Investigating organisational culture from the 'outside', and implications for investing

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Dr Alex Gillespie and Dr Tom Reader consider how organizational culture can be researched from 'outside' an organization and what dimensions could be of particular interest for potential investment decisions.

Organisational culture has consistently been shown to predict a range of performance metrics, including an organisation's return on assets (ROA), return on equity (ROE), return on investment (ROI), operating margin, market share developments and sales growth.[1] Future success or failure is often apparent and embedded in the cultural properties of an organisation. So, for any stock-picker, being able to measure and assess the culture of an organisation could potentially provide a valuable (and often neglected) addition to the decision-making process.

Yet this is challenging because culture studies typically involve going 'inside' an organisation to collect data (e.g. surveys, interviews, focus groups). For investors, such data is generally unavailable and so alternative indicators of culture are required. This reflects a gap in the academic literature, whereby research is critiqued for focussing too heavily on the subjective viewpoints of organisational members, who may often be unaware of aspects of their culture, or lack insight on cultural dimensions that are externally orientated (e.g. product/service quality).

Dr Tom Reader and Dr Alex Gillespie, funded by the AKO Foundation (a UK charity),[2] aim to explore this issue: specifically, whether organisational culture can be measured utilising data from 'the outside' – for example using analysis of company call transcripts, social media buzz, CEO presentations, annual reports, customer complaints, financial data, board composition, executive attrition, and so forth. Through this innovative focus on these external, unobtrusive indicators of culture, the aim is to examine whether the cultural profiles of organisations can be i) linked to dimensions of culture (see below) and measured in a standardised fashion; ii) associated with performance metrics; and iii) used to support decision-making for investing in companies.

This research aims to address academic questions on how organisational culture should be conceptualized and measured, and is designed to have real-world application.

What is organisational culture?

Organisational culture refers to the values and practices shared within an organisation. The proposal is that, from the boardroom to the shop-floor, the culture of an organization shapes the attitudes and behaviours of its members, and this in turn influences its performance.

Specifying exactly what culture consists of, however, is elusive. The team has identified over 40 definitions of organisational culture within the academic literature. In some cases, definitions of culture are succinct – a former managing director at McKinsey simply described culture as "the way we do things around here."[3] In other cases, definitions of culture are complex and multi-faceted. Schein argues that an organisational culture consists of: i) a shared and explicit framework of values and beliefs by which employees make sense of and undertake their work; ii) internalised and non-conscious assumptions (e.g. on questioning authority) that shape how people think, feel, and act; and iii) the systems, procedures, and histories that provide the context in which people function.[4]

Nonetheless, it is universally accepted that all organisations have a distinctive culture or personality which shapes how people behave within them.[5] From an academic – and indeed, an investor – standpoint, however, questions remain about the types of culture that best engender organisational performance, and the ways in which a culture can be measured.

Which aspects of an organisational culture influence performance?

The organizational culture literature is vast; there are over 4,000 academic papers with the term in either the title or abstract. Empirical papers typically characterise an organization's culture by 'dimensions,' and attempt to examine whether and how these predict organizational outcomes such as financial performance. Culture dimensions are somewhat akin to personality traits, with dimensions referring to different aspects of organizational life (e.g. innovation, ethics, adaptability). These dimensions can be assessed through employee surveys, interviews, observations, and ethnographies. Organisations are assessed first in terms of whether they are high or low on any given dimension, and then on the impact of this upon organisational performance. For example, in technological industries, a culture that fosters innovation is essential for performance.

People orientation

Over one hundred studies specify a link between organisational performance (e.g. profitability) and factors such as increased job satisfaction, employee commitment, work engagement, and employee well-being. This reflects the 'people orientation' of an organisation, whereby it supports employees through placing emphasis on training and growth opportunities, rewarding and publicly recognising work, and supporting employees when they have difficulties. Employees reciprocate the support of the organisation through being more committed to it, which leads to increased effort, innovativeness, fewer absences, and lower employee turnover.

Despite the common-sense link between people orientation and organisational success, organisations do vary in their people orientation. Examples include the Virgin Group (where employees are allowed flexible working hours, given discounted gym memberships, and achievements are publicly celebrated) and Sports Direct (where zero-hours contracts were criticised as "nineteenth-century working practices" and investigated by a House of Commons Select Committee). Yet people orientation is consistently shown as critical to performance, as illustrated in a Gallup review which found that 70% of US employees are not engaged in their work, costing businesses up to $550 billion in lost productivity annually. Indeed, experimental research shows that simply giving employees a personalised 'Thank You' card results in increased performance.[6]

Ethical orientation

Ethical orientation relates to the moral position of an organisation, and the extent to which there is a culture to ignore the 'right' route in order to gain short-term advantage. As demonstrated in 63 research studies, the ethical practices employed by a company can have an influential impact on performance.[7] Recent examples include the Volkswagen emissions scandal and Toshiba admitting that it had overstated its earnings by nearly $2 billion. Conversely, we point to L'Orèal, honoured as one of the World's Most Ethical Companies every year since 2012 by the Ethisphere Institute.

Research into organisational culture has extensively examined the ethics of reward structures, and shown them to shape organisational behaviour and performance. One study investigated CEO's incentives to cheat as a result of stock options.[8] Data was obtained from the U.S Government Accounting Office, which identified companies with accounting irregularities. The sample included 434 misrepresenting firms, with a sales range from $357,000 to $39.1 billion. The restatements covered a range of specific types of misrepresentation including adjusted revenue or expenses and stock-related issues. The study concluded that high CEO compensation delivered by stock options increases the chances of financial misrepresentation.

Adaptability

Adaptability is an imperative survival trait, referring to an "organizational capacity to change in response to external conditions."[9] It indicates a company's willingness to learn, to innovate and take risks in order to achieve or maintain competitiveness. Twenty-two research papers have demonstrated a link between adaptability and financial performance.

The last twenty years of fast-paced innovation is littered with companies that did not adapt well to change (such as Kodak and Nokia), as well as those that did (Ryanair and Svenska Handelsbanken, for example). A recent study[10] of adaptability which examined 32 technology companies in the US and Ireland concluded that firms whose cultures were higher on adaptability had significantly stronger revenue growth, higher market valuations (Tobin's Q), higher rankings on Fortune Magazine's "Most Admired" list, were more likely to be recommended by stock analysts, and had higher employee ratings as reported by Glassdoor.

Market orientation

Market orientation refers to a culture: "that (1) places the highest priority on the profitability creation and maintenance of superior customer value while considering the interests of other key stakeholders; and (2) provides norms of behaviour regarding the organizational development of and responsiveness to market information."[11]

Across 141 academic papers examined, market orientation is consistently found to be a key predictor of financial success. This is because companies that develop and implement a market orientation culture actively obtain market information and integrate the voice of the customer into their business.[12]

One study observed fifty-six US companies over nine years to see the impact of responsive and proactive market orientation on firm performance.[13] This focus included understanding the customers' articulated needs (responsive) and having the ability to foresee customer latent requirements (proactive). The most successful companies demonstrated organisational culture with high levels of proactive market orientation. This is because it paved a way for innovation which allowed organisations to acquire new customers and increase their profits.

Other, underexplored, dimensions of culture

Alongside the above dimensions, case-study and practitioner research highlights the importance of other, and less investigated within the academic literature, aspects of culture. Examples include the extent to which a company is focused on the long-term; the clarity of communication from senior management; an organisational focus on excellence; and executive buying and selling of company stock. The team will also investigate those underexplored aspects of culture as well as the above-mentioned dimensions, in order to work towards the development of a company analysis toolkit, which is intended to be both comprehensive and practical.

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Notes

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2. The AKO Foundation is a UK charity founded by Nicolai Tangen and which is ultimately funded from the

profits of AKO Capital. The primary focus of AKO Foundation is the making of grants to projects in the areas of education and the arts and it has, since its inception, been funded by approximately £45.5 million. Recipients of funding include Teach First, Strømme Foundation and Ark. For more details on AKO Foundation and entities supported by the Foundation, see http://www.akocapital.com/40/ako-foundation

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