

Factoring corporate culture into investment choices

How to tell if companies are talking
the talk instead of walking the walk –
and why it's so important to find out

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What is corporate culture and why should investors care?

Corporate culture is the set of beliefs and attitudes about the way things are done in an organisation or, more formally, the ‘set of values and norms widely shared and firmly held by members of an organisation’.¹ It shapes a firm’s internal environment and influences the decision-making and behaviour of both management and employees. This makes it a driving factor in an organisation’s success and may be attributable to stock outperformance therefore, a key consideration for investors.

It’s widely accepted that corporate culture is driven by the top, that is, the board. The board sets the tone of the organisation, which filters through to management and employees. While not necessarily at the top of a board meeting agenda, we believe corporate culture permeates through an organisation’s decisions and actions.

The challenge of measuring corporate culture

Despite its importance for a firm’s success, corporate culture is notoriously difficult to measure. In our view, commonly used objective metrics of other aspects of a firm’s performance, such as sales numbers or percentage of women board members, do not provide meaningful insights.

Employee surveys may offer insights, but don’t work for cross company comparisons because methodologies and measures vary, they are not always conducted regularly and results are often not publicly available. Employee rating sites (e.g., Glassdoor) may give a view of employee happiness, but don’t necessarily reveal the true culture of an organisation.

A unique approach to accurately capturing corporate culture

At RQI Investors, we use a unique approach to measure the strength of a firm’s culture. Our method involves assessing conference calls by analysing the way management speaks. We then analyse company attributes related to the language and themes that emerge during these calls, before going on to consider whether we can capture stock outperformance by trading on this information.

To do this we have used a specialist ‘culture’ dictionary based on five dimensions of corporate culture: **innovation**, **integrity**, **quality**, **respect** and **teamwork**, identified as the most mentioned company values in the corporate websites of firms in the S&P 500.²

The values and attributes that make up corporate culture and how we analyse them

At a high level, based on our ‘culture’ dictionary, the values we see at play, as extrapolated from the from the five key dimensions of corporate culture are:

Dimensions	Associations
Innovation	Creativity, efficiency, excellence, passion, pride
Integrity	Ethics, fairness, honesty, responsibility, transparency
Quality	Customer relationships, dedication, product quality
Respect	Leadership, professionalism and talent
Teamwork	Collaboration, cooperation, leadership, professionalism

1 O’Reilly, C. (1989). Corporations, Culture, and Commitment: Motivation and Social Control in Organizations. *California Management Review*, 31(4), 9-25. <https://doi.org/10.2307/41166580>

2 Kai Li, Feng Mai, Rui Shen, Xinyan Yan, Measuring Corporate Culture Using Machine Learning, *The Review of Financial Studies*, Volume 34, Issue 7, July 2021, Pages 3265–3315,; using word2Vec (Mikolev et al. 2013); Guiso, Luigi & Sapienza, Paola & Zingales, Luigi. (2014). The Value of Corporate Culture. *Journal of Financial Economics*. 117. 10.1016/j.jfineco.2014.05.010.

To measure the strength of corporate culture in practice, we use a 'bag of words' approach to analyse conference calls. Broadly, the more the dictionary words are mentioned, and the more consistently, the stronger the culture of the firm.

Importantly, we look at different parts of the conference call: the prepared management section, then the Q&A section where analysts can ask questions without notice. We expect that differences in how management talks between these sections will help show if culture is not truly embedded in the firm.

In our view, the more spontaneous and less scripted the language used, the more likely they are to accurately reflect the culture of the company compared to other potential data sources such as company websites, annual reports and so on, which contain more scripted 'PR' talk.

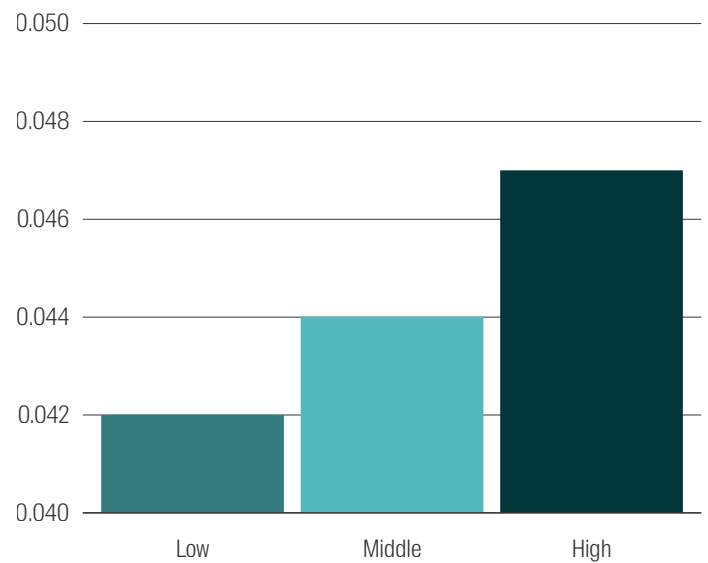
Stronger culture can be equated with higher quality and lower risk

Having determined a way to measure corporate culture, we naturally follow the data to assess if better culture is, in fact, a characteristic of higher quality, less risky and lower volatility companies.

To do this, we split companies into three groups, those with low, middle and high culture scores and looked at the average return on assets (ROA) as a proxy for quality, and volatility as a proxy for risk. We can see the results in *Figure 1* on the right.

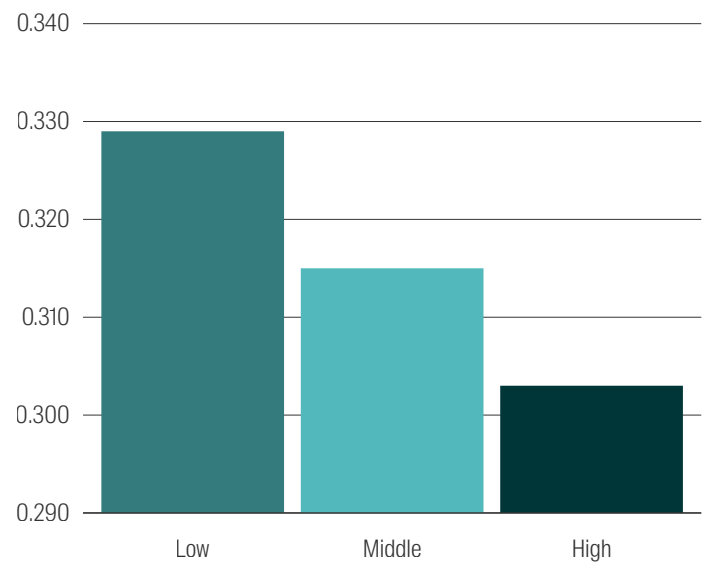
What we found is, that as the score for culture increases so, on average, does the Return on Assets (ROA) for those firms, showing that organisations with better culture tend to be of better quality. In our study of firms within the MSCI All Country World Index that trade in North American or European markets, we also saw that firms with higher culture scores had lower volatility, showing that they are lower risk. This is seen in *Figure 2* on the right.

Figure 1: Average return on assets of firms split by corporate culture score



Source: RQI Data, January 2010 to June 2024

Figure 2: Average Volatility of firms split by corporate culture score



Source: RQI Data, January 2010 to June 2024



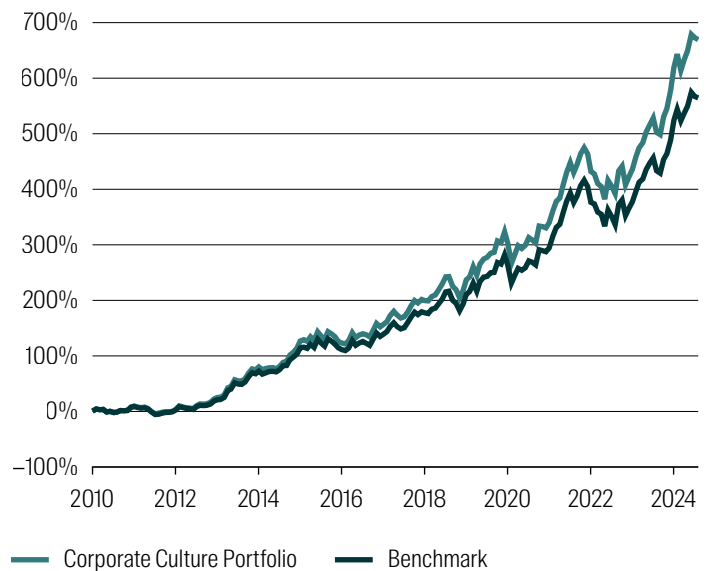
Trading impacts: tilts to strong culture can support outperformance

Having established the link between corporate culture and positive attributes regarding quality and risk we went further, back testing³ to see how this information would play out in real market conditions.

To do this, we constructed an optimised portfolio tilting toward firms with strong culture and away from those with weaker culture. Given our dictionary is in English, our universe included stocks within the MSCI All Country World Index that trade in North American or European markets,⁴ comprising around 1,000 stocks and covering approximately 80% of the relevant market cap. This is what we have used as the benchmark in *Figure 3*.

Over the nearly 14-year period in question, the corporate culture-tilted portfolio outperformed the benchmark. Such consistency of performance shows that strong corporate culture is indeed a company attribute that is rewarded by the market. This outperformance amounts to just over a 1% excess return p.a. over close to 14 years.

Figure 3: Back test performance of Long Short portfolio



Source: RQI Data as at 30 June 2024

3 Backtesting is a quantitative method used primarily to evaluate the historical performance of a trading or investment strategy by applying it to past market data.
4 As we currently only have English conference call transcripts and hence limited coverage in Asia and the Emerging markets.

Conclusion: a compelling methodology that effectively factors corporate culture into investment decisions

The insights outlined in this summary clearly show that firms with the strongest cultures, analysed using a curated dictionary of words proven to be linked with important corporate values, perform better than their counterparts. This superior performance can be seen not only in terms of quality and risk, but also in a pattern of consistent outperformance relative to the market.

RQI Investors is confident that the approach described here represents an effective methodology to measure corporate culture and use the resulting insights to help guide better investment decisions.

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