Corporate Culture and the Bottom Line

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The paper deals with the effects of corporate culture on financial performance. Previous authors have suggested that culture has an impact on financial performance. Unlike previous studies which have only examined the effects of culture on financial performance using cross sectional data, this study was done in a single organization. The company had twenty relatively comparable divisions, and provides a somewhat rare, if not unique, opportunity to assess the effects of corporate culture on financial performance.

The results, using a regression analysis, suggest that there is a statistically significant relationship (at 0.05 level) between culture and financial performance (measured by 'EBIT,' or earnings before interest and taxes). Thus these results provide support for the previously hypothesized relationship between culture and financial performance with significant implications for management theory and practice © 2001 Published by Elsevier Science Ltd. All rights reserved.

Introduction

During the past decade it has become recognized that 'corporate culture' has a significant impact on overall organizational performance (Siehl and Martin, 1990; Kotter and Heskett, 1992). Explicitly or implicitly, it has been presumed that corporate culture affects the overall financial performance of a firm. In spite of this presumption, there has been very little empirical research dealing with the financial effects of corporate culture. In one notable exception, Kotter and Heskett (1992) conducted macro-level research on different companies, and compared samples of (*a priori*) 'strong culture companies' with 'weak culture companies' (1992, p. 19) from 22 different industries. However, neither they nor others have done much research on the effects of culture on financial performance of a single firm. In part, this might be due to the difficulties of gaining a suitable research site. Nevertheless, there is a gap in our understanding of this phenomenon. Accordingly, the purpose of this article is to report the results of a field study of the impact of corporate culture on the 'bottom line,' or financial performance, of a firm. It presents the results of a relatively singular opportunity to investigate the relationship between corporate culture and financial performance in a single firm.

The Nature of Culture

The concept of corporate culture has become embedded in management vocabulary and thought. Although there are many different definitions of the concept, the central notion is that
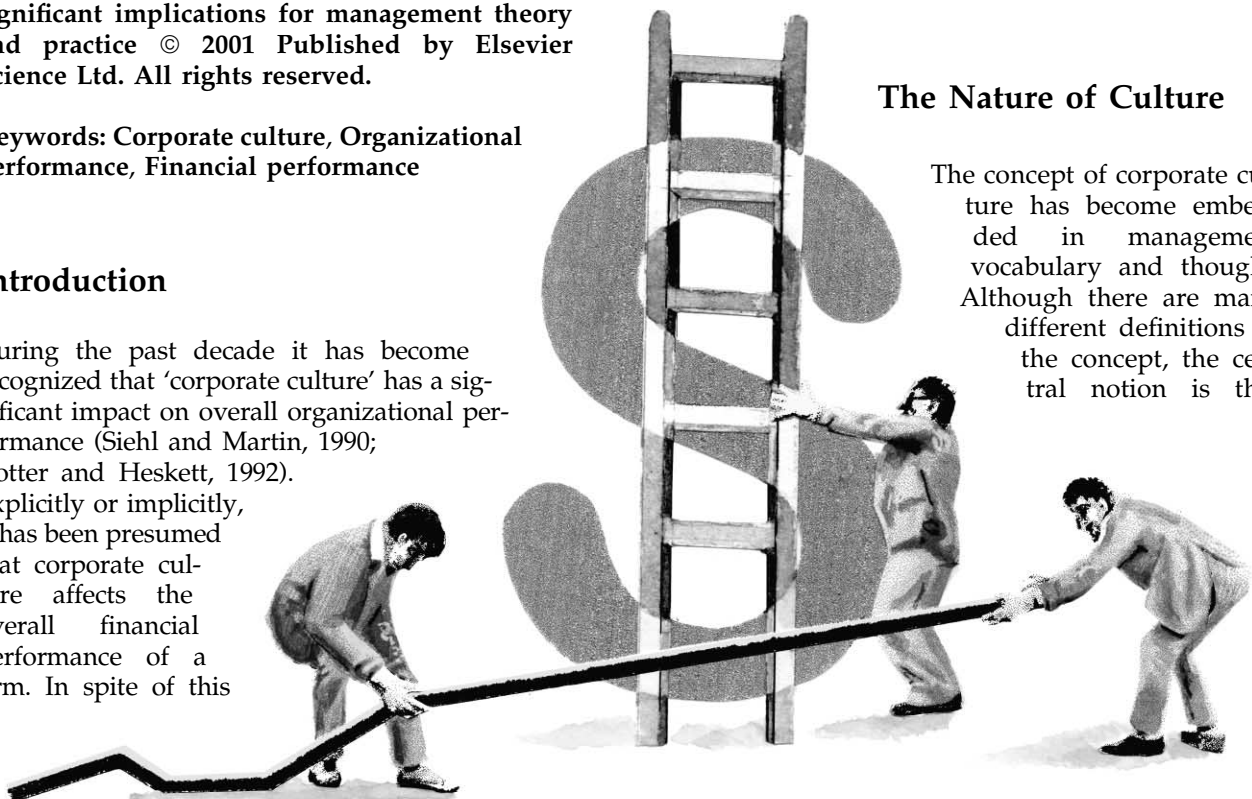
culture relates to core organizational values. In turn, values are things which are important to organizations and underpin decisions and behavior. All organizations have cultures or sets of values which influence the way people behave in a variety of areas, such as treatment of customers, standards of performance, innovation, etc.

An increasing number of successful organizations have, at least in part, attributed their success to effective culture management. For example, Starbucks Coffee Company, which has grown from just two retail stores in Seattle (USA) to more than 2500 stores world-wide during the past decade, views culture as a critical factor in the organization's success (Schultz and Yang, 1997; Flamholtz and Randle, 1998). Specifically, the company's paradigm is that: 'the way we treat our people affects they way our people treat our customers, and, in turn, our success, which includes financial performance.' This belief has led the company to a number of human resource practices that are designed to enhance people's feeling of being valued by the company. These include the widespread use of stock options and the practice of providing full benefits to all employees who work more than 20 hours per week.

There are many areas in which corporate culture influences behavior and decision-making. However, there appear to be four key areas in which all organizations must manage their culture or values: (1) the treatment of customers, (2) the treatment of an organization's own people or human capital, (3) standards of organizational performance, and (4) notions of accountability. These are the 'key areas of cultural concern' for all organizations. Naturally, there are also many other areas of organizational performance that are of concern, but these tend to be more idiosyncratic to specific firms. Such additional areas can include beliefs with respect to innovation, corporate citizenship, openness to change, as well as others.

Culture and Organizational Performance

The basic paradigm underlying the notion that culture affects performance is based upon a few key ideas. The first is that culture affects goal attainment. More specifically, companies with 'strong' cultures are more likely to achieve their goals than those with relatively 'weak' cultures. So-called 'strong-culture organizations' are thought to have a higher degree of organizational success (measured in market value or other financial measures of performance), because of a believed link to motivation. As stated by Kotter and Heskett, strong cultures are often said to help business performance because they create an unusual level of motivation in employees (1992, p.16).

In addition to the hypothesized relationship between culture and financial performance, culture also has come to be viewed as component of other organizational effectiveness or success models (Flamholtz and Randle, 1998, 2000). It has been theorized that the role of culture, as part of a six factor framework, explains organizational effectiveness and, in turn, financial performance (Flamholtz, 1995; Flamholtz and Randle, 1998, 2000). Specifically, culture has been viewed as a critical organizational development area, or key strategic building block, of successful organizations. This framework has, in turn, been supported by further empirical research (Flamholtz and Aksehirli, 2000).

Research Design

The intent of the present study is to determine whether corporate culture has a significant impact on financial performance. As noted above, although this issue has been addressed in part by Kotter's and Heskett's study of culture across companies (1992), the current study differs from prior research in that it utilizes data from a *single* company with 20 operating divisions. This section describes postulated relationships and the nature of the research design, including the research site, the methodology used to measure culture, and the research questions.

Research Strategy

This study was conducted as part of a program of action research on a medium-sized industrial enterprise. The company was engaged in an organizational development program designed to enhance overall organizational effectiveness, and, consequently, financial performance. During the program, it became apparent that culture management, discussed further below, was a critical area for the company's organizational development. As a result, it was possible to assess the impact of a company's culture on its financial performance as a byproduct of the ongoing organizational development program.

Research Site Description: 'Banner Corporation'

The research site (for which we shall use the pseudonym, 'Banner Corporation') is a US-based, medium-sized industrial enterprise. Banner represents the classic 'old economy.' The company is a parts manufacturer for industrial, truck and other automotive businesses. It is a supplier of parts for such companies as Ford Motor Company, Navistar, and Dana Corporation.

Reasons for the Study

The company was formed primarily through acquisitions in a classic 'roll up' strategy, a strategy of

industry consolidation through acquisitions. It consisted of several different 'divisions,' each of which had been stand alone entrepreneurial companies, with revenues ranging from about $25 million annually to about $100 million. Altogether, the twenty divisions totaled about $800 million in annual revenue at the time of this study. These divisions consisted of a set of reasonably related technologies, such as foundries and forges. The foundries ranged from processing capacity for 'grey iron' to 'ductile iron' to 'lost foam' to other similar technologies. The nature of the business of such entities is 'job order manufacturing.'

The similarities between the divisions present a relatively unique opportunity for comparison. The company had been formed from a set of stand-alone companies, so there was no common Banner Corporation corporate culture. Each of the individual companies, or 'divisions,' as they were termed, operated in various parts of the United States. Many still kept their own names and logo after acquisition by Banner Corporation. An organizational assessment had determined that some employees of Banner did not know who the parent company was and others seemed not even to care.

Although this might even have been a sufficient reason to undertake a culture management project, the actual driving reason was to support a fundamental change in corporate strategy. Specifically, the 'old' strategy had been to consolidate a fragmented industry and allow the individual companies (divisions) to operate autonomously, with a few corporate policies and systems. The 'new' strategy was to leverage the company's critical mass and use its combined resources to serve large clients, such as Ford, Navistar, Dana, etc. This required a cooperative effort among the divisions of sales and order fulfillment.

Therefore, this research was a component of an overall cultural management program designed to create a common Banner Corporation culture. The organizational development objectives were to: (1) develop a culture or set of values, or a desired culture, for Banner Corporation, (2) measure the extent to which people throughout the company agreed with the proposed culture, (3) measure the extent to which people perceived that the organization was actually behaving in ways consistent with the stated culture, and (4) design strategies to increase the extent to which the stated or desired culture actually pervaded the organization.

The overall culture management program is shown graphically in Figure 1. As seen in Figure 1, the culture management process begins with the identification of the existing corporate culture. These are the current actual values of the organization with respect to certain key dimensions, such as treatment of customers, etc. The next step is to formulate the ideal or desired culture of the organization. These are what
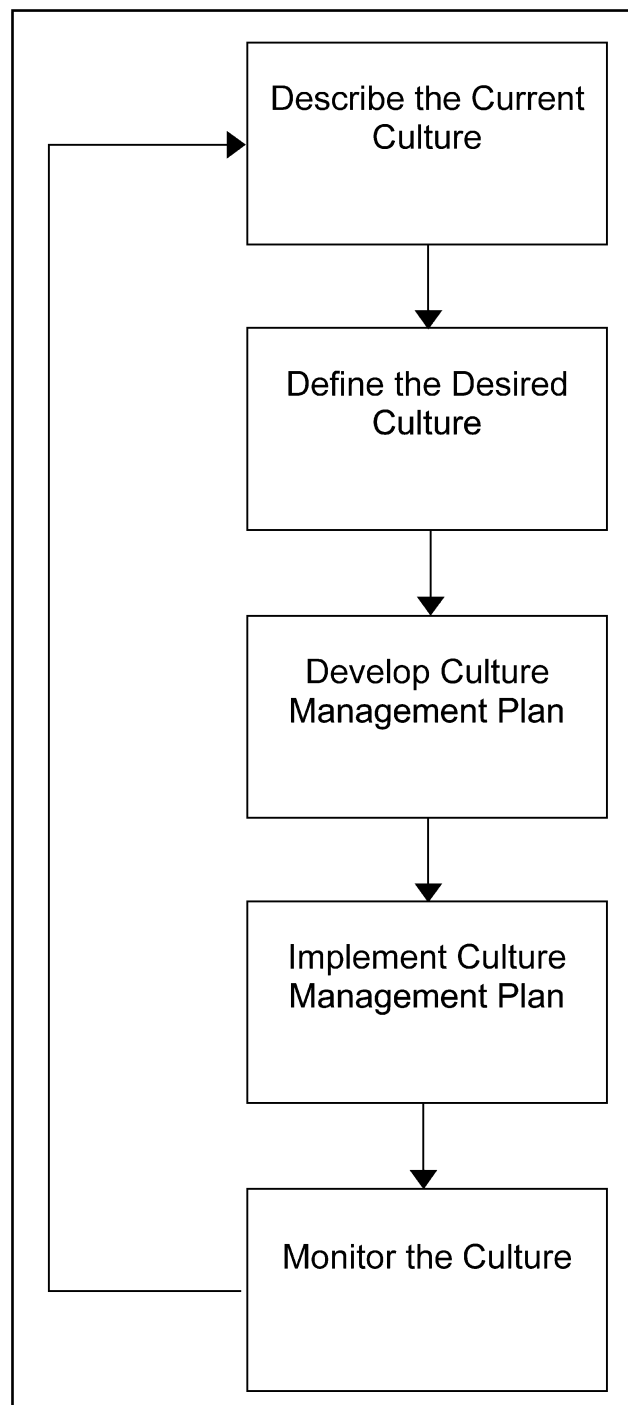

Figure 1 Culture Management Process

the organization wants the culture to actually be or become. In addition, this desired culture can be viewed as the organization's 'strategic culture' because it is intended to support the overall strategic development of the enterprise. It should also be noted that steps 1 and 2 can be reversed, with the identification of the desired culture first and then identification of the current culture. This can be necessary in situations where there is no strong pre-existing culture.

The third step in the culture management process is to assess the extent to which the current and desired

culture are consistent and identify any 'cultural gaps,' that is, significant differences between the current and desired culture. This is accomplished by means of a culture questionnaire, as described below. The three steps above are the key steps of concern to us in this research. However, for completeness, the remaining steps include: (4) the development of action programs to change the culture, and (5) monitoring cultural changes to assess the effectiveness of the culture management program and determine the necessary future interventions.

Research Question

The general research question this article addresses is: Is there a relationship between a corporate culture and the financial performance of an organization? There was also a more specific research question in the context of this study. We were interested in determining the relationship between: (1) the extent to which people in the divisions accepted the stated culture of the company and (2) the company's financial performance. More specifically, as a result of the nature of the formation of this company, there was no common or unified 'Banner Corporation' culture, so we were able to observe the full effects of a culture on Banner's financial performance.

Methodology

This section describes the method for the research as part of the overall culture management process. First, we shall describe the action project at the company. Then we will discuss how the research was conducted as part of that project.

The first phase in the process was to formulate the desired corporate culture, or the statement of core values designed to guide the development and functioning of the organization. Although some organizations have pre-existing statements of values, others including the current research site, have explicit or implied cultures but not formal statements. In this instance, because it was created as part of a 'roll up strategy,' the company did not have an explicit cultural statement.

The first step in this phase was to train the senior management team (including the CEO, CFO, Senior Group VPs, VP of Human Resources, and selected others) in the nature of culture and culture management. The management team was already familiar with an organizational success model, which included culture as one of the key building blocks of successful organizations (Flamholtz, 1995; Flamholtz and Aksehirli, 2000). The model is shown in Figure 2. This model defined culture as the 'values, beliefs, and norms which govern or influence the behavior of people in organizations.'

The next step in this process was to develop an explicit statement of cultural values. To facilitate this, a set of key categories were used. These are the key categories, or key areas, in which culture is manifest in (Flamholtz and Randle, 2000). They include: (1) the way people are treated by the organization, as well as the implicit or explicit view of people, (2) the way customers are treated by the organization, (3) the standards of performance and accountability, (4) the teamwork among people in the organization, and (5) corporate 'citizenship' (or the way the organization operates as a member of its communities). Although there are other possible areas or arenas in which culture can be manifest, these were the ones that identify *a priori* as the key starting point for the development of a formal statement of corporate culture.

The next step was to identify a set of statements which defined the desired culture of the organization in each key area, for example, treatment of people, treatment of customers, etc. The intent was to develop a statement of the ideal way the company should culturally function in all of these areas. This was done through facilitated discussions of the way the organization wanted to work and what it wanted the culture to be on all of these key dimensions. For example, the senior management team discussed the ideal way people would be treated at Banner Corporation and then converted this discussion into a set of cultural statements (see Appendix A for sample cultural statements).

Once these cultural statements were formulated, the next phase was to determine whether there was agreement or 'buy-in' throughout the organization. To assess this, these statements were assessed on a Likert Scale. Specifically, the statements were used as part of a cultural assessment questionnaire to determine the degree of agreement by members of the organization.

The questionnaire was administered to all salaried employees of the organization (950). The questionnaire was designed with two objectives: (1) to determine the extent to which people throughout Banner Corporation agreed with the stated or desired culture, and (2) to determine the extent to which people perceived that each division, as well as the corporate office (headquarters), was behaving in ways consistent with the desired or ideal corporate culture. The response rate was 78 per cent. However, what was truly astounding was that over 96 per cent of those who responded agreed with the stated or ideal culture of Banner Corporation. This meant that the senior executive team had truly tapped in to the way that people throughout the corporation wanted the company to be managed.

The next phase of the action project to improve culture management throughout Banner Corporation was to conduct a workshop designed to analyze and interpret the data derived, as well as to develop goals
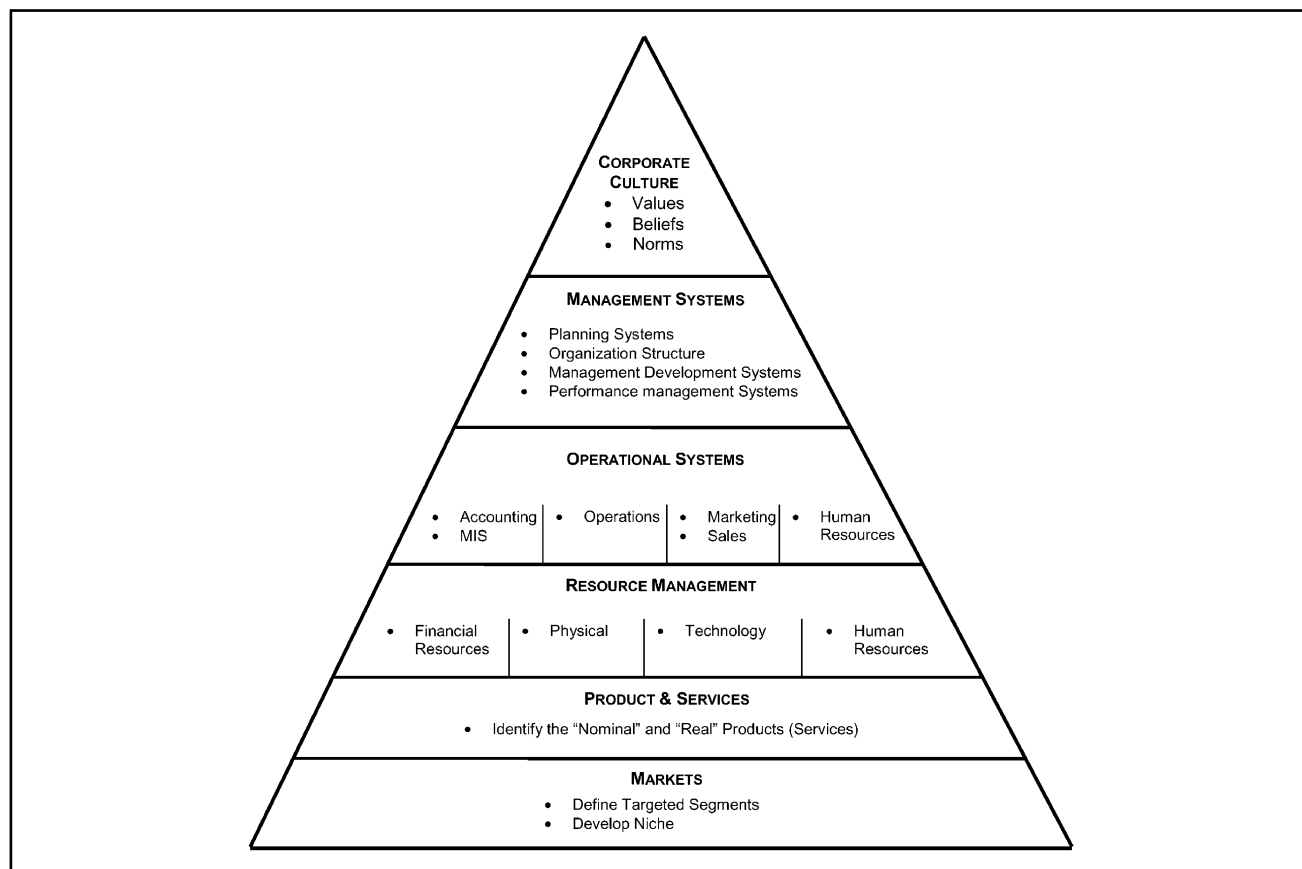
Figure 2 Pyramid of Organizational Development: The Six Key Building Blocks of Successful Organizations

and action steps of the effective management of the culture. Since this is not relevant to the current study, it will not be discussed further here.

Hypothesis Testing

The data was also used as an input to the research to address the question concerning the impact of corporate culture on the financial performance, or 'bottom line,' of organizations as described below. To assess this issue, we compared divisional data with divisional 'EBIT' (earnings before interest, and taxes), a classic measure of financial performance and the one that Banner Corporation also uses to assess its own divisional performance. Specifically, we ran a regression between: (1) the degree to which each division was perceived by its own personnel to be 'living' the desired corporate culture and (2) EBIT. The former variable can be measured as the degree of agreement between the desired corporate culture and the culture that is perceived to exist. The basic hypothesis is then: that the greater the degree of agreement between the desired corporate culture and the culture perceived to exist, the better the financial performance. Stated differently, the divisions which perform best financially are those that behave in ways consistent with the company's desired culture, whereas the lowest performing divisions (financially) are those that behave in ways inconsistent with the desired culture.

Results

The data derived and used in this comparison are shown in a graph in Figure 3. The x-axis shows a 'divisional agreement with corporate culture score.' This is a measure of the degree of similarity between the desired corporate culture and the culture perceived to exist in each division. It can be viewed as a measure of cultural 'buy-in' by the divisions. This is the extent to which people perceive that their division is behaving consistently with the company's desired culture. Operationally, we measured agreement by the '% favorable responses' to value statements, where % favorable was defined as the sum of responses which were 'to a very great extent' and 'to a great extent' (on a Likert scale). The y-axis presents EBIT values for the various divisions. Accordingly, Figure 3 shows the relation between the degree of cultural agreement between the division and the corporate culture and EBIT for all divisions.

The regression equation describing the relationship among variables in Figure 3 is: $y = 0.3888 \, x - 18.015$. $R^2 = 0.4552$, and was statistically significant at the 0.05 level.[1] This means that approximately 46 per cent of EBIT is explained by the variable of corporate culture, or cultural 'buy-in'.
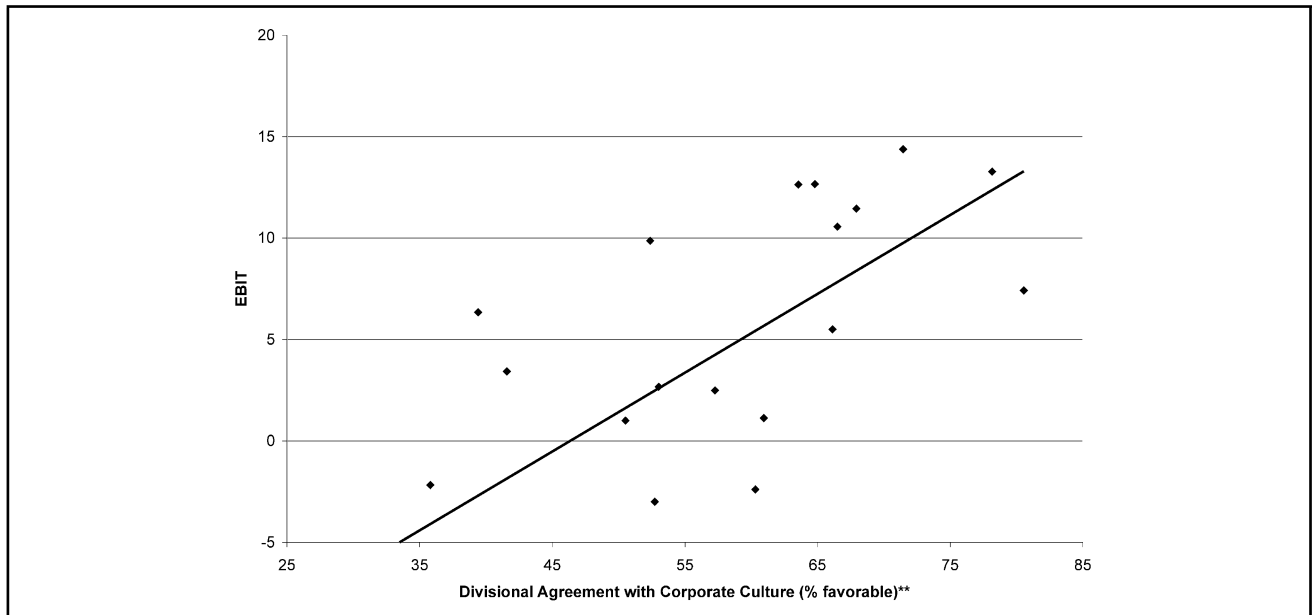
Figure 3 Divisional Cultural Agreement vs EBIT
**This is the "Percentage Favorable Response" to value statements by divisional personnel, defined as the sum of responses "To a very great extent" and "To a great extent", using a Likert scale

Conclusions, Implications, and Future Research

The data derived from this study demonstrate that organizational culture does have an impact on financial performance. It provides additional evidence of the significant role of corporate culture not only in overall organizational effectiveness, but also in the so-called 'bottom line.' This has important implications for management theory and practice. It is one thing to assert that culture is a significant factor of organizational success and quite another to be able to demonstrate that the effective management of culture can enhance profitability.

Management Implications

In the current study, the data suggest that the divisions which adhered to the desired corporate culture had greater profits, as measured by EBIT, than those that did not adhere as closely to the desired corporate culture. When these data were presented at the research site as 'preliminary' findings, one of the senior executives asked, 'Let me understand this. Do you mean to suggest that those divisions which show greater adherence to our desired or ideal corporate culture are more profitable than those that do not?' When the reply was 'yes,' he then said, 'Well, if that is so, then the data are not preliminary.'

Based on this finding, the corporation then added 'effective culture management' as a key result area of the divisional performance management system. This meant that divisional general managers were to be held responsible for measurable improvements in reducing the gap between the desired or ideal culture and the actual divisional culture. In addition, this factor was to be used in the incentive compensation system of the company.

Future Research

From an academic perspective, the results reported here are preliminary but quite promising. It would be valuable for future research to replicate the current study. However, this will require a research site comparable to the Banner Corporation. The research site does not require a whole industry, only the existence of a large number of relatively comparable divisions. Nevertheless, this is difficult to do in practice.

Conclusion

This study has provided a relatively rare opportunity to assess the impact of corporate culture on financial performance in the context of a single company. The results provide support for previous theoretical work on the importance of culture, as well as the role of culture, in models of organizational success.

While the results are not completely definitive, they do provide statistically significant evidence of the impact of culture on the 'bottom line.' This visible impact of culture on the bottom line is of critical importance as a basis for influencing managerial practice and increasing the extent to which culture is truly seen and managed as a significant variable.

Appendix A

Banner's Cultural Principles

For your reference, the following principles define the culture that Banner desires.

Our Vision... To become the leading component supplier to the capital and durable goods industries on a global basis.

Our Customers...

❖ We view our customers as the most important element in our business. We will listen to our customers.
❖ We will make business decisions with our customer's perspective in mind.
  This means that we commit to thinking from an 'outside-in' perspective vs. thinking primarily from an internal perspective about what works best for us.
❖ We will treat all customers with respect.
  Although we may have different standards for the level of service we give to selected customers, we value ALL of our customers and will treat them professionally.
❖ We will keep our commitments to customers.
❖ We will use the customer's measurements as our 'scorecard.'
❖ We will strive to exceed the customer's expectations.
  We want to 'delight' our customers. To differentiate ourselves from our competition, we need to try to exceed customer's expectations. This does NOT mean that we will accept unreasonable requests from our customers or that we are committed to providing services that the customer will not pay for.

Our People...

❖ Our people are Banner's most valuable asset.
❖ We will be known for having the best people in our industry.
❖ At Banner, we will treat people with respect and preserve human dignity.
❖ We will provide a safe, clean and challenging work environment for all of our people.
❖ We will invest in the development of our people. We encourage people to pursue continuous personal improvement, enabling them to grow with the company.
❖ We will be equitable in hiring, compensation, and promotion.
❖ We value every employee's input.
❖ We will communicate openly with our employees.

Performance Standards and Accountability...

❖ We will continuously improve in everything we do and will strive to be 'best in class'.
  We will measure our performance against the highest standards. Perfection is our ultimate goal. We will also benchmark our performance against competitors.
❖ We expect everyone at Banner to act with honesty and integrity.
  Honesty is an absolute standard for all of our activities, including communication within Banner, communication with customers, and communication with external agencies. Anything less is unacceptable.
❖ Within Banner we will communicate clear expectations, evaluate results, give constructive feedback, and reward performance.
  We will implement corrective action plans when performance is less than expected.
  Low performance is unacceptable.
  We will hold business units accountable for achieving their plans.

Teamwork and Communication...

❖ Open and timely communication on all issues (good and bad) is expected and encouraged.
❖ Asking for help is encouraged, and we expect assistance to be provided by anyone who has the ability to help.
❖ We want to be recognized as **Banner** by everyone (customers, employees, suppliers, shareholders, and the communities in which we operate).
❖ All divisions will use the official Banner logo as their logo.
❖ At all levels of the organization, we expect decisions to be made based on what is best for Banner.
  In making decisions at the division level, managers will first consider what is best for Banner — before considering what is best for the division.

Corporate Citizenship...

❖ Banner will be a good citizen of the communities in which we operate.
❖ We will be visible within the community.
  Whenever feasible, business units will make charitable contributions and participate in local civic organizations.
  We want our business units to be successful, so that good jobs are maintained within their local communities.
❖ We will be a good neighbor in maintaining plant appearance and complying with environmental standards.
  We will find ways to be a good neighbor, while at the same time running an economically viable plant.

Note

1. $y = 0.388x - 18.015$

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