Thought Piece:

Culture

As Jeff Bezos puts it, a company's culture can be a source of advantage or disadvantage. Ergo, what matters is having the right culture.

> *A word about corporate cultures: for better or for worse, they are enduring, stable, hard to change. They can be a source of advantage or disadvantage. You can write down your corporate culture, but when you do so, you're discovering it, uncovering it—not creating it. It is created slowly over time by the people and by events—by the stories of past success and failure that become a deep part of the company lore. If it's a distinctive culture, it will fit certain people like a custom-made glove. The reason cultures are so stable in time is because people self-select. Someone energized by competitive zeal may select and be happy in one culture, while someone who loves to pioneer and invent may choose another. The world, thankfully, is full of many high-performing, highly distinctive corporate cultures. We never claim that our approach is the right one—just that it's ours—and over the last two decades, we've collected a large group of like-minded people. Folks who find our approach energizing and meaningful.* - J Bezos

In our inaugural Castelnau quarterly report to you, we cited Culture and our way of operating as one of six 'edges' possessed by the Castelnau Group.

At that time, we wrote:

> *(re:) Culture. We have a way of operating that lends itself to learning by thinking, doing and observing. A confidence to try things in a thoughtful and careful way and humility to spot and admit failures that can be utilised for incremental learnings. It is a flat, self-organising culture that you need to be inside to truly appreciate but it allows us to draw on the full breadth of capability from many diverse and able brains and experiences* - Castelnau Q4 2021 report

We realise that such a statement from such a youthful business might seem a tad grandiose or even hubristic. Indeed, every annual corporate report we read these days seems to have some variation of the "we are fostering a culture of innovation and entrepreneurship" blurb.

So, what then gives us the right to suggest that our Culture is an edge for Castelnau Group?

In short, we believe it is because we have studied and stand on the proverbial 'Shoulders of Giants'. In other words, we have identified and observed the best business cultures and humbly seek to emulate the best ones that suit our chosen way of operating. Starting with a clean slate also allows us to begin with clear intent from the ground up. Indeed, perhaps that aforementioned (organisational) youth of ours is an advantage in creating a culture that can be an edge. Of course, only time will tell - cultures take years not quarters to manifest. We believe ours will be a source of advantage.

In the following, we try to show some substance underlying our learnings on culture. We examine how the Giants built great cultures and how that applies to what we are doing at Castelnau.

i) Learning from the giants

Culture is especially interesting because it is just so hard to replicate. Would an unlimited budget allow one to replicate Amazon's culture?

A simple Google Ngram search shows the deluge of writing and pontificating about corporate culture that has taken place in recent decades. Culture is indeed a complex topic to define, never mind to identify or indeed, to create. We choose to take our lead from the Giants, the men (and women) in the arena.

Whilst all agree on its importance, brilliant CEOs of brilliant businesses do vary in their expression of what culture means to them. Reed Hastings of Netflix, believes culture reflects "what behaviour is rewarded" within an organisation. Simon Wolfson says NEXT's culture is "about what we expect from one another". Jim Tisch of Loews said that Culture "is the glue that holds people in the firm together and it also provides the vision for all the people in the firm to know just what they're driving to". None of these are contradictory statements.

Steve Jobs' favourite saying was apparently an Aristotle line: "We are what we repeatedly do. Excellence, then not an act but a habit". To paraphrase Jobs, culture might be the habits of a company.

Culture is clearly not strategy (it eats that for breakfast), and it seems harder to implement. So, what do the Giants teach us about how to create a culture?

Here might be one way of decoding the art of building corporate Culture:

a. Deciding on HOW things get done (deciding on the direction)

b. Having utmost DISCIPLINE in repeatedly doing it that way (giving it strength)

c. Constantly REINFORCING via communication and stories (keeping it on course)

a. Deciding HOW things get done

The chosen strategy of a business will no doubt, influence how things get done. Here are some different examples of strong business cultures from a disparate group of great businesses with disparate business models. Importantly, each business has created a very durable competitive advantage thanks in small part to the underlying Culture. Each culture has its own nuance, appropriate for the chosen business model.

For example:

Berkshire and **Capital Cities** developed a culture of de-centralised decision making, high integrity behaviour and shareholder centricity. The culture was centred around the hiring of ultra-high-integrity people, having extreme clarity of purpose and then getting out of the way of the operational managers.

From its rebirth under Michael O' Leary in 1994, **Ryanair** focussed on absolute lowest cost air travel and its entire culture was centred around 'the how' in which this would be realised. The culture required to achieve this was a no-nonsense, open and often cut-throat culture which still thrives nearly 30 years later.

IKEA founder Ingvar Kamprad fostered a culture of low cost, simplicity and (interestingly) fostering what he called a safe place "to practice making decisions" while not fearing failure.

Amazon and **Costco** developed a culture ensuring that all decisions (sometime big bets, but also small incremental changes) were made through a customer obsession lens. The culture was about unwavering commitment to the customer in all facets of business without pandering to short-term gains or (again) fear of failure.

The founders of **JD Wetherspoon** and **Sports Direct** instilled a culture of experimentation, adaptation and continuous learning throughout their organisations. The culture led to deeply embedded entrepreneurial and hard-nosed 'ways of doing things' that eschewed traditional retail practices.

Howden Joinery, Games Workshop and **Richer Sounds** all created a culture of clarity of purpose, empowered employees and insistence on a level of customer service beyond the normal call of duty of a retailer. All had founder managers who were deeply involved in day-to-day operations and constantly reinforced the culture.

Other great conglomerates like **Halma** and **Teledyne** instilled a culture of astute capital allocation with a disciplined focus on return on capital.

b. DISCIPLINE of repeatedly doing it

Once the direction of travel is established, then the need for discipline comes into play. That is, our Giants always seem to be making sure that the way of doing things does not fade, get diluted or superseded by short term demands on the business. Charlie Munger says one of the most valuable tasks a director can ever perform is guarding against the drift in the culture.

Here is Jim Collins (reporting back from his business lab!)

> *It all starts with disciplined people. The transition begins not by trying to discipline the wrong people into the right behaviours, but by getting self-disciplined people on the bus in the first place. Next, we have disciplined thought. You need the discipline to confront the brutal facts of reality, while retaining resolute faith that you can and will create a path to greatness. Most importantly, you need the discipline to persist in the search for understanding until you get your Hedgehog Concept. Finally, we have disciplined action, the primary subject of this chapter. This order is important. The comparison companies often tried to jump right to disciplined action. But disciplined action without self-disciplined people is impossible to sustain, and disciplined action without disciplined thought is a recipe for disaster.* - Jim Collins, Good to Great

c. REINFORCING via communication

Perhaps a less well appreciated aspect of strong culture is the importance of constant reinforcement. All of the strongest cultures overseen by our Giants have exceptional communication habits for reinforcement of the cultural practices.

> *Yeah, well I think culture has to come from the top, it has to be consistent, it has to be part of written communications, it has to be — you know, has to be lived, and it has to be rewarded when followed, and punished when not.* - W Buffett

In a great interview with Outsider Tom Murphy, Murphy describes the culture that he famously was instrumental in creating at Capital Cities. Intentionally or not, in the interview how Murphy describes culture as a series of communications is really interesting. In a sense, Murphy was demonstrating the virtuous cycle of repeatedly telling employees about their culture. Murphy understood the need for constant reinforcement.

> *In terms of culture, we told our employees that we hire the smartest people we can find and that we have no more of them around than necessary. We also told them that we would be highly decentralized and give them a lot of responsibility. For most employees, we'd give them a ticket on the horse race, which means we'd give them options. We also told employees that we were in a business that was fun to be in. In fact, very few people ever left the company voluntarily.*
>
> *We told employees that the one thing they could not do was anything that would embarrass the company. They could not do anything that was improper or unethical because there would be no second chance. That's how we operated and that's how the leadership ran the company. We thought we had a responsibility to the communities that we served, and we figured that if we did a good job serving the community and our employees, then our stockholders would do fine. Of course, we were lucky, too, that we happened to be in a wonderful business.* - Tom Murphy, Interview Dec 2000 (emphasis ours)

We have noticed that many of the great business leaders create employee handbooks or communications missives to keep culture on track.

For example:

- Berkshire's owner's manual from 1999 (post the Gen Re acquisition) and of course Warren Buffett's annual shareholder letter are best in class examples of shareholder - and employee - communication
- Tom Kirby's (of Games Workshop) Little Black Book (and the sequel - The Little Red Book!) is a fascinating (and really enjoyable) handbook when tells you all you need to know about the fantastic culture that Kirby nurtured at this fantastic business
- IKEA - The Testament of a Furniture Dealer by its founder Ingvar Kamprad is full of deep social principles and common sense
- Jeff Bezos annual shareholder letters
- Simon Wolfson's letters and presentations (which it is clear are intended equally for both an internal and external audience)
- And as a sign of 21st century excellence Stripe's operating principles offer a fascinating guide on "how we interact with each other and our users, translating our values and beliefs into concrete actions."

Here is Warren Buffett describing his routine to keep his 70 CEOs on task.

> *My job is to have those 70 CEOs sending out the right message. Every two years, I write them a very simple letter. It's a page-and-a-half. I don't believe in 200-page manuals because if you put out a 200-page manual, everybody's looking for loopholes basically - W Buffett*

ii) Applying all this to Castelnau

As we recently outlined, our ambition with Castelnau is to create a Culture suitable for a winning strategy. Our ambition is very high in this regard though we recognise that this is a marathon not a sprint.

We are seeking to build a culture that is:

- customer centric
- with devolved empowerment
- that embraces continuous improvement
- is a safe place to fail
- with dynamic execution
- acts with integrity and openness
- is aligned to reward for success
- and finally is an attractive, even magnetic place, for good people

To give some specifics, at our controlled companies we think we are on the right track in beginning to build out the broader culture. For example:

Dignity
Principles implemented as of June 2022

Hornby
New principles being formed

Cambium
Principles in place since 2015

Stanley Gibbons
Rebuilding the business' reputation

Above all, we believe we are attracting the right people and the self-selection that Jeff Bezos referred to above is in evidence in the new hires across our group companies.

Conclusion

Baruch Lev (once dubbed "the world's most exciting accountant"!) is a NYU professor who has written extensively about the deficiency of accounting to capture the real value within modern companies - its intangible assets. Whilst Lev spends most of his time thinking about how to treat R&D and goodwill, it seems to us that Culture is the key intangible asset that he should be assessing.

In no small way, Culture, your company's way of operating, is its ultimate intangible asset. We provide a NAV monthly to you, our shareholders. But the more useful metric is of course Intrinsic value. The difference between NAV and IV is to a large extent determined by the intangible assets - the strong culture - that we are building.

"Culture – and that includes your attraction for great people – is the only alpha." David Krakauer, President Santa Fe Institute