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Culture change: Three essential phases

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The first article in this series examined how to get started on a culture transformation and shared some pitfalls to avoid.[1] In this piece, we explore three important steps in any transformation journey. I am struck by how each of three separate transformation initiatives I was part of followed the same pattern despite taking place in radically different circumstances. One came about as the result of a business combination between two consulting giants. The second was in response to a dramatic reputational failure. The third came from a CEO who wanted to nudge the culture in a new direction. The game-changing transaction, the burning reputational platform, and the internal desire for change followed similar paths. Compliance teams can use this to monitor and test progress and report to the board.

Building the case

I described in the first article how an objective measure of the culture through a blind study led the board and CEO of a bank directly to a transformation plan with a very specific focus. Because I described this in the previous article, I will not repeat that here other than to say that the objectivity and clarity of the data was critical in gaining agreement at the outset.

When it became clear how widespread and systemic bribery had been at the industrial company, the company recognized its control functions had not just been misled but had failed.[2] So, it invested in new leadership teams to redirect its audit and compliance departments. These new teams came with extensive credentials and experience largely from outside the company. Critically, before setting out to transform the audit department, we first hired an external expert to give an opinion. If you were on the board, you might wonder why the talent you had just invested in needed more external experts. It might be tempting to point out that the problem was obvious, and the fix was simple: equip our controls teams with better training and tools to detect improper payments more effectively. However, viewing this as a technical fix is shortsighted. To sustain their performance, the controls teams needed to attract radically different talents and offer them strong career prospects inside the company. This required not only the control functions to change their mindset but it also challenged other departments to acknowledge the change in role. The imprimatur of an independent expert at the outset helped reduce internal politics about a "land grab" and cleared the way forward.

The case for change was not immediately evident in the merger of the two consulting firms because it made such strong commercial sense; the firms were highly complementary, given their relative geographic and industry strengths. However, we quickly found strong cultural differences showed up in everything from the role of a partner to how to deliver our main service—the financial audit.[3] Each firm was adamant that its approach was correct, and we spent time trying to convince the other side during the run-up to the merger. This impasse put the merged firm at risk of mass defection of staff, which in turn would provide a golden opportunity to its competitors. Realizing this, the firms landed on a plan that asked every person in the merged firm to learn and adopt aspects of the other legacy firm's philosophy. As exhausting as this was to implement, it provided the new firm with an invaluable thing from day one: shared identity and culture that was new for everyone yet not completely unrecognizable to anyone. Had this issue not been identified and addressed early, the firm would have been distracted from the market as it sought to reset its internal bearings.

Newton's third law in culture transformation

After building the case for a culture change, organizations tend to deliberate loudly about it. The bank began a rigorous communication program headlined by the CEO; the chief audit officer at the industrial conglomerate held an all-hands meeting at which he announced an entirely new set of priorities. He offered anyone who was not interested help finding a role elsewhere in the company. The consulting firm told its staff they would be forced into cross-teaming on assignments.

At this point, expect resistance. This is because leaders at all levels have succeeded inside the "old" culture. It has worked out well for them, and many will be skeptical about the new priorities—even if they accept them at face value. Some may even be hostile. Resistance might even be endemic as midlevel managers simply fall back on the priorities and habits they are comfortable with. The more radical your change of direction, the more forceful the resistance can be. I think of this as Newton's Third Law in culture change: for every action, there is an opposite reaction. How you respond in that moment is critical and will decide the fate of the transformation.

Two moments especially stick in my mind because of their impact. In the audit transformation, when the auditors themselves were asked to become respected business advisors and not just technocrats, fully three-quarters of the staff opted out. As the revolving door spun wildly, some in the company believed this heralded the end of the transformation, proving the new direction to be misguided and forcing audit "back in its box." Instead, we looked at this as "addition by subtraction." This moment allowed us to focus on recruiting a completely different type of individual. This was not easy. After all, how do you convince a successful professional in a blue-chip firm to throw that away for a career in the audit group of an old industrial conglomerate? It took well over a year before we started to see the effect of standing firm on this, but the culture turned with every new addition, and the quality changed forever. Persistence, even in the face of a mass mutiny, paid off.

The other moment had a more immediate impact. One culture transformation involved repositioning risk management as a priority alongside client service. An early opportunity presented itself in the form of something that many considered a minor risk issue; on-time completion rates of basic training were stubbornly just not where they needed to be. So, the executive committee decided to withhold the planned promotions of anyone who had any staff member who had missed a single deadline. The shockwave was immediate; leaders everywhere argued furiously that this was massively unfair—the "punishment" was severe, especially for senior managers when the "crime" was committed by someone else, often several layers below their immediate reporting. Despite the tremendous pushback, this had the intended effect; it was a shot clearly heard around the company. The cultural transformation would have stalled if the company had backed off in that moment of furious reaction.

Maturation

It would be nice to imagine that once the first battle is fought, culture starts to fall in line with whatever the new set of priorities are. However, this is naïve. The third phase that every successful culture change passed through was installing some controls to make the changes stick. The next article in this series will describe more about how the techniques work, but I will give a sense here of what maturation looks like.

In most organizations, staff are reviewed by their managers for promotion or bonus rewards, typically annually. These reviews are largely left to each individual manager, with some overall quality reviews on top. At the industrial company, we sustained the culture change by injecting much more discipline into this process. The controls were simple and will seem like common sense whether your organization is undergoing a culture change or not. What is different is the intensity with which they are applied. Every staff member had an in-depth review of our new standards every six months. Input came from the entire leadership team, not just the individual's manager. No one was allowed to progress if they had feedback from only one or two leaders. We called these "power reviews," and they were a bad sign. Better still, we wanted to see customer input. The process was exhausting, as we measured each person against a set of standards we had laboriously written out and published, so if we failed to abide by them, it would be transparent. We also planned forward: By which six-month milestone should the individual expect to make the next step? Is it fast enough? Do we need to intervene? While these are basic disciplines in talent management, the level of discipline—and transparency—were unlike anything I've seen before or since and were critical to sustaining the change.

How compliance officers can assess

Three common stages: a carefully researched case, handling early resistance, and a disciplined set of controls to embed the new priorities are important markers we can test. Compliance teams should monitor each of these phases. Challenge the basis of the culture transformation—what objective assessment has been done to ensure this is the right path? Monitor carefully how the organization responds to resistance. Finally, find out what controls have been put in place to reinforce the culture change and test how well they are working. At one organization, compliance made an early assessment of the entire culture change program, which included analyzing data to see whether the promotion and rewards systems actually aligned with the stated culture. This became an essential report for the CEO and the board.

The next article in this series will deal with how to sustain a culture change.

Takeaways

- Cultural changes pass through three important phases: building a clear case, dealing with resistance, and embedding it into the control systems.
- Compliance teams provide value by monitoring culture transformations and understanding these three phases point the way.

1 Anthony O'Reilly, "So you want to change your culture: Where to begin," *Ethikos* 36, no. 3 (July 2022), https://bit.ly/3TlnP5r.
2 U.S. Securities and Exchange Commission, "SEC Files Settled Foreign Corrupt Practices Act Charges Against Siemens AG for Engaging in Worldwide Bribery With Total Disgorgement and Criminal Fines of Over $1.6 Billion," Litigation Release 20829, December 15, 2008, https://www.sec.gov/litigation/litreleases/2008/lr20829.htm.
3 Elizabeth MacDonald and Joann S. Lublin, "Coopers, Price Waterhouse To Hold Vote Amid Concerns," *Wall Street Journal*, November 10, 1997, https://www.wsj.com/articles/SB879121235735924000.