Corporate Culture: Evidence from the Field*

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ABSTRACT

We survey 933 North American CEOs and CFOs and interview 16 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 survey and interviews reveal the following insights. First, executives characterize culture as "a beliefs system," "a coordination mechanism," "an invisible hand," or "how employees interact with one another." Second, 91% of executives say culture is important at their firm and 78% of executives view culture as one of the top 3 or top 5 factors that affect their firm's value. Cultural fit in M&A deals is so important that 48% of executives would walk away from a target that is a cultural misalignment. Third, 52% feel that culture is primarily set by the current CEO. Fourth, boards of directors do not directly choose the firm's culture; instead, they influence the choice of culture by picking the CEO (who sets the culture). Boards also modify the eventual success of the culture by reinforcing or undermining the culture via specific policies they influence like incentive compensation. Fifth, 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 describe the cultures at their firms in detail and also suggest several sources of publicly available data to measure corporate culture.

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1. Introduction

Culture is given credit for some of the greatest business successes and blamed for some of the biggest failures.[1] 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? How do other corporate policies (e.g., compensation) reinforce or work against culture?
4. What aspects of business performance does corporate culture affect? Does culture impact corporate risk-taking, growth, M&A, financial and tax reporting, whether employees take a long-run view, or corporate ethics?
5. Are the upside benefits of effective culture greater than the downside costs of ineffective culture?[2]
6. Do companies think their culture is ideal and if not, what deters firms from having the ideal corporate culture?
7. How can corporate culture be measured?

Our paper tries to answer these questions by analyzing a survey of 933 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. These data are supplemented with 16 in-depth interviews of business executives. Briefly, we find 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. 51% of executives consider corporate culture to be a top 3 value driver and another 27% say it is a top 5 driver of firm value at their companies. 91% believe 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. Boards affect culture not via active management but primarily via CEO choice. Boards of directors and compensation schemes modify the success of a firm's culture by attracting and/or retaining the right type of talent, by rewarding employees for living the values of the culture and by focusing employees on long term objectives.

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 a striking 48% of 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%-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. 84% of officers believe that a poorly implemented, ineffective culture increases the chances that an employee might

[1] Policy-makers often point to dysfunctional corporate culture in banking as a first order contributor to the financial crisis (e.g., Dudley (2014)). Several practitioner books identify culture as a key driver of Google's success (e.g., Edwards (2012), Schmidt and Rosenberg (2014)). The corporate culture at VW and Toshiba are recent examples of failures.

[2] 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 to practitioners (like good culture meaning friendly work conditions, regardless of whether this helps the firm execute its strategies).

do something unethical or even illegal. 55% believe that an effective culture would reduce the tendency of companies to engage in end-of-quarter practices such as delaying valuable projects to hit market expected earnings numbers. Only 50% of officers would maximize NPV if doing so meant choosing a project with negative cash flows in the first two years – and the driver behind this decision is corporate culture.

Only about 15% of officers believe that their culture is exactly where it should be. When asked what prevents their firms' 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 affecting the effectiveness of the firm's culture include: (i) trust and coordination among employees; (ii) the decision process is consistent with the firm's long term interests; (iii) there is widespread agreement among employees about the firm's goals and values; and (iv) employees are willing to report compliance risks or unethical behavior.

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.

Our work relates to a number of strands in the literature. First, our findings are consistent with recent research pointing to the first-order importance of internal firm practices for determining productivity and performance (Bloom and Van Reenen (2007); Backus (2014); Kotter and Heskett (1992); Guiso, Sapienza, and Zingales (2015)). Second, our research highlights the the vital, but underappreciated, role that corporate culture plays in the value creation of a firm (Lazear (1995); Hermalin (2001); Akerloff and Kranton (2005) Van den Steen (2010)). Third, our results suggest that leadership style (Bertrand and Schoar (2003)), human resource incentive schemes (Lazear (2000)), and governance (Popadak (2015)) work to modify corporate culture. Finally, we provide some of the first evidence linking culture to ethics (Guiso, Sapienza, and Zingales, (2006)), myopia (Graham, Harvey, Rajgopal (2005)), whistle-blowing (Bowen, Call, Rajgopal (2010), Dyck, Morse, Zingales (2010)), and performance in an economic downturn (Fahlenbrach, Prilmeier, Stulz (2012)).

The rest of the paper proceeds as follows. Section 2 describes how we gather the data via a survey of hundreds of CEOs and CFOs and 16 direct interviews. Section 3 outlines the results linked to the survey questions and insights from interviews. Some concluding remarks are offered in the final section.

2. Interview and Survey Samples

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, to learn about their views on corporate culture. Given our interest in investigating the causes and effects of corporate culture in the context of finance and accounting, our 16 interviews were primarily with chief financial officers (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.

Un-tabulated results reveal that the companies in the interview sample 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.

2.1 Survey Logistics

We obtained valuable feedback on the initial draft of the survey instrument from (i) 11 individuals, comprising of academics, regulators, culture consultants; and (ii) one professional expert on survey content, wording, and scientific design. Our goal is to minimize biases induced by the questionnaire and maximize the response rate. We use the penultimate version of the survey to conduct 20 beta tests to gather feedback and to make sure that the time required to complete the survey is reasonable (about 10-15 minutes). Based on this feedback, we made changes to the wording of several questions, and deleted some questions. The final survey, available at http://corpculture.org/survey.htm contains 14 main questions, some with sub-parts, and was administered over the Internet. The survey is anonymous and does not require subjects to disclose their names or their corporate affiliation and is IRB approved at the authors’ home institutions.

Invitations to take the survey were sent via email. We used two key databases of email addresses of CFOs supplied by (i) a list of CFO email addresses maintained by the Fuqua School of Business at Duke University for their quarterly survey; and (ii) a list of CEO and CFO email addresses from among the alumni of the Columbia Business School. The majority of executives have the job title of CEO (including job titles such as President, Chairman, Founder, Managing Partner) or CFO (including job titles such as Treasurer, VP or Senior VP of Finance, and Chief Accounting Officer, and Controller). In total, approximately 5,803 email addresses from these two sources were surveyed. We emailed an invitation to sub-sections of these email addresses on several dates (September 15, 22 of 2015) to take the survey, a reminder was sent a week or more later to these sub-groups (September 29). We expect to close the survey on October 30, 2015. To date, our response rate is 9.5%.[3] We supplemented this sample with additional emails to other lists from *CFO* magazine, the Center for Leadership and Ethics (COLE) at Duke University, the Fuqua School of Business Board of Visitors, and a list of Fortune 1000 CEOs and CFOs. The results do not vary whether we include all of these groups or not. All total, we obtained 1183 total responses. We eliminated responses

[3] The response rate is higher than internet based surveys of senior executives conducted in recent times. Graham and Harvey (2001) report a rate of 9%; Graham, Harvey and Rajgopal (2005) obtain 8.4% in the most directly comparable Internet-delivered portion of their survey; and Dichev, Graham, Harvey and Rajgopal (2013) report a rate of 5.4%. The quarterly CFO survey administered at Duke University attracts a response rate of approximately 4.5%.

from participants located outside the United States and Canada to avoid possible confounding influences from national cultures. That filter leaves us with 933 usable observations.

One advantage of online administration is the ability to randomly scramble the order of choices within a question, so as to mitigate potential order-of-presentation effects. Specifically, the survey scrambles the order of answers in questions 4d, 6, 13 and 14. For the remaining questions, order of sub questions is deemed not to be a first-order issue (demographic questions, qualitative questions) or there is a natural order to the presented alternatives (e.g., 3, 7 and 11). Participants were allowed to skip questions if they did not want to answer them. That is why the number of observations for several questions in the survey falls below 933. Most multiple-choice questions were followed by a free-text response option, so that survey takers could provide answers that were not explicitly specified in the question. We comment on these qualitative textual responses at appropriate places in the paper.

2.2 Summary statistics and data issues

While the survey is anonymous, we gather demographic information to understand our sample better and to explore conditional effects of culture in later analyses. In particular, the survey instrument asks for the firm's competitive position (market leader, challenger etc.), credit rating, debt to assets ratio, measures of profitability (after-tax profit or not, the firm's ROE), growth opportunities (annual growth rate in sales revenue), information on potential proxies for culture (proportion of employees that have worked for less than three years, employee turnover, whether the firm is a family firm, how important is meeting or beating quarterly earnings estimates to the firm), information on agency problems (proportion of CEO pay that is incentive-based, managerial ownership), information environment (public versus private), the firm's operating environment (firm age, number of business segments, the physical location of company headquarters), size (sales revenue, number of employees), industry, and several variables specific to the CEO (age, job title, time in the job, compensation mix).

Table 1 reports descriptive data on the surveyed firms (with non-profits excluded). **Table 1a** shows that 27% of our sample comes from public firms. Most CEOs (47%) in our sample are between the ages of 50 and 59. Most CEOs (28%) have spent between four and nine years at the firm. 84% of the firms reported a profit last year. In terms of industry composition, the sample is most heavily represented by manufacturing (18%); banking/finance and insurance (17%); and service/consulting (15%). Following the recommendation by List (2007), we benchmark our public firm survey sample to Compustat. **Table 1b** shows that the public firms, among the survey respondents, are statistically indistinguishable from Compustat firms for leverage, return on equity, and CEO tenure while surveyed public firms have greater revenue, lower sales growth, lower incidence of after-tax profit, more employees, and older CEOs with greater ownership stakes and percentage of pay that is incentive-based and better rated debt. We preform tests for statistical differences in mean as well as the Wilcoxon rank sum test for differences in distribution, which has almost as much power as the difference in means test statistic when the data are normally distributed but is much more robust to outliers.

2.2 Caveats

While we believe that surveys and interviews are an excellent way to obtain data that provide insights about corporate culture, we acknowledge that there are limitations. Field studies such as ours suffer from problems such as potential response bias, limited number of observations, whether questions on a survey could be misinterpreted, do respondents do what they say, do they tell the truth, do they recall the most vivid or their most representative experience. A survey about corporate culture also faces challenges related to whether the survey 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 statements about causality, given the one-shot nature of the survey. Nonetheless, it is our hope that our combination of interviews and survey evidence provides fresh insights into the issues we study, perhaps uncovering issues otherwise underdeveloped in research based on more traditional methods.

3. Empirical Results

3.1 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."

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?" The appendix contains a table listing the clusters of words most commonly used by survey takers to describe their corporate cultures. Based on a review of survey takers responses, we synthesized their descriptions into seven types of cultures: (i) entrepreneurial; (ii) hierarchical; (iii) collaborative; (iv) results oriented; (v) high integrity; (vi) in transition and (vii) dysfunctional. A brief description of these types follows:

(i) *Entrepreneurial*: We classify cultures as entrepreneurial when participants used words such as "start-up culture, "aggressive," "scrappy," dynamic," "charming chaos," "innovative," thinking outside of the box" and "reaching beyond the obvious." 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."

(ii) *Hierarchical*: Descriptions such as "buttoned down," "traditional" and "centralized" were coded as hierarchical cultures. 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." Another states, "you might say you need a more hierarchical company because it's a larger company. It's the environment, and maybe there is some history because culture is partly defined by why we do things, how we do things around here, the established practices in a place."

(iii) *Collaborative*: Cultures characterized as "open," cooperative," "friendly, "family like," "participatory," "universal recognition no superstars". An example from the interviews: "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 describes it as follows, "we don't show up at work to hit home runs, we show up at work to help advance the runner."

(iv) *Results oriented*: Survey takers who describe their culture in terms of "customer focus" "results driven," "service first," "continuously improving," "high performance," were classified as results oriented. An executive clarifies "I think within XX, every business will have a listed competitor that it is trying to outsmart, outrun or outdo in some way. It would be quite exceptional within XX not to have someone working within a business who is not aware of who the primary competitor or competitors are."

(v) *High integrity*: Respondents who described their cultures as "compliance driven," "credibility focused," "accuracy of financials" were classified as high integrity cultures.

(vi) *In transition*: Survey participants who indicated that their firm's culture was in a transitionary phase are captured here. An executive who had witnessed tremendous growth at an iconic company described the cultural transformation during the 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 would not have been feasible unless expected. 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."

(vii) *Dysfunctional*: Several participants indicated that the culture at their firm was not conducive to growth and profitability because it was "selfish", "rudderless," "confused," "mercenary" and the like. An executive illustrated how, for instance, instability at the top also leads to an unproductive 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."

3.2 How important is corporate culture?

3.2.1 Overall importance of corporate culture

The survey asks the following three questions to investigate the importance of corporate culture: (i) How important is corporate culture at your firm?; (ii) 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 (iii) Do you believe that improving your corporate culture would increase your firm's value?

Table 2a indicates that 91% of survey respondents consider corporate culture to be "very important" or "important" at their firm. This result is corroborated in **Table 2b**, where 51% of respondents rank culture as a "top 3" driver of firm value and an additional 27% rank culture as a "top 5" contributor. Thus, collectively, 78% of participants consider culture to be among the top five factors affecting firm value. Given the importance of corporate culture to corporate success, the relatively sparse literature on the topic in economics, finance and accounting is surprising.

The interviews provide potential reasons behind managers' beliefs that corporate culture is very 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, leadership, market position, operating plan, product, 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, an overwhelming 91% said yes (Table 2c).

In interviews, managers indicate that, in general, 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."

Executives emphasize 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. "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.

3.2.2 Importance of corporate culture in M&A deals

Several interviewed CFOs mentioned that the cultural fit of a potential M&A target is 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, 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. We asked CFOs to quantify a "discount" if any applied to the company B.

Table 3 reports that 48% of respondents would not even make an offer for B, given the cultural misalignment. 31% of respondents would discount their offer price for B, with 12% offering a discount as steep as 20% 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." 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 although cultural fit is beginning to get explored in the literature as a potential driver of M&A transactions (e.g., Bouwman 2013), a lot remains to be done.

3.3 What mechanisms underlie the creation and effectiveness of corporate culture?

We explore the factors that underlie a company's culture, determine the degree to which it is effective at helping the firm execute its strategy and achieve its goals, and/or potentially modify the effects of culture.

3.3.1 The influential role of leadership

We ask participants to rank order who or what is the driving force behind setting the firm's current culture. **Table 4** reports that 52% of respondents identify the current CEO as the most important driver of the firm's current culture. 33% state that their company's reputation or image in the marketplace is the most influential driver of culture. 33% of participants identify the owner and 30% of survey takers identify the founders as responsible for the company's culture. It is interesting to note that the board of directors (12%) and incentive compensation (10%) are not perceived as creators of the current culture. We hypothesize that governance generally serves as a modifier to the existing culture (see section 3.3.3 for details), rather than as a primary force establishing the culture.

The primary role of leaders appears to be 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 fostering employee engagement. 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."

3.3.2 Factors underlying the effectiveness of culture

How do employee interactions impact corporate culture? **Table 5** reports the importance of a number of internal workplace factors in creating an effective culture.

(i) Coordination, trust, and communication:

Survey respondents consistently identified the importance of trust among employees (83%) and coordination (73%) as key factors that help their culture to be more effective. 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 fostered trust and executives cited the ease with which employees communicated and coordinated across groups allowed the firm to execute on its strategy. Consistent with that thinking, a majority (50%) identify the importance of consistency and predictability of employees' actions as a key factor that helps their culture become effective.

(ii) Engagement:

Survey respondents rate the importance of broad agreement about goals and values (67%) as an important contributor to an effective culture. Broad agreement can be the result of effective culture (which leads to employees "being on the same page") or it can be a necessary condition for effective culture. Interviewed executives candidly emphasize the difference between aspirational and actual cultures and that disengagement occurred when employees only view the aspirations as lip service.

The interviews highlight the importance of engagement, which reflects the portion of employees that commit to the cultural values. Interviewed executives enumerate many techniques they use to achieve greater employee engagement. For example, as one executive states, "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."

(iii) Learning and innovation

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 (55%) identified the emergence of new ideas organically in the firm as a key factor in making their cultures effective. 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 it 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 2008-2009 recession.

(iv) Critiquing and whistle-blowing behaviors:

Most firms indicate an environment that facilitates employee whistle-blowing is conducive to effective corporate culture. In particular, survey respondents believe that employees' willingness to report unethical behavior (52%), their comfort in suggesting critiques (58%) and more broadly, taking decisions that reflect the firm's long term interests (69%) make their firm's cultures more effective. 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 were apt to point out that layers of bureaucracy make whistle blowing difficult.

Many executives emphasized the necessity of active critiquing both within peer groups and within hierarchies to help the firm achieve its goals; however, they were quick to note 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."

(v) Sense of urgency:

A majority of survey respondents (53%) 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.

For example, an executive described to us how a firm's sense of urgency changed and how that affected overall performance, "we now do phone calls with them 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 retail who would talk to the head of all of wireless. It would take six layers to get there."

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."

3.3.3 Potential modifiers of corporate culture

Certain forces can modify or filter how a given corporate culture works, potentially changing the end result that occurs from a given cultural set-up. 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. **Table 6** presents information on the relative importance of the following potential modifiers of a firm's culture: (i) senior management behavior, (ii) governance or the board of directors, (iii) the finance function/department; and (iv) incentive compensation.

These modifiers potentially create a tension at the firm between informal and formal systems 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 system for guiding actions, and there is a formal incentive system 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 against or work for the culture shaped by the leadership.

The results in **Table 6** indicate that senior management behavior and governance/board of directors are positive modifiers of an effective culture. 74% (55%) of respondents thought senior management behavior (corporate governance/board) reinforces the effectiveness of corporate culture. 49% of respondents also believe that the finance function positively influences the effectiveness of corporate culture. Interestingly, 57% believe that incentive compensation positively influences cultural effectiveness whereas 21% believe that compensation schemes work against the effectiveness of culture. The role of the CEO and senior management has already been discussed in section 3.3.1. Details behind the other three responses are presented in the following paragraphs.

(i) Board/Corporate Governance

A CFO points out that boards indirectly set cultures via their choice of the CEO: "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 nitty-gritty of the implementation of cultural values: "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."

(ii) Compensation Structure

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, 57% of executives believe that the compensation system reinforces the effectiveness of the culture and 21% believe it works against the culture. Among those that believe that culture reinforces the culture, 78% say that their compensation system rewards employees for living the values of the culture, 67% indicate that the compensation scheme helps to attract and retain the right type of talent to the firm and 60% believed that their compensation systems focus employees on long term objectives (see **Table 6b**). 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; tying incentive compensation to team effort; tying 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, 54% indicate that compensation focuses employees on short term objectives, 37% say their firm's compensation scheme attracts and retains the wrong type of people to the firm and 35% say compensation leads to fear of failure and insufficient risk taking, and (see **Table 6c**). 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. "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. 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."

Executives believe 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."

(iii) The role of 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, as summarized in **Table 6d**, most (43%) highlight that the finance function in their organization exemplifies accountability/integrity and transparency. 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 functions 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: "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 an ability to significantly influence how the firm/company views itself, and how the leadership view their impact on the results of the company. Without the finance function's culture of integrity, compliance, etc… the behavior of executives end up a lot of time destroying what it took them years and years to build."

Only 9% of respondents indicate that the finance function works against the corporate culture in their firms. 35% of these respondents believe that (i) finance employees operate in a separate silo; and (ii) finance focuses employees too much on short term objectives, and 34% believe that finance focuses employees too much on short-term objectives.

3.4 What aspects of business performance does corporate culture affect?

The previous sections detail the mechanisms underlying corporate culture and the other corporate forces that modify the effectiveness of culture. This section explores the effects of corporate culture on 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.

3.4.1 Risk-taking

Table 7a reports that 55% believe that their firms take on the "right amount or risk, 28% believe their firms take too little risk, and 12% believe that their firms take too much risk. Among the 55%, 69% believe that the role of corporate culture is a "very important" or "important" reason that their firm takes the appropriate amount of risk (See **Table 7b**). Among firms that take on too little risk, 54% 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 takers were asked about mechanisms via which culture affects risk taking. Some examples of how effective culture facilitates risk taking from these comments include, "encourages risky acquisitions," "culture is aligned around innovation and step function changes in growth, not incremental behavior," "ours is a high risk venture focused on developing life-saving drugs. If we don't manage risk well there is no company."

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)," "avoidance rather than management of risk."

Interviewed executives reported that culture enhances firm performance through the risk-reward trade-off. For example, as one executive describes, "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, "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: "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, you come back into more business as usual. There's a little bit of a cultural safety blanket there that allows people to take risks in their career."

3.4.2 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 3.3.2 and 3.4.1. We explore the cultural effects on long-term versus myopic behavior via several additional survey questions.

One question explores how firms will trade-off short term risk/negative cash flows versus higher long-run NPV. In particular, 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 the superior project would be chosen.

It is remarkable that 36% they would choose the NPV inferior project and 15% are not sure which project they would choose. If a participant chose A, we ask whether their firm's culture played a role in their company's preference for A? 81% 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?" 57% 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)?" 84% of respondents said "yes," as seen in **Table 8d**.

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?" **Table 8e** shows that 55% of executives believe that it is either "extremely likely" or "very likely" that an effective corporate culture would reduce "real earnings management." Only 16% 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," "employees do not take (inappropriate) risks in their jobs because the numbers will take care of themselves," "belief that good news can wait, bad news can't when something comes up," "we focus on doing great work

- and the profits will follow," "we implement systems and tolls for 'zero non-compliance' and monitor the same at periodical intervals," "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," "strong culture of doing the right thing for the company and for the world," and "integrity is a key part of our corporate culture, enhancing / reinforcing the quality of our financial reporting."

Negative examples are "if the culture promotes or tolerates 'rogue' behavior then less likely to have compliance with the norms of society," "the pressure to meet numbers leads to doing the wrong thing," "quarter loading!" "reporting drives front end actions so no new initiatives are ever taken," "an aggressive culture of risk taking impacts aggressiveness of accounting policies to compensate for high risk projects that go bad," and " we take creative chances with numbers."

One manager alluded to 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."

3.4.3 Other aspects of performance affected by corporate culture

Table 9 reports a frequency table showing whether executives believe culture affects profitability and other important corporate finance and accounting actions and the potential mechanisms behind such actions. In particular, executives believe that corporate culture has a "big effect" on the following behaviors and actions: (i) productivity (60%); (ii) creativity (56%), (iii) firm value (57%) and profitability (54%). Even for the least popular choice (among the choices we provided), tax aggressiveness: 30% believe that culture has a moderate or big effect on tax aggressiveness, though 37% say culture has no effect.

Survey respondents identify several ways that culture affects corporate creativity and innovation. Examples of how ineffective cultures hurt creativity and productivity: "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."

Corporate culture can also exert a positive effect on creativity and innovation: "reinforces 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." "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."

Culture can affect *productivity* in similar ways. Examples of effective cultures boosting productivity include, "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."

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: (i) recruiting dedicated employees; (ii) staff working extra hours for client satisfaction without direct compensation; (iii) employees knowing "how to act and what to do and hence they need less direction;" (iv) "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;" (v) "collaboration and teamwork increase efficiency in the completion of engagements," (vi) "employees don't work at cross purposes," and (vii) "we make decisions to do what is right the first time."

The interviews provide rich context to interpret the above results related to cultures effects on performance. First, executives report that culture enhances firm performance because it enables superior execution. "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 temper, 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." Through an economic lens, we interpret these statements to mean that culture acts as a technology that reduces informational costs because it enhances coordination.

Second, executives report 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. It could be functionally, it could be geographically, and it could be 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."

Third, executives report 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." Finally, "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."

Fourth, 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, "Great culture with right values, focus will deliver results even with a mediocre strategy." Similarly, another executive states, "if I think about strategy and execution, mediocre strategy and great execution you can get by. So, I think culture helps implement execution and to that extent, I would say culture is very important." The main idea seems to be that 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."

3.5 Are the upside benefits versus downside risks of corporate culture symmetric?

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. As summarized in **Table 10**, 41% of respondents believed that the potential "value creation from effective culture is greater than value destruction from ineffective culture" relative to 41% 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 CFOs interviewed believe that the downside risk from a poor culture was far greater than the upside risk of a good culture. For instance: "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 remarks: "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 Y 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.

3.6 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. As listed in **Table 11a**, 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 20% believe that their culture needs "considerable work."

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" (see **Table 11b**). 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 provide additional insight into leadership deficiencies with respect to ideal corporate culture. The following comments are typical: "founder syndrome," "arrogance," "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 team work;" "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 3.4.2:

(i) *Need new leadership:* Some firms need new leaders: "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." Sometimes, new leaders subvert a culture, "our company was created by our founders with this values-based culture, and the inverted pyramid management construct. I am the longest serving executive at our company, so I have worked with our founders. I was here when we brought in a new CEO from outside of the company, and I was his CFO for many years. He turned the pyramid over so that he was on top. He flipped it as he was accustomed to running a business that way. We lost our way as the consequences of decisions that were being made at the top were being borne by the associates and impeded their ability to take 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." 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."

(ii) *Not engaging the rank and file*: "the only way we are going to fix this 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."

(iii) *Excessive focus on consensus building*: "you don't move without consensus, apparently they think that companies are democracies instead of benevolent dictatorships. And so, unless somebody raises their hand, nothing gets done."

3.7 How can corporate culture be measured?

Several researchers in financial economics have attempted to measure various dimensions of a firm's culture using publicly available data. These include: (i) firm fixed effects (Cronqvist et al. (2012)); (ii) 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); (iii) the firm's appearance in the rankings of the top 100 Great Places to Work (Edmans (2012); Bergeron, Smith and Lehn (2012)) and more fine grained data from the organization including the larger sample of the non-top 100 ranked firms (Guiso, Sapienza and Zingales (2015)); (iv) 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 (2015)); (v) appearance of the word "trust" in the MD&A section of a firm's 10-K filing (Audi, Loughran and McDonald (2015)); (vi) corporate philanthropy (Bereskin, Campbell and Kedia (2013)); (vii) political orientation of the senior managers proxied by donations to Republicans or Democrats (Hutton, Jiang and Kumar (2012)); (viii) firms' corporate social responsibility (CSR) behavior, from the KLD database (Hoi, Wu and Zhang 2012, Gao, Lisic and Zhang (2014)); (ix) compliance records with regulators of worker, product and environmental safety (Kedia, Luo and Rajgopal (2015)); and (x) the CEO's unethical behavior (Davidson, Dey and Smith (2012)).

There is room for improvement with each of these proxies. For instance, several focus exclusively on human relations variables or corporate social responsibility measures although a firm's culture likely encompasses many other dimensions. Textual analysis, which covers a variety of techniques has achieved some successful external validation, but in other instances, the assumption by researchers to know which words, a priori, would best capture a firm's culture has limited the effectiveness of this approach. 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. "I don't think you could determine it without the benefit of working there to be quite honest" reflects this sentiment. 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 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 set up the measurement question well, "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?" Others suggest the following concrete avenues to measure corporate culture:

(i) *Conference call transcripts/analyst reports*: A CFO recommends, "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: "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 hear in their notes their feelings about the company."

(ii) *Employee age/tenure*: "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 advocates 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." A different take on turnover: "when Welch was head of GE, he stated openly that he expected 30 percent of 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."

(iii) *Company's external communication*: "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."

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

(v) *CEO change*: "you should look at where here 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. JC Penney is the perfect example."

(vi) *Culture of the prior firm of the CEO*: "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."

(vii) *External websites with employee opinions*: "look at third-party services where employees get on and say 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."

(viii) *Culture-environment fit:* "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."

(ix) *Uniform commitment across the company*: "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."

(x) *Communication patterns*: "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?"

(xi) *Corporate actions*: "when XX was the CEO and Chair of YY, and they had their annual meeting, he also had a board 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."

An executive cautioned against concluding too much about a firm's culture from its externally visible trappings, "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: "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." An 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 52% of executives say the culture matches the values "very closely," as reported in **Table 12**. Hence, researchers need to be cautious before assuming that the firm's stated values correspond to its operational culture.

Because the values espoused by management, the engagement and momentum demonstrated by employees to live those values, and the incentive systems at the firm determined the 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.

4. Conclusions

Corporate culture is perhaps the most under-researched value driver among the important contributors to firm performance. In particular, 91% of surveyed executives tell us that corporate culture is important to their firms. 78% place culture among the top 3 or the top 5 value drivers of their company. 48% of executives would just 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, be risk tolerant, 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.

The literature on corporate culture is just emerging. 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?

Before we started working on the project, culture was a vague amorphous topic to us. Then we 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 in finance and accounting (and beyond) need to hear. Corporate culture does matter, a lot, more than most of the things we academics study. We acknowledge that culture is still a bit imprecise because (i) culture means different things to different people; and (ii) it can be a 'catch all' that commentators default to and explain the otherwise unexplainable. However, the importance of the topic means it deserves the research attention of serious, rigorous scholars and we hope our paper is a bridge to enable such future work.[4]

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APPENDIX

Clusters of responses to the open-ended question "What words or phrases best describe the current corporate culture at your firm?"

Culture type assigned by us	**Typical words or phrases used by executives**
Entrepreneurial	Dynamic startup culture, little to no bureaucracy and hierarchy, passion, creative, can-do, engaged, hectic, stressed, always looking for a better way, aggressive, perseverance; flexibility; proactivity, agility, shape the future; ambitious; constantly looking for innovation; start-up, fast paced, fun, scrappy, thinking outside the box, disruptive.
Hierarchical	centralized authority, conventional, traditional, buttoned-up; remote command and control.
Collaborative	Open, collaborative, professional, cooperative, sharing, with basic direction given, little to no politics, participatory, congeniality and collegiality, smooth and helpful, collaborative universal recognition no superstars, ; respect; equity; team work and selfless behavior to meet client demands; cooperation, not confrontation; 'not my job' does not exist at our firm; shared; supportive; family values of trust and respect, extremely close family atmosphere, friendly culture
Results oriented	Customer delight, continuous improvement, accountability, dynamic and mission-driven (customer satisfaction), excellence, continuously improving, high performance, high quality, high precision, service first, client focus, strong customer service commitment, focus on patient care #1, focused on results;,
High Integrity	honest, factual, trustworthy, transparent, accuracy and credibility of financials, compliance with regulations and laws, sincerity, honesty; ethical, moral, accountability,
In transition	Charming chaos which was familiar and helpful in the past but now it's coming to its limitations since we are growing fast, becoming more mainstream as we hire more GEN X/millennials, evolving,
Dysfunctional	I am in it for myself, frustrated, misguided, below average, low performing; adequate; low risk, low reward; scared to make a mistake, fragmented, transactional, short term, mercenary, confused and rudderless; adherence to process, lack of innovation; they try to reach a consensus on too many things;

Table 1: Panel A: Demographic characteristics of the survey participants, N= 933

Ownership	Percent	*After-tax Profit*	Percent
Public	27	Yes	84
Private	73	No	16
		Competitive Position in Industry	Percent
Executive Age	Percent	Market Leader	22
< 40	5	One of the Leading Firms	45
40-49	18	Middle of the Pack	22
50-59	47	Challenger	12
60+	30		
		Industry	Percent
Executive Tenure	Percent	Retail/Wholesale	10
<4 Years	27	Banking/Finance/Insurance	17
4-9 Years	28	Mining/Construction	3
10-19 Years	23	Transportation/Energy	2
>20 Years	22	Energy	2
		Service/Consulting	15
CEO Turnover	Percent	Agriculture/Forestry/Fishing	2
>Industry Average	6	Public Administration	0
=Industry Average	13	Communication/Media	4
<Industry Average	81	Technology	9
		Manufacturing	18
Meeting/Beating Earnings Targets	Percent	Healthcare/Pharmaceutical	6
Very Important	61	Other Industry	12
Somewhat Important	27		
Not Important	10	*Number of Segments*	Percent
		1	27
		2	21
		3	23
		4	13
		5	6
		6	2
		6+	8

Table 1
Panel B: Representativeness of surveyed public firms (total possible N=199)

Benchmark Public Firm Survey Responses to Compustat

Debt to Assets

	Mean	Std. Dev.	10th Percentile	25th Percentile	50th Percentile	75th Percentile	90th Percentile	Obs.
Survey	26%	20%	0%	10%	25%	35%	51%	125
Compustat	31%	36%	0%	0%	13%	55%	100%	8,571
Mean Difference	5%		Wilcoxon Rank-Sum Difference				36,685	
Test Statistic	(1.57)		Test Statistic				(1.33)	

Return on Equity

	Mean	Std. Dev.	10th Percentile	25th Percentile	50th Percentile	75th Percentile	90th Percentile	Obs.
Survey	15%	14%	3%	8%	12%	18%	25%	133
Compustat	15%	27%	0%	0%	6%	15%	48%	7,480
Mean Difference	0%		Wilcoxon Rank-Sum Difference				163,917	
Test Statistic	(0.18)		Test Statistic				(6.69)***	

Revenue (1=Less than $25 million, 2=$25-$99 million, 3=$100-$499 million, 4=$500-$999 million, 5=$1-$4.9 billion, 6=$5-$9.9 billion, 7=More than $10 billion)

	Mean	Std. Dev.	10th Percentile	25th Percentile	50th Percentile	75th Percentile	90th Percentile	Obs.
Survey	5.09	1.71	3.00	4.00	5.00	7.00	7.00	193
Compustat	3.79	2.32	1.00	1.00	3.00	7.00	7.00	10,885
Mean Difference	1.30		Wilcoxon Rank-Sum Difference				336,174	
Test Statistic	(7.73)***		Test Statistic				(7.78)***	

Revenue Growth									
	Mean	Std. Dev.	10th Percentile	25th Percentile	50th Percentile	75th Percentile	90th Percentile	Obs.
Survey	9%	16%	1%	3%	5%	10%	20%	146
Compustat	26%	113%	-15%	-1%	4%	18%	56%	7,336
Mean Difference	17%		Wilcoxon Rank-Sum Difference				61,998	
Test Statistic	(1.76)*		Test Statistic				(2.40)**	

Profit (1=Earned an after-tax profit, 2=Did not earn an after-tax profit)								
	Mean	Std. Dev.	10th Percentile	25th Percentile	50th Percentile	75th Percentile	90th Percentile	Obs.
Survey	1.11	0.32	1.00	1.00	1.00	1.00	2.00	193
Compustat	1.36	0.48	1.00	1.00	1.00	2.00	2.00	7,233
Mean Difference	0.25		Wilcoxon Rank-Sum Difference				173,557	
Test Statistic	(7.14)***		Test Statistic				(7.11)***	

Number of Employees (25=Fewer than 50, 75=50-99, 300=100-499, 750=500-999, 1750=1000-2499, 3750=2500-4999, 7500=5000-9999, 11250=More than 10,000)								
	Mean	Std. Dev.	10th Percentile	25th Percentile	50th Percentile	75th Percentile	90th Percentile	Obs.
Survey	6,916	4,544	300	1,750	7,500	11,250	11,250	197
Compustat	2,541	3,786	25	75	300	3,750	11,250	7,237
Mean Difference	4,375		Wilcoxon Rank-Sum Difference				397,488	
Test Statistic	(15.9)***		Test Statistic				(13.5)***	

CEO Age (38=<40, 45=40-49, 55=50-59, 62=60+)								
	Mean	Std. Dev.	10th Percentile	25th Percentile	50th Percentile	75th Percentile	90th Percentile	Obs.
Survey	54.5	6.0	45.0	55.0	55.0	55.0	62.0	197
Compustat	53.4	6.2	45.0	45.0	55.0	55.0	62.0	8,892
Mean Difference	1.1		Wilcoxon Rank-Sum Difference				86,665	
Test Statistic	(2.57)**		Test Statistic				(2.62)***	

CEO Tenure (3=<4 years, 6=4-9 years, 14=10-19 years, 22=20+ years)								
	Mean	Std. Dev.	10th Percentile	25th Percentile	50th Percentile	75th Percentile	90th Percentile	Obs.
Survey	7.6	5.7	3.0	3.0	6.0	14.0	14.0	192
Compustat	8.1	5.8	3.0	3.0	6.0	14.0	14.0	1,813
Mean Difference	0.50		Wilcoxon Rank-Sum Difference				9,289	
Test Statistic	(1.13)		Test Statistic				(1.28)	

Management Ownership								
	Mean	Std. Dev.	10th Percentile	25th Percentile	50th Percentile	75th Percentile	90th Percentile	Obs.
Survey	9%	15%	0%	1%	4%	10%	25%	150
Compustat	3%	5%	0%	0%	1%	3%	7%	8,984
Mean Difference	6%		Wilcoxon Rank-Sum Difference				264,769	
Test Statistic	(13.6)***		Test Statistic				(8.26)***	

Percent of Incentive-based CEO Pay (0=None 13=1-24%, 38=25-49%, 63=50-74%, 88=75%+)								
	Mean	Std. Dev.	10th Percentile	25th Percentile	50th Percentile	75th Percentile	90th Percentile	Obs.
Survey	58%	28%	13%	38%	63%	88%	88%	174
Compustat	72%	20%	38%	63%	88%	88%	88%	8,978
Mean Difference	15%		Wilcoxon Rank-Sum Difference				224,542	
Test Statistic	(9.72)***		Test Statistic				(7.22)***	

Credit Rating (1=AAA, 2=AA+, 3=AA, 4=AA-, 5=A+, 6=A, 7=A-, 8=BBB+, 9=BBB, etc…)								
	Mean	Std. Dev.	10th Percentile	25th Percentile	50th Percentile	75th Percentile	90th Percentile	Obs.
Survey	7.01	4.48	1.00	3.00	7.00	10.00	13.00	182
Compustat	10.50	3.33	6.00	8.00	10.00	13.00	15.00	1,784
Mean Difference	3.49		Wilcoxon Rank-Sum Difference				77,551	
Test Statistic	(12.9)***		Test Statistic				(10.6)***	

There are seven categories for sales (category 1:<$25 million; category 2:$22-$99 million; category 3:$100-$499 million; category 4: $500-$999 million; category 5:$1-$4.9 billion; category 5:$5-$9.9 billion; category 7: >$10 billion), and for all other variables listed in this table the numbers are reported for each percentile as indicated. The table reports summary statistics on the representativeness of the surveyed public firms relative to the universe of firms listed on the NYSE and NASDAQ and with CRSP share codes of 10 or 11. Data on CEO age, CEO tenure, management ownership and percentage of pay that is incentive based comes from Execucomp. All firms contained in sample calculations are public.

Table 2: Importance of culture

Panel A: Survey responses to the question: Rate the importance of corporate culture

Question: How important is corporate culture at your firm? (choose the best option)

Obs.	Mean	Std. Dev.	Very Important (1)	Important (2)	Somewhat Important (3)	Not Important (4)	Don't Know (5)
905	1.48	0.80	67%	24%	5%	5%	0%

Panel B: Survey responses to the question: In terms of all of the things that make your firm valuable, where would you place corporate culture?

Question: In terms of all of the things that make your firm valuable, where would you place corporate culture?

Obs.	Mean	Std. Dev.	Top 3 (1)	Top 5 (2)	Top 10 (3)	Not in Top 10 (4)
909	1.82	1.01	51%	27%	11%	11%

Panel C: Do you believe that improving your corporate culture would increase your firm's value?

Question	Do you believe that improving your corporate culture would increase your firm's value?	Number	Percent
	Yes	684	91%
	No	65	9%

Table 3: Culture and acquisitions

Survey Responses to the Question:
You work at a firm with an effective, strong culture. You are evaluating two acquisition targets, A and B.
• A and B would bring the same strategic and operational benefits if acquired, and the targets are identical in all dimensions except corporate culture.
• Company A's culture is very aligned with your firm's culture, whereas company B's culture is not at all aligned.
Relative to how much you would offer for A, how much less would you offer for company B due to the culture misalignment?

How much less would you offer for company B due to the culture misalignment?									
			Same Amount	5% Less	10% Less	20% Less	>30% Less	No Offer	Don't Know
Obs.	Mean	Std. Dev.	(1)	(2)	(3)	(4)	(5)	(6)	(7)
807	5.04	1.74	8%	3%	9%	12%	7%	48%	13%

Table 4: Who sets the culture?

Survey Responses to the Question: the most important factors in setting corporate culture

Which of the following have been most influential in setting your firm's current culture? (Check up to 4):	Frequency	Percent
Current CEO	488	52.3%
Owners	311	33.3%
Our reputation or image in the marketplace	311	33.3%
Founder	284	30.4%
Internal policies and procedures	216	23.2%
Hard times we experienced	184	19.7%
Past CEO	160	17.1%
Changing needs of the marketplace	146	15.6%
Non-management employees	128	13.7%
Incentive compensation	107	11.5%
Board of Directors	101	10.8%
Other	87	9.3%
Peer firms	28	3.0%

Table 5: What actually drives the firm's culture?

Survey responses to the question: Please indicate which factors determine the effectiveness of your culture

In the context of your firm's current culture, please indicate which factors determine the effectiveness of your culture.	Mean	% Key factor (1)	% Little/no effect (0)	% Works against effectiveness (-1)	% Don't know (0)
Trust among employees	0.74	83%	7%	9%	1%
Coordination among employees	0.61	73%	14%	11%	2%
Broad agreement about goals and values	0.58	67%	21%	9%	3%
Decisions reflect firm's long-term interests	0.57	69%	16%	12%	3%
New ideas develop organically	0.46	55%	32%	9%	5%
Employees' willingness to report compliance risks or unethical behavior	0.45	52%	36%	7%	5%
Employees' comfort in suggesting critiques	0.43	58%	24%	15%	3%
Hiring, firing, and promotion decisions	0.42	57%	25%	15%	3%
Consistency and predictability of employees' actions	0.41	50%	37%	9%	4%
Urgency with which employees work	0.40	53%	30%	13%	3%
Other	0.35	44%	6%	9%	42%

Table 6: What reinforces culture?

Panel 6A: Survey Responses to the Question: Modifiers behind the firm's culture

Do the following items reinforce or work against the effectiveness of your corporate culture?	Mean	% Works against (-1)	% No Impact (0)	% Works for (-1)
Senior Management Behavior	0.53	21%	5%	74%
Governance/Board of Directors	0.44	11%	34%	55%
Finance function/department	0.40	9%	41%	49%
Incentive compensation	0.36	21%	22%	57%
Other	0.23	19%	38%	43%

Panel 6B: Survey Responses to the Question: Important ways in which compensation reinforces corporate culture

What are the most important ways incentive compensation reinforces your corporate culture? [check all that apply]	Number	Percent
Rewards employees for leading/living the values of the culture	122	78%
Attracts/retains the right type of talent to our firm	105	67%
Focuses employees on long-term objectives	94	60%
Other	12	8%

Panel 6C: Survey Responses to the Question: Important ways in which compensation works against corporate culture

What are the most important ways compensation works against your corporate culture? [check all that apply]	Number	Percent
Focuses employees too much on short-term objectives	43	54%
Attracts/retains the wrong type of people to the firm	29	37%
Leads to fear of failure and insufficient risk taking	28	37%
Other	19	24%

Panel 6D: Survey Responses to the Question: Important ways in which finance reinforces corporate culture

What are the most important ways the finance function reinforces your corporate culture? [check all that apply]	Number	Percent
Exemplifies accountability/integrity/transparency	363	43%
Provides analytical tools for superior execution	254	30%
Focuses employees on long-term objectives	202	24%
Other	26	3%

Panel 6E: Survey Responses to the Question: Important ways in which finance works against corporate culture

What are the most important ways the finance function works against your corporate culture? [check all that apply]	Number	Percent
Finance employees operate in a separate silo	43	35%
Finance focuses employees too much on short-term objectives	42	34%
Finance focuses on imperfect metrics	32	26%
Other	7	6%

Table 7: Culture and risk taking

Panel 7A: Survey Responses to the Question: Do you think your company takes the right amount of risk in its investments to achieve its goal

Do you think your company takes the right amount of risk in its investments to achieve its goals?	Number	Percent
Yes, right amount of risk	449	55%
No, too little risk	231	28%
No, too much risk	94	12%
Don't know	41	5%

Panel 7B: Survey Responses to the Question: How important is corporate culture a reason that your company takes on the right amount of risk

How important is corporate culture a reason that your company takes on the right amount of risk.	Number	Percent
A very important reason	94	30%
An important reason	122	39%
A somewhat important reason	56	18%
Not a reason	44	14%

Panel 7C: Survey Responses to the Question: How important is corporate culture a reason that your company takes too much/little risk?

How important is corporate culture a reason that your company takes too much/little risk?	Number	Percent	Number	Percent
	Too much		Too little	
A very important reason	24	27%	54	25%
An important reason	21	24%	63	29%
A somewhat important reason	21	24%	44	20%
Not a reason	22	25%	56	26%

Table 8: Culture and short-termism

Panel 8A: Survey Responses to the Question:

Suppose your firm is considering two projects A and B:
·A and B are very similar in that they require the same capital up front, have the same expected life, and have the same probability of failure
·A and B are very similar in that they require the same capital up front, have the same expected life, and have the same probability of failure
·A generates negative cash flows for the first two years, while B has positive cash flows in all years Assuming all cash flow forecasts are equally accurate, does your firm's culture make it more likely that project A or B will be chosen?

Which project will you choose?		Freq.	Percent
1	A	418	50%
2	B	299	36%
3	Not Sure	122	15%

Panel 8B: Survey Responses to the Question: Does the firm's culture play a role in the preferences for project A?

Does the firm's culture play a role in the preference for project A?		Freq.	Percent
1	Yes	345	81%
2	No	83	19%

Panel 8C: Survey Responses to the Question: If your firm's culture improved, do you think it would be more likely that project A would be chosen?

If culture improved, would project A be chosen?		Freq.	Percent
1	Yes	159	57%
2	No	119	43%

Panel 8D: Survey Responses to the Question on Culture and Ethical 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)?		Freq.	Percent
1	Yes	654	84%
2	No	120	16%

Panel 8E: Survey Responses to the Question on Culture and Real Earnings Management

Sometimes companies engage in end-of-quarter practices such as delaying valuable projects to hit market expected earnings. How likely is it that an effective corporate culture would reduce the chance that such actions are taken?

How likely is it that an effective corporate culture would reduce the change that such actions are taken?		Freq.	Percent
1	Extremely likely	149	19%
2	Very likely	286	36%
3	Somewhat likely	193	24%
4	Not likely	130	16%
5	Don't know	43	5%

Table 9: Culture and corporate outcomes

Survey Responses to the Question: To what extent does the corporate culture affect the following items?

To what extent does the corporate culture affect the following items:	Mean	% No Effect (1)	% Little (2)	% Moderate (3)	% Big Effect (4)	% DK/NA (1)
Productivity	3.51	1%	9%	29%	60%	1%
Firm value	3.47	3%	8%	29%	57%	3%
Profitability	3.47	1%	9%	34%	54%	2%
Creativity	3.46	2%	8%	32%	56%	1%
Our rate of growth	3.42	2%	9%	36%	52%	1%
Willingness to take on risky projects	3.26	4%	11%	43%	40%	3%
Management of downside risk	3.21	5%	14%	42%	35%	4%
Compliance	3.18	9%	14%	29%	43%	4%
Quality of our financial reporting	2.98	11%	21%	30%	35%	3%
Tax aggressiveness	2.43	30%	29%	21%	9%	11%
How much debt we use	2.68	21%	25%	27%	18%	9%
Other	3.93	7%	17%	22%	33%	20%

Table 10: Asymmetric impact of culture on value

Survey Responses to the Question: Are the upside benefits of effective culture greater than the downside costs of ineffective culture?

Are the upside benefits of effective culture greater than the downside costs of ineffective culture?	Freq.	Percent
Value destruction from ineffective culture is greater than value creation from effective culture	334	41%
Value destruction from ineffective culture and value creation from effective culture are about the same	154	19%
Value creation from effective culture is greater than value destruction from ineffective culture	334	41%

Table 11: State of our current culture

Table 11: State of our current culture

Panel 11A

Survey Responses to the Question: Our firm's corporate culture is:

Our firm's corporate culture	Freq.	Percent
Is exactly where it should be	138	15%
Needs some work but is close to where it should be	501	54%
Needs considerable work to get to where it should be	186	20%
Needs a substantial overhaul	108	12%

Panel 11B

Survey Responses to the Question: What is preventing your firm's culture from being exactly where it should be?

What is preventing your firm's culture from being exactly where it should be?	Mean	Strongly Disagree -2	-1	0	1	Strongly Agree 2
Leadership needs to invest more time to develop the culture	0.85	5%	11%	12%	36%	35%
Our culture has not caught up with recent changes in the business environment	0.29	13%	17%	19%	29%	22%
Our firm has inefficient workplace interactions (e.g., too much time spent building consensus, etc.)	0.23	11%	21%	19%	32%	17%
Firm policies work against the intended culture (e.g., compensation, governance, etc.)	0.00	16%	21%	23%	27%	13%
Our employees are not fully committed to the culture	-0.06	15%	26%	20%	26%	12%
Our cultural values are not fully aligned with our business needs	-0.07	18%	24%	17%	27%	13%

Table 12: Does culture track stated values?

Our current corporate culture tracks closely with our stated firm values.	Freq.	Percent
Very closely	461	52%
Somewhat	260	29%
Not very closely	121	14%
Not at all	48	5%