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Last year's *Changing the Game Forum* included a spirited discussion of the role of the board of directors in shaping the culture of the firm. There was a wide ranging of opinions, symptomatic of a timely issue on which positions and practices are not yet well formulated. This makes it an ideal topic for continued discussion during this year's Forum! This white paper begins by summarizing some of the main points may during last year's debate, drawing heavily, at first, on the session summary from last year. (Center for Corporate Change, 2004).

On one hand, several of last year's featured speakers were strong advocates of the board of directors taking an active position with respect to the culture of the organization. For example, Mr. Rand Garbacz, of AT Kearney in San Francisco, in his position paper framing the session, noted that

> "Culture impacts the interests of all other stakeholders, and thus derivatively has a direct, measurable impact on shareholder wealth". Therefore, he said, culture, as a governance role is neither optional nor tangential. He argued that culture starts with the board and identified a number of board issues that significantly influence corporate culture.

Ms. Ellen Heffes, Managing Editor of *Financial Executive*s magazine and moderator of the session, acknowledged that it is not clear at this point that the board has or should have a role in shaping the corporate culture. She posed the question, "What was the culture and ethical behavior like at companies like Enron, WorldCom, HealthSouth, or Adelphia that allowed malfeasance or misguided judgments. Where were the boards?

Ms. Bethany McLean, Senior Writer at Fortune magazine, observed that the corporate culture of Enron was one of the most important factors in the company's apparent success and dramatic demise. She said that rather than the board shaping the Enron culture, the executive management of the company shaped the board's culture. The Enron board became too much a part of the Enron culture and therefore lost its independence. Ms McLean noted that the board of directors should stand apart from the corporation's culture so as to not loose its ability to observe and judge management's behavior objectively; that is, they must resist being seduced by the company, its power and its success.

Mr. James Sprayregen, partner at Kirkland & Ellis, emphasized that in his experience, board culture can be a major driver of company performance, and can lead to poor performance. But ironically, the two panelists who argued most passionately for the positive role that corporate culture played in determining organizational performance, also argued most emphatically that corporate culture is the responsibility of the CEO and not the responsibility of the board of directors.

For example, Mr. Ed McVaney, former CEO of J.D. Edwards brought the issue to a sharp point by saying that;

> "Any board that tries (to manage corporate culture) will find itself and the CEO frustrated". "…your corporate culture runs your business 90% of the time – especially when you're not there" and is therefore a very important ingredient to the company's performance. The culture is critical to the organization's success "way before the board ever gets there." He argued that the culture of a company is essentially the demonstration of the company's work environment and that is certainly the CEO's job. He also noted that changing the corporate culture is very difficult and time consuming and therefore not an appropriate role for the board.

Mr. David Nadler, Chairman of Mercer Delta, noted that while board culture is critical, corporate culture is not the responsibility of the board. He noted that a great deal of data shows that corporate culture is a very profound driver of a business, but also stressed the difficulty of trying to change cultures. He concluded that the board should not try to shape the culture of the company, but it should be very concerned about it. Culture should be addressed as any other key issue on the board's agenda such as financial performance or risk assessment. Therefore, he said, the board should gather information about the company's culture and review the firm's strategy and execution as it impacts the culture of the organization. The CEO, not the board, is responsible for formulating that corporation's purpose and mission, and if the board does not like the positions taken on these issues by management, they need to "take out the management."

What conclusions can we reach from this discussion? What guidelines are available for inside and outside Directors? Are there "best practices" for Boards to follow to define their role in shaping corporate culture? This paper presents some of the conclusions that we would draw, based upon our experience with culture change projects in literally thousands of organizations.

In the Post-SOX World, the Board's Role in Culture is No Longer Optional.

Arguing that the Board of Directors of a publicly held corporation can completely avoid taking a role in the shaping of the culture of the corporation seems naïve to us in the "Post-SOX" world. Sarbanes-Oxley clearly establishes an obligation that the board must demonstrate that the corporation is free of fraud and malfeasance. At a minimum, the board must act to ensure *compliance*.

Once again, GE provides a timely example of "best practice" in this area (Maitland, 2005). Table 1 shows that GE's Bob Corcoran, VP for Citizenship, reported 1338 integrity concerns in 2004. These 1338 concerns were generated from a global population of 300,000 employees, and resulted in 198 warnings, 16 transfers, and 29 demotions or pay cuts.

[insert Table 1 about here]

There are several points worth noting about these data. First, they report a trend that is *increasing*. Is this good or bad? Surely, a trend line that shows integrity concerns dropping to zero over a three-year period would not do much to restore investor confidence. As one CEO put it, "Do you think that we have 40,000 angels in our company?" Integrity concerns are inevitable; the question is what does the corporation (and the Board) do about it? Monitoring, managing, and reporting are as important a function of the board and the management team is this area as they are in any other business matter.

A second point of interest in these data is that *no one got fired*. A little goes a long way. Not only can the existence of a compliance system prevent major malfeasance, but it also seems to show that the presence of a system can serve to limit the severity of the punishment required. This suggests that an effective system can help keep us all out of trouble.

It Doesn't Matter Who Starts the Process: The Board is Ultimately Responsible.

There are many examples of ways in which the roles of the board and the management team can be blurred. Family owned or controlled businesses are one example (Denison, Ward, and Leif, 2004, Leif & Denison, 2005). Founders, family members, and alliances with board members that stem from these relationships all exert a strong influence on the culture of the organization. There are both positive and negative examples of this influence.

Two of my favorite examples are from German organizations. During WWII, Henkel, who produced the leading detergent, Persil, was required by the government to produced unbranded soap to support the war effort. However, for several years until the end of the war Henkel continued to advertise Persil, *even though no one could actually buy it!* This brilliant brand-building decision was made by the family – the owners. Would a hired-gun CEO trying to make the numbers for the quarter ever have made this decision? Nonetheless, Persil is still the leading brand in Germany and strong throughout Europe.

At the end of 1923, Bertelsmann founder Reinhart Mohn was told by his doctor that his severe asthma would require that he had to leave the business and move to the Harz Mountains. He didn't take the news very well. He had just taken over the bookstore from his father because of the poor economic conditions they had laid off all but six of their employees. What to do?

So, he began a revolutionary new leadership style where employees were free and relied on self-management and teamwork as a foundation of their corporate culture. Mohn knew each of his people well and arranged the work to fit each individual's preferences and skills. He also insisted on broad-based feedback as a part of the decision-making process. Through this process, he felt that he was able to learn which workers were good problem solvers and which ones he could trust, even from a distance (Schuler, 2004).

Essentially, Mohn recreated the governance system of the organization to allow it to function without direct, day-to-day close supervision by the Chief Executive. This innovation in culture, governance, and organization is seen as one of the key features that allowed the organization to survive and grow.

What Happens When the CEO is also the Chairman?

Another factor that makes it hard to draw a clear distinction between the role of the board and the role of the management team is when one individual holds the titles of both the CEO and the Chairman. Several of the organizations with which we have been involved in extensive culture change projects have this characteristic. David Needleman, CEO and Chairman of JetBlue, Bob Ulrich, CEO and Chairman of Target, and David Brandon, CEO and Chairman of Dominos have all driven substantial culture change throughout their organizations, and have all created organizations with a substantial performance advantage in the marketplace.

Is Organizational Culture an Important Business Performance Issue?

Defining organizational culture is a tricky business. Many definitions of culture include aspects of an organization's values, behaviors, and basic assumptions that have little to do with performance issues. Our approach (Denison, 1984; 1990; Denison & Neale, 1993, Denison & Mishra, 1994; Fisher and Alford, 2000; Denison, Haaland, & Goeltzer, 2004; Denison, Ward, & Lief, 2004) has focused on those aspects of culture that have the greatest impact on business performance. Figure 1 describes the four factors that have the greatest impact on organizational performance: Involvement, Consistency, Adaptability, and Mission. The Forum presentation presents some of our latest research on the impact that each of these cultural factors has on performance measures such as ROE, customer satisfaction, growth rates, and market-to-book ratios (Denison & Fisher, 2005). This model has been the basis for culture assessments on over 6000 different organizations. For a more detailed description of the method and it application visit our webpage at www.denisonculture.com.

[insert Figure 1 about here]

This approach to measuring organizational culture has been applied by over 6000 different organizations, of all sizes, industries, in different languages all around the world. It represents one of a small number of approaches currently available that allow organizations to measure and monitor culture. The model focusing on a set of factors, supported by a long history of research, that appear to have a direct influence on business performance. This approach is primarily used by organizations that are trying to *change* their cultures and improve their performance.

In our experience, these culture change efforts are seldom driven by the board. In fact, as we polled our network of consultants in preparation for this Forum, we found very few examples of culture change projects that were driven by the board. Nearly all of the successful projects were driven by high-level line management. To a lesser degree, successful projects were often driven by staff organizations such as Human Resources, Strategy, or Learning & Development. Board level involvement, when it occurs, has typically followed one of three patterns: a) an executive of one of our client companies, who is a board member of another company, recommends our approach to the CEO; b) a management team, trying to drive change by focusing on the firm culture, decides that it is time to "get the board on board," and thus draws board members into an existing change process in an effort to build understanding and support; c) board members begin a discussion about the culture of the firm, and decide to encourage or require management to take action on this issue.

This suggests that best business practice in the culture arena is like best business practice in any other arena. Executives and board members advise each other on what works and what doesn't. The wisdom and experience of board members brings a valuable set of resources to the corporation. This hasn't changed. The board and the management team have a common interest in keeping the firm healthy and competitive and collaborate in this effort.

From Reactive Compliance to Visionary Leadership

The board of directors can no longer avoid the issue of corporate culture, but they do have some important choices to make about how to go about it. One way to view these issues is in terms of a continuum from reactive compliance to visionary leadership.

[insert Figure 2 about here]

At a minimum, directors must demonstrate that they have controls in place that adequately address the compliance issues required by Sarbanes-Oxley. This is a minimum requirement and it is dangerous for both corporations and individual directors to ignor. The GE example that we cite provides one example of how a relatively simple monitoring system can be used to gain control over compliance issues. While much has been written about the resources devoted to SOX compliance, less has been shared about companies who have positioned this as a "convenient nuisance" and used it to address a set of issues that should have been addressed long ago.

The real potential, however, comes when directors help to move the discussion beyond issues of compliance and begin to focus on building competitive advantage for the firm. This step must be grounded in a knowledge of the importance of corporate culture to business performance, and an understanding of what is appropriate in a given industry. In the American airline industry today, nearly half of all flights, and a far bigger proportion of industry profits, come from two airlines, JetBlue and Southwest. Both of these firms have competitive strategies that are rooted in their innovative cultures. Can you imagine a director in the airline industry who was not intimately familiar with the logic by which corporate culture influences competitive advantage in the industry?

The mid-point on this continuum is intended to represent the perspective taken by David Nadler and Ed McVaney during last year's Forum. This implies that the board is fully informed, and fully supportive, and sees the ability and experience of the executive team at shaping culture as one of the key requirements for the job. At the same time, however, this position recognizes that changing culture is a complex issue, and that micro-management from the board level can interfere with an already difficult task. In addition, this position recognizes that the dangers of the board losing their independence, as outlined by Bethany McLean, make also be a good reason to leave this issue to the CEO and management team.

Moving further up the continuum toward visionary leadership requires a few caveats. Most of the examples that we have seen have involved either a family-owned or family-influenced firm, or a situation in which the CEO also holds the title of Chairman of the Board. Both of these signify a high level of confidence in the direction that comes both from the management team and the board and signify a confidence that the firm has a "recipe for success" that deserves broad-based support. This approach involves some degree of risk, but may in fact provide the most sustainable advantage. The stakes are high, but so is the potential.

Figure 1.
Linking Organizational Culture and Business Performance

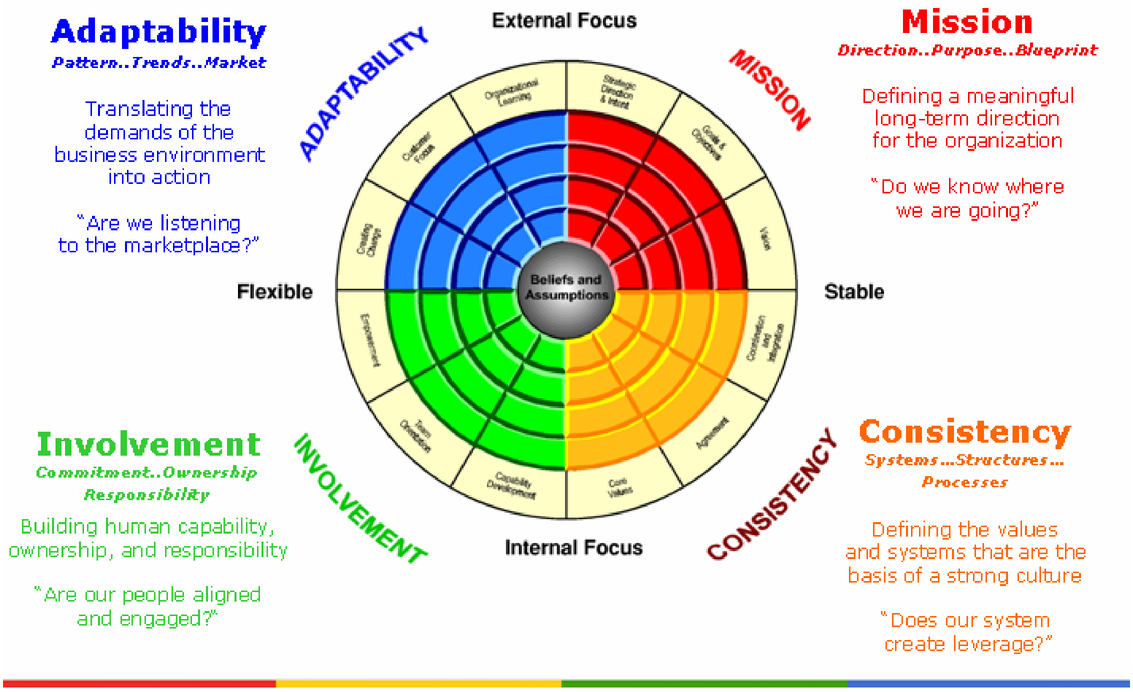

Figure 2.
Reactive Compliance or Visionary Leadership?

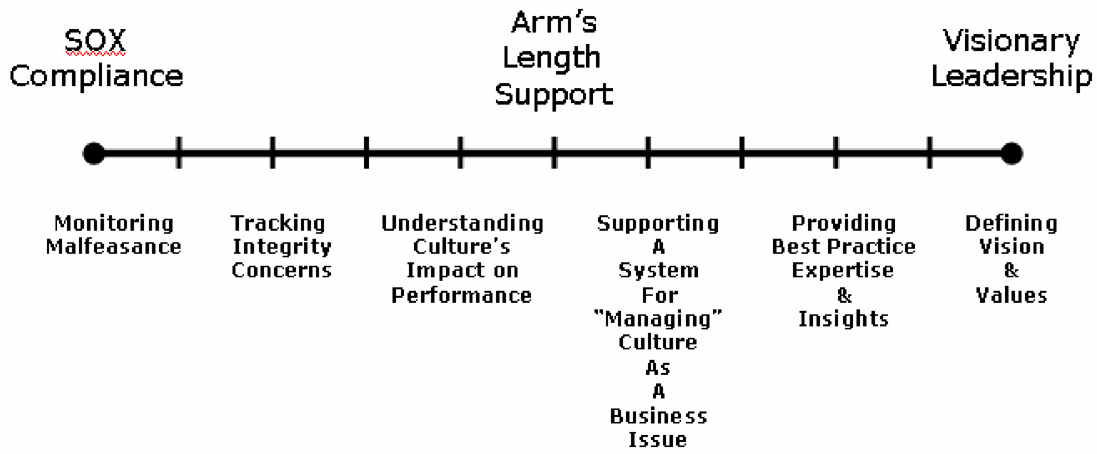

Table 1.

General Electric Integrity Concerns

By Policy Area

	2000	2002	2004
Fair employment practices	308	363	402
Conflicts of interests	220	237	240
Controllership*	94	224	247
Environment, health and safety	42	63	83
Supplier relationships	62	78	71
Complying with competitions laws	16	46	23
International trade controls	16	36	39
Working with governments	70	80	55
Intellectual property	16	51	34
Improper payment	78	22	28
Privacy	15	26	35
Money laundering prevention	3	15	4
Insider trading/dealing/stock tip		2	0
Security and crisis management		18	10
Other Integrity Concerns	151	105	67
Total	1,091	1,366	1,338

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