



# Do employee relation responsibility and culture matter for firm value? International evidence

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## ABSTRACT

Using a dataset on employee relation responsibility (ERR) from 30 countries, we examine the effects of employee relationships on firm value. In addition, this paper attempts to understand the role of national cultural dimensions regarding their relation with ERR and firm value. We find that firms with good employee relationships tend to demonstrate significantly higher levels of firm value than firms whose employees exhibit poor rapport. We also find that the positive impact of ERR on firm value is significantly strengthened in cultures with high degrees of power distance, collectivism, masculinity, and risk avoidance. These results are robust even after mitigating endogeneity issues, adjusting sample composition bias and using alternative independent variables. Our findings extend the previous CSR-related research into a new horizon, with the objective of investigating this less explored subject within the sub-areas of CSR research. The findings of this study are noteworthy given that we incorporate the role of national culture into the ERR-firm value link, a task that has not yet been undertaken.

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## 1. Introduction

Financial implications of corporate social responsibility (CSR) have captured academic attention. As is well known in the CSR literature, stakeholder theory, as postulated by Freeman (1984), asserts that a company must consider and satisfy a variety of constituents, such as workers, consumers, suppliers, and local community, all of whom can affect or be affected by the company<sup>1</sup>. Stakeholder theory implies that a company can secure support from its related constituents by enhancing its engagement in certain CSR activities and that its CSR-oriented activities connecting social dimensions with business models can offer benefits that enhance the company's performance and lead to long-term survival. Although several studies have revealed either a negative link or no link between CSR and firm performance or value, many studies have exhibited a positive relation between the two constructs<sup>2</sup>. In this paper, we aim to answer

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<sup>1</sup> CSR is posited to integrate social dimensions into economic activities by incorporating more employee-friendly human resource management (HRM) practices (Bae et al. 2011; Jones et al. 2014; Collier and Esteban 2007), accomplishing higher levels of environmental performance via pollution reduction and recycling activities (Jo et al. 2015; Miles and Covin 2000), pursuing mutually beneficial transactions with suppliers (Andersen and Skjoett-Larsen 2009), and considering the goals of the local community (Kapelus 2002).

<sup>2</sup> For instance, Waddock and Graves (1997) find that CSR leads to an increase in firm performance. Russo and Fouts (1997) also observe that CSR activities focused on environment improvement demonstrate a positive relation with financial performance. Gao et al. (2012) find a positive link between CSR activities and financial performance by exploring the equity market impact of corporate donations. Hillman and Keim (2001) find that stakeholder management CSR conducted in an effort to build constructive relations with primary stakeholders such as employees, customers, suppliers, and communities can result in positive shareholder wealth creation measured by market value added, while social CSR issues that are not directly related to primary stakeholders may not create value for shareholders.

this widely explored CSR-linked question: do companies do well by doing good? However, rather than focusing on the role and impact of overall CSR for empirical analysis, we investigate a specific area of CSR from inside stakeholder relationships, that of employee relationships, as such relationships have great potential to influence firm value. Research indicates that good employee relationships within a company help the firm appear attractive to current employees who are and new job candidates who will be more likely to commit themselves to the performance of the company. Hence, our research aims to contribute to academia by analyzing the impact of the stakeholder relationship with employees on firm value, thus extending the previous related empirical research connected with CSR into a new horizon with the objective to fill this less explored area of CSR and related finance research. We posit that a company's employee relation responsibility (ERR) is a sub-category of CSR and that it addresses the company's comprehensive concerns for employees.

We also attempt to understand the role of national cultural dimensions in the association between employee relation responsibility and firm value. National cultural dimensions have recently been used in financial studies to examine their roles in investors' trading activities and stock price movements (Eun et al. 2015), cross-border merger volumes and synergy gains (Ahern et al. 2015), trading volume, volatility and momentum profits around the world (Chui et al. 2010), and allocation of funds in international portfolio holdings (Karolyi 2016). Previous studies have also found that national culture has a considerable influence on business ethics and CSR. Since Hofstede (1980, 1983, 1984, 1997) identified the cultural dimensions that differ across countries, several researchers have attempted to understand the substantial extent to which national culture impacts companies' attitudes and behaviors in terms of business ethics and CSR (Christie et al. 2003; Moon and Franke 2000; Blodgett et al. 2001; Vitell et al. 2003; Waldman et al. 2006). For example, Christie et al. (2003), using survey data from the US, Korea, and India, find that cultural dimensions of individualism and power distance have a strong influence on business managers' perceptions towards general aspects of business ethics and a variety of questionable business practices, such as bribery and nepotism. We attempt to extend the previous research on the relationship between national culture and CSR by investigating the combined effect of ERR and national culture on firm value and interpret the ERR-firm value association in view of cultural dimensions in different countries. To our best knowledge, this empirical research is the first endeavor to examine relationships with employees in the setting of CSR-related stakeholder relationships, national cultural dimensions, and firm value.

This study first examines the impact employee relationships have on firm value and provides empirical evidence that ERR is positively and significantly related to firm value. We also hypothesize that the impact of ERR on firm value will be strengthened by national cultural dimensions across countries, and we obtain an empirical finding that ERR has significantly greater effects on firm value in all cultural dimensions when measured as the levels of power distance, collectivism, masculinity, and risk avoidance. In addition to the multivariate analyses, we perform supplementary tests that consider endogeneity issues from the perspective of reverse causality, time-invariant omitted variables, and sample composition bias. We also use alternative independent variables to ensure the robustness of our empirical results. After these tests, we still find that the impacts of ERR and its interaction with cultural dimensions on firm value are still positive and significant.

The remainder of this paper is organized as follows. In Section 2, we account for the theoretical perspective on the association of employee relations with firm value in the CSR framework and extend this theoretical perspective with cultural dimensions. We also formulate testable hypotheses in this section. In Section 3, we describe the research methods in relation to econometric specifications and data sources. Empirical results are presented in Section 4, and we summarize our findings, implications and limitations in Section 5.

## 2. Literature review and hypothesis development

### 2.1. CSR, employee relation responsibility (ERR), and firm value

CSR involves the firm's response to issues beyond the narrow technical and legal requirements of the organization and considers the various stakeholders, i.e., those groups and individuals who are related to the operation and performance of the organization (Freeman 1984). By embracing CSR, a company provides benefits for society in general by improving the environment and reducing social inequality. More particularly for the firm itself, CSR leads to an increase in corporate value by enhancing its reputation and, in turn, increasing its potential to charge a premium price for products and recruit and retain high-quality workers. Accordingly, adopting CSR can be advantageous to both corporate shareholders and stakeholders, which presents a potential win-win situation.

The literature on CSR proposes a number of theoretical implications regarding how CSR activities are linked to firm value. For example, CSR can promote a positive brand image (Moskowitz 1972), nurture good client relationships (Solomon and Hanson 1985), reduce company vulnerability to negative legal and regulatory actions as a result of the reduction of information asymmetry with respect to stakeholders (Porter and Van der Linde 1995; Freeman 1984), and attract investments from socially responsible institutions and individuals (Cheng et al. 2014). In this regard, CSR can increase firm value, and thereby help the company identify several channels through which CSR can effect financial benefits. Examples include, but are not limited to, a strong recommendation from securities analysts (Ioannou and Serafeim 2015) and a greater likelihood to access finance (Cheng et al. 2014). Although CSR may raise related expenditures considerably, the potential financial benefits will appear in the long run if a company carefully manages the CSR process (Henderson 2002).

In this research, we state that a company's endeavor to provide benefits for employees, one group of company stakeholders, in the overall CSR context can also lead to higher firm value. Little research has examined the association between a company's social responsibility for employees and firm value. Furthermore, there is no specific established terminology representing the

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