

ORGANIZATIONS

Employee Loyalty Around the Globe

New research confirms that workers everywhere have the same needs.

The benevolent cycle in which loyal employees beget loyal customers beget greater profits has been laid out convincingly by such luminaries as Frederick Reichheld (“The Loyalty Effect”) and James Heskett, W. Earl Sasser and Leonard Schlesinger (“The Service Profit Chain”). But can managers engaged in global businesses assume that the phenomenon seen in the United States applies in the rest of the world? And if so, what creates individual employee loyalty across the great diversity encountered in varied national labor markets? After all, we have all heard that siestas are a must in Spain and that no self-respecting French person works in August. Can we ever hope to make all our employees — whatever their nationalities — feel well-treated and therefore loyal?

The question has been answered in a landmark global study conducted by Walker Information Global Network, an Indianapolis-based international partnership that addresses stakeholder issues, and the Hudson Institute, a public-policy organization specializing in work-force research. More than 9,700 full- and part-time employees representing business, nonprofit and government organizations in 32 countries and regions as varied as the United States, Bolivia, Finland and Hong Kong participated in the survey. The conclusion: The cultural differences that we observe in cuisine, clothing and sport as we travel around the globe should not be confused with differences in work-force issues.

The study confirms the useful cliché that people are people wherever they live, and that most people care deeply about the same few things. In the workplace, people everywhere ask, Am I fairly compensated for my work? Am I well suited for my work? Does my employer trust me to do that work?

The researchers segmented the world’s employee population as follows: 34% of

worldwide employees are Truly Loyal, 8% are Accessible, 31% are Trapped and 27% are High Risk. The Truly Loyal exhibit the kinds of behaviors that make businesses successful — they work hard, stay late, go the extra mile to delight the customer, and recommend the company to their friends as a good place to work. The Accessible feel and act as committed as the Truly Loyal, but for reasons unrelated to loyalty, may leave within two years (perhaps a spouse is transferring, or childcare needs intervene). Trapped employees want to leave their jobs but for one reason or another feel that they cannot. High Risk employees are spending their working hours clicking through Monster.com — or whatever the local alternative may be. Six out of ten High Risk employees would not recommend their organization as a good place to work.

The study emphasized ethics because of its high impact on employee loyalty. Employees who perceive their employers as ethical are more likely to be proud to be associated with the company. Of the employees who felt they were working for an ethical company, 55% were Truly Loyal.

FINANCE

How CFOs Really Practice Finance

Integrating design and manufacturing helps, but only if the “fit” is right.

Shareholder value could suffer by following “rules of thumb” instead of textbook theory. The debate about how best to practice corporate finance can be likened to the one about whether life exists in outer space: lots of theories but little agreement. Recently, in an effort to learn more about the daily practices of CFOs, John Graham and Campbell Harvey of Duke University’s Fuqua School of Business compiled

Only 9% of those who questioned their employer’s ethics were Truly Loyal. It is worrying that one-third of worldwide employees do not believe that their organization is highly ethical, and only six in 10 believe that their senior managers are people of high personal integrity.

View this as an opportunity, says Walker Information vice president Marc Drizin: “Being an ethical company doesn’t really cost money over the long term. What it does cost is cheap compared to the cost of replacing workers revolving through your door. Some U.S. statistics may help us to understand this: On average, it costs \$8,000 to \$10,000 to replace a manufacturing employee. It costs \$15,000 to replace that kid on the front line who sells you hats and jackets. It costs \$3,000 just to interview someone before actually hiring or training him or her. And the cost for an IT worker, on average, is astronomical: over 125% of that employee’s annual compensation.”

Offering career-development programs is one relatively cheap way to show commitment to the work force. As Drizin says, “Some organizations are reluctant to train because they are afraid that they are simply training that person for the next job — elsewhere. But being an exporter of talent is not a bad thing.... The person who leaves will tell everyone else, ‘Man, that was a good place to work. Go apply for my job!’”

— Katherine J. Sweetman

responses from 392 CFOs in a working paper titled “The Theory and Practice of Corporate Finance: Evidence From the Field” (http://papers.ssrn.com/paper.taf?ABSTRACT_ID=220251). Their research focused on capital budgeting, cost of capital and capital structure.

Graham and Harvey found that although the financial theories and tools of academia are slowly being adopted into

the field, CFOs are reluctant to forsake their favorite “yardsticks” in favor of textbook approaches to solving problems.

Nowhere was this more apparent than in regard to capital structure. For example, financial theory, starting with the Nobel Prize-winning Franco Modigliani and Merton Miller papers in the 1950s, asserts that companies choose their capital structure on the basis of a trade-off between the benefits of debt (the tax deductibility of interest payments) and the drawbacks of debt (higher interest payments). However, the surveyed CFOs cited as the most important factor “maintaining financial flexibility” — that is, keeping debt levels low in order to be ready for unforeseen opportunities. The tax benefits of debt and wariness about financial vicissitudes — the more theoretically based rationales for determining capital structure — were ranked fourth and fifth.

“Capital structure is the area where people use ‘rules of thumb’ the most. But, the responses did not strictly follow what is expected from the theory,” says Graham. “I surmise that the polled CFOs may be making decisions that are consistent with the theory of optimal structure, as their concern about their credit ratings indicates, even though they do not ascribe those actions to the theory’s main tenets.”

Graham explains further that the study’s results may have implications for shareholder value creation over the long term:

“Being ultraconservative with capital structure and making suboptimal decisions about capital budgeting could hurt shareholders in the long run,” he says. “Some of the country’s leading companies have very little debt — Microsoft, Wal-Mart and Intel, for example — and they could probably take on more, increase their tax shield and still have an AA credit rating.”

The researchers also asked CFOs about the decision to issue common stock. The most relevant factor was earnings per share (EPS) dilution.

“We don’t have an academic theory that justifies EPS dilution as the leading concern of CFOs,” Graham says. “If you dilute your earnings in the short term to invest in a

valuable project that takes a number of years to pay off, you might think that shareholders would reward the company.” Either management doesn’t do a good job explaining why EPS decreases in the short term, or “the stock market knows something about why EPS matters that academics haven’t yet figured out.”

CFOs do seem to flex their intellectual muscles when choosing financial measures for capital budgeting. The majority use internal rate of return (IRR) and net present value (NPV). However, the use of “payback period,” which Graham and Harvey regard as a relatively unsophisticated measure of corporate value compared to IRR and NPV, ranked third.

However, when it comes to the actual implementation of IRR and NPV, CFOs

tend not to spend much time adjusting the measures for risk, despite recent academic interest in the subject. More than half of the CFOs do not adjust either cash flows or their discount rate for the risks presented by interest rates, foreign exchange, the business cycle, commodities or inflation.

Despite these and other results, Graham remains optimistic about the future of financial decision making.

“Many academic theories are relatively pervasive in practice,” concludes Graham. “For example the vast majority of companies do use the capital asset pricing model (CAPM), which they didn’t do 20 years ago. On this and other matters, we are starting to see that business-school tools are actually starting to take hold in the field.”

— Dun Gifford, Jr.

PRACTICE VS. THEORY

How CFOs behave doesn’t always match what finance theory advises.

Here are two questions from the poll of 392 CFOs. Respondents were asked to score how frequently they use each criterion on a scale of 1 to 4 (0 meaning “never,” 4 meaning “always”). The tactics favored by financial theory are shown in *italic type*.

- What factors affect how you choose the appropriate amount of debt for your company?
 - 2.59 Financial flexibility
 - 2.46 Our credit rating
 - 2.32 The volatility of our earnings and cash flows
 - 2.07 *The tax advantage of interest deductibility*
 - 1.95 *The potential cost of bankruptcy, near bankruptcy or financial distress*

Whereas academics explain capital structure as a function of a trade-off between the tax deductibility of interest payments and the risk of bankruptcy, CFOs focus on financial flexibility.

- What factors affect your company’s decision about issuing common stock?
 - 2.84 EPS dilution
 - 2.69 The amount that the market overvalues or undervalues our stock
 - 2.53 An increase in our stock price provides the chance to sell stocks at a high price
 - 2.34 *Providing shares to employee-bonus or stock-option plans*
 - 2.26 *Maintaining a target debt-to-equity ratio*

CFOs point to EPS dilution as the main factor in the decision to issue stock, while many academics would argue that company value is independent of the number of shares outstanding.