

Financial Returns from Organizational Culture Improvement: Translating “Soft” Changes into “Hard” Dollars

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Abstract

Culture change initiatives can lead to real financial returns. This presentation summarizes the results of a series of studies that demonstrate the strong relationship between constructive organizational cultures and financial performance. First we review cross-sectional studies confirming that constructive cultures are related to financial outcomes across organizations within the same industry. Then the results of longitudinal case studies show how organizational development programs have produced measurable cultural changes that, in turn, have led to improvements in bottom-line financial performance.

Keywords

Organizational Culture, ROI (Return on Investment)

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We discuss five different studies that validate and support the importance of the work carried out by training and development practitioners to improve organizational culture. The studies referenced use quantitative data to measure both organizational culture, via the Organizational Culture Inventory® (OCI; Cooke and Lafferty, 1987), and financial performance (based on corporate financial reports), and draw strong correlations between the two. The OCI is a well-respected survey that has been completed by over 2 million individuals over the past twenty years and is statistically reliable and valid (Cooke and Szumal, 1993).

Three cross-sectional studies linking organizational culture and financial performance are of key interest to us here. The first focuses on organizations in a variety of industries and demonstrates a positive correlation between the strength of Constructive cultural norms and earnings/sales ratios (Cooke, 2004). The second is a study by Klein (1992) that focuses on retail stores within a single chain and shows stronger sales growth at the stores with constructive cultures than at sister stores with less constructive cultures. The third is a large study of newspapers which shows many bottom-line measures are positively related to the strength of constructive norms. (Human Synergistics/Center for Applied Research, Inc. and The Readership Institute, 2001).

Possibly the best-known longitudinal study that links financial performance to adaptive (similar to constructive) cultures is the classic work by Kotter and Heskett (1992). They show that companies with adaptive cultures performed significantly better than those with non-adaptive (overlapping with what Cooke and Lafferty (1987) refer to as defensive) cultures over an 11-year period along various financial indicators. Their research design, however, is retrospective and neither survey-based nor intended to trace the impact of culture change interventions.

The two longitudinal case studies presented here complement Kotter and Heskett's research by demonstrating that investments in cultural change programs and positive changes in cultural norms are followed by significant improvements in financial performance. By suggesting that culture leads to performance, the case studies also complement the cross-sectional studies (which show significant correlations between culture and performance but do not demonstrate causality).

These research results should be of value to training and development practitioners when recommending cultural change initiatives to CEOs and other high-level executives of client organizations. The quantitative results should enable them to make a stronger case for the return the organization will realize from an investment in improving organizational culture.

Organizational Culture Inventory (OCI)

While culture can be assessed either quantitatively or qualitatively, survey-based quantitative measures provide the type of data that are useful for relating culture to performance. The survey used in the studies reviewed here is the Organizational Culture Inventory (OCI). The OCI measures the operating cultures of organizations in terms of behavioral norms, or "what's expected" of members. It includes 120 statements describing behaviors that might be expected or implicitly required of members of an organization. The results of the assessment are mapped on a circumplex—a circular graph divided into 12 sections like the hours on a clock. The twelve sections represent norms for twelve behavioral styles that cluster and statistically factor into three types of cultures:

- *Constructive* cultures, including Humanistic-Encouraging, Affiliative, Achievement and Self-Actualizing;
- *Passive/Defensive* cultures, including Approval, Conventional, Dependent and Avoidance; and
- *Aggressive/Defensive* cultures, including Oppositional, Power, Competitive and Perfectionistic (Cooke and Lafferty, 1987; Szumal, 2003).

The scores for members of an organization are aggregated, plotted on a profile and, in the process, converted to percentile scores based on statistical norms drawn from years of research that allow objective comparison of styles within and across organizations.

Cross-sectional Studies

Culture in Relation to Earning/Sales Ratios and Volatility

The first study was made possible by Tower-Perrins, which provided Human Synergistics with data on earnings/sales ratios for publicly-traded corporations over a three-year period. Human Synergistics had carried out OCI projects with many of these organizations and was able to create a data set of 69 companies that included both the financial and culture data. A measure of average performance across the three years was developed for each firm. Additionally, the standard deviation across the three years was calculated to serve as a proxy for volatility in performance (Cooke, 2004).

Correlations were carried out to see if the cultural styles were related to performance. As expected, the strength of Constructive norms across organizations was significantly related to earnings/sales ratios ($r = .22$, $p \leq .05$). No relationships between the financial measures and either the Passive/Defensive or Aggressive/Defensive styles were observed. However, the Aggressive/Defensive styles were significantly related to volatility ($r = .34$; $p \leq .01$).

These results are consistent with those of previous studies showing a positive relationship between Constructive cultures and other, non-financial, measures of performance. For example, Constructive cultural norms have been shown to be related to member commitment and motivation, teamwork and cooperation, and organizational-level indicators such as adaptability and client satisfaction (Cooke and Szumal, 2000). These positive outcomes are likely to translate into better financial performance. Additionally, the results around volatility are consistent with previous findings showing that Defensive cultures can lead to internal competition, power struggles, and an undue emphasis on short-term performance.

While informative, the power of this study (and the potential magnitude of the correlations) is limited by the fact that companies from many different industries were included. The next two studies we review focus on specific companies and industries.

Constructive Culture and Sales Growth in Retail Men’s Apparel Stores

Martin Klein, now Director of the Courage Institute, studied the culture and performance of a group of men’s apparel stores (1992). Klein divided the 44 stores in his sample into categories, including:

- *High Growth* -- stores with the largest sales increases compared to previous years and the greatest sales volume (n=11), and
- *No Growth* -- stores with the largest sales decreases and smallest total sales volume (n=12).

Having spent 20 years working in retail (Sanders) and studying various types of stores (Cooke), we can verify that retail chains place a strong emphasis on sales growth. Store managers are promoted or fired, and stores are maintained and expanded or closed, depending upon whether they can beat last year’s numbers. Those who could show consistent growth along with higher sales volume, such as those in Klein’s High Growth sub-sample, would certainly be considered “the cream of the crop” by the senior management of any retail chain.

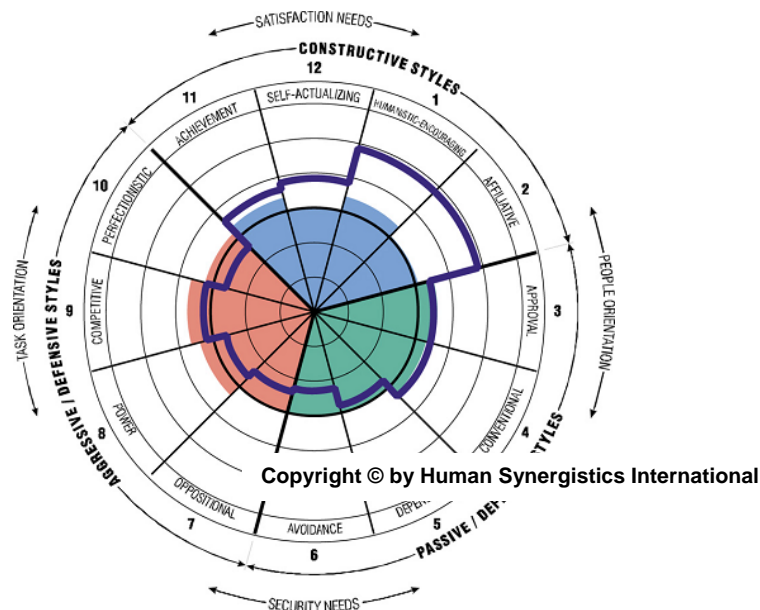


Figure 1: High Sales Growth Stores Culture Profiled against No Growth Stores (High growth stores are inside the dark line, no growth stores are in the shaded area).

The staff of each store completed the OCI, their responses were aggregated to the store level, and ANOVA (analysis of variance) tests were run. Klein found, as predicted, that the Constructive cultural styles were significantly stronger in the High Growth stores than in the No Growth stores. We took his results a step further and mapped them on the OCI circumplex, which shows the High Growth stores are higher on every Constructive cultural style and lower on most of the Defensive cultural styles (see Figure 1). Teams in the Constructive stores focused on achieving goals instead of winning competitions, on helping each other instead of fighting each other, and on working as a team instead of as a group of individuals that happen to work in the same place. This is a culture for performance, and the results confirm that it is successful.

Readership Institute Culture Results

In 2001, the Readership Institute at Northwestern University conducted *The Impact Study*, focusing on newspapers and their readers. This was a multi-faceted study designed to help newspapers grow sustainable readership through research findings that could be put into action and yield measurable results in US markets. Part of that research included assessing the organizational culture at 90 newspapers via the OCI.

The results showed that newspapers had predominantly defensive cultures, with 73 of the 90 being defensive. In these defensive cultures, “employees lose sight of the overall goal, get lost in details, and make little effort to coordinate with others. Newspaper employees also are confrontational, which causes unproductive conflict, results in safe but ineffectual decisions, and creates the inability to solve problems in a group” (Readership Institute, 2001).

However, a separate survey carried out to identify the “ideal culture” for newspapers clearly suggested that people in the industry view a Constructive culture as more appropriate. Additionally, managers tended to have a more constructive view of the current culture than others. This suggests that the Defensive cultures of the newspapers in the sample can be changed.

Table 1: Culture and Newspaper Effectiveness

Effectiveness (Outcomes)	Strength of Cultural Norms ¹		
	Constructive	Passive/Defensive	Aggressive/Defensive
<i>Individual Level</i>			
Satisfaction ²	.576***	-.420***	-.352***
Stress ²	-.255*	.245*	.303**
Turnover ³	-.193*	.104	.292**
<i>Group Level</i>			
Cooperation/Teamwork ²	.424***	-.345***	-.466***
Inter-Unit Coordination ²	.512***	-.370**	-.197*
<i>Organizational Level</i>			
Product/Service Quality ²	.455***	-.294**	-.338***
Customer Satisfaction ⁴	.046	.143	-.294**
Readership ⁴	.211*	.104	-.066
Profit ⁵	.224*	-.148	-.018

Notes:
* p < .05; ** p < .01; *** p < .001. Organizational n = 79. One-tailed correlations with list-wise deletion of missing cases. Coefficients differ slightly with case-wise deletion.
¹ Culture factor scores based on the *Organizational Culture Inventory* (Human Synergetics).
² Based on the *Organizational Effectiveness Inventory* (Human Synergetics).
³ Based on organizational records collected by the Readership Institute (Northwestern University).
⁴ Based on surveys of newspaper readers carried out by the Readership Institute.
⁵ Regression residual of profit not explained by revenue and circulation strata.
Analyses by: Robert A. Cooke, Ph.D., Human Synergetics, 7/2003

Why they should change is readily apparent from the findings of the study showing the positive effects of Constructive cultures. Using correlation analysis, Human Synergetics found significant positive relationships between Constructive norms (and negative relationships between Defensive norms) and many factors that directly affect the bottom line of newspaper companies (see Table 1). These include satisfaction, stress, turnover, cooperation and teamwork, intra-unit cooperation, product/service quality, customer satisfaction, and reader behavior. The strength of Constructive norms was also directly related to profit, controlling for the size of the newspaper. Organizational culture is both directly and indirectly related to the bottom line at newspapers.

Longitudinal Case Studies

Culture Change at The Ohio State University Medical Center

In 2001, Dr. Fred Sanfilippo, the Dean of the Ohio State University Medical Center determined that one of the key factors they needed to change to improve the center was the organization's culture. They administered the OCI and found that their predominant cultural styles were Defensive, especially Avoidance and Oppositional. This suggested that the behaviors typically found included lack of involvement and poor teamwork, waiting for others to act first, and blaming others if a problem occurred. Prevailing norms also included opposition to new ideas, refusal to accept criticism, and a focus on process rather than outcomes. However, the Dean and his leadership team also identified a strong desire among the staff to change to a more participative, constructive and achievement-oriented culture.

The medical center has a three-part mission: research, education and patient care. To succeed in this mission it also has a key goal to deal with the financial challenges facing an academic medical center. The senior leadership realized the key to succeeding in their mission was first and foremost investment in their people. They started with high-level leadership training for executives, leadership training for faculty and staff, and management training for all who wanted to improve their skills. The culture change program also included 360° feedback, culture retreats and an organization-wide focus on becoming a more collegial, achievement-oriented and self-actualizing institution.

Over just four years, the results have been impressive. The culture has moved from being primarily Passive/Defensive—emphasizing Avoidance—to an Aggressive/Defensive one—high in Competitive norms—with strong movement toward becoming a more Constructive culture. This means that the dominant norms now are toward winning and being noticed, with a strong emphasis on setting and achieving goals and on helping and encouraging others.

Improvements in the mission areas of research, education and patient care have been equally impressive. With respect to research, the OSU Medical Center has doubled research funding, created a research faculty track and three new high-technology medicine departments, and built the largest research center at the university ever without any state or university capital funding. In education, they increased the number of MD applicants by 28% (well above the national average), and MD-PhD applicants by 129%, increased merit scholarships to 34 from just 4 two years ago, and increased continuing medical education by 193% in just two years. In patient care or clinical medicine, 80% of their physicians are rated as among the best doctors in the geographical area, they have the most “wired” hospitals for the fifth consecutive year and, by

the *US News and World Report's* honor roll system, they are now in the top quartile of academic medical centers in the country.

The goal of dealing with the financial issues facing an academic medical center facilitates all of their mission areas, and OSU has done phenomenally well in that regard. In 2000, before the culture change program started, funding per square foot was about \$75. That has risen every year and is now over \$100 per square foot. More impressive still, the center's FY 2000 budget was about \$600 million accompanied by a deficit of over \$40 million. In just four years, they have grown to an FY 2004 budget of over \$900 million with a \$7 million surplus. These are impressive results that show that investment in culture change pays a huge return over time.

Lion Nathan's Culture Change Success

Lion Nathan is the largest brewer in New Zealand and the second-largest in Australia. As part of their corporate goal "to make our world a more sociable place" (Lion Nathan 2004 Annual Report), they have worked to develop a great business by improving on many fronts, not the least of which is corporate culture.

In 1996, Lion Nathan CEO Gordon Cairns and HR Director Bob Barbour developed a plan to assess and improve their organizational culture. They started at the top with Cairns using a 360° assessment—the Life Styles Inventory (LSI)—to create a leadership development plan that included coaching by Barbour on a regular basis (Barbour, 2003). The development plan now includes leaders at all levels of the organization. They use the LSI about every 18 months, talent reviews every six months in a "Competency X Results" model, and other tools to continually develop internal talent (Cairns, 2002).



We measure our culture and know that it drives business results

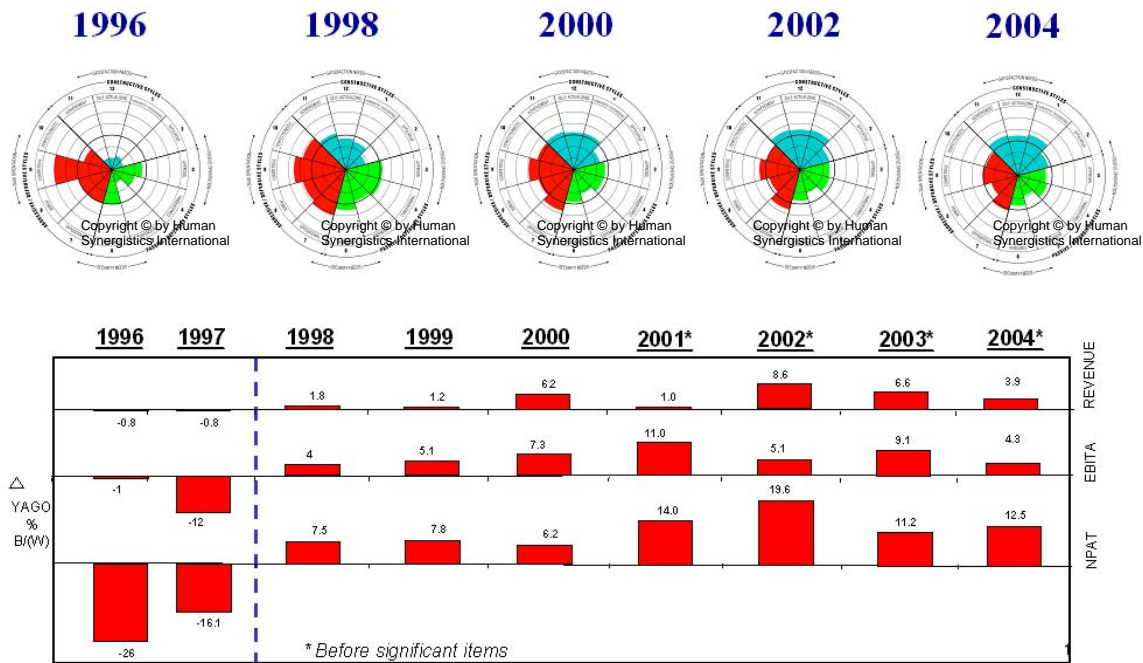


Figure Courtesy of Shaun McCarthy, Human Synergistics New Zealand

Figure 2. Lion Nathan Organizational Culture and Financial Results over Time

Lion Nathan also administered the Organizational Culture Inventory in 1996 and has continued to do so every two years since (see Figure 2). At the time of the first assessment, the organizational culture of Lion Nathan was Aggressive/Defensive. The strongest cultural styles were Competitive, Power, Oppositional and Avoidance. The results suggested that members felt they had to win at all costs. People competed against each other internally, sometimes to the detriment of the organization. Being in control was important, and if something went wrong, one criticized it openly and passed the blame for problems on to someone else. Cairns and his team recognized that this was not a healthy environment to work in, nor one that would lead to long-term business success.

The turnaround in the culture at Lion Nathan has been remarkable. The most recent OCI results show that over the past eight years, the culture of the organization culture has become very constructive (see Figure 2). This transformation is discussed in the 2004 Annual Report, which states that Lion Nathan offers its employees three things: “1) The chance to be the best that they can be; 2) The ability to make a real difference; and 3) The opportunity to have a great time doing it.” Given this strong constructive environment, Lion Nathan has been rated one of the top ten employers in Australia (Cairns, 2002).

Lion Nathan has also gained strong financial returns on the investment made to redirect culture, as indicated by three key financial measures: revenues; earnings before interest, taxes and amortization (EBITA); and net profit after taxes (NPAT, before significant or abnormal items). First, note these numbers declined in the first two years after the culture change initiative began. Culture change can create uncertainty with an organization; however, the pain has been well worth it. Since 1998, Lion Nathan has reported increases in each of these key financial measures every year, as shown by the annual rate of change in Figure 2. In addition, the common stock price has risen every year since 1999, more than doubling from \$3.58 to \$7.58 (Australian dollars) in 2004—a 12.8% annual increase. Clearly culture change has been good for the shareholders of Lion Nathan.

Summary

The five studies reviewed above convincingly show the return on investment that organizations can achieve with culture change initiatives. The cross-cultural studies show a strong correlation between constructive cultures and business success. Retail stores with more constructive cultures showed stronger growth in revenue and indeed higher revenue than their defensive-culture sister stores. Newspapers with constructive cultures had higher satisfaction, more cooperation and teamwork, lower stress, better readership, and higher profit.

It is important to note, however, that link between culture and profit was not direct. Detailed analysis of the retail store data indicated that Constructive cultures translated into cooperation and teamwork, which promoted high quality service and, in turn, repeat business and better sales. Similarly, the more constructive and successful newspapers were driven by a philosophy oriented toward serving their readers, which made out-performed their defensive counterparts.

In the longitudinal studies, the Ohio State University Medical Center showed that over four years they moved from a defensive, avoidant culture to a competitive and more constructive culture, through leadership development and an organization-wide emphasis on culture change. They also improved their research, education and patient-care performance, raised their budget by 50% and moved from a \$40 million deficit to a \$7 million surplus. Finally, Lion Nathan showed that a concerted culture change program, led and supported by senior management, can

completely change an organization's culture. The company's culture moved from Defensive to Constructive, achievement and team-oriented, and the financial results show it, especially in the past six years.

Key factors in both Lion Nathan and the medical center were strong missions and committed leadership. These factors allow the translation of "soft" organizational culture change initiatives into "hard" dollars for the organizations bold enough to implement them.

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