Institute of Business Ethics

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It is a great pleasure to be here today and to talk about culture and governance in the charity sector. That may seem like a strange assignment for someone mostly involved in the world of commerce and finance. I am here today with my Institute of Business Ethics hat on, and it is true that we are mostly concerned with what goes on inside business. But charities, like businesses, are organisations with leadership structures which need to be effective, and many of the core principles that apply to business apply to charities too.

We can see this at the IBE because we are also a charity ourselves and have therefore been reading the Charity Governance Code. Though it is expressed differently, much of the content is clearly derived from the UK Corporate Governance Code that applies to companies. So I want to draw on that connection today to talk about the cultural and ethical aspects of leadership, why they matter and how trustees can pick up the challenge of addressing them.

Please note: this is not intended to be a sermon! While trust in business remains low and large swathes of the public regard business as lacking in ethics and integrity, it is not our role to wag the finger. The IBE exists to help businesses address some of the difficult issues around ethics, culture and behaviour that confront them every day. We believe, and our subscribers believe, that this will help make them more trustworthy in ways that will strengthen their franchise and make their profits more sustainable in the long run.

Read across to charities. A well-run charity will incur fewer risks, almost certainly acquire a stronger reputation with the public than a poorly run one, and thus be better placed to meet its philanthropic objective over the longer term.

We also don't believe that those who work in business are inherently bad. Rather they are subject to pressures they do not encounter in their personal lives – to meet deadlines, budgets, sales targets etc – often with the threat of punishment for failure and the lure of reward for success. When people work together in groups to meet these pressures, their guard is down. If the pressure is intense, they will more easily resort to short cuts. If one of the group does this, others may be afraid to speak up and go along with the rest. Or they may decide that, because the group is doing something, it must be socially acceptable whatever their reservations.

You can see this in corporate failures. We do not know exactly what happened at Volkswagen, but it is clear that an ambitious Chief Executive wanted to be the number one world car manufacturer. That in turn required raising market share in the US, and that required the company to deliver what turned out to be the impossible, namely a range of diesel cars that were at the same time both extraordinarily economic and extraordinarily clean. Small wonder that, down the line, people started to cheat.

Now you may think that charities are different. After all, they all exist with a purpose of delivering social benefit, not to extract profit for themselves from society. But this would be a trap for two reasons.

First, charities can tell themselves that, just because they have a positive social purpose, they must be good organisations through and through. The danger here is that the end justifies the means and standards of behaviour within the organisation and towards stakeholders fall short. Think for a moment of the high pressure sales techniques employed by some charities to generate donations from vulnerable people.

Second, charities are not immune from the plague of the dominant chief executive. If Royal Bank of Scotland suffered grievously from having a powerful chief executive who could not be gainsaid, something similar is true of Kids Company. It was run by someone of great charisma, who was very persuasive, determined to run things her own way and not inclined to listen. Sound financial management is essential any operation, and charities are no exception. Someone needs to resist the beguiling cry that money must be available for children who need it NOW. Sadly, the trustees in Kids Company failed to rise to the challenge and the rest is history.

One of the frequently-used definitions of culture in the corporate sector is "the way we do things round here." This is a good starting point for charities too. What sort of organisation do we want to be? How do we ensure that the values that drive decisions and behaviour are embedded throughout the organisation? And very importantly, how do we ensure that the behaviour we expect of ourselves is consistent with our core purpose and the way we therefore would like to be seen by the outside world? The right people to answer these questions in the first instance are the trustees. If they don't bother, there could well be a sense of drift.

This is what Anthony Salz, who wrote a review of the culture at Barclays bank had to say: without a clear statement of values at the top the culture shapes itself and people work out for themselves how they are supposed to behave.

At the IBE we believe it is up to each organisation to choose the values that are right for it. Some values are basically commercial. Innovation would be a case in point. Some are ethical and behavioural. It is clear that a charity's values in this respect have to be consistent with its objectives. For example, a charity dedicated to the support of human rights will look stupid if it turns a blind eye towards sexual harassment or treats its employees with the kind of disrespect afforded to those work for Sports Direct. We would look stupid at the IBE if we condoned bullying or failed to pay our suppliers on time.

There are some values, however, which are pretty basic. I would suggest reliability, honesty, openness and respect as being among the most important ethical values. To see why they matter, consider the obverse: would you like to work for an organisation that was unreliable, dishonest, secretive, and treated all those it encountered with disrespect? By contrast, you might be proud to work for an organisation that displayed these four values in a positive way. Then you might work harder and deliver more. There is some evidence that companies which are perceived by employees as being a good place to work produce better results than those where they are unhappy.

So, how does an organisation embed the values it as chosen. First, it is important that the leadership, including the trustees collectively and individually, live up to those values. The Chief Executive or whoever runs the charity operationally is very important in this because he or she will be seen as a role model, and the trustees must be prepared to challenge a leader who fails to live up to the agreed values.

Second, it is important that the expectations are communicated down the line. Larger organisations often do this through a code of behaviour which helps guide staff in their decision-making both generally and in specific situations they might encounter. In these cases the follow-through is important. Staff – and the senior leadership too, including the trustees– may need some training. It is important to make sure that staff are aware of the code and what it says and to track instances where people fail to live up to expectations. Otherwise it will not be taken seriously.

It is also important to develop an open atmosphere in which people can give voice to their concerns or worries. When they see something that makes them comfortable, they should not be afraid to speak up. The organisation should be prepared to take them seriously and protect them against retaliation. Oxfam has caused its reputation unnecessary harm by its apparent lethargy in response to an increase in sexual exploitation claims, some involving staff at country director level, and its dismissal of its Nigerian Country Director in 2011 only shortly after she had disclosed to head office an allegation of sexual assault by a senior official.

The Oxfam story, as reported recently in The times, is a reminder that all of the issues we are talking about today - flawed leadership, poorly defined purpose, lack of respect for colleagues, a closed and secretive culture in which fraud can lurk – can exist in charities just as easily as in companies. Trustees are responsible for the oversight of risk. They need to promote a culture in which these problems are less likely to occur.

Let's now have a look at the Charity Governance Code to see what it says about some of the things we have been talking about. The Code is a pretty good document, though my personal view is that, in its preamble, it perhaps takes too much for granted in terms of assuming that trustees know what they are supposed to be there for. In my experience, and I'm not talking about the IBE here, this isn't always the case. Trustees come from all walks of life. They don't necessarily have business experience or much practical knowledge of governance.

Trustees are essentially the group of people to whom the charities affairs are entrusted. They don't actually run it – this is normally delegated to an executive or manager. But they are responsible for what happens. That means making sure the purpose of the charity is clear, that the charity is delivering on this purpose, that it is compliant with the law and the regulations that apply to it, that its strategy is appropriate for the delivery of its purpose and that risks are identified and managed.

The Code rightly points out that trustees are not employees of the charity. If they work for it or volunteer for it, then that role is entirely separate to their obligations as trustees. The important thing is that trustees are collectively and individually responsible for what happens. They have a duty to promote maximum effectiveness in the delivery of purpose and that key risks are identified and addressed. This is not just about compliance and box-ticking. It is about trying to make a good organisation better. Seen in this light the Code is pretty helpful.

Much of what we have been talking about this evening is there. For example, the first principle talks about organisational purpose. It says the board should be clear about the charity's aims and ensure that they are being delivered effectively and sustainably. This is says is the board's core role – to focus on strategy, performance and assurance. It goes on, in its second principle to talk about strategic leadership in line with the charity's aims and values. The board sets the tone, including vision, values and reputation.

Next comes integrity where the code rightly makes an important point about reputation. Trustees should behave with integrity even where - perhaps, I should say, especially - where difficult decisions have to be made. This section talks, by the way, about conflicts of interest. In my view conflicts are one of the big issues in governance, and boards often fail to face up to them. In commercial companies where they may have to make a choice between doing the right thing or forgoing revenue – the tendency of utility companies to put less well-off customers automatically on the more expensive standard variable rate is a case in point.

But conflicts exist in charities too – for example should you accept a generous donation from someone with a dubious reputation or an ulterior motive. It is important to acknowledge conflicts and face up to them. By the way, the way the management is incentivised can create conflicts. Setting revenue targets may push them into high pressure selling.

Finally I want to touch on the final principle – openness and accountability. Trustees and the charity over which they preside have to be accountable. Transparency is generally a good thing. Trustees need to ensure that stakeholders are kept informed and that they are listened to. Trustees need to be informed about negative as well as positive feedback. Openness is also important internally. Where staff have a problem, they must feel able to speak up without recrimination or retaliation. The charity is protecting itself through this process, as well as its employees.

So much for the code. I want to touch briefly on something else before I close, which is the question of how trustees can tell when things are going wrong. This is as much of an art as well as a science. You can tell a lot from the demeanour and attitude of the person in charge. Do they live up to the code of behaviour and the values to which all have agreed? How do they approach decisions? How do they treat subordinates? Are they open? Do they listen?

ICSA, the Governance Institute, produced a useful document earlier this year which lists some of the warning signs. The list is divided into three types of marker: measurable, evidential and judgemental. Some of the most telling indicators may well be a matter of impression. As I just mentioned, the demeanour of the top person is very telling, but so is a sense of drift on the trustee board or complacency regarding the benefit the organisation provides. You can't score this sort of information and use it to measure culture, but you can take it into account in conjunction with other things that are more evidence-based or measurable. Evidence-based markers might well relate to processes. Do we have a proper speak-up or whistle-blowing line in place? Is it properly overseen? Do we have a conflict of interest policy? And is it followed through? Some of them may be measurable, for example staff turnover and timeliness of returns to the regulator.

A key point to bear in mind is that, when the culture is eroding, several of these indicators may turn amber or red at the same time. When this happens trustees need to look carefully at what is going on. This requires more than just superficial examination. It is important to figure out what is the root cause of the problem and address that. Otherwise the solutions will only be sticking plaster ones. For example, if there is a problem with late returns to the regulator, it isn't necessarily going to help simply by issuing an instruction to revert to punctuality. Is the problem that the person responsible doesn't care, or that the organisation doesn't care, that the person is being poorly supervised, or that some other organisational issue is getting in the way?

One other point in this context. Fraud is usually hard to detect because fraudsters are quite clever. One might expect the accounts manager who is syphoning away money to have a shifty look about him or her. But this would be too obvious. Beware the book-keeper who is jovial but bumbling, keeps making silly mistakes, but seems pathetically grateful for the job!

So there we are. I have tried to argue in this speech that culture matters to charities just as it matters to other organisations. A good culture leads to opportunity and a better delivery of the charity's purpose. A bad one adds to risk. Trustees who are responsible for the organisation have a key role in developing the culture and ensuring that it is fit for purpose. The Charity Governance Code can help in this regard. And finally I have pointed out some of the markers that will help tell you what sort of culture you have actually got.

Some of this may seem rather tedious and involves a lot of extra work. Yes, there is an effort in setting it up right and making sure it stays on track. But more than anything else this involves getting into the right frame of mind. A good culture liberates and empowers an organisation while keeping it safe. The benefits are there for the long term, while clearing up a mess will take a lot of time and trouble if things go wrong.