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Corporate culture in a new era: Views from the C-suite

By John R. Graham, Campbell R. Harvey, Jillian A. Grennan, and Shivaram Rajgopal

This is a condensed version of a previous JACF12581 article (in 34.4) summarizing the findings of extensive interviews of senior executives about how corporate culture is created, measured, sustained, and improved. Most managers believe that corporate culture is one of the three most important forces behind the ultimate success or failure of a firm and that improving their corporate culture would increase their firm's value. The board of directors and compensation schemes reinforce the current culture of the firm, both in positive and negative ways. Boards affect culture not via active management but primarily via CEO choice. The finance function may influence the culture, especially when it serves an internal governance role by acting as a steward of integrity. Incentive compensation and hiring, firing, and promotion decisions also may modify the effectiveness of a firm's culture. Some schemes reinforce the culture by rewarding employees for living the values of the culture while other schemes that are not well aligned with the culture lead employees to ignore the cultural values. Effective cultures boost profitability and value by aiding employee productivity and creativity. Effective cultures also enable employees to focus on the long term, embrace an appropriate amount of risk, avoid real earnings management, and comply with regulations. Firms with effective cultures encourage employees to suggest improvements and develop ideas organically, and to blow the whistle if they notice something amiss in the trenches. The authors acknowledge that empirical research in culture is difficult because of measurement difficulties, but the executives suggest several avenues to measure a firm's corporate culture.

CORPORATE CULTURE AND ORGANIZATIONAL ARCHITECTURE

By James A Brickley, Clifford W Smith and Jerold L Zimmerman

The authors argue that enterprises must successfully combine *both* formal elements of their firm's organization and less formal elements such as corporate culture to achieve their strategic missions. An organization's design and culture should be complementary and re-enforcing. The formal elements include the assignment of decision rights, the performance measurement systems, and how rewards to those employees are determined. Corporate culture refers to the attitudes, standards, behavioral norms, and beliefs that characterize the members of an organization. There are three important roles for corporate culture: (1) providing non-monetary rewards; (2) helping to set employee expectations; and (3) enhancing communication throughout the firm.

Corporate culture has two major components: unobservable-shared values and observable norms. Shared values, such as integrity, openness, and empathy, are ideals employees should strive to follow. Cultural norms are the day-to-day practices that reflect these values. Although values are difficult to observe directly, one may observe norms from a firm's customs, slogans, heroes, social rituals, modes of speech, and even their dress.

Executives face two serious challenges in trying to change their corporate cultures. First, they must adjust their cultures to implement new or revised corporate strategies that arise from changing technologies, government regulation, or competition. Second, they must find ways to recruit, motivate, and retain new employees who have different values from the existing staff. The authors illustrate both successful and unsuccessful handling of these issues with specific examples, including Southwest Airlines, the US Marine Corps, Google, Target, Apple, Facebook, Uber, Lyft, PepsiCo, and Sealed Air. They describe obstacles to changing corporate culture including the ingrained habits of long-time employees and the different core values that various generations of employees have.

THE ROLE OF ORGANIZATIONAL DESIGN AND CULTURE IN THE VALUE-BASED HEALTHCARE MOVEMENT: THE CASE OF THE CLEVELAND CLINIC

James Stoller, Bruce Lindsay and Don Chew

Two former Cleveland Clinic physician leaders discuss the culture of the legendary healthcare provider, and how a dramatic change in organizational structure in 2008 has led to the rise of a "value-based healthcare delivery system." As discussed in the article, that system was hailed, and its main elements identified, by Harvard strategist Michael Porter (in the *New England Journal of Medicine*) around the same time.

In Porter's conception, value-based healthcare has six main elements. First and most important is the reorganizing of legacy hospital and healthcare systems from separate departments based on physician specialties into integrated practice units (or IPUs) centered on *patient* medical conditions such as heart and vascular disease and urological and kidney disorders. Such a structure in turn makes possible the second key element: detailed records of patient outcomes (in all stages of treatment) and all the associated costs. Such record-keeping and measurement in turn provides a much more reliable basis for the third element: the replacement of fee for services by the "bundled" capitation pricing that has been increasing for decades.

Such reorganization and outcomes-cost monitoring is also consistent with, and supported by, two other elements: increased specialization by hospital systems in their areas of expertise and comparative advantage; and expanding the geographic reach of the systems—both aimed at achieving "virtuous cycle of volumes"

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the discipline of EVA, management is better able to ensure that its investment in TQM results in increased shareholder value while not underinvesting in their non-shareholder stakeholders.

PURPOSE, CULTURE, AND STRATEGY IN BANKING

By Anjan Thakor

The author discusses the concept of culture in banks, how it is shaped by the bank's purpose, and how it influences the bank's strategy, risk management, and capital structure. He argues that culture has both a direct and indirect impact on bank performance and both effects work in concert to amplify each other. Culture influences employees' mindsets, attitudes and work approaches directly, thereby driving organizational performance while the financial variables scholars have studied extensively—such as bank capital and asset portfolio composition – are themselves influenced by the bank's culture. Regulators who focus solely on these determinants to change bank behavior are, however, addressing the symptoms, rather than the root causes, of undesirable bank behavior.

Although intangible, culture has tangible consequences. It affects employee decisions and organizational performance continuously. A well-aligned culture will support the execution of strategy, while misalignment can frustrate even the most brilliantly designed strategy. Deciding what kind of culture to promote depends on the strategy. Bank leaders would do well to remember that so-called soft issues such as culture are hard challenges. In many instances, acting to serve the greater good helps the bottom line as well. Having an authentic higher purpose engenders employee trust in the organization's leaders and this encourages the design of more complex, customized and profitable products and services.

WORKPLACE GENDER DIVERSITY AND EMPLOYEE TURNOVER

By Aiyesha Dey, Joseph Pacelli, George Serafeim, and Fangzhong Liu

The authors study how companies try to create and manage diverse workplaces and to know why those well-intentioned efforts may be ineffective. Specifically, they examine the relation between workplace gender diversity and organizational turnover for a large sample of firms spanning 61 countries and 71 industries over the period 2010 through 2021. Their findings indicate a positive diversity-turnover relation. Such effects are consistent with managerial theories predicting that workplace diversity can increase exit rates for minority employees, raising the possibility of more ominous organizational consequences of increasing diversity. That relationship, however, is partially attenuated when companies commit to fostering inclusive workplaces as reflected in female employees occupying managerial positions and provision of greater support and growth opportunities to female candidates. This study offers important managerial implications regarding the potential outcomes of diversity initiatives and suggests that the success of such initiatives might depend on a company's ability to provide workers with social support and meaningful career growth opportunities.

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Corporate culture in a new era: Views from the C-suite*

John R. Graham[1] | **Jillian Grennan**[2] | **Campbell R. Harvey**[1] | **Shivaram Rajgopal**[3]

[1]Duke University, Durham, North Carolina 27708, USA

[2]University of California at Berkeley, Berkeley, California 94720, USA

[3]Columbia University, New York City, New York 10027, USA

Correspondence
Jillian Grennan, University of California at Berkeley, Berkeley, 94720, California, USA.
Email: jillian.grennan@berkeley.edu

INTRODUCTION

Corporate culture has been likened to an organization's heartbeat—the less visible, somewhat intangible force that shapes its movements, health, and longevity. Just as humans need a strong heartbeat to live, culture is often the difference between business success and failure. Google's culture is frequently celebrated as a cornerstone of its innovation and achievement.[1] Zappos's superior customer service stems from a teamwork culture, cultivated as early as the hiring stage. In contrast, the troubles at VW, Toshiba, Uber, and Wells Fargo are routinely held up as examples of cultural failures.[2]

Yet designing a culture that can be credited with great business success is difficult, especially when considering the global catalysts shifting workers to hybrid arrangements and placing new demands on management practices and governance structures.[3] Employees are increasingly seeking work that aligns with their personal values, rather than just financial incentives.[4] Similarly, employees, especially when not immersed full-time in toxic office cultures, are feeling empowered as whistleblowers and increasingly reporting to the SEC failures within their companies.[5]

Amidst these transformations, we believe now is the time to reflect on what corporate culture means, and how it contributes to a company's productivity, efficiency, and value creation. To do so, we analyze executives' answers to questions about culture, including "How do companies build and maintain a culture focused on enhancing efficiency and value?" "What role do other formal institutions, such as board oversight and compensation systems, play in reinforcing (or undermining) culture?" and "How does one measure the effectiveness of a corporate culture?"

It is in this context of reflection and inquiry, that we synthesize insights from a comprehensive survey of chief executives and financial officers (CEOs and CFOs, referred to interchangeably as "executives" or "managers") of a wide range of North American public and private companies.[6] Along with specific questions about corporate culture and its role in their organizations, we also conducted in-depth interviews of executives representing over 20% of the US equity market capitalization. As we review the insights, we endeavor to incorporate the perspectives on culture, most relevant to this era of unprecedented change for leaders and workers.

In the pages that follow, we begin by summarizing the survey findings to provide context for the interviews and open-ended responses. Among the most important findings is that a majority of the executives responding to the survey considered corporate culture as "a top three value driver" at their companies, and almost all agreed that improving their corporate culture would increase

[1] See Edwards, Douglas. 2012. *I'm Feeling Lucky: The Confessions of Google Employee Number 59*. Boston, MA: Houghton Mifflin Harcourt; and Schmidt, Eric, and Jonathan Rosenberg. 2014. *How Google Works*. New York, NY: Grand Central Publishing.

[2] Milne, Richard. 2015. "Volkswagen: System Failure." *Financial Times*, November 15; Inagaki, Kana. 2015. "Toshiba's once lauded culture became the cause of its problems." July 21; Cancialosi, Chris. 2016. "Wells Fargo and the True Cost of Culture Gone Wrong." *Forbes*, September 15; and Isaac, Mike. 2016. "Inside Uber's Aggressive, Unrestrained Workplace Culture." *New York Times*, Feb 22.

[3] Barrero, José María, Nicholas Bloom, and Steven J. Davis. 2023. "The Evolution of Work from Home." *Journal of Economic Perspectives* 37(4): 23-50.

[4] Kitterman, Ted. 2022. "Purpose Offers Opportunity for High Attrition Industries." *Best Places to Work*, September 18.

*This article supplements insights from the authors' article, "Corporate Culture: The Interview Evidence," published in this journal one year ago, Vol. 34 No. 4 (Fall 2022), and survey-based evidence previously reported in "Corporate Culture: Evidence from the Field." https://doi.org/10.1016/j.jfineco.2022.07.008

[5] Sun, Mengqi. 2020. "Tips to the SEC Surge as Work from Home Emboldens Whistleblowers." *Wall Street Journal*, June 1.

[6] The details of our methods and findings have been reported in a number of our earlier papers, including Graham et al., 2022, "Corporate Culture: Evidence from the Field." *Journal of Financial Economics* 146, 552-593, Graham et al., 2022, "Corporate Culture: The Interview Evidence." *Journal of Applied Corporate Finance* 34, 22-41, and "What Do Financial Executives Say about Corporate Culture and Strategy?" *Management and Business Review*, Fall 2023.

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their firm's value. And although the CEO was identified as "the most influential person" in setting the firm's current culture, corporate boards were also seen as affecting culture—but primarily through their choice and oversight of the CEO.

The finance function was also seen as having potentially important effects on corporate culture, especially in its internal governance role as steward of corporate assets and investor capital. Incentive compensation along with hiring, firing, and promotion decisions were also identified as working to reinforce cultural values in successful companies while undermining values in others. Indeed, cultural fit was seen as important enough in a contemplated M&A deal that most managers claimed they would walk away from a target whose culture is badly aligned with the bidder's culture.

There was also a consensus that culture is a major influence on corporate risk-taking, and plays a critical role in instilling a long-term focus in employees and managers. Conversely, a poorly implemented, ineffective culture was seen as increasing the odds of illegal or unethical employee or managerial behavior. Somewhat surprisingly (at least to us) was how widespread the practice of "real earnings management" appeared to be, with over 40% of our responding CFOs acknowledging the willingness of their companies to postpone investment in value-increasing projects to hit quarterly earnings targets.

The executives who responded to our survey also warned of a widespread disconnect between companies' stated values and their prevailing social norms. Very few officers said they believed that their own culture was exactly where it should be. And when asked how their culture could be improved, most respondents state that leadership needs to invest more time to develop the culture by encouraging: (1) coordination and trust among employees; (2) agreement about the firm's goals, values, and long-term interests; (3) constructive criticism, learning, and the development of new ideas; (4) the sense of urgency and predictability with which employees worked; and (5) willingness to identify problems when something goes awry.

Finally, executives suggested a number of ways to assess a given firm's culture, including conference call transcripts and analyst reports, employee tenure and turnover, examination of the company's external communication and press portrayals of the CEO, and external websites with employee opinions such as Glassdoor.com. A common belief was that no single source of data can measure the nuance of culture but rather triangulating between various sources may be most successful. To that extent, we linked the survey and interview data with crowd-sourced employee reviews from platforms like Glassdoor, and the cultural values advertised on corporate websites, and yielded insightful correlations. However, there is a considerable need for further research to establish definitive causal relationships between culture and various measures of firm performance.

Interview procedure

Reflecting our interest in investigating the causes and effects of corporate culture in the context of finance and accounting, most of our 18 follow-up interviews were with CFOs, though we also interviewed one CEO and several other top-level managers (including one chief marketing officer). Given the potentially sensitive nature of corporate culture, and to encourage frank discussion, we promised the executives anonymity.

Each interview began with open-ended questions such as, "What is corporate culture?" and "How would you describe the corporate culture at your firm?" The interviews varied in length, from 40 to 90 min, and the executives were forthcoming in their responses and generally enthusiastic about the topic.

The companies represented by our 18 interviewees were all large companies (with average sales of $47 billion) that together make up about 20% of the market capitalization of the NYSE plus NASDAQ. Besides being much larger than the typical Compustat firm, they were also more leveraged, more profitable, and with lower sales growth and higher credit ratings.

The interview findings

Among the responses to our opening question, "What is corporate culture?" we heard words such as "a beliefs system," "a coordination mechanism," "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," and "the tone for what type of company this is." What's more, these views were pretty much consistent with academic definitions of culture like the following: "the values and norms widely shared and strongly held throughout the firm that help employees understand which behaviors are and are not appropriate."[7]

Next, we asked the interviewees to describe "the culture *at your firm*?" "Customer," "collaborative," and "focused" were the three most common. Based on our review of survey takers' responses, we organized their descriptions into seven distinctive clusters or categories focused on the following core cultural values: (1) adaptability; (2) collaboration; (3) community; (4) customer satisfaction; (5) product quality and precision; (6) integrity; and (7) performance. A brief description of each of these cultural values follows:

1. *Adaptability*: we classified cultures as "adaptable" when participants used words such as "start-up culture," "aggressive," "scrappy," "dynamic," "innovative," "reaching beyond the obvious," "little to no bureaucracy and hierarchy," "entrepreneurial," "can-do," "always looking for a better way." As one executive described his company, "[Company XX] didn't want processes… [or] systems… [or] 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."

[7] O'Reilly, Charles, Jennifer Chatman, and David Caldwell. 1991. "People and Organizational Culture: A Profile Comparison Approach to Assessing Person-Organization Fit." *The Academy of Management Journal* 34, 487-516.

The antithesis of adaptable organizations was those characterized as "buttoned down, traditional, centralized authority, conventional, traditional, remote command and control."

2. *Collaboration*: we classify cultures as "collaborative" when participants described their firms using words such as "teamwork, cooperative, friendly, supportive, family, participatory, universal recognition, no superstars, sharing, little to no politics, collegial, helpful, selfless behavior, cooperation, no confrontation, or close-knit." As one interviewed executive said of his firm, "certainly the majority of our management are promoted from within. The management team all viewed themselves as 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."
3. *Community*: we identified cultures as "community-oriented" when participants used words such as "involvement and partnership in the community, respectful of diversity, empowering our employees, delivering sustainable outcomes, inviting and fun environment, citizenship, servant leadership, caring, progressive, open-minded, inclusive, and developing all types of talent." As one executive said about his firm, "we hire people with passion and expect it from all our co-workers, commitment to the environment, caring for those in the communities where we work. Our employees know they are valued, and we encourage them to give back to the community, and our managers are urged to treat all people with dignity and respect, and to do what's best for our stakeholders as a whole."
4. *Customer satisfaction*: we classified cultures as "customer-oriented" when participants used words such as "market-driven, service first, customer delight and attention to their needs, the customer is always right, pride in our service,… and meeting and exceeding customer expectations." As one of our interviewees said, "we spend a lot of time on customer service because we believe long term that's going to be the only differentiator we have. To drive that down through the company, it's engaging with customers all the time from the senior executive level down, reinforcing that culture of owning the customer's problem and fixing it. We do that by spending a lot of time training employees about how… we want them to engage with customers and pointing out simple opportunities for them to… [do so]. We thank customers all the time. We send gifts to customers who spend some time thanking us. Those are all the things we try to do to foster a customer-service culture."
5. *Quality and precision*: we classified cultures as "quality- and detail-*oriented*" when participants used words such as "paying attention to detail, develop deep expertise, precision, emphasis on quality, decisions based on analytics, technology-focused, data-driven, reliable and highest quality products, consistency in work and products, strong process and engineering focus, continuous process improvement, functional experts solving problems, scientific leaders, evidence-based decision-making, and adherence to design."
6. *Integrity*: we classified cultures as valuing "integrity" when participants used words such as "credibility, accuracy of financials, honesty, trustworthy, transparency, compliance with regulations and laws, sincerity, ethics, morality, and accountability."
7. *Performance*: cultures were identified as "performance- or results-oriented" when participants used words such as "continuous improvement, accountability, demand excellence, work hard, achieve results, high performance, focused on results, be #1, high expectations, investor-driven, internally and externally competitive, profits no matter what, results not excuses, the right results the right way, utilizing the best talent for the best results, and personal ownership of results."

When responding to our survey question about their view of the effectiveness of their own corporate cultures, 14% of the executives either indicated that their cultures were "in transition" or explicitly identified aspects of their culture that needed improving. One executive described the cultural transformation at his firm during an explosive growth phase as follows: "to start with, there was a ridiculous degree of individual authority. Many projects that would later become workgroups of substantial size were just one individual's job. There was so much going on that communication about a particular project or decision would not have been feasible… [L]ater, the founder and I engineered more explicitly one of the largest culture shifts in the company away from decentralized decision-making to a much more review-oriented culture."

A number of participants described their cultures using words like "selfish, rudderless, confused, misguided, fragmented, or unrealistic." One executive illustrated how instability at the top leads to an ineffective culture, saying that "when 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."

At the same time, however, several executives were also quick to point out that there is no one culture or set of cultural values that is likely to be effective at all companies or even within the same firm at all times. One comment conveyed this sentiment as follows: "Clearly, the kind of camaraderie that [XX] enjoys might not be appropriate in a lot of other financial sectors where this deeply humble collaboration is not necessarily the best approach. There's also… [a] downside to a very strong culture. It can become a set of handcuffs, limiting freedom of thought and the ability for outside talent to hit the ground running and become part of the team. So, that's the balancing act,…[a strong culture can be both] a blessing and a curse."

Importance of corporate culture

Over 90% of our survey respondents viewed corporate culture as either "very important" or "important" at their firm. At the same time, over half (54%) ranked culture as a "top-three" driver of firm value and another 25% ranked culture as a "top-five" contributor. Thus, taken together, almost 80% of participants consider culture to be among the top five factors affecting firm value.

When asked *why* they believed that corporate culture is so important for corporate performance, a number of CFOs rated culture as more important than attributes like "brand, employee talent, financial health, market position, operating plan, product,

strategy, unique competitive advantage, and vision for the company." As one executive put it, "If you started two businesses, they had the same manufacturing process, same raw materials, distribution, everything was the same, and one had a good culture and one a bad culture, the good culture would outperform the bad…. 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… Ultimately, the strong culture is going to succeed."

Another executive said that culture creates a competitive advantage by raising a barrier to imitation: "our competitors cannot copy our culture."

When asked whether respondents believed that improving culture would increase their firm value, an overwhelming 92% said yes. But executives acknowledged that changing a firm's culture, at least in the short run, is hard: "culture is always longer term because that is the code/behavior of the company. Until there is a deliberate effort to change it, that persists."

One manager voiced a widely shared view when he said that companies with a strong culture and a weak strategy could "muddle through," but not the other way around. As he went on to say, "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 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."

The executives we interviewed also provided compelling examples of why corporate culture is likely to be important for companies and at *all* stages of development. As one told his own story, "the previous CEO did not ascribe success to culture, didn't think it was important. [One of his sayings was] if you want friends, buy a dog.'„,. he did not want to meet with employees [because] 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…. there was such a void, that it just felt really good for people, and was adopted quickly."

Finally, executives emphasized that having an effective corporate culture helps their firms find common goals in the face of challenges inherent in running an organization with diverse geographies, ages, and attitudes. As one executive described his company, ''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 1000 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.''

Corporate Culture in M&A Deals. Several interviewed CFOs mentioned that the cultural fit of a potential M&A target is very important and seriously considered when "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 said that several failed acquisitions were attributable to a lack of cultural integration: "A lot of deals failed to deliver the promised return… because the companies overpaid, but others failed because they aren't successful integrating the two and getting the synergies. And usually, the main reason is culture. If the cultures don't fit, are not close enough that one can change and adapt, I bet almost every time that transactions will deliver less than expected."

When we asked our CFOs to quantify the size of the "discount," if any, they would apply to a target company that represented a bad cultural fit, a remarkable 54% said they would not even make an offer for the company. And roughly a third of said they would discount their offer price, with discounts as steep as 20%. As one CFO summarized the downside risk of a bad culture fit, "You purchase the right to never-ending problems because of cultural factors [that] I would describe as [matters of] compatibility."

Another executive said that a bad cultural fit comes down to inability to trust the employees of the targeted firm: [I] "had an attractive valuation on a firm that was a great fit strategically, but the CEO was known to be difficult. I didn't invest because I knew we would have to fire the CEO in a year"

When asked how exactly a company might test for the cultural fit of an M&A 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, [and] open door communication."

Creating an effective corporate culture

When asked to rank order who or what is the driving force behind setting the firm's current culture, 55% of our respondents identified the current CEO as the most important driver, 32% identified the owner, and 30% the founders, while 18% pointed to past CEOs, as responsible for the company's culture. But as few as 12% cited either the board of directors or incentive compensation as drivers of the current culture. This somewhat surprising finding led us to hypothesize that boards and other more formal institutional mechanisms generally serve mainly as modifiers or reinforcers of the existing culture. As one interviewed executive noted, "corporate culture is created from the top-down. Only when leadership fails to cultivate the culture [does] it become a bottom-up culture."

The primary role of leaders appears to be to instill a common belief system that pervades the company. As one interviewed executive 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 put it, "Once you become CEO, you need to define what you want the culture to be…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."

Nevertheless, as another executive pointed out, "a good leadership team and good CEO will put in the processes to make sure the message filters down to the very bottom of the organization." And ensuring that this happens can be a very challenging task. As one executive conceded, "I think the best you can do is establish a tone from the top that carries down to the key leadership of the company, and individuals will build around that. It is how they behave, how they act, and their trustworthiness."

All that said, other executives cited the founders of their companies as playing outsized roles in setting the culture. As one saw it, "The memorable leaders substantially define the culture. Even years after they ceased to be an active force in the organization their legacy is still alive. They define the culture because they defined a lot of the character of the firm. There could be some structural things that could influence culture, but in my experience, the leaders of the company do almost more to shape the culture of the company than the structural environment."

Other factors executives identified as affecting leadership's ability to create an effective culture were context and diversity. As one executive put it, "the individual leader's attributes have to be conducive to the industry… to know if the leader's approach is going to work effectively." This executive cited Bill Perez, the former CEO of S.C. Johnson, as an example. ''Bill was excellent at determining what consumers wanted. Nike was looking for a new CEO with world-class insights in various areas of marketing. Bill Perez was selected and did exactly what he was hired to do. Nine and a half months after Bill started, Phil Knight fired him. Bill was shocked. The culture said, 'We're Nike, we know what we want more than the customers do. We tell the customers what they want.' The culture absolutely ate him alive.

Normally someone who fails doesn't get a big second chance, but Wrigley wanted all of the same things that Bill was doing at Nike and had done at S.C. Johnson. Bill went to Wrigley and… was a massive success. Same person, same actions, totally different results. Context is essential.''

Diversity in top leadership has also helped some companies establish more effective cultures. As one executive described his situation, "the culture gets affected by the top leaders at the company. We have six people that are members of our executive committee… three males and three females. The CEO and his executive committee make all of the decisions as to where the company is going using a very balanced approach. Our largest operations are run by a woman who is very marketing driven. She brings a lot of insight into shaping the culture that the CEO or CFO may not. I think a balanced executive committee helps."

Investments in corporate culture

Several CFOs pointed out the importance of investing in the firm's culture: "one thing I've realized as I've reached the most senior management is how much work it is and how conscious you have to be to sustain and adapt that culture. I think most employees kind of take culture for granted. It takes continuous refinement and reinvestment to keep the culture alive."

Interviewed executives cited a number of techniques they use to achieve greater employee engagement. For example, as one executive stated, "we have internal videos, other internal messaging, various newspaper articles that go out to all of the employees to continually reinforce what the culture is. In addition, every year, the CEO exerts great effort to achieve the difficult task of getting in front of all of the employees in an effort to reinforce the culture as well."

Another executive said, "we take new employees through history, we give them books of past writings and have meetings where in some cases we'll ask an employee to talk about a critical policy or historical thing that happened in the past. Indoctrination into culture is also promotion from within, it's celebration of things that demonstrate the culture, it's 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 resource processes of encouraging engagement. For example, "retention of employees below you was a big part of what you were evaluated on if you were up for a promotion."

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

Finally, some argued that investing in corporate culture should be viewed as necessary at all times and not as a luxury the firm can afford only when business is good. "We invested in our people in a downturn, and when the economy started to turn around, we started to grow, and grow quickly. By the end of this year, we recovered everything and more than we lost. At the same time, our customer survey results are at an all-time high, our employee survey results are at an all-time high, and we are more profitable than we have ever been as a company, and our stock is trading at a historical high level. As we look at it, the investments that we made to stay true to our culture, has paid off not only for our people, but for our shareholders."

Or as another executive put it, "In many situations you would have to give up some short-term performance to achieve the goal of moving the culture toward the firm's overall culture. Let's say it's an acquisition…. You are better off consolidating those [operations] very quickly, and getting people to get to know each other and start working together. [But] Anytime you do that, you are going to incur a lot of upfront costs. [And the same is true of the] incentive structures we put in place when we acquire a company to try and stimulate the operations. In each case, we are making a short-term financial stipend to those individuals to try and get them onboard, to integrate, and to work toward that same common culture."

Social norms underlie the effectiveness of culture

Several interviewees highlighted the importance of social norms, which reflect the way employees embody the cultural values in their day-to-day actions. The following discussion reports on the importance of a number of social norms in creating an effective culture, notably (1) coordination and trust among employees; (2) agreement about the firm's goals, values, and long-term interests; (3) constructive criticism, learning, and the development of new ideas; (4) the sense of urgency with which employees worked; and (5) the predictability of employees' actions and willingness to whistle-blow when something is awry.

Our survey respondents consistently identified the importance of trust among employees (85%) and coordination (77%) as determinants of an effective culture. One executive cited the role of coordination and trust in effective collaboration: "Teamwork is enhanced. Goals are set at higher level with coordination of effort, which is enhanced by a trusting culture, and knowing that people care for each other." Or as another executive put it, "trust that the company will do the 'right' thing, that superior effort will result in superior rewards and praise among peers. People do not mind going the extra mile if they know everyone is putting forth the same effort." Other executives noted how the absence of coordination or trust could hamper overall performance. "Our metrics are much better because we now do phone calls with stores twice a week where they can get on the phone and tell us about their stores and their experiences, and are we getting them inventory on time, and did our software work correctly for billing and logistics. Versus before, that would filter up to the manager of preferred retail who would then talk to the head of [XX] who would talk to the head of all of [YY]. It would take six layers to get there."

Survey respondents also viewed broad agreement about goals and values (70%) and long-term decision-making (73%) as important contributors to an effective culture. As one executive said, "Our culture is a challenge for the fact that we are very diverse. Yet all of our divisions, even though they look different, they are working towards that common focus. We have done very well as a company and I think a key part of that is because we are so involved with our associates trying to work towards that common goal."

Another executive said that "one of our cultural norms is perseverance. We focus on the long haul. Real and meaningful success comes through sustained efforts. So, management has a longer-term horizon for decision-making. This trickles down into all of our actions. When faced with downsizing certain groups due to backlog, we work very hard to preserve talent, and place employees in other groups."

The value of constructive criticism, learning, and new ideas also came up in several interviews. As one executive described his firm, "people were encouraged to come up with new ideas and to try things. I'm thinking about all the things that came out of people who went above and beyond their job descriptions because they cared either about the job they were doing or about making the company more successful. I'm thinking about the guy who came up with the [XX] model, or [XX], which is basically a $10 or $20 million a year business. Would he have done that if he were working at another company [YY]? Probably not… because they had a culture where that kind of tinkering was not encouraged."

Many executives emphasized the value of active feedback and criticism within both peer groups and hierarchies to help the firm achieve its goals. But they also noted that once a decision had been made, the employees need to commit quickly and implement the program. For example, one of our interviewees cited a common saying at his firm, "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."

By 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."

Another way executives thought about learning is in terms of employee turnover in times of economic adversity. "In a challenging macroeconomic environment, do employees respond by saying, 'we have to stick together to ward off these challenges; let's figure out a way to do so.' Those who do tend to find creative internal solutions to their challenges. Alternatively, in a challenging macroeconomic environment, the most talented employees could jump ship… leaving the firm with worst prospects for recovery." Several executives cited the importance of these dynamics during the 2007–2009 recession.

Another common theme in our interviews is the importance of employee understanding of an agreement about the types of actions that are encouraged and help up for emulation. For example, if half of the employees are very competitive but the other half are collaborative, the interactions between the employees could produce office politics that reduce 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." In short, confidence in how their managers react to bad news can help companies execute their strategy.

With respect to whistle-blowing, one executive summarized the consensus as follows: "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…Unless you can have this environment that…we will always do the right thing by you." But others point out that layers of bureaucracy make whistle-blowing difficult. For example, "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."

Organizational structure and corporate culture

As discussed in a number of other articles in this issue of the *JACF*, a company's culture is almost certain to reflect and be affected by key elements of its organization design, including its allocation of decision rights (who gets to make what decisions), its performance measurement system, and its system of rewards (and punishments). For example, a company's incentive compensation scheme can either reinforce a given culture, or it undermine it by introducing inconsistent or conflicting incentives.

We present survey evidence and interview feedback on the relative importance of the following elements or features of corporate structure: (1) incentive compensation; (2) hiring, firing, promotion; (3) external governance such as the board of directors; and (4) internal governance such as the oversight and guidance exercised by the finance function.

Our survey results were broadly consistent with attempts by senior management and corporate boards of directors to use formal governance elements to reinforce the culture[8]. As one interesting example, about half the respondents said their incentive compensation had a positive influence on the corporate culture. Nevertheless, roughly one in six (17%) viewed their compensation schemes as working against the effectiveness of culture. And of the 50% of executives who said their compensation system reinforces the effectiveness of the culture, only about a third (35%) indicate that the compensation scheme helps to attract and retain the right type of talent to the firm. Even fewer (29%) said their compensation system rewards employees for "living the values" of the culture or (32%) focusing on long-term objectives.

As examples of compensation structures that reinforced the culture, executives offered the following: "discretionary rewards associated with promoting the culture and living the values"; "one-year financial stipends for managers from acquired firms to get them onboard with the new culture quickly"; and "linking incentive compensation to [things like] team effort…retention and promotion outcomes of the employees below them."

Among the companies that indicated that their compensation schemes work against the effectiveness of their culture, 39% indicated that their compensation focuses employees on short-term objectives, 24% said it attracts and retains the wrong type of people, and 20% said it leads to fear of failure and insufficient risk-taking.

One belief widely expressed by interviewed executives is that compensation "that is not aligned with culture… will change the culture.„ People… do what you pay them to do even when you're saying something different." Another common observation was that compensation schemes are too often designed to "reward mediocrity": "high performers are not incentivized, low performers are not penalized."

One example of compensation structures working against the effectiveness of the culture is the practice of grading employee performance on a curve. As one executive explained, "we instituted this stack rank for employees, each employee gets evaluated and it is on a bell curve. Each department has a quota, certain number of people are performing above, certain number are meeting expectations and a certain amount are below… 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 [or]… cooperate. You don't want to help the guy next to you because they might do better than you."

Another common criticism of compensation structures is their tendency to reward employees for achieving a metric without regard to how they achieved it. For example, in the fairly recent case of Wells Fargo, a culture that claims to value people, and customers in particular, but rewards employees for sales volume found employees misrepresenting information to the customers to meet sales targets. Executives viewed the Wells Fargo case as the most visible sign of a much more general problem. As one summed up the matter, "the easiest thing is to pay (based on) the metrics, but you could end up with a bunch of people that you don't want to have around you."

Finally, interviewed executives said that two key elements of an effective compensation structure are fairness and reasonableness. As one put it, "compensation has to be right in terms of the marketplace. 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."

Hiring, firing, and promotion

Just by virtue of their hiring, firing, and promotion decisions, corporations instill cultural values by identifying and choosing to hire employees who share their ideals. And by promoting employees who live up to such ideals, corporate HR departments work to reinforce the culture. A number of executives told stories of using these tactics to help ensure that the retained employees with integrity and other desirable traits. As one CFO told us, "compliance and making the right decisions are constantly preached by our CEO and upper management. They make it a point to hire people with high character." But, as another executive cautioned, values must be continuously instilled through "relentless communication on compliance…and a policy of high profile one and done firings when compliance is violated." Still another echoed this sentiment more broadly across different cultural values, noting that "culture is developed partially based upon principles the leadership instills in the organization and by hiring people that you believe can thrive in a particular culture."

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

[8] Grennan, Jillian 2023. "A Corporate Culture Channel: How Increased Shareholder Governance Reduces Firm Value." Available at: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2345384 provides empirical support for formal governance influences culture.

At the same time, many examples of ineffective cultures were seen as perpetuated by hiring, firing, and promotion systems that worked against cultural values. One executive observed that "individuals do not feel empowered to express new ideas… those with differing views from the owner are eventually fired or demoted so people do not feel encouraged to be creative." And we heard a number of complaints about nepotism and favoritism reducing productivity, among them the following: "management applies different levels of accountability for employees within the same department. Some employees overproduce while others plod along knowing their likeability… shields them from accountability."

Nevertheless, another executive described a very different problem, one in which misguided corporate benevolence ends up reducing profitable growth: "our firm had a no lay-off, treat employees as family policy but this limits the rate of company growth. We reject contracts that require hiring more employees if we feel that there is a risk of having to lay off those employees when the contract ends."

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

The role of corporate boards

Slightly over half (56%) of surveyed executives said they believed that their boards of directors reinforced their firm's current culture. At the same time, roughly one in ten (11%) thought governance worked against the culture, while the remaining 33% thought their boards had no impact on culture.

Our interviewees provided much the same picture. Among the characteristics differentiating effective from ineffective boards was their relationship to the CEO and their ability to distinguish cultural reality from aspiration. Proactive boards intent on improving culture were seen as contributing to corporate success. As one CEO attested, "we have an active board that plays a role in shaping and monitoring the culture. We have an inquisitive board that asks a lot of questions. They ask questions not just of the top tier of management, but… the second tier and any key individuals under that now and then. The board listens to all levels very carefully and will express their opinions about if we are moving too fast or too slow or are we over-extending in one area or not."

Another executive praised his board for its commitment to identifying where everyday practices may be misaligned with cultural values. As he put it, "Our board is very supportive of our culture. The head of our compensation committee will ask: Are people feeling good? Are they being supportive? Are we doing the right things with the compensation? This is a perfect example of a board member who is very focused on making sure he is supportive of the culture."

By contrast, boards stacked with insiders and disengaged from the industry were viewed as undermining culture. As one example: "the board does not engage with management a lot in regard to monitoring or shaping the culture. We have an older board, and they are a little bit disengaged and a little bit dated in terms of what is going on in today's market. So, I don't think they get into our culture, they don't understand it. It's not what they were doing back when they were working."

Another offered much the same story about boards generally: "the boards do not influence culture. The people on the board are for the most part handpicked by the CEO, and share his vision. Ultimately, for the shareholders, I'd say they are too close to his vision. But life is good right now. Boards are not known for disrupting when things are good."

Yet another executive described the challenge somewhat differently: "You have to think of the culture at different levels. There is a culture between the CEO, the management team, and the board. If the board-CEO-management team just aren't connecting, you've got a problem there. If those get out of sync, you end up with problems."

Interviewees consistently expressed the view that boards have a responsibility to act when leaders do not deliver and that directors should not wait for a crisis before they react. They also identified the board's biggest responsibility as picking the CEO, thereby indirectly setting the culture through their choice of CEO. One executive pointed out that, although the board sets the overall tone in large part through its choice and monitoring of the CEO, it does not get involved with the implementation of cultural values. As he said, "The important thing for our board is to drive accountability, transparency, and integrity. The board sets the ground rules at that level. But, is a board really going to go beyond that in a more in-depth cultural way in terms of engagement of employees for example? I haven't really seen that."

Finally, executives cited a number of ways that even well-intentioned boards could fail to react properly when it comes to culture. As one said, "it is critical for boards to try to fully understand and appreciate the aspirational and the actual culture. I differentiate between aspirational and actual because sometimes boards only hear what management wants them to hear. Good boards have an intuitive feel for the culture of the company and kind of know what makes sense and what can and can't be done from either a social contract or just a human relations perspective…. boards that are tone-deaf to the actual culture may push managers to do things that create destructive results or begin to disengage employees."

To that end, a number of executives said they believed that the onus was partly on management to help the board understand the culture. As one executive summed things up, "with all the pressure on boards these days for rapid performance, it becomes critical that the management team also helps the board understand the culture. You may need to steamroll over the old culture if you've got big changes, but in today's hurry-up world with activist investors and other things, the board is kind of a last line of defense. So, it is important that the board fully understand the culture."

The role of the finance function

The finance function within the firm is broadly defined to include employees in treasury, corporate, M&A, and compliance-type positions. Roughly half (49%) of our survey respondents said that their company's finance function works to reinforce the firm's goals of strengthening accountability and transparency. Smaller percentages (30%) agreed that finance provides analytical tools for better decision-making, and (24%) focuses employees on long-term objectives.

Perhaps most remarkable, in a number of interviews we heard about finance departments with distinct "subcultures" in which accountability, integrity, and ethics were said to be transmitted by finance employees to the rest of the firm. One executive offered the following testimony: "the finance organization has its own culture that has grown up within the culture of our company… 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… 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."

Another interviewed finance executive focused heavily on the corporate risk management function, noting that it leads to more robust conversations with top management and the rest of the firm: "Finance employees are both the guardians of integrity but also the mirror of the organization… finance has the ability to significantly influence how the firm/company views itself, and how the leadership views their impact on the results of the company. Without the finance function's culture of integrity [and] compliance… the behavior of executives ends up a lot of time destroying what it took them years and years to build."

Another way finance was seen as influencing the overall culture was through the development of norms for consistent decision-making based on facts rather than sentiment. As one CFO recounted, "the finance culture influenced the rest of the culture. When I got there, there were no analytical processes for choosing real estate, pricing management, and purchasing… we developed very complex analytical processes around developing the comps and unit returns and all this other stuff. The finance group developed tools that were easy to understand, and used by the different groups used to become successful. We totally changed the culture."

At the opposite end of the spectrum were a small fraction (8%) of survey respondents who said that the finance function undermined corporate culture in their companies. Roughly a third of this group attributed this to the tendency of finance employees to operate in "a separate silo," and another third said that employees were too focused on short-term objectives. As one executive told us, finance departments that are not integrated with the rest of the business can be detrimental to firm performance. "Finance is an area where you have such a range of skills and different backgrounds, so you're not quite as immersed in the firm's culture as you might be in some other functions. If you don't connect the function to the firm culture it lessens the effectiveness of the finance group."

How does corporate culture evolve?

Our interview evidence is largely consistent with the view of organizational theorist Edgar Schein, who argues that (1) culture is created by the firm's leaders; (2) it evolves over time to respond to the life cycle, environmental pressures, and to the firm's market position; and (3) employees either fit the culture of a firm or leave or are let go eventually.[9]

Though almost everyone who took part in our survey and interviews agreed that "leaders define the firm's culture," several executives thought that the founder's values mattered more to younger firms. As one executive explained, "for the younger firms, I think it will depend on the leader… when you get to a certain scale at which leaders of the company realize that their direct action is not enough to reinforce certain behaviors, culture begins to pick up and carry out their will in a subtler way and extends their influence."

A number of interviewed executives said that leaders who were effective in one culture might fail in another. One cited the example of Ron Johnson who "left Apple, one very unique culture, and came to J.C. Penney, a very different culture, trying to bridge and change that organization and bring it along but it didn't work."

At the same time, very few thought that a bottom-up culture was a realistic proposition: As one CFO put it, "Corporations are… benign dictatorships. Whether the.. CEO is benign or not, he or she will shake the culture through strong will or by behavior. If the CEO is not strong enough to drive the agenda of the board, the board will replace the CEO, so that culture always comes from the top."

Another interviewed CFO saw a bottom-up culture as a failure of leadership: "for many companies that maybe don't have leadership that pays attention to culture, you are stuck with more a bottom-up approach to your culture. In those situations, the lower levels of the organization are driving a lot of the culture."

"Our company was created by our founders with a 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… [At a time we were losing market share,] we brought in a new CEO from outside of the company, and I was his CFO for six years. He turned the pyramid so that he was on top… he was accustomed to running a business that way. We [had] lost our way because… the decisions that were being made at the top [prevented]… the associates [from]… taking care of the customers. So during this time, we were ceding market share to our largest competitor."

Another executive contrasted the effect of an internal versus external CEO hire on the firm's culture as follows:

> "The insider CEO who had grown up in the company kept the basic tenets of the culture the same… The outsider CEO came in with a totally different culture, totally different mindset, and it was really difficult. Ultimately, it didn't work with the external hire, because he tried to make it into a different com-

[9] Schein, Edgar. 2010. *Organizational Culture and Leadership*. San Francisco, CA: John Wiley & Sons.

pany, which made it a very difficult environment for employees to navigate."

Several CFOs held up for praise CEOs who have tried to carry forward the values espoused by their founders. One such CEO was reported as saying, "you have to have leaders that live it. It is created originally, then you have to have people that lead it. I can speak to another company, [XX], where I have been on the board since 2003. That company has a very strong and unique culture, started by their founder [YY]. They will start business meetings by reading [YY]'s quotes… Their business has changed dramatically since the founder's days, but their culture has not. I suspect that if they got off their culture, it would be really damaging to their ability to drive results. They very much promote from within, as they have never had anyone from the outside come in and lead the company. As board members, we acknowledge that it is critically important."

Competitive marketplace effects

Over a third of our responding executives said that a company's reputation and competitiveness in the marketplace plays a more important role in setting the firm's culture, the second most important influence after the CEO. Pointing to how the marketplace shapes culture, one CFO remarked, "we were a company that was really being impacted by technology substitution, revenues were declining. The company had grown and was in a great niche, and was led by the same guy for many, many years, so there was more of a sleepy culture. The board recognized the situation, brought in some new leadership, a new CEO who was trying to bring a results-oriented culture into the old business."

Emphasizing the role of changes in the corporate landscape, another executive said, "if the external environment becomes more competitive and more unpredictable, it requires a different culture and comprehension of what was going than what was going on before and you have to change. Just relying on what worked before is probably the biggest thing that can cause you to fail because you need to develop how you need to execute given the facts and circumstances of that time."

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

Lifecycle effects

Several executives expressed their belief that culture is important in companies at all stages in the corporate lifecycle. As one executive told us, "culture is important when things are going really well, when things are going poorly, and when you are in long-run growth status. With a newly developing company, culture and leading people with passion becomes extremely important. With a mature company, you have a much broader base that you have to make sure….[is] aligned with the real interest of the company. Culture is a really key part of that."

The big distinction in cultures we found was between those of start ups and mature companies. The CFO of a very successful firm, [XX], that was a start up a few years back stated, "I wonder if the need of the business is what contributed to our…go fast culture." The same executive, who now offers consulting advice to a large established company, [YY], contrasted its culture with the start up's as follows: "[YY]… was more about we want to retain people, retention was a big part of what you were evaluated on if you were a director of the company. They had been around 75 years, so they had had some practice at managing people. Development and job evaluations were very important aspects of work life at [YY], [but]..not [at XX]… [There] people look at the yearly evaluation and say 'yeah, whatever' and move on, [since the] stock is doing great… at [XX], circumstances in which they have to do business… [are] fast moving… try to get it right the first time, but if you don't get it right…fess up to your mistake, pick out what is good and move on. At [XX] there is not a lot of post-morteming, there is no time, it is just move on to the next thing. Where at [YY], they spend a lot of time looking back and decisions take a long time."

One executive commented on the importance of a company's industry position on its culture: "I do think that position or being a market leader for a long time with very reliable revenues has colored [ZZ]'s outlook, has maybe made it more defensive, having a sense of having safe revenues coming from our main products. And frankly, the recent vulnerability of those revenue streams has given it, ironically, a little bit more of a fresh perspective and less of a defensive outlook."

Another executive attributed the contrasting cultures at two companies he had worked for to differences in their industry position and competitive intensity: "the number one value at [XX] is the respect for individual. [XX] is the only place that I have worked where if you yell at subordinate or somebody like that then they will fire you…. [By contrast,] [AA] and [BB] both share a very competitive environment. So that created the competitive cultural environment inside. Everybody felt that they were the best at what they did. There were no lateral moves and no demotion. At [AA], if you are in top ranks, either you are moving up or you are moving out. At [XX], if people didn't make it in one job, then they will offer them something lower that was a better fit to them. However, for [XX], no one comes close in terms of competition."

Nevertheless, only 3% of executives thought their industry peers played a role in shaping their own company's culture. As one executive put it, "trying to adopt a culture of another successful firm in our industry would not work at my firm, because it would be contrary to the DNA plus there was such a strong competitive environment in my industry." Or as another executive argued, "our peer companies absolutely do not have a similar culture. There are competitors with varying degrees of good culture and then there are some that are absolutely command and

control type still because they are run by their founders. It's their way of running the business, and if people don't like they can leave… And it's not that they don't have a degree of success, it's just that they are run differently."

Effects on culture on business outcomes

We also posed a series of questions exploring the effects of corporate culture on employee productivity, risk-taking, and firm value. Roughly 60% of our respondents said they saw culture as having a "big effect" on both the productivity and value of their companies. Moreover, an effective culture was said to increase productivity and long-run profitability and value in a number of ways: (1) "recruiting dedicated employees"; (2) "staff working extra hours for client satisfaction without direct compensation"; (3) employees knowing "how to act and what to do and hence… need less direction"; (4) "our well known integrity makes us good partners to external organizations who therefore cut us a lot of slack in the inevitable cases where problems crop up"; (5) "collaboration and teamwork increase efficiency in the completion of engagements"; and (6) "we make decisions to do what is right the first time."

Conversely, ineffective cultures were said to reduce productivity and value in the following ways: by creating a "citadel mentality between profit centers and lack of accountability cause sub-optimization"; "discourag[ing] initiative and slow[ing] project management"; by making us "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."

As one executive summed up the relationship between culture and firm value, "a good corporate culture means everyone knows how to act and what to do and needs less direction so they can just focus on pursuing what is valuable for the company, and this inevitably leads to better corporate performance and therefore value. It also creates longevity and development internally and with external partners, which increases perceived value."

In terms of corporate risk-taking, 60% of executives said that their companies take on the "right amount" of risk, while 29% thought their firms take "too little" risk, and 11% that their firms take "too much" risk. But in each of these three cases, over half identified corporate culture as an "important" contributor to the level of corporate risk-taking.

When asked how effective culture facilitates risk-taking, respondents' comments included the following: "encourages risky acquisitions"; "culture is aligned around innovation and step function changes in growth, not incremental behavior"; and "ours is a high-risk venture focused on developing life-saving drugs. If we don't manage risk well there is no company." Ineffective cultures, by contrast, were said to lead to the wrong amount of risk-taking in the following ways: by creating "shooting the messenger so there is a clear unwillingness to commit to large risky projects"; a tendency to "give up upside in exchange for downside protection"; a performance measurement system in which "rewards need to be within a quarter or the risk is not taken"; and "conservative culture overestimates risks forcing to generate two or three shield-options to protect the company."

Interviewed executives also reported that culture enhances firm performance by viewing risk-reward trade-offs over a longer time horizon. As one executive described his firm's approach, "we do tend to take a little more risk because of this long-term perspective that comes from our culture… When [something]… is the right thing to do for the business in the long term, that for us is a mitigation of the risk."

But as he went on to say, this link between risk and performance is not always easy to incorporate in formal models of risk: "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 the decision. The risk is in the ability to predict future potential and that is risk you cannot conceive of as a return-on-investment problem. But the firm's culture enabled it to take advantage of a lot of opportunities that it otherwise would not, because it 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 [are very] different from the quantitative methods that we usually think of as risk analysis."

In a related issue, several CFOs highlighted tolerance of failure as a sign of a productive culture. As one executive told us, "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."

Another executive characterized culture as a kind of shock absorber in the event of a failure: "one of our cultural attributes is that you don't have to fear if you take a risk with a job and move into an area you don't know, if you're with an unsuccessful project or something you don't disappear with that project. There's a little bit of a cultural safety blanket there that allows people to take risks in their career."

The pervasive problem of real earnings management

With the aim of exploring how companies get their managers and employees to focus on long-term objectives, we asked our respondents to choose between two otherwise identical projects with a five-year duration. Project A has a higher NPV than B, but requires reporting negative cash flows for the first two years, whereas B reports positive cash flows throughout. A remarkably high 41% said they believed their company would choose project B with the lower NPV. And 80% of those who said their companies would choose A said they believed their firm's culture played an important role in that decision.

In a 2005 survey of over 400 U.S. company CFOs by three of the authors,[10] we posed 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?" In one of our more recent surveys, over

[10] Graham, John, Campbell Harvey, and Shivaram Rajgopal. 2005. "The Economic Implications of Corporate Financial Reporting." *Journal of Accounting and Economics* 40, 3-73.

half (56%) of the responding executives said they found it "very likely" that an effective corporate culture would reduce this kind of real earnings management.

When it comes to matters of corporate compliance—and business ethics as well—the vast majority (on the order of 85%) of respondents said that corporate culture plays an important role. Free-text positive responses of survey takers included statements like the following: "people are more likely to do the right thing within a culture that focuses on long-term success as opposed to short-term goals"; "we have a culture of playing by the rules. If we didn't employees would be more prone to play games"; "the compliance department is always at the table whether it is in a strategy discussion or a workplace error deviation. As a result, everyone feels comfortable when an issue arises and it needs to be reported"; "integrity is a key part of our corporate culture, and this enhances/reinforces the quality of our financial reporting."

Among the negative examples from open-ended survey responses were the following: "an aggressive culture of risk-taking impacts aggressiveness of accounting policies to compensate for high-risk projects that go bad"; and "a rules-based culture can lead to compliance in a blind fashion that reduces the individual's ability to think beyond prescribed rules and ultimately may inhibit performance."

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

A few interviewed executives complained that they sometimes do not get credit from the market for decisions or investments they make that reinforce 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." But as he went on to say, "Our long-term investors get it and understand it completely."

Other business outcomes

After a majority of our surveyed executives said that corporate culture has a "big effect" on employee creativity, profitability, and growth, a number identified ways that culture affects corporate creativity and innovation. When we asked executives how corporate culture can exert a positive effect on creativity and innovation, we received statements like: "creativity blossoms when workers feel supported to take risks and not fear punishment if they fail"; "our engineering team worked on their own time to create an interactive video game that has become the centerpiece of our technical recruiting efforts at conferences and events"; and "many of our company's best ideas have been green-lighted because a team member went on a tangent without committing excessive resources to the pursuit before getting other team members involved."

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

A number of executives reported that culture enhances firm performance by encouraging and enabling superior execution. As one executive said, "culture is like the tendons and ligaments that hold the body together and allow it to be healthy as a body and execute daily." Another executive likened 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, but unless they are all playing from the same sheet of music at the right tempo, you will fail. If you have the trumpets playing too loud, the song won't sound right. It is that delicate balance of getting people on the same page."

Executives also reported that culture enhances firm performance by reducing "agency costs"—that is, by limiting the effects of conflicts of interests and incentives that arise in all large organizations. As one CFO commented, "Reducing agency costs is what culture does. Functionally, geographically, and by business unit, all those things people have identities with or could be sub-optimizing over and making enterprise decisions for the sake of their own silo or entity. If you have a really strong culture, it's easier for people to overcome that…sub-optimization. I've seen that in action. The stronger your culture, the lower those agency costs are…in the long run."

A number of executives also reported that the link between culture and performance and value becomes more visible in challenging macroeconomic environments. The value in bad times comes from cultures' empowering of employees to make decisions based on a long-term perspective. As one executive stated, "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… If a company has a bad culture and they are in financial stress, … they will start losing their best employees."

Or as another executive explained, "a strong culture can help a lot when times are not good because it is a way to maintain a certain discipline and consistency…you do not want people under times of stress to fall out of good habits… top management cannot always tell people directly what to do, so if [you]… want a consistency of action across the company, then you want to create an environment where… people… make decisions from the same principles and assumptions."

What keeps companies from improving corporate culture?

As mentioned earlier, only 15% of our respondents said they thought their corporate culture were "exactly where it should be." Nevertheless, 54% said their culture "needs some work but is close to where it should be," 21% said that their culture needs "considerable work," and a small minority (11%) viewed their culture as requiring a "substantial overhaul."

For the 85% who indicated that their culture is not perfect, the most important factor appears to be top management's failure "to invest more time to develop the culture." But also cited were "inefficient workplace interactions" and the failure of the culture to keep pace with "changes in the business environment."

Written responses in the survey provide additional insight into leadership deficiencies, including multiple references to "founder syndrome," "arrogance," "micro-management," "hierarchical communication (trickle down)," and "slow adoption of technology." Others noted that "silos still exist" and pointed to "lack of initiative and culpability," "frequent leadership changes [and] lack of vision" and the failure of middle managers in "transmitting/enforcing the culture to their charges." Still, others complained about "inconsistent tone at the top," with "contradictions to stated values trickle down to everyone," and about "changes in management, where the management has come primarily from another company." Still other culprits were a performance management system where "the business is eat what you kill, which at times doesn't foster teamwork" and "financial targets set by CEO on a top down basis without input from staff."

To overcome these obstacles to an effective culture, our interviewers offered the following suggestions:

1. *Need for new leadership*: As one executive told his story, "the company had grown and was in a great niche, and was led by the same guy for many years—so there was more of a sleepy culture with not much attention to detail or accountability." A similar tale was provided by another executive who said: "we needed.. our company… to transform 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."
2. *Invest in the culture*: One executive complained that he didn't have enough people selling the cultural message: "the only way we are going to fix this culture is to [reach] people in the field. We can sit up here all we want in corporate headquarters, but unless we can convince people in the field to get on board…, this ain't gonna work."
3. *Adjust social norms*: A key theme emerging from the survey and interviews is that for stated cultural values to have the desired effect on business outcomes, they must be complemented and reinforced by norms that dictate actual behavior and formal institutions. For example, one executive said that although the cultural insistence on collaboration at times often helped his firm succeed, it also led to lack of individual initiative and inefficient workplace dynamics: "we don't move without consensus; apparently employees think that companies are democracies instead of benevolent dictatorships. And so, unless somebody raises their hand, nothing gets done."

Measuring the effectiveness of corporate culture

A number of researchers have attempted to measure various dimensions of culture using publicly available data. They do so by using advanced measurement techniques that make use of computational linguistics and granular data on companies.[11] But measurers of culture can be far more art than science, and so make little claim to precision. For instance, several of these approaches focus exclusively on HR or corporate social responsibility measures, even though culture is bound to have many other dimensions.

We explored the reliability of external measures of the effectiveness of corporate culture by correlating the survey data with crowd-sourced employee reviews from Glassdoor. We compared employee responses to the survey question "Our firm's corporate culture: 4 = is exactly where it should be, 1 = needs a substantial overhaul." The higher the survey score, the more effective the perceived culture. This analysis revealed a significant positive correlation, indicating that Glassdoor reviews align with executives' perceptions of culture.

While Glassdoor offers valuable data, our survey and in-depth interviews provided additional insights into the elements of culture deemed most important, offering a more comprehensive view than Glassdoor alone. In fact, given our general finding that the values espoused by management, the social norms adopted by employees to live out those values, and the formal institutions at the firm all work together to determine the effectiveness of the current culture, we concluded that no single source of publicly available data is likely to tell the whole story—and that the best approach is to construct composite measures that aggregate across a variety of data sources.

To make a first attempt at aggregating across multiple sources, we next assessed corporate websites for external validation, analyzing whether they reflect the culture executives advertise or aspire to. Using archive.org, we extracted cultural values from companies' websites as of the survey date and compared them with executives' survey responses. We found a weak statistical link between website-stated values and executives' views. This suggests either strategic misrepresentation on websites such as code-switching or that website values are aspirational.[12] To clarify this, we summed the absolute differences between cultural values listed on corporate websites and those mentioned in executives' descriptions of current culture. Our findings indicate that greater misalignment between executive perceptions and website portrayals correlates with descriptions of the culture as ineffective.

Triangulating between various sources appears most effective, yet executives consider direct conversations with firm personnel,

[11] Gorton, Gary, Jillian Grennan, and Alexander Zentefis. 2022. "Corporate Culture." *Annual Review of Financial Economics* 14, 535-561; Grennan, Jillian, and Kai Li. 2023. "Corporate Culture: A Review and Directions for Future Research" in Hilary, Gilles and David McLean, eds. *Handbook of Financial Decision Making*, Chapter 5, p. 141. Edward Elgar Publishing.

[12] Grennan, Jillian 2020. "Communicating Culture Consistently: Evidence from Banks." https://papers.ssrn.com/sol3/abstract_id=3350645 documents systematic differences in the cultural values described in the investor relations, career, and about us sections of corporate websites, suggesting some strategic misrepresentation.

akin to those conducted through expert networks, appear to be the gold standard. As one executive expressed, "I don't think you could [measure] it without the benefit of working there, to be quite honest." When asked how they assess the culture of another company like a potential acquisition, one 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…. I visited the company and got a sense of the engagement of the employees, [and the extent to which] these people were going to buy into… this change."

To help overcome some of the limitations of existing approaches, we asked our CEOs and CFOs to suggest other potential publicly available data to measure corporate culture. Listed below are some potential ways to come up with a more complete measure:

1. *Conference call transcripts/analyst reports*: One CFO recommended that researchers "look at the transcripts of the earnings call…. There you can pick out the tone and the words of the CEO and [learn a] 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."[13]

   Another CFO suggested the use of analyst reports "because if you can find the right five or six analysts that cover companies, most of them will take the time to go out and visit the company in person, meet the management teams, and you can see in their notes their feelings about the company."

2. *Employee age/tenure*: As one executive explained, "age gets you some sense of which generation and the diversity of age, so you get the demographic pieces of the firm." Another advocated looking at 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 use of turnover was suggested by another executive (who did not work at GE) who said, "when Welch was head of GE, he stated openly that he expected 30% 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."
3. *Company's external communications*: As one executive suggested, "you can also read not [only] the shareholders' letter in the annual report, but [also]… the letters to employees. And.. the press releases with results and how they communicated with analysts."
4. *CEO change*: As one executive said, "you should look where there has been a change in the CEO role, where they have brought the CEO from the outside, and track what operational changes were made. That will showcase cultural changes."

   As another executive commented on a different CEO change, "[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]."
5. *External websites with employee opinions*: Another suggestion was to look at "third-party services that employees use to communicate whether they love the company or not." But as one executive pointed out, "of course the content there has a negative bias, but you will get a sense of what people really think about the corporate culture." And as he went to caution, however tempting it is to rely on quantifiable metrics like spending on employee benefits, "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."
6. *Communication patterns*: One executive suggested, "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?"

Other executives cautioned against concluding too much about corporate culture from externally visible happenings and data, such as employee turnover. For as one executive commented, "we might have 100% retention, but are we retaining the people that…we really need to fire, but we don't like to fire people, so we just move them around all the time?" Another CFO warned against relying on mission statements and published employee codes of conduct. He said, "every company [now has an].. employee code of conduct but that won't give you much insight on culture because that is so much focused on [compliance and] the behaviors that aren't acceptable and[, as a result,] they look very similar from company to company."

Another executive had a similar reaction along with 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." And to explore the extent to which this feeling was representative, we asked a survey question asking how closely their current corporate culture tracks closely with the firms' stated values. Only 51% of executives said that their culture matches the values "very closely."

CONCLUSION

Corporate culture is under siege, driven by shifts in employees' personal values and working norms, in the wake of the pandemic. As highlighted by the rise of movements like "Quiet Quitters," "Lazy Girl Jobs," and the "Great Resignation," many leaders are rethinking how best to motivate and retain employees. This shift is further intensified by the increasing necessity for digital reskilling, especially with the rise of technologies like generative AI.

Having an effective corporate culture can foster a motivated workforce and bring success to firms. Why? Because an effective culture enhances profitability and value by promoting employee productivity, creativity, long-term focus, appropriate risk-taking, compliance with regulations, and limiting earnings management.

[13] Conference call transcripts have recently been used to quantify culture, see: Li et al., 2021. "Measuring Corporate Culture Using Machine Learning." *Review of Financial Studies* 34, 3265–3315.

Through a series of in-depth interviews and a comprehensive survey, we found that culture works by bringing unity to employees' perspectives through the expectations they have for how they need to behave to fit in and succeed in their firm. When executives invest in culture, as well as the governance and incentive systems that reinforce it, they can achieve an effective culture. These cultures help executives realign employee expectations with their changing work environment, enhancing resilience and ultimately, business success.

This study synthesizes existing evidence to argue that corporate culture, often misunderstood and under-researched, is a crucial driver of firm performance and value. Over 90% of surveyed CEOs and CFOs acknowledge its impact on productivity and value, with many willing to abandon acquisition targets due to cultural mismatches.

Senior leadership, particularly CEOs, largely shapes a company's culture, reinforced by board-directed compensation schemes. Despite measurement challenges, our interviews suggest ways to quantify culture's effectiveness and benefits. However, much more attention needs to be paid to culture in research in economics, finance, and accounting. Researchers need to heed executives' suggestions and build robust measures of culture from public data. While our approach of triangulating survey and interview data with crowd-sourced employee reviews and advertised values on websites shows promise, much more work needs to be done to determine causal links between culture and risk-taking, profitability, firm value, M&A decisions, and employee creativity and productivity.

In fact, CFOs, who are often skeptical of intangible factors, have consistently emphasized culture's importance throughout our work. Giving quantitatively-minded leaders, quantitative measures of culture may finally help make the business case for investing time and resources in culture. As our research makes clear corporate culture is vital, possibly more so than traditionally emphasized finance metrics. And so, in this new era for leaders and employees, interpreting success or failure requires a nuanced understanding of how corporate culture interplays with broader organizational and economic trends.

From the early days of this project almost a decade ago, we heard repeatedly and insistently, 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 the series of surveys and interview findings summarized in these pages hold up to the test of time and the new challenges leaders face to motivate and retain employees. Importantly, the evidence conveys a powerful message that academics and practitioners need to hear: Corporate culture does matter, and it may well matter a good deal more than many of the things that finance academics have long focused most of their attention on.

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