Corporate Culture: The Interview Evidence*

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ABSTRACT

We conduct in-depth interviews of senior executives representing over 20% of the market capitalization of the U.S. equity market to understand: (i) the importance, antecedents and consequences of corporate culture; (ii) the mechanisms that underlie the creation and effectiveness of corporate culture; as well as (iii) the factors that deter a firm from achieving its aspirational culture. Our interviews provide the following insights. First, executives characterize culture as "a beliefs system," "a coordination mechanism," and "an invisible hand." Second, most executives view culture as one of the top three factors that affect their firm's value. Cultural fit in M&A deals is so important that most executives would walk away from a target that is culturally misaligned. Third, culture is primarily set by the current CEO. Fourth, boards do not directly choose the firm's culture; instead, they influence the choice of culture by picking the CEO and through their influence on specific policies like incentive compensation. Fifth, executives emphasize that for a firm's culture to be effective, the firm's espoused values must be backed up by actual behavior and norms. Sixth, an effective culture improves firm value and profitability by: (i) fostering creativity and encouraging productivity; (ii) promoting more risk tolerance; (iii) mitigating myopic behavior; (iv) creating a climate for suggesting critiques and for allowing ideas to germinate organically; and (v) by compensating for mistakes in ways that the firm's assets cannot. In addition to the above, executives suggest several sources of publicly available data to measure corporate culture.

I. Introduction

Culture is given credit for some of the greatest business successes and blamed for some of the biggest failures. Policy-makers often point to dysfunctional corporate culture in banking as a first order contributor to the recent financial crisis (e.g., Dudley (2014)). Several books identify culture as a key driver of Google's success (e.g., Edwards (2012), Schmidt and Rosenberg (2014)). The corporate culture at VW, Toshiba, and Wells Fargo are recent examples of failures (Milne (2015); Inagaki (2015); Cancialosi (2016)). Though corporate culture is a very popular topic, many fundamental research questions remain open. In this paper, we attempt to provide answers to the following questions:

1. What is corporate culture?
2. How important is corporate culture?
3. What mechanisms underlie the creation and effectiveness of corporate culture?[1] How do other formal institutions (e.g., governance or compensation) reinforce or work against culture?
4. Do companies think their culture is effective and if not, what deters firms from having an effective corporate culture?
5. Are the upside benefits of an effective culture greater than the downside costs of ineffective culture?
6. What aspects of business performance does corporate culture affect? Does culture impact firm value, productivity, corporate risk-taking, growth, M&A, financial and tax reporting, whether employees take a long-run view, and/or corporate ethics?
7. How can corporate culture be measured?

We try to answer these questions in multiple ways. First, we surveyed 1,348 chief executive and financial officers (CEOs and CFOs, referred to interchangeably as executives or managers) across a wide range of North American public and private firms. The details underlying the survey evidence and an econometric investigation into the effects of culture on business outcomes are reported in an accompanying paper (Graham, Harvey, Popadak and Rajgopal (2016)) that supplements this paper. Second, the survey contained several open-ended questions. We analyze the text of these questions to enhance our understanding of the survey respondents' views of corporate culture. Thrid, we conducted in-depth interviews of business executives representing over 20% of the U.S. equity market capitalization. The purpose of this paper is to discuss the interview evidence and the open-ended responses from the survey. We summarize the survey statistics to provide context for the interviews and open-ended responses.

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[1] We use the word *effective* to describe a corporate culture that promotes employee behaviors that are needed to successfully execute the firm's strategies and achieve corporate goals. We use ineffective to indicate a culture that does not promote these behaviors and may even work against them. We use these words to describe culture because common descriptors like good or bad culture can have unintended connotations (like good culture meaning friendly work conditions, regardless of whether this helps the firm execute its strategies).

Survey evidence offers a number of insights about corporate culture. Briefly, the survey shows that managers are largely united in believing that corporate culture is one of the most important forces behind value creation and the ultimate success or failure of a firm. The majority of executives consider corporate culture to be a top three value driver at their companies. Almost every officer believes that improving their corporate culture would increase their firm's value. The current CEO is seen as the most influential person responsible for setting the firm's current culture.

The interviews offer insight into how other firm policies and practices may reinforce or work against the effectiveness of the culture. Boards affect culture not via active management but primarily via CEO choice. The finance function may influence the culture, especially when it serves an internal governance role by acting as stewards of integrity. Incentive compensation and hiring, firing, and promotion decisions also may modify the effectiveness of a firm's culture. Some schemes reinforce the culture by rewarding employees for living the values of the culture while other schemes that are not well aligned with the culture lead employees to ignore the cultural values.

Additional survey evidence reveals what decisions and actions are influenced by corporate culture. Managers believe that corporate culture has substantial effect on the creativity at the firm, productivity of employees and hence, on firm value and on profitability. Cultural fit is seen as so important in an M&A deal that most managers would walk away from acquiring a target whose culture is misaligned with the bidder's culture, while other managers would require heavy discounts to the purchase price of the target (between 10% and 30%). More than half of the officers believe that culture is a very important or an important reason why firms either take too much or too little risk in its investments. Effective culture plays a large role in instilling a long-term focus in employees and managers. Most officers believe that a poorly implemented, ineffective culture increases the chances that an employee might act unethically or even illegally. 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.

The interviews help explain why certain decisions and actions are influenced by corporate culture. Executives caution time and again that the company has to "walk the talk" and live the values espoused for the culture to be effective. Hence, researchers might want to be careful before relying on stated values without validating whether these values are reflected in practice. Executives suggest examining the social norms within the firm would give a better sense of the values. A brazen recent example of this disconnect between stated values and norms is a lawsuit filed by an investor against Goldman Sachs. The suit accused the bank of contradicting its executives' frequent public statements on how important integrity is to the bank. In the judge's decision, he wrote words such as "honesty," "integrity," and "fair dealing" apparently do not mean what they say; they do not set standards; they are mere shibboleths (values regarded as no longer important in action). He concluded Goldman's claims of honesty and integrity are "simple puffery" (see Soltes (2016) for more details).

Very few officers believe that their culture is exactly where it should be. When asked what prevents their firm's culture from being where it should be, most survey respondents state that leadership needs to invest more time to develop the culture. Other significant factors determining the effectiveness of the firm's culture are social norms that strengthen: (1) coordination and trust among employees; (2) agreement about the firm's goals, values, and long-term interests; (3) constructive criticism, learning, and the development of new ideas; (4) the sense of urgency with which employees worked; and (5) the predictability of employees' actions and willingness to whistle-blow when something is awry.

Finally, interviewed executives suggest several ways to measure a given firm's culture, including conference call transcripts/analyst reports, employee age/tenure/turnover, studying the company's external communication, press portrayal of the CEO, understanding circumstances surrounding a CEO change, including culture of the prior firm of the new CEO, external websites with employee opinions such as Glassdoor.com, assessments of whether the culture is in sync with the needs of the business, evaluating the communication patterns inside the company, and actions taken by management.

The rest of the paper proceeds as follows. In Section II, we describe how we gather the data via 18 interviews. Then, in Section III, we outline the insights from interviews. Some concluding remarks are offered in Section IV.

II.   Interview Procedure

Before we conducted in-depth interviews with corporate executives, we began by performing a thorough literature review to identify the key themes and unanswered questions in the multidisciplinary corporate culture literature. Based on this review, we created a series of questions that we asked corporate executives during interviews.

A.   Interview Logistics

Given our interest in investigating the causes and effects of corporate culture in the context of finance and accounting, our 18 interviews were primarily with CFOs, though we also interviewed one CEO and several other top-level managers (e.g., one chief marketing officer). Given the potentially sensitive nature of corporate culture, and to encourage frank discussion, we promised the executives anonymity. The first interview was conducted on October 22, 2014 and the final interview concluded on April 3, 2015.

Interviews are very time consuming and involve conducting background research about the company, interview time, transcribing, and coding of the responses. However, they are an ideal way to begin a project on a topic as subjective as corporate culture. Each interview began with open-ended questions such as, "What, in your view, is corporate culture?" and "How would you

describe the corporate culture at your firm?" The interview process allowed us to initially capture broad themes and narrow the focus as the interview proceeded. We also use interviews to identify under-researched topics, and as input in developing survey questions. We categorized the interview responses, which provide many insights to answering the questions posed in the introduction. All interviews were conducted via telephone. Many of the clarifying questions in the interviews are similar to those that appear on the survey instrument. All the contacted executives agreed to be interviewed, and all interviews were done before the survey was administered. The interviews varied in length, lasting from 40 to 90 minutes. The executives were forthcoming in their responses, and were enthusiastic about the topic. With the interviewee's permission, each interview was recorded and transcribed, ensuring accuracy in the presented quotations later in the paper.

Untabulated results reveal that all the companies, where each of our interviewed executives worked for, are important to the US economy and make up about 20% of the market capitalization of the NYSE plus NASDAQ. They are much larger than the typical Compustat firm with average (median) sales of $47 billion ($34 billion), and they are more levered, more profitable and have lower sales growth and higher credit ratings.

B. *Caveats*

While we believe that interviews are a useful way to obtain data that provide insights about corporate culture, we acknowledge that there are limitations. Interviews such as ours suffer from problems such as potential response bias, limited number of observations, whether questions are misinterpreted, do interviewees really do what they say, do they tell the truth, do they recall the most vivid or their most representative experience. An interview about corporate culture also faces challenges related to whether it is long enough to cover the multiple dimensions of the firm's culture and whether the term corporate culture means the same thing to all respondents. Finally, it is not possible to make statistical statements about cause and effect. Nonetheless, it is our hope that the interview evidence provides fresh insights into the issues we study, perhaps uncovering issues otherwise underdeveloped in research.

III.   The Interview Results

A. *What is Corporate Culture?*

We started the interviews by asking, "What is corporate culture?" Interviewed executives characterize culture as "a beliefs system," "a coordination mechanism," "an invisible hand," "how employees interact with one another," "a standard of behavior," "norms around how people treat people," "part work ethic, part ambiance of the work environment," "how the company really works, the operating style," and "the tone for what type of company this is." Next, we asked the interviewees, "How would you describe the culture at your firm?" Interviewees often described the

cultural values espoused to employees as well as the day-to-day practices of their employees. The executives often related their firm's culture to the way decisions were made within the organization and the group dynamics. The executives' views of corporate culture parallel the academic definition of culture. According to O'Reilly and Chatman (1996), culture includes "the values and norms widely shared and strongly held throughout the firm that help employees understand which behaviors are and are not appropriate." Cultural values are standards that employees strive to fulfill, while norms are the day-to-day practices that attempt to live out these values. Guiso, Sapienza, and Zingales (2015) give the example of impeccable customer service being a cultural value, while the associated social norm would be lived out by employees exhibiting a day-to-day positive attitude towards customers.

In Graham, Harvey, Popadak and Rajgopal (2016), the first question on the survey is open-ended and asks, "Briefly, what words or phrases best describe the current corporate culture at your firm?" Table 1 lists the 30 most common words and word stems used by survey takers to describe their corporate cultures. Customer, collaborative, and focused are the three most common words. Based on our review of survey takers responses, we synthesized their descriptions into seven distinctive cultural values: (1) adaptability; (2) collaboration; (3) community; (4) customer-oriented; (5) detail-oriented; (6) integrity; and (7) results-oriented. A brief description of these cultural values follows:

1. *Adaptability:* we classify cultures as valuing "adaptability" when participants used words such as: start-up culture, aggressive, scrappy, dynamic, innovative, thinking outside of the box, reaching beyond the obvious, little to no bureaucracy and hierarchy, creative, entrepreneurial, can-do, always looking for a better way, flexibility, proactivity, agility, shape the future, constantly looking for innovation, fast paced, or disruptive. One executive stated, "[Company XX] didn't want processes, they didn't want systems, they didn't want bureaucracy, they wanted people to take responsibility and make decisions even if those decisions turned out to be wrong – fail quickly and then move on. Become a learning machine essentially, where you take each cycle of data, feed it back into the algorithm and make changes based on what you see – as opposed to trying to get it right the first time and spending a year preparing for that first time instead of a week and iterating on the data." The opposite of adaptable cultures includes descriptions such as "buttoned down, traditional, centralized authority, conventional, traditional, buttoned-up, remote command and control." An anecdote from an interviewed CFO of a large multinational brings this idea to life, "at [XX], I would describe the culture as very hierarchical. People behave in a way that acknowledges the position in the hierarchy with great deference. At [XX], an analyst would defer to a director just based on position in the hierarchy."

2. *Collaboration:* we classify cultures as valuing "collaboration" when participants used words such as: teamwork, cooperative, friendly, supportive, family, participatory, universal recogni-

tion, no superstars, sharing, little to no politics, collegial, helpful, selfless behavior, cooperation, no confrontation, or extremely close-knit atmosphere. An example from the interviews is, "certainly the majority of our management are promoted from within. The management team was all partners in the business, rather than employees. Our culture is one of humility, of collaboration and determination. It's very much that we work together to achieve great things." Another example is as follows, "we don't show up at work to hit home runs, we show up at work to help advance the runner."

3. *Community:* we classify cultures as valuing "community" when participants used words such as: involvement and partnership in the community, respectful of diversity, community-oriented, empowering our employees, delivering sustainable outcomes, inviting and fun environment, citizenship, servant leadership, caring, progressive, open-minded, inclusive, develop all types of talent, we hire people with passion and expect it from all our co-workers, commitment to the environment, caring for those in the communities where we work, employees are valued, giving back to the community, treat all people with dignity and respect, be a passionate leader, optimism and social responsibility, or what's best for our stakeholders as a whole.

4. *Customer-oriented:* we classify cultures as valuing "customers" when participants used words such as: customer-centric, people-focused, market-driven, service first, customer delight and attention to their needs, the customer is always right, behavior to meet the client demands, we take pride in our service, we listen to our customers, a strong bias on understanding the business issue from the point of view of the customer, creative in meeting the customers' needs, mission to satisfy the customer, ensuring our service meets our promises to customers, meeting and exceeding customer expectations. As one of our interviewees said, "we spend a lot of time on customer service because we believe long term that's going to be the only differentiator we have. To drive that down, through the company, it's engaging with customers all the time from the senior executive level down, reinforcing that culture of owning the customer's problem and fixing it. We do that by spending a lot of time training employees about how it is that we want them to engage with customers and pointing out simple opportunities that they have to engage a customer all the time. We thank customers all the time. We send gifts to customers who spend some time thanking us, and going out of their way. Those are all the things we try to do to foster a customer-service culture."

5. *Detail-oriented:* we classify cultures as valuing "details" when participants used words such as: paying attention to detail, develop deep expertise, be precise, emphasis on quality, decisions based on analytics, technology-focused, data-driven, providing the most reliable and highest quality products, consistency in work and products, strong process and engineering focus permeates, continuous process improvement, functional experts solving problems, scientific leaders, evidence-based decision-making, and adherence to design.

6. *Integrity:* we classify cultures as valuing "integrity" when participants used words such as: compliance driven, credibility focused, accuracy of financials, honest, trustworthy, transparent, accuracy and credibility of financials, compliance with regulations and laws, sincerity, honesty, ethical, moral, accountability.

7. *Results-oriented:* we classify cultures as valuing "results" when participants used words such as: continuous improvement, accountability, demand excellence, work hard, achieve results, high performance, focused on results, be #1, high expectations, all demanding, investor-driven, internally and externally competitive, make a profit no matter what, produce results not excuses, the right results the right way, utilizing the best talent for the best results, personal ownership of results.

In response to the first survey question in Graham, Harvey, Popadak and Rajgopal (2016), 14% of the executives indicated that their current culture was in transition or explicitly stated parts of their culture needed to change to be effective. For example, one executive described the cultural transformation at his firm during an explosive growth phase: "to start with, there was a ridiculous degree of individual authority. Many projects, that would later become workgroups of substantial size, were just one individual's job. There was so much going on that communication about a particular project or decision would not have been feasible. And then later, the founder and I engineered more explicitly one of the largest culture shifts in the company away from decentralized decision-making to a much more review-oriented culture." A few participants indicated that their culture was ineffective and not conducive to growth and profitability because it was "selfish, rudderless, confused, misguided, fragmented, or unrealistic." An executive illustrated how instability at the top leads to an ineffective culture, "when you have continuity within your team and a continuity within your focus that helps a great deal. Whereas if you look at [XX], their perpetual change at the top and their reengineering of what they're going to do and how they're going to go to market creates a culture where the associates are very unsure of what is going to happen. There is also a lot of negative press, which is very self-reinforcing to an individual and affects his or her performance."

Executives, however, were quick to point out that there is no unique culture or set of cultural values that is effective at all firms or even within the same firm at all times. A quote summarizes this sentiment: "clearly, the kind of camaraderie that [XX] enjoys might not be appropriate in a lot of other financial sectors where this deeply humble collaboration is not necessarily the best approach. There's also, the downside to a very strong culture and it can become a set of handcuffs, limiting freedom of thought, limiting the ability for outside talent to hit the ground running and become part of the team. So, that's the balancing act, is it's a blessing and a curse."

B. How Important is Corporate Culture?

B.1. Overall Importance of Corporate Culture

The survey asks the following three questions to investigate the importance of corporate culture: (1) How important is corporate culture at your firm? (2) In terms of all of the things that make your firm valuable, where would you place corporate culture? (choose among Top 3, Top 5, Top 10, not in Top 10); and (3) Do you believe that improving your corporate culture would increase your firm's value?

As reported in Graham, Harvey, Popadak and Rajgopal (2016), 91% of survey respondents consider corporate culture to be "very important" or "important" at their firm. This result is corroborated in the finding that 54% of respondents rank culture as a "top 3" driver of firm value and an additional 25% rank culture as a "top 5" contributor. Thus, collectively, 79% of participants consider culture to be among the top five factors affecting firm value.

The interviews provide potential reasons why managers' believe that corporate culture is so important for corporate performance. When we asked executives to consider the importance of culture to firm value relative to other factors that create value, most indicated that culture is among the top 3 value-creating forces. No interviewee said corporate culture was outside the top 10. Moreover, various CFOs rated culture as more important than brand, employee talent, financial health, market position, operating plan, product, strategy, unique competitive advantage, and vision for the company. As one executive states, "there is a relation between the financial performance of a company and the culture. A good culture can lead to better results. If you started two businesses, they had the same manufacturing process, same raw materials, distribution, everything was the same," and one had an effective culture and one had an ineffective culture, "the good culture would outperform the bad culture. This is because the people in the effective culture would be working towards mutual success, they would all be striving to achieve success, whereas in the ineffective culture, people might just be in it for themselves, trying to get up the corporate ladder, just a more divisive environment. Ultimately, the strong culture is going to succeed." Another executive pointed out that culture creates competitive advantage by raising a barrier to imitation: "our competitors cannot copy our culture. It's a force multiplier."

When asked whether respondents believed that improving culture would increase their firm value, Graham, Harvey, Popadak and Rajgopal (2016) report that an overwhelming 92% said yes. But executives acknowledged that changing a firm's culture, at least in the short run, is hard: "culture is always longer term because that is the code/behavior of the company. Until there is a deliberate effort to change it, that persists. So your strategy can change from year to year."

When we asked executives more about the relationship between strategy and culture, they indicated that a firm with an effective culture and mediocre strategy will outperform a company with an ineffective culture and superior strategy. For example, one manager mentioned that a company could muddle through with a strong culture and a weak strategy but not the other way

around: "when I see companies that are not doing particularly well even if they have a really great strategic plan it is because they don't communicate that plan well. Then, it almost doesn't matter if you have a plan. Because people on the frontline, the people who are actually selling to your customers, if they don't get that, it's not going to work. The culture actually helps even if you don't have a great plan and you're not communicating well because culture helps tremendously to make sure that you are continuing to do the right things for the company in the long run."

Executives we interviewed provide compelling examples of why corporate culture is important for all firms and at all stages in the firm's development. Consider this example given by one of interviewees, "the previous CEO did not ascribe to culture. He didn't think it was important. [One of his sayings was] 'if you want friends, buy a dog.' He did not have the warm fuzzy approach; he did not want to meet with employees that would have made him uncomfortable. He was brilliant, and a good person, but he didn't bring caring and compassion to the workplace so we didn't have a culture. I [as new CEO] basically filled a huge void. I said we are going to have a culture and values. People were just dying for it. They were so thirsty. Honestly, there was such a void, that it just felt really good for people, and was adopted quickly. The employees wanted to buy into it."

Finally, executives emphasized that having an effective corporate culture helps their firms find common goals in the face of challenges inherent in running an organization with diverse geographies, ages, and attitudes. As one executive said, "we are very diverse. Our San Francisco group is young, likes to work as a team in a common space with very flexible hours. They tend to be more entitled than some of my older employees based out of Boston. The two groups don't necessarily work together very well. On top of that, we have over 1,000 creative people. Creative people really don't like structure. They like to be freewheeling with ideas, and they like to operate somewhat autonomously. Yet all of our divisions, even though they look different, they are working towards that common focus. We have done very well as a company and a key part of that is because we are so involved with our associates trying to work towards that common goal." The common focus and common goal implies that there is a common culture amongst all these differences.

B.2. Importance of Corporate Culture in M&A Deals

Several interviewed CFOs mentioned that the cultural fit of a potential M&A target is very important and is widely discussed in terms of: "integration and targeting a company and what value it could ultimately bring and speed at which things could get done, or way in which talent will assimilate." Another executive argues that several failed acquisitions are attributable to lack of cultural integration: "you find that lot of deals [M&A transactions] failed to deliver the promised return. Many failed because the companies overpay but others failed because they aren't successful integrating the two and getting the synergies – and usually the main driver is culture. If the cultures don't fit, not close enough that one can change and adapt, I bet almost every time that transactions will deliver less than expected."

To quantify the value importance of culture in an M&A context, in Graham, Harvey, Popadak and Rajgopal (2016), we asked CFOs the following hypothetical where two similar firms, A and B, are being targeted. Target B has a misaligned culture though both firms were similar in terms of strategic and operational benefits. In particular, we asked CFOs to quantify a "discount" if any applied to the company B. Graham, Harvey, Popadak and Rajgopal (2016) report that a remarkable 54% of respondents would not even make an offer for B, given the cultural misalignment. 32% of respondents would discount their offer price for B, with 22% offering a discount as steep as 20% or more of the purchase price of company B.

The interviews offer some color to the result that most firms would walk away from an acquisition of a target that is not a cultural fit: "we would test for cultural fit. If the gap was wide enough it did not matter if it was a great price. We won't move forward. That would disqualify a potential acquisition." Another manager put it this way, "as a business development guy, I would definitely pay more for the company whose culture is closer. Less friction and assimilation cost, we can get it all done easier, faster and at less cost." Commenting on the downside risk, one executive mentioned "I think it would be first-order premium. There have been disasters of purchases that had negative value in the end. You purchase the right to never-ending problems because of cultural factors and I would describe this as compatibility."

Another executive emphasized a bad cultural fit comes down to how much do you trust the employees. For example, this executive explained that he "had an attractive valuation on a firm that was a great fit strategically, but the CEO was known to be difficult. I didn't invest because I knew he would have to fire the CEO in a year and I had lots of uncertainty about what kind of person would work for a leader like that." When asked how exactly did the company test for cultural fit of the target, one executive responded, "we had a checklist set of questions that we would ask about the elements of the culture and we would compare them with the key elements of our culture. For example, we would look for strong focus on customer, high levels of integrity, open door communication and so on . . . (among) a list of 10-12 [things we looked for in a target]." These comments suggest that a lot remains to be done to understand the role of culture in M&A transactions.

Finally, one executive told us when cultures are very different, as long as they are both effective cultures, a successful strategy his firm used was not to integrate: "I'm not going to integrate it, touch it, anything. I'm going to have your back and protect that culture . . . keep your culture, but connect it to our firm. We'll protect the culture and connect the brand." This executive highlighted, however, that for these different cultures to co-exist and be effective, employees needed to act with respect and trust for other employees' actions.

B.3. What Mechanisms Underlie the Creation of and Effectiveness of Corporate Culture?

In this subsection, we explore the factors that underlie the creation of a company's culture. Then, we investigate which factors promote an effective culture that helps the firm execute its strategy and achieve its goals, and/or which factors work against the effectiveness of the culture.

B.3.1 The Influential Role of Leadership

In Graham, Harvey, Popadak and Rajgopal (2016), we ask participants to rank order who or what is the driving force behind setting the firm's current culture. 55% of respondents identify the current CEO as the most important driver of the firm's current culture. 32% of participants identify the owner, 30% identify the founders, and 18% identify past CEOs as responsible for the company's culture. It is interesting to note that the board of directors (12%) and incentive compensation (12%) are not perceived as creators of the current culture. We hypothesize that these formal institutions generally serve as modifiers to the existing culture (see Section B.3.4 for details), rather than as a primary force establishing the culture. We also note non-management employees were not thought to be influential (13%). As one interviewed executives said, "corporate culture is created from the top-down, only when leadership fails to cultivate the culture, it becomes a bottom-up culture."

The primary role of leaders appears is to instill a common belief system that pervades the whole company. For example, one interviewee commented, "our leader really focused on the values. He lived it and led the culture. You have to have leaders that live it." Or as another CEO put it, "once you become CEO, you need to define what you want the culture to be." Beyond focusing the firm on certain values, leadership plays a critical role in encouraging employees to live out the cultural values in their day-to-day practices. For example, "core values start to build a culture. I can set up an environment and I can tell them my expectations, but if the employees don't buy into it then I can't dictate a culture. Delivering that cultural message and being consistent with it is really important." Or as another executive said, "a good leadership team and good CEO will put in the processes to make sure the message filters down to very bottom of the organization unchanged."

While leadership clearly plays an influential role in setting the culture, several executives noted that it is a very challenging task. For example, one executive pointed out that instilling a common belief system in the whole company "is very difficult. I think the best you can do is establish a tone from the top that carries down to the key leadership of the company, and individuals will build around that. It is how they behave, how they act, and their trustworthiness."

Given that it is such a challenging task, other executives argued that the more memorable leaders, often the founders, play an exaggerated role in setting the culture. "The memorable leaders substantially define the culture. Even years after they ceased to be an active force in the organization their legacy is still alive, they define the culture, because they defined a lot of the

character of the firm. There could be some structural things that could influence culture, but in my experience the leaders of the company do almost more to shape the culture of the company than the structural environment."

Other factors executives thought interacted with leadership's ability to create an effective culture were context and diversity. First, as one executive put it, "the individual leader's attributes have to be conducive to industry or the sector one is in to know if the leader's approach is going to work effectively." This executive cited Bill Perez, the former CEO of S.C. Johnson, as an example. "Bill was excellent at determining what consumers wanted. Nike was looking for a new CEO with world-class insights in various areas of marketing. Bill Perez was selected and did exactly what he was hired to do. Nine and a half months after Bill started, Phil Knight fired him. Bill was shocked. The culture said 'we're Nike, we know what we want more than the customers do. We tell the customers what they want.' The culture absolutely ate him alive. Normally someone who fails doesn't get a big second chance, but Wrigley wanted all of the same things that Bill was doing at Nike and had done at S.C. Johnson. Bill went to Wrigley and did it there, and he was a massive success. Same person, same actions, totally different results. Context is essential."

Second, diversity in top leadership helped some executives to establish more effective cultures. As one executive described, "the culture gets affected by the top leaders at the company. We have 6 people that are members of our executive committee, which is broken down 3 male and 3 female. The CEO and his executive committee make all of the decisions as to where the company is going using a very balanced approach. Our largest operations are ran by a woman who is very marketing driven. She brings a lot of insight into shaping the culture that the CEO or CFO may not. I think a balanced executive committee helps."

B.3.2 Investment in Corporate Culture

Several CFOs point out the importance of investing in the firm's culture: "one thing I've realized as I've reached the most senior management is how much work it is and how conscious you have to be to sustain and adapt that culture. I think most employees kind of take culture for granted. It takes continuous refinement and reinvestment to keep the culture alive." Interviewed executives enumerated many techniques they use to achieve greater employee engagement. For example, as one executive stated, "we have internal videos, other internal messaging, various newspaper articles that go out to all of the employees to continually reinforce what the culture is. In addition, every year, the CEO exerts great effort to achieve the difficult task of getting in front of all of the employees in an effort to reinforce the culture as well."

Another executive said, "we take new employees through history, we give them books of past writings and have meetings where in some cases we'll ask an employee to talk about a critical policy or historical thing that happened in the past. Indoctrination into culture is also promotion from within, its celebration of things that demonstrate the culture, its finding little hero stories

among our employees that go to extraordinary lengths and celebrating those things." In addition to training, executives also cited formal human resources processes of encouraging engagement. For example, "retention of employees below you was a big part of what you were evaluated on if you were up for a promotion."

Some executives stated that they have mentoring programs for new recruits to learn the culture, "we've had a peer mentor help bring people into the company and explain why does this happen, why does that happen, you know some of these little mystifying behaviors that any company has can make you feel like an alien if somebody doesn't explain why it happens. Something as simple as, 'Well, gee, why do I have to get a tray in the lunch room if I'm just getting a cup of coffee?' We have found that having a peer there to help ease that transition is more important for millennials because they may not have the patience just to put up with it."

Another executive explained that indoctrinating mid-level managers is critical for sustaining the culture. "I think the area where we see the most challenge is bringing in mid-level managers into the company that certainly don't have the decade of cultural background from rising through the ranks. It does create a challenge and certainly the success of keeping the talent can be hugely determined by how much you can help ease them into the culture."

Finally, others argued that investing in corporate culture is necessary at all times and it should not be viewed as luxury a firm can only afford to do when business is good. "We invested in our people in a downturn, and when the economy started to turn around, we started to grow, and grow quickly. By the end of this year, we recovered everything and more than we lost. At the same time, our customer survey results are at an all-time high, our employee survey results are at an all-time high, and we are more profitable than we have ever been as a company, and our stock is trading at a historical high level. As we look at it, the investments that we made to stay true to our culture, has paid off not only for our people, but for our shareholders." Or as another executive put it, "In many situations you would have to give up some short-term performance to achieve the goal of moving the culture toward the firm's overall culture. Let's say it's an acquisition, you have multiple offices, you are better off consolidating those offices very quickly, and getting people to get to know each other and start working together. Anytime you do that, you are going to incur a lot of upfront costs. Also, incentive structures we put in place when we acquire a company to try and stimulate the operations that are existing. In each case, we are making a short-term financial stipend to those individuals to try and get them onboard, to integrate, and to work toward that same common culture."

B.3.3 Social Norms Underlie the Effectiveness of Culture

How do employee actions affect the corporate culture? Several interviewees highlighted the importance of social norms, which reflect the way employees embody the cultural values in their day-to-day actions. The following discussion reports on the importance of a number of social norms

in creating an effective culture. They include: (1) coordination and trust among employees; (2) agreement about the firm's goals, values, and long-term interests; (3) constructive criticism, learning, and the development of new ideas; (4) the sense of urgency with which employees worked; and (5) the predictability of employees' actions and willingness to whistle-blow when something is awry.

1. Coordination and trust: Graham, Harvey, Popadak and Rajgopal (2016) report that survey respondents consistently identified the importance of trust among employees (85%) and coordination (77%) as determinants of an effective culture. One executive highlighted that coordination and trust are the key factors contributing to effective collaboration at his firm: "Teamwork is enhanced. Goals are set at higher level with coordination of effort, which is enhanced by a trusting culture, and knowing that people care for each other." Or as another executive put it, "trust that the company will do the 'right' thing, that superior effort will result in superior rewards and praise among peers. People do not mind going the extra mile if they know everyone is putting forth the same effort." Other executives, however, noted how poor coordination or trust could hamper overall performance. "Our metrics are much better because we now do phone calls with stores twice a week where they can get on the phone and tell us about their stores and their experiences, and are we getting them inventory on time, and did our software work correctly for billing and logistics. Versus before, that would filter up to the manager of preferred retail who would then talk to the head of [XX] who would talk to the head of all of [YY]. It would take six layers to get there." Or "as with any organization, the perception of 'who can be blamed' enters the decision making protocol. If the results of decisions or actions are not reviewed with an empirical view then decision are made within the content of avoiding blame and a culture of distrust will unfold. Decisions will no longer be made with facts but to minimize blame." Similarly, one executive said, "lack of employee trust curtails productivity and adoption and implementation of value-added ideas."

2. Goal agreement and long-term decision-making: In Graham, Harvey, Popadak and Rajgopal (2016), survey respondents rate the importance of broad agreement about goals and values (70%) and decision-making that reflects the long-term (73%) as contributors to an effective culture. As one executive said, "Our culture is a challenge for the fact that we are very diverse. Yet all of our divisions, even though they look different, they are working towards that common focus. We have done very well as a company and I think a key part of that is because we are so involved with our associates trying to work towards that common goal." Focusing more on the long-term aspect, one executive said, "One of our cultural norms is 'perseverance.' We focus on the long haul. Real and meaningful success comes through sustained efforts. So management has a longer-term horizon for decision making. This trickles down into all of our actions. When faced with downsizing certain groups due to backlog, we work very hard to preserve talent, and place employees in other groups."

3. Constructive criticism, learning, and new ideas: Learning came up in several interviews. Common topics related to learning addressed by executives were if failure is viewed as an opportunity for learning from such mishap or was failure viewed as terminal, if creativity and innovation are encouraged, and how often employees let issues fall between the cracks rather than quickly embrace change. A majority of survey respondents in Graham, Harvey, Popadak and Rajgopal (2016) identified the emergence of new ideas organically in the firm (60%) and comforting in suggesting critiques (67%) as meaningful determinants of their culture's effectiveness. As one executive put it, "our culture promotes divergent views and works complex business problems from the ground up. Creativity comes from our ability to engage disparate views in this process." Or as another executive said, "people were encouraged to come up with new ideas and to try things. I'm thinking about all the things that came out of people who went above and beyond their job descriptions because they cared either about the job they were doing or about making the company more successful. I'm thinking about the guy who came up with the [XX] model, or [XX], which is basically a $10 or $20 million a year business. Would he have done that if he were working at another company [YY]? Probably not. Would he have been working at the [YY]? Probably not, because they had a culture where that kind of tinkering was not encouraged."

Many executives emphasized the necessity of active critiquing both within peer groups and within hierarchies to help the firm achieve its goals; however, they also noted that once a decision had been made, the employees need to commit quickly and implement the program. For example, one of our interviewees emphasized that a common saying at his firm was: "have backbone but commit. You are to have the backbone to disagree and suggest to your colleagues that they could improve this or that by doing this or that. You are supposed to feel comfortable giving the critique and also receiving that critique. It is a type of coaching. But once a decision has been reached you commit." In contrast, we heard other executives discuss firms with ineffective culture "where a lot of people protect each other and won't bring up something that is derogatory to their colleague's project or program. They are even less willing to say something to their superiors. As one of my colleagues said, they are terrified of me, so they will not challenge me when I say something and I am going to drive us off a cliff, if they don't."

A key distinction emphasized by executives that linked learning to the effectiveness of the culture was the degree of internally-focused vs. externally-focused learning. For example, "within the industry you might see a consistency of culture. You might see a common culture within tech industry versus manufacturing for example. But then you would see a lot of variation within the tech sector that are influenced by things other than the dynamics of the tech sector itself. One difference within industry is if the learning is internal or external. When you are trying to follow somebody there is more of a roadmap but it limits your horizon in the sense that there may be something that you competitor has not done that would be a great idea. At another firm, because there was no one to follow, you had to invent it yourself and you learn." What this example conveys

is that internal learning does not cap your potential for upside rewards.

Another way executives thought about learning is through the lens of employee turnover in times of economic adversity. In a challenging macroeconomic environment, do employees respond by saying, "we have to stick together to ward off these challenges; let's figure out a way to do so." If they do, that is indicative that they will look for creative internal solutions to their challenges. Alternatively, in a challenging macroeconomic environment, the most talented employees could jump ship, because they are always looking toward the external environment. This could leave the firm in an even worse position with worst prospects for recovery. Several executives highlighted the importance of these dynamics during the 2007-2009 recession.

4. Sense of urgency: Graham, Harvey, Popadak and Rajgopal (2016) report that 61% believe that the urgency with which employees work helps to determine the effectiveness of the culture. Common topics related to urgency addressed by executives include work/life balance, time spent in meetings, time spent building a consensus vs. just taking action, and how quickly all employees can get on board with a new project. To understand how lack of urgency may lead to an ineffective culture for firm performance, one can imagine examples of excessive time spent on planning yet chronic inability to meet plans, frequent employment of consultants to defer decisions, or even an unwillingness to face real issues while debating peripheral ones.

Several executives highlighted the need for urgency when the firm is a newcomer to the industry versus an established, mature firm. The CFO of a very successful firm that was a start up a few years back stated, "I wonder if the need of the business is what contributed to our culture, we have a go fast culture that is not good for whiners, we don't have time for babies, we don't have time to hold hands and sing on the mountain. We have got to get going or we are going to lose this race. It was very evident in the first year here that maybe a hard ass environment was what we needed, we were all working many hours a day, 7 days a week, just a lot of stuff going on."

5. Consistent actions and willingness to whistle-blow: In Graham, Harvey, Popadak and Rajgopal (2016), the majority of survey respondents indicate an environment that facilitates consistent and predictable actions by employees (55%) and that facilitates employee whistle-blowing (56%) contribute to the effectiveness of the corporate culture. A common theme that our interviews relayed is that having employees aligned on the types of actions that are laudatory enables an effective culture. For example, if half of the employees are very competitive but the other half are collaborative, the interactions between the employees will likely produce office politics that encumber employee productivity. As one executive put it, "part of culture, in terms of how people behave or that common sense of purpose, is knowing how people will react to things and being willing to share bad news. Knowing how your boss will react to something. Sometimes, even if it's not positive – rather than being like I have no idea if my boss is going to fly off the handle, like am I

going to get fired or promoted as a result of this. That sense of uncertainty, I think is bad." Thus, knowing with certainty how employees would react allowed the firm to successfully execute on its strategy.

With respect to whistle-blowing, one executive summarized it thus: "you have seen the frauds and these things that haven't gotten reported because there has been a culture of fear or loss of job. As much as people want to do the right thing and raise their hand and say something, there is always that fear that I do that and I will lose my job and then where am I going? Unless you can have this environment that says no matter what, we will always do the right thing by you." But others point out that layers of bureaucracy make whistle blowing difficult. For example, "core values start to build a culture. I can set up an environment and I can tell them my expectations, but if the employees don't buy into it then I can't dictate a culture. Delivering that cultural message and being consistent with it is really important."

B.3.4 Formal Institutions that Potentially Modify Corporate Culture

Certain formal institutions can alter how a given corporate culture works, potentially changing the relationship between culture and business outcomes. For example, incentive compensation can potentially reinforce the intent of a given culture, or it may work against the culture by introducing a different set of incentives. We present information on the relative importance of the following formal institutions that potentially can modify of a firm's culture: (1) incentive compensation, (2) hiring, firing, promotion, (3) external governance such as the board of directors, and (4) internal governance such as the finance function.

These potential modifiers may create a tension at the firm between the informal institutions (i.e., culture) and formal institutions (i.e., governance) that is reminiscent of an economic debate about the limits of contracting and how far from the first-best benchmark the firm falls when actions are not verifiable (Levin (2003)). Given that actions are often unobservable, contracts must be written on outcomes and agents must resort to using incentive schemes. If culture is an informal institutions for guiding actions, and there is a formal institution with its own set of incentives based on outcomes, if the two do not reinforce each other, the formal system is likely to mitigate the effectiveness of the informal system. In each case, it is important to recognize that the modifier can either work for or work against the culture.

The results reported in Graham, Harvey, Popadak and Rajgopal (2016) indicate that senior management behavior and governance/board of directors reinforce the culture. 65% of respondents believe senior management's behavior reinforces the effectiveness of corporate culture. 48% believe the board of directors contributes to the effectiveness of the culture. 43% of respondents also believe that the finance function positively influences the effectiveness of corporate culture. Interestingly, 50% believe that incentive compensation positively influences cultural effectiveness whereas 17% believe that compensation schemes work against the effectiveness of culture. Hiring, firing, and

promotion reinforce an effective culture 52% of the time but work against the effectiveness of the culture 13% of the time. The role of the CEO and senior management has already been discussed in Section B.3.1. Details behind the other four responses are presented in the following paragraphs.

1. Incentive Compensation

Compensation packages define the rewards earned by employees in return for their labor and are a potentially important modifier for determining the effectiveness of the firm's culture. As highlighted earlier, Graham, Harvey, Popadak and Rajgopal (2016) show that 50% of executives believe that the compensation system reinforces the effectiveness of the culture and 17% believe it works against the culture. Among those that believe that culture reinforces the culture, 35% indicate that the compensation scheme helps to attract and retain the right type of talent to the firm, 29% say that their compensation system rewards employees for living the values of the culture, and 32% believe that their compensation systems focus employees on long-term objectives. Examples of compensation structures that reinforce the culture include "discretionary rewards for associated with promoting the culture or for really living the culture, and living the values," "one-year financial stipends for managers from acquired firms to get them onboard with the new culture quickly," and "linking incentive compensation to team effort," and "linking higher-level employee incentive compensation to retention and promotion outcomes of the employees below them."

Among firms that indicate that their compensation schemes work against the effectiveness of the firms' culture, Graham, Harvey, Popadak and Rajgopal (2016) report that 39% indicate that compensation focuses employees on short term objectives, 24% say their firm's compensation scheme attracts and retains the wrong type of people to the firm and 20% say compensation leads to fear of failure and insufficient risk taking. A belief commonly expressed by interviewed executives is, "incentive compensation is strong motivator and driver of the behavior and ultimately if that is not aligned with culture it will change the culture. Because people invariably will do what you pay them to do even when you're saying something different. If they are misaligned, incentive compensation will affect and change the culture." Other specific comments about negative cultural effects of compensation schemes include "compensation and benefits are, for the most part, all for one and one for all," "high performers are not incentivized, low performers are not penalized," and "(our) compensation structure rewards mediocrity."

A prominent example of compensation structures working against the effectiveness of the culture is the practice of grading employee performance on a curve. As one executive explained, "we instituted this stack rank for employees, each employee gets evaluated and it is on a bell curve. Each department has a quota, certain number of people are performing above, certain number are meeting expectations and a certain amount are below, regardless of what they are actually doing, you have to rank them that way, a forced ranking. So, of course the people at the bottom are completely demotivated because they know they are going to be fired eventually and it doesn't

motivate them to do better. It doesn't motivate people to cooperate; you don't want to help the guy next to you because they might do better than you."

The examples of compensation structures that redirected employee efforts away from the aspirational culture invariably rewarded employees for achieving a metric without regard to the actions they took to achieve that metric. For example, a firm's culture that aspires to value people, and customers in particular, but rewards employees for sales volume found employees misrepresenting information to the customers and not satisfying the customers' needs in order to meet sales targets. The recent Wells Fargo scandal provides a prominent example of the consequences when compensation structures work against the stated cultural values (**?**). Executives viewed this example as a much more general problem: "setting goals and a mission for the company and getting people engaged around that is a part of culture. Achieving goals and having a burning desire to achieve goals is part of building a culture too. Compensation is incentivizing people to hit certain goals." If employees tweak their actions to achieve specific outcomes that satisfy the compensation criteria, then the way of doing business the leadership aspires to may be undermined. Executives quickly identified such limitations of compensation, "the easiest thing is to pay (based on) the metrics, but you could end up with a bunch of people that you don't want to have around you."

Finally, interviewed executives said that key elements to the compensation structure are fairness and reasonableness. For example, "compensation has to be right in terms of the market place. Compensation has to be perceived as fair and awarding performance or else your culture gets screwed up. Paying outsized amounts of money works on certain types of people at certain levels in terms of getting them to outperform and work extra hours and getting their commitment. But ultimately, as long as you are within the band of paying competitively compared to the market, culture is more important."

2. Hiring, Firing, and Promotion

Through hiring, firing, and promotion, corporations can instill cultural values by selecting employees, avoiding the challenge of shifting their ideals. By firing employees or not promoting employees if they fail to adapt their ideals to the selected cultural values, these practices serve to reinforce the culture long after employees are initially matched to the firm. Executives often conveyed stories about how they used these tactics to ensure only the employees with highly desirable values such as integrity worked at their firm. As one executive said, "compliance and making the right decisions are constantly preached by our CEO and upper management. They make it a point to hire people with high character." Or as another executive stated, values are instilled via "relentless communication on compliance being the number one culture goal, and a policy of high profile one and done firings when compliance is violated." Another executive echoes this sentiment more broadly across different cultural values, "culture is developed partially based upon principles the leadership instills in the organization and by hiring people that you believe can thrive in a particular culture."

Executives told us that promotions especially at more senior levels often depended on the culture. For example, one executive said, "I think you get to a certain level of the organization, and you kind of realize how important the culture is. As a leader in the firm, I always remind people about the culture of the firm, and how if you want to move to that next level, you have to embrace the culture. So, I think the employees know the importance of the culture, but sometimes they have to be reminded of it."

While hiring, firing, and promotion may reinforce cultural values and lead to goal agreement among employees, it may also be a necessary condition for effective culture. Many examples of ineffective cultures stemmed from hiring, firing, and promotion systems that worked against cultural values. For example, "individuals do not feel empowered to express new ideas as the culture is such that those with differing views from the owner are eventually fired or demoted so people do not feel encouraged to be creative." Or "our firm had a no lay-off, treat employees as family policy but this limits the rate of company growth. We reject contracts that require hiring more employees if we feel that there is a risk of having to lay off those employees when the contract ends." Complaints of nepotism and favoritism affecting productivity occurred repeatedly. For example, "nepotism impacts hiring decisions and reduces promotion opportunities," and "management applies different levels of accountability for employees within the same department. Some employees overproduce while others plod along knowing their likeability with management shields them from accountability."

Finally, in an egregious example of firing practices working against the effectiveness of the culture, one executive explained, "there was an issue of a fraudulent payment executed. The blame fell on the last person in the payment chain, the accounts payable person. The AP person's job is to check to see all the approvals were duly made and the documents are matched, as was in this case, not to question the validity of an expense. But to ensure that someone was blamed for the error, the AP person was fired. This was done to demonstrate to the board of directors and auditors that the error was dealt with by fixing the process. Unfortunately, the root cause was not modified. Not a good signal to send to the staff and more importantly, it enforced a destructive corporate culture where nobody will make any extra effort."

3. Governance/Board of Directors

Graham, Harvey, Popadak and Rajgopal (2016) find that 56% of surveyed executives believe governance/board of directors reinforce their firm's current culture. On the other hand, 11% thought governance worked against the culture and 33% thought the board had no impact on culture. Our interviewees echoed the sentiment that certain boards have a very positive impact on the culture while others do not. Some of the characteristics differentiating the impact of boards was their activeness, their relationship to the CEO, their demographic traits, and their ability to differentiate between actual and aspirational culture.

Proactive boards that are interested in the culture reinforced the culture and helped firms succeed. As one CEO emphasized, "we have an active board that plays a role in shaping and monitoring the culture. We have an inquisitive board that asks a lot of questions. They ask questions not just of the top tier of management, but also ask the second tier and any key individuals under that now and then. The board listens to all levels very carefully and will express their opinions about if we are moving too fast or too slow or are we over extending in one area or not." Another executive appreciated that his board felt a responsibility to determine where everyday practices may be misaligned with cultural values. As he put it, "Our board is very supportive of our culture. The head of our compensation committee will say: How are things? Are people feeling good? Are they being supportive? Are we doing the right things with the compensation? This is a perfect example of a board member who is very focused on making sure he is supportive of the culture."

In contrast, reactive boards stacked with insiders and disengaged from the industry worked against the effectiveness of culture. For example, "the board does not engage with management a lot in regards to monitoring or shaping the culture. We have an older board, and they are a little bit disengaged and a little bit dated in terms of what is going on in today's market. So I don't think they get into our culture, they don't understand it. It's not what they were doing back when they were working." Or as another executive put it, "the boards do not influence culture. The people on the board are for the most part, handpicked by the CEO, and share his vision. Ultimately, for the shareholders, I'd say they are too close to his vision. But life is good right now. Boards are not known for disrupting when things are good." Or as another executive described, "from a board perspective to the CEO, the culture discord was at that level. You have think of the culture at different levels. There is a culture between the CEO, the management team, and the board. If the board/CEO/management team just aren't connecting, you've got a problem there. If those get out of sync, you end up with problems."

Interviewees consistently expressed the sentiment that boards have a responsibility to act when leaders do not deliver and thought directors should not wait for a crisis before they react. Interviewees viewed the board's biggest responsibility as picking the CEO, and thereby indirectly setting the culture via their choice of CEO. As one executive said, "in a company, the CEO has the strongest impact on the overall culture and the board has biggest impact on both choosing the CEO and also on what the CEO prioritizes and what is allowed and not allowed. It is very high level but the board does, in my view, hugely impact by setting the tone at the top." Another executive clarified that the board sets the overall tone but does not get involved with the implementation of cultural values. As he said, "at some level, the board sets the tone. The important thing for our board is to drive accountability, transparency, and integrity. The board sets the ground rules at that level. But, is a board really going to go beyond that in a more in-depth cultural way in terms of engagement of employees for example? I haven't really seen that."

Finally, executives pointed out ways that even well-intentioned boards could fail to properly

react when it comes to culture. As one executive described, "it is critical for boards to try to fully understand and appreciate the aspirational and the actual culture. I differentiate between aspirational and actual because sometimes boards only hear what management wants them to hear. Good boards have an intuitive feel for the culture of the company and kind of know what makes sense and what can and can't be done from either a social contract or just a human relations perspective. So it is critical, but I think boards that are tone-deaf to the actual culture may push managers to do things that create destructive results or begin to disengage employees." To that end, executives believed the onerous was partly on management to help the board understand the culture. In particular, one executive said, "with all the pressure on boards these days for rapid performance, it becomes critical that the management team also helps the board understand the culture. You may need to steamroll over the old culture if you've got big changes, but in today's hurry-up world with activist investors and other things, the board is kind of a last line of defense. So it is important that the board fully understand the culture."

4. The Finance Function

We also explored the role of the finance and accounting function in either reinforcing or subverting the effectiveness of the firm's culture. The finance function within the firm is broadly defined to include employees in treasury, corporate, M&A, and compliance-type positions. Among the 49% of respondents who believe finance reinforces the effectiveness of their cultures, many (43%) highlight that the finance function in their organization exemplifies accountability/integrity and transparency (see Graham, Harvey, Popadak and Rajgopal (2016)). 30% believe that finance provides analytical tools for superior execution, while 24% believe finance focuses employees on long-term objectives. In interviews, we heard about finance departments with distinct subcultures where certain values resonated more with the finance employees such as accountability, integrity, and ethics and this influenced the rest of the culture. For example, one executive said, "the finance organization has its own culture that has grown up within the culture of our company. The finance organization is not as transient as some of the organizations. In the finance organization, people tend to stay a lot longer, and as a result we know each other better, and we work closely together. I trust my peers. My peers trust me. It's a close knit organization. The finance organization has a foundation with a framework. The foundation of that framework is integrity. I remind everyone that finance has a higher level of responsibility. If we see something that is not appropriate or not right, we have an obligation, and we cannot forget that."

As an example of how finance's role as a risk management team and the funding decider encourages more robust conversation rather than a defer-to-seniors norm, consider the following, "finance holds a very special place in an organization. Finance employees are both the guardians of integrity but also the mirror of the organization because sometimes people think they're much better than they are. As a function, finance has the ability to significantly influence how the firm/company

views itself, and how the leadership views their impact on the results of the company. Without the finance function's culture of integrity, compliance, etc ... the behavior of executives ends up a lot of time destroying what it took them years and years to build."

Another way finance influenced the overall culture was developing a social norm for consistent decision-making that was based on facts rather than sentiment. For example, "the finance culture influenced the rest of the culture. When I got there, there wasn't analytical processes behind choosing real estate, pricing management, and purchasing. They didn't even do detailed analytical customer research. When I was there, we developed very complex analytical processes around developing the comps and unit returns and all this other stuff. The finance group by developing these tools, which were successful and easy to understand, become tools that the different groups used to become successful. We totally changed the culture."

Only 8% of survey respondents indicate that the finance function works against the corporate culture in their firms. 32% of these respondents believe that finance employees operate in a separate silo and 35% believe that finance focuses employees too much on short-term objectives. As one executive conveyed, finance departments that are not integrated with the rest of the business can be detrimental to firm performance, "finance is an area where you have such a range of skills and different backgrounds, so you're not quite as immersed in the firm's culture as you might be in some other functions. If you don't connect the function to the firm culture then it lessens the effectiveness of the finance group. If our finance professionals can't share common insights, then it does make the finance professionals remote or distant."

B.4.   How Does a Firm's Culture Evolve?

Schein (2010) suggests that leaders first start the process of culture creation when they join firms. After cultures exist, they determine the criteria for who will or will not become a leader. Schein (2010) goes on to argue that firms' cultures are strongly affected by the shared experiences undergone by employees in the firms early history and that, once established and taken for granted, the firm's basic assumptions are very hard to change. Hence, early environmental pressures have a big imprint on the firm's culture. The interview evidence is largely consistent with the perspective that (1) culture is created by the firm's leaders; (2) it evolves over time to respond to the life cycle, environmental pressures and to the firm's market position; and (3) employees either fit the culture of a firm or leave or let go eventually and the demographics of the workforce matter as well. Detailed comments are presented next.

1. Leadership and Founders

All executives agreed that "leaders define the firm's culture." Several executives thought that the founder's values mattered a lot to younger firms. However, they thought culture matters both to

start ups and mature companies, except the mechanism driving the dissemination of such culture changes from the founder to legacy practices. As one executive explained, "for the younger firms, I think it will depend on the leader. How much they recognize the culture is important. However, when you get to a certain scale at which leaders of the company realize that their direct action is not enough to reinforce certain behaviors, culture begins to pick up and carry out their will in a subtler way and extends their influence."

A few interviewees thought that leaders, effective in one culture might fail in another. An executive cited the example of Ron Johnson who "left Apple, one very unique culture, and came to J.C. Penney, a very different culture, trying to bridge and change that organization and bring it along but it didn't work." On another point, very few CFOs thought that a bottom-up culture was a realistic proposition: "No, it almost never happens. I am sure someone will come up with an exception somewhere but generally the way that the corporations are set up, they're benign dictatorships. Whether the dictator or CEO is benign or not he or she will shake the culture through strong will or by behavior. If the CEO is not strong enough to drive the agenda of the board, the board will replace the CEO so culture always comes from the top." One CFO thought that poor leadership leads to a bottom up culture: "for many companies that maybe don't have leadership that pays attention to culture, you are stuck with more a bottom-up approach to your culture. In those situations, the lower levels of the organization are driving a lot of the culture."

The following anecdote highlights the potential destructive role that leadership can play in subverting a culture, "Our company was created by our founders with a values-based culture, and the inverted pyramid management construct. The leadership keeps it alive, or not. I am the longest serving executive at our company, so I have worked with our founders. I was here during a time when we brought in a new CEO from outside of the company, and I was his CFO for six years. He turned the pyramid so that he was on top, and reverted the pyramid. This is very common where the CEO is on the top of the pyramid. He flipped it as he was accustomed to running a business that way. We lost our way, because what happened was that the decisions that were being made at the top were being borne by the associates. This impeded their taking care of the customers. So during this time, we were ceding market share to our largest competitor. At one point, we ceded 600 basis points of market share."

One executive compared and contrasted the effect of an internal versus external CEO hire on the firm's culture. He said, "the insider CEO, who had grown up in the company, kept the basic tenets of the culture the same but demonstrated them in a different way. The outsider CEO came in with a totally different culture, totally different mindset, and it was really difficult. Ultimately, it didn't work with the external hire, because he tried to make it into a different company, which made it a very difficult environment for employees to navigate."

Several CFOs mentioned that their CEOs have tried to carry forward the values espoused by their founders. For example, one CEO said, "you have to have leaders that live it. It is created

originally, then you have to have people that lead it. I can speak to another company, [XX], which I have been on their board since 2003. That company has a very strong and unique culture, started by their founder, [YY]. They will start business meetings by reading [YY]'s quotes, to keep the culture. Their business has changed dramatically since the founder's days, but their culture has not. I suspect that if they got off their culture, it would be really damaging to their ability to drive results. They very much promote from within, as they have never had anyone from the outside come in and lead the company. As board members, we acknowledge that it is critically important."

2. Marketplace

The marketplace plays an influential role in shaping culture. Graham, Harvey, Popadak and Rajgopal (2016) find 35% of respondents believe a firm's reputation in the marketplace influential in setting the firm's culture. This is the second most popular response after current CEO. Another 17% of respondents believe the changing needs of the marketplace influence a firm's culture. Pointing to how the marketplace shapes culture, one CFO remarked, "we were a company that was really being impacted by technology substitution, revenues were declining. The company had grown and was in a great niche, and was led by the same guy for many, many years – so there was more of a sleepy culture. The board recognized the situation, brought in some new leadership, a new CEO who was trying to bring a results oriented culture into the old business." Emphasizing the role of the corporate landscape, one executive said, "if the external environment becomes more competitive and more unpredictable, it requires a different culture and comprehension of what was going than what was going on before and you have to change. Just relying on what worked before is probably the biggest thing that can cause you to fail because you need to develop how you need to execute given the facts and circumstances of that time."

Still another executive described the relation between marketplace and culture as follows: "The issue with culture is, is the culture supporting the behaviors that are needed to allow the company to prosper? One issue is, do the cultural attributes represent the future of the company, or the past? We continue to dredge the past up because a lot of those attributes work well as long as you spice them up with the future. I sit on the board of company that is in the process of reinventing the culture and deemphasizing the past culture for a new, more rapidly moving, innovative culture. Their culture was quality and integrity, but slower-moving and that clearly didn't fit anymore. So it's an issue of, is the culture in sync with the needs of the business, and that is a critical element that gets lost and you look at some companies."

3. Lifecycle of the Firm

Several executives believe culture is important regardless of lifecycle stage of the firm. For example, one executive told us how "culture is important when things are going really well, when things are going poorly, and when you are in long-run growth status. With a newly developing company,

culture and leading people with passion becomes extremely important. With a mature company, you have a much broader base that you have to make sure that they are aligned with the real interest of the company. Culture is a really key part of that."

The biggest distinction in the lifecycle were in the cultures of start ups versus mature companies. The CFO of a very successful firm, [XX], that was a start up a few years back stated, "I wonder if the need of the business is what contributed to our culture, we have a go fast culture." The same executive, who now offers consulting advice to a large established company, [YY], contrasted their culture with the start up, "[YY] was the other way around. It was more about we want to retain people, retention was a big part of what you were evaluated on if you were a director of the company. They had been around 75 years, so they had had some practice at managing people. Development and job evaluations were very important aspect of work life at [YY], which are not [at XX], and still are not. People look at the yearly evaluation and say 'yeah, whatever, there is a curve, I will be here' and move on, stock is doing great. It is kind of two environments that shape the culture." The same attributes were seen in decision making as well, "at [XX], circumstances in which they have to do business, which is very fast moving, no room for fools, try to get it right the first time, but if you don't get it right the first time, fess up to your mistake, pick out what is good and move on. At [XX] there is not a lot of post-morteming, there is no time, it is just move on to the next thing. Where at [YY], they spend a lot of time looking back and decisions take a long time." Another CFO who worked for a fast charging start up mentioned, "because the environment is one of a technology dependency, this means you have to be responsible and aware of the constant changes that are going on in that space, and it does require that a company is a little less collegial and a little more hard driven in order to be successful."

4. Industry

An executive at ZZ commented on the importance of industry position on the firm's culture: "I do think that position or being a market leader for a long time with very reliable revenues has colored [ZZ]'s outlook, has maybe made it more defensive, having a sense of having safe revenues coming from our main products. And frankly, the recent vulnerability of those revenue streams has given it, ironically, a little bit more of a fresh perspective and less of a defensive outlook." On the other hand, "at [ZZ], because there was no one to follow you had to invent it yourself and you learn. I remember in [ZZ] a lot of crazy learning experiences. For example, in the early days some of the warehouses had to be shut down because they were so poorly run they could not be sustained, but rather than say let's close them we learned how to improve and just shut one or two down."

Another executive attributed the contrasting cultures at two companies he had worked at to the industry position of those companies: "the number one value at [XX] is the respect for individual. [XX] is the only place that I have worked where if you yell at subordinate or somebody like that then they will fire you. However, [AA] and [BB] both share as very competitive environment. So

that created the competitive cultural environment inside. Everybody felt that they were the best at what they did. It was not backstabbing but you knew that you were basically going up or going out. There were no lateral moves and no demotion. At [AA], if you are in top ranks, either you are moving up or you are moving out. At [XX], if people didn't make it in one job, then they will offer them something lower that was a better fit to them. However, for [XX], no one comes close in terms of competition."

As shown in Graham, Harvey, Popadak and Rajgopal (2016), only 3% of executives thought their industry peers played a role in shaping the culture. As one executive put it, "trying to adopt a culture of another successful firm in our industry would not work at my firm, because it would be contrary to the DNA plus there was such a strong competitive environment in my industry that is aggressive." Or as another executive argued, "our peer companies absolutely do not have a similar culture. There are competitors with varying degrees of good culture and then there are some that are absolutely command and control type still because they are run by their founders and it's their way of run the business, and if people don't like they can leave attitude. And it's not that they don't have a degree of success, it's just that they are run differently."

5. Demographics of the Workforce

Demographics play a variety of roles from the highest leadership down in how the culture evolves. For example, one respondent thought "[XX] definitely tends to be a little bit of an older company, and I think that in some ways that can be felt too. So I think that demographics of employees and their personal lives can make them less risk-taking." Related to the role of matching employees and firms, one CFO stated, "I believe a company takes on a culture over time and that culture develops and you hire people that you believe can thrive in a particular culture. And people do thrive in a culture or they don't thrive in a particular culture."

Another thought that the proportion of the workforce that are salesmen matters, "I think you get some differences between businesses that have salesforces and others that don't. When you have a salesforce that is a huge proportion of the overall employee base, especially when it is an outward bound salesforce that will influence how the company is run and the culture."

B.5.   Business Outcomes Affected By Corporate Culture

The previous subsections detail the mechanisms underlying corporate culture and the other formal institutions that modify the effectiveness of culture. This subsection explores the effects of corporate culture on firm value, employee productivity, risk-taking behavior, risk management, incentives to make short-run versus long-run decisions, employee ethics, the incentive to manage earnings, profitability, growth, financial reporting, audit quality, tax aggressiveness, and capital structure.

B.5.1 Productivity and Firm Value

It is well-established in the economics literature that there are persistent differences across firms in terms of employee productivity and firm profitability even after production inputs and technology are accounted for (Syverson (2011)). In Graham, Harvey, Popadak and Rajgopal (2016), we examine the performance variation across firms can be associated with differences in corporate culture. One question on the survey asks, "to what extent does the corporate culture at your firm affect productivity" and "to what extent does the corporate culture at your firm affect firm value." Only 1% of respondents said culture had no effect on productivity and only 3% of respondents said culture had no effect on firm value. In fact, most 62% (57%) said culture had a "big effect" on productivity (firm value).

We highlight several reasons why corporate culture is important in Section B.1 and many of the reasons have clear links to firm value and productivity. In this section, we include a few excerpts that convey exactly how an effective culture has a big effect on firm value and productivity. As one executive said, "a good corporate culture means everyone knows how to act and what to do and needs less direction so they can just focus on pursuing what is valuable for the company, and this inevitably leads to better corporate performance and therefore value. It also creates longevity and development internally and with external partners, which increases perceived value."

Culture can affect productivity in many ways. Survey respondents offered the following examples of effective cultures boosting productivity: "encourages teamwork," "together we will find a way," "creates a personal drive of individuals to get the job done without being pushed unwillingly into actions," "the attitude that every worker will do what is needed now instead of waiting for someone else to tell them what to do," "culture creates excitement. Excitement about what they are doing makes people more productive," "we check our egos at the door and everyone picks trash up off the floor. By developing common goals and pursuing them as equals we have maintained incredible productivity," "very low attrition rates compared to peers which improves overall productivity," and "our culture eliminates confusion and wasted effort. Locations across the globe work towards common goals in line with the culture and this allows for greater productivity, quicker achievement of results, and therefore firm profitability."

Survey respondents' examples of ineffective cultures hurting productivity include: "citadel mentality between profit centers and lack of accountability cause sub-optimization," "discourages initiative and slows project management," "we are too casual in our employee relations which can lead to employees having an attitude that the customers and viability factors are subservient to their personal lives." Survey respondents highlight some of the mechanisms underlying these effects. They indicate that an effective culture aids value and profitability in several ways: (1) "recruiting dedicated employees," (2)" staff working extra hours for client satisfaction without direct compensation," (3) employees knowing "how to act and what to do and hence they need less direction," (4) "our well known integrity makes us good partners to external organizations who therefore cut us a

lot of slack in the inevitable cases where problems crop up," (5) "collaboration and teamwork increase efficiency in the completion of engagements," (6) "employees don't work at cross purposes," and (7) "we make decisions to do what is right the first time."

B.5.2 Risk-taking

Graham, Harvey, Popadak and Rajgopal (2016) show that 60% of executives believe that their firms take on the "right amount" or risk, 29% believe their firms take "too little" risk, and 11% believe that their firms take "too much" risk. Among those that believe that their firm takes the right amount of risk, 61% believe that the role of corporate culture is a "very important" or "important" reason that their firm takes the appropriate amount of risk. Among firms that take on too little risk, 52% believe that culture is a "very important" or an "important" reason why firms take on too little risk. Among firms that take on too much risk, about half of the executives believe culture is a driving force.

Survey evidence from Graham, Harvey, Popadak and Rajgopal (2016) provides some examples of how effective culture facilitates risk taking. The survey respondents' comments include: "encourages risky acquisitions," "culture is aligned around innovation and step function changes in growth, not incremental behavior," and "ours is a high risk venture focused on developing life-saving drugs. If we don't manage risk well there is no company."

Survey respondents' comments related to how ineffective cultures lead to the wrong amount of risk-taking include, "risky projects dilute your efforts by using up too much time," "there is a culture of shooting the messenger so there is a clear unwillingness to commit to large risky projects," "would always rather give up upside in exchange for downside protection," "easy for management to say no," "rewards need to be within a quarter or the risk is not taken," "conservative culture overestimates risks forcing to generate two or three shield-options to protect the company," "pricing and terms are stretched to avoid anything like a downside surprise (near-termism)," and "avoidance rather than management of risk."

Interviewed executives also reported that culture enhances firm performance through the risk-reward trade-off. For example, as one executive described, "we do tend to take a little more risk because of having this long-term perspective that comes from our culture. We think of it as what is the right thing to do for the business in the long term. When the answer is 'it is the right thing to do for the business in the long term' that for us is a mitigation of the risk." This link between risk and performance is not always easy to incorporate in formal models of risk, as illustrated by this interviewee's response, "I want to differentiate between different kinds of risks. For a small company, in a rapidly growing business environment, risks don't so much look like risks at the time when you are making decision. The risk is in the ability to predict future potential and that is risk you cannot conceive of in the same way as a return on investment problem. But the firm's culture enabled it to take advantage of a lot of opportunities that otherwise would not, because the firm's

culture enabled us to process information about the opportunities effectively. The culture allowed the firm to reduce the measurement error of that type of risk. But the ways the culture operates to reduce this type of risk is so different from the quantitative methods that we usually think of as risk analysis."

Several CFOs highlighted the need to tolerate failure for a culture to be effective. For example, as one executive said, "at [XX], failure was OK. The founder would always say '50% of the shit we do ain't going to happen.' But there is always something good that will come out of that, you need to be tolerant of failure, and that was part of the culture. Because you are going after big numbers, big growth rates, big revenue numbers, big customer numbers." The same executive talked about another company that had a "lovely" culture in terms of dealing with people but "almost went out of business." Another executive described culture as a shock absorber in the event of a failure: "one of our cultural attributes is that you don't have to fear if you take a risk with a job and move into an area you don't know, if you're with an unsuccessful project or something you don't disappear with that project. There's a little bit of a cultural safety blanket there that allows people to take risks in their career."

B.5.3 Short-termism

Interviewed executives consistently made connections between effective cultures and managerial and employee focus on long-term objectives. We reviewed some survey evidence confirming this link in Section B.3.3. We explore the cultural effects on long-term versus myopic behavior via several additional survey questions. Graham, Harvey, Popadak and Rajgopal (2016) explores how firms will trade-off short term risk/negative cash flows versus higher long-run NPV. In particular, in Graham, Harvey, Popadak and Rajgopal (2016) , we ask the survey respondent to choose between two otherwise identical projects with a five-year duration. Project A has a higher NPV relative to the other project B. However, A reports negative cash flows for the first two years whereas B reports positive cash flows throughout. Assuming all cash flow forecasts are equally accurate, we ask whether the firm's culture make it more likely that Project A would be chosen.

Graham, Harvey, Popadak and Rajgopal (2016) report that a remarkable 41% said they would choose the NPV inferior project. If a participant chose A, we ask whether their firm's culture played a role in their company's preference for A? 80% of the respondents said yes. Respondents who picked the lower NPV project B were asked, "if your firm's culture improved, do you think it would be more likely that project A would be chosen?" 56% said yes. Overall then, an effective culture is more likely to lead to appropriate (long run NPV) investment choices.

Next, we ask whether ineffective cultures can lead to unethical behavior, "do you think having a poorly implemented/ineffective culture at a company increases the chances that an employee would do something unethical (or even illegal)?" 85% of respondents said "yes." To explore a possible a link between real earnings management documented in Graham, Harvey, and Rajgopal (2005) and

culture, we ask the following question, "sometimes companies engage in end-of-quarter practices such as delaying valuable projects in order to hit market expected earnings. How likely is it that an effective corporate culture would reduce the chance that such actions are taken?" Graham, Harvey, Popadak and Rajgopal (2016) report that 56% of executives believe that it is either "extremely likely" or "very likely" that an effective corporate culture would reduce real earnings management. Only 19% of respondents believe that an effective culture was not likely to reduce real earnings management.

Free-text responses of survey takers indicate that corporate culture has a moderate or big effect on compliance at their firms. Many provide examples. Positive examples include "people are more likely to do the right thing within a culture that focuses on long-term success as opposed to short-term goals," "we have a culture of playing by the rules. If we didn't employees would be more prone to play games," "the compliance department is always at the table whether it is in a strategy discussion or a work place error deviation. As a result, everyone feels comfortable when an issue arises and it needs to be reported." Free-text responses consistently indicate that well-aligned cultural values and norms generate a big effect on compliance. For example, "integrity is a key part of our corporate culture, and this enhances/reinforces the quality of our financial reporting," "with a strong emphasize on integrity, tools to train/monitor employees, and ability to report questionable practice anonymously, our employees adhere to policy and procedures and achieve compliance."

Negative examples from open-ended survey responses include: "if the culture promotes or tolerates 'rogue' behavior, then less likely to have compliance," "an aggressive culture of risk taking impacts aggressiveness of accounting policies to compensate for high risk projects that go bad," "poor culture can make it more attractive to take improper risks" and "a weak culture will be seen as being overly accommodative to noncompliance." Free-text responses reveal that fostering cultural norms that are well aligned with the cultural values is critical for success: "a rules-based culture can lead to compliance in a blind fashion that reduces the individual's ability to think beyond prescribed rules and ultimately may inhibit performance."

The interviewees also conveyed a strong link between culture and short-termism. One executive spoke of the connection between culture and the firm's myopic reporting behavior, "at [XX], CEO [YY] cared a lot more about stock price and making earnings. [YY] was prone to push me very hard on accounting treatments and I couldn't stand it. You get very different leaders with different dynamics going on. I do think culture matters in the attitude on quarterly earnings and stock price matters."

A few interviewed executives lamented that they sometimes do not get credit from the market for decisions or investments they make that stick with the firm's cultural values such as avoiding mass layoffs in a downturn that may destroy morale or an investment in an emerging market for the longer term: "We certainly do not get credit for culture related investments particularly if

you think of the short-term nature of some of our investors. Our long-term investors get it and understand it completely."

B.5.4 Other Business Outcomes

Graham, Harvey, Popadak and Rajgopal (2016) report that executives believe that corporate culture has a "big effect" on the following: creativity (57%), profitability (54%), and our firm's growth rate (51%). Survey respondents identify several ways that culture affects corporate **creativity and innovation** in their free-text responses. Examples of how ineffective cultures hurt creativity include: "creativity is threatening to the status quo, so is ruthlessly attacked," "lack of sharing and warring tribes mentality as well as top down approach stifles creativity," "unconventional or unorthodox thinking is discouraged," "we had opportunities to branch-out in the past that we did not act on because the culture dictated that we 'stick to our knitting'," and "new ideas and new ways of getting things done are not rewarded and failure is seen negatively."

Survey respondents also described how corporate culture can exert a positive effect on creativity and innovation. Examples include: "our culture reinforces the desire to innovate," "creativity blossoms when workers feel supported to take risks and not fear punishment if they fail," "our engineering team worked on their own time to create an interactive video game that has become the centerpiece of our technical recruiting efforts at conferences and events," and "many of our company's best ideas have been green lighted because a team member went on a tangent without committing excessive resources to the pursuit before getting other team members involved."

Interviewees cited several ways that culture has a big effect on profitability and growth. First, executives reported that certain cultures attract superior human capital: "companies that are known for and invite people who think outside the box and challenge themselves constantly to be the best attract others who want to catch up. I think about XXX, who was a superstar coder, one of the five best on the planet, a guy like that inspires other people to work really hard. His presence in the company attracts people who want to work with him, he's got a reputation in the industry and everyone knows who he is. People who want to work with the best tend to be people who themselves have the potential to be very good, because they don't accept the status quo. If you bake that into the corporate culture, then 50% of the company's value might be based on the corporate culture.

Second, executives reported that culture enhances firm performance because it enables **superior execution**. As one executive said, "culture is like the tendons and ligaments that hold the body together and allow it to be healthy as a body and execute daily." Another executive likens the superior execution enabled by culture to the best orchestral performances: "culture is your sheet music to success. It is no different than an orchestra. You can hire the best trumpet players, oboist, violinist, and unless they are all playing from the same sheet of music at the right tempo, you will fail. If you have the trumpets playing too loud, the song won't sound right. It is that delicate

balance of getting people on the same page."

Third, executives reported that culture enhances firm performance through **reduced agency costs**. "When corporate culture is working at its best, it reduces dramatically the agency costs within an organization because you have an invisible hand at work inside of each of the employees that helps to guide their decisions and judgments in a way that the overall corporation would desire it to be. Culture is a form of agency cost reduction in that it keeps people aligned and behaving in a way that works well. Culture is like the air, it can be almost invisible and easy to move through, but if it's extremely strong and it can be a hell of a tailwind or a headwind." Another CFO said, "Reducing agency costs is what culture does. I'll give you an example. [agency issues could result from] functionally, geographically, and by business unit, all those things people have identities with or could be sub-optimizing over and making enterprise decisions for the sake of their own silo or entity. If you have a really strong culture, it's easier for people to overcome that agency cost or the sub-optimization. I've seen that in action. The stronger your culture, the lower those agency costs are on average, in the long run."

Fourth, executives reported that the value part of the culture-performance link is **more apparent in a challenging macroeconomic environment.** The value in bad times comes from cultures empowering employees to make consistent decisions based on a long-term perspective. As one executive stated, "culture enables a long-term perspective and in challenging macroeconomic environments this allows firms to outperform." Or as another explains, "culture is more important in the bad times than in the good times. The rising tide lifts all boats, everyone looks good in the good times. In bad times, the companies that don't have a good foundation, hurt more. If a company has bad culture and they are in financial stress, then they are gone or they will start losing their best employees." Or as another executive explained, "a strong culture can help a lot when times are not good, because it is a way to maintain a certain discipline and consistency, and if it is the right discipline and consistency you do not want people under times of stress to fall out of good habits. Another way culture is important is that top management cannot always tell people directly what to do, so if top management want a consistency of action across the company then you want to create an environment where the way people frame decisions and make decisions come from the same principles and assumptions, and culture attempts to transmit that consistency."

Finally, executives report that culture has a unique role in that it can substitute or make up for mistakes in a way that other executive actions or firm assets cannot. This logic ties in with a view that culture enhances firm performance and value more so than strategy or financing decisions. For example, "culture will trump strategy every time because people would do what culture supports and leads them to do, and so a great strategy that is not in sync with culture will never get implemented in the same way."

B.6. Are the Upside Benefits of an Effective Culture Greater Than the Downside Costs of Ineffective Culture?

Given the pervasive effects of culture documented above, one might wonder about the relative magnitude of the downside risk of ineffective culture versus upside benefits of effective culture. Graham, Harvey, Popadak and Rajgopal (2016) survey shows that 39% of respondents believed that the potential "value creation from effective culture is greater than value destruction from ineffective culture" relative to 42% who believed the opposite. Unprofitable firms and those that are poorly positioned in their industries are most acutely aware of the downside potential of ineffective corporate culture.

Several interviewed CFOs provide examples of how the downside from an ineffective culture could occur much faster than the upside from an effective culture. For instance, one executive said, "culture is also a big factor when it comes to value destruction. Firms that don't have the culture of integrity and compliance end up a lot of time destroying, through the behavior of their executives, what it took them years and years to build them." Another executive remarked, "the downside risk of culture will always be bigger than the upside because the downside can happen in a nanosecond. The upside is built up over time. [XX] is a great example of that. After the merger, the culture was so difficult and the leader was so focused on one way to do it that he basically almost lost the company. Basically [YY] came in to take it over because of how this guy was running it. Once they changed him out and took it over and stuff, every dollar of synergy that was originally planned to get done from the merger actually got achieved." Market leaders and profitable firms are those more attuned to the positive effects of corporate culture. For example, one can argue that an effective culture such as Google's has created far more upside value.

B.7. What Deters a Firm From Having the Ideal Corporate Culture?

Given the common executive view about the value-creating potential of effective corporate culture, one might wonder why all firms do not have optimal cultures at all times. Graham, Harvey, Popadak and Rajgopal (2016) show that only 15% of respondents believe that their corporate culture is "exactly where it should be." In contrast, 54% felt believe their culture "needs some work but is close to where it should be" and 21% believe that their culture needs "considerable work," and 11% believe that their culture needs a "substantial overhaul."

We probe the 85% of respondents who indicate that their culture is not perfect to understand what obstacles prevent cultural improvement. The most important factor appears to be "leadership needs to invest more time to develop the culture." Inefficient work place interactions and the need for the culture to catch up with recent changes in the business environment are significant but less important obstacles.

Written responses in the survey provide additional insight into leadership deficiencies with respect to ideal corporate culture. The following comments are typical: "founder syndrome," "ar-

rogance," "micro-management," "hierarchical communication (trickle down), slow adoption of technology (limited management exposure to new tools);" "managerial intransigence; lack of strategic focus;" "silos still exist;" "lack of initiative and culpability;" "frequent leadership changes, lack of vision;" "middle managers are unsuccessful in transmitting/enforcing the culture to their charges;" "contradictions to stated values trickle down to everyone;" "inconsistent tone at the top;" "(big) changes in management, where the management has come primarily from another company;" "the business is eat what you kill, which at times doesn't foster teamwork;" "missing financial targets set by CEO on a top down basis without input from staff;" "weak leadership at the very top;" "blocking agents in powerful positions within the firm;" and "various senior management styles which produce conflicting messages."

The interviews reveal some of these obstacles to an effective culture. Many of these represent ineffectual manifestations of the factors determining culture discussed above in Section B.3.

1. *Need for new leadership*: Some firms need new leaders. As one executive explained, "the company had grown and was in a great niche, and was led by the same guy for many, many years – so there was more of a sleepy culture with not much attention to detail or accountability. It didn't have the urgency that some other companies I've been involved with have had." Highlighting the need for a new business model which might come only with new leadership, an executive stated: "we needed to get our company to be a different company, we needed to transform them into something else or they are not going to exist a few years from now. The main business was a cash cow that is going to decline over time if we don't change something."

2. *Not investing in the culture*: Underinvestment in culture is commonly reported by executives. One executive lamented that he didn't have enough people selling the cultural message. He said, "the only way we are going to fix this culture is you have got to get to the people into the field. They are the ones that are doing all of the work. We can sit up here all we want in corporate headquarters, but unless we can convince people in the field to get on board of what needs to happen, this ain't gonna work."

3. *Social norms that work against the culture*: A key theme emerging from the survey and interviews is that for stated cultural values to have full impact on business outcomes, they must be complemented by norms that dictate actual behavior and formal institutions. These factors came up as common reasons their firm's culture was not where they desired it to be. For example, one executive that believed the cultural value of collaboration at times helped his firm succeed also descirbed how this value could lead to inefficient workplace dynamics, "we don't move without consensus, apparently employees think that companies are democracies instead of benevolent dictatorships. And so, unless somebody raises their hand, nothing gets done."

B.8. How Can Corporate Culture Be Measured?

Several researchers have attempted to measure various dimensions of a firm's culture using publicly available data. These include: (1) firm fixed effects (Cronqvist, Low and Nilsson (2009)); (2) data from the KLD database on two aspects of firm's human relations and organizational policies namely employee relations (covering union relationships, the presence of profit sharing programs, employee involvement in decision making or employee stock/option ownership, health and safety strength, and retirement benefits packages) and the diversity index (covering female or minority CEO, progress in the promotion of women and minorities to top management positions, female and minority representation); (3) the firm's appearance in the rankings of the top 100 Great Places to Work (Edmans (2011); Bargeron, Lehn, and Smith (2015)) and more fine grained data from the organization including the larger sample of the non-top 100 Great Places to Work firms Guiso, Sapienza, and Zingales (2015)); (4) textual analysis of employee-generated reviews of their firm's culture from career intelligence websites such as Glassdoor.com, Careerbliss.com, and Vault.com (Popadak (2016)); (5) appearance of the word "trust" in the MD&A section of a firm's 10-K filing (Audi, Loughran, and McDonald (2015)); (6) corporate philanthropy (Bereskin, Campbell, and Kedia (2016)); (7) political orientation of the senior managers proxied by donations to Republicans or Democrats (Hutton, Jiang, and Kumar (2015)); (8) firms' corporate social responsibility behavior from the KLD database (Hoi, Wu, and Zhang (2013); Gao, Lisic, and Zhang (2014)); (9) compliance records with regulators of worker, product and environmental safety (Kedia, Luo, and Rajgopal (2015)); and (10) the CEO's unethical behavior (Davidson, Dey, and Smith (2015); Grieser et al. (2016)).

There is room for improvement in how culture is measured empirically. For instance, several focus exclusively on human relations variables or corporate social responsibility measures although a firm's culture likely encompasses many other dimensions.[2] Textual analysis, which covers a variety of dimensions, has achieved some successful external validation, but researchers have to assume which words, a priori, would best capture a firm's culture. In an attempt to establish additional means to empirically measure culture, we ask CEOs and CFOs to suggest other potential publicly available data to measure corporate culture.

Some executives think it is very difficult to identify external markers of culture in a satisfactory way from public data. For example, one executive commented, "I don't think you could determine it without the benefit of working there to be quite honest." A CFO of a large consumer products company stated that they don't discuss culture explicitly in annual reports or conference calls, "you would not see references to our culture. It was implied, it wasn't direct. When asked how they assess the culture of another company, say, a potential acquisition, a CFO replied, "I talk to people. In the company we just acquired, I was very engaged in talking to the leadership as well as the

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[2]Graham, Harvey, Popadak and Rajgopal (2016) measure culture broadly with a survey but it is difficult to extrapolate to assign specific cultural attributes to firms that did not participate in the survey.

next level of leadership in that company. I visited the company and got a sense of the engagement of the employees, are these people going to be bought in, are they going to be excited about this change."

One executive's comments aligned closely with our arguement that culture is difficult to measure with a single source of data, "the real issue with culture is, is the culture a) weak or strong, for starters, so does it matter? And b) is it supporting the behaviors that are needed to allow the company to prosper?" Given the challenge to empirically measure culture, other executives suggest the following sources as potential ways to get a more complete measure of corporate culture:

1. *Conference call transcripts/analyst reports*: A CFO recommended, "look at the transcripts of the earnings call if it is a public company. There you can pick out the tone and the words of the CEO and lot about the culture and how he refers to the results, how they got them, how he talks about his people, how they talk about customers and what he/she emphasizes. That would give you lot of clues." A different CFO remarked, "another piece of information is analyst reports because if you can find the right five or six analysts that cover companies, most of them will take the time to go out and visit the company in person, meet the management teams, and you can see in their notes their feelings about the company."

2. *Employee age/tenure*: As one exectuive explained, "age gets you some sense of which generation and the diversity of age, so you get the demographic pieces of the firm." A different executive advocated measuring abnormal turnover, "you need to make sure that you are benchmarking turnover to what the industry is doing and to profitability and the growth of the company and the external environment." In contrast, another executive (who did not work at GE) said this about turnover, "when Welch was head of GE, he stated openly that he expected 30 percent turnover in leadership positions each year. Now that sends one hell of a tone throughout the company, but it is clear. He moved out people he thought were underperformers and brought in or advanced others and kept movement within the leadership organization. That was a real clear message."

3. *Company's external communication*: As one executive said, "you can also read the external communication, not necessarily the shareholders' letter in the annual report but for example, the letters to employees. And the external communication will be the press releases with results and how they communicated with analysts."

4. *Press portrayal of the CEO*: Another CEO said, "I think reading articles that have been written on the CEO can provide some light on how things are run and the culture."

5. *CEO change*: As one executive said, "you should look where there has been a change in the CEO role, where they have brought the CEO from the outside to the company, and to track what operational changes were made. That will showcase cultural changes."

6. *Culture of the prior firm of the CEO*: As one executive remarked, "[XX] had its own culture which was greatly influenced by its CEO, as is always the case. The CEO had come from

[YY]. So many aspects of the culture were adopted from [YY]."

7. *External websites with employee opinions*: "look at third-party services that employees use to communicate whether they love the company or not." Another executive clarifies, "of course the content there has a negative bias, but you will get a sense of what people really think about the corporate culture." This executive cautions that although quantifiable metrics on issues like spending on employee benefits are tempting to rely on, "if you really want to understand how people think about the culture, you need to read comments from people who are at the company or have just left."

8. *Culture-environment fit*: As one executive commented, "do the cultural attributes represent the future of the company, or the past? So it's really an issue of, is the culture in sync with the needs of the business."

9. *Common beliefs across the company*: As one executive said, "if you have 10 people at five different units, do you have a strong culture or not? Or is there a strong sense of common beliefs? I think if people say yes, then culture would have an influence and that would be a good way to measure it, but if people said no, then culture is not as prominent or important part of the company."

10. *Communication patterns*: As one executive advocated, "try to get dumps of an organization's communication patterns. Get anonymous information about the company's top 500 users and observe how information passes around. Get data on who is emailing whom and when. Who is creating meetings?"

11. *Corporate actions*: Finally, one executive said, "when [XX] was the CEO and Chair of [YY], and they had their annual meeting, he also had a meeting of board members away from the annual meeting so that they would not be there. I think you can look at actions over time that give a sense of what is happening inside of a company and the way people are performing."

Other executives cautioned against concluding too much about a firm's culture from its externally visible trappings. For example, one executive said, "we have 100% retention, but are we retaining the people that are crap and we really need to fire them, but we don't really like to fire people, so we just move them around all the time?" Another CFO warned against relying on mission statements and published employee codes of conduct. He said, "every company would have in today's world the employee code of conduct but that won't give you much insight on culture because that is so much focused on the behavior that aren't acceptable and compliant and they look very similar from company to company." Another executive had a similar reaction but a slightly different take on this issue, "At [XX], they were very good at talking about it and having that vision and getting it out there and communicating it clearly. It was just the implementation where they sucked." To evaluate this question, we asked a survey question asking how closely their current corporate culture tracks closely with the firms' stated values? Only 51% of executives say the culture matches the values "very closely." Hence, researchers need to be cautious before

assuming that the firm's stated values correspond to its operational culture.

Given that the values espoused by management, the social norms adopted by employees to live out those values, and the formal institutions at the firm all work together to determine the effectiveness of the current culture, we conclude that no single source of publicly available data adequately captures such nuance. A better approach to measuring culture might be to aggregate across data sources to quantify each of these determinants of culture.

IV.   Conclusion

Corporate culture is perhaps the most under-researched value driver among the important contributors to firm performance. In particular, Graham, Harvey, Popadak and Rajgopal (2016) report that 91% of surveyed executives believe that corporate culture is important to their firms. 79% place culture among the top three or the top five value drivers of their company. 54% of executives would walk away from an acquisition target that is a cultural misfit. Senior leadership, especially the current CEO, sets the current culture in most firms. The board of directors and compensation schemes reinforce the current culture of the firm, both in positive and negative ways. Effective cultures boost profitability and value by aiding employee productivity and creativity. Effective cultures also enable employees to focus on the long term, embrace an appropriate amount of risk, avoid real earnings management, and comply with regulations. Firms with effective cultures encourage employees to suggest improvements and develop ideas organically, and also to blow the whistle if they notice something amiss in the trenches. We realize that empirical research in culture is hampered by measurement difficulties. Interviewed executives suggest several avenues to measure a firm's corporate culture.

A literature on corporate culture in economics, finance, and accounting is beginning to emerge. Many first-order questions remain to be addressed. Can we develop defensible measures of culture from public sources of data? Can we identify causal associations in large sample data between culture and firm value, profitability, risk taking, choice of M&A targets, M&A performance and employee creativity and productivity? How much of the blame for the financial crisis can be attributed to corporate culture in banks?

From the early days of this project, we have heard, loudly and over and over, how important culture is, especially from CFOs who are typically the numbers people and are usually suspicious of hard-to-quantify aspects of the business environment. We believe that our paper conveys a powerful message that academics and practitioners need to hear. Corporate culture does matter, a lot, more than many of the things academics study. The importance of the topic means culture deserves the research attention of serious, rigorous scholars and we hope Graham, Harvey, Popadak and Rajgopal (2016) and the accompanying interview evidence in this paper will serve as a bridge to enable such future work.

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Table I   Corporate Culture Summary Statistics

This table shows the top 30 lemmatized words and their frequency of occurrence as well as the top 30 word stems and their frequency of occurrence from the open-ended survey question, "Briefly, what words or phrases best describe the current corporate culture at your firm?" (see Graham, Harvey, Popadak and Rajgopal (2016) for more details).

Lemmatized Words	Freq.	Word Stems	Freq.
Customer	105	Collabor	114
Collaborative	100	Custom	106
Focus	96	Famili	89
Work	95	Open	71
Family	83	Focus	67
Open	69	Respect	60
Drive	63	Valu	58
Value	58	Team	57
Team	57	Driven	56
Integrity	52	Integr	56
People	47	Innov	49
Entrepreneurial	46	Peopl	47
Client	43	Entrepreneuri	46
Respect	40	Client	43
High	40	Account	42
Fun	38	High	40
Hard	37	Fun	38
Service	37	Ethic	37
Innovative	34	Hard	37
Professional	31	Servic	37
Accountability	28	Care	34
Collegial	28	Profession	34
Caring	32	Commun	32
Teamwork	28	Collegi	31
Result	27	Support	31
Top	27	Focus	30
Trust	27	Teamwork	28
Ethical	26	Perform	27
Friendly	25	Result	27
Supportive	25	Top	27