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Employee Ownership and Financial Performance of State-Owned Entities: A Mediating Role of Employee Loyalty

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Abstract

The paper examines the mediation impact of employee loyalty in the relationship of employee ownership and financial performance of state-owned entities of Pakistan. Employee ownership is measured as percentage holding in state-owned entities, and financial performance is assessed trough profitability ratios; net profit margin and return on assets. Employee loyalty is determined through questionnaire circulated among the employees covered under the scheme. Meanwhile, secondary data is collected from already published sources. The study reveals that employee loyalty partially mediates the impact of employee ownership on the financial performance, which will support the policy makers to design corporate policies.

Keywords: Employee ownership; Financial performance; Mediation; Agency theory; Conflict of interest.

1. Introduction

Employee ownership is a form of shared capitalism which is defined as "schemes that tie worker pay or wealth to their own workplace performance, whether at the level of the workgroup, institution, or company" (Kruse *et al.*, 2010). The main argument in the support of shared capitalism is that it helps to stimulate organizational growth. When employees participate in the wealth of the company they work more and better which improves corporate performance and stimulate economic growth. This idea of shared capitalism was initiated by Weitzman (1984) it was a solution of sharing wealth and fight against poverty and inequalities (Kruse *et al.*, 2010). Blasi *et al.* (2013), argued that shared capitalism is a major reason for America's economic growth, but, the outcomes of employee ownership remained debatable. Employee ownership is a form of financial participation by the employees, which encourage them to purchase the shares of the organization they work for Pendleton (2010) through which they share the wealth of that company (Landau *et al.*, 2007).

Introducing employee ownership in a corporate setup distinctively lies with management. If they offer it as an investment opportunity, employee can decide whether to buy the company stock. The main economic conclusions regarding employee ownership are that it protects and improves corporate performance. Employees and managers are natural opponent of hostile takeover Pagano and Volpin (2005). Kruse *et al.* (2010), pointed out positive impact of employee ownership on corporate performance. Similarly, O'Boyle *et al.* (2016) based on the meta analysis reported significant and positive impact on organizational efficiency and growth. However, there are studies which documented the negative impact of employee ownership on corporate performance (Beatty, 1995; Chaplinsky and Niehaus, 1994; Conte *et al.*, 1996; Park and Song, 1995). Benartzi *et al.* (2007), argued that employee ownership is a costly arrangement for both the employees and employers.

However, this investment in employee ownership schemes is a result of the cognitive biases of behavior i.e. loyalty and familiarity (Cohen, 2009; Huberman, 2001). Kaarsemaker *et al.* (2009), argued that the basic reason behind the support of policy makers is that employee ownership improves organizational performance through change in employee attitude and behavior. Javed (2018a), argued that the impact of employee ownership on corporate performance is not straight, rather is mediated by behavioral aspects. However, affect on attitude and behavior is rarely described (Kaarsemaker *et al.*, 2010; Knyght *et al.*, 2010; Landau *et al.*, 2007; McCarthy *et al.*, 2010; Pendleton, 2001; Sengupta *et al.*, 2007).

Kaarsemaker (2006), argued that employee ownership generally improves employee performance related attitudes and behaviors. It is also evident in the literature that men are more likely to participate in employee ownership and age does not have any significant impact (Hashi and Hashani, 2014). Risk averse employee are not an active participants of employee ownership (Kruse *et al.*, 2010).

This paper investigates the role of employee ownership when they have been given shares to align their objectives with the organization. We hereby used the primary data collected from the employees through questionnaire to have in-depth analysis of how employees perceived and explained the impact of employee ownership on their attitude and behaviors. The analysis converge the findings based on the behavioral and financial aspects.

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In economic theories of employee ownership alignment of principal agent relationship is suggested as a benefit of employee ownership (Blasi *et al.*, 1996; Sesil *et al.*, 2002) which is in their mutual benefits. Employee ownership is discussed under different names and forms (Kaarsemaker *et al.*, 2010) which would be surprising if it had similar effects. McConville *et al.* (2016), reviewed the impact of employee ownership and its routes towards behavior and attitudes through psychological ownership. According to expectancy theory given by Vroom (1964) employees make assessment about the impact of their actions on the identifiable outcomes.

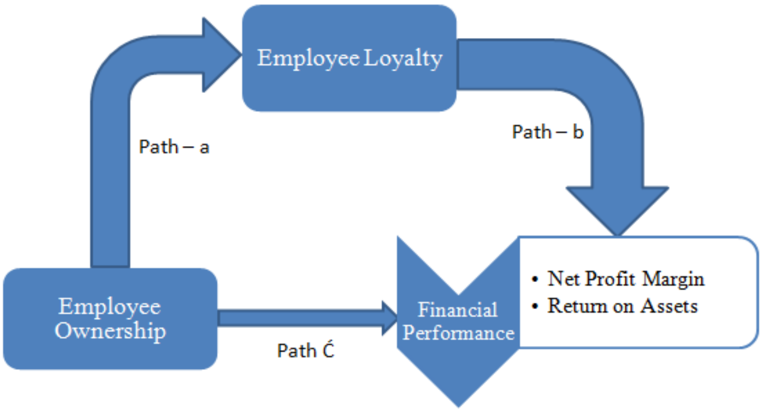
Long (1982), argued that if employees significantly depends on the financial outcome of employee ownership, greater the behavioral effects are likely to be. Employees may feel a weak connection between efforts in large organizations where share value is a function of other factors outside the organization (Blasi *et al.*, 1996). However, in those organizations where efforts and rewards are connected employees tend to improve their productivity and monitor their works to avoid shirking from their responsibilities (Freeman *et al.*, 2010b). Freeman (2007), found a week connection between size of a firm and employee motivation.

Akerlof (1982), argued that employee ownership can be seen as a gift from the organization and employees are expected to return back something which is a reciprocal effect. This reciprocal effect is more effective for the poor performing employee, whereas top performers consider it their legitimate right (Baron, 2013). Bryson and Freeman (2014), commented on what employee can give back is hard work, greater loyalty and lower employee turnover. Employees' put their best efforts when employee ownership schemes are designed to promote their voice and involvement in the organizations (Dube and Freeman, 2010; Pendleton and Robinson, 2010). Freeman (2007), argued that increased participation have higher drive towards employee satisfaction and motivation. Impact of employee ownership is not straight rather an intervening variable is required (Javed, 2017;2018a; Klein, 1987). Impact of employee ownership on net profit margin is partially mediated by employee motivation (Javed, 2018b) Here employee loyalty is a proposed mediator of the impact of employee ownership on the financial performance of state owned entities of Pakistan.

The research is based on the following research questions are designed:

- Does employee ownership improve the financial performance of state-owned entities?
- Does employee loyalty mediate the impact of employee ownership on financial performance?

1.1. Research Framework



The research above cited research questiones are addresed through following hypothesis:

Employee loyalty mediates the impact of employee ownership on the financial performance of the state-owned entities of Pakistan.

***H*$_1$** *"Employee motivation mediates the impact of employee ownership on net profit margin of state-owned entities of Pakistan".*

***H*$_2$** *"Employee motivation mediates the impact of employee ownership on return on assets of state-owned entities of Pakistan".*

2. Methodology

Study is based on primary as well as secondary data, participants of primary data are the employees of state-owned entities covered under the scheme of employee ownerhsip. Primary data was collected through questionnaire, that is adapted from the items used by Starnes *et al.* (2006). Using online survey, 1,415 questionnaires were gathered for analysis which represents a response rate of 57%. Mean age of the participants is 47.83 years out of which 2.3% were female and average length of service was 18.72 years. The questionnaire was developed to measure employee loyalty passed through series of preliminary tests, with the value of Kaiser-Meyer-Olkin (0.758), Bartlett's test ($P < 0.01$) and Cronbach's alpha (0.924) all the calculated values are significantly favorable. Secondary data about the state-owned entities is collected from the already published sources.

Statistical representation of the model is based on the following two linear models:

$$M = \alpha + \beta_1 X + \mu \qquad 01$$

$$Y = \alpha + \beta_2 X + \beta_3 M + \mu \qquad 02$$

Here; M is a mediator, X is an independent variable, Y is a dependent variable, β is a coefficient and μ is an error term.

3. Data Analysis and Findings

Data analysis is performed by using the “PROCESS macro” a modeling tool for SPSS developed by Hayes (2012). The model computed the following values:

3.1. Loyalty as Mediator of Net Profit Margin

1) Independent variable predicts dependent variable – path c

$F(1, 446) = 35.18, p = <0.01, R^2= 0.073$

$\beta = 1.3198, t(446) = 5.9313, p = < 0.01$

2) Independent variable predicts mediating variable – path a

$F(1, 446) = 43.1024, p = <0.01, R^2= 0.088$

$\beta = -0.0515, t(446) = 6.5652, p = < 0.01$

3) Independent and mediating variable together predicts dependent variable

$F(2, 445) = 21.9640, p = <0.01, R^2= 0.0898$

a. Mediating variable predicts dependent variable – path b

$\beta = 3.8119, t(445) = 2.8602, p = < 0.01$

b. Independent variable no longer predicts dependent variable path Ć

$\beta = 1.5161, t(445) = 6.5585, p = < 0.01$

4) Sobel Test (normal theory test) = z score test if C – Ć ≠ 0

$\beta = -0.1963, z = -2.5970, p = 0.0094$

5) Bootstrap Confidence Interval

BootLLCI = -0.3580, BootULCI = -0.0845

Path analysis is conducted to test the hypothesis, the derived results indicate that employee ownership significantly predicts net profit margin *($\beta = 1.3198$, t-statistic = 5.9313, $p < 0.01$)*. The first path of the constituents of mediation analysis is statistically significant *($\beta = -0.0515$, t-statistic = 6.5652, $p < 0.01$)*. The second constituent path of indirect relationship is also statistically significant*($\beta = 3.8119$, t-statistic = 2.8602, $p < 0.0044$)*. The defined rule for perfect mediation is that the when mediating variable in controlled in the model the previous significant impact of independent relationship should become insignificant which is referred to as path Ć above. The computed values indicate the when employee loyalty is controlled employee ownership still significantly predicts net profit margin *($\beta = 1.5161$, t-statistic = 6.5585, $p < 0.01$).*

This state exhibits that employee loyalty is not the only mediator; rather the impact is mediated by number of variables. Therefore, employee loyalty partially mediates the impact of employee ownership on net profit margin. The indirect effect of employee ownership on net profit margin is measured as a product of the coefficients of the constituent paths (a x b). The indirect impact of employee ownership and employee loyalty on net profit margin is *(-0.0515 x 3.8119) -0.1963.*

The results indicate that unit change in employee ownership will indirectly affect the organizational profitability by -0.1963. It is obvious from the indirect results that employee loyalty positively predicts net profit margin, the derived value is statistically significant. However, employee ownership has a negative impact on employees’ loyalty. Therefore the combined indirect impact of employee ownership and employee loyalty is significantly negative.

Mediation is also tested by Sobel test or normal theory test, the derived values indicate that derived value is statistically significant *($z = -2.5970, p < 0.01$)*. Similar results are also found in confidence interval approach; the derived confidence interval does not pass through zero. Both the tests endorse the existence of mediation effect in the mode.

3.2. Loyalty as Mediator of Return on Assets

1) Independent variable predicts dependent variable – path c

$F(1, 446) = 82.2188, p = <0.01, R^2= 0.1557$

$\beta = 1.1666, t(446) = 9.0675, p = < 0.01$

2) Independent variable predicts mediating variable – path a

$F(1, 446) = 43.1024, p = <0.01, R^2= 0.0881$

$\beta = -0.0515, t(446) = 6.5652, p = < 0.01$

3) Independent and mediating variable together predicts dependent variable

$F(2, 445) = 45.5996, p = <0.01, R^2= 0.1701$

a. Mediating variable predicts dependent variable – path b

$\beta = 2.1445, t(445) = 2.7818, p = < 0.01$

b. Independent variable no longer predicts dependent variable path Ć

$\beta = 1.2770, t(445) = 9.5497, p = < 0.01$

4) Sobel Test (normal theory test) = z score test if C – Ć ≠ 0

$\beta = -0.1104, z = -2.5365, p = 0.0112$

5) Bootstrap Confidence Interval

BootLLCI = -0.1964, BootULCI = -0.0434

Path analysis is also conducted for return on assets, the derived results indicate that employee ownership significantly predicts return on assets *($\beta = 1.1666$, t-statistic = 9.0675, $p < 0.01$)*. Both the constituent paths of indirect relationship are also statistically significant, their derived values are *($\beta = -0.0515$, t-statistic = 6.5652, p*

<0.01) and *(β = 2.1445, t-statistic = 2.7818, p < 0.01)* respectively. These values fulfill the second requirement of mediation analysis, and demonstrate that there is a mediation effect in the model.

In a perfect mediation model, when mediating variable is controlled previously significant impact of independent variable on dependent variable becomes insignificant which is referred as path Ć above. The derived results indicate that employee ownership still significantly predicts return on assets which determine that there is a partial mediation effect in the model *(β = 1.2770, t-statistic = 9.5497, p < 0.01).*

The indirect effect of employee ownership on return on assets is product of coefficients of the constituent paths (a x b). The indirect impact of employee ownership and employee loyalty on return on assets is *(-0.0515 x 2.1445) - 0.1104.* The results indicate that unit change in employee ownership will indirectly affect the return on assets by -0.1963. Employee loyalty also significantly predicts return on assets, but the negative coefficient of first path of indirect relationship converts the whole impact to negative. Therefore the combined indirect impact of employee ownership and employee loyalty on return on assets is significantly negative.

Mediation is also tested by Sobel test or normal theory test, the derived value is statistically significant *(z = -2.5365, p < 0.01)* similar results are also found in bootstrap confidence interval approach. The derived interval is statically significant which endorses the existence of mediation effect in the model.

4. Conclusion

The study was designed to find out the mediating role of employee loyalty between employee ownership and profitability of state-owned entities of Pakistan. Profitability is measured through net profit margin and return on assets. Based on the above empirical results it is concluded that employee loyalty partially mediates the impact of employee ownership on organizational profitability. If employee ownership scheme is implemented as measure to control implicit agency costs it can improve the performance of state-owned entities in the long run.

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Annexutre– AMeasurement of Variable

Variables	Measurements	Reference
Employee Ownership	Employee ownerhsip as a percetage of tatal outstanding shares	Javed (2018a)
Employee Loyalty	Questionniare	Torp (2011)
Net Profit Margin	Profit before tax as percentage of total sales	Javed (2017), Richter and Schrader (2017)
Return on Assets	Profit before tax as a percentage of total assets	Javed (2017), Richter and Schrader (2017)

Annexutre - BQuestionnaire

Statements	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
	1	2	3	4	5
I am willing to put in a great deal of effort beyond that normally expected in order to help this organization become successful					
I talk about this organization with my friends as a great organization to work for					
I feel very little loyalty for this organization ®					
I would accept almost any type of job assignment in order to keep working for this organization					
I find that my values and the organization's values are very similar					
I am proud to tell others that I am part of this organization					
I could just as well be working for a different organization as long as the type of work was similar ®					
This organization really inspires the very best in me in the way of job performance					
It would take very little change in my present circumstance to cause me to leave this organization ®					
I am extremely glad that I chose this organization to work for over others					
I was considering at the time I joined					
There's not too much to be gained by sticking with this organization indefinitely ®					
Often, I find it difficult to agree with this organization's policies on important matters relating to its employees ®					
I really care about the fate of this organization					
For me this is the best of all possible organization for which to work					
Deciding to work for this organization was a definite mistake on my part ®					