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The effect of corporate culture on firm performance: Evidence from China

Hailin Zhao [a], Haimeng Teng [b], Qiang Wu [b,*]

[a] *School of Accounting, Nanjing University of Finance & Economics, China*
[b] *Lally School of Management, Rensselaer Polytechnic Institute, USA*

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ABSTRACT

This study examines whether corporate culture promotion affects firm performance in China in terms of firm market value, firm financial performance and innovation output. We find consistent evidence that corporate culture promotion is negatively related to firm market value, positively related to innovation output and not significantly related to firm financial performance. In addition, the negative effect of corporate culture promotion on firm market value is driven by small firms and firms located in less developed provinces. Furthermore, we find that some specific corporate culture promotions, such as innovation culture promotion and integrity culture promotion, are not related to firm value or financial performance. However, innovation culture promotion is positively associated with innovation output.

1. Introduction

Corporate culture is “a set of norms and values that are widely shared and strongly held throughout the organization” (O’Reilly and Chatman, 1996; Guiso et al., 2015). In a controversial *New York Times* op-ed, former Goldman Sachs vice president Greg Smith attributes Goldman Sachs’s previous success to its good culture promoting teamwork, integrity and humility, and in his book he blames its transformation from a partnership into a publicly traded company for the disappearance of this culture (Guiso et al., 2015). In a recent survey of 1461 North American CEOs and CFOs, Graham et al. (2017) find that 91% of executives view culture as very important at their firms, and that 78% consider culture as one of the top 3 or 5 factors that

* Corresponding author at: Lally School of Management, Rensselaer Polytechnic Institute, Troy, NY 12180, USA.
E-mail addresses: seaforest99@163.com (H. Zhao), tengh@rpi.edu (H. Teng), wuq2@rpi.edu (Q. Wu).

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affect their firms' value. The authors also point out that empirical evidence on whether and how corporate culture affects firm value and corporate decision making is underexplored.

In this paper, we study whether and to what extent corporate culture, as captured by the intensity of corporate culture promotion through the Internet, affects the firm performance of China's privately listed companies in terms of market performance, financial performance and innovation performance.[1] In China, state-owned companies are controlled by the government, and their cultures are shaped by the political climate. In contrast, privately listed companies are publicly owned and can nurture their own cultures as they wish according to their own characteristics and purposes. Thus, we focus on China's privately listed companies to study the impact of corporate culture on firm performance.

Aside from anecdotal evidence, prior studies find some empirical evidence that corporate culture affects corporate decision making and firm performance. For example, Ahern et al. (2015) find that the volume of cross-border mergers and the combined announcement returns are lower when countries are more culturally distant in terms of trust and individualism. Corporate culture can also affect corporate reporting behavior. For example, Braguinsky and Mityakov (2015) argue that firms from developed countries have a culture of transparency, and that foreign-owned companies in Moscow are less likely to misreport their employees' earnings due to this transparency. Overall, both anecdotal and empirical evidence shows the important role that corporate culture plays in corporate behavior and firm performance.

However, culture can take different forms. Firms usually choose to *promote* corporate culture according to their firm characteristics. For example, high-tech companies, such as Apple, promote a culture of innovation, while customer-oriented companies, such as Walmart, promote a culture of integrity. Although Apple and Walmart promote two different cultures, they each promote a culture tailored to their own purposes. It is difficult to say that innovation culture is superior to integrity culture, or vice versa. This is similar to cultures across different countries. Deshpandé and Farley (2004) find that although cultural components differ across countries, the differences of mean and slope for the effect of organizational culture on firm performance across countries are not significant. For example, Japan and the United States may have different types of organizational culture, but neither leads to better performance than the other.

In addition, it has been understood that the relationship between corporate culture and firm performance may be more than a simply direct association, and may be contingent on corporate strategies and environment changes (Sørensen, 2002; O'Reilly et al., 2014). For example, integrity may be identified as a firm's culture, but whether this integrity culture is associated with firm value depends on corporate strategies and specific circumstances (O'Reilly et al., 2014). For example, integrity culture may be important in terms of stock market valuation if the firm's competitors are known to be fraudulent (e.g., Greve et al., 2010). Thus, we argue that the strength of overall corporate culture is more important than what kinds of culture firms promote. However, one challenge for empirical studies is how to quantify the strength of corporate culture. It is reasonable to expect that if a firm more publicly promotes and emphasizes its corporate culture, the strength of its corporate culture will be higher. Therefore, in this paper, we try to answer the question of whether corporate culture matters by examining the relation between the corporate culture promotion level and firm performance.[2]

To capture the level of corporate culture promotion, we hand-collect data from Chinese companies' websites in 2014 and conduct a factor analysis. Words are worth nothing if they are not matched by actions; at the same time, good actions without marketing may be underestimated by the market. Thus, in this paper, we measure corporate culture promotion by both words and actions, considering CEO speeches, culture web-

[1] Two types of companies exist in China's stock trading market: privately listed companies and state-owned firms. Although state-owned firms can be traded in stock exchanges, they are subject to many trading constraints. Usually, only a small portion of shares of state-owned companies can be freely traded. In contrast, privately listed companies in China are closer to what are considered publicly traded firms in the United States. In contrast, most if not all shares of privately listed companies can be freely traded in China's stock exchanges. Therefore, privately listed companies are public-owned firms, as opposed to state-owned firms.

[2] To verify that the promotion of certain types of culture does not affect firms' performance in terms of Tobin's Q or return on assets (ROA), we test the effect of hand-collected specific cultural information, integrity and innovation culture indicated in firms' slogans on firm performance. We find the same results as Guiso et al. (2015): neither integrity culture promotion nor innovation culture promotion significantly affects firm performance. We discuss this in detail later in the paper.