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Fair Employee Treatment and Financial Characteristics of Firms

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Abstract

Present paper investigates the interactions between firm's key financial decisions and its fair employee treatment and welfare policies. Fair employee treatment has two components—measurable and unmeasurable. Certain ratios like employee compensation to sales, employee compensation to total assets, and total employee welfare to sales are computed to capture the measurable part of fair employee treatment. To envisage the unmeasurable component, a dummy variable for fair employee treatment is used which is based on the listing of the firm in India's Best Companies to Work for 2017: The complete List prepared by Great Place to Work and published by Economic Times. Linear multiple regression analysis is conducted using firm's leverage, price to book value, and enterprise value to EBDITA as dependent variables, and fair employee treatment, and employee compensation to sales as independent variables. Results indicate a negative relationship between employee compensation and firm valuation, and confirm that high leverage firms are more likely to cut-down on employee compensation but ensure better and fair treatment of employees. The result of binary logistic regression model predicts that firm's dividend policy, employee stock options, and firm leverage positively impact the probability of fair employee treatment.

Keywords

Fair Employee Treatment, Leverage, Binary Logistic Regression, Employee Compensation

1. Introduction

Employees and executives are firms' nonfinancial stakeholders, who can have a significant influence on its financial decisions such as capital structure, capital allocation, and payout policy. Titman [1] was the first to point out that the

stakeholders' incentives to make firm-specific investments affects a firm's financing decisions. Employees and executives will be less willing to work with a firm with higher finance leverage (high cost of financial distress), and therefore will demand higher wages. As a result, the revenues of distressed firms are likely to decline and, while its costs are likely to increase. A highly leveraged firm is more likely to go bankrupt and a bankrupt firm is more likely to liquidate. In addition to liquidation risk, which will result in loss of employment for the employees of the firm, debt-overhang is another issue which impacts the employee treatment in a highly leveraged firm. These firms facing debt-overhang tend to invest less, which means they may be less willing to take on new opportunities and thus may offer their employees less opportunities for career advancements. Moreover, highly leveraged firms have a greater tendency to lay off workers and reduce employment in response to a short-term reduction in demand. A firm with less onerous debt obligations may be willing to maintain high employment when times are bad, in order to reduce the future costs of hiring and retaining workers when demand increases. However, a more highly leveraged firm may be forced to cut costs by laying off workers to meet its debt obligations. Sharpe (1995) and Hanka [2] provide evidence that suggests that a firm's debt ratio does in fact affect the employment. Specifically, Hanka found that, holding all else constant; firms with higher debt ratios are more likely to lay off employees. Sharpe found that, firms with less debt were more likely to maintain a larger workforce through a recession than were the firms with higher debt ratios. Contrary to this, firms can also use its financial leverage to influence the bargaining outcome of the employment covenants. Bonnars and Deere (1991) owner how a firm's leverage can be used to improve employer's bargaining power. Firms with increased financial leverage can successfully use their financial position to achieve wage concessions. Firms can exercise higher bargaining power against the labor unions' demand of increase in wages. Such firms may draw bargaining power owing to the employees' fear of unemployment as increase in wage demands would push a firm towards bankruptcy. With the increase in the stress to bring about substantial raise in employee wages, increases the probability of firm's bankruptcy. And given the limited/unattractive employment alternatives, unionized employees would actually gain less from achieving higher wages, thus lowering employees' bargaining power. Hence, high debt ratios may prove instrumental in effectively persuading employee concessions especially during business downturns. Therefore, highly leveraged firms should have lower allocation towards employee compensation and welfare. This led us to take measurable employee compensation in the control variable.

Managerial talent choose to work for a company that provides better future opportunities over the one that compensates well but offer fewer opportunities for advancement. Because of this, a high debt ratio may be very costly for a firm that is trying to attract the best talent. To make firm attractive for the highly talented managers, these highly lever 0 aged firms are more likely to provide employee stock options. Fenn and Liang [3] demonstrate that managerial stock in-

centives affect corporate payout policy. They found a strong negative relationship between dividends and management stock options, and a positive relationship between repurchases and management stock options. Share repurchases implicitly change existing compensation contracts of firm employees and executives. At the time of repurchase, employees are typically not allowed to tender unvested shares, and their fractional holding in the firm equity increases. This increased employee ownership results into higher pay-for-performance sensitivity. This creates stronger incentive for the employees to provide costly effort, but also exposes them to higher risk. This opportunistic behavior subjects risk averse employees and executives to higher than optimal risk due to random increase in compensation sensitivities, prompting them to request higher fixed wages when they sign the employment contract [4]. Contrary to this, regular dividend paying firms, which are not likely to repurchase shares in foreseeable period, would be preferred by the executives and employees, as in these firms their compensation plans are not subject to unexpected changes. Jensen [5] argues that managers with large free cash flow have incentives to overinvest beyond the optimal level and high leverage constrains the managers from diverting free cash flow to obtain private benefit. However, availability of free cash is not the only factor which influence the capital allocation decisions of a firm, return of capital employed also play critical role in such decisions. Thus, if a firm's investment in human capital is a positive net present value project, then free cash flows, firm leverage, and return of capital employed should have some influence on capital allocation in employee related activities.

Present paper investigates the interactions between firm's key financial decisions namely capital structure, payout policy, and capital allocation and its fair employee treatment and welfare plans. Fair employee treatment has two components—measurable and unmeasurable. The measurable component takes account of fair allocation of firm's resources towards employee compensation and welfare schemes, whereas, unmeasurable and intangible component covers organization culture or work environment that provides an employee the intrinsic motivation to work towards his or her career advancement.

The remainder of the paper is organized as follows. Section 2 discusses the related literature. Section 3 describes the sample, and measurement of variables. Section 4 presents the findings and analysis. Finally, Section 5 concludes the findings and implications.

2. Literature Review

Adequate literature is available linking employee workplace practices and firm performance. Barney [6] [7] emphasized the significance of human resource philosophies as the source of sustained competitive advantage for the firm. Huselid [8] based on the evidence from the US and Germany, proved both economically and statistically significant relationships between the employee work place practices on firm performance. The high performing work practices have a significant impact on the employee intermediate outcomes and also on the short

and long-term performance outcomes of an organization. Sels, *et al.* [9] in their research contributes towards the influence of HRM on operational and financial performance with mediating effects of operational performance (productivity, employee turnover and absenteeism) on the relationship between HRM intensity and financial performance. Their results show a strong effect of intensive HRM on the profitability of small and medium sized companies. Collins, Ericksen, Allen's work [10] also emphasized in their work about the employee management practices helping the employers to improve workforce alignment, *i.e.*, with high levels of workforce alignment experience higher performance than firms with lower levels of workforce alignment. Subramaniam and Youndt [11] found that the combination of human and social capital positively affected firms' innovative capabilities. Research work by Soon [12] on Singapore firms indicates that work-life harmony is a critical business strategy that Singapore firms can employ to reduce their employee turnover, and in turn improve overall firm performance. Best [13] presented strong evidence of satisfied employees contributing to greater levels of productivity. He found that companies in which employees report high levels of satisfaction, have significantly greater valuations than both their respective industry medians and matched firms. Thus, successful efforts in increasing employee satisfaction appear to enhance overall firm productivity, which is subsequently rewarded by investors through higher equity values, thus contributing to the firms' valuations.

Involvement of employees in decision making also contributes in firm performance enhancement. Bae, Kang and Wang [14] investigated the stakeholder theory of capital structure from the perspective of a firm's relations with its employees. They found that firms that treat their employees fairly, maintain low debt ratios. Another study of manufacturing sector by Kuyea and Sulaimonb [15] presented the statistical relationship between employee involvement in decision making and firms' performance in the manufacturing sector in Nigeria. Their work further highlighted the significant difference between the performance of firms whose employee involvement in decision making are deep and the performance of firms whose employee involvement in decision making are shallow. Bowman [16] explored the relationship between investing in employees and the corresponding stock market performance. According to Matsa [17], it is important to take into consideration workforce needs and their management while making financing decisions. Arumugam and Mojtahedzadeh [18] in their work on Malaysian industries, indicated the employee management practices have an important role to play in improving organization's financial performance. It also investigates the relationship between Human Resource Management Practices, Job Satisfaction, and Financial Performance in a systematic manner to increase successful rate of Human Resource Management practices. The research highlighted that the Job satisfaction plays a fundamental role in determining the performance in Malaysian industries.

Another branch of literature explores the influence of nonfinancial stakehold-

ers, such as customers, suppliers, and workers on firm's financial decisions, particularly, capital structure decisions. Titman [1] was the first to point out that the stakeholders' incentives to make firm-specific investments affects a firm's financing decisions. Because nonfinancial stakeholders face switching costs if the firm is liquidated, their incentive to make firm specific investment depends on the firm's financial decisions. Some studies provide explicit investigation on how a firm's incentive and ability to offer fair employee treatment are relevant to its capital structure decisions. Maksimovic and Titman [19] show that firms that want to credibly commit themselves to providing better employee benefits need to have lower debt ratios. The key argument of their study is that employees and other nonfinancial stakeholders are reluctant to do business with a highly levered firm because financial difficulties can affect the firm's incentives to honor its implicit contracts with them. A financially distressed firm would have incentive to improve its cash flow position by cutting costs related to employee benefits. Therefore, the rational employees who recognize these incentives of a highly levered firm to change the terms of trade that are created by outstanding debt, they would negotiate higher wages for their labor, which would result into reduction of firm value. Myers [20] argues that firms with high debt outstanding has incentives to pass up valuable investment opportunities that could make a positive net contribution to the market value of the firm. This underinvestment issue is more severe for firms with higher growth opportunities than those having surplus free cash flow available, implying that financial leverage is negatively related to growth opportunities. While, both Titman [19] and Myers [20] predicts a negative relation between a firm's leverage and fair employee treatment, they differ in terms of causality. Titman [19] predicts that the degree of a firm's commitment in fair treatment of its employees determines its capital structure, contrary to this, Myers [20] predicts that a firm's capital structure influences its investment in employee benefits. Jensen [5] argues that firms with higher free cash flows are likely to have more resources to invest in employee compensation and welfare than those with lower free cash flow, these firms are likely to treat their employees more generously even at the cost of shareholder's value. Debt serves as a disciplinary mechanism that prevents managers from wasting cash, which in turn can also control the overinvestment in employee benefits. Therefore, higher leverage can result into lower employee benefits. Analogous to this, Hanka [2] demonstrates that higher debt is associated with more frequent employment reductions, lower wages and reduced pension funding. If we combine the arguments of Jensen [5] that firms with higher free cash flows are likely to have more resources to invest in employee benefit, and argument of severity of underinvestment for high growth firms, as proposed by Myers [20], we can say that, besides the availability of free cash flows, firm level growth opportunities also play an important role in employee treatment. In addition to capital structure and capital allocation, another financial decision *i.e.*, firm's payout policy also interacts with its employee benefits, specifically the composition of employee and executive compensation. Kim & Patel [21] suggests that firm-related

factors are important for the effective utilization of employee ownership. It revealed that employee ownership and its joint effects with country, year, industry, or firm explain the variance in return on assets.

Mehran [22] hypothesize that incentive compensation and management stock ownership, by mitigating conflicts between managers and shareholders, can lead to an increased and more optimal use of leverage, and the level of repurchases and dividends may be positively related to management share ownership and stock options. Fenn and Liang [3] demonstrate using data on more than 1100 nonfinancial firms during 1993-1997 that managerial stock incentives affects corporate payout policy. They found a strong negative relationship between dividends and management stock options, and a positive relationship between repurchases and management stock options. Share repurchases implicitly change existing compensation contracts of firm employees and executives. At the time of repurchase, employees are typically not allowed to tender unvested shares, and their fractional holding in the firm equity increases. This increased employee ownership results into higher pay-for-performance sensitivity. This creates stronger incentive for the employees to provide costly effort, but also exposes them to higher risk. This opportunistic behavior subjects risk averse employees and executives to higher than optimal risk due to random increase in compensation sensitivities, prompting them to request higher fixed wages when they sign the employment contract [4]. Contrary to this, regular dividend paying firms, which are not likely to repurchase shares in foreseeable period, would be preferred by the executives and employees, as in these firms their compensation plans are not subject to unexpected changes.

In the present paper, we investigate the interactions amongst a firm's financial decisions namely capital structure decisions, capital allocation, and payout policy and its fair treatment of employees, and their compensation plans. Fair treatment of employees in a firm is not measureable directly in monetary terms, rather it is based on the tacit dimensions of organizational culture such as fairness, respect, credibility, pride and camaraderie. Therefore, it seems relevant to investigate whether or not these soft dimensions of organizational culture interact with the firm's financial decisions. Cross section financial data for BSE 100 firms is collected from CMIE (Centre for Monitoring Indian Economy) data for year 2016-17. To identify the firms having best practices for employee treatment, India's best companies to work for 2017: The complete list prepared by Great Place to Work and published by Economic Times has been accessed. Present study is a worthwhile effort, and to best of our knowledge no such study has been conducted in the Indian context.

3. Data and Methodology

3.1. Sample

The sample includes cross-section data on firms' financial parameters and reported expenses, and investments in employee compensation and welfare for

BSE 100 firms. These are largest 100 firms in terms of market capitalization listed on Bombay Stock Exchange, Mumbai, India. Data on various firm, financial, and employee parameters, such as, size of the firm, free cash flows, dividend payout, firm's valuation, leverage, profitability, and employee's expenses and welfare for year 2016-17 has been collected from CMIE prowess database. Out of 100, for 20 firms, data on all the parameters mentioned above was not available for the study period, therefore, final sample has been reduced to 80 firms. Fair employee treatment has both measurable and unmeasurable components. The measurable component takes account of fair allocation of firm's resources towards employee compensation and welfare schemes, whereas, unmeasurable and intangible component covers organization culture or work environment that provides an employee the intrinsic motivation to work towards his or her career advancement. Certain ratios like employee compensation to sales, employee compensation to total assets, and total employee welfare to sales are computed to capture the measurable part of fair employee treatment. To envisage the unmeasurable component, a dummy variable for fair employee treatment is used which is based on the listing of the firm in India's Best Companies to Work for 2017: The complete List prepared by Great Place to Work and published by Economic Times. The dummy variable takes value of 1 if the sample firm is part of the Great Place to Work list, otherwise it takes the value of 1. This list *i.e.*, 'India's Best Companies to Work For—2017' has recognized the 100 best workplaces from organisations that represent 20 industry sectors. Great Place to Work assesses workplaces by employing reliable and consistent methodology and tools addressing two very crucial workplace dimensions *i.e.*, trusting relationships and workplace culture. These two dimensions are characteristic of a great place to work. One of the proprietary and globally-trusted tools used by Great Place to Work is Trust Index© survey. It is an employee survey covering workplace aspects—fairness, respect, credibility, pride, and camaraderie. Another tool Culture Audit© assesses aspects related to hiring, inspiring, speaking, listening, caring, developing, thanking, celebrating and sharing. It reveals about the value system, policies and practices supporting a workplace culture. 'India's Best Companies to Work For' list reflects to a great extent about workplace experience of employees, fair treatment of employees, and effectiveness of people management practices and policies that reinforce workplace culture. Thus, place of a firm in the list of great place to work implies that the firms are successful in creating and sustaining a great workplace practices and culture making the firm a great place to work.

For studying the differences amongst the sample firms in terms of capital structure, they are classified into three categories, namely high, moderate and zero debt firms. As the name suggests, firms having no debt in their capital structure are classified as zero debt firms, firms having debt to total asset ratio between 1 percent to 30 percent are classified as moderate debt firms, and firms having more than 30 percent debt to total asset ratio are classified as high debt

firms. Similarly, firms are classified into three categories, namely zero-dividend firms, moderate-dividend firms, and high-dividend firms in terms of their dividend payouts.

3.2. Model Specification

Linear multiple regression analysis is conducted using firm's leverage, price to book value, and enterprise value to EBDITA as dependent variables, and fair employee treatment, and employee compensation to sales as independent variables. Dummy variables are used for fair employee treatment and ESOPs. Dummy variable of fair employee treatment will take value of 1 if the firm is part of India's best companies to work for 2017: The complete list published by Economic Times, otherwise 0. Various independent variables which may influence the leverage, and valuation of a firm are identified from the literature, and are used in multiple regression as control variables. Control variables used in analysis include dividend payout ratio, size of the firm, net profit margin, R&D/sales, promoters' holdings, firm's leverage, and employee stock option issued by the firm, ESOP. A dummy variable is used for employee stock option offered by the firms. Dummy variable of ESOP will take value of 1 if firms has issued ESOPs, otherwise 0.

$$\begin{aligned}&\text{Firm Leverage}\\&=\beta_0+\beta_1\left(\text{Employee Fair Treatment Dummy}\right)\\&\quad+\beta_2\left(\text{Employee Compensation/Sales}\right)+\beta_3\left(\text{Firm\_Size}\right)\\&\quad+\beta_4\left(\text{Dividend Payout Ratio}\right)+\beta_5\left(\text{Promoters' Holding}\right)\\&\quad+\beta_6\left(\text{Net Profit Margin}\right)+\beta_7\left(\text{R\&D/Sales}\right)+\beta_8\left(\text{Dummy\_ESOP}\right)+\varepsilon_i\end{aligned}\tag{1}$$

$$\begin{aligned}&\text{Price to Book Value}\\&=\beta_0+\beta_1\left(\text{Employee Fair Treatment Dummy}\right)\\&\quad+\beta_2\left(\text{Employee Compensation/Sales}\right)+\beta_3\left(\text{Firm\_ Size}\right)\\&\quad+\beta_4\left(\text{Dividend Payout Ratio}\right)+\beta_5\left(\text{Promoters' Holding}\right)\\&\quad+\beta_6\left(\text{Net Profit Margin}\right)+\beta_7\left(\text{R\&D/Sales}\right)\\&\quad+\beta_8\left(\text{Dummy\_ESOP}\right)+\beta_9\left(\text{Firm's Leverage}\right)+\varepsilon_i\end{aligned}\tag{2}$$

$$\begin{aligned}&\text{Enterprise Value/EBDITA}\\&=\beta_0+\beta_1\left(\text{Employee Fair Treatment Dummy}\right)\\&\quad+\beta_2\left(\text{Employee Compensation/Sales}\right)+\beta_3\left(\text{Firm\_ Size}\right)\\&\quad+\beta_4\left(\text{Dividend Payout Ratio}\right)+\beta_5\left(\text{Promoters' Holding}\right)\\&\quad+\beta_6\left(\text{Net Profit Margin}\right)+\beta_7\left(\text{R\&D/Sales}\right)\\&\quad+\beta_8\left(\text{Dummy\_ESOP}\right)+\beta_9\left(\text{Firm's Leverage}\right)+\varepsilon_i\end{aligned}\tag{3}$$

Binary logistic regression analysis is conducted to study the determinants of fair employee treatment. A dummy variable for fair employee treatment is specified as dependent variables, and dividend payout ratio, employee compensation to sales, firm's leverage, dummy of employee stock option, natural logarithm of firm's total assets for firm size, and R&D to total asset, promoters' holdings, and

price to book ration are specified as independent variables.

$$\begin{aligned}&\text{Employee Fair Treatment Dummy}\\&=\beta_0+\beta_1\left(\text{Dividend Payout}\right)+\beta_2\left(\text{Employee Compensation/Sales}\right)\\&\quad+\beta_3\left(\text{Firm\_ Size}\right)+\beta_4\left(\text{Promoters' Holding}\right)+\beta_5\left(\text{Price to Book Value}\right)\\&\quad+\beta_6\left(\text{R\&D/Sales}\right)+\beta_7\left(\text{Dummy\_ESOP}\right)+\beta_8\left(\text{Firm's Leverage}\right)+\varepsilon_i\end{aligned}\tag{4}$$

4. Findings and Analysis

Table 1 provides financial and other characteristics of firms with fair employee treatment, and low employee treatment score. Those BSE 100 companies that appear in India's Best Companies to Work for 2017: The complete List published by Economic Times are considered fair employee treatment firms, while remaining firms are considered as low employee treatment firm. Out of the sample of 80 BSE 100 firms, only 10 firms are listed in the fair employer list. Table 1 provides mean values of various financial parameters for both the categories of firms along with p-values of two-tailed t-test conducted on their mean values.

There are statistically significant differences for the two categories of firms in terms of price to earnings ratio, employee compensation to total assets, employee compensation to sales, total employee welfare plans to sales, total firm cash flows, firm's leverage, and return on capital employed. Though, the sample is not a true representative of fair employee treatment firms, results are unanticipated. Contrary

Table 1. Financial Characteristics of fair employee treatment firms and low employee treatment firms. (*p < 0.10, **p < 0.05, ***p < 0.01).

Variables	Fair Employee Treatment Firms	Low Employee Treatment Firms	P-Value Two Tail T-Test.
P/B	4.5383	6.1965	0.2581
P/E	34.465	49.9465	0.0007***
Size of the Firm	5.9023	5.7798	0.3322
Employee Compensation/Total Assets	0.0238	0.0634	0.0006***
Employee Compensation/Sales	0.04248	0.1188	0.0029***
Total Employee Welfare Plan/Sales	0.04613	0.12785	0.0053***
ESOPs	209.5416	139.975	0.5552
R&D/Sales	0.001089	0.002716	0.1729
SGA/SALEs	0.04081	0.6785	0.2602
CSR/Sales	0.00210	0.09474	0.1740
Cash Flows	−3485.575	12,254.1295	0.0275**
Total Debt/Total Assets	0.2563	0.0893	0.0229**
D/P Ratio	26.3991	27.9481	0.9316
ROCE	8.2975	13.6614	0.0916*
Net Profit Margin	12.9641	12.47568	0.8523

Source: Authors' Calculation.

to the findings of the earlier studies, low employee treatment firms are demonstrating significantly higher valuations, higher allocation for employee compensation as percentage of sales and total assets, better allocation of revenues to employee welfare plans, better returns on capital employed and firm cash flows, and significantly lower leverage. Since various firm level variables may affect the employee treatment in a firm, further analysis is performed in Table 2 studying financial and employee fair treatment differences across three categories of firms in terms of their financial leverage. Firms having no debt in their capital structure are classified as zero leverage firms, firms having debt to total asset ratio between 1 percent to 30 percent are classified as moderately levered firms, and firms having more than 30 percent debt to total asset ratio are classified as highly levered firms. In the sample of 80 firms, there are 7 highly levered, 35 moderately levered, and 38 zero leverage firms.

Results in Table 2 shows that zero leverage firms spend higher amount on employee compensation and employee welfare as percentage of their sales, pay higher dividends, have issued more employee stock options, and spend substantially higher amount on corporate social activities in comparison to both highly levered and moderately levered firms. However, these firms have lowest fair employee treatment score. Contrary to this, highly levered firms are equally profitable as zero leverage firms, have lower employee compensation and employee welfare as percentage of their sales, ranked lowest in terms of offering ESOPs, and have lowest dividend payment amongst the three categories, nevertheless, these firms demonstrate highest fair employee treatment score.

Another important financial decision which may influence employee related practices in a firm is its payout policy. Literature suggests that there exists a conflict between employee compensation and dividend payouts made to the firm's shareholders. Since, the shareholders are the residual claimant on the firm's earnings, excessive payment to its employees would result into lower profit available for distribution amongst the shareholders. Contrary belief is that a successful firm should treat all the stakeholders fairly, including employees and shareholders. Table 3 presents financial and employee fair treatment differences

Table 2. Fair employee treatment and other financial and firm level characteristics for highly levered, moderately levered, and zero leverage firms.

		Net Profit margin	Employee compensation/Sales	CSR/Sales	ESOPs	Total employee welfare plan/Sales	D/P Ratio	Fair Employee Treatment score
Highly Levered Firms (7 firms)	Mean	14.75%	6.03%	0.32%	0.14	6.12%	10.08%	0.42
	Median	7.12%	5.24%	0.14%	0	5.24%	2.53%	0
Moderately Levered Firms (35 firms)	Mean	8.38%	8.54%	0.18%	0.31	9.00%	31.02%	0.11
	Median	7.61%	6.52%	0.15%	0	7.16%	24.23%	0
Zero Leverage Firms (38 firms)	Mean	15.86%	14.12%	1.06%	0.42	14.78%	38.14%	0.07
	Median	13.23%	6.76%	0.23%	0	7.67%	41.64%	0

Source: Authors' Calculation.

across three categories of firms in terms of their dividend payout. Firms not paying any dividend are classified as zero leverage firms, firms having dividend payout ratios from 1 percent to 30 percent are classified as moderate dividend firms, and firms having more than 30 percent of dividend payout ratio are classified as highly levered firms. In the sample of 80 firms, there are 40 high dividend firms, 26 moderate dividend firms, and 14 zero dividend firms.

Results in Table 3 indicates that zero dividend firms spend relatively lower amount on employee compensation and employee welfare as percentage of their sales, have issued more or less same employee stock options, and spend lower amount on corporate social activities in comparison to both high dividend firms and moderate dividend firms. Also, all the three categories of firms have almost identical fair employee treatment scores. Contrary to this, high dividend firms generate more return on capital employed than other two categories of firms, have higher employee compensation and employee welfare as percentage of their sales, and contribute substantially higher amount on corporate social responsibilities. Whereas, moderate dividend firms are upmost on issuing employee stock options. There seems to be a negative pattern between firm's dividend payment and its leverage, as zero dividend firms are most levered among all, followed by moderate dividend firms, and high dividend firms. For high dividend firms, more employee compensation and employee welfare to sales, substantially higher contribution towards corporate social responsibility, and almost identical employee stock option as zero dividend firms, indicate that these firms, which are able to generate higher return of capital employed are also able to reduce the postulated conflict amongst various stakeholders.

Results of Table 1, Table 2, and Table 3 are merely indicative, but not conclusive. Therefore, regression analysis is performed to study whether fair employee treatment influence firm's financial parameters such as leverage, and firm value. Ordinary least square regression is performed for firm's leverage, price to book value ratio, and enterprise value to EBIDTA using various employee and financial indicators as independent variables. A dummy variable is used for fair employee treatment, and employee stock options, another employee related independent

Table 3. Fair employee treatment and other financial and firm level characteristics for zero dividend, moderate dividend, and zero dividend firms.

		Employee compensation/Sales	CSR/Sales	ESOPs	Total employee welfare plan/Sales	Total Debt/Total Assets	ROCE	Fair Employee Treatment
Zero Dividend (14 firms)	Mean	9.00%	0.28%	0.29	9.28%	17.67%	10.82%	0.14
	Median	6.83%	0.16%	0.00	6.83%	15.34%	6.58%	0.00
Moderate Dividend (26 firms)	Mean	8.66%	0.18%	0.50	9.30%	7.32%	15.20%	0.12
	Median	6.01%	0.18%	0.50	6.50%	3.50%	15.15%	0.00
High Dividend (40 firms)	Mean	13.16%	1.01%	0.28	13.69%	5.40%	17.44%	0.13
	Median	6.27%	0.20%	0.00	7.29%	0.10%	12.78	0.00

Source: Authors' Calculation.

variable used is employee compensation to sales. Other independent variables used in the regression analysis include dividend payout, size of the firm, net profit margin, R&D to sales, and promoters' holding. Fair employee treatment and employee compensation to sales are the two independent variable which are likely to affect firm's leverage and its valuation. It is expected that firms that compensate and treat their employees well should have lower leverage, and better valuations. Issuing employee stock option is an indicator of reduced agency conflict between a firm's shareholders and its employees. According to dividend signaling hypothesis, dividend payout is expected to reduce information asymmetry between firm's management and shareholders. R&D expense to sales ratio indicates firm uniqueness, as firms having higher ratio are supposedly research intensive firms developing unique product and services. Firm uniqueness is likely to influence employee treatment, firm leverage, and firm valuation. Firm size, profitability, and promoter's holding are control variables. Table 4 presents the estimates of OLS regression of firm's leverage, price to book value, and enterprise value to EBDITA on employee fair treatment dummy and other firm level control variables.

In regression 1, the dependent variable is firm's leverage. Fair employee treatment

Table 4. Estimate of OLS regression of firms' leverage, price-to-book value ratio, and enterprise value to EBDITA Ratio. The p-values in the parentheses are based on the standard errors that are heteroscedasticity-consistent. (*p < 0.10, **p < 0.05, ***p < 0.01).

Dependent Variable Method: OLS	1. Firm's Leverage	2. Price/Book Value	3. Enterprise Value/EBIDTA
Fair Employee Treatment	0.1374** (0.022)	−1.4435 (0.432)	3.1719 (0.5741)
Employee Compensation/Sales	−0.1223 (0.228)	−0.7248 (0.900)	−24.8904** (0.0454)
ESOP	−0.1056*** (0.000)	2.1983 (0.249)	0.0012 (0.5402)
Dividend Payout Ratio	−0.0012*** (0.011)	0.0171 (0.617)	−0.0944 (0.1517)
Ln (Total Assets)	0.0087 (0.775)	−0.2733 (0.8857)	−3.021 (0.4880)
Net Profit Margin	0.0012 (0.410)	0.0554 (0.226)	0.1294 (0.4198)
Promoters' Holding	−0.0912* (0.100)	5.8925** (0.0782)	0.1429 (0.1379)
R&D/Sales	0.0003 (0.3403)	0.0168 (0.1435)	−0.0075*** (0.0080)
Firm's Leverage	----------	−5.2051 (0.4266)	−29.6740*** (0.0038)
No. of Firms	80	80	80
Adjusted R^2	0.2833	0.3155	0.1700

Source: Authors' Calculation.

dummy, ESOP dummy, dividend payout, and promoters' holding are statistically significant independent variables. Coefficient of fair employee treatment dummy is positive, that confirms a positive relation between firm leverage and fair employee treatment. Coefficient of other three variables, *i.e.*, employee stock option dummy, dividend payout, and promoters holding are negative, depicting their negative relation with the firm leverage. Another important employee-related independent variable is employee compensation to sales. The results reveal that employee compensation to sales, which is quantifiable unlike the employee fair treatment, has a negative coefficient to the firm leverage. However, this relationship is not statistically significant, but worth mentioning. The composite effect of positive coefficient of fair employee treatment, and negative coefficient of employee compensation to sales can be interpreted that high leverage firms are more likely to cut-down on employee compensation but ensure better and fair treatment of employees. Thus, a firm's ability to offer practices and policies towards fair employee treatment and work culture can compensate for the wage-cuts by impacting positive employee experience. It may act as an important determinant of firms' financial decisions. Negative coefficient of employee stock option is in line with the findings of the earlier studies that higher firm leverage makes its employee stock option offering less attractive. Negative coefficient for dividend payout ratio indicates that highly levered firms pay smaller dividends. Another interesting insight from the result is that promoters are averse to the idea of financial leverage.

In regression 2, the dependent variable is price to book value ratio, which describes firm valuation in terms of market value of equity to its book value. Promoters' holding is the only statistically significant variable. Coefficient of promoters' holding has a large positive value, demonstrating a positive relation between firm's value and its promoters' holding.

In regression 3, the dependent variable is enterprise value to EBDITA, which describes firm valuation in terms of enterprise value to its operating cash flow. Enterprise value is determined as market capitalization plus book value of debt minus cash and equivalent short term investments. Enterprise value is often viewed as the cost of a takeover, *i.e.*, in the event of a buyout, the acquiring company assumes the acquired company's debt but also receives its cash. Enterprise value is most useful when comparing firms with significant differences in capital structure. EBIDTA is a proxy for operating cash flow because it excludes depreciation and amortization. Employee compensation to sales, R&D to sales, and firm leverage are statistically significant independent variables. All the three statistically significant variables have negative coefficient, establishing their negative relation with the firm enterprise value to its operating cash flows. Negative coefficient of employee compensation to sales indicates negative perception of the market towards the higher employee compensation expenditures. Negative coefficient of R&D to sales indicates the uncertainty associated with the R&D projects, and its adjustment in firm valuation. Negative coefficient of firm leve-

rage is in line with the findings of earlier literature, that highly levered firms attract lesser enterprise value.

To estimate the probability of fair employee treatment in the sample, a binary logistic regression analysis is performed using dummy dependent variable for fair employee treatment, which takes value of 1, if the firm is listed in the India's best companies to work for 2017: The complete list published by Economic Times, otherwise 0. Independent variables for binary logistic regression consist of dividend payout ratio, employee stock option, firm leverage, employee compensation to sales, size of the firm, promoters' holding, firm valuation in terms of price to book value, and research propensity of the firm measured by R&D to sales. Results of the regression analysis are presented in Table 5.

According to the result of binary logistic regression model, dividend payout, employee stock options, and firm leverage are statistically significant to determine the probability of fair employee treatment. Coefficient of all the three variables is positive, specifying their positive impact on the probability of fair employee treatment. Another crucial inference can be drawn from the above results that firms which pays higher dividend to keep their shareholders satisfied, besides offering employee stock options to their employees to motivate them, attract higher probability of fair employee treatment. Therefore, such firms extend

Table 5. Estimate of binary logit regression of firms' fair employee treatment on firm's leverage and other firm level control variables. The p-values in the parentheses are based on the standard errors that are heteroscedasticity consistent. (*p < 0.10, **p < 0.05, ***p < 0.01).

Dependent Variable Method: Binary Logit	Fair Employee Treatment
Dividend Payout Ratio	0.0775** (0.030)
ESOP	6.2137*** (0.0198)
Firm's Leverage	17.2031*** (0.0131)
Employee Compensation/Sales	−39.0231 (0.3267)
Ln (Total Assets)	1.3053 (0.5355)
Promoters' Holding	5.7247 (0.1876)
R&D/Sales	−0.0163 (0.3792)
Price to Book Ratio	0.1690 (0.6500)
Constant	−17.564
No. of Firms	80
McFadden R-Squared	0.5141

Source: Authors' Calculation.

the fair treatment not only to their employees, rather towards all the other stakeholders equally.

Surprisingly, employee compensation to sales has a negative coefficient (though statistically insignificant), indicating that employee compensation and fair employee treatment are moving in the opposite direction. In line with Bonnars and Deere (1991)'s findings that high debt ratios may effectively facilitate employee concessions during business downturns, it was proposed that the firms with increased financial leverage can successfully use their financial position to achieve higher bargaining power than the employees for wage concessions. However, the results present that employee compensation to sales has a negative coefficient to firm's leverage (though statistically insignificant). But, the result accentuate the importance to consider the combined effect of positive coefficient of fair employee treatment, and negative coefficient of employee compensation to sales on a firm's leverage. It is likely that high leverage firms compensate for the cut-down on employee pay but are more likely to provide better and fair treatment of employees. Also this credible commitment of a firm to provide fair employee treatment in lieu of reduced compensation/benefits yields internal and external branding (reputation) to the firm. Hence, it seems relevant to further explore the above relationship with a larger sample/specific sector.

With minimum values of statistically significant explanatory variables namely, dividend payout, firms leverage, and ESOP (minimum value is 0), probability of employee fair treatment is estimated to be 0 percent, while using maximum values of these variables, probability of employee fair treatment would be 11.08 percent Therefore, the probability of fair employee treatment would be greater for a highly leveraged, higher dividend paying firm. Also, the possibility of fair employee practices would be offered by firms which also issue employee stock options, consequently fulfilling firm's objective of employee retention and attraction. Moreover, combination of dividend payout, leverage, and employee stock options as determinants of probability of fair employee treatment in a firm indicates towards reduced agency conflict amongst the three major stakeholders namely, employees, management and shareholders.

5. Conclusion and Recommendations

There exists a non-linear relationship amongst firms' financial policies, quantifiable measure of employee welfare such as employee compensation, and employee welfare, and non-quantifiable fair employee treatment. Zero leverage firms spend higher amount on employee compensation and employee welfare as percentage of their sales, pay higher dividends, have issued more employee stock options, and spend substantially higher amount on corporate social activities in comparison to both highly levered and moderately levered firms. However, these firms have lowest fair employee treatment score. Contrary to this, highly levered firms are equally profitable as zero leverage firms, have lower employee compensation and employee welfare as percentage of their sales, ranked lowest in

terms of offering ESOPs, and have lowest dividend payment amongst the three categories, nevertheless, these firms demonstrate highest fair employee treatment score. Also, higher dividend payout, higher leverage and issuance of employee stock options increase the probability of fair employee treatment in a firm. The levels of employee benefits may remain relative to the firms, but employees' fair treatment would not be detrimental to the stakeholders. Overall, the evidence presented in the present work highlights the significance of employee treatment in firms. Higher dividend payouts, higher leverage and issuance of employee stock options increase the probability of fair employee treatment in a firm, thus draws practical implications for firms. Broadly, the evidence emphasizes valuable implications for all types of firms—high, moderate and zero levered firms. However, in case of high, and moderately levered firms, the findings have potentially quite important implications regarding employee treatment, and its relation with the functioning and financial performance of the firms. Also, fair employee treatment can prove to be an important aspect of intra-firm bargaining, which can be further explored in future researches. The present study addresses an important research area which can be extended with other variables such as attrition rates, job market, labour mobility, etc. And multi-year data would provide wider application and more robustness to the findings and implications.

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Conflicts of Interest

The authors declare no conflicts of interest regarding the publication of this paper.

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