Organizational Maturity Services LLP

Human Governance Briefing
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Poor human governance, toxic company culture and business risk

This week we ran our regular module on how human governance drives corporate culture and material risk. It has become a critical, if somewhat depressing session, highlighting how the underlying cause of corporate failures can almost always be explained through human governance analysis. Can you find any that aren't? Yet even where the idea that "culture" is in some way to blame, corporate denial and 'sticky plaster' solutions are typically the norm. Our 5-minute video highlights the key issues and how you can begin to examine this complex area.

How much does pay matter to value?

Aldi have just announced an increase in pay for over 3,000 staff in the UK with the promise to provide the highest wages in the UK supermarket sector. Matthew Barnes, CEO for Aldi UK, explained its rationale: *"We recognise the valuable contribution that our thousands of store employees make every day. Their dedication and commitment is a key reason why Aldi is the UK's fastest-growing supermarket."*

This kind of move generally makes investment managers and analyst teams nervous about cost control and margins. However, US retailer Costco showed some time ago that higher pay can actually lower costs and drive value. The important consideration for investors is whether Aldi is a sufficiently *mature* company in human governance terms to generate greater overall value (defined and measured by us as aggregated *Output, Revenue, Cost, Quality*) from such move. Most retailers on our OMINDEX are not (e.g. Costco: A; Tesco B; Sainsburys BBB-; M&S BB+; Burberry BB+) so any moves made in response to Aldi should be of concern both to incumbent retail CEOs hoping for upside benefit and for investors anxious about historically thin sector margins.

Whole systems management trumps integrated reporting

Rio Tinto (OMINDEX: BB) strives to be seen as a good corporate citizen; its ‘sustainability’ reports are held up as examples of good practice. IIRC, the people who brought us integrated reporting <IR> cite RTZ reports as a role model for materiality disclosure. The company does indeed do a good job on integrated reporting relative to others but what does this show?

Worryingly, senior executive changes are still being made following continued allegations of bribery. A new CEO just over six months ago; the firing of minerals chief Alan Davies and the head of legal and regulatory affairs a short time ago, as well as a new head of HR. Where did “tone at the top” go in terms of leadership in minimizing risk relating to ethical behaviour?

This appears to be another struggle where corporate commitment to organizational values has not “stuck”. How often do we need to see this to realize that not enough is being done to understand the whole system value creation model as it relates to human governance? Embedded purpose and values is more than a plaque on the wall, training programs and signed compliance statements. It is about an observable culture that manages people and value within a whole system and can avoid such *ethical* failures.

How much does CEO pay matter to value?

The FT recently reported recent findings of a research study showing a “negligible” link between executive pay and value. In the words of the research team, they found *“…a material disconnect between pay and fundamental value generation”.* This has been obvious to most observers for some time but it is always useful to have some evidence. The question is then what to do about it? We have teamed up with the Maturity Institute to set a new standard for CEO pay that will finally address how CEO pay should explicitly link to a coherent definition of value. Please contact stuart.woollard@omservices.org if you would like more information.

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