Employee Satisfaction, Labor Market Flexibility, and Stock Returns Around The World

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Overview

- What is the role of employee satisfaction for a firm?
  - Employee satisfaction is associated with superior long-run returns, current valuation ratios, future profitability, and earnings surprises.
  - The effect is more pronounced in flexible labor markets, such as the US and UK, but not rigid labor markets, such as Germany.
  - These results are consistent with employee satisfaction improving recruitment, retention, and motivation in flexible labor markets.
  - In rigid labor markets, legislation already provides minimum standards for worker welfare and so additional expenditure may exhibit diminishing returns.
  - The findings have implications for profitability of socially responsible investing strategies around the world

Why is this an important question?

- Employee satisfaction can be a valuable motivational tool. The efficiency wage hypothesis highlights numerous channels through which satisfaction may increase motivation.
- Akerlof (1982) posits that employees view a positive working environment as a "gift" from the firm and respond with a "gift" of increased effort.
- Separately, employees are more likely to be innovative if companies have a culture that tolerates failure and a reputation for providing job security.
- These motivational benefits may be particularly important for rank-and-file employees, who are harder to incentivize with equity than executives, due to their small individual effect on firm value.

Why is this an important question?

- Taylor (1911) argues that workers should be treated like any input – management's goal is to extract maximum output from them while minimizing their cost.
- Under this view, satisfaction is an indicator that employees are overpaid or underworked, both of which reduce firm value.

- Theoretically it seems employee satisfaction can either be good or bad for the firm. So, empirically showing if firms will cater to employee satisfaction is important.
- Maybe, there is also a difference in flexible versus rigid labor markets.

Why look for employee satisfaction around the world

- The authors argue that Edmons (2011 and 2012) has already looked and the role of employee satisfaction on stock market returns in the US.
- Moreover, Edmons also solves the big econometric concern of reverse causality. Edmons has successfully argued that employee satisfaction causes higher stock returns and not the other way around.
- However, the US has flexible labor markets. And so in order to test if labor market flexibility has any role of play in the relationship of employee satisfaction and stock returns they need to look for a counter factual of less flexible labor markets. The authors argue this provides a cleaner test of the theoretical predictions.

Data

- The authors use data from 14 countries with varying degree of labor market flexibility.
- They also collect the best companies (BC) list produced by the Great Place to Work® Institute.
  - While the Institute produces BC lists in 44 countries,
  - 15 have at least 10 BCs publicly traded in the domestic market.
- They use two measures of country-level labor market flexibility, which are available for 14 of these 15 countries.
  - The first measure is the OECD Employment Protection Legislation ("EPL") Index.
  - The second comes from Fraser Institute's Economic Freedom of the World ("EFW") index.

Comments

- It is a very nice paper.
- The authors are very careful and thorough.
- I learnt a lot from the paper. I never learnt corporate finance or asset pricing, it taught me both (a little). I believe their results.
- I have a few comments for the authors, hopefully that will help alleviate questions regarding the data and findings.

The right thought experiment

- I have spend years on identification and causal interpretation.
- So, I was thinking of the right thought experiment.
- We want two companies who are very similar and equally likely to be in the BC list, but due to random chance one of them does not make it on the BC list and the other will switch their status from not being to being on the list or vise-versa.
- Then we can do a D-in-D and see if this company who is treated will have a treatment effect (employee satisfaction) and that will cause their stock price to rise.
- If I understand the setup correctly, the authors compare companies that are on the list to those that will never make it.

Omitted variables

- The authors have spend a lot of time to worry about reverse causality. Which I think they have done a good job to defend.
- However, I worry about the omitted variables that could explain the rise in the stock price other than being on the BC list.
- Since, the authors do not conduct the ideal thought experiment, it is easy to argue that the treated and control companies are different on observables and unobservables and that is driving the results.
- I can think that there are other factors than being on the BC list that make them different from the control companies that drive the stock price.

Can the authors do something

- I think the authors can actually test the thought experiment I have in mind.
- Looking at Table 1 panel A, I can see that the size of the companies that can be on BC list changes over time. The authors can look at the changing criteria and use that to look at the each additional company that makes it on the list and how that compares to the company that does not make it.
- Alternatively, they can also look at companies that are down graded and removed from the list to use them as the counterfactual.
- In summary, the authors can do a much better job at creating a treated and control sample based on the selection criteria.

Labor market flexibility measures ELP/EWF

- Looking at table 1 Panel B, that shows the mean and variance for the ELP/EWF measures it does not appear there is a huge variability in these measure.
- In fact, the authors use Germany and the US as examples of countries that have labor market rigid/flexible. But looking at the index it seems Germany is not the most rigid or US is not the most flexible.
- Is there variation in these indices within a country. Can the authors also exploit that variation.

Conclusion

- The paper examines an interesting and important question.
- Having attended a lot of CF and AP seminars, I think this is a different question. I learnt about the role of employee satisfaction in a corporation and its implication on the stock price.
- I hope my comments are helpful for the authors.