Relationship Between Employee Expenses and Net Profit of Indian Companies: An Empirical Study with Reference to NIFTY 100

NLDIMSR Innovision Journal of Management Research,
Jan - Dec 2020, Volume 4, Issue 1 & 2
DOI: 10.31794/NLDIMSR.4.1-2.2020.1-6

Arindam Saha
Assistant Professor, Jaipuria Institute of Management, Indore.

Sangeeta Jain
Professor and Director, IMS, DAVV, Indore.

Abstract

The paper discusses about the relationship between a firm's performance and HR expenses of recent five to ten years of large cap organisations of India. Since these companies make a heavy impact on India's overall industrial growth and scenario, a study of this nature is considered worth doing. The study uses financial data of ten years (2008-2017) of companies that come under NIFTY. Data was collected for top 30 companies and then overall top 100 companies to understand this relationship between expenses done on employees, and profit after tax. Regression analysis is used to understand the relationship between the independent variable- employee expenses, and the dependent variable- Profit after Taxes. The interpretation is based mainly on the values of adjusted R square and p-value.The data analysis on 30 companies of Nifty Fifty says that 14% of the relationship can be explained whereas, the data analysis of top 100 Nifty companies says that 31.5% of the relationship between the two variables is explained. It establishes that there is a significant relationship between employee expenses (independent variable) and Profit after Taxes (net profit - for this study) as dependant variable. This outcome is very crucial for organisations who are always debating the kind of expenses to be done on human resources. It is of great relevance for both practicing HR managers as they are now widely treated as business partners, and business schools in India where HR as a subject specialisation is offered in management courses. A renewed respect for HR as business partner as well as a specialisation area for graduating students of management is expected.

Key Words: Financial Performance, HR expenses, large cap companies.

1. Introduction

The Indian economy saw a different phase during the financial downturn of 2008-2012 and emerged back as well at the global level. Significant developments in the manufacturing industry and service sectors both, has propelled the growth and marching towards becoming top five economies of the world today. When look back at 2008-2012 era, find that Indian corporate is one of the main driving forces for this economic resurgence. A tight control of RBI and government, over the banking and financial institutions, is one major reason why could come up so well, as quoted by numerous studies. The present study aims to understand a unique dimension of expenses/investments done on employees and how it has resulted into a driver of financial growth for companies. The study tests the relationship between quality of human resources and performance of Indian companies, the biggest ones, and explores a quantitative relationship. The findings of this paper may provide useful insights for practising HR managers and business leaders.

HR – an investment or an expense?Organisations have traditionally treated employees (its human resources) a cost and 'investment' done on developing the intellectual capital as 'expenses'. To add, "…most economic and financial models treat employees- the prime carriers of knowledge- as a cost and not as a resource." (Pulic, 2004).Quite long back, Drucker in 1954 opined that the future belongs to knowledge society and knowledge workers. We have long since embarked on this journey and yet have ignored employees as resources and all expenses related to maintaining the HR as investments for present and future growth. "The treatment of employees as investment is the beginning and the end of knowledge-based economy". (Pulic, 2004).The existing literature suggests that the relative significance of intangible assets such as, human capital, customer relations, brand name, corporate reputation, intellectual property, and patents, etc. have increased in knowledge economy. (Vishnu and Gupta, 2013). Hence it is impertinent that organisations not only measure but also manage their human capital. Shifts in the domain of HR, where Personnel Management became Human Resources Management, and then BPHR (Business partners). The fact is - balance sheets in India still find salaries and training as expenses, and not as investments for growth. In order to get HR its rightful status. This paper started with a premise that the main driver of any organisation's progress – its people – must be seen under the view of assets and/or resources, and all expenses has to be seen as investments.

To understand the contribution of HR in an organisation, many approaches and methods have been discussed in the past two and a half decades, say since 1990s. To name a few – Balanced scorecard, HR scorecard, 360 degree feedback, EVA (Economic Value Added), etc. It is an irony that there are not even a miniscule of organisations existing on this earth that treat HR as assets and all expenses on HR as investments. The HR Accounting may have been accepted by a few but largely, the traditional accounting standards are being followed where employee expenses are treated and recorded as 'expenses' on Profit and Loss statements.

Review of Literature

Human Capital, HR Expenses/Investments, Intellectual capital (IC), Intangible benefits, Human Assets, Manpower expenses, etc. have been used by various studies to understand the concept of contribution of employees towards the financial performance of any organisation. Researchers have worked heavily towards conceptualising Intellectual capital and Human capital. Typologies have been provided by researchers (Seetharaman et al, 2004), (Pulic, 2004) to understand the interrelated concepts. Roos and Roos (1997) conceptualise IC as sum of the hidden assets of the company not fully captured on the balance sheet. Studies concerning the impact of human/intellectual capital on firm performance have been conducted around the globe on various sectors, such as, pharmaceuticals (Kamath, 2008).

Quite a few researchers, in recent past, have tried to establish a linkage between the quality of human resources and the financial performance of an organisation. While majority of these studies have been conclusive, at times there were contradictions and/or insufficient evidence to establishing a direct relationship between the two. Some studies have reported a weak or negative relationship between Intellectual capital and firm performance (Firer and Williams, 2003), while some have reported explainable relationship (Vishnu and Kumar, 2014).

A useful method for studying the impact of intellectual capital on corporate performance is Value Added Intellectual Coefficient (VAIC) model proposed by Ante Pulic in 1993. The present study considers Pulic's conceptualisation, but, in the context of large cap Indian organisations. It also limits itself in studying the relationship between HR Expenses and Net Profit only.

Research Methodology

The research problem is stated here as - How to study the impact of expenses on human resources as input and financial performance of the company as output?Here, HR Expenses is a sum of total salaries and wages paid to employees, training costs, benefits such as Provident Fund and Gratuity, employee self-learning initiatives, and all welfare activities an organisation engages into, for its people. An objective measure of Financial Performance is Net Profit and this is the dependant variable of the study.

Research Objectives: Expenses on human resources is supposed to be a measure of either quantity or quality or both of human resources. It is one of the vital input for production or service delivery in an organisation. To measure the impact of HR expenses on financial performance will be essential for better decision making for the organisation. This study tries to find the relationship between HR expenses and Net Profit in the context of 100 major Indian companies, of various sectors, belonging to NIFTY.

Hypothesis

Formulation of null hypothesis and alternate hypothesis-

0: There is no significant impact of HR expenses on net profit of major Indian companies

1: There is significant impact of HR expenses on net profit of major Indian companies

Data Collection, population and sample: The secondary data is collected from database ACE EQUITY and simple linear regression method of quantitative research methodology is adopted to explore the nature of relationship between the independent variable (Employee Expenses) and dependent variable (Net Profit after Taxes).

There are two data points-One considers 30 companies that belong to NIFTY FIFTY and the second considers the top 100 of NIFTY. In the final analysis of 100 companies, the data is taken for 98 companies as the employee expenses of two companies were not available with the database - Ace Equity. The rationale behind the two data points was to see whether the findings have differences when a larger set of companies is considered. All the figures are in million rupees and up to ten years' value for both HR Expenses and Net Profit are considered for regression. Ms-Excel is used as a software to run the regression.

Results and Discussion

A total of 30 companies of Nifty Fifty for which the data was available with Ace Equity was taken for the first level analysis. The output summary of regression of these 30 companies (most of which are also part of BSE 30) is being provided here in table 1 and table 2. Values of independent and dependant variables are averages of ten years.

Table 1. Regression summary (Nifty Fifty-30 companies)

Regression Statistics	
Multiple R	0.413753324
R Square	0.171191813
Adjusted R Square	0.141591521
Standard Error	50774.45639
Observations	30

2. here implies that 14% explanation is being provided by the human resource expenses in the net profit.

Table 2. T-Stat and p Value (Nifty Fifty-30 companies)

ANOVA output					
	Df	SS	MS	F	Significance F
Regression	1	14909996953	14909996953	5.783450063	0.023034525
Residual	28	72185271796	2578045421		
Total	29	87095268750			

	Coefficients	**Standard Error**	**t Stat**	**p-value**	**Lower 95%**	**Upper 95%**
Intercept	45209.94587	12046.12464	3.753069741	0.000811394	20534.57814	69885.3136
HR Expenses (Average of 10 years; in million rupees)	0.260166104	0.108182551	2.404880467	0.023034525	0.038564194	0.481768014

The output and p-valuehere indicates that there is a significant impact of HR Expenses on Net Profit of an organisation. The next set of data was taken for Nifty 100 companies and the output summary of regression of 98 Nifty 100 companies is being provided here in table 3 and table 4. As stated earlier, employee expense data of two companies is not available with Ace Equity. Values of independent and dependant variables are absolute numbers (in million rupees) of up to recent ten years for each company.

Table 3. Regression Summary(Nifty 100 companies)

Regression Statistics	
Multiple R	0.562582705
R Square	0.3164993
Adjusted R Square	0.315798992
Standard Error	3398.435939
Observations	978

2. here implies that almost 32 % explanation is being provided by the HR expenses in the

Net Profit. This outcome is vital to organisational decision makers as it clearly indicates - the quality and quantity of manpower reflects growth of a company.

Table 4. T-Stat and p Value (Nifty 100 companies)

ANOVA output					
	Df	SS	MS	F	Significance F
Regression	1	5219654829	5219654829	451.9429423	1.01995E -82
Residual	976	11272182029	11549366.83		
Total	977	16491836858			

	Coefficients	**Standard Error**	**t Stat**	**p-value**	**Lower 95%**	**Upper 95%**
Intercept	1648.577177	119.0274968	13.85038937	5.84465E -40	1414.997908	1882.156446
HR Expenses (Average of 10 years; in million rupees)	0.528578959	0.024863832	21.2589497	1.01995E -82	0.479786236	0.577371683

Here also, the *p* **value** is very less than 0.05, hence the null hypothesis is rejected. This means that there is a significant relationship between Employee Cost and Net Profit of an organisation.
Both the sets of outputs – Nifty 50 (30 major companies) and Nifty 100 (98 major companies) companies presented here clearly indicatesthat the importance of investing in employees has a direct and significant impact of the financial outcomes/profits. This interpretation is very vital to the core of HR as a function and a department as it has to fight for not only appropriate budget but also for its contribution to company's growth.

Discussion

The analysis and interpretation is done under two main points here:-

A. Overall relationship between the independent variable employee-expenses/costs and dependant variable net profit.

B. Differences in the overall relationship between the independent variable employee-expenses/costs and dependant variable net profit when two data sets are considered – top 30 (out of Nifty Fifty), and top 98 (Nifty 100).

It is surprising to note that, though significant, the relationship between employee costs/expenses and net profit is different when the data of 30 top companies are taken and when we take top 100 Nifty companies into consideration. Large Cap Indian companies often invest in modernisation of technology and fund management. The findings of this paper have deeper implications for practising HR managers, as, some of the companies in the given data show much lesser net profit than their HR expenses. These companies should introspect and adopt the practice of benchmarking to match the performance of the industry leader in their segment. This study emphasise not only on hiring right amount of workforce but also recruiting quality manpower and avoid overcompensation so as to achieve the optimum financial output for the given manpower costs. It should also be noted that HR expenses usually outnumber financial performance during lean period (between 2007 and 2012) whereas the same manpower can deliver higher returns during the boom period (between 2013 and 2017). There is an interesting perspective which can be explored in future with the help of primary data that the skills and knowledge imparted by academic and other types of skill building institutions can have significant impact on the financial performance of Indian corporate.

Conclusion and Policy Implications-

During the slowdown or recession, companies prefer cost cutting and resort to practices such as lay-offs, VRS, pay-cut, no perks, etc. but when there is a boom period they prefer to modernisation, production capacity enhancement, automation, R&D, expansion of distribution channel for better penetration, etc. The main conclusion of this paper is to give value of HR when considering improving financial performance of firms. In any future time of recession or slowdown we would not be worried had we invested more on developing people. Companies need to indulge into developing good HR policies and take good care of its people. Second important conclusion is for HR managers as they should confidently posit the criticality of recruiting good people whatever may be the cost of procurement (salaries and benefits demanded by talent). For 30 top companies the relationship is explained at 14% but interestingly, when we raised the bar to all Nifty 100 companies, it was 31.5%. A very significant finding indeed. Another interesting conclusion is for the trade unions which negotiate on various benefits for workers, including wage hikes. They would be better off if the discussion happens with such data which establishes positive relationship between wages paid and financial performance of the company. Fourth important conclusion is for all business schools that offer (or not offer) HR as a specialisation area. Since the job market for HR (openings) is comparatively less as compared to sales and/or finance, faculty members and placement team members tend to demotivate students who want to opt for HR as a career. The study makes it very clear- if people are so important for firm performance, it is better to have competent HR managers as well- for they only can ensure a good quality of intake of employees who would add value to the organisation.

References:

Bhartesh, K.R. and Bandyopadhyay, A.K., 2005. Intellectual capital: concept and its measurement. *Finance India, 19*(4), p.1365.

Bhasin, M.L., 2015. Disclosure of intellectual capital in annual reports: an empirical study of the Indian IT corporations.

Bontis, N., Dragonetti, N.C., Jacobsen, K. and Roos, G., 1999. The knowledge toolbox: A review of the tools available to measure and manage intangible resources. *European management journal, 17*(4), pp.391-402.

Choudhury, J., 2010. Performance impact of intellectual capital: a study of Indian IT sector. *International journal of business and management, 5*(9), p.72.

Firer, S. and Mitchell Williams, S., 2003. Intellectual capital and traditional measures of corporate performance. *Journal of intellectual capital, 4*(3), pp.348-360.

Kamath, B., 2008. Intellectual Capital Disclosure in India: content analysis of "Teck" firms. *Journal of Human Resource Costing & Accounting, 12*(3), pp.213-224.

Kujansivu, P. and Lönnqvist, A., 2007. Investigating the value and efficiency of intellectual capital. *Journal of Intellectual Capital, 8*(2), pp.272-287.

Maditinos, D., Chatzoudes, D., Tsairidis, C. and Theriou, G., 2011. The impact of intellectual capital on firms' market value and financial performance. *Journal of intellectual capital, 12*(1), pp.132-151.

Murale, V., 2010. Impact of intellectual capital on firm value: A panel data analysis of Indian IT firms. *Advances in Management.*

Pulic, A., 2004. Intellectual capital–does it create or destroy value? *Measuring business excellence, 8*(1), pp.62-68.

Roos, G. and Roos, J., 1997. Measuring your company's intellectual performance. *Long range planning, 30*(3), pp.413-426.

Seetharaman, A., Lock Teng Low, K. and Saravanan, A.S., 2004. Comparative justification on intellectual capital. Journal of Intellectual Capital, 5(4), pp.522-539.

Vishnu, S. and Kumar Gupta, V., 2014. Intellectual capital and performance of pharmaceutical firms in India. *Journal of Intellectual Capital, 15*(1), pp.83-99.