Corporate Culture: Evidence from the Field

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While there is a lot of talk about corporate culture, there is very little empirical work—because culture is very difficult to measure. In our paper, Corporate Culture: Evidence from the Field, we use a novel interview/survey method that is ideally suited to explore the questions: ‘what is culture and how do you measure it?’, ‘does culture matter?’, ‘can we attach a value to culture?’, ‘what are the implications of an ineffective culture?’, and ‘how can a more effective culture be established within the firm?’ Our paper is based on a very large sample of 1,348 executives from North American firms in the survey part and 20% of the U.S. market capitalization in the interviews. Essentially, our study creates the first large scale database of corporate culture.

The results are striking. 92% believe that improving culture will lead to increased value at their firm. Yet 84% of CEO/CFOs believe they need to improve their firm’s culture. A notable 85% believe that a poorly implemented culture increases the chances that an employee would act unethically or even illegally. While executives share a near-unanimous belief that corporate culture matters, a prerequisite to improving culture is to determine how and why culture matters.

We show the potential importance of separating cultural values and norms for understanding the connection between culture and performance. Cultural values are the ideals employees strive to fulfill, while cultural norms reflect whether employees “walk the talk” by actually living out these values. While leaders are often puzzled when employees act contrary to a company’s stated values, our research suggests warning indicators are usually there in the form of employees’ day-to-day actions or norms. Our analyses 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 that for stated cultural values to have full impact on business outcomes, they must be complemented by norms that dictate actual behavior.

We also highlight what executives think works for and against an effective corporate culture as well as what does not matter. We find that formal institutions such as governance and compensation can either reinforce or work against the corporate culture. Some of the factors that executives say do not affect culture, such as the board of directors, are surprising; ultimately, these non-factors may be the items that need to change for culture to have its greatest potential impact on performance. Finally, given that an effective culture is positively associated with value
creation and economic efficiency, we ask executives what is preventing their firm’s culture from being effective in practice: 69% blame their firms’ underinvestment in culture.

Some additional highlights from our study reveal how business executives strongly believe that an effective corporate culture enhances firm value. For example, it might be surprising that culture matters so much that 54% of executives would walk away from an M&A target that is culturally misaligned, while another one-third would discount the target by between 10%-30% of the purchase price. Executives also link culture to a wide range of decisions including ethical choices (compliance, short-termism), innovation (creativity, risk taking) and value creation (productivity, investment). For example, 77% percent of executives indicate that culture plays a moderate or important role in compliance decisions, and 69% indicate the same about the importance of culture to financial reporting quality.

The executives’ responses also point to the role of culture in decisions by firms to potentially take myopic actions that boost short-term stock price at the expense of long-term value. A majority believe that an effective culture would reduce the tendency of companies to engage in value-destroying end-of-quarter practices such as delaying valuable projects to hit consensus earnings. Similarly, using a hypothetical question that asks respondents to choose between two otherwise identical projects with five year durations, we find that 41% would choose the NPV-inferior project that favors short-term profitability. Among executives that choose projects that enhance long-term value (over projects that enhance short-term objectives), 80% indicate their firm culture influences their choices. Finally, many executives believe that their firms take on too little risk because of a dysfunctional culture.

In conclusion, we believe corporate culture deserves substantial attention going forward and we hope our paper helps build a bridge to enable this future. Our paper contains a host of descriptive information, which we interpret within the context of the related theory, offering suggestions on how firms can implement effective culture and what considerations future theory should focus on. In addition, we have an accompanying paper, Corporate Culture: The Interview Evidence, in which 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.

The complete paper is available for download here.