

Economics.
For Society.

Unlocking the culture code
Università della Svizzera italiana
November 14, 2024

Corporate Culture & Societal Culture

Luigi Guiso
(EIEF)

UBS Center for Economics in Society Lecture
November 14, 2024, Lugano



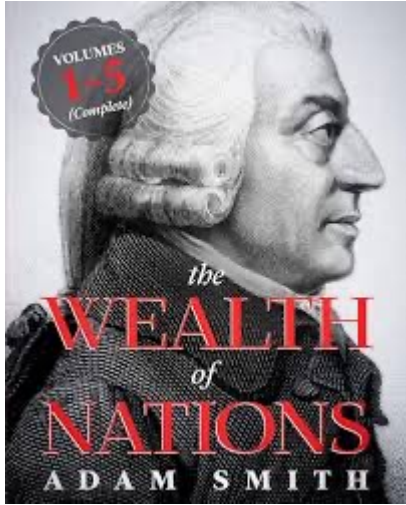
The classical view of the firm

- In modern economies most production takes place in firms
- They are typically owned and operated by individuals or groups of individuals
- In the classical view, the objective of the firm is to choose factors of production to maximize profits, uniquely guided by the prices of the inputs they face

No role for culture

- In this world no role for culture (values, norms of behavior and beliefs)
- Wages and compensation for capital set in competitive markets align workers' and capitalists' incentives
 - Workers get what they contribute to the firm
 - Capitalists get their contribution
- This is the world of Adam Smith, where the invisible hand takes care of aligning the interest of selfish buyers with those of selfish sellers

Well known but evergreen



“It is not from the benevolence of the butcher... that we expect our dinner, but from their regard to their own self-interest”

- People do have values, norms and beliefs but they do not enter the functioning of the firm

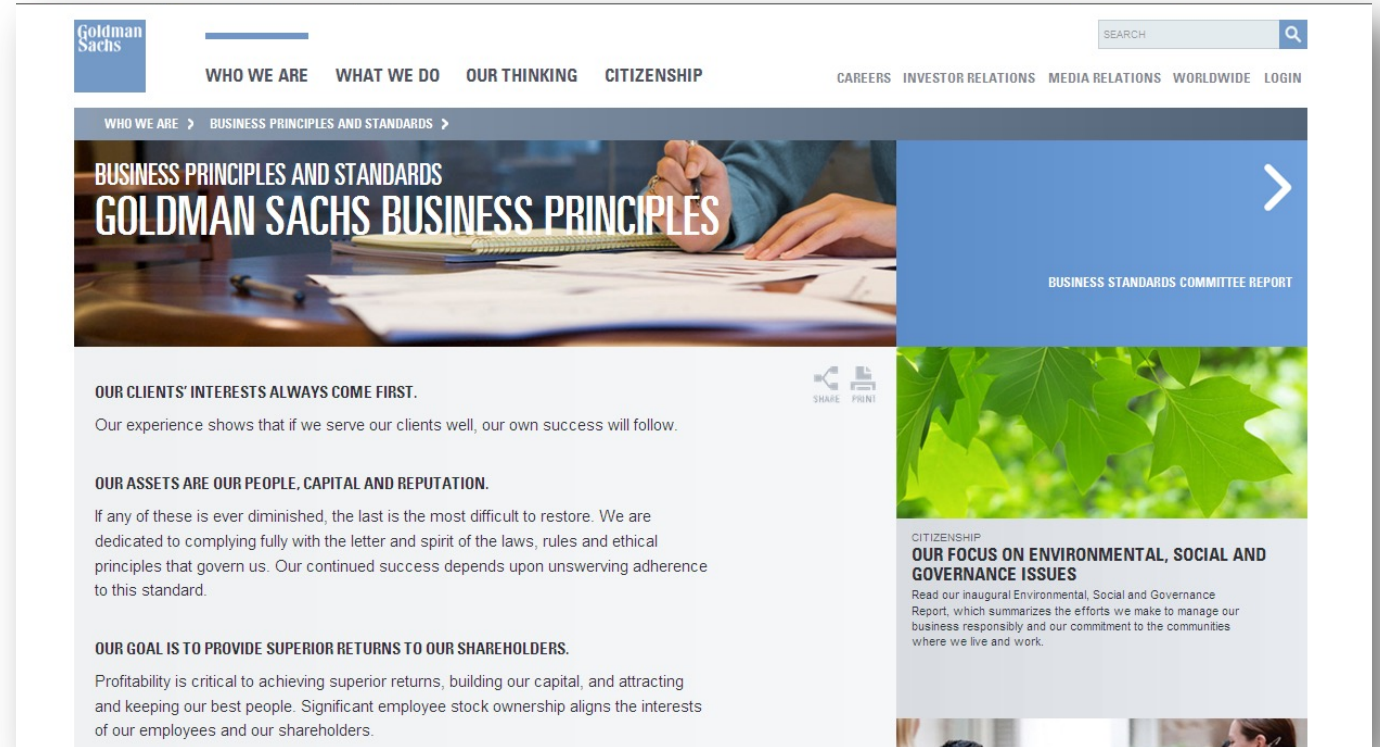
- Production and society are separated

(Ironically, Marx has the same view, all that matters is economic forces, culture is a superstructure)

Yet...

Firms declare they have values

- 85% of S&P 500 firms dedicate a section of the web page to “corporate values.”
- Pro-claimed values range from “**integrity**” to “**teamwork**”, from “**innovation**” to “**respect**”, from “**creativity**” to “**dedication**” ...



Cheap talk?



...or an essential component of a broader strategy?

Focus on one component of culture: values

- Values are “a person’s principles or standards of behavior” (Oxford Dictionary)
- Distinguish between 3 sets of values:
 1. *Functional values*
 - Used strategically to maximize profits
 2. *Ideological values*
 - Political positions firms may want to embrace or not
 3. *Moral values*
 - Preferences of stakeholders over non-monetary outcomes directly impacted by firms’ decisions

Functional values

- Timeliness in a railway company
- Precision in factory chips/watches lab
- Managers integrity/ethics
- Cooperation
- These are value-maximizing values
- Companies will
 - recruit on this basis
 - reward on this base
 - fire on this base
 - indoctrinate on this base
- This is the corporate culture we analyzed in Guiso et al. (2015)

GSZ: Impact of values on outcomes: ROS

- Proclaimed values have no effect on firm performance
- Managerial integrity, as reported by workers, strongly predicts corporate performance
- Firms where employees think that **Management's actions match its words** have higher Return on Stocks and higher growth opportunities

Value based leadership

Bennedsen et al (2023), elicit CEO's values in a Danish sample, matched with their firms (e.g., **Honesty** and **Stakeholder focus**). Authors claim these values:

- Correlate with higher firm ROA and lower ROA volatility
- Makes firm more resilient during crisis (pandemic)
- Improves organizational climate: lowers conflict and turnover
- Allows firms a less hierarchical organization

Why do corporate functional values matter?

- We do not live in Adam Smith's *frictionless* world of perfect competition
- **Conflict of interest** mis-aligns incentives
 - Between managers and shareholders (cannot be sure managers act in their best interest)
 - Between firms and workers (workers cannot be sure managers deliver what they promised and vice versa)
- **Legal contracts** can help address conflict but there are limitations
 - Incomplete, not verifiable, courts are inefficient, legal action is costly
- **Culture** is then the tool to address these issues
 - Rely on the fact that people's behavior may be driven by social norms of cooperation and regard for others existing outside of the contracts
(see the N+ papers by Ernst Fehr).

Culture in the functional view

- Is just another “asset” firm leaders can rely upon to maximize the value of the firm
- If corporate values were only functional, **societal culture** would play little additional role
- The corporate world and the social world **would be by and large separated**, as Milton Friedman strongly advocated
- Long be the dominant view of the objective of the firm: **Shareholder Value Maximization**

An expanded view

1. Since Mark Granovetter (1985) pathbreaking contribution, a new strand has developed that views the firm as *embedded* in societal culture
2. Firm behavior, as much as any organization, cannot be understood *separately and independently* of the **cultural environment** in which the firm operates
3. Scope for *ideological* and *moral* values to slip inside the firm

Ideological and moral values

- **Ideological:** By and large, they are non-functional and not related to a company's business
 - Pro-life vs pro-choice
 - Israel vs Palestine conflict
 - Political partisanship
- Societal politics spills over into corporate politics
- **Moral values:** Define preferences over outcomes:
 - Dislike pollution
 - Like/Dislike selling an abortion drug
 - Like/Dislike selling arms to Israel
- The most interesting ones

From societal culture to corporate behavior

- Societal *ideological* or *moral* values can affect corporate behavior because they affect **stakeholder's** choice (and the later are profit-relevant)
- *Four* relevant channels (Hart et al. (2024))
 - Shareholders/Managers
 - Customers
 - Individual investors
 - Workers

Shareholders: Ideological values

- Evidence that over the past 15 years, executive teams in U.S. firms have become increasingly partisan – i.e., a single party **D** or **R** dominates the political views of the team (Fos, Kempf, Tsoutsoura, 2023)
- Due to increased assortative matching by executives on political affiliation
 - **D (R)** CEOs attract and hire **D (R)** executives
- Executives who are misaligned with the political majority of their team are likely to leave the firm
- When this happens, their company's stock price falls (the market perceives ideological homogeneity as detrimental for firm value)
- CEOs are using the firms to fulfil their ideological values at the expense of shareholders

Consumer's values

- Consumer's purchase choices may be driven by the *type of goods sold by the firm* and the *nature of the producer*
- They may be affected by the *social stances that the firm pursues* and the values it declares
- Firms in turn may react to consumer values-driven choices

Example: Harley-Davidson

News > World > Americas

Harley-Davidson ditches diversity programs after conservatives accuse company of going 'totally woke'

- HD recently retreated on its engagement in Diversity, Equity and Inclusion policy after it faced calls for a boycott from conservative activists
(case of **ideological values**)

HD not an isolated case

- **Jack Daniel** (whisky) has followed the same route. Owner of JD Brown-Forman scraps DEI policies after a boycott from conservative activists
- **Bud Light** (US largest beer maker) sales have dropped 14% and profits 28% following a boycott of the beer brand after it made a promotional deal with a transgender influencer

Companies' values endorsement trigger consumers reactions => affect profits
=> firms adjust values endorsements policy

Worker's values

- Firm's values affect where workers want to work (Colonelli et al, 2023)
 - Workers have a strong preference for firms with ESG policies
 - Ready to take 10% lower wages to work with ESG sensitive firms
 - ESG signals as valuable in attracting workers as work-from-home arrangements and more powerful than most non-wage amenities
- A survey by Flexjobs: number 1 reason for why people quit is “a toxic corporate culture” (62% of workers)

Investor's values

- Individual investor's values affect direction of savings
 - Individual stockholders twist stock away from **sin stocks** (stock of companies in “vice” sectors – gaming, alcohol, tobacco) and direct investment towards green and ESG companies (e.g., Hong and Kacperczyk, 2007)
 - Behavior driven by **moral values**
- May affect equilibrium returns: “brown” companies must offer higher returns to attract investors, higher cost of capital discipline emissions
 - Some firms respond with greenwashing strategies to mislead investors: e.g., **Sustainability Linked Bonds** => no obligation to use the money to lower emissions, but bonds name is ambiguous.

Investors: Collective response

Follow This, a new type of investor activism

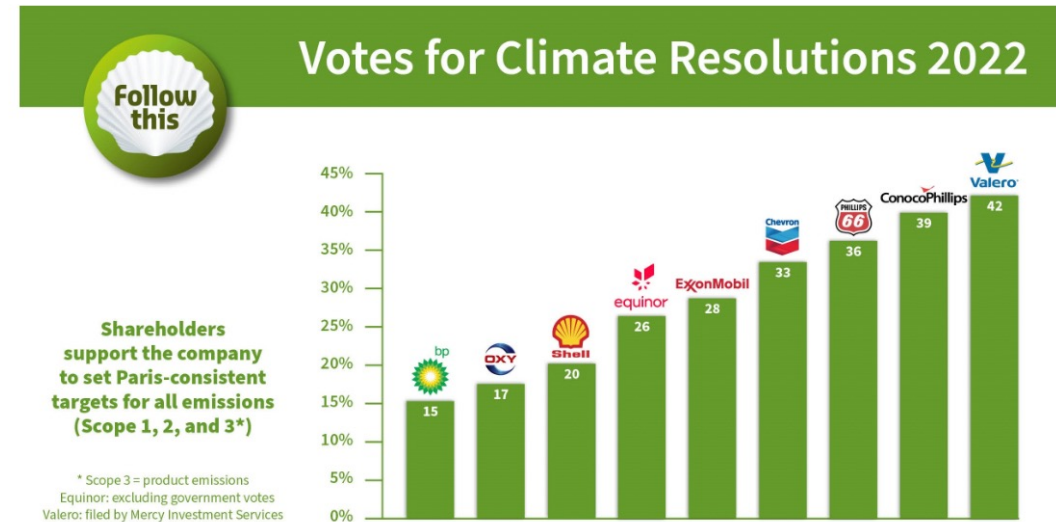
Working with investors

Engagement with progressive investors is key to how Follow This works. In this partnership, Follow This always acts as a confidential partner and honest broker of information.

By uniting with key investors to vote for climate resolutions, we support oil majors to put sustainability at the core of their strategy.

[Learn more](#)

- Dutch NGO, pursues green policy
- Buy Shell share and give voting rights to Follow This
- Intervene at Shell AGM and steer policy
- Set up in 2014, I
- Evidence that its creation reduced emissions



<https://www.follow-this.org/for-investors/>

Investors: Business to business

FINANCIAL TIMES

Quotidiano - Dir. Resp.: Roula Khalaf
Tiratura: N.D. Diffusione: 61158 Lettori: N.D. (DS0001835)

► **ING in climate push**

The Dutch bank has said it will dump big clients it believes are not making progress on reducing environmental impacts, in the latest split between European and US banks on climate.— PAGE 6

Banks

ING warns clients it will 'say goodbye' if they delay climate action

- Pressure on firms may come from institutional investors and banks with tight ESG

Position taken to defend rooted ESG values or to enhance profits?

Conclusions: What do we learn?

- Functional, corporate values matter for firm performance
- Firms are sensitive to societal cultural values in so far as the induced choices (customers, investors, workers) affect profits
- Magnitude of this profit-driven response matters for society as it determines the extent to which stakeholders can induce firms to internalize externalities
- Polarization of customer's, worker's and investor's values is a challenge for firms
 - Neutral? Lean to one or the other? Tradeoff between maximizing customers' base and gaining market power vis a vis a group.

Some references

[Luigi Guiso, Paola Sapienza, Luigi Zingales \(2015\) «The value of corporate culture», Journal of Financial Economics»](#)

[Luigi Guiso, Paola Sapienza and Luigi Zingales \(2015\) «Corporate Culture, Societal Culture, and Institutions» The American Economic Review P&P,](#)

[Luigi Guiso, Paola Sapienza and Luigi Zingales \(2024\) « Comparative \(dis\)advantage of embedded culture: finance, market, firms», Handbook of Cultural Economics, Elsevier, forthcoming](#)

[Morten Bennedsen and Chevrot-Bianco \(2023\) «Value-based Leadership «. \[Link\]](#)

[Fehr, Ernst and Charness. 2024. Social Preferences: Fundamental Characteristics and Economic Consequences. *The Journal of Economic Literature*. Forthcoming](#)

[Mark Granovetter \(2005\), «, The Impact of Social Structure on Economic Outcomes», Journal of Economic Perspectives](#)

[Vyacheslav Fos, Elisabeth Kempf, Margarita Tsoutsoura, \(2023\), «The Political Polarization of Corporate America»](#)

[Jacob Conway \(2024\) «Consuming Values», University of Chicago](#)

[Emanuele Colonnelli, Tim McQuade, Gabriel Ramos, Thomas Rauters, Oliva Xiong \(2023\), “Polarizing Corporations: Does Talent Flow to “Good” Firms?” Un iversity of Chicago Booth School of Business WP](#)

[Harrison Hong a, Marcin Kacperczyk \(2009\), « The price of sin: The effects of social norms on markets»](#)

[Michele Fioretti, Victor Saint-Jean and Simon Smith \(2024\), «The Shared Cost of Pursuing Shareholder Value», WP](#)

[Michele Fioretti, Andrea Andolfatto, Clement Mazet-Sonilhac and Jean-Stephane Mésonnier, \(2024\), “ Greening Banks: Shareholders vs Stakeholders”, WP](#)

[Olivier Hard, David Thesmar and Luigi Zingales \(2024\), «Private Sanctions», Economic Policy](#)


No role for culture

- In this world no role for culture (values, norms of behavior and beliefs)
- Wages and compensation for capital set in competitive markets align workers' and capitalists' incentives
 - Workers get what they contribute to the firm
 - Capitalists get their contribution
- This is the world of Adam Smith, where the invisible hand takes care of aligning the interest of *selfish* buyers with those of *selfish* sellers



UBS Center
for Economics in Society
at the University of Zurich

Economics.
For Society.

Watch **replay** on  YouTube