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ORGANIZATION SCIENCE

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Abstract:	<p>We investigate why employee-friendly firms often benefit from lower costs of debt financing. We theorize that banks use employee treatment as a screen to assess firms' trustworthiness, which encompasses not only confidence in firms' ability to perform well but also the belief that they will act with good intent towards their creditors. We integrate screening theory and stakeholder theory to explain the—oftentimes unintended—consequences that firms' actions towards employees have on their relationships with other stakeholders. An analysis of U.S. firms between 2003 and 2010 shows that favorable employee treatment reduces the cost of bank loans, and this relationship is stronger when banks cannot infer firms' intent from their relations with stakeholders other than employees. A policy capturing study provides further support that employee treatment serves as a screen for intent. We discuss the implications of our stakeholder-screening perspective as a novel way to understand the second-order, unintended effects of a focal stakeholder relationship on firms' relations with other stakeholders.</p>

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Why Do Banks Favor Employee-Friendly Firms? A Stakeholder–Screening Perspective

Abstract

We investigate why employee-friendly firms often benefit from lower costs of debt financing. We theorize that banks use employee treatment as a screen to assess firms' trustworthiness, which encompasses not only confidence in firms' ability to perform well but also the belief that they will act with good intent towards their creditors. We integrate screening theory and stakeholder theory to explain the—oftentimes unintended—consequences that firms' actions towards employees have on their relationships with other stakeholders. An analysis of U.S. firms between 2003 and 2010 shows that favorable employee treatment reduces the cost of bank loans, and this relationship is stronger when banks cannot infer firms' intent from their relations with stakeholders other than employees. A policy capturing study provides further support that employee treatment serves as a screen for intent. We discuss the implications of our stakeholder–screening perspective as a novel way to understand the second-order, unintended effects of a focal stakeholder relationship on firms' relations with other stakeholders.

Keywords: employee treatment; stakeholder relations; screening theory; bank loans; credit risk

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3 *The fundamental problem isn't lack of capital. It's lack of trust. And without trust, Wall Street*
4 *might as well fold up its fancy tents.*

5 —Former U.S. Labor Secretary Robert Reich (2008)
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8 INTRODUCTION 9

10 Human capital often underpins a firm's competitive advantage (Kochan and Rubinstein 2000,
11 Wang and Barney 2006). By treating employees favorably, firms hope to elicit greater contribution
12 towards achieving organizational goals and financial performance (e.g., Edmans 2012). However, how
13 firms treat their employees could potentially have second-order effects: efforts to support one group of
14 stakeholders—such as employees—also influence the contribution of other stakeholders towards
15 organizational objectives (Jayasinghe 2016). Other than employees, another important stakeholder group
16 is a firm's creditors. While the former contribute to performance by providing labor, the latter contribute
17 by providing capital. On the one hand, creditors could be concerned that employee-friendly firms
18 overinvest in worker benefits to the detriment of maintaining sufficient debt-servicing funds (Falato and
19 Liang 2016). After all, firms may treat their employees well because they believe it is the right thing to do
20 irrespective of the performance consequences. On the other hand, concern for employees' well-being
21 could make firms especially careful to repay their debt so as to reduce bankruptcy risk and, thus, to keep
22 employment stable (Bae et al. 2011, Verwijmeren and Derwall 2010). Yet, beyond shaping firms' own
23 capital structure choices out of their concern for employee well-being, firms' employee treatment can
24 have a spillover effect to the cost of bank loans, mainly determined by creditors, through affecting how
25 these important financing providers view potential borrowers.
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44 The idea that actions targeting employees might—even unintentionally—influence other
45 stakeholders is consistent with screening theory, which focuses on how external audiences “screen” and
46 sort firms' unobservable differences (Riley 2001, Stiglitz 1975, 2000). Thus, if creditors perceive a link
47 between firms' employee treatment and their financial stability, observing employee treatment helps them
48 infer additional information about firms' financial capability as borrowers. In short, employee-friendly
49 firms may be in a better financial position to repay their debt (Francis et al. 2019). Indeed, the screening
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3 literature has largely investigated cues that shed light on firms' ability to meet performance expectations
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5 (Connelly et al. 2016). Similarly, research on how the capital market reacts to firms' stakeholder
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7 engagement has focused on perceptions of whether such engagement contributes to, or detracts from,
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9 long-term performance (e.g., Cheng et al. 2014).
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11 Our argument, however, differs because we theorize that employee treatment not only conveys
12
13 information about firms' quality, but also about their intent. Whereas quality denotes the ability to meet
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15 performance expectations, intent denotes the motivation to behave appropriately in exchange relationships
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17 (Connelly et al. 2016). Costly behavior—such as being more generous to employees than the law
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19 demands—can signal a propensity for cooperation (Gintis et al. 2001). The financial costs of treating
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21 employees well are similar for all firms, but firms with particular characteristics will be more disposed to
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23 bear these costs. In so doing, they reveal their social preferences and show themselves as trustworthy
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25 interaction partners (Fehrler and Przepiorka 2013). The risk to banks not only pertains to firms' financial
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27 performance, but also arises from their lack of intent to pay or to safeguard creditors' interests. Even well-
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29 performing firms harm creditors, such as when they engage in restructuring and transfer debt to spun-off
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31 divisions (McSherry 2014). Banks can use firms' reputation in honoring their commitments to employees
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33 to infer intent because it is costly for firms to build such a reputation (Kuwabara 2015), and such firms
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35 thus have strong incentives to commit to their obligations to other stakeholders as well.
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39 We advance a multi-stakeholder screening theory to explain why employee-friendly firms can
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41 receive the benefit of lower loan costs. The premise is that how a firm treats its internal stakeholders not
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43 only provides information about its performance prospects, but also communicates its trustworthiness to
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45 external stakeholders. Trustworthiness—the perception that an organization will fulfill its obligations and
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47 not behave opportunistically (Puranam and Vanneste 2009)—includes perceptions of a firm's quality, or
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49 ability, as well as of its intent, or integrity and benevolence, in engaging with partners (Schoorman et al.
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51 2007). Firms with favorable employee treatment are perceived to have integrity in keeping contractual
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53 commitments and to show benevolence to other stakeholders. Our stakeholder-screening perspective
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55 shifts the focus from the intended consequences of corporate actions—for example, the direct
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3 performance benefits from treating employees well—to the unintended consequences (Merton 1936) that
4 emanate from interdependent stakeholder interests (Rowley 1997).
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7 Consistent with our multi-stakeholder lens, we further argue that banks rely more on employee
8 treatment as a screen when they cannot glean equivalent information on firms' trustworthiness by
9 observing their interactions with stakeholders other than employees. Thus, borrowers' relations with
10 diverse primary stakeholders—owners, suppliers, and lenders—moderate the value of employee treatment
11 as a screen. Our archival study of U.S. firms supports our theory and also shows that the effect of
12 employee treatment as a screen for intent dominates its effect as a screen for quality. To provide direct
13 evidence on how employee treatment and the cost of loans are linked, we conduct a policy capturing
14 analysis, which demonstrates that strong financial metrics are necessary, but insufficient, for obtaining
15 low-cost loans. Employee treatment acts as a cue for both quality (future performance prospects) and
16 intent (integrity and benevolence); perceptions of good intent are more important in translating favorable
17 employee treatment into banks' willingness to lend at low interest rates than perceptions of quality.
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30 This study is a departure from conventional ways of understanding how firms benefit from
31 treating employees well. Integrating screening theory and stakeholder theory highlights the unintended
32 consequences of employee treatment. External stakeholders use firms' action in favor of internal
33 stakeholders as an information cue which, in turn, shapes their provision of resources. We contribute to
34 stakeholder theory by articulating how screening accounts for the relationship between a firm's treatment
35 of its internal stakeholders and its interaction with external stakeholders. In this way, we draw attention to
36 the spillover effects of a firm's relation with one stakeholder group on the willingness of other
37 stakeholders to contribute to the firm. We also specify the *nature* of the spillover effects by showing that
38 employee treatment cues reveal not only quality (the dominant focus of the literature) but, to a greater
39 extent, intent. In other words, banks seek information that conveys whether the borrower is likely to be a
40 trustworthy partner. This focus on screening for intent—whilst acknowledging that screening for quality
41 occurs too—is critical because most work in organization theory on screening highlights the role of
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3 signals of quality. As such, our study implies that even financial stakeholders view firms more holistically
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5 than might have been expected.
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7 8 **THEORY AND HYPOTHESIS DEVELOPMENT**

9 **Information Asymmetry and Screening Theory**

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11 Information asymmetry arises between those who hold information and those who could make
12
13 better decisions if they had it (Connelly et al. 2011). There are two broad types of information asymmetry
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15 (Stiglitz 2000): information about quality, and information about intent. Quality denotes “the underlying,
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17 unobservable ability of the signaler to fulfill the needs or demands of an outsider observing the signal”
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19 (Connelly et al. 2011: 43). Most frequently, quality pertains to the organization’s ability to earn positive
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21 cash flows in the future (Ross 1973, 1977). Information asymmetry regarding quality potentially leads to
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23 adverse selection. Intent denotes the organization’s behavioral intentions (Connelly et al. 2011),
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25 particularly those to maintain positive relations with exchange partners (Gallus and Frey 2017).
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27 Information asymmetry regarding intent occurs when one party has reason to be concerned about the
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29 future actions of the other party, potentially leading to moral hazard (Sanders and Boivie 2004).
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33 An extensive literature in information economics examines the implications of information
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35 asymmetry. One stream focuses on signaling by the informed party (e.g., Reuer et al. 2012, Stiglitz 1975).
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37 Under information asymmetry, organizations can send observable signals to make their external
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39 stakeholders better informed. Stakeholders rely on signals to evaluate firms in situations as diverse as
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41 stock trading, IPO performance, acquisitions, and investment in relationship-specific assets (e.g.,
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43 Gomulya and Mishina 2017, Raman and Shahrur 2008). A second stream focuses on screening by the
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45 uninformed party (Rothschild and Stiglitz 1976, Stiglitz 2000). Screening theory is “the mirror image of
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47 signaling theory—it differs from signaling in the assumption of which party moves first” (Sanders and
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49 Boivie 2004: 169). Whereas in signaling theory the informed party (e.g., firms) moves first, in screening
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51 theory the uninformed party (e.g., banks) moves first (Weiss 1995). Screening emphasizes how
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53 uninformed parties filter information to sort underlying differences. For instance, individuals with higher
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55 education have traits such as perseverance that make schooling less costly and reduce quit rates and
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absenteeism in the workplace (Weiss 1995). Similarly, governance characteristics serve as screening filters, affecting investors' valuations of new firms (Sanders and Boivie 2004).

An Unintended Consequence of Employee Treatment: the Cost of Bank Loans

We contend that stakeholders use firms' observable interactions with other stakeholders as cues to screen firms. Crucially, stakeholders must trust the firms they eventually engage with. Trust implies confidence in the firm's ability to achieve results, as well as in its integrity ("the trustor's perception that the trustee adheres to a set of principles that the trustor finds acceptable," Mayer et al. 1995: 719) and its benevolence ("the extent to which a trustee is believed to want to do good to the trustor," Mayer et al. 1995: 718). Thus, a firm's trustworthiness encompasses both its quality in the form of the ability to achieve results, and its intent in the form of the integrity and benevolence it shows to its partners. Past interactions help establish trust (Boyle and Bonacich 1970). Early on, stakeholders lack direct interactions with a focal firm so that initial engagement occurs under high information asymmetry.

In our context, banks are concerned about borrowers' credit risk. Analyzing credit risk cannot be limited to assessing future cash flows. As Moody's Analytics (2018: 1) states, lenders must "assess management integrity, employee skill set, and corporate governance." The risk to a bank extends beyond its uncertainty about a firm's ability to generate cash flows to encompass uncertainty about the principles the firm adheres to, such as its commitment to safeguarding the interests of the lender. Since *ex ante* credit risk is not directly observable, banks rely on observable signals to evaluate such risk.

Compared to arm's-length equity investors, private lenders such as banks are better informed about the well-being of their borrowers' employees. Employee treatment can serve as a salient cue on how firms will honor their obligations to creditors. Certainly, firms hope to improve productivity by treating employees well (Jiang et al. 2012). Favorable treatment enhances employees' morale, commitment, and identification with the firm (Bode et al. 2015, Wang et al. 2009). However, we emphasize that employee treatment provides a more complete picture of the borrower above and beyond its financial strength. In addition to its implications for performance, employee treatment acts as a "soft" indicator for firms' non-financial characteristics, which are especially useful in evaluating firms'

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3 trustworthiness with respect to integrity and benevolence. Employees are the primary stakeholder with
4 whom firms engage repeatedly, and their interests are aligned with those of many other non-shareholding
5 stakeholders. As Titman (1984) contends, employees suffer hugely if a firm is liquidated. Their interest in
6 securing the firm's long-term survival is similar to that of lenders, who do not share any increase in
7 performance beyond a certain point but experience substantial losses when the firm performance declines.
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11 Stakeholders evaluate firms' social actions as indicators of firms' moral reputational capital,
12 which "disposes stakeholders to hold beliefs about the firm that can influence the types of actions those
13 stakeholders engage in" (Godfrey 2005: 783). A trustworthy firm will eschew activities that harm its
14 stakeholders' interests. Employees who invest in firm-specific human capital are vulnerable to hold-up as
15 the firm may exploit them by paying lower compensation or having them work long hours (Wang et al.
16 2009). However, favorable employee treatment serves as a credible commitment made by firms to not
17 holding up their employees (Gouldner 1960). External stakeholders can thus use employee treatment to
18 screen firms for their trustworthiness because it is costly for firms to build reputations as fair employers.
19 Since banks and employees have aligned interests as fixed claimants, employee-friendly firms are also
20 likely to be more trustworthy in honoring their commitments to banks.
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24 In sum, firms' employee treatment is an observable action that serves as a cue of trustworthiness,
25 helping lenders sort firms into risk strata. By virtue of superior human capital and their potential to be
26 competitive, such firms are perceived as capable of repaying debt. In addition, by respecting contracts
27 with, and showing goodwill to, an important primary stakeholder group, such firms are perceived as being
28 of the type that acts with good intent to all other stakeholder groups including creditors.
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Hypothesis 1. Employee treatment is negatively related to the cost of bank loans, other things being equal.

Advancing a Multi-Stakeholder Framework: Information Asymmetry and Relations with Other Primary Stakeholders

Interactions with stakeholders other than employees also provide useful information to creditors about firms' trustworthiness, moderating the value of employee treatment as a screen. Correspondingly, we build a multi-stakeholder framework and theorize about the information provided through three core

relationships with primary stakeholders other than employees: owners, suppliers, and lenders. Finally, we theorize about how banks differ in the weight they attach to borrowers' trustworthiness.

Long-term ownership. "Dedicated" institutional investors with concentrated portfolios and extended investment horizons have incentives to monitor firm actions and, under their monitoring, firms are less likely to take myopic actions that hurt non-shareholding stakeholders including employees and creditors (Bushee 1998, Connelly et al. 2010). Consistent with this logic, Neubaum and Zahra (2006) find that long-term institutional ownership is associated with attention to the interests of multiple stakeholders. Recent research finds that in influencing firm decisions, institutional investors are motivated by their beliefs and norms about how managers should or should not behave (Dyck et al. 2019). Evidence also indicates a lower agency conflict between long-term institutional investors and debtholders (Kim et al. 2019). Therefore, for firms with higher long-term institutional ownership, banks are less worried about their intent to pay back their debt because long-term institutional investors will monitor firms' intent and constrain managers' opportunistic behaviors against non-shareholding stakeholders. As a result, banks rely less on employee treatment as a screen for intent when their borrowers have higher long-term institutional ownership. On the other hand, Yan and Zhang (2009) show that short-term institutional investors, who trade actively for profits, may be better informed than long-term institutional investors about firms' future financial performance. Therefore, long-term institutional investors have limited ability to reduce information asymmetry about firms' financial prospects, although they may pressure firms to disclose more about future performance (Boone and White 2015).

In contrast, information asymmetry regarding firms' integrity and benevolence remains high when firms are owned by transient investors, who have diversified portfolio holdings and make frequent trades for profits. Ownership by transient investors leaves open the potential for myopic firm behavior since they favor momentum trading (Bushee 1998). To meet short-term earnings goals, firms with transient investors may try to boost short-term performance at the expense of non-shareholding stakeholders. In short, long-term institutional owners govern firms to behave in a trustworthy manner. The added value of employee treatment as a screen for trustworthiness is thus weaker for such firms.

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3 *Hypothesis 2. The negative relationship between employee treatment and the cost of bank*
4 *loans is weaker for firms with a higher level of long-term ownership.*
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6 **Supplier trust.** Some suppliers rely on a few major customers for most of their revenue while
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8 others have a diversified customer base. Supplier dependence may, of course, reflect positively on a
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10 customer's financial quality as suppliers make relationship-specific investments to support their sales and
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12 suffer substantial losses when customers become financially distressed, declare bankruptcy, or delay
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14 payment (Dhaliwal et al. 2016). If they doubted the stability of their customers' cash flows, they would
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16 not make their business dependent on those major customers and form such an exclusive relationship.¹
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19 Nonetheless, over time, some suppliers make themselves vulnerable to customers even when said
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21 customers are not large and do not have substantial negotiation power. We argue that the existence of
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23 dependent suppliers, who put themselves in a vulnerable position and rely on long-term and repeated
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25 relationships with a principal customer, provides an alternative screen for the (customer) firm's
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27 trustworthiness and thus decreases banks' reliance on employee treatment as a screen. Suppliers'
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29 confidence in a small number of customers reveals information about their customers' trustworthiness.
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31 Also, dependent suppliers are prone to customer hold-up, since they make relationship-specific
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33 investments to customize products for their clients (Homburg et al. 1999). As the relationship-specific
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35 investments have little value outside the focal relationships, suppliers are subject to customers' rent
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37 extraction once the investments are made. Therefore, dependent suppliers' willingness to make risky
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39 relationship-specific investments suggests their belief in customer firms not acting opportunistically.
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41 Overall, banks can infer a firm's intent toward its stakeholders from the firm's long-term relationships
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43 with dependent suppliers. As a result, the value of employee treatment as a screen for banks to infer the
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45 trustworthiness of firms is lower for firms with dependent suppliers who trust them.
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48 *Hypothesis 3. The negative relationship between employee treatment and the cost of bank*
49 *loans is weaker for firms with a higher level of supplier trust.*
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54 ¹ We thank an anonymous reviewer for pointing out that an alternative explanation for dependent suppliers is customers' greater
55 financial strength. This explanation applies particularly to industry leaders such as Apple and Facebook. Thus, in our analysis, we
56 account for the market share of the borrowing firm. See the Methods section and Appendix A for more details.
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3 **Prior firm–bank relationships.** According to Poppo et al (2008), trust emerges from the shadow
4 of the past (i.e., prior history) or the shadow of the future (i.e., expectation of continued cooperation in the
5 future). Prior history creates a unique path to trust. Whilst it does provide an insight into firms’ quality,
6 “this logic provides little to no economic motivation for the origin (and sustenance) of trust” (Poppo et al.
7 2008: 41). A long relationship contributes to “non-calculative trust,” whereby exchange partners perceive
8 each other as trustworthy and acting in each other’s interests irrespective of potential economic gain
9 (Gulati and Sytch 2008: 168). Prior interactions create shared identities in social relationships and support
10 relational forms of exchange, discouraging opportunism. Thus, perceptions of trustworthiness are formed
11 by data and by personal experience with the actors in question (Hardin 2002). Data availability matters
12 more for the initial decision to engage. Eventually, as two actors interact with one another over time, trust
13 may develop, and information becomes more readily shared (Currall and Judge 1995).

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16 Consistent with the above argument, we contend that information asymmetry between a bank and
17 its borrower is lower if the two parties have a prior lending relationship. The prior history provides insight
18 into the predictability of the borrower’s behavior. Under such circumstances, the borrower’s employee
19 treatment is less informative because trust built through prior interactions mitigates information
20 asymmetry by allowing more open information sharing and reduces the inclination to guard against
21 opportunistic behaviors (Zaheer et al. 1998). Lenders have greater confidence in the borrowing firm’s
22 intent insofar as the borrowing firm can be relied on to fulfill obligations, to behave predictably, and to
23 act fairly when the opportunism is present, thereby reducing the value of employee treatment as a screen.

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26 *Hypothesis 4. The negative relationship between employee treatment and the cost of bank
27 loans is weaker for firms that have a stronger prior relationship with their banks.*

28
29 **Banks’ social capital.** We further consider that lenders’ social capital will shape how sensitive
30 banks are to borrowers’ trustworthiness beyond merely their ability to perform well and, thus, how they
31 value employee treatment as an indicator of intent towards stakeholders. Following the work of political
32 scientist Robert Putnam, we define social capital as “features of social organization such as networks,
33 norms, and social trust that facilitate coordination and cooperation for mutual benefit” (Putnam 1995: 66).

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3 The premise is that connections amongst individuals and organizations produce norms of reciprocity that
4 foster interpersonal trust and a willingness to live by the standards of one's community and to punish
5 those who do not (Bowles and Gintis 2002). Specifically, networks of civic engagement foster norms of
6 generalized reciprocity and encourage social trust. Such networks facilitate coordination and
7 communication, amplify reputations, and help to solve the dilemmas of collective action that cannot be
8 tackled by individuals acting alone or by markets (Bowles and Gintis 2002, Putnam 1995). Communities
9 can enforce norms as a considerable fraction of members willingly engage in the costly punishment of
10 shirkers even when there is no reasonable expectation of being personally repaid for their efforts.
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20 As a result, dense networks reduce incentives for opportunism. Communities with high social
21 capital are characterized by norms that constrain narrow self-interest, prescribe cooperative behavior, and
22 emphasize collective interests, thus having higher mutual trust among their members. On the one hand,
23 firms from communities with high social capital are more socially responsible (Hoi et al. 2018), and
24 auditors more readily trust such firms (Jha and Chen 2015). On the other hand, investors from
25 communities with strong social norms are more likely to emphasize firms' social achievement as well as
26 financial achievements (Dyck et al. 2019). Similarly, lenders located in such communities will view
27 opportunistic behaviors as contrary to prescribed values, resulting in sanctions to constrain such behaviors.
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37 In our context, whilst all lenders are concerned about firms' ability to repay debt, lenders from
38 communities with different levels of social capital will value firms' intent to care about social values
39 differently. Correspondingly, we expect them to differ in their use of soft indicators such as employee
40 treatment in screening borrowers for integrity and benevolence. Banks located in communities with strong
41 social capital are likely to be guided by such norms and thus place a greater value on borrowers' good
42 intent. They will wish to avoid borrowers who breach their employees' trust because such banks may be
43 especially sensitive to any negative contagion to their reputation if they are seen to facilitate the activities
44 of irresponsible borrowers. In contrast, banks from communities with weak social capital care less about
45 cooperative behaviors and collective interests. Their major concern is the borrower's financial quality.
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Thus, we contend that lenders from communities with lower social capital are less sensitive to borrowers' intent, and the value of employee treatment as a screen will decrease.

Hypothesis 5. The negative relationship between employee treatment and the cost of bank loans is weaker when the lender is located in a community with a lower level of social capital.

METHODS

We conduct two studies to test our theory. Study 1, our primary study, is an archival study based on a sample of U.S. publicly listed firms. Study 2 is a policy capturing study to unpack the mechanisms that shape banks' reliance on employee treatment to evaluate firms' credit risk.

STUDY 1. ARCHIVAL STUDY OF U.S. FIRMS

We obtain data from five sources: (1) bank loan data from the Loan Pricing Company (LPC) Dealscan database; (2) employee treatment data from Kinder, Lydenberg, Domini, & Co., Inc. (KLD); (3) firm characteristics and customer-supplier relationship information from Compustat; (4) ownership data from Thomson Reuters Institutional Holdings; and (5) social capital data from the Northeast Regional Center for Rural Development (NERCRD) at the Pennsylvania State University. In Dealscan, the unit of observation is a loan, also known as a loan facility (see Appendix A for an overview of the loan granting process). We choose KLD ratings over the period of 2003 to 2009 due to its limited coverage before 2003 and its change of measurement in 2010 and match the ratings in the year before loan initiation with the loan facility data. After we exclude loans with missing information and loans issued to financial and utilities companies, our final sample consists of 4,662 loan facilities granted to 1,464 unique firms.

Measures

Our dependent variable is the cost of bank loans (*cost of loans*), measured as the natural logarithm of the drawn-all-in spread (i.e., interest rate) charged by the bank over the London Interbank Offered Rates (LIBOR) for the drawn portion of the loan facility.

The key variable is *employee treatment*. KLD is the most comprehensive database for evaluating firms' employee treatment, relying on multiple public and private data sources. The database provides sector-specific analysts' ratings on firms' strengths on six aspects: union relations, cash profit sharing,

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3 employee involvement, retirement benefits, health and safety, and others. All six ratings are binary
4 variables that equal one for firms rated as having a strength in the aspect and zero otherwise. Following
5 prior studies (e.g., Wang et al. 2009), we add the six ratings to construct *employee treatment*.²
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9 *Long-term institutional ownership* is the proportion of the borrower's shares held by non-transient
10 financial institutions (Bushee 1998). To ensure that investors can monitor the firm and provide banks with
11 an alternative screen of trustworthiness, we focus on the top five institutions ranked by their holdings of
12 the firm's shares. *Supplier trust* is the number of suppliers whose sales to the firm make up at least 10%
13 of their total sales (Titman and Wessels 1988). Importantly, to minimize the influence of a focal
14 (customer) firm's financial capability, we set *supplier trust* to zero if the firm's market share is above the
15 sample median, so that dependence on industry leaders does not count as trust. *Prior firm–bank relation*
16 is the strength of the prior relationship between the focal borrowing firm and the bank, estimated by the
17 proportion of loans to the borrower in the last five years that are from the lead bank. Finally, *bank social*
18 *capital* is the level of social capital in the bank's home county, which reflects the banks' emphasis on
19 social values (Rupasingha et al. 2006). For 1997, 2005, 2009, and 2014, the NERCRD provides a social
20 capital index. We linearly interpolate the variable for the missing sample years (Jha and Chen 2015).
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34 Our control variables include (1) borrower characteristics: *firm size*, *market-to-book ratio*, *stock*
35 *price*, *profitability*, *tangibility*, *cash flow volatility*, *Altman's Z-score*, *existence of S&P credit ratings*,
36 *cash slack*, and *employee concern*; (2) industry factors: *industry munificence*, *industry uncertainty*, and
37 *industry concentration*; (3) loan features: *loan maturity*, *loan size*, *number of participating banks*,
38 *performance pricing*, and indicators for loan type and purpose; (4) bank characteristics: *bank size*, *bank*
39 *market share*, and *foreign bank*; (5) state characteristics: *state GDP growth rate*, *state unemployment rate*,
40 and *state union coverage*; and (6) macroeconomic conditions: *term spread* and *credit spread*. We also
41 include year and industry dummies to control for unobservable temporal or cross-industry variations in
42 the cost of bank loans. Detailed explanations of the variables are reported in Appendix B.
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55 ² KLD also provides concerns of employee treatment, but research suggests a lack of convergent validity when using strengths
56 and concerns in conjunction (Flammer and Kacperczyk 2016). Our main findings are robust to alternative measures of employee
57 treatment: (1) the strengths rating minus the concerns rating; and (2) inclusion in *Fortune's List of Best Companies to Work For*.
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Regression Models

We first run an ordinary least squares (OLS) regression to explain the *cost of loans* using *employee treatment* and the controls. We acknowledge that firms with favorable financial conditions might treat their employees better and, at the same time, obtain cheaper loans because they have lower credit risk. In addition to controlling for state, bank, and firm fixed effects, we mitigate the endogeneity concern using an instrumental variable (IV) approach in a two-stage least squares (2SLS) model. We first regress *employee treatment* on the IVs and the controls and then use the predicted *employee treatment* (and its interaction with moderators) as the test variable in the second stage. We cluster standard errors by firm to produce unbiased standard errors in the presence of within-firm dependence of the residuals.

We identify two IVs: *industry voluntary quit rate*, the annual employee voluntary quit rate for a firm's industry; and *state unemployment insurance*, the generosity of unemployment insurance (UI) measured by the natural logarithm of the maximum weekly benefit amount times the maximum number of weeks covered under the state UI system. These two variables are plausibly exogenous predictors of *employee treatment*. First, in industries with high voluntary quit rates (e.g., the accommodation and food services industries), workers perform unskilled tasks and are more replaceable, and thus employers have less incentive to adopt employee-friendly policies.³ One may argue that firms with a high quit rate may exhibit poor performance, which affects their cost of loans in a way unrelated to employee treatment. This concern, however, is mitigated by measuring quit rates at the industry level, because it is less likely that all firms in an industry with a high quit rate perform poorly compared with those in other industries.

Second, the UI system in the U.S. provides temporary income to involuntarily unemployed workers. The government encouraged individual states to adopt UI plans, resulting in state-specific regimes that differ in the amount and duration of benefits. Higher benefits reduce the costs of being unemployed and increase employee shirking. As a response, firms located in states with higher UI benefits offer better employee treatment to mitigate adverse workplace behaviors (Flammer and Luo

³ Theoretically, employers in industries with a high quit rate could have an interest to treat employees favorably if the quit rate captures employee mobility. This argument is, however, inconsistent with the fact that the accommodation and food services industries are ranked highest in terms of voluntary quit rates.

2017). Moreover, UI benefits are mostly financed through taxes paid by firms and aggregated over time to states' trust funds. Given our control for state-level characteristics, it is less likely that state UI benefits have a prominent impact on firms' cost of loans through other channels than employee treatment.

Results

Table 1 presents the summary statistics of our sample loans. Panels A, B, and C report the frequency distribution of the loans by year, loan purpose, and loan type, respectively. Panel D presents the descriptive statistics for our variables. The mean loan spreads over the LIBOR and loan facility amounts are about 180 basis points and 510 millions of dollars, respectively. The average *employee treatment* is 0.27. Appendix C presents the Pearson correlations, and a VIF test does not reveal multicollinearity issues.

[Insert Tables 1 and 2 about here]

We report the OLS and 2SLS estimation results in Table 2. In Model 1, our baseline OLS result shows that *employee treatment* reduces the *cost of loans* ($p = 0.002$). Adopting one additional employee-friendly policy decreases the loan spread by 7.96% (or 14.3 basis points). Given an average loan facility of \$510 million, this means an average saving of \$729,000 per year in loan interest expenses, which is economically significant. The result holds after we control for state and bank fixed effects ($p = 0.000$) and further control for firm fixed effects using the pre-sample mean scaling method ($p = 0.024$) (Blundell et al. 1999). Our control variables (fixed effects) should largely account for time-varying (time-invariant) factors that predict the cost of loans. Unobservable factors may exist, but, to result in a significant confounding effect, such factors must vary much across years and at the same time, not significantly correlate with our comprehensive set of controls. Such confounding effects, if any, should be minimal.

In Model 2, *predicted employee treatment* from the second-stage regression has a significantly negative coefficient ($p = 0.003$), consistent with Hypothesis 1.⁴ The first-stage regression confirms that *industry voluntary quit rate* (*state unemployment insurance*) negatively (positively) affects *employee treatment*. Following Semadeni et al. (2014), we conduct three diagnostic tests. First, the F -test associated

⁴ The magnitude of the 2SLS coefficient (-0.870) is greater than that of the OLS coefficient (-0.083), because the 2SLS estimate could capture a "local" effect of employee treatment on the cost of loans (Jiang 2017). Firms that adopt an employee-friendly policy in response to lower quit rates or more generous UI benefits should expect to benefit the most from doing so.

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3 with the addition of our IVs to the first-stage model rejects the null ($F = 10.21$; $p = 0.000$) of weak
4 instruments, supporting the relevance of our IVs. Second, Sargan's test of instrument endogeneity fails to
5 reject the null ($\chi^2 = 0.21$; $p = 0.649$) of endogenous instruments, validating the assumption that our IVs
6 affect the cost of loans mainly through employee treatment. Third, the Durbin–Wu–Hausman test rejects
7 the null ($F = 19.53$; $p = 0.000$) of the absence of endogeneity, supporting our use of the IV approach.
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13 We report the moderating results in Table 3. Model 2 shows that the interaction of *predicted*
14 *employee treatment* and *long-term institutional ownership* is significantly positive, supporting Hypothesis
15 2 that the effect of *employee treatment* on *cost of loans* is weaker for firms with higher long-term
16 ownership. Hypothesis 3 predicts a weaker negative relation between *employee treatment* and *cost of*
17 *loans* for firms with greater *supplier trust*. This is supported by Model 3, which shows a significantly
18 positive interaction between *predicted employee treatment* and *supplier trust*. As reported in Model 4, the
19 interaction of *predicted employee treatment* and *prior firm–bank relation* is significantly positive,
20 although the effect is insignificant in the full Model 6. The result partially supports Hypothesis 4, which
21 predicts a weaker negative effect of *employee treatment* on *cost of loans* for borrowers with stronger prior
22 relationships with their banks. Model 5 supports Hypothesis 5—that banks domiciled in low-social-
23 capital counties place less weight on employee treatment as a screen—in that the negative effect of
24 *predicted employee treatment* on cost of bank loans is stronger when *bank social capital* is high.
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39 To facilitate interpretation, we quantify and plot the interaction results using Models 2 and 5 for
40 illustration. The results in Models 3 and 4 are directionally consistent with those of Model 2 and thus not
41 plotted for brevity. As shown in Figure 1, the joining lines are steeper under the conditions of lower *long-*
42 *term institutional ownership* and higher *bank social capital*, indicating stronger marginal effects of
43 *predicted employee treatment* under such conditions. In terms of economic significance, under those
44 conditions, an increase in *predicted employee treatment* from one standard deviation below to one
45 standard deviation above the mean would reduce the interest rate by a differential amount of 29.1 and
46 22.3 basis points, respectively. These differential amounts can translate into an increase in annual interest
47 expenses of over \$1 million based on the average loan size in Table 1 (\$510 million), which is
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3 economically nontrivial. Figure 2 shows the ranges of the moderators where we see a significant effect of
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5 employee treatment on the cost of loans at the 5% level.
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7 [Insert Table 3, Figure 1 and Figure 2 about here]
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9 **Intent versus Quality**

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11 While consistent with employee treatment being used as a screen for intent, the above results do
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13 not completely exclude the possibility that it also acts as a screen for quality, because some of the
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15 moderating factors can speak to information asymmetry about quality as well. To further distinguish
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17 intent from quality, we conduct an additional analysis to provide direct evidence for employee treatment
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19 as a screen for intent. Our analysis proceeds in two stages. First, we employ a text-based measure of CEO
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21 integrity introduced by Dikolli et al. (2020). These authors estimate CEO integrity using causation words
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23 in firms' letters to shareholders, where the pervasive use of such words indicates low integrity.⁵ We
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25 regress *employee treatment* on *integrity* and a major financial quality measure, *profitability*, both being
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27 standardized to facilitate a direct magnitude comparison. Models 1–3 of Panel A of Table 4 show that
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29 *integrity* and *profitability* both explain *employee treatment* and the magnitudes of their coefficients are
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31 comparable, suggesting that employee treatment is a cue for intent above and beyond being a cue for
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33 quality. Model 4 shows that the effect of *integrity* still exists, but the effect of *profitability* becomes
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35 insignificant, when we include other financial variables that can predict firms' incentives to improve
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37 financial performance through improving employee treatment.
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41 Second, we use the model in Model 4 of Panel A to construct $employee\ treatment^{Integrity}$ and
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43 $employee\ treatment^{Quality}$, which capture employee treatment explained by integrity and financial factors,
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45 respectively. In Model 1 of Panel B, we first show that *employee treatment* loads negatively in this
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47 smaller sample with available data for *integrity*. Model 2 shows that the integrity component, but not the
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49 quality component, of employee treatment still explains the cost of loans after controlling for a set of
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51 financial factors. In addition, the magnitude of the coefficient of $employee\ treatment^{Integrity}$ is much larger
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55 ⁵ Examples of causation words are *attribute*, *because*, *reason*, and *why*. A CEO is considered as lacking integrity if the letter
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57 contains more causation words than warranted by the firm's fundamentals because causation words are used to explain
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59 discrepancies between declared intentions and actual actions. We thank the authors of Dikolli et al. (2020) for sharing these data.
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3 (-0.030 versus -0.001) than that of *employee treatment*^{Quality}. Overall, our results provide some support
4 that banks use employee treatment more as a screen for firms' intent than quality.
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7 [Insert Table 4 about here]
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9 **Robustness Tests**

10 We also conduct two additional robustness tests. First, we use family ownership as an alternative
11 approach to operationalize long-term ownership. Family-controlled firms are generally long-term oriented
12 due to family owners' concern about the preservation of socioemotional wealth (Gómez-Mejía et al.
13 2007). Compared with non-family firms, family firms may be willing to incur a greater performance
14 hazard such as below-target performance to protect their socioemotional wealth. Therefore, for family
15 firms, the screening value of employee treatment as intent will be lower as they are generally viewed as
16 having higher integrity and benevolence. Our results show that the interaction of *predicted employee*
17 *treatment* and *family firm* is significantly positive, thus corroborating our primary analysis. Second, to
18 mitigate the concern that *prior firm-bank relation* may capture the firm's quality as well, we categorize
19 firms' financial health (proxied by *Altman's Z-score*), and replicate our test using the subsample of
20 financially less healthy firms. For this subsample, *both* the prior relations and employee treatment are less
21 likely to reflect performance prospects and instead are more likely to reflect behavioral intent. Our results
22 show a consistent and positive interaction of *employee treatment* and *prior firm-bank relation*.
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39 **STUDY 2. POLICY CAPTURING**

40 To build further evidence for the mechanisms that link employee treatment to the cost of bank
41 loans, we implement a policy capturing study, which is apt for isolating the influence of informational
42 cues on decision-making (Aguinis and Bradley 2014, Connelly et al. 2016). The technique requires
43 subjects to evaluate scenarios that are constructed to allow researchers to manipulate variables of interest.
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50 **Sample and Design**

51 We partnered with Prime Panels to recruit 103 banking and finance professionals, all working in
52 the U.S. The average length of professional experience was 14.58 years (S.D. = 10.60), and 83 subjects
53 (80.58%) were university graduates. We created descriptions of firms that were identical except for four
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3 dimensions: *operating ratio*, *bond rating*, *capital spending forecast*, and *employee treatment*. The
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5 *operating ratio*, the ratio of operating expenses to revenues and a common creditworthiness indicator, was
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7 listed as 1.8 times or 0.6 times. The *bond rating* was listed as AAA or BBB on a scale from AAA to C.
8
9 The *capital spending forecast*, selected because it may predict changes in creditworthiness (Becker and
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11 Strömberg 2012), was described as increasing or flat over the period 2019–2021 versus 2016–2018.
12
13 *Employee treatment* was a composite rating of union relations, cash profit sharing, employee involvement,
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15 retirement benefits, and health and safety, which is consistent with the KLD items (except the “other”
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17 dimension) used in our archival study. We distinguished three levels of treatment (strong, equivalent to a
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19 KLD score of +1; no particular strengths or concerns, equivalent to 0; weak, equivalent to -1).

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22 Because we have three variables—*operating ratio*, *bond rating*, *capital spending forecast*—each
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24 of which has two levels, and a fourth variable—*employee treatment*—which has three levels, we have 24
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26 permutations in total. In policy capturing, showing subjects all permutations can cause fatigue and low
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28 engagement (Mitchell et al. 2011, Wang et al. 2015). We thus presented each subject with eight randomly
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30 selected scenarios from the 24. For each scenario, subjects scored their willingness to extend a loan on a
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32 scale from 1 (very low) to 5 (very high) and provided the interest rate they would require. The average
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34 interest rate was 9.43% (S.D. = 4.55%). For each firm, subjects scored how profitable they expected it to
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36 be after one year and after five years (1= very unprofitable, 5 = very profitable), capturing the short-term
37
38 and long-term profitability expectations related to the firm’s quality. They also indicated, on a scale from
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40 1 (very low) to 5 (very high), agreement with the statements that “the company will have the best interests
41
42 of its lenders at heart,” and “the company adheres to principles I find acceptable.” The former statement
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44 reflects belief in the firm’s benevolence towards the stakeholder whose interest is at play in the decision
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46 to advance a loan, and the latter statement reflects belief in its integrity. Whereas short-term and long-
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48 term profit expectations map to quality, perceptions of the firm’s benevolence and integrity map to intent.

51 **Analysis and Results**

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54 Our analysis progresses in two stages. First, we regress the willingness to lend and proposed
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56 interest rate on the scenario variables. The regression weights indicate each cue’s contribution to the
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3 decision (Wang et al. 2015). As subjects respond to multiple scenarios, we include rater fixed effects. In
4 the second stage, we conduct mediation analyses to understand whether perceptions of quality and intent
5 mediate the effect of financial metrics (such as *operating ratio*) and *employee treatment* on the
6 willingness to advance a loan and the interest rate at which subjects would advance a loan.
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11 Table 5 displays the results of the regression analysis on subjects' *willingness to lend* (Model 1)
12 and the log-transformed *interest rate* (Model 2).⁶ The *operating ratio* and *bond rating* predict willingness
13 to lend ($p = 0.000$) and a low rate of interest offered ($p = 0.000$), whereas the coefficient on a forecasted
14 increase in capital expenditure has no discernible effect on either the *willingness to lend* or *interest rate*.
15
16 The coefficient on *employee treatment* suggests that favorable employee treatment is positively associated
17 with *willingness to lend* ($p = 0.000$) and negatively related to the *interest rate* offered ($p = 0.000$).
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24 [Insert Table 5 about here]
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26 We also assess the influence of employee treatment under different financial conditions. To do so,
27 we create dummies representing combinations of 1) positive financial metrics (*operating ratio* and *bond*
28 *rating*) and favorable employee treatment, 2) positive financial metrics and neutral employee treatment, 3)
29 positive financial metrics and weak employee treatment, 4) negative financial metrics and favorable
30 employee treatment, 5) negative financial metrics and neutral employee treatment, and 6) negative
31 financial metrics and weak employee treatment. We regress the *willingness to lend* and the log-
32 transformed *interest rate* on these dummies (Table 6), controlling for the *capital spending forecast*. To
33 aid interpretation, we assess only those permutations where the two key financial metrics are both positive
34 or both negative. Compared to the baseline which is the combination of negative financial metrics and
35 neutral employee treatment, positive financial metrics are associated with higher willingness to lend and a
36 lower interest rate, and both effects are magnified under favorable employee treatment. In practical terms,
37 positive financial performance is necessary, but insufficient, for the most favorable loan decisions.
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51 [Insert Table 6 and Figure 3 about here]
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55 ⁶ Consistent with other policy capturing studies, we do not provide a correlation table because subjects are exposed to a random
56 selection of scenarios (Connelly et al. 2016).
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3 To examine whether the influence of employee treatment on lending decisions is mediated by quality
4 and/or intent, we used structural equation modeling (SEM). Because we have multiple observations per
5 respondent, we used the Generalized SEM in Stata which allows for multilevel models. We consider three
6 pathways through which employee treatment potentially influences lending: 1) directly, 2) indirectly via
7 enhanced perceptions of firm intent, and 3) indirectly via enhanced perceptions of firm quality (Figure 3).
8
9 To measure intent, we average the ratings of the focal firm's benevolence and integrity (pairwise
10 correlation: 0.700, $p = 0.000$). To measure quality, we average expectations of the firm's short-term
11 profitability and long-term profitability (pairwise correlation: 0.762; $p = 0.000$). Consistent with Preacher
12 and Hayes (2008), we use bootstrapping with 500 replications to correct the confidence intervals of the
13 mediated effects. Doing so allows us to weigh up the effects of intent and quality without assuming that
14 these effects are normally distributed (MacKinnon et al. 2004).
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26 Once perceptions of intent and quality are included in predicting the likelihood of advancing a loan,
27 the direct effect of employee treatment is insignificant ($\beta = -0.006$, $p = 0.860$), implying full mediation.
28 The indirect pathway through intent is significant ($\beta = 0.253$, $p = 0.000$), with the bootstrap estimate of
29 the 95% confidence interval ranging from 0.197 to 0.309. The indirect pathway through quality is also
30 significant ($\beta = 0.110$, $p = 0.000$), with the bootstrap estimate of the 95% confidence interval ranging
31 from 0.094 to 0.168. Thus, the indirect effect through intent on the likelihood to extend the loan is
32 disproportionately large (69.7% of the total effect), and greater than the indirect effect through quality,
33 with non-overlapping confidence intervals.
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43 Similarly, once perceptions of intent and quality are included in predicting the (log-transformed)
44 interest rate, the direct effect of employee treatment becomes insignificant ($\beta = 0.014$, $p = 0.360$). The
45 indirect pathway through intent is significant ($\beta = -0.063$, $p = 0.000$), with the bootstrap estimate of the
46 95% confidence interval ranging from -0.091 to -0.048. The indirect pathway through quality is also
47 significant ($\beta = -0.029$, $p = 0.000$), with the bootstrap estimate of the 95% confidence interval ranging
48 from -0.046 to -0.018. Again, such results suggest that the indirect effect through intent on the interest
49 rate charged is disproportionately large (68.5% of the total effect), and greater than the indirect effect
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3 through quality, with non-overlapping confidence intervals.
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5 In sum, while employee treatment also conveys information about quality, the primary pathway
6 through which it influences lending is as a cue for intent, in the form of enhanced perceptions of firms'
7 integrity and benevolence.
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11 DISCUSSION

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13 We advance a screening-based theory that links firms' treatment of their internal stakeholders to
14 external stakeholders' provision of resources. Our stakeholder–screening perspective highlights how
15 efforts to satisfy one stakeholder group influence relations with other stakeholders—even in ways that
16 may be unintended by management. Creditors use employee-friendly policies as a screen for firms'
17 trustworthiness, affecting the cost of their loans. Employee treatment plays a pronounced role as a screen
18 under high information asymmetry when lenders cannot readily infer trustworthiness from observing
19 firms' interactions with stakeholders other than employees. We discuss the implications of our findings
20 under two thrusts: the contribution of a screening perspective to stakeholder theory, and the existence of
21 stakeholder complementarities.
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32 Screening and Stakeholder Theory

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34 We adopt a screening perspective to examine how external stakeholders evaluate firms based on
35 these firms' relations with their internal stakeholders. External stakeholders use employee treatment to
36 screen not only firms' quality but also their intent. Forging a link between screening and stakeholder
37 theory is important because it implies that how firms engage with one stakeholder group can have
38 unintended consequences for their relations with other stakeholders. There has been extensive research on
39 signaling which “focuses mainly on actions insiders take to intentionally communicate positive,
40 imperceptible qualities” (Connelly et al. 2011: 45). Thus, firms choose information to share with
41 stakeholders (Lev et al. 2010). In contrast, screening recognizes that not all information cues are
42 intentionally communicative. Employee treatment, however, is ultimately reflected in public rankings of
43 employers (for example, *Forbes' Best Employers List*), as well as disclosures from labor unions of
44 egregious working conditions and, potentially, inferred through employees' own external engagement
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3 (Bode et al. 2015). Whilst such rankings are intended for potential employees, external stakeholders
4 access this information too.
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7 What value do external stakeholders obtain from information on how firms treat their primary
8 internal stakeholders? Information *not* intended for a particular audience is crucial in shaping that
9 audience's perceptions of trust (Fershtman and Gneezy 2001). A firm's trustworthiness reflects belief in
10 its quality as well as its intent. Most research in information economics assesses information asymmetry
11 with respect to the ability to achieve results (quality), but banks already have access to financial records
12 that indicate whether firms are financially capable of repaying loans. There are fewer investigations of
13 information asymmetry with respect to how firms treat their stakeholders (intent). Even financially
14 successful firms sometimes act opportunistically towards their lenders. In this regard, employee treatment
15 reveals information about whether firms are "trustworthy interaction partners" (Fehrler and Przepiorka
16 2013: 139). Firms build reputations over time for treating stakeholders well. These hard earned
17 reputations are at risk if employers are found to treat *any* stakeholder group poorly. The effect of a firm's
18 failure to meet one stakeholder group's claims on the attitudes of other stakeholders not only applies to
19 employee treatment, but also to the treatment of other stakeholder groups. For example, when American
20 Airlines defaulted on a loan and entered bankruptcy, it struggled to keep employees motivated and
21 customers loyal. This case shows the ripple effects when stakeholders' interests are harmed.
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24 The distinction between firms' quality and intent has implications for stakeholder theory.
25
26 Whereas most stakeholder research adopts an instrumental lens to understand when engagement creates
27 economic value (Berman et al. 1999, Jones 1995), oftentimes value creation—and, potentially, value
28 destruction—occur in response to less deliberate measures by firms. If managers purely assess the first-
29 order economic consequences of a policy or practice, they neglect other channels through which such
30 policy or practice can affect corporate performance. Employee-related practices are particularly relevant
31 to screening for intent because firms are less likely to communicate such internal practices on purpose to
32 shape external perceptions. This focus on internal practices distinguishes our study from research
33 identifying the benefits of social engagement for access to resources and which offers transparent
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3 reporting as an explanation (Kim et al. 2012). However, even in the case of firms' external social
4 engagement (e.g., Cheng et al. 2014) and philanthropy (e.g., Zolotoy et al. 2019), perceptions of intent may
5 be an important driver of investor behavior alongside perceptions of quality. It is unlikely that firms
6 purposefully treat employees well to engender perceptions of good intent, which makes our study depart
7 from previous research that emphasizes a firm's actions with clear strategic goals (e.g., Bae et al. 2011).

13 **Stakeholder Complementarities**

14
15 Our study contributes to stakeholder research by illustrating how efforts for one stakeholder
16 group (employees) influence the perceptions and behavior of another stakeholder group (debtholders).
17 This study recasts stakeholder management in terms of the *jointness* of stakeholder interests, which
18 implies that whether a firm creates value for one stakeholder group is related to how it creates value for
19 other stakeholder groups. Research has often focused on the conflicts between diverse stakeholders
20 (Freeman 2010). We shift the focus to how diverse stakeholder groups can have complementary interests.

21
22 An important reason for our attention to debtholders is that they have fixed claims on the firm
23 (Titman 1984). Fixed claims include lenders' rights to have their loans repaid, suppliers' rights to have
24 their invoices paid, and customers' rights to have their warranties honored. Whereas many conflicts
25 highlighted in the stakeholder literature center on disputes with actors who have residual claims on firms'
26 net cash flows—such as the conflict that arises when employees appropriate cash flows that would
27 otherwise accrue to shareholders (Coff 1999)—there is scope to generate complementarities between
28 employees and other fixed claimants. Most non-financial stakeholders are concerned about the downside
29 risk of firms going out of business, whereas residual claimants emphasize the upside benefits of increased
30 cash flows. The implication is that information asymmetry poses a challenge for stakeholders, who must
31 utilize various sources of information to assist their decision-making (Gomulya and Mishina 2017).

32
33 External stakeholders' reliance on employee treatment varies with their information asymmetry vis-à-vis
34 the firm. The jointness of stakeholder interests is consistent with attention to the nexus of relationships
35 between a firm's stakeholders (Rowley 1997). But, our study suggests that, in addition to relationships
36 that exist between stakeholders, information flows may be as important. This has implications for the

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3 emergence of interorganizational trust. Whilst trust develops in the course of repeated interactions,
4 initially trustworthiness must be inferred. Here, observations of firms' interactions with other stakeholders
5 weigh heavily—consistent with our finding that employee treatment is more frequently used as a screen
6 when banks have weak relationships with their borrowers.
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11 Although our study focuses on employees and creditors, we encourage scholars to assess whether
12 our results generalize to other stakeholders. How firms treat other non-financial stakeholders such as
13 customers and suppliers is well publicized (for example, in the Temkin customer service ratings of firms)
14 and, thus, observable. Customers and suppliers are critical stakeholders in a firm's value chain, and their
15 wealth depends on the firm's long-term survival due to their investment in relationship-specific human or
16 physical capital. Relationships with these key non-financial stakeholders could thus affect corporate
17 financing by signaling firms' future growth prospects as well as their intent to honor their explicit and
18 implicit contracts. Moreover, the screening perspective is even relevant within organizations to
19 understand how competing understandings result in concerted action. Individual organizational units
20 interpret environmental change differently (Dutt and Joseph 2019). Potentially the reactions of some units
21 have greater informational value and, thus, credibility to shape organizational action. We welcome future
22 research to assess whether the screening-based mechanisms that we identify in the context of employee
23 treatment apply to other stakeholders inside and outside the firm.
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TABLE 1
Summary Statistics

Panel A: Distribution of loans by year								
Year	2004	2005	2006	2007	2008	2009	2010	All
N	899	902	756	791	453	309	552	4,662

Panel B: Distribution of loans by primary purpose			Panel C: Distribution of loans by type		
	N	%		N	%
Corporate purposes	2,022	43.4	Revolver	3,125	67.0
Working capital	1,325	28.4	Term loan	1,287	27.6
Takeover	536	11.5	364-day facility	250	5.4
Acquisition line	213	4.6			
Commercial paper backup	156	3.3			
Debt repayment	153	3.3			
Others	257	5.5			

Panel D: Descriptive statistics							
	N	Mean	S.D.	P25	Median	P75	
<i>Cost of loans</i>	4,662	4.871	0.870	4.317	5.011	5.521	
<i>Employee treatment</i>	4,662	0.267	0.611	0.000	0.000	0.000	
<i>Firm size</i>	4,662	7.383	1.494	6.345	7.245	8.384	
<i>Leverage</i>	4,662	0.158	0.144	0.043	0.126	0.236	
<i>Market-to-book ratio</i>	4,662	1.835	0.890	1.263	1.566	2.132	
<i>Stock price</i>	4,662	3.142	0.838	2.729	3.264	3.736	
<i>Profitability</i>	4,662	0.141	0.084	0.096	0.134	0.181	
<i>Tangibility</i>	4,662	0.299	0.231	0.119	0.230	0.435	
<i>Cash flow volatility</i>	4,662	0.034	0.030	0.017	0.025	0.039	
<i>Altman's Z-score</i>	4,662	3.686	2.857	2.035	3.108	4.690	
<i>Existence of S&P credit ratings</i>	4,662	0.630	0.483	0.000	1.000	1.000	
<i>Cash slack</i>	4,662	-0.062	0.114	-0.113	-0.052	0.000	
<i>Employee concern</i>	4,662	0.588	0.743	0.000	0.000	1.000	
<i>Industry munificence</i>	4,662	0.113	0.081	0.060	0.100	0.152	
<i>Industry uncertainty</i>	4,662	0.120	0.107	0.053	0.088	0.146	
<i>Industry concentration</i>	4,662	0.245	0.197	0.108	0.191	0.314	
<i>Loan maturity</i>	4,662	3.843	0.535	3.611	4.094	4.094	
<i>Loan size</i>	4,662	5.428	1.268	4.605	5.521	6.215	
<i>Number of participating banks</i>	4,662	1.884	0.910	1.386	1.946	2.565	
<i>Performance pricing</i>	4,662	0.604	0.489	0.000	1.000	1.000	
<i>Bank size</i>	4,662	11.259	1.891	10.178	12.006	12.779	
<i>Bank market share</i>	4,662	0.135	0.105	0.019	0.144	0.246	
<i>Foreign bank</i>	4,662	0.052	0.222	0.000	0.000	0.000	
<i>State GDP growth rate</i>	4,662	0.046	0.034	0.034	0.049	0.064	
<i>State unemployment rate</i>	4,662	0.059	0.020	0.047	0.053	0.063	
<i>State union coverage</i>	4,662	0.139	0.063	0.074	0.154	0.180	
<i>Term spread</i>	4,662	1.107	0.989	0.120	0.810	2.170	
<i>Credit spread</i>	4,662	1.029	0.456	0.810	0.910	1.000	
<i>Long-term institutional ownership</i>	4,662	0.250	0.105	0.176	0.240	0.313	
<i>Supplier trust</i>	4,662	0.003	0.055	0.000	0.000	0.000	
<i>Prior firm-bank relation</i>	4,188	0.443	0.402	0.000	0.333	1.000	
<i>Bank social capital</i>	4,446	-0.070	0.368	-0.267	-0.033	0.178	

TABLE 2
Regressions of the Cost of Bank Loans on Employee Treatment: Main Results

	Model 1 (OLS)			Model 2 (2SLS)	
	Baseline	State and bank fixed effects	Firm fixed effects	First stage	Second stage
<i>Employee treatment</i>	-0.083*** (0.027)	-0.096*** (0.025)	-0.053** (0.023)		
<i>Predicted employee treatment</i>					-0.870*** (0.294)
<i>Industry voluntary quit rate</i>				-0.008** (0.003)	
<i>State unemployment insurance</i>				0.108** (0.053)	
<i>Firm size</i>	-0.124*** (0.016)	-0.112*** (0.015)	-0.019 (0.016)	0.154*** (0.017)	-0.045 (0.050)
<i>Leverage</i>	0.978*** (0.115)	0.917*** (0.127)	0.474*** (0.126)	-0.305** (0.133)	1.119*** (0.124)
<i>Market-to-book ratio</i>	-0.064*** (0.019)	-0.072*** (0.018)	-0.068*** (0.020)	0.051** (0.022)	0.025 (0.023)
<i>Stock price</i>	-0.147*** (0.019)	-0.130*** (0.020)	-0.108*** (0.021)	-0.002 (0.022)	-0.081*** (0.021)
<i>Profitability</i>	-0.526*** (0.176)	-0.549*** (0.176)	-0.613*** (0.188)	-0.053 (0.216)	-0.520*** (0.171)
<i>Tangibility</i>	-0.026 (0.083)	-0.021 (0.085)	0.055 (0.088)	0.165* (0.090)	0.065 (0.094)
<i>Cash flow volatility</i>	1.957*** (0.421)	1.994*** (0.389)	1.367*** (0.396)	0.281 (0.407)	1.771*** (0.429)
<i>Altman's Z-score</i>	-0.013** (0.006)	-0.014** (0.006)	-0.017** (0.007)	0.007 (0.007)	0.006 (0.006)
<i>Existence of S&P credit ratings</i>	0.083*** (0.029)	0.058* (0.030)	0.001 (0.030)	-0.017 (0.039)	0.063** (0.029)
<i>Cash slack</i>	-0.049 (0.119)	-0.069 (0.110)	-0.062 (0.118)	0.017 (0.133)	-0.072 (0.114)
<i>Employee concern</i>	0.012 (0.015)	0.016 (0.016)	-0.000 (0.016)	-0.025 (0.020)	-0.010 (0.016)
<i>Industry munificence</i>	-0.155 (0.194)	-0.202 (0.199)	-0.471** (0.191)	-0.526** (0.213)	-0.437* (0.260)
<i>Industry uncertainty</i>	0.306**	0.393***	0.450***	0.565***	0.730***

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	(0.136)	(0.129)	(0.127)	(0.172)	(0.224)
<i>Industry concentration</i>	-0.109	-0.083	-0.051	-0.023	-0.120
	(0.081)	(0.083)	(0.069)	(0.090)	(0.076)
<i>Loan maturity</i>	0.044	0.025	-0.010	0.012	0.067**
	(0.027)	(0.028)	(0.029)	(0.026)	(0.027)
<i>Loan size</i>	-0.079***	-0.086***	-0.055***	0.030**	-0.051***
	(0.013)	(0.012)	(0.012)	(0.012)	(0.015)
<i>Number of participating banks</i>	-0.020	-0.013	-0.024	-0.025	-0.035*
	(0.016)	(0.015)	(0.015)	(0.017)	(0.018)
<i>Performance pricing</i>	-0.034	-0.029	-0.028	0.022	-0.016
	(0.022)	(0.023)	(0.023)	(0.025)	(0.024)
<i>Bank size</i>	-0.013	0.019	0.022	-0.003	-0.019**
	(0.009)	(0.016)	(0.017)	(0.009)	(0.010)
<i>Bank market share</i>	0.065	-0.393	-0.433*	0.000	0.100
	(0.171)	(0.258)	(0.258)	(0.198)	(0.170)
<i>Foreign bank</i>	0.050	0.020	-0.069	-0.047	0.023
	(0.049)	(0.068)	(0.062)	(0.041)	(0.050)
<i>State GDP growth rate</i>	0.162	0.390	0.297	0.949*	1.000*
	(0.502)	(0.501)	(0.542)	(0.539)	(0.536)
<i>State unemployment rate</i>	0.934	1.256	1.422	0.048	0.860
	(1.047)	(1.290)	(1.355)	(1.418)	(1.016)
<i>State union coverage</i>	-0.358	0.042	-1.025	0.094	-0.188
	(0.220)	(1.254)	(1.318)	(0.262)	(0.224)
<i>Term spread</i>	0.161***	0.155***	0.144***	-0.040	0.120***
	(0.031)	(0.033)	(0.031)	(0.033)	(0.033)
<i>Credit spread</i>	0.110***	0.129***	0.145***	0.006	0.113***
	(0.033)	(0.034)	(0.038)	(0.036)	(0.033)
<i>Pre-sample mean cost of loans</i>			0.401***		
			(0.022)		
Loan type, loan purpose, year, & industry dummies	Yes	Yes	Yes	Yes	Yes
State and bank dummies	No	Yes	Yes	No	No
Observations	4,662	4,662	4,054	4,662	4,662
Adjusted R-squared	0.673	0.697	0.753	0.244	0.684
Weak instrument test				$F = 10.21$ ($p = 0.000$)	
Sargan's test of instrument endogeneity				$\chi^2 = 0.21$ ($p = 0.649$)	
Durbin–Wu–Hausman test of endogeneity				$F = 19.53$ ($p = 0.000$)	

Note: All the variables are defined in Appendix A. All models include an unreported intercept. Standard errors clustered by firm are reported in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively.

TABLE 3
Regressions of the Cost of Bank Loans on Employee Treatment: Moderating Effects

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
<i>Predicted employee treatment</i>	-0.935*** (0.338)	-1.163*** (0.351)	-0.943*** (0.337)	-1.012*** (0.344)	-0.932*** (0.337)	-1.223*** (0.354)
<i>Long-term institutional ownership</i>	-0.029 (0.137)	-0.193 (0.148)	-0.033 (0.137)	-0.030 (0.136)	-0.025 (0.137)	-0.185 (0.147)
<i>Supplier trust</i>	-0.016 (0.301)	-0.029 (0.296)	0.000 (0.182)	-0.051 (0.300)	0.029 (0.280)	-0.008 (0.180)
<i>Prior firm–bank relation</i>	-0.023 (0.026)	-0.025 (0.026)	-0.027 (0.026)	-0.062** (0.031)	-0.023 (0.026)	-0.062** (0.031)
<i>Bank social capital</i>	-0.054* (0.029)	-0.053* (0.029)	-0.056* (0.029)	-0.055* (0.029)	-0.004 (0.033)	-0.014 (0.033)
<i>Predicted employee treatment × Long-term institutional ownership</i>		0.884** (0.371)				0.831** (0.368)
<i>Predicted employee treatment × Supplier trust</i>			1.089*** (0.141)			0.947*** (0.143)
<i>Predicted employee treatment × Prior firm–bank relation</i>				0.150* (0.089)		0.133 (0.089)
<i>Predicted employee treatment × Bank social capital</i>					-0.253*** (0.093)	-0.214** (0.093)
All control variables in Table 2	Yes	Yes	Yes	Yes	Yes	Yes
Loan type, loan purpose, year, & industry dummies	Yes	Yes	Yes	Yes	Yes	Yes
Observations	4,019	4,019	4,019	4,019	4,019	4,019
Adjusted R-squared	0.709	0.710	0.710	0.709	0.710	0.711

Note: All the variables are defined in Appendix A. All models include the control variables and an intercept, not tabulated here for brevity. Standard errors clustered by firm are reported in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively.

TABLE 4
Employee Treatment as Screens of Integrity versus Quality

Panel A: First-stage analysis				
	Dependent variable = <i>Employee treatment</i>			
	Model 1	Model 2	Model 3	Model 4
<i>Integrity</i>		0.031** (0.015)	0.032** (0.015)	0.034** (0.015)
<i>Profitability</i>	0.055** (0.025)		0.057** (0.025)	0.020 (0.030)
<i>Firm size</i>				-0.063 (0.119)
<i>Leverage</i>				0.014 (0.032)
<i>Market-to-book ratio</i>				-0.052 (0.050)
<i>Stock price</i>				0.040 (0.035)
<i>Tangibility</i>				-0.038 (0.076)
<i>Cash flow volatility</i>				0.024 (0.031)
<i>Altman's Z-score</i>				0.137** (0.054)
<i>Existence of S&P credit ratings</i>				0.036 (0.049)
<i>Cash slack</i>				-0.056** (0.028)
Year fixed effect	Yes	Yes	Yes	Yes
Firm fixed effect	Yes	Yes	Yes	Yes
Observations (no. of firm-years)	1,585	1,585	1,585	1,585
Adjusted R-squared	0.740	0.740	0.742	0.743
Panel B: Second-stage analysis				
	Dependent variable = <i>Cost of loans</i>			
	Model 1	Model 2		
<i>Employee treatment</i>	-0.063*** (0.018)			
<i>Employee treatment</i> ^{<i>Integrity</i>}		-0.030** (0.014)		
<i>Employee treatment</i> ^{<i>Quality</i>}		-0.001 (0.115)		
All control variables in Table 2		Yes	Yes	
Loan type, loan purpose, year, & industry dummies		Yes	Yes	
Observations (no. of loans)		2,148	2,148	
Adjusted R-squared		0.693	0.690	

Note: *Integrity* is the text-based CEO behavioral integrity score developed by Dikolli et al. (2020). *Employee treatment*^{*Integrity*} and *employee treatment*^{*Quality*} are the components of employee treatment explained by *integrity* and the financial factors, respectively, estimated by Model 4 of Panel A. Both models in Panel B include the control variables and an intercept, not tabulated here for brevity. Standard errors clustered by firm are reported in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively.

TABLE 5
Linear Fixed-Effects Regression of Willingness to Lend and Interest Rate Charged to Firm

Dependent variable:	Model 1	Model 2
	<i>Willing to lend</i>	<i>Interest rate (log)</i>
<i>Operating ratio</i>	0.577*** (0.055)	-0.121*** (0.022)
<i>Bond rating</i>	0.411*** (0.055)	-0.112*** (0.022)
<i>Capital spending forecast</i>	0.065 (0.054)	0.006 (0.022)
<i>Employee treatment</i>	0.341*** (0.033)	-0.068*** (0.013)
Constant	3.021*** (0.055)	2.231*** (0.022)
Observations	824	824
R-squared	0.189	0.046
F-tests	F (4, 717) 73.95***	F (4, 717) 18.77***

Note: *, **, and *** denote statistical significance at the 10%, 5%, and 1% levels, respectively.

TABLE 6
Effects of Combinations of Financial Metrics and Employee Treatment (Linear Fixed-Effects Regression)

Dependent variable:	Model 1	Model 2
	<i>Willing to lend</i>	<i>Interest rate</i>
<i>Positive financial metrics & favorable employee treatment</i>	1.110*** (0.136)	-0.290*** (0.067)
<i>Positive financial metrics & neutral employee treatment</i>	0.775*** (0.138)	-0.217*** (0.067)
<i>Positive financial metrics & poor employee treatment</i>	0.351*** (0.143)	-0.106 (0.070)
<i>Negative financial metrics & favorable employee treatment</i>	-0.053 (0.145)	0.018 (0.070)
<i>Negative financial metrics & poor employee treatment</i>	-0.547*** (0.134)	0.063 (0.066)
<i>Capital spending forecast</i>	0.045 (0.077)	0.000 (0.037)
Constant	3.160*** (0.103)	9.988*** (0.402)
Observations	416	416
R-squared	0.276	0.060
F-tests	F (6, 307) 38.32***	F (6, 307) 8.46***

Note: *, **, and *** denote statistical significance at the 10%, 5%, and 1% levels, respectively.

FIGURE 1
Moderating Effects

We select a high value and a low value (i.e., one standard deviation above and below the mean, respectively) of each moderator, and also a high value and a low value of *predicted employee treatment*. Using Models 2 and 5 in Table 3, we predict and plot four values of *cost of loans*, by setting all the other variables at their mean values. The slopes of the lines reflect the effect of employee treatment on the cost of loans for high versus low values of the moderator.

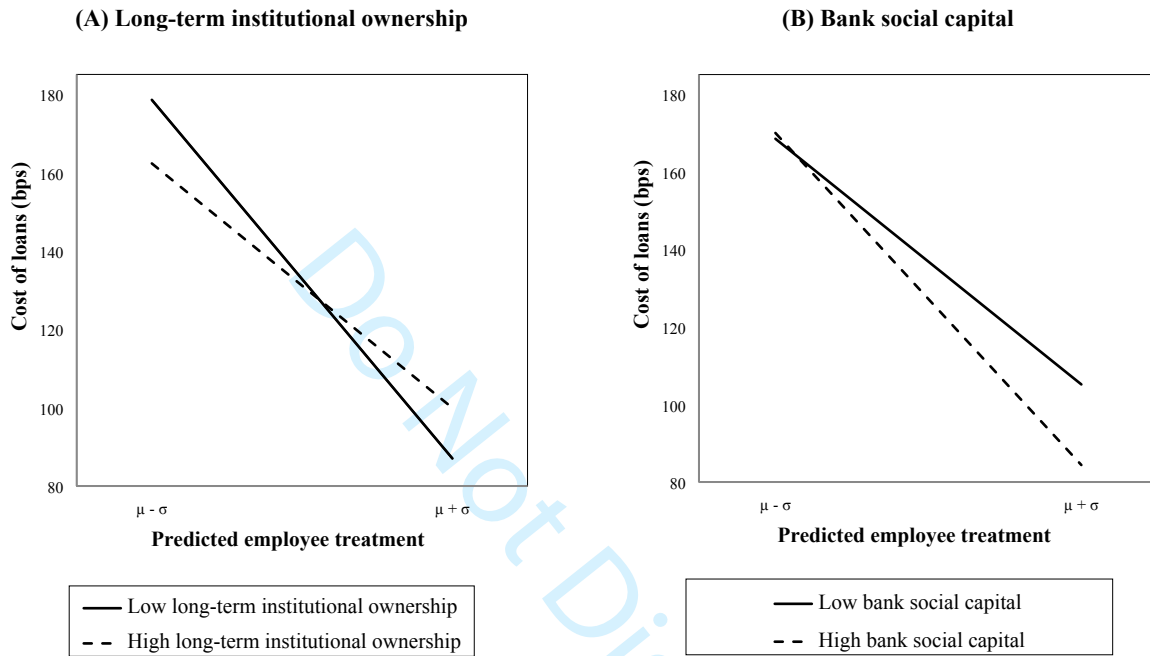


FIGURE 2
Region of Significance of the Effect of Employee Treatment on Cost of Loans

In this figure, we plot the point estimate and the 95% confidence interval upper and lower limits of the relation between *predicted employee treatment* and *cost of loans* at each possible value of the moderator.

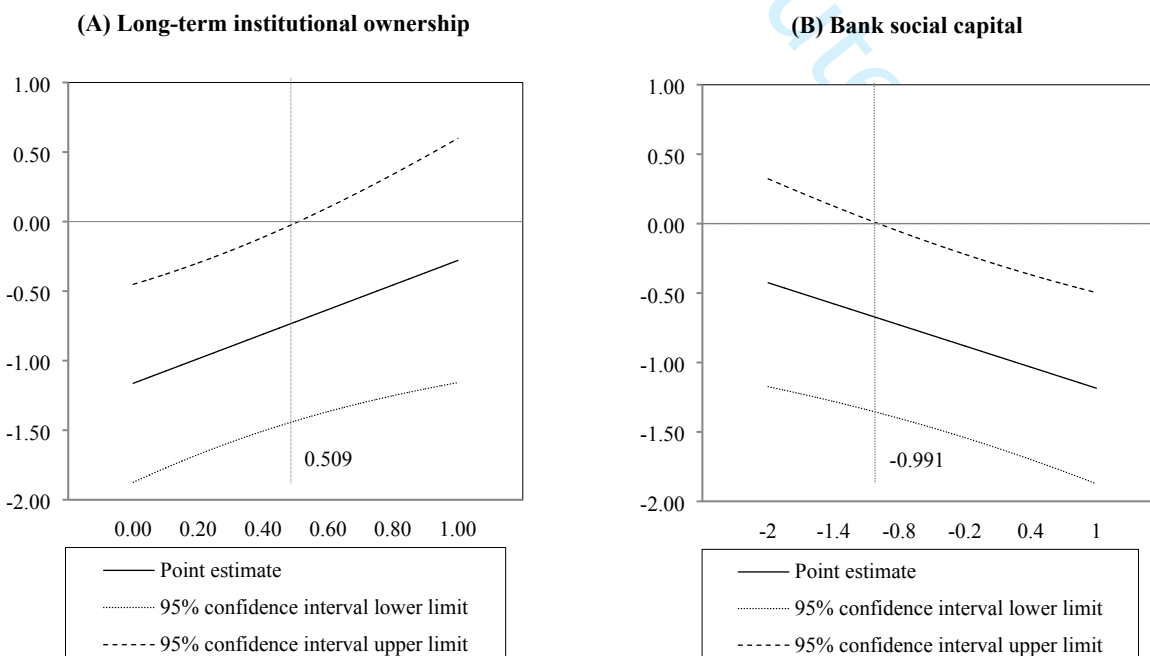
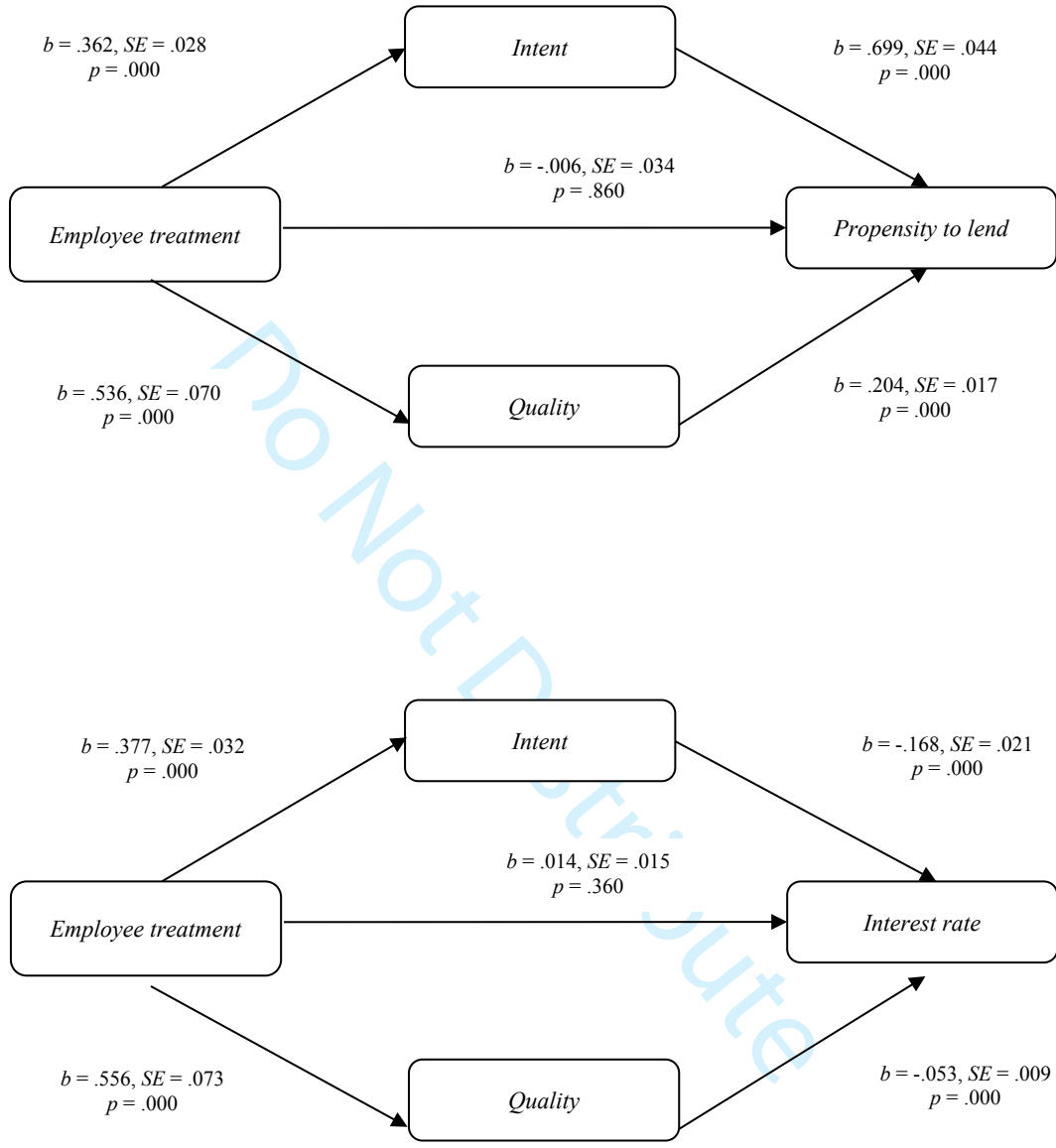


FIGURE 3
Mediation Models



APPENDIX A

Institutional Process of Syndicated Loan Granting

Bank loans are a major type of private sector financing in the capital market. A syndicated loan involves two or more lenders under a single set of legal documents for granting funds to a borrower. Banks participate in a syndicated loan in different ways. Lead arrangers, or arranging banks, play a lead role in the syndication process and advise and manage the transaction. They are responsible for analyzing credit quality and negotiating key terms with the borrower. Participating banks join the syndicate by reviewing the documentation provided by lead arrangers and committing a particular amount of funds to the syndicate. While delegating the power of assessing credit quality and monitoring borrowers to lead arrangers, participating banks are ultimately responsible for their own credit analysis in making the decision to join a syndicated loan. Below we provide a brief summary of the syndication process.

Step 1: A prospective borrowing firm presents a loan term sheet to potential lead arrangers.

A prospective borrowing firm with a need of bank finance initiates the transaction. The firm develops a term sheet specifying the amount of funds to raise and the desired number of years of loan term (i.e., maturity). The term sheet sometimes also specifies the availability of collaterals, the desired seniority of the loan, and special needs of waiving a certain covenant restriction. The firm presents its term sheet to a list of banks, normally including its primary relationship banks (which already know the firm well through past lending experience) and other banks that are perceived to have particular expertise in an industry or country.

Step 2: The potential lead arrangers submit their bids to the borrowing firm to make the short list.

After receiving the term sheet from the prospective borrowing firm, the banks decide the approximate interest rate they would like to charge by assessing the borrowing firm's credit quality as well as the attractiveness of the deal, and then submit a bid package to the borrowing firm. It is essential for the banks to set the appropriate interest rate after the screening process. The banks do not want to bid aggressively with low interest rates, because doing so would cause a failure to obtain sufficient compensation for the borrowing firm's credit risk if they won the deal. On the other hand, the banks do not want to set too high an interest rate either, because doing so would cause the borrowing firm to choose other banks, especially when the borrowing firm is perceived as trustworthy and thus has other choices in the lending market.

Step 3: The borrowing firm shortlists the banks and then the banks submit a final proposal.

The borrowing firm compares the bids it has received and makes a short list. The shortlisted banks prepare a final package including their finalized interest rate and, more importantly for winning the deal, also a detailed proposal of how they would structure the transaction and select the participating banks. It is, however, important to note that the number of banks interested to submit a bid in the first place and the attractiveness of the interest rates charged in the bids reflect perceptions of the borrower's trustworthiness. Only when a borrowing firm is sufficiently trustworthy does it receive multiple bids with favorable interest rates.

Step 4: The selected lead arranger designs and executes the syndication strategy.

The bank that wins the deal assumes the role of the lead arranger of the syndicated loan. The lead arranger decides the proportion of the loan it would like to hold and syndicates out the remaining amount to participating banks. Specifically, the lead arranger calls for submission of credit commitments from the targeted participating banks. If the total commitments exceed the amount of the loan to be syndicated out, an oversubscription occurs, and the lead bank will scale back the amounts to be allocated to each participating bank on a pro rata basis. If the lead arranger does not receive enough commitments to cover the amount to be syndicated out, an undersubscription occurs, and, for a fully underwritten bid, the lead bank will have to bear the consequence and hold a larger proportion of the loan than expected.

APPENDIX B
Variable Definitions

Variable	Definition	Data source
<i>Employee treatment</i>	Number of strengths in employee relations	KLD
<i>Cost of loans</i>	Natural logarithm of all-in-drawn spread (i.e. interest rate) in basis points measured over LIBOR or LIBOR equivalent	Dealscan
<i>Loan maturity</i>	Natural logarithm of loan maturity in months	Dealscan
<i>Loan size</i>	Natural logarithm of amount of loan facility in millions of dollars	Dealscan
<i>Number of participating banks</i>	Natural logarithm of number of lenders that participate in the loan syndicate	Dealscan
<i>Performance pricing</i>	Indicator variable that equals to one if the loan contract includes a performance pricing component; and zero otherwise	Dealscan
<i>Bank size</i>	Natural logarithm of the total amount of loans (in millions of dollars) granted by the lead bank in the past year	Dealscan
<i>Bank market share</i>	Total amount of loans granted by the lead bank divided by the total amount of loans recorded by the Dealscan database in the past year	Dealscan
<i>Foreign bank</i>	Indicator variable that equals to one if lead bank is not a U.S. bank; and zero otherwise	Dealscan
<i>Firm size</i>	Natural logarithm of sales in millions of dollars	Compustat
<i>Leverage</i>	Long-term debt divided by market value of assets	Compustat
<i>Market-to-book ratio</i>	Ratio of market value of assets to book value of assets	Compustat
<i>Stock price</i>	Natural logarithm of stock price	Compustat
<i>Profitability</i>	EBIDTA divided by total assets	Compustat
<i>Tangibility</i>	Net PP&E divided by total assets	Compustat
<i>Cash flow volatility</i>	Standard deviation of quarterly cash flows from operations scaled by total assets over the past five years	Compustat
<i>Altman's Z-score</i>	Altman's (1968) Z-score.	Compustat
<i>Existence of S&P credit ratings</i>	Indicator that takes value of one if firm has an S&P senior debt rating, and zero otherwise	Compustat
<i>Cash slack</i>	Cash reserve scaled by total assets in excess of the industry average	Compustat
<i>Employee concern</i>	Number of concerns in employee relations	KLD
<i>Industry munificence</i>	Growth rate of total sales in the industry	Compustat
<i>Industry uncertainty</i>	Standard deviation of total sales in the industry	Compustat
<i>Industry concentration</i>	Herfindahl-Hirschman Index of the industry	Compustat

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2			
3	<i>State GDP growth rate</i>	GDP growth rate of the state	Bureau of Economic Analysis
4			
5			
6	<i>State unemployment rate</i>	Unemployment rate of the state	Bureau of Labor Statistics
7			
8	<i>State union coverage</i>	Proportion of labor covered by labor unions in the state	Union Membership and Coverage Database
9			
10			
11	<i>Term spread</i>	Difference between ten-year Treasury yield and two-year Treasury yield	Federal Reserve Board
12			
13	<i>Credit spread</i>	Difference between BAA-rated corporate bond yield and AAA-rated corporate bond yield	Federal Reserve Board
14			
15			
16	<i>Pre-sample mean cost of loans</i>	Natural logarithm of average all-in-drawn spread in basis points measured over LIBOR or equivalent charged to same borrowing firm over five-year pre-sample period	Dealscan
17			
18			
19	<i>Industry voluntary quit rate</i>	Annual employee voluntary quit rate for the firm's NAICS industry	Bureau of Labor Statistics
20			
21			
22	<i>State unemployment insurance</i>	Natural logarithm of maximum weekly benefit amount times maximum number of covered weeks under state unemployment insurance system	Department of Labor
23			
24			
25	<i>Long-term institutional ownership</i>	Proportion of borrower's shares held by non-transient institutions; we require institutions to be ranked top five by their holdings of borrowing firm's shares.	Thomson Reuters Institutional Holdings
26			
27	<i>Supplier trust</i>	Number of dependent suppliers whose sales derived from firm take up at least 10% of total sales; set to zero if firm's market share is above sample median; the Statement of Financial Accounting Standards (SFAS) No. 131 requires a firm to disclose the identity of customers that represent more than 10% of its total sales	Compustat Segments
28			
29			
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32			
33	<i>Prior firm-bank relation</i>	Number of loans by lead bank to borrower in the last five years scaled by total number of loans to borrower in the last five years	Dealscan
34			
35			
36	<i>Lender social capital</i>	Social-capital index in county where bank is located (dimensions: per capita no. of tax-exempt NPOs, per capita no. of social organizations, % of voters who voted in presidential elections, and response rate to decennial census)	Northeast Regional Center for Rural Development
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APPENDIX C
Correlation Matrix

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	
<i>Cost of loans</i>	(1)											
<i>Employee treatment</i>	(2)	-0.246										
<i>Firm size</i>	(3)	-0.469	0.360									
<i>Leverage</i>	(4)	0.331	-0.078	0.025								
<i>Market-to-book ratio</i>	(5)	-0.295	0.053	-0.094	-0.401							
<i>Stock price</i>	(6)	-0.526	0.174	0.354	-0.319	0.320						
<i>Profitability</i>	(7)	-0.281	0.086	0.127	-0.208	0.456	0.371					
<i>Tangibility</i>	(8)	0.044	0.056	0.020	0.292	-0.136	0.016	0.111				
<i>Cash flow volatility</i>	(9)	0.117	-0.068	-0.208	-0.192	0.177	-0.061	0.004	-0.132			
<i>Altman's Z-score</i>	(10)	-0.279	0.032	-0.075	-0.594	0.621	0.331	0.447	-0.234	0.186		
<i>Existence of S&P credit ratings</i>	(11)	-0.139	0.154	0.503	0.373	-0.140	0.147	0.022	0.136	-0.249	-0.310	
<i>Cash slack</i>	(12)	0.015	-0.009	-0.010	-0.052	0.001	0.024	-0.009	0.083	0.146	0.096	-0.068
<i>Employee concern</i>	(13)	-0.089	0.115	0.344	0.085	-0.102	0.043	-0.052	0.102	-0.105	-0.106	0.170
<i>Industry munificence</i>	(14)	0.059	-0.014	-0.100	0.070	0.042	0.032	0.069	0.199	0.031	-0.004	-0.010
<i>Industry uncertainty</i>	(15)	0.095	0.028	-0.140	0.048	-0.063	-0.026	-0.033	0.142	0.010	-0.064	-0.016
<i>Industry concentration</i>	(16)	-0.055	0.019	0.102	-0.094	-0.033	0.057	-0.015	-0.261	-0.011	0.042	0.026
<i>Loan maturity</i>	(17)	0.102	-0.095	-0.091	0.116	-0.055	0.026	0.056	0.014	-0.062	-0.042	0.079
<i>Loan size</i>	(18)	-0.412	0.283	0.671	0.105	-0.026	0.385	0.142	0.172	-0.209	-0.122	0.475
<i>Number of participating banks</i>	(19)	-0.304	0.140	0.448	0.066	-0.068	0.368	0.114	0.069	-0.172	-0.091	0.344
<i>Performance pricing</i>	(20)	-0.126	-0.002	-0.013	-0.145	0.032	0.136	0.091	-0.030	0.010	0.110	-0.071
<i>Bank size</i>	(21)	-0.256	0.117	0.334	0.024	0.038	0.214	0.120	-0.019	-0.175	-0.028	0.260
<i>Bank market share</i>	(22)	-0.180	0.114	0.284	0.005	0.023	0.159	0.076	-0.028	-0.121	-0.020	0.174
<i>Foreign bank</i>	(23)	0.108	-0.034	-0.060	0.088	-0.052	-0.034	-0.053	0.085	0.022	-0.047	0.037
<i>State GDP growth rate</i>	(24)	-0.290	-0.043	0.004	-0.089	0.148	0.179	0.089	0.029	0.011	0.098	0.059
<i>State unemployment rate</i>	(25)	0.372	0.042	-0.027	0.129	-0.183	-0.269	-0.074	0.019	-0.007	-0.121	-0.075
<i>State union coverage</i>	(26)	-0.063	0.032	0.047	-0.046	0.079	-0.031	-0.083	-0.286	0.042	0.027	-0.038
<i>Term spread</i>	(27)	0.362	0.009	-0.083	0.113	-0.155	-0.221	-0.069	0.035	0.030	-0.107	-0.069
<i>Credit spread</i>	(28)	0.289	0.040	-0.049	0.036	-0.120	-0.186	-0.054	0.047	0.034	-0.032	-0.110
<i>Long-term institutional ownership</i>	(29)	0.066	-0.067	-0.007	0.042	-0.166	-0.032	-0.085	-0.075	-0.063	-0.048	-0.013
<i>Supplier trust</i>	(30)	0.038	-0.024	-0.034	-0.041	0.004	0.006	0.027	0.020	0.017	0.011	-0.039
<i>Prior firm-bank relation</i>	(31)	-0.152	0.051	0.084	-0.053	0.000	0.105	0.047	0.024	-0.012	0.041	-0.004
<i>Bank social capital</i>	(32)	-0.171	0.117	0.246	0.049	0.023	0.094	0.072	-0.001	-0.058	-0.033	0.195

		(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)	(20)	(21)	(22)
Employee concern	(13)	0.062										
Industry munificence	(14)	-0.104	-0.087									
Industry uncertainty	(15)	0.030	-0.070	0.528								
Industry concentration	(16)	0.103	0.048	-0.138	0.087							
Loan maturity	(17)	0.001	-0.066	0.027	0.010	-0.023						
Loan size	(18)	-0.073	0.196	0.030	-0.038	-0.040	0.089					
Number of participating banks	(19)	-0.057	0.095	0.005	-0.015	0.006	0.208	0.578				
Performance pricing	(20)	0.011	-0.057	0.018	0.012	0.003	0.090	0.057	0.248			
Bank size	(21)	-0.064	0.089	-0.030	-0.046	0.031	0.107	0.359	0.347	0.032		
Bank market share	(22)	-0.049	0.083	-0.069	-0.035	0.019	0.056	0.301	0.292	-0.002	0.824	
Foreign bank	(23)	0.043	-0.034	0.038	0.033	-0.020	-0.022	-0.052	-0.103	-0.080	-0.195	-0.226
State GDP growth rate	(24)	0.004	-0.070	0.107	0.012	-0.052	0.084	0.047	0.034	0.086	0.073	-0.081
State unemployment rate	(25)	0.024	0.067	-0.087	0.007	0.033	-0.101	-0.082	-0.080	-0.095	-0.120	0.038
State union coverage	(26)	-0.047	0.019	-0.155	-0.134	0.055	-0.024	-0.003	0.007	-0.040	0.008	0.047
Term spread	(27)	0.053	-0.014	0.000	0.080	0.026	-0.173	-0.123	-0.056	-0.058	-0.203	-0.057
Credit spread	(28)	0.012	0.076	0.091	-0.067	0.006	-0.169	-0.097	-0.128	-0.025	-0.094	-0.050
Long-term institutional ownership	(29)	-0.004	0.005	-0.046	-0.063	0.046	0.058	-0.026	0.040	0.054	0.061	0.050
Supplier trust	(30)	0.020	-0.022	0.027	0.007	-0.041	0.003	-0.035	-0.015	-0.028	0.004	0.005
Prior firm–bank relation	(31)	0.008	0.007	-0.001	-0.028	-0.046	-0.088	0.144	0.158	0.095	0.123	0.150
Bank social capital	(32)	-0.067	0.067	-0.025	-0.033	0.009	0.035	0.224	0.085	-0.047	0.204	0.130

		(23)	(24)	(25)	(26)	(27)	(28)	(29)	(30)	(31)	(32)
State GDP growth rate	(24)	0.002									
State unemployment rate	(25)	0.033	-0.740								
State union coverage	(26)	-0.065	-0.163	0.146							
Term spread	(27)	0.027	-0.588	0.658	0.022						
Credit spread	(28)	0.029	-0.273	0.363	-0.016	0.297					
Long-term institutional ownership	(29)	-0.042	0.008	-0.025	-0.013	-0.089	0.070				
Supplier trust	(30)	-0.013	0.004	-0.014	-0.037	0.007	0.048	-0.020			
Prior firm–bank relation	(31)	-0.030	0.026	-0.031	-0.015	-0.006	0.035	0.019	0.002		
Bank social capital	(32)	-0.088	0.043	-0.094	0.138	-0.099	-0.131	-0.018	-0.053	-0.037	

Note: All variables are defined in Appendix A. Pearson correlations that are significant at the 5% level are reported in boldface.