Cultural Capital
A Fundamental Driver of Financial Performance

By Richard Barrett, Founder of Barrett Values Centre®

ABSTRACT

This paper explores the topic of cultural capital and its relationship to financial performance. It reviews research on this topic and comes to the conclusion that even though there is no direct measure of cultural capital, proxy measures such as cultural alignment and Cultural Entropy® clearly indicate a positive correlation between cultural capital and sustained high revenue growth.

Do you see your organization's culture as a significant part of your business' performance equation? Do you see it as a driver of your financial performance? If your answer is not a resounding "Yes," then you may want to read on.

WHAT IS CULTURE?

The most universally accepted definition of culture is "the way things are done around here." Effectively, what this means is that culture is a way of being. It is a reflection of the conscious and subconscious values, beliefs, and behaviors of a group or collective entity, such as an organization, that determine the "personality" of the group. Culture is who you are, and what you stand for.

Culture is determined by the values, beliefs, and behaviors of the current leaders of an organization and the institutional legacy of past leaders as reflected in the values and beliefs that underpin the policies, systems, processes, structures, and procedures of the organization.

WHAT IS CULTURAL CAPITAL?

Cultural capital is a measure of the value that can be placed on the way of being or "personality" of a group, collective entity, or an organization. The difference in the performance of a strong, adaptable culture compared to a weak, rigid culture is a reflection of the level of cultural capital in the two organizations. Although there is no precise measure of cultural capital, the Cultural Entropy score (the degree of dysfunction) can be used as a proxy for measuring cultural capital--high the Cultural Entropy score is synonymous with low cultural capital, and low Cultural Entropy score is synonymous with high cultural capital.

CULTURE AND PERFORMANCE

Whether you recognize it or not, your organizational culture is an important factor in your performance. Therefore, monitoring and measuring your culture is vitally important to your organization's success. During the past 150 years, we have seen a significant shift in how organizations leverage their competitive advantage.

In the Agricultural Age, organizations focused on manpower. The more manpower you could muster, the more land you could till, and the more income you could make delivering your crops to the market place. In the Industrial Age, productivity and quality became the principal areas of competitive advantage. Companies worked on improving their margins and delivering the quality that customers were seeking. In the Information

Age, the focus shifted to intellectual capital, and organizations competed for the best and brightest. We moved into a knowledge economy. Now, as we move into the Cultural Age, not only are organizations having to focus on quality, productivity, and talent management, they are recognizing that who they are and what they stand for—their vision and values—are significant differentiators in attracting and keeping talented people and fostering high levels of staff engagement. In other words, cultural capital has become the new frontier of competitive advantage.

As we passed through these different ages, organizations developed methods for measuring and managing their competitive advantage by focusing on the most important drivers of performance. They focused on measuring because whenever you attempt to measure something, what you measure tends to improve. Consequently, during the Industrial Age, organizations measured productivity and quality. During the Information Age, they attempted to measure intellectual capital. And, now during the Cultural Age, they are attempting to measure cultural capital.

Until the creation of Barrett analytics, cultural capital was difficult to measure. The Barrett analytics and the Barrett Model provide a breakthrough technology for measuring and managing organizational cultures, and more importantly, a way of managing performance by measuring the Cultural Entropy score.

RESEARCH FINDINGS

The link between culture and performance has been investigated and proven by a number of researchers. Eric Flamholtz from the University of California at Los Angeles conducted a study to explore the effect corporate culture has on the bottom line. As part of his research, Flamholtz discovered a strong positive correlation between cultural agreement (a proxy for values or cultural alignment) and the company's EBIT (Earnings Before Interest and Taxes). Some of the results of this study are shown in the following diagram.

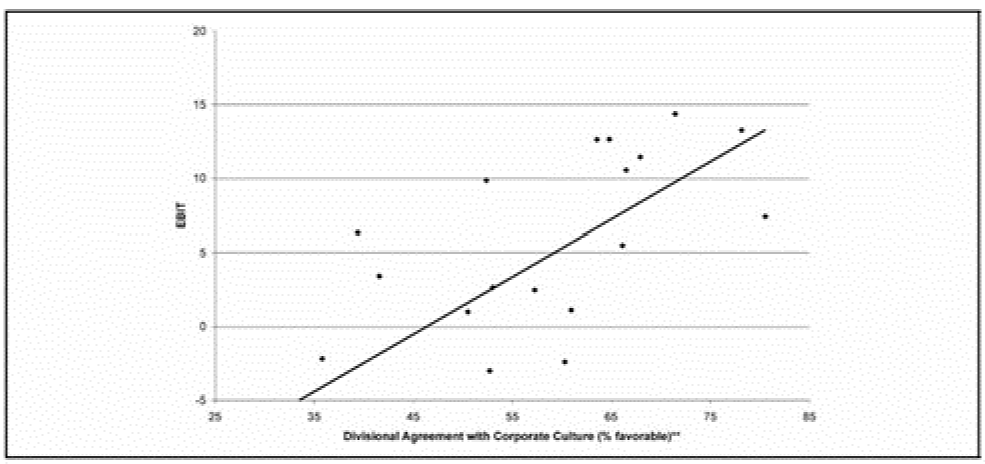

Figure 1: Cultural alignment and the bottom line

Flamholtz concludes, "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."

Performance of the best companies to work for in the USA

More recently, the Barrett Values Centre researched the financial performance of the top twenty publicly-traded Best Companies to Work for in the USA, by evaluating the growth in their share price over the previous ten years.

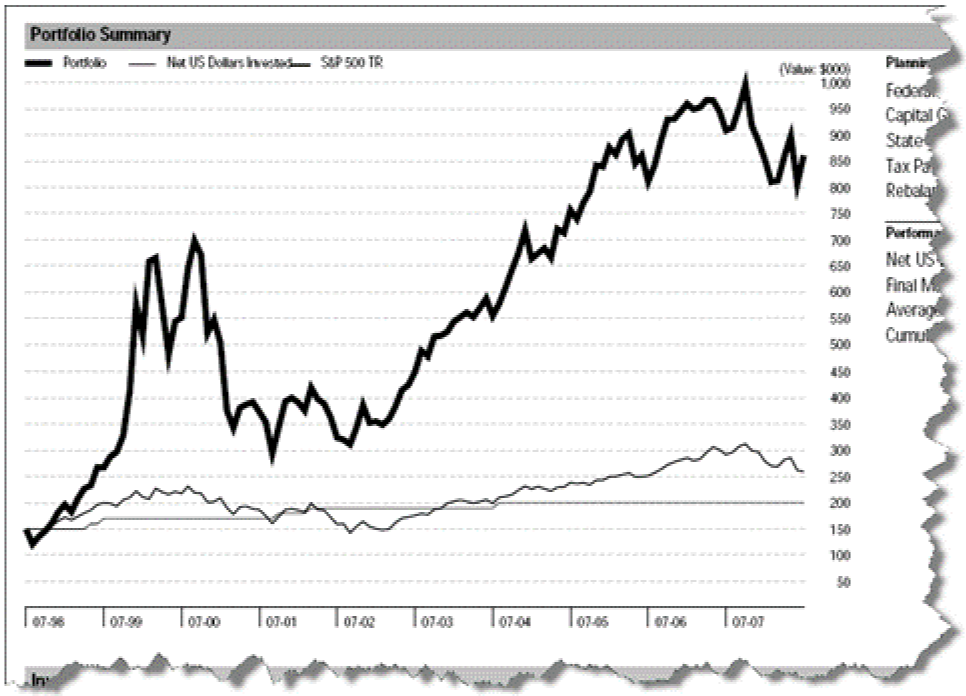

Figure 2: Growth in share price of the top twenty publicly traded best companies to work for in the USA

The results showed that investing in the top twenty companies realized an average annualized return of 16.74%, compared to 2.83% for the S&P 500. This strong financial performance underlines the importance of the employee experience in contributing to the success of a company.

THE BEST EMPLOYERS SURVEYS

Hewitt Associates have been using their employee engagement survey as part of their Best Employers Survey for more than a decade. They have found that the Best Employer organizations, be they in the private or public sector, are always “best in class” in terms of performance. Here are some of the key characteristics of Best Employers:

1. Best Employers attract and retain employees, resulting in significantly lower levels of employee turnover—40% lower in Asia, 45% lower in Australia, 54% lower in Canada, 30% lower in Europe, and 50% lower in the USA. Best Employers have nearly double the number of applications per position than other organizations. Scott McNealy of Sun Microsystems estimates that being a Best Employer is worth $75 million annually to his company in recruiting, retention, and productivity gains.
2. Best Employers have faster revenue growth. Among the data collected in the Best Employer surveys is each company’s financial information for the last three years. Using these numbers, it has consistently been found that Best Employers exceed the rest in revenue growth, year after year. For example, the Best Employers attained 17.3% revenue growth compared to 10.73% for the rest.

3. Best Employers have higher levels of productivity. Revenue per employee is consistently higher in the Best Employers. Breaking down the revenue per full-time employee shows that companies considered the Best are able to achieve higher levels of employee productivity.

PERFORMANCE OF THE BEST EMPLOYERS IN AUSTRALIA AND NEW ZEALAND (BEANZ)

A study of 163 organizations, carried out by Aon Hewitt and Barrett Values Centre as part of the Best Employer study in Australia/New Zealand, showed that:

Cultural alignment and Cultural Entropy significantly influence employee engagement, and employee engagement significantly influences organizational and financial performance.

The findings of this study confirmed that the degree to which employees are aligned with the values of the current culture has a significant impact on financial performance. The study found a strong correlation (0.8) between Cultural Entropy and employee engagement (See Figure 3).

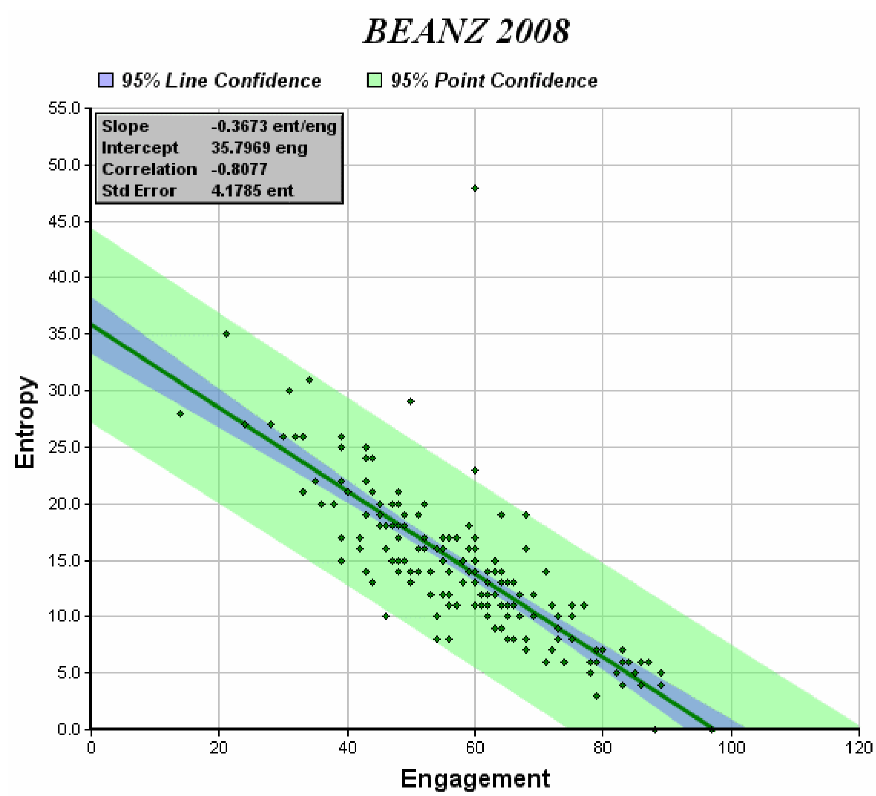

Figure 3: Correlation between cultural entropy and employee engagement for 163 organizations in Australia and New Zealand.

The values that were present in the best employers in Australia and New Zealand, and not in the worst, were all values that reflected a positive employee experience— employee recognition, teamwork, coaching/mentoring, and balance (home/work).

Organizations with low Cultural Entropy (below 10%) and with high employee engagement (above 65%) had 35% revenue growth over three years compared to only 7% for organizations with high Cultural Entropy (above 20%) and low employee engagement (below 65 %).

CONCLUSION

Using employee engagement and Cultural Entropy as proxy measures for cultural alignment (cultural capital), we can categorically state that organizations with high levels of cultural alignment will have superior levels of financial performance.