Investment Returns of The Best Companies to Work for in America

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Overview

- Theory
- Historical Studies
- The 100 Best Companies to Work for in America
- Results

Theory: Social Factors

- The attraction: potentially meaningful public information not well-understood by markets.
- Examples: Environmental performance, "sustainability", employee relations practices.
- The reality: Much rhetoric, but little data supporting the existence of a social factor.

Theory: Cost vs. Investment

- Cost – Employees are an expense. The value of output will not vary meaningfully if you pay them more than their reservation price.
- Investment – Employees are an investment, and appropriate HR policies will result in bottom line returns.

Studies: Labor Economists

- Abowd (1989) find: higher pay → lower returns.
- Gorton and Schmid (2000) find: greater employee involvement → lower ROA and price/book ratio.
- Many studies find: unions → lower ROA, growth and reinvestment rates.

Studies: HR Academics

- Becker and Huselid (1997) find: “high performance” HR systems → higher price/book ratio.
- “High Performance” defined as including:

“…rigorous recruitment and selection procedures, performance-contingent incentive compensation systems, management development and training activities linked to the needs of the business, and significant commitment to employee involvement.”

Studies: Consultants

- Pfau (2001) finds: “superior human capital practices are not only correlated with financial returns they are, in fact, a leading indicator of increased shareholder value.”
- Reviewed 1999 and 2001 data and concluded that causality ran from HR practices to shareholder returns.

Studies: Social Investors

- Diltz (1995) finds: CEP employee relations variable → no effect on returns.
- Dhrymes (1998) finds: KLD employee relations variable → no effect on returns.

100 Best: Pros and Cons

- Pros
  - Same people have been doing it since 1984.
  - Uses non-public employee survey data.
  - Candidate companies self-select.
- Cons
  - Methodology has evolved over time.
  - Many potentially qualified companies not included because they didn’t volunteer for consideration.

100 Best: Pub Dates

- 1st Hardcover Edition
  - March 1984
  - Paperback (minor revisions) 1985
- 2nd Hardcover Edition
  - February 1993
  - Paperback (minor revisions) January 1994
- *Fortune* Magazine
  - January 1998
  - January 1999
  - January 2000
  - January 2001

Results: Positive Stock Selection

BARRA System (EW vs. S&P 500)

Expressed in annualized %

	3/84-1/93	2/93-1/98	2/98-2/02
Asset Selection	0.91	1.82	2.70
Risk	3.05	3.05	6.49
T-stat	0.92	1.16	0.86

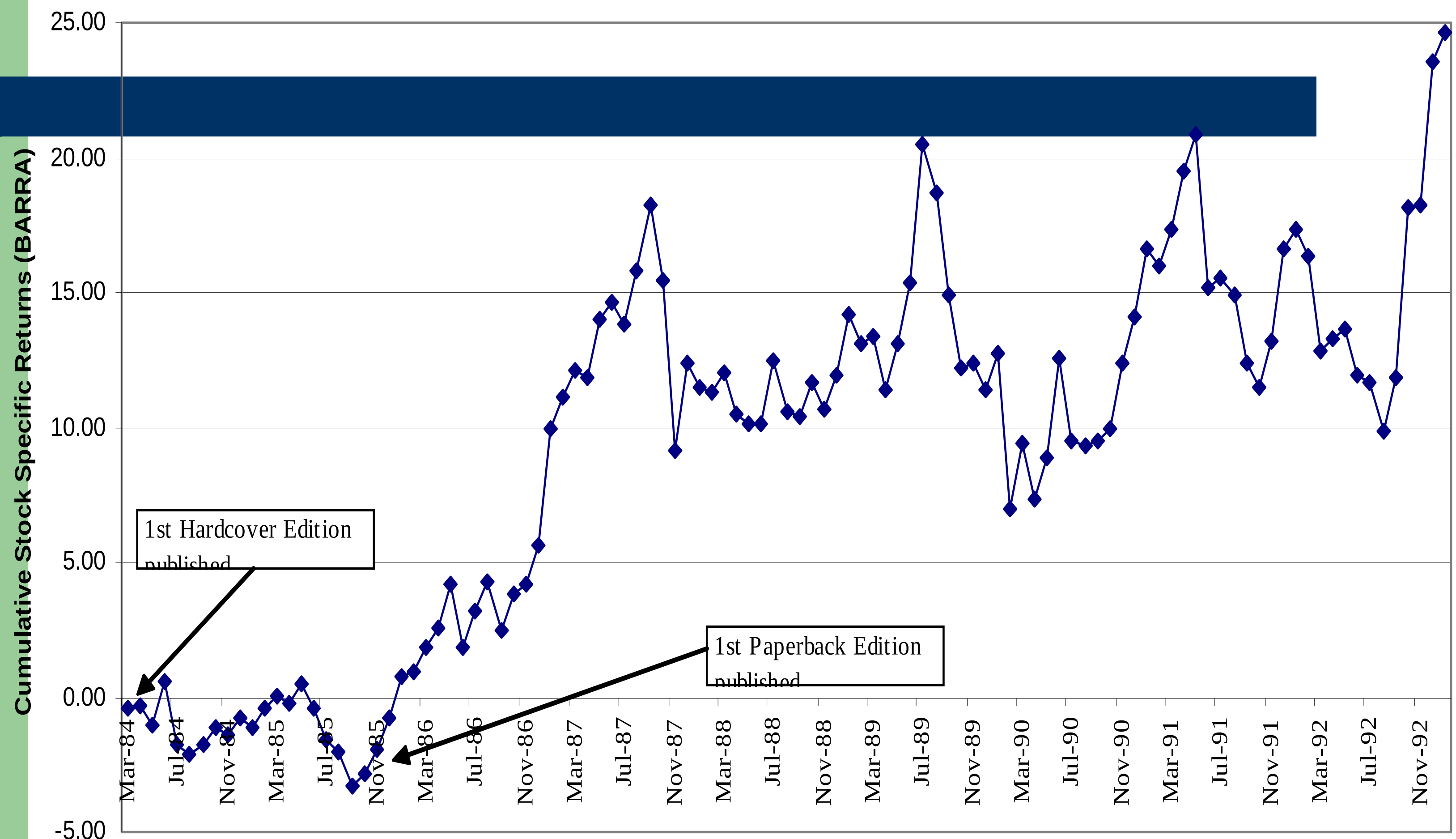
Results: Positive Stock Selection

Northfield Fund. Factor Model (EW vs. S&P 500)

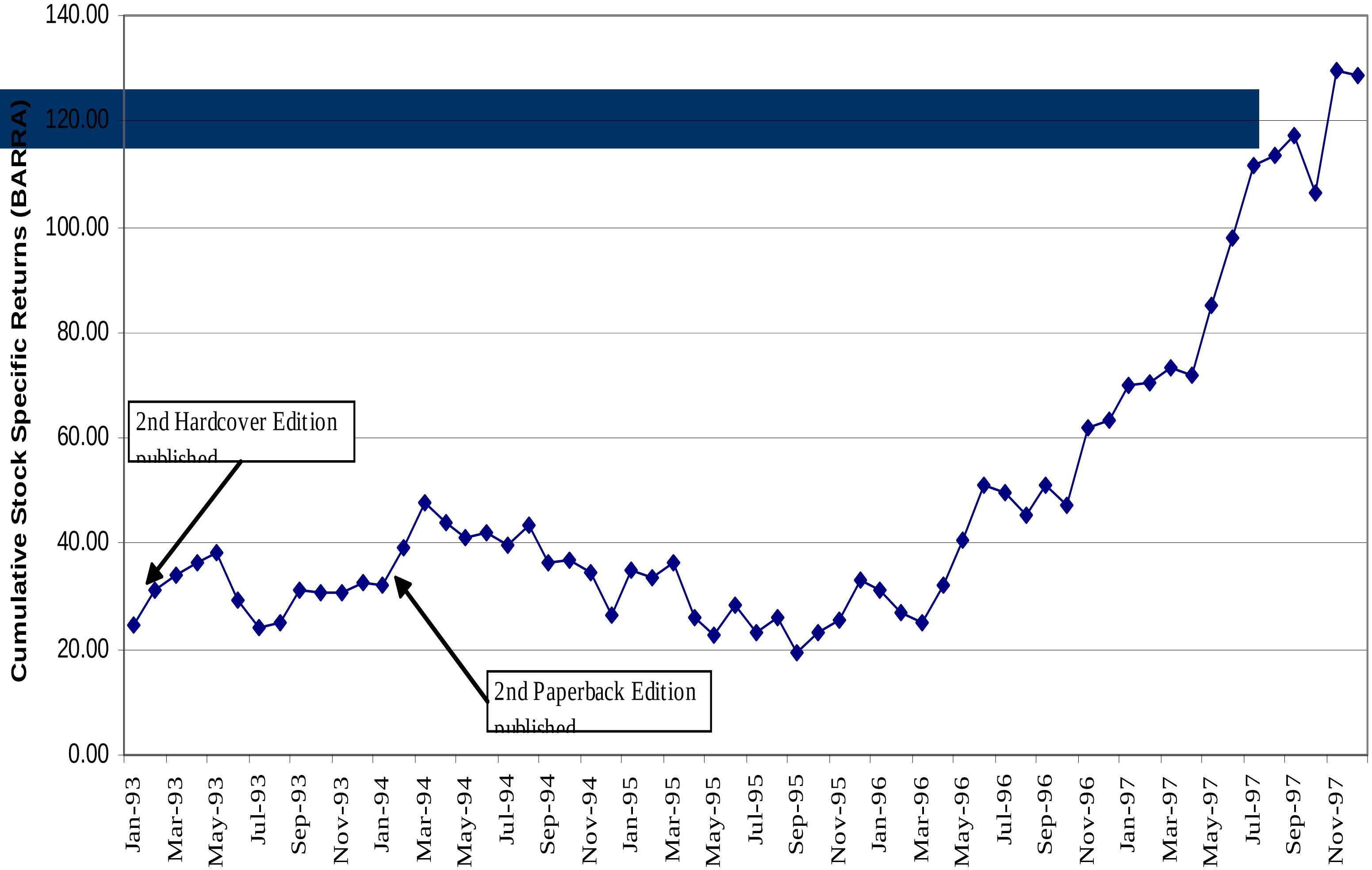
Expressed in %/month (t-stats in parens)

	2/93-1/98		2/98-2/02	
Total Alpha	0.06	(0.27)	0.85	(3.72)
of which…				
Factors	-0.01	(-0.10)	-0.26	(-1.54)
Industries	-0.04	(-0.34)	-0.05	(0.42)
Stock Specific	0.11	(1.41)	1.07	(9.64)

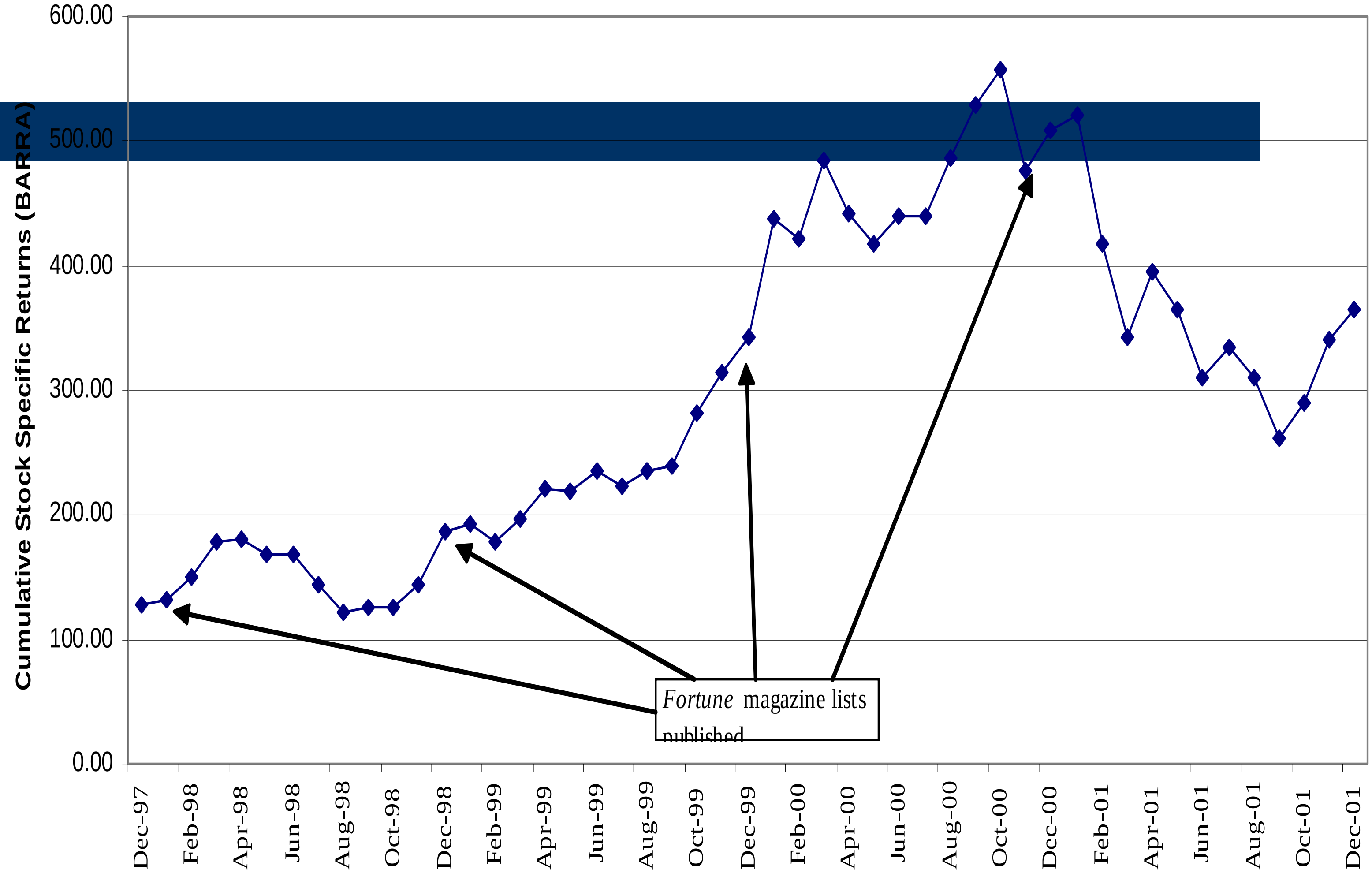
EW Stock Specific vs. S&P 500
March 1984 - January 1993



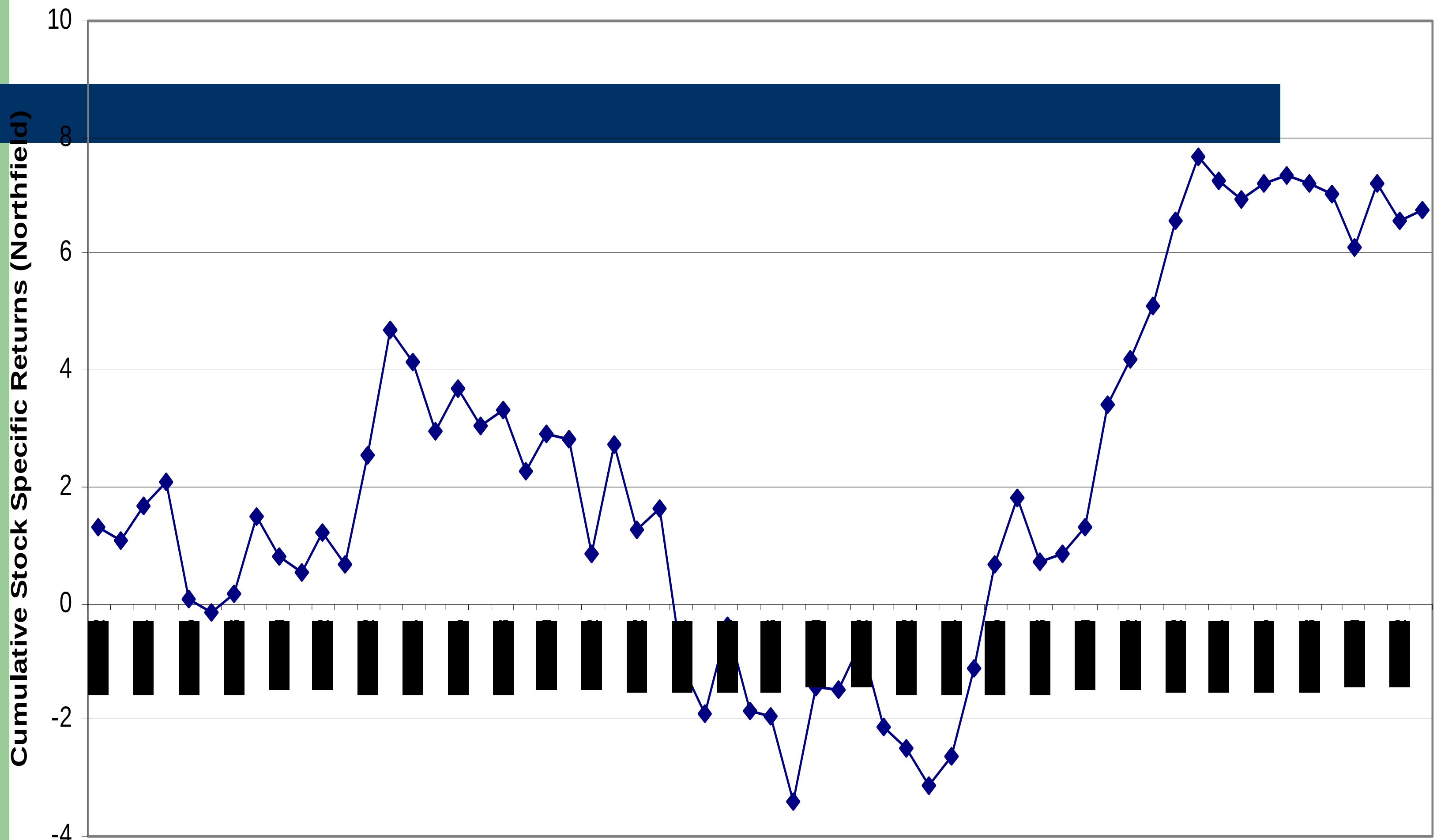
EW Stock Specific vs. S&P 500
January 1993 - December 1997



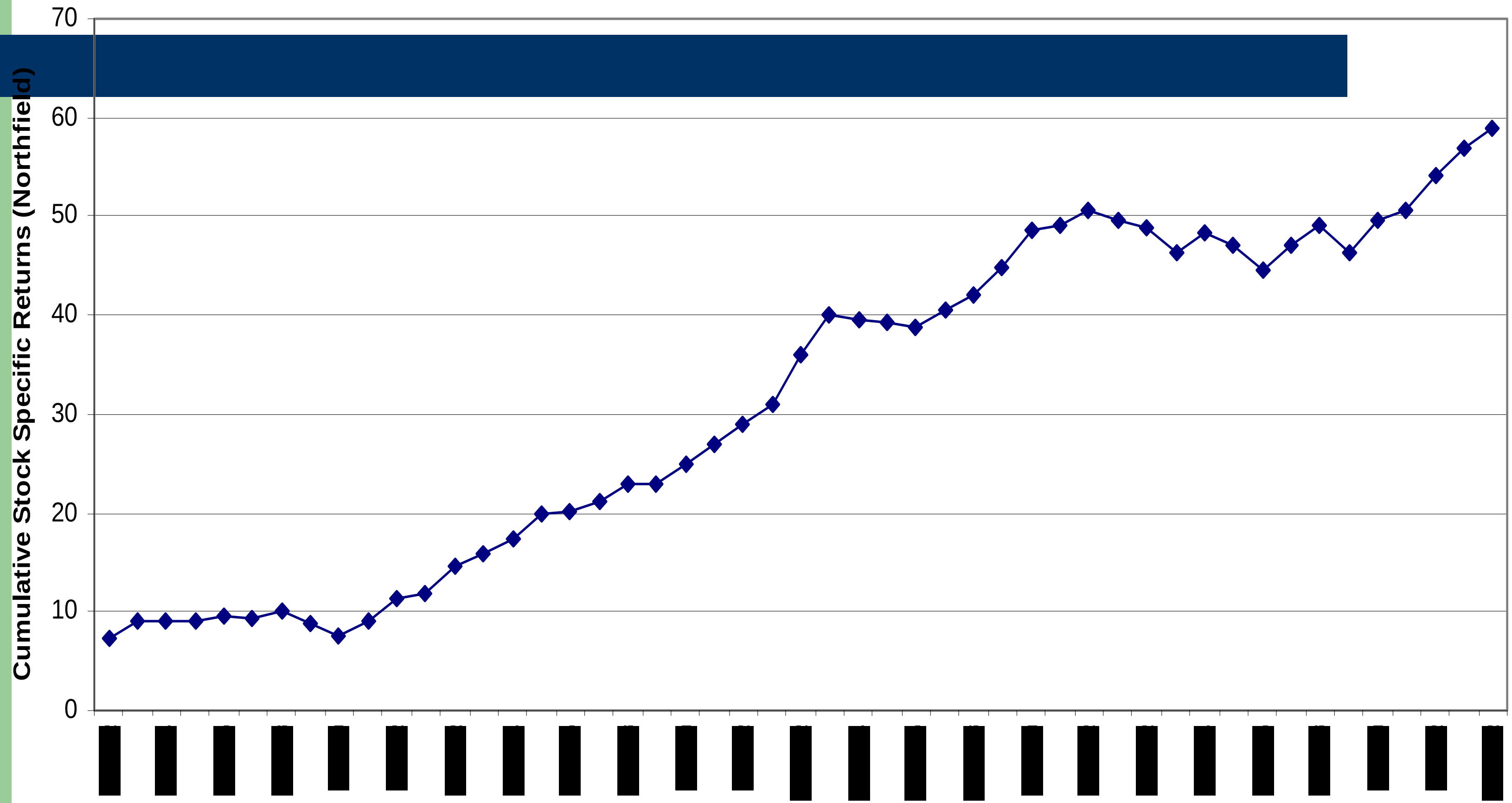
EW Stock Specific vs. S&P 500
January 1998 - December 2001



EW Stock Specific vs. S&P 500
February 1993 - January 1998



EW Stock Specific vs. S&P 500
February 1998 - December 2001



Results: Complicating Factors

- Sector weights not fully discounted?
  - Sector Overweights (+5% or more vs. S&P 500)
    - Consumer Cyclicals
    - Tech Hardware
    - Software & Services
  - Sector Underweights (-5% vs. S&P 500)
    - Energy
- Stock-specific returns strongest during tech bull market.

Results: Possible Reasons

- Company self-selection
- Inclusion of non-public employee survey data
- “Peacock’s Tail”
- Indirect measurement of the R&D variable?

Conclusion

- We believe that the *100 Best Companies* list contains positive information.
- Multiple models show positive selection over all three time periods analyzed.
- However, the effect may not be strong enough or predictable enough to be tradable.

Notes

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