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Balancing governance and culture to create sustainable firm value

Jillian Popadak

INTRODUCTION

As a motivating example of how governance and culture may interact to alter firm value, consider Sears Holdings. Hedge fund billionaire Eddie Lampert acquired a large position in the company nearly a decade ago. In the first year after Lampert's acquisition, Sears Holdings thrived and equity prices outperformed the market by 18 percent. Two years later, profits had declined 45 percent and sales retreated to pre-Lampert levels. Press commentary suggests the cause of Sears' descent is Mr. Lampert's re-orientation of Sears' corporate culture toward results.[1] Lampert runs Sears like a hedge fund portfolio, with separate business units competing for his money. Such a structure fostered change in the norms and expectations that employees have for how they need to behave to fit in and succeed in the firm.

In theory, this interaction between governance and culture could increase or decrease firm value. On one hand, when unit leaders are told their performance is all that matters, they may run their units in the most efficient way. By incentivizing individual pieces of the firm to produce results, this may lead to a greater sum than if the units operated as a whole. On the other hand, the whole can be greater than the sum of its parts if implicit cultural norms such as collaboration are already working to create value. Even worse, introducing new rules could reduce the effectiveness of the value-enhancing culture.

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In the case of Sears, many insiders claim that by focusing on the aspects of the job that could be easily quantified, employees began to skimp on tasks that cannot easily be quantified but are important to long-term value. For example, an insider notes, "The model creates a warring-tribes culture … cooperation and collaboration are not there." Another Sears employee remarked, "The result was confusing to the customer; it became disjointed." What the Sears example highlights is

1 Kimes, M., July 11, 2013, "At Sears, Eddie Lampert's Warring Divisions Model Adds to the Troubles," *Business Week.*

that the whole lost value when the explicit emphasis on performance overpowered the implicit values to collaborate, satisfy the customer, and not act selfishly.[2]

In this brief, I demonstrate the importance of an effective corporate culture as a source of sustainable long-term firm value and of finding an optimal balance between culture and governance. Because the behavioral pattern that culture implicitly dictates to employees can be reinforced or undermined by governance standards—and the demand for stronger shareholder governance is at an all-time high—now is a critical juncture for finding the right balance. While shareholder activism may appear to be a panacea for corporate maladies, if it afflicts firms with tendencies that prevent beneficial long-term actions, knowing how to avoid such pitfalls is of the utmost importance.

BACKGROUND: DEMAND FOR STRONGER SHAREHOLDER GOVERNANCE

The revelation of widespread failings among corporate leaders over the past decade has emboldened shareholders to take actions that strengthen their rights. These actions are commonly referred to as shareholder governance, because they deal with the system of control within the corporation that is meant to assure shareholders of receiving an appropriate return on their investment. These shareholder-led governance initiatives seek to change the explicit rules through which a firm operates to make it harder for corporate leaders to take actions that better themselves at the expense of their shareholders.

> Shareholder-led governance initiatives seek to change the explicit rules through which a firm operates.

There are two common approaches: (1) grant shareholders additional power through legal protection codified in the corporation's charter and bylaws; and (2) generate additional power through coordinated actions with influential investors such as activist hedge funds. Long-term investors such as pension funds typically take the first route and support initiatives that increase board independence, quality, expertise and diversity, so that the decision-making power within the firm is delegated to the most qualified candidate. The second route involves influential investors such as activist hedge funds who deem themselves the most qualified decision-maker. They provide their own ideas for unlocking value that often include limiting investment, divesting assets, and increasing payout rather than legal changes.

Both approaches to strengthening shareholder governance have been growing rapidly. Shareholders submitted a total of 462 corporate governance proposals in 2015, and public pension funds nearly doubled the number of proposals they submitted in 2015 compared to previous years.[3] Hedge funds gained a seat on the board of directors at more than 100 companies. This represents an all-time record. Individual investors appreciate what these activist investors are doing and are investing their money with them in support. There are more than 10 activist hedge funds that manage $10 billion each, or about as much as the entire asset class had before the financial crisis.[4] Since the crisis, the compound annual growth rate of assets under management for activist hedge funds is a staggering 30 percent.

2 Gelles, D., October 29, 2013, "For Once-Mighty Sears, Pictures of Decay," *New York Times*.

3 Kumar, R., 2016, *Annual Corporate Governance Review,* Georgeson Proxy Advisory Publication.

4 Zenner, M., and E. Junek, 2015, "The Activist Revolution: Understanding and navigating a new world of heightened investor scrutiny," J.P. Morgan Corporate Finance Advisory Paper.

SHORT-TERMISM, SCALE, AND SCOPE: DEBATES SURROUNDING SHAREHOLDER GOVERNANCE

This increase in activism is leading to a confluence of challenges and intensifying some long-held debates. The most common debate that exists about shareholder activism centers on if they afflict firms with short-term tendencies rather than more beneficial longer-term behavior.[5] The short-termism debate is exacerbated by *scale* and *scope*. Scale refers to the idea that the number of firms in need of stronger governance does not scale proportionately with the amount of money being funneled toward it. Scope refers to the idea that activists' proposals might work against firms' competencies. Later in this brief, I detail how new and better data measuring firms' corporate culture has provided new evidence on the scope of activist interventions and the short- and long-term effects on firms. In this section, I document the effects of the recent dramatic increase in the scale of activism.

Constant returns to scale refers to the idea that if activists invested $1 billion in a given year and made 10 percent returns on that investment, if instead they had $10 billion to invest in a given year, they could still achieve 10 percent returns. If with additional money, activist shareholders can only achieve five percent returns, this indicates decreasing returns to scale. Because the tactics that activists follow are tied to their skill in identifying firms where shareholder value can be unlocked, such skill requires attention and non-trivial actions which are difficult to scale up.

Scale and short-termism are intertwined. For example, if the governance strategies that activist hedge funds pursue display decreasing returns to scale, then some funds under pressure to realize returns for the investors may pursue a short-term "hit-and-run" approach with greater fervor. Carl Icahn acknowledges such a "hit and run" approach is one source of heterogeneity in the observed returns to activism.[6] Put another way, not all activists are created equal, nor do they all play by the same playbook.

What does the evidence suggest about scale? In a recent research paper, I explore how shareholder activism has evolved over the last few years and its consequences for expansion.[7] Some of the key facts about contemporary activists that I want to highlight are: (1) they are targeting different firms (these firms are larger and they are not underperforming in the way previous research has documented); (2) the activists are holding smaller ownership stakes and exiting the equity earlier; (3) the activists are increasingly engaging with management on strategic initiatives in comparison to optimizing the incentives for success with governance or compensation reform; and (4) spin-off activists exhibit much greater heterogeneity in success than the earlier cohorts of activists.

The relationship between the scale of activism and the lack of underperformance at targeted firms is particularly worrisome because of its implications for the scope of activities affected by activists. While activist hedge funds previously targeted firms that were underperforming relative to their peers in terms of profitability and return on equity (ROE), that is no longer the case. On average, the firms targeted by hedge fund activists in the last five years exhibit above average returns and profitability relative to the peers in their industry both in the year they are

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5 Surveys of corporate executives overwhelmingly support the view that stronger governance is associated with short-termism (see Graham, Harvey, and S. Rajgopal, 2005, "The Economic Implications of Corporate Financial Reporting," *Journal of Accounting and Economics* 40, pp. 3-73) but academic research finds mixed evidence regarding the claim that shareholder activism is associated with short-termism (see Brav, A., W. Jiang, and H. Kim, 2015, "The Real Effects of Hedge Fund Activism: Productivity, Asset Allocation, and Labor Outcomes," *Review of Financial Studies* 28, pp. 2723-2769 for evidence against short-termism and see Cremers, M., E. Giambano, S. Sepe, and Y. Wang, 2015, "Hedge Fund Activism and Long-Term Value," Working Paper for evidence supporting short-termism.)

6 Benoit, D., and V. Monga, October 5, 2015, Are Activist Investors Helping or Undermining American Companies? *Wall Street Journal.*

7 Popadak, J., 2016, "Heterogeneity in the Returns to Shareholder Activism," Working Paper.

targeted and the two years prior to targeting. Targeting firms that would typically be classified as outperforming suggests “overreaching” by the activists.

For example, in an interview that my co-authors and I conducted with the CFO of a large public company that has been outperforming its peers, the CFO stressed to us that the challenge today is that most of the things that are good for the long-term are only undertaken if they coincide with showing financial results.[8] As he said:

> *I spend a lot of time trying to figure out what investments our firm can make if we are trying to show earnings growth. I have to worry about activists and it is a huge pain because I don’t think activists are about long-term value maximization. Those guys just want to come in and make some changes, get a transaction done and make some profits within a year. They are not about governance or this or that. It is a charade.*

Targeting firms that would typically be classified as outperforming suggests “overreaching” by the activists.

He further explained that some CEOs care a lot more about stock price and making earnings and are prone to push CFOs very hard on things such as accounting treatments.

If today’s activists are intervening to change the emphasis of the firm from smart corporate finance decisions to decisions that satisfy easy-to-measure metrics like earnings and payout, then it is natural to wonder what is happening to the other harder-to-measure factors that contribute to firm performance.

THE IMPORTANCE OF BALANCING IMPLICIT AND EXPLICIT RULES

If hedge fund activism as an investment strategy has expanded too quickly, it could be the case that these activists’ strategies are being applied to firms that do not need such interventions.

Shareholder-led governance initiatives seek to change the explicit rules through which a firm operates. The explicit rules or strategies activists agitate for may be redundant and may even create extra costs if implicit rules already provide the right incentives for action. The implicit rules for behavior in a firm are the norms and expectations that are commonly referred to as *corporate culture*. This distinction between implicit and explicit rules is important because it provides a lens for thinking about how culture and other harder-to-measure factors that contribute to firm performance may fit into the previous debates about the short-termism, scale, and scope.

Cooperation, collaboration, and customer-orientation are all examples of shared employee expectations that define a corporate culture.[9] Demonstrating the value of these shared beliefs in an easy-to-quantify metric is near impossible. Because of this difficulty, activist investors rarely credit these implicit norms as providing value and often rebuff initiatives aimed at investing in culture. But as my research with co-authors has shown, culture is a very effective means for creating long-term sustainable value.[10] Interviewed executives consistently made connections between effective cultures and managerial and employee ability to achieve long-term objectives.

8 Graham, J., C. Harvey, S. Rajgopal, and J. Popadak, 2015, “Corporate Culture: Evidence from the Field,” Working Paper.

9 O’Reilly, C., J. Chatman, and D. Caldwell, 1991, “People and Organizational Culture: A Profile Comparison Approach to Assessing Person-Organization Fit,” *The Academy of Management Journal* 34, pp. 487-516.

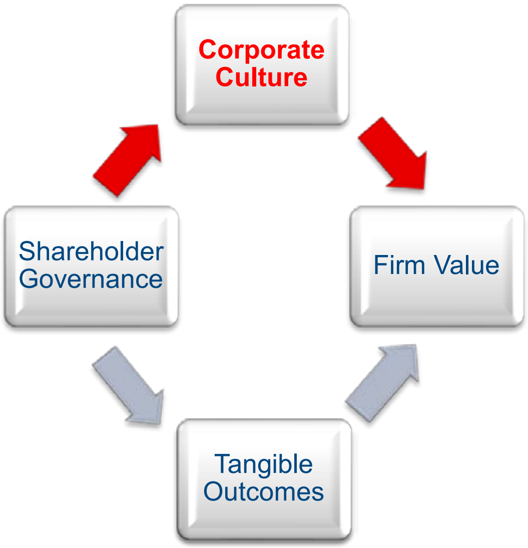
10 Graham, J., C. Harvey, S. Rajgopal, and J. Popadak, 2015, “Corporate Culture: Evidence from the Field,” Working Paper.

One of our survey questions specifically explored how executive's make trade-offs between short-term and long-term reward and the role culture plays in such decisions. In particular, we asked the survey respondents to choose between two otherwise identical projects with a five year duration. Project A has a higher net present value (NPV) relative to project B. Project A, however, reports negative cash flows for the first two years, whereas B reports positive cash flows throughout. Assuming all cash flow forecasts are equally accurate, we ask whether the firm's culture makes it more likely that the superior project would be chosen.

Only 50 percent of respondents chose the project with the higher NPV, leaving a remarkably high percentage of respondents that would choose the NPV-inferior project. If a participant chose A, we then asked whether their firm's culture played a role in their company's preference for Project A. Eighty percent of the respondents said "yes." For the respondents who picked the inferior-NPV project, we asked, "If your firm's culture improved, do you think it would be more likely that project A would be chosen?" Fifty-six percent said "yes." In summary, an effective culture is more likely to be associated with appropriate (long-run NPV positive) investment choices.

When we pushed executives to figure out what was underlying this relationship, it always came back to the investors. In our open-ended interviews, the executives lamented that they do not get credit from the market for decisions or investments they make that support the firm's cultural values. For example, avoiding mass layoffs in a downturn that may destroy morale or an investment in an emerging market for the longer term are not considered valuable. As one interviewee put it, "We certainly do not get credit for culture-related investments particularly if you think of the short-term nature of some of our investors. Our long-term investors get it and understand it completely."

What is a systematic way in which one can think about the interaction between the explicit measures activists seek and the implicit norms inherent in culture? As the following picture illustrates, culture can be thought of like an intangible asset in the firm. When governance changes, it can have a meaningful effect on both the tangible and the intangible assets. When investors evaluate the effectiveness of activists they should consider more than just levels of investment or profitability but also the intangible asset value.



By classifying corporate culture as an intangible asset, one has a lens for understanding how activism affects overall firm value. Activists are not insiders in the firm, so they take their cues from the information observable to outsiders. This leads to a tension between that which is easy to observe (tangible assets and their value) and that which is hard to quantify (intangible assets and their value). Corporate executives who fear scathing criticism from activists can make what appear to be value-enhancing decisions by shifting the allocation of capital between intangible and tangible assets. Such a shift does not create any new value. But because intangible value is hard to observe, pinpointing whether new value is being unlocked or merely old value is being shifted, is difficult.

THE VALUE OF SHAREHOLDER GOVERNANCE AND CORPORATE CULTURE

As the previous discussion highlights, achieving the optimal mix of implicit and explicit rules via culture and governance should have a meaningful effect on firm value. Before exploring how the culture and governance interact with each other to create value, it is worth reviewing the evidence on how changes in each individually may create value. The value of corporate culture has been studied at various times in the past century, while the value of stronger governance came into sharp focus more recently.

In a 2015 research paper, co-authors and I document the close relationship between regulation by the Securities and Exchange Commission (SEC), increasing ownership by institutional shareholders, and the strengthening of shareholder governance.[11] Specifically, in 1988, the Department of Labor issued the "Avon" Letter which required pension trustees to diligently vote their shares at annual meetings. The problem was most trustees' votes were a mere "rubber-stamp" in support of what management wanted. Then, in 1992, the SEC reformed shareholder voting rules by substantially reducing the barriers to communication between institutional investors and firm leadership. As a consequence, institutional investors began to express their views on key proposals, organize public campaigns to pressure management, and mount pressure against members of the board of directors. Hence, the 1990s can be thought of as the era when investors learned about or were forced to take governance seriously.

> Achieving the optimal mix of implicit and explicit rules via culture and governance should have a meaningful effect on firm value.

Consistent with stronger governance creating value, in the early 2000s, researchers showed an investor could have earned average annual returns of 8.5 percent above market returns in the 1990s by going long on well-governed firms and shorting poorly governed firms.[12] As additional researchers tried to understand these remarkable returns, a few facts became apparent. First, governance is not one size fits all. This implies the governance structures that create value for one firm may not create value at another firm. Second, with efficient markets such high returns can only be justified if the market learned about the value of strong governance precisely during this period. Third, the market did learn about the value of strong governance and more recent research suggests strengthening governance has a significant but smaller effect of only one-to-two percent of firm value.[13]

In comparison to the estimated value of shareholder governance, there exists less evidence on the value of corporate culture. While corporate culture is given credit for some of the greatest business successes and blamed for some of the biggest failures, its value is largely unknown. For example, both the President of the New York Federal Reserve and the Governor of the Bank of England have suggested that dysfunctional corporate cultures at the big banks contributed to the failures emblematic in the financial crisis. Yet, in stark contrast, business experts examining Google's great success credit the corporate culture as a key driver. While most everyone that has ever worked in a corporate setting has a sense that corporate culture matters, defining what makes culture effective, measuring its value, and quantifying its effects have been a major challenge to researchers.

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11 Michaely, R., Popadak, J., and Vincent, C., 2015, "The Deleveraging of U.S. Firms and Institutional Investors' Role," Working Paper.

12 Gompers, P., J. Ishii, and A. Metrick, 2003, "Corporate Governance and Equity Prices," *Quarterly Journal of Economics* 118, pp. 107-156.

13 Cunat, V., M. Gine, and M. Guadalupe, 2012, "The Vote is Cast: The Effect of Corporate Governance on Shareholder Value," *Journal of Finance* 67, pp. 1943-977.

In a previously referenced paper with co-authors, we surveyed more than 1,800 CEOs and CFOs around the globe in the fall of 2015 to try and address the challenge.[14] What we found is overwhelmingly, executives believe that culture matters for performance. More than 90 percent of executives said culture was important at their firms, and corporate culture was on executives' lists of the top three factors impacting firm performance. But only 16 percent said their own corporate culture was exactly where it needed to be, and 91 percent said they believed improving their firm's corporate culture would improve the value of the company.

So how valuable is corporate culture to these executives? They attribute a big part of stock price appreciation, ranging from five to 50 percent, to corporate culture. When asked if they would discount a target firm in a mergers and acquisitions deal if the culture was misaligned, 31 percent said they would discount the offer up to 30 percent and an extraordinary 48 percent would not even make an offer. In relation to other value-drivers, executives said culture adds more value than strategy or financing decisions. The reasons why culture creates value are: it enables superior execution; it reduces agency costs; it facilitates a long-term perspective that contributes value in challenging macroeconomic environments; and it ameliorates the effects of sub-optimal decisions such as the development of a mediocre business strategy.

Such a large value attributable to corporate culture is consistent with additional research examining the banking industry in the most recent financial crisis. Specifically, the study found that one could use a bank's performance data from the 1998 financial crisis, which then-Secretary of the Treasury Robert Rubin said at the time was "the worst financial crisis in the last 50 years," to predict default rates and stock performance in the most recent financial crisis with very high accuracy.[15] The researchers were surprised to learn that the banks did not appear to learn from their earlier mistakes in the 1998 financial crisis. While some of the firms changed their strategy in response to the first series of mistakes, few firms changed their culture, leading the professors to conclude that the persistence in risk culture of banks make their performance sensitive to crises.

QUANTIFYING CORPORATE CULTURE

Understanding how corporate culture interacts with other factors affecting firm performance, such as activist intervention, has been a major challenge because culture is rarely observable to those outside the firm. In particular, it is very hard to be able to get inside the firm and learn the truth about the patterns of employee behavior. In a recent paper, I acknowledged that there is a lot of information available about a firm's corporate culture in the user-generated reviews of firms that are posted on the Internet.[16] In fact, survey evidence found that 84 percent of millennials and 70 percent of baby boomers refer to user-generated content when making decisions—and career decisions are no different.[17]

Beginning in the late 1990s, firms started to recognize that there exists a market for "career intelligence" data and they developed guidebooks with details about the true workplace environment, education requirements, interview practices, salaries, advancement prospects, and career building tips across many industries and jobs. The popularity of information sharing online helped transform these niche guidebook companies onto a much bigger platform.

14 Graham, J., C. Harvey, S. Rajgopal, and J. Popadak, 2015, "Corporate Culture: Evidence from the Field," Working Paper.

15 Fahlenbrach, R., R. Prilmeier and R. Stulz, 2012, "This Time Is the Same: Using Bank Performance in 1998 to Explain Bank Performance during the Recent Financial Crisis," *Journal of Finance* 67, pp. 2139-2185.

16 Popadak, J., 2014, "A Corporate Culture Channel: How Increased Shareholder Governance Reduces Firm Value," Working Paper.

17 A nationally representative survey of Americans over the age of 18, "Talking to Strangers: Millennials Trust People over Brands," Bazaarvoice Report.

For example, two of the biggest online job boards collect and provide detailed employee reviews of the workplace environment. Usage reports from these websites suggest they get 180 million unique visitors per month.[18]

Overall, there are several popular websites including CareerBliss.com, CandidCareer.com, Glassdoor.com, Indeed.com, Payscale.com, and Vault.com. Some websites cater to college students while others cater to the executive set while yet others have went the route of catering to any job hunter. These websites reach a diverse set of users in terms of experience (part-time or full-time), age (some websites report an average user age of 22 while others report 47), to location (some are just in the U.S. while others collect data internationally). Regardless of the audience these websites cater to, or the main purpose behind the services they provide, there is a trove of data on the Internet about what really goes on inside most firms.

I collected millions of reviews from these popular websites and transformed them into simple quantitative measures of corporate culture. Specifically, I wanted to construct annual measures of corporate culture at the firm level. To do so, I isolated reviews from current employees and used the time-stamp recorded with the review to assign it to a year and a firm. I then mapped the text of the reviews into six aspects of culture. They include: adaptability, collaboration, customer-orientation, detail-orientation, integrity, and results-orientation. Management scholars have identified that these six aspects of corporate culture as the ones that matter for the overall variation observed in corporate culture.[19]

I used techniques from computation linguistics to create the measures. Specifically, I transform the text of the employees' reviews to a single number for each aspect of culture for a firm in a given year. While such a transformation involves many technical details, the mathematics match intuition. For example, if a review said, "Working in an ethical place that values employee involvement to help others on their team is a really nice environment," then the algorithm would recognize the key words and phrases—"ethical," "values employee involvement," "help others," and "team"—and assign an appropriate weight to those words based on the length of the review.

Because "ethical" is a positive word associated with integrity, the algorithm assigns a positive weight for the integrity aspect of culture. Because "values employee involvement," "help others," and "team" are all positive phrases and words associated with collaboration, the algorithm assigns a positive weight for the collaboration aspect of culture. If that one sentence is all the employee said about the firm, then the weight would be higher than if that was one sentence in a very long diatribe about the firm. The algorithm is also programmed to recognize negative phrases such as "individuals aren't very connected" and assign a negative weight to the collaboration aspect accordingly. So, unlike algorithms that match simply on dictionary words, this algorithm makes use of sets of cognitive synonyms and antonyms that may use multiple words but all express a single distinct concept.[20]

How should you interpret the cultural measures that I developed? Because the measures encompass both the positives and the negatives associated with a given aspect, the interpretation should reflect this. For example, a firm with a strong team-orientated or cooperative culture would receive a high positive score for the "collaboration" aspect while a firm with a competitive or every employee for himself culture would receive a low or even negative

18 http://www.indeed.com/about

19 Chatman, C., Caldwell, D., O'Reilly, C., and B. Doerr 2014, "Parsing Organizational Culture: How the Norm for Adaptability Influences the Relationship Between Culture Consensus and Financial Performance in High-technology Firms," *Journal of Organizational Behavior* 35, pp. 785-808.

20 WordNet develops and distributes a computational database of synsets: https://wordnet.princeton.edu/

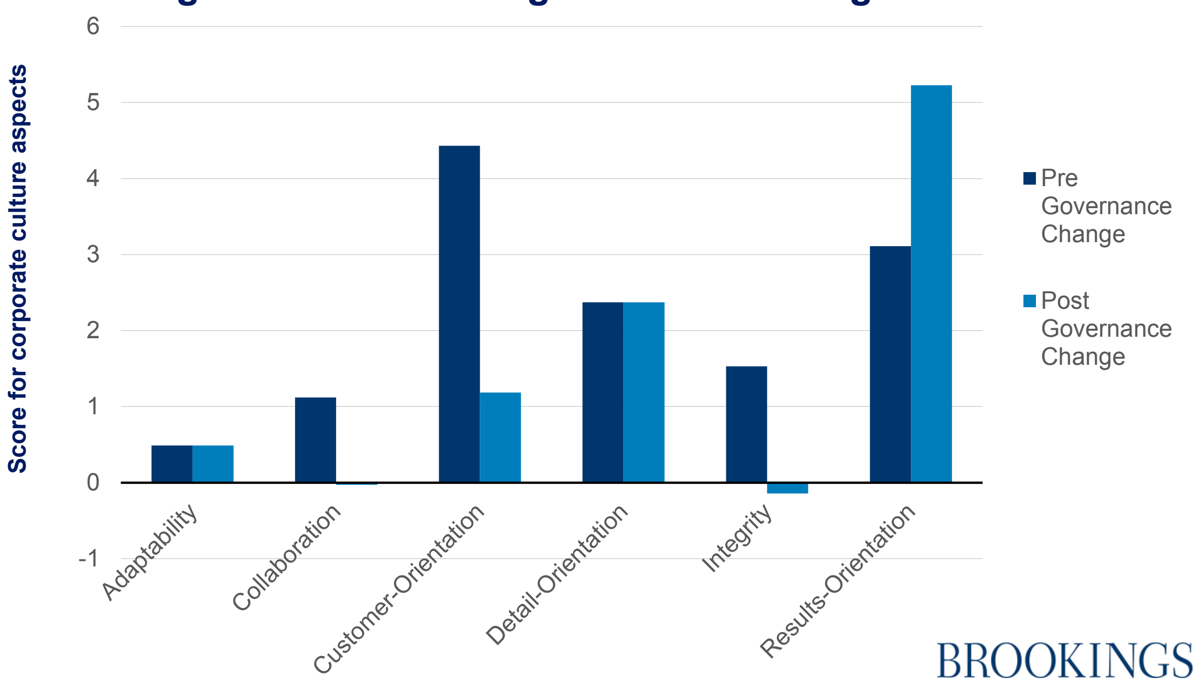
score for the “collaboration” aspect. Similarly, a firm that is innovative or where employees are resourceful in finding solutions when problems arise would receive a high positive score for the “adaptability” aspect while a firm with a lot of red tape and bureaucracy would receive a low or even negative score for the “adaptability” aspect.

Should the reviews and the algorithm to transform the reviews into measures of culture be trusted? I performed several validity tests that suggests yes. First, the quantitative measures of culture strongly correlate with external, well-known rankings such as the Dow Jones Sustainability Index and Fortune’s 100 Best Companies to Work For.[21] Second, the measures are statistically stable but never static over time, which coincides with what the management scholars’ case studies of corporate culture and organizational change reveal.[22] Third, my measures do not exhibit bimodality—that is unlike many Amazon reviews where people either love or hate the product, I went back to make sure an average rating was coming from uniform opinion rather than disagreement. Finally, my measures conform to media coverage and intuition about industry characteristics. For example, tech firms in Silicon Valley exhibit high levels of adaptability, whereas utility companies exhibit virtually no adaptability. Similarly, health care employees report high levels of collaboration and integrity.

EXPLORING THE RELATIONSHIP BETWEEN SHAREHOLDER GOVERNANCE AND CULTURE

Using the new data that I collected on a firm’s corporate culture, I set out to understand the effect of stronger shareholder governance on culture and firm value. I followed the cultural traits of firms that had shareholders pass a proposal to strengthen the governance at the firm during their annual meeting. The figure below depicts what happened at the firms where governance strengthened relative to a comparable set of firms where governance did not change.

Change in culture when governance strengthens



21 These measures have been used to quantify culture. See Guiso, L., Sapienza, P., Zingales,L., 2015, “The Value of Corporate Culture,” *Journal of Financial Economics* 117, pp. 60-76.

22 Kotter, J., and J. Heskett, 1992, *Corporate Culture and Performance,* New York: Free Press.

What the figure shows is that firms with stronger shareholder governance exhibited statistically significant increases in results-orientation but decreases in customer-orientation, integrity and collaboration in the year following the governance change. A similar pattern of increases in results-orientation and decreases in collaboration and integrity are apparent if I look two or three years past the reform date.

Next, I relate these governance-induced changes in corporate culture to firm value. On average, the increase in results-orientation is positive for the firm in that it increases firm value by about two percent; however, the decrease in customer-orientation, integrity, and collaboration have the effect of reducing firm value by one-to-five percent. Taken together, that means firm value is reduced by one-to-three percent after governance strengthens, when focusing exclusively on the corporate culture channel. But recall from before changes in governance could affect both the tangible value and the intangible value of the firm. When I look at the tangible improvements, I find the aggregate effect is a modest one percent increase in firm value.

To further test for evidence of a trade-off between intangible and tangible value in the firm, I examine financial statements and indicators for brand value such as national customer satisfaction indices. I find in the short-term, there are significant increases at these firms in sales growth, profitability, and payout while in the long-term, there are significant declines in intangible value, customer satisfaction, and brand value. In fact, the gains from the easy-to-observe performance metrics erode and the losses from the harder-to-measure intangible assets may even dominate by three years after the change in shareholder power. Of course, other things could be occurring during this time, so some caution is warranted when interpreting these findings.

Because I observe that shareholders face a trade-off between enhancing activities that produce easy-to-observe performance metrics and those that strengthen difficult-to-measure intangible assets, it is natural to wonder if it is possible to distinguish between firms that benefit from an activist's catalyst or strengthening of shareholder power and firms that need an alternative plan for unlocking value. I explore the heterogeneity in starting culture and its implications both in the context of traditional governance changes and activist interventions.

First, I find that firms that already ranked in the upper third of the results-orientation distribution do not see gains in firm value from strengthening governance. This is true even in the short-term, as no increase in stock price above the market can be detected. Interestingly, all firms suffer to some extent from declines in collaboration, integrity, and customer-focus after an increase in governance. On net, this suggests shareholders should look to increase their power in firms with low results-orientation if they want to create sustainable value. Second, I test for heterogeneity in treatment by constructing calendar time portfolios that go long on firms with below-average culture prior to an activist intervention and short firms with above-average culture prior to an activist intervention. Again, I find this strategy that exploits heterogeneity in the starting culture can generate small but significant returns over a period of two-years.

CONCLUSION: A PATH FOR RESTORING BALANCE

My research demonstrates that investors need to carefully consider the balance of governance and culture if the goal is sustainable long-term value creation. Stronger governance and activist firepower is not always the best remedy for corporations' shortcomings. In fact, the evidence suggests more recent activists may be overreaching when identifying possible targets. What this calls for is recognition by the broader investment community that implicit and explicit systems interact. By creating these new measures of corporate culture and documenting some intriguing relationships, I hope this serves as a call for others to explore corporate culture as an underappreciated source of sustainable value for firms. Moreover, I hope investors can begin an open dialogue with management that gives them the credit they deserve for investing in creating and sustaining effective corporate cultures.

GOVERNANCE STUDIES

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