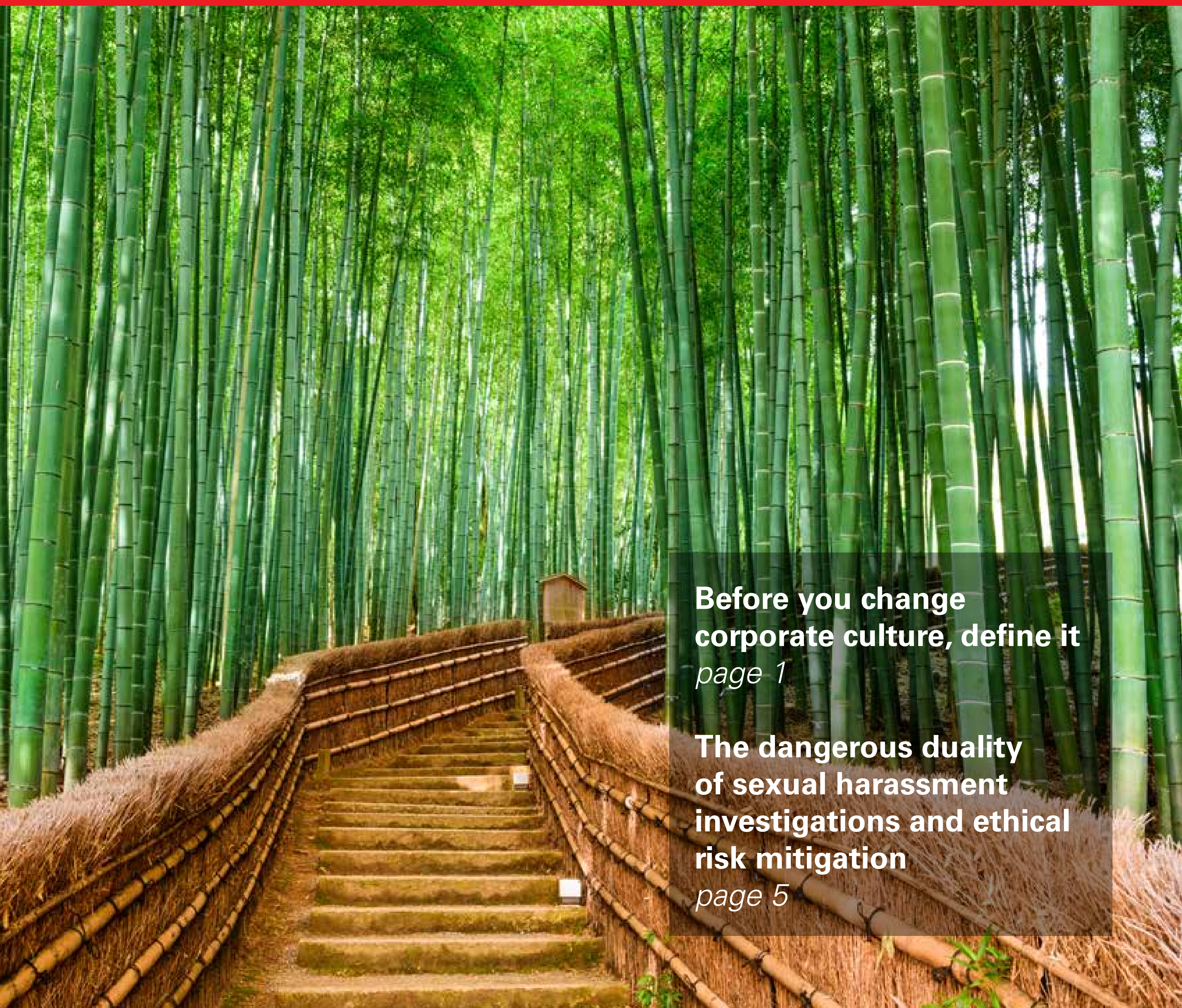

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Corporate Culture: The tipping point has arrived

BY PAMELA M. HARPER, CCEP, JD, MBA

Corporate culture has reached a tipping point. Although it is widely recognized that corporate culture can be an asset or a liability, recently it has been highlighted as a liability—one that negatively impacts performance, dilutes brand equity, creates reputational havoc, and ultimately, diminishes shareholder value. During the last year, we have been subjected to a corporate landscape littered with toxic behavior and misconduct, most notably, Uber, Wells Fargo, Weinstein and Company, and Social Financial (SoFi), among others. In the case of Uber, the ride-share company serves as a cautionary tale of the insidious impact that poor corporate culture can have on an organization, and why setting and complying with ethical standards is critical to the bottom line.

Uber's cultural dynamic

Uber cultivated a culture that enabled and normalized bad behavior, as evidenced by cultural values that included "always be hustlin," among others. Uber software engineer, Susan Fowler's chronicle of sexual harassment was the catalyst that launched an internal investigation and subsequent scrutiny into business practices that were at best, dubious, and at worst, illegal.[1] A few of the more notable practices at Uber included:

- failing to timely report a data breach that affected 57 million users and then subsequently paying the hacker who stole the data $100,000, under a "bug bounty" program;
- the use of spyware called "Hell" that allowed Uber to spy on drivers from its competitor, Lyft;
- failure to carry out driver background checks and properly report criminal offenses, which resulted in the City of London revoking its license to operate; and
- engaging in possible violations of the Foreign Corrupt Practices Act (FCPA).

Dara Khosrowshahi, Uber's new CEO, who was given the task of addressing these and other problems, acknowledged that, "the culture went wrong, the governance went wrong, and the board went in a very bad direction."[2] While his predecessor, Travis Kalanick, labored under the illusion that Uber had a "public relations problem," Mr. Khosrowshahi recognized that "We don't have a PR problem; we have an 'us' problem—we behaved poorly." This "problem" helped contribute to Uber's $3 billion loss in 2016.

In an attempt to begin to address the culture, one of Khosrowshahi's first initiatives was to implement one of the investigation's recommendations to "reformulate Uber's 14 cultural values." Employee opinions were solicited, with more than 1,200 submissions received, and focus groups were conducted to establish a new set of cultural norms; one of the most compelling being, "We do the right thing. Period." These norms define the rules of engagement. They set the tone, expectations, and zeitgeist of the organization. This was the first in a series of steps that Uber took to rectify the damage that was done internally and to rebuild the company's image.

Enhancing brand equity through corporate culture

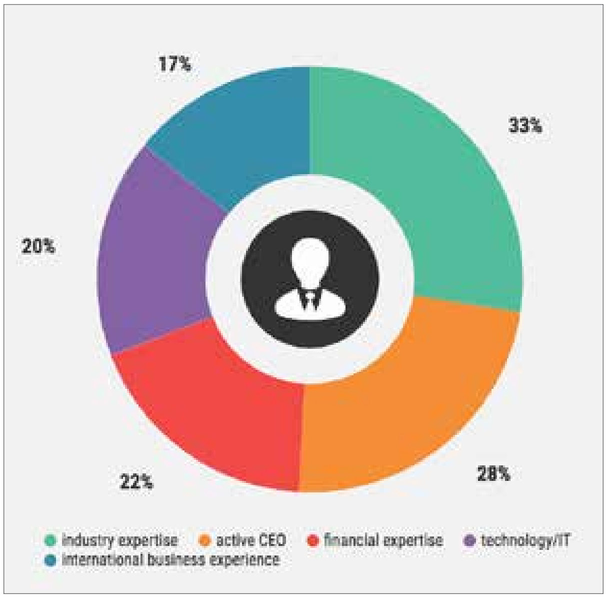
There are steps, however, that companies can take to preemptively demonstrate their commitment to creating and maintaining an ethical culture.

1. Raise the level of discussion surrounding culture and ethics in the boardroom

Discussing the culture and ethics of a company should be an integral, rather than ancillary, part of board meetings. According to the Deloitte and Society for Corporate Governance 2016 Board Practices Report, the top three risks that boards are focused on are cyber, finance/legal, and product. Only 26% of respondents cited "reputational risk." Equally disturbing, only 5% cited "culture/tone" as a top area of focus going forward. The same percentage held for "compliance/ethics activities."[3]

For some reason, the issue of culture is either not on the radar screen or not deemed significant enough to warrant attention. This perspective may be driven, in large part, by the fact that, according to the Report, the top five attributes that boards seek in

Sought-after expertise in new directors



new directors are: industry expertise (33%), active CEO (28%), financial expertise (22%), technology/IT (20%), and international business experience (17%). Corporate (as opposed to industry) compliance expertise is apparently not in demand nor deemed relevant. This paradigm needs to change.

Some companies hew more closely to this regime than others. For example, according to GE's 2017 Proxy Statement, the board consisted of 18 members, each of whom was either a current or former CEO/chairman of a corporation, academic institution, foundation, or regulatory authority. And yet, notwithstanding all of the board's industry expertise and intellectual bandwidth, GE's "culture of confidence", as chronicled by the *Wall Street Journal*, prevailed and enabled practices that contributed to a $10 billion loss in the fourth quarter last year, and GE now finds itself under investigation by the SEC regarding its accounting practices.[4] In advance of the annual shareholder's meeting in April 2018, GE announced three new board nominees, two of whom are former CEOs, with a reduced board slate of 12 members.

During the last year, three companies demonstrated why it is so important to address the issue of culture in the boardroom in a deliberate fashion.

Wells Fargo & Company (WFC)

It is well documented that the bank's sales practices resulted in almost 3.5 million accounts being opened without customer knowledge or consent. This, combined with issues in connection with the overpayment of fees for auto loans, drove the Federal Reserve Bank to order limits on the growth of Wells Fargo's assets as well as to replace four of its board members. Receiving less attention, though equally damaging was the Federal Reserve Bank's letter to John Stumpf, in his capacity as former chair of the board of directors, noting that "WFC pursued business strategies and goals that motivated compliance violations and improper practices without ensuring its risk management programs were sufficiently robust to prevent such behavior." The bank further found that Stumpf, in his role, "…continued to support the sales goals that were a major cause of the problem, and the senior executives who were most responsible for the failures…" Bottom line, his performance as chairman was found to be "an example of ineffective oversight."[5]

Wynn Resorts Ltd.

Amid allegations of sexual misconduct, Steven Wynn resigned as chairman and CEO of Wynn Resorts earlier this year. As a result, Wynn Resorts and its board of directors now finds itself in the throes of a shareholder derivative action which alleges that the board of directors and general counsel "disregarded decades of misconduct by Mr. Wynn and continued to endorse Mr. Wynn's leadership… while assuring shareholders that the Company's risk, compliance, and governance controls were extensive and effective to detect, prevent, and remedy such misconduct." The complaint further alleges that by ignoring and concealing Mr. Wynn's misconduct, the board of directors breached its fiduciary duty; the results of which included a 19.3% slide in market share the first two days after his misconduct was profiled in the media, a downgrade from "stable" to "negative" in Standard and Poor's Global Ratings, and investigations by gaming regulators in Nevada, Massachusetts, and Macao.[6]

The Weinstein Company

It is well documented that independent board members often suffer from asymmetric information. Presumably, they only know what they are told. This was the position taken by the board members of the Weinstein Company. After the *New York Times* investigative profile of Mr. Weinstein's misconduct,[7] the board issued a statement indicating that it was "…shocked and dismayed by the recently emerged allegations of extreme sexual misconduct and sexual assault by Harvey Weinstein. These allegations come as an utter surprise to the board. Any suggestion that the board had knowledge of this conduct is false." If indeed it was an "utter surprise," and the board was unaware, then there was a clear failure to ask the right questions. Ignorance is not an excuse. If, however, the board was aware and, as in the Wynn case, chose to silently accept and conceal misconduct, then its moral compass, too, was compromised. After months of uncertainty following the release of the allegations against Harvey Weinstein, The Weinstein Company filed for bankruptcy.

In each of these cases, the right questions were not asked or knowledge of misconduct was not acted upon. Each serves as compelling evidence why culture should be an integral part of boardroom dialogue, and as board members become subject to greater regulatory scrutiny and liability, self-interest alone will drive a heightened level of discussion.

2. Conduct cultural audits

According to the Ethics and Compliance Initiative's 2018 Global Business Ethics Survey, the State of Ethics and Compliance in the Workplace, the single largest influence on employee conduct is culture. The report found that in 2017, 40% of surveyed employees defined their company's ethical culture as "weak or weak-leaning."[8]

Just as financial audits are conducted, so too should cultural audits, and they should be treated with the same level of gravitas. Though not legally mandated, the performance of cultural audits should be included as an inherent component of an effective corporate compliance and ethics program, applied enterprise-wide and conducted consistently and objectively.

3. Clearly articulate corporate cultural values/norms

Netflix's cultural values are universally hailed as being among the most progressive, thorough, and thoughtful. Among the statements embedded in its values statement are:

- "We are strict about ethical issues… Harassment of employees or trading on insider information are zero tolerance issues…"
- "We tell people not to seek to please their boss. Instead seek to serve the business."

After reading Netflix's declaration, there is absolutely no ambiguity with respect to its culture, its values, and expected conduct and behavior.[9]

4. Utilize the proxy statement to communicate corporate culture

Shareholders care about culture, particularly when it has the potential to negatively impact shareholder value. Wynn Resorts as well as Wells Fargo are now battling shareholder actions due to misconduct.

Of the top 50 Fortune 500 companies, 31 considered it significant enough to address their Code of Business Conduct and Ethics, though to varying degrees, in their SEC Schedule 14A Proxy Statement filing for 2018. Some discussions were expansive, some more perfunctory. However, each company chose to devote a separate designated section addressing the matter.

In reviewing the Schedule 14A submissions of the top 50 Fortune 500 companies, the industry that consistently proved the most comprehensive in its discussion of

ethics and their Codes of Conduct was, not surprisingly due to the level of regulatory scrutiny, the financial services industry:

- **JP Morgan**'s discussion not only addresses how the company does business, but also the importance of its 20 business principles as well as its general Code of Conduct, and separate Code of Ethics for Finance Professionals.
- **Citigroup Inc.**'s discussion of its commitment to a culture of ethics chronicles the board's establishment of a standing committee of Ethics and Culture in 2014, whose mission, according to its charter is to "foster a culture of ethics within the organization." In addition, it addresses the programs that it has implemented to embed culture in its organization, its collaboration with key stakeholders, its Code of Conduct as well as its Code of Ethics for Financial Professionals, and its Ethics Hotline. Citigroup, among

the top 50 Fortune 500 companies is the *only* company with a standing Ethics and Culture Committee; one that is not commingled with another committee such as Governance or Compliance.

Finally, in addition to the financial services companies, there were two companies which, in their 2018 Proxy Statement disclosures, devoted separate stand-alone discussions exclusively to the issue of culture: Home Depot, by choice and Wells Fargo, by necessity. Home Depot engaged in a full discussion that defined its culture of "Doing the Right Thing." Conversely, Wells Fargo, discusses the initiatives it has taken to transform is culture. Notwithstanding the proxy statement, said Timothy Sloan, CEO, in an interview with *Bloomberg Businessweek*, "I don't think we have a culture problem…we had an incentive plan in our retail banking business that drove inappropriate behavior. That's been changed."[10]

Conclusion

With each day bringing a new disclosure, corporate culture has reached a tipping point. It is convenient and naïve to categorize corporate culture as a Human Resources issue. Culture is a risk issue and as companies refresh their boards of directors, they ought to consider the value of expanding the skill sets that they deem important in the selection process. Culture is not, contrary to popular belief, a "soft" matter. As Wells Fargo can attest with its $3.7 billion set aside for litigation last year (according to Bloomberg Law) and Uber with its $3 billion loss, it has "hard" consequences. Defining corporate culture, as Netflix has done, and if publicly traded, using the proxy statement as a communication tool as well as disclosure tool, are proactive risk mitigation measures that companies can and should undertake. ■

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