PRINCIPIA

Assessing Corporate Culture

How do we measure what matters?

Ethics Briefing
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Regulators worldwide are stepping up their scrutiny of corporate culture. The Financial Reporting Council in the UK has called on companies to increase their focus on assessing and monitoring culture. Australia's prudential regulator APRA has established risk culture as a key focus for 2021, with a requirement on banks to "demonstrate how culture influences the way that risks are managed". And in the United States, new disclosure rules issued by the SEC mandate all public companies to disclose material human capital metrics in quarterly and annual filings.

A critical component will be the ability to *measure what matters*. Research consistently demonstrates the importance of corporate culture, but assessing materiality will depend on understanding more precisely how culture influences the way people behave and the decisions they make. Examining the health of culture through the lens of ethics – to what extent can our people reliably and consistently do the right thing? – provides a new perspective.

In this briefing, we focus on how companies can extend the breadth of culture analysis beyond traditional HR metrics and engagement surveys to cover the elements that are most powerfully predictive of long-term performance.

1. Key questions for leaders

Do we understand the breadth and scope of our existing culture metrics?

- Leadership teams have devoted significant time and attention to enhancing the measurement and monitoring of culture. Realising that traditional engagement surveys are insufficient in providing insight, many have built new capabilities through broader surveys, regular pulse checks, and behavioural monitoring tools.
- But for many, the result is a complex, fragmented, and burdensome array of uncoordinated metrics. Ownership is often distributed across HR, compliance, and risk teams, with varying degrees of coordination and growing survey fatigue. Understanding the breadth and scope of existing efforts provides a starting point for action.

Do we understand how our metrics relate to business outcomes?

- Often driven by regulatory scrutiny, some companies have made progress in connecting people metrics to business outcomes. Many banks, for example, have developed their understanding of conduct risk, tracing predictive correlations between people metrics and operational risk loss data.
- But assessing the materiality of human capital, and the influence of culture on long-term performance, will require a broader and deeper understanding of the correlation between people metrics and financial performance, as well as their impact on the company's ability to manage risk and serve the interests of all stakeholders.

Are we measuring the right things?

- Regulatory guidance, such as the principles-based disclosure framework adopted by the SEC, rarely specifies particular metrics that must be reported, instead placing the onus on individual companies to determine the material factors essential to an understanding of their business.
- Traditional HR metrics may provide a starting point, but are unlikely to be sufficient. To meet expectations, leaders will need to understand how a broader range of cultural factors translate into business outcomes.
- PwC research reveals the narrow scope of companies' initial approaches to meeting the new disclosure standards. While 93% of companies reported statistics on employee demographics, less than one-quarter (23%) included even the most basic elements of analysis on culture, such as engagement or satisfaction scores.
- Leaders seeking to determine their approach to new disclosure rules face a decision point: to follow the crowd in reporting traditional metrics, or to invest in understanding the material aspects of their culture and human capital strategy in order to identify critical gaps in their approach to measurement and monitoring.

2. Common gaps in the measurement and monitoring of culture

Many companies' approaches to the measurement and monitoring of culture are focussed on employee engagement and satisfaction, with many common gaps in measuring what matters:

- Purpose & belonging: While many companies have articulated their mission and purpose, relatively few track the extent to which people are motivated by and connected to purpose in their day-to-day roles and interactions. Principia research shows that people's connection to the purpose of the organization is one of the most powerful factors in influencing conduct and decision making.
- Recognition & respect: Engagement surveys typically track satisfaction with remuneration and perceptions of fairness in compensation decisions. But beyond financial incentives, informal signals of recognition and respect are central to shaping culture: are the 'rainmakers' the most respected people in the organization, or is it those who are seen to be committed to long-term stewardship? Understanding these cultural signals is integral to an informed view of how culture shapes behaviour.
- Speak up: The obligation to raise a hand when witnessing misconduct, or with ethical concerns, is a mainstay of culture and compliance programs. But shaping a culture where doing so is encouraged, and where those who speak up are protected, respected and valued, is a more complex undertaking. Understanding people's willingness to speak up, and the systemic foundations that provide and protect the space to do so, is critical to an understanding of the health and robustness of organizational culture.
- Awareness & deliberation: Conduct and decision making frequently rely on employees navigating complex grey areas: the decisions involved in driving revenue or managing risk are rarely black-and-white. Understanding the material influence of culture depends on an appreciation of how employees identify and deliberate on difficult decisions and dilemmas, and how the cultural environment influences the decisions they make.

3. Next steps for leaders to better understand culture as a material factor in long-term performance

Leaders seeking to ensure that company culture is properly analysed and reflected as a material factor in driving business performance should:

- Map existing surveys and other datasets to identify key gaps: Mapping existing datasets onto an established framework of the material drivers of organizational culture enables leaders to identify key gaps in their approach to measurement and monitoring.
- Connect disparate datasets and track key metrics: While many cultural factors may be monitored through existing employee surveys, data will often be owned by different parts of the organization, with some measurement activities embedded into regular routines (such as annual staff surveys) and others the result of one-off initiatives. The result is often a complex array of uncoordinated metrics, with limited ability to connect disparate sources of data. A streamlined set of indicators can enable greater insight and more effective reporting to boards and regulators, and provide effective tracking of the impact of strategic initiatives and interventions.
- Enhance approaches to free-text analysis: Most companies collect free-text input as a standard element in employee surveys. But very few conduct robust analysis beyond manual scanning by HR teams. Shifting from manual to algorithmic interrogation through new AI tools such as natural language processing can drive additional insight, and ensure that oversight of culture is not limited by the scope of closed survey items.
- Explore non-traditional datasets for additional insight: Approaches to measuring and monitoring culture should not be limited to employee surveys. Mining non-traditional datasets has the potential to expand and deepen insight into culture and provide an early-warning system for potential issues: research on employee reviews on Glassdoor, for example, shows that mining existing data can provide powerful, predictive insight on culture.
- Examine correlations between culture and business outcomes: Determining the materiality of culture metrics requires an analysis of their correlation to business outcomes. Understanding how culture influences strategic goals such as growth, profitability, and Net Promoter Score, as well as downside measures such as operational risk loss, will enable companies to demonstrate how human capital strategies drive long-term performance.

To discuss further with a Principia specialist in your sector, please contact research@principia-advisory.com