



Beyond Whistle-Blowing: How Boards Must Shape Culture

Hoping people follow the rules isn't enough. Directors have to promote good values. **By Dov Seidman**

The call is mounting for boards to assert leadership in fostering their organization's culture. Culture, not compliance, is the lens by which directors' performance will be judged from now on. We are living in an era that demands a standard of conduct beyond what the law requires—and boards hold the ultimate responsibility for corporate values and their expression in business conduct.

Many organizations have a culture based on rules and laws. In the worst corporate cultures, employees literally don't know the rules, or they know about the rules but don't fully understand them. However, in the majority of companies, the culture is one of *informed acquiescence*, where employees know that laws exist and they follow them in order to get their work done. But both cultures are prone to inherent flaws. First, while rules do some things very well, they create at best only minimum standards of behavior. Second, if you ask people to heed the letter of the law without inspiring them to internalize its spirit, you wind up with a system full of holes. No one can write enough rules to cover every imaginable situation in which employees may find themselves. Eventually, a rule is missing, or a gray area around a rule leaves people uncertain about the right thing to do.

The nightmare situation occurs when an employee or group of employees intentionally tries to take advantage of a gap to interpret the rules in a self-serving way. This is precisely what we see happening in the 130-plus cases of stock option backdating.

If boards are to accomplish their oversight responsibilities, they must help their organizations transition from a culture of laws to a culture of *principled performance*. In a self-governing culture, people

conduct themselves not according to laws but to values such as honesty, trust, integrity, openness, respect and responsibility. Values fill the gaps where rules don't exist. Values remove the gray areas. Values inspire people to do the right thing.

The Federal Sentencing Guidelines were revised three years ago to make more explicit that responsibility for good values is a top-down affair. Among other things, the guidelines now say that companies must "promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law," and "the organization's governing authority shall be knowledgeable about the content and operation of the compliance and ethics program and shall exercise reasonable oversight." It's worth focusing on four words in these statements.

◆ **Ethics.** In ancient Greek, "ethics" meant both "morals" and "habits," as if to remind us that you cannot have morals just some of the time. Aristotle said that excellence is not a single act, it is a habit. This word is a reminder to boards that a self-governing culture makes ethical conduct a consistent habit, not an occasional condition. So the question is: Is your culture ethical 24/7/365? That's what it takes for sustainable self-governance.

◆ **Oversight.** The word suggests that board members could, for example, go down to the shop floor and talk with employees to see with their own eyes whether the ethics and compliance program is successful. In fact, the Sentencing Guidelines say that within reason, i.e., short of invading privacy, directors are expected to do whatever is necessary to fulfill their obligation to oversee organizational culture.

◆ **Knowledge.** The guidelines hint that passively knowing about the conduct

occurring in their company is not enough. Board members must use that knowledge in their meetings. If you simply discuss the outcomes of your whistle-blower hotline program, you are not trafficking in active knowledge. Active knowledge requires ensuring that these programs make an impact on employees' conduct, behavior and business performance.

◆ **Encourage.** The board must empower every employee to take part effectively in a self-governing culture, which will sometimes mean having the guts to make difficult decisions. If the organization demonstrates ethical lapses, penalties must be implemented, even if they hurt someone close to the board.

I remind you that the board itself is part of this same self-governing culture. If you want employees to participate voluntarily in upholding certain values, directors must uphold them, too. In effect, self-governance begins and ends in the boardroom. If your company states that it values transparency, honesty and truth, you must ask yourselves whether business in the boardroom is conducted accordingly.

There is no better example of a board's implicit failure to model its internal values than the Hewlett-Packard case. What is astonishing about this situation is that the board chairman and senior executives tried to skirt the spirit of the law by thinking it was enough to live up to the letter. While the board would not have tolerated this type of conduct at any other level within HP, they justified and excused it for themselves. As we now know, they could not have been more wrong.

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