The culture struggle

A company's beliefs and behaviour around risk can have a dramatic effect on performance, Aon Hewitt says

By John Deex

THERE'S NO DOUBT ABOUT IT, CULTURE is a financial services industry buzzword, particularly among regulators.

And something else we know for sure: bad culture is a very bad thing, and can lead to all manner of detriment to consumers.

But what has been less obvious is just how many benefits a strong culture can bring.

New research by human resources consultant Aon Hewitt has found the performance of businesses with a strong, strategically aligned culture is four times better than those without, and share price volatility is much reduced.

"Depending on whether you have a good culture or a bad culture, that's going to drive whether you have a good or bad business performance," Aon Hewitt Principal Actuary Ashley Palmer tells *Insurance News*.

"Organisations that have a high cultural alignment with their business strategy, we see they have four times higher earnings and revenues compared with organisations that have low cultural alignment with their business strategy. So, quite clearly, culture matters."

A bad business culture can damage reputations, which adds to share price volatility.

"There is a correlation between an increase in risk maturity and a reduction in share price volatility," Mr Palmer says. "For a firm that has an average risk maturity [score] of one, which is basic, we see they have about a 50% share volatility. For firms with a [score of] five, the most advanced, we see they have share price volatility of 25%. That is a big change.

"For all the firms we can think of where they have had a problem with culture and brand and reputation, you see a big swing in share price."

But what exactly do we mean by culture? And how can businesses make sure theirs is good, not bad?

According to Mr Palmer, culture is the glue that holds everything together.

"If you have got your people in one hand, and the business strategy in the other, culture is that glue that can align your people with the successful execution of the business strategy," he tells *Insurance News*. "We see it as the shared assumptions around how to think, feel and act as it relates to work.

"A more pragmatic view is how work gets done. It's the how. It's what happens when nobody's looking."

More specifically, Mr Palmer says, culture comes down to the intersection of three components – beliefs, behaviours and decisions.

By beliefs, he means what is important and what do people prioritise first? Behaviours: how do people behave, what is the style of leaders, what kind of norms do people expect and how does communication occur? Decisions: how do choices get made, how disciplined are employees, how much autonomy do they have, how many voices get considered?

Mr Palmer believes the behaviour of established leaders is crucial.

"The reality is that employees don't read the risk manual from page one to the end and they don't read the employment manual – they are pretty big documents," he says.

"What they do is they observe when they get in an organisation. They look at people with title, power, responsibility, the high achievers, and they model their beliefs, behaviours and decisions pretty much on what they do.

"As a result, we know that a key driver to move the needle on risk culture is the board and the senior leadership, because ultimately employees in an organisation look at those senior leaders, at what is acceptable and what isn't.

"You see those examples across different industries where norms are set, and those norms are quite hard to break."

Happiness and employee engagement, while important, are not necessarily aligned

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with risk culture. Mr Palmer says before the global financial crisis many employees at many organisations were engaged and happy, because business was booming and bonuses were hitting new heights.

"But clearly risk culture was at a very, very dangerous stage. Good risk culture isn't the same as good employee engagement and happy employees, and in fact it can be very different."

So what should organisations be doing to build strong business culture?

Mr Palmer believes a typical response is to bury heads in the sand because it's all too hard.

"But the reality is that [building culture] can be done very practically, so we see organisations are embedding risk questions within employee engagement surveys. A more robust approach is to look at psychometric assessments and simulations, to put employees into simulated, more difficult situations and see how they make decisions and respond."

Recruitment is clearly crucial, but so is succession.

"We know the tone from the top, from the senior leaders, is so important. So when you're looking at succession planning and promoting to senior positions, doing the right kind of leadership competencies and assessments is really important to make sure you are improving your risk culture, rather than diminishing it.

"What it actually comes down to is the board and the senior leadership really living it. Not seeing it as compliance, but as the right thing to do."

Mr Palmer says, despite boardroom ambitions to the contrary, most organisations are guilty of "short-termism".

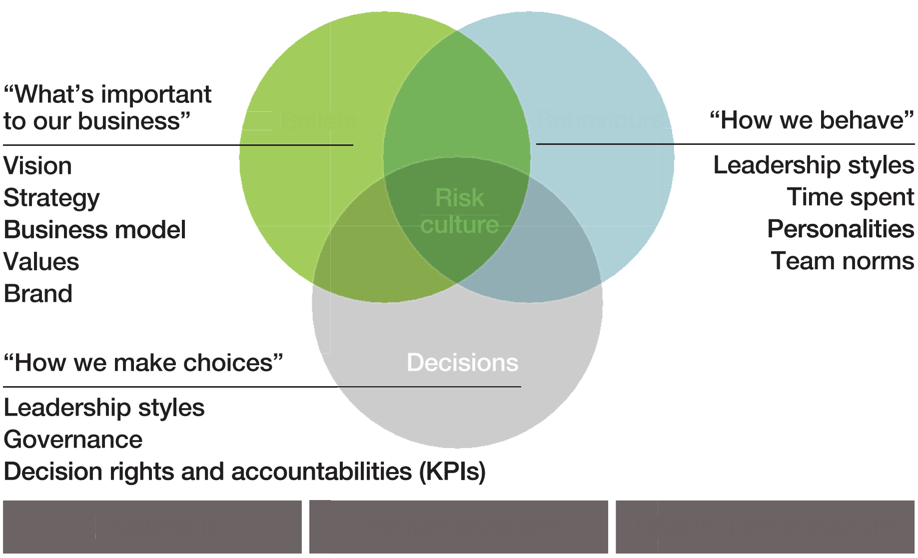
"Boards and leadership teams, when you actually sit down with them to discuss what their objectives are and their business strategy, they are looking for the organisation to be long-term in thinking. But the reality, when you go and measure it, is different.

"Often there is an incongruence between what the board is looking for and how policies and procedures then work."

Key performance indicators (KPIs) and incentives typically put the focus on short-term achievements, Mr Palmer says.

"Clearly, incentives are there to drive behaviour and, by default, they drive culture, but typically they are driven by very short-term results or short-term orientations."

Definition of risk culture



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>
> – Ashley Palmer

He believes KPIs and incentives need to be more focused on customer outcomes and long-term business performance.

People are a key asset but, by definition, also a key risk, and we are living in a world where reputations can be quickly destroyed by social media.

"Anyone within an organisation can ruin a reputation very fast today," Mr Palmer says. "My personal estimate is that 50-70% of the difference between the market cap of a listed organisation above its book value is at risk. That's the kind of level of shareholder value that relates to reputation these days.

"The Warren Buffett quote still holds, that organisations toil for 20 years to build a reputation and can lose it in a few minutes.

"I think it is quite right that culture is top of the agenda and is being spoken about and tackled today. It is very clear this is a top priority for regulators.

"They are looking at boards, they are looking at senior leaders, they are looking at alignment to incentives and this is an important global component as we move forward.

"Great leaders are great because they are great at creating the right strategy and executing the right strategy.

"But what is typically forgotten is that if the culture is not right, even if you have got the most optimal business strategy and business plan, it will be undermined and it will fail."

Culture may be a focus for regulators and boardrooms, but across all sectors there is much still to do, and the insurance industry is no exception.

Mr Palmer says the insurance and financial services sector "comes out pretty much in the middle range".

"Risk culture or risk maturity is actually no better or worse than other industries," he says.

"I was a little bit underwhelmed by that. I would have expected them to be more taking the lead, given the regulatory focus, so there is clearly more to do."

The focus on culture will not disappear any time soon, and nor should it, with the pace of change accelerating.

"We are seeing increased agile or remote working," Mr Palmer says.

"If we go back to that definition of culture as what happens when nobody's looking, increasingly most of the time, nobody is looking.

"So that elastic band of culture is getting ever stretched. It needs to be strong." □

Compound annual growth rate (CAGR)

Low culture alignment versus high culture alignment