مركز الحوكمة
CENTER FOR GOVERNANCE

BOARD ENGAGEMENT WITH CULTURE

How Boards Oversee and Contribute to Organizational Culture

A PIF COMPANY

2025

Center for Governance

Report

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INTRODUCTION

Boards have a core responsibility for performance and risk. Board engagement with culture can help both. Globally, investors and regulators are keen to understand how companies leverage culture for performance and as a value driver. Culture has become an investment issue. Boards are increasingly expected to oversee and engage with it, including helping companies tell their culture story to shareholders and stakeholders.

Many Boards find it difficult to deal with culture: it is more nuanced and subtle that many other areas of corporate governance. Culture is under researched and data is hard to find. Yet, **91%** of CEOs believe that culture is key to the business, **79%** considers it a top value driver and **54%** would disregard an acquisition target with a poor cultural fit[1]. How can boards engage with culture? A good place to start is to look at what culture is, how to measure it, why it matters, and how investors and Boards engage with it.

WHAT IS CULTURE AND HOW TO MEASURE IT

Culture cannot exist without clarity of purpose, or the reason why a company exists. Culture is increasingly an intangible asset. Together with talent it represents approximately 52% of an organization's market value[2].

Culture is "why and how we do things around here", the mix of stated expectations of people's behavior vis-à-vis how things are actually done in daily practice. Culture is the living reflection of how individuals in a company understand the reason why the business exists in the first place. These shared values, assumptions and behaviors determine and reflect the culture of an organization and really matter. Culture isn't a thing: it is a practice that needs to be supported by measures and actions. Boards should not fall into the trap of executives discussing culture as what they would like to see, as opposed to describing in simple words how things actually work in the company.

Defining the right culture and embedding it in the business is a management duty, while Board engagement is about oversight and holding executives accountable for how it is defined, lived and reported on. It is difficult for Boards to engage with culture. Culture remains under-researched, and there is no widely accepted framework for measuring it likely because, much like beauty, culture is subjective and varies from one observer to another. Nevertheless, promising methods for its measurement are beginning to emerge.

To help companies gather intelligence, in 2018 the Embankment Project for Inclusive Capitalism, a program led by EY and the Coalition for Inclusive Capitalism, produced a framework for measuring culture for long term value creation[3]. Program participants included companies and investors representing US$30 trillion in assets under management and 2 million employees globally. Proposed cultural dimensions and examples of survey questions to measure culture include, in order of priority:

[1]Graham et al. (2022). Corporate Culture: Evidence from the Field. Working paper, 27th Annual Conference on Financial Economics and Accounting Paper, Colombia Business School Research Paper No. 16-49. Available at: www.papers.ssrn.com.
[2]Global Intangible Finance Tracker (GIFT)-2018.
[3]Coalition for Inclusive Capitalism & EY (2018).The Project for Inclusive Capitalism Report. Available at: www.EY.com.

01

Ethics and Integrity: it clarifies what 'doing the right thing' means for day to day life at work, and encourages people to live these behaviors and drives trust, attracts talent, customers, suppliers, and reduces reputational risk. Survey questions: "I feel encouraged and supported to speak up" and" I feel conflicted between doing the right thing for our external stakeholders and performing to meet business expectations".

02

Alignment of Culture with Purpose: it guides people across the business to behave in a way that is consistent with what the company stands for and fosters a balance between going after short-term targets and long-term objectives. Survey questions: "It is clear to me that my work contributes to our shared purpose" and "I feel there is a common understanding as to our purpose as an organization".

03

Leading by Example: it demonstrates expectations as to how to live company's values, sets the foundation to build culture, signals what really matters to leadership, shapes behaviors important to strategy delivery. Survey questions: "Based on my experience, Leadership consistently demonstrates our stated values in their everyday behavior" and "Based on my experience, leadership engages with the workforce about our culture and values in a meaningful way".

04

Performance & Accountability: it clarifies what must be achieved for effective execution of strategy and who is accountable. It also encourages desired behaviors and acts as a deterrent to those that are not. Survey questions: "I am clear of what is expected on me from a performance perspective" and "I receive timely feedback that strengthens my performance".

05

Inclusion and Wellbeing: it sets the foundation on which staff can thrive, facilitates better decision making, a sense of ownership of decisions and accountability for the business, and drives resilience. Survey questions: "I feel I have an appropriate work/life balance" and "I feel supported in developing my long- term career".

A study on corporate culture by Duke University and Columbia Business School suggests that employee surveys on culture should also include seven key cultural values:

01	02	03	04
Adaptability, how willing and encouraged people are to experiment, fail fast, take initiative and act on opportunities.	Collaboration, to what extent people are team-oriented, supportive rather than aggressive.	Community, whether individuals are caring, inclusive in their approach and work ("the team above the self").	Customer-Orientation, how and to what extent employees listen to customers, are emotionally attached to the brand and proud of "serving".
05	**06**	**07**	
Detail-Orientation, whether precision, attention to detail, analysis are qualities valued and lived.	Integrity, the extent to which people value and practice transparency and honesty, are willing to report unethical behavior.	Results- Orientation, whether employees value and focus on achievement, performance and a sense of urgency.	

Once a company selects appropriate survey metrics (cultural assessment) and a survey is created, the Board needs to hold management accountable for standardizing it across all entities and subsidiaries. In addition to culture surveys, Net Promoter Scores, employee engagement scores, employer review sites (e.g., Glassdoor), scans of social media and other human capital metrics can provide Boards with intelligence.

Boards can also regularly probe management to elaborate on the selected dimensions of culture most relevant at any point in time. For instance, directors can ask CEOs: "Explain the processes in place to encourage speaking up" or "Explain the actions taken to help staff better connect with our purpose and values" or "Explain how we test for consistency in tone at the top (or at the middle).

Shallow answers, no evidence or CEOs' inability to articulate answers are red flags.

WHY CULTURE MATTERS

We can think of culture as behavior at scale. Last February, a long standing shareholder of Toyota Industries blamed the group's "broken culture" for recent data scandals. Toyota admitted it had falsified engine data. Several tragic incidents on Boeing aircrafts are linked to culture: failures to comply with quality requirements, a disconnect between executives and staff, inadequate and confusing safety processes.

Culture needs to be woven into Board work on strategy, performance and risk because how a company operates (culture) has a strong influence on what and how it delivers. A winning culture can have a significant positive effect on profits and returns to investors, can protect reputation, reduce business risk and foster growth[4]. But culture can also be a key factor in corporate failings and has the potential to rapidly destroy value[5]. Wells Fargo fraud in the Pandemic Relief Loan program for small businesses (2020), Nissan financial misconduct (2018), Wire card $20bn scandal and demise (2020), BlackBerry failure to respond to Apple and Samsung's dominance (2016), Barclays Bank and UBS involvement in the Libor rigging scandal (2011), UBS $2.3bn unauthorized trading (2011) and BP response to the

[4]Collins, J. (2001). Good to Great:Why Some Companies Make the Leap...And Others Don't. United States: Random House Business;Taylor, B. (2010). How One Company's Turnaround Came from the Heart. Harvard Business Review. Available at: www.hbr.org; Camberato, J. (2022). How does Company Culture Affect Business performance? Forbes Finance Council. Available at: Forbes.com; Evans, Ocansey & Ganu (2017).The Role of Corporate Culture in Managing Occupational Fraud. Research Journal of Finance and Accounting 8,24. Available at: http://www.researchgate.net; Graham et al. (2022). Corporate Culture: Evidence from the Field.Working paper, 27th Annual Conference on Financial Economics and Accounting Paper, Colombia Business School Research Paper No. 16-49. Available at: www.papers.ssrn.com; LRN (2021). Benchmark of Ethical Culture. Available at: https://pages.lrn.com

[5] Collins, J. (2009). How the Mighty Fall: And Why Some Companies Never Give In. United States: Random House Business.

Deepwater Horizon fatal oil spill disaster (2010), are painful reminders that culture matters.

Studies show that business fortunes can be turned around by focusing not just on strategy and new operating models, but also on culture[6]. Examples include Microsoft's market cap skyrocketing performance under CEO Satya Nadella (from $300 billion in 2014 to over $2.7 trillion today), the Nevada Donor Network (NDN) transformation from near-insolvency to being an internationally recognized organization in this space for the last 7-years in a row, Steve Job's turnaround at Apple, Howard Schulz' at Starbucks, Bob Iger's at Walt Disney.

Culture is critical to deliver results. It can have a positive and significant impact on operational excellence (fast decision making, innovation, teamwork and incentives based on performance), innovative products (responsiveness to market demands, focus on staff needs and diversity of thinking, talent development), customer intimacy (ethical and agile way of working, nurturing staff creativity, anticipating client's needs).

Companies that get culture right show above average return on investment, return on assets and return on equity[7]. Culture can also influence an array of investment decisions and attitudes towards risk, and is a significant contributor to the difference between the book and market value of a business[8].

Studies on employee data also indicate that culture is affecting the great resignation, record numbers of people voluntarily quitting their jobs since the pandemic. Southwest Airlines, LinkedIn and Johnson & Johnson are seeing lower turnover thanks to culture. Most interestingly, dissatisfaction with compensation is not among the real causes of the great resignation: a toxic culture is (one that fails to promote diversity, isn't inclusive or ethical and where staff feels disrespected)[9]. Culture matters to employees. The ten cultural elements they value most include feeling respected, supportive leaders who walk the talk, how staff perceived benefits and perks, formal and informal learning opportunities, job security and stability[10].

INVESTOR AND BOARD ENGAGEMENT WITH CULTURE

Investors care about culture. Culture has become an investment issue because company value is increasingly defined by intangible assets and human capital. The talent pool, and the culture that enables that talent, are key sources of competitive advantage and differentiation. Investors are interested in how companies are using culture to deliver long-term value and enhance the viability of the business. They also look at Boards as a reflection of a company's culture. Around the world investors seek deeper engagement with Boards and use their influence as investment stewards to drive governance improvements and hold Boards accountable on, among others, culture.

Regulation is helping: the UK Corporate Governance Code now requires Boards to oversee culture; recent revisions to the Japanese and Dutch Governance Codes stress the importance of culture oversight; Saudi Arabia's Corporate Governance Regulations require listed Boards to oversee executive management competencies and duties, which include "building and developing a culture of ethical values"[11]. Investors are asking questions that encourage Boards to think more deeply about the real culture of the organization, not only the desired one. Questions Boards can expect include:

- Can you describe how things get done around here (actual culture on the ground)?
- If not, where is this disconnect coming from?
- Can you describe how the desired and actual culture of this company aligns with its purpose and values?
- Which criteria do you use to measure culture? Which data sources and methods?

[6] Ferreira, J. (2021). Uncomfortable Inclusion: How to Build a Culture Of High Performance In Life And Work. Forbes Books.
[7] Korn Ferry (2015).Time for Truth. Available at: https://focus.kornferry.com.
[8] International Corporate Governance Network (ICGN) (2020).Viewpoint: The Board's Role in Overseeing Culture". Available at: www.icgn.org
[9] Sull et al.(2022).Toxic Culture is Driving the Great Resignation. MIT Sloan Management Review. Available at: www.sloanreview.mit.edu
[10] Sull & Sull (2021). 10 Things your Corporate Culture Needs to Get Right. MIT Sloan Management Review. Available at: www.sloanreview.mit.edu
[11] Capital Market Authority (2023). Corporate Governance Regulations, Articles 24-25. Available at: www.cma.org.sa.

- What are the desirable behaviors across the company?
- Can you describe the tone at the top, how executives model the behaviors they seek across the organization?
- In case of poor executive conduct, how is compensation affected?
- Are you working on anything that can cause a cultural clash or disruption? If so, why? What is the plan to limit the potential damage? Expectations".

Boards do not have to wait for investors to engage. They should proactively initiate dialogue and set up meetings directly or through an advisory council (with directors, the CEO, investors and external cultural experts) or stakeholder workshops. To get started, Boards can also invite investors to work on a joint research project, create a survey tailored to the Board and investors' needs or partner with universities and research centers specialized on organizational culture. Making culture a Board priority is a learning process and one that never ends, because culture is a way of being. A good place to start is with the basics: asking executives (and staff when needed) questions and listening to the answers can help Boards form a picture that can be validated with hard data. It is important for Boards to pay attention to red flags in the executive suite, indicators of potential issues, lack of clarity or focus on culture.

RED FLAGS INCLUDE:

- Lack of clarity on purpose and values, therefore on culture (inability to articulate what the desired culture looks like as well as that on the ground).
- Inconsistency between strategy at headquarters and subsidiary level, and about the desired practiced culture (if innovation is the strategic direction, a culture where people can succeed and fail fast (and safely) is needed; if the goal is the pursuit of excellence, encouraging and incentivizing continuous improvement, learning and collaboration are needed).
- Lack of accountability for lived culture (leaders not setting the tone at the top and/or not modelling the behavior expected from their people: great ways to observe behavior are employee town-hall meetings, site or important customer or investor visits).
- Executive myopia, or the inability to see and act on behavior that diverges from desired patterns (cases do not get reported and promptly acted upon). Divergent behavior can also represent an opportunity to assess whether it signals desired behavior (in a toxic culture, employees not afraid of speaking up can embody desired behavior).

As for engagement with the metrics of culture (hard evidence), in addition to cultural assessments Boards can legitimately expect and ask for hard data from multiple sources and layers in the business: customers, staff and other key stakeholders. Regular discussions with the Chief Human Resources Officer and the Chief Marketing Officer are encouraged to help Boards make sense and put data into context.

For companies operating with local or foreign subsidiaries, Board engagement with culture also requires consideration for whether desired aspects of culture are in conflict with local values and ways of acting (for instance speaking up when politeness and hierarchy are the norm can be difficult and not welcomed – red flag). Boards should also look for evidence of how companies tell their culture story, in other words, how the desired culture is communicated internally and externally. To this end Boards can use the Chair's letter to shareholders or to employees, the annual report, quarterly updates, investor days or employee town- halls. Corporate websites and, when applicable, company's public filings with regulators and capital market authorities or proxy statements are also appropriate options to tell one's culture story and oversee consistent messaging.

LOOKING AHEAD

There are clear links between performance and organizational culture, yet many Boards find it difficult to prioritize and engage with culture. As expectations from regulators, investors and stakeholders rise, Boards need to make culture a priority. There is a critical oversight role to play in validating the desired versus actual way of doing things, which values the company holds dear, and to what extent they are lived in everyday life across the organization. By engaging with executives on culture and wanting to understand the data behind it (culture metrics), Boards can help business leaders appreciate that culture is a strategic asset, a living practice that has significant effects on many financial and non-financial performance indicators, including the bottom line. Culture lives, hence Board oversight must stretch to its evolution in the context of strategy and purpose, and to holding executives accountable for it.

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ABOUT THE CENTER FOR GOVERNANCE

The Center for Governance was established by the Public Investment Fund (PIF) in 2020, and is dedicated to enhancing corporate governance capabilities and know-how in Saudi Arabia and beyond. We are a catalyst for governance excellence in the Kingdom, delivering practical solutions that elevate standards, build trust and foster societal progress.
sectors in three core areas:

- We undertake board evaluations for all kinds of entities, and provide advisory services relating to governance, risk and compliance.
- We design and deliver development programs aimed at board members, the C-Suite and governance professionals.
- Through rigorous research and thought leadership, we uncover new insights that raise awareness and understanding of governance, directorship andorganizational performance.

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