Corporate Culture: Evidence from the Field

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December 13, 2016

Comment

Why do some firms generate great wealth for investors and offer innovative solutions to problems, while seemingly similar firms are much less successful? Why do employees at some firms repeatedly act unethically, shocking their leaders with scandals, while seemingly similar employees at other firms are quick to blow the whistle on unethical actions? One answer might be corporate culture. While policymakers, executives, and the press often credit corporate culture with some of the greatest business successes and failures, there is limited large-scale evidence to support such arguments. In our recent article, “Corporate Culture: Evidence from the Field,” available here, we use a novel survey tool to gather data about corporate culture from 1,900 chief executive and financial officers. The richness of our data allows us to explore the roles played by cultural values, norms, and other firm policies and practices such as governance and compensation in determining the effectiveness of corporate culture and, in turn, the effect of culture on three different types of business outcomes: ethical behavior, innovation, and productivity/firm value.

Our surveyed business executives indicate that having an effective corporate culture affects value: 91 percent of executives consider corporate culture to be “very important” or “important” at their firm, and 79 percent rank culture as at least a “top five” factor among all of the things that make their firm valuable. Cultural fit in mergers and acquisitions is so important that 54 percent of executives would walk away from a target that is culturally misaligned, while another 33 percent would require discounts between 10 percent and 30 percent of the purchase price of the target. 92 percent of corporate executives believe that improving corporate culture would increase firm value.

Executives also believe that culture influences a wide range of decisions and actions. 85 percent believe a poorly implemented, ineffective culture increases the chance that an employee might act unethically or even illegally. Relatedly, we find that nearly half of corporate officers indicate that they would choose a short-term project over one that maximizes net present value, or NPV. Among those officers that select the NPV-superior investment, 80 percent indicate their firm’s culture plays a key role in the decision. 70 percent believe effective culture is an important reason their firm takes on the appropriate amount of investment risk, while 29 percent indicate that ineffective culture leads them to take on too little investment risk to achieve their firm’s goals. Finally, 53 percent believe that an effective culture reduces the tendency of companies to engage in end-of-quarter earnings management practices (such as delaying valuable projects) to deliver the market’s expected earnings numbers.

While leaders are often puzzled when employees act contrary to a company’s stated values (see Wells Fargo and VW scandals), our research suggests warning indicators are usually there in the form of employees’ day-to-day actions or norms. Our econometric investigation of the survey data suggests leaders should start paying attention to these norms to understand the influence corporate culture has on firm performance. In fact, we do not find a strong relation between tracking stated cultural values and business outcomes. Instead, we find for stated cultural values to have full impact on business outcomes, they must be complemented by norms that dictate actual behavior. For example, we find that creativity (an example of an innovation outcome) is positively associated with the norms of “new ideas develop organically” and “comfort in suggesting critiques.”

As with cultural norms, leaders should assess the alignment of other firm policies and practices with their stated values to maximize the effectiveness of the corporate culture. Our survey respondents indicate hiring, firing, and promotion policies reinforce the effectiveness of culture 52 percent of the time, and incentive compensation positively influences culture 50 percent of the time. Governance and the board of directors support the effectiveness of the culture 48 percent of the time while the finance function only does so 43 percent of the time. In our paper, “Corporate Culture: The Interview Evidence,” we highlight some of the schemes that executives shared with us and that either reinforce the culture by rewarding employees for living the cultural values or lead employees to ignore those values.
We believe our research conveys a powerful message that corporate culture matters a lot. A key finding of our research is that stated cultural values, even among those firms that track those values, do not by themselves guarantee a successful outcome. Rather, cultural values must be complemented by norms that dictate actual behavior and then reinforced by other firm policies and practices. Given that an effective culture significantly affects firm value and influences innovation and ethical outcomes, we believe corporate culture deserves further substantial research, and we hope our paper helps build a bridge to enable such future work. One potential direction may be to explore why 92 percent of executive believe improving culture would increase firm value, yet they also indicate that they significantly under-invest in culture. Our interview evidence suggests that a firm’s investors play a role in this decision, but more work is needed.

This post comes to us from professors John Graham, Campbell Harvey and Jillian Popadak of Duke University’s Fuqua School of Business, and Professor Shiva Rajgopal of Columbia Business School. It is based on their recent papers, “Corporate Culture: Evidence from the Field,” available here, and “Corporate Culture: The Interview Evidence,” available here.

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