

Labor in the Boardroom

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Shareholder vs. Stakeholder Control of Firms

- Liberal market economies (Hall and Soskice, 2001):
 - Owners (e.g., shareholders) control firms
 - Example: United States
 - Shareholders elect board of directors \Rightarrow runs firm, fiduciary duty to shareholders
- Alternative model: owners **and workers** share governance of firms
 - Ex: Germany or Sweden
 - Formal control rights: **have votes on corporate boards alongside owners**
 - Differs from, e.g., employee ownership (no claim to profits)
 - Recent policy proposals in the United States
 - Accountable Capitalism Act (40% of worker-elected directors)
 - Reward Work Act (1/3 worker-elected directors)
- Open and unresolved debate on effects of shared governance

Potential Effects of Shared Governance

- Worker voice

- ⇒ Information exchange, productivity \uparrow , turnover \downarrow
Hirschman (1970), Freeman and Medoff (1984)

- ⇒ Ability to enforce implicit contracts, e.g., through better information
Malcomson (1983), Freeman and Lazear (1995)

- Rent-seeking, hold-up and underinvestment

- ⇒ Worker bargaining power \uparrow \Rightarrow wages \uparrow and investment \downarrow
Grout (1984)

- ⇒ Shareholder values view: codetermination as agency cost leading to disinvestment
Jensen and Meckling (1976,'79)

- Ideal experiment: randomly assign firms to shared governance

Existing evidence compares large vs. small firms (Gorton and Schmid, 2004, Lin et al., 2018, and Kim et al., 2018)

This Paper

- This paper: quasi-experimental evidence on causal effect of worker-elected directors on corporate board \Rightarrow firm- and worker-level outcomes
- We exploit cohort-specific reform of shared governance in German shareholder corporations
 - Incorporated **before** August 10, 1994: **1/3** of of board seats to workers
 - Locked in even after reform!
 - Incorporated **after** August 10, 1994: **zero** board seats to workers

\Rightarrow Difference-in-discontinuity

- Incorporation date cutoff: August 10, 1994
- Legal form: shareholder vs. other corporations
- Rich firm, board & administrative matched employer-employee data

Effects of Shared Governance: Preview of Results

- Increases capital stock and intensity
- Moderate shift towards higher-skilled and technical occupations
- Higher VA per worker, but no shift in TFP
- No evidence for large wage increases
- No evidence for effects on leverage, profitability

Interpretation

Hold-up hypothesis empirically rejected

Cf. Card, Devicienti, and Maida (2013)

What may account for *positive* effects on capital?

- Shared governance may lead to more cooperative solutions
 - Investment under-provided in market, pareto-improving equilibrium through **repeated interactions**
Lancaster (1973), van der Ploeg (1987)
- Joint bargaining over investment, employment, wages
- Workers may have long horizon and preference for capital investment

Worker Representative Views

"shared governance per se opposes short-term shareholder interests. The focus is on the long-term safeguarding of the company through investments and innovations with participation of the employees"

Berthold Huber, IG Metall (Metalworker's Union), 2004
Worker Board Representative, Deputy Chairman Siemens

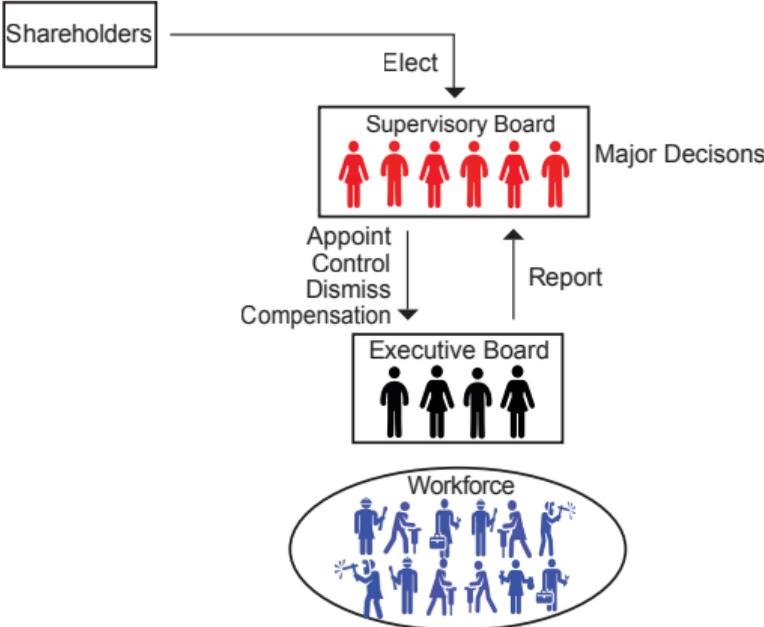
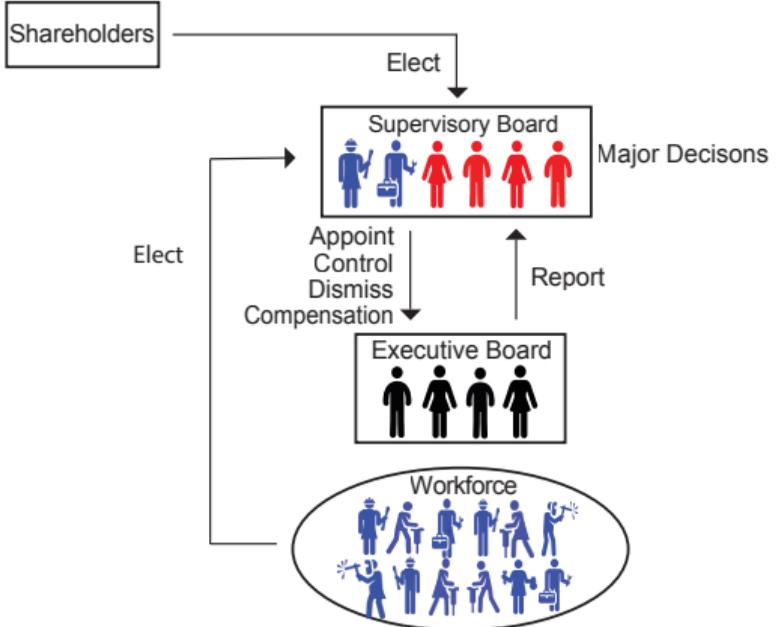
"[I] only speak about facts that directly affect the interests of employees. But there is enough of that - for example, when it comes to the strategic focus, to planned offshoring/outsourcing or too little investment."

Johann Rösch, 2014
Worker Board Representative, Karstadt

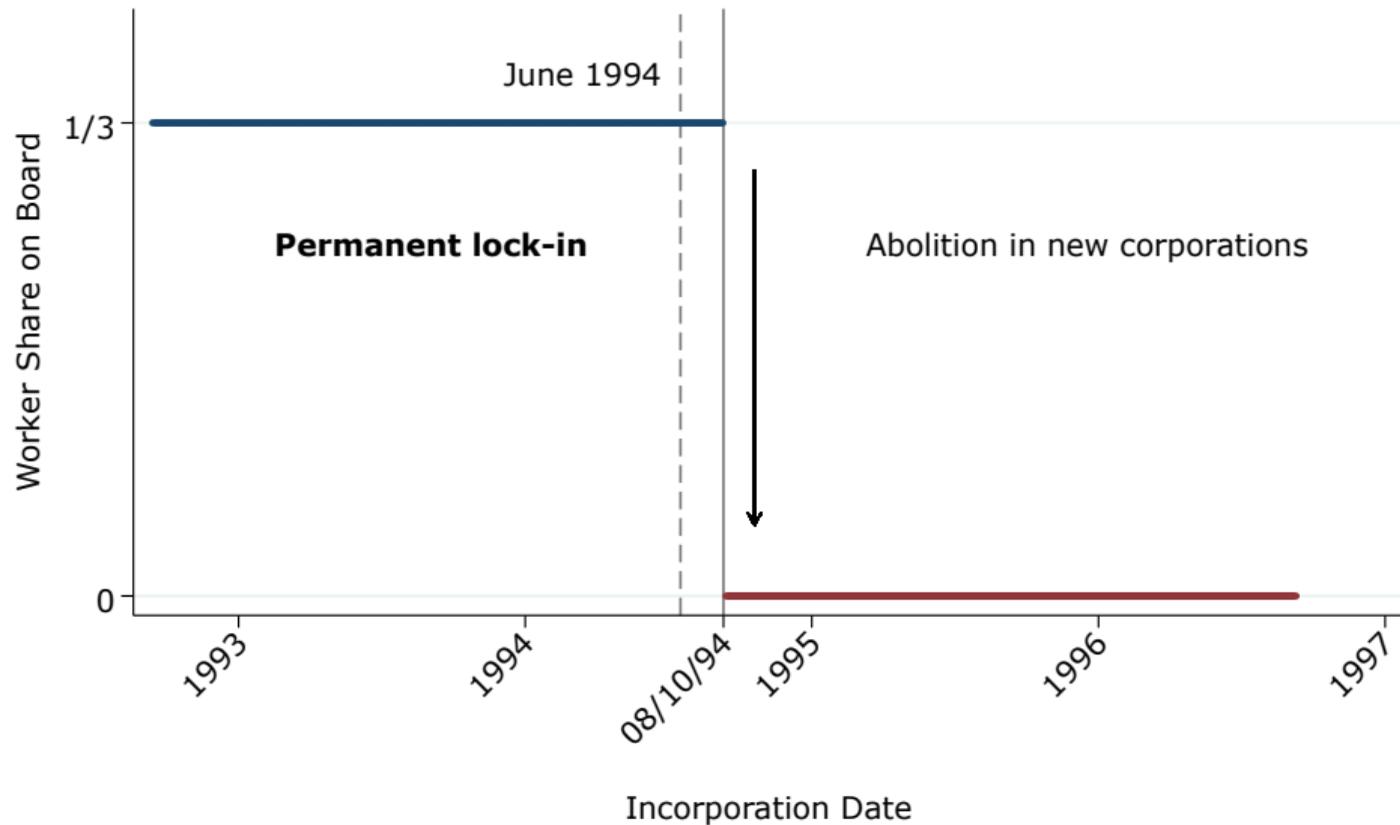
Overview

- Introduction
- **Institutions, Reform, and Research Design**
- Empirical Results
- Discussion

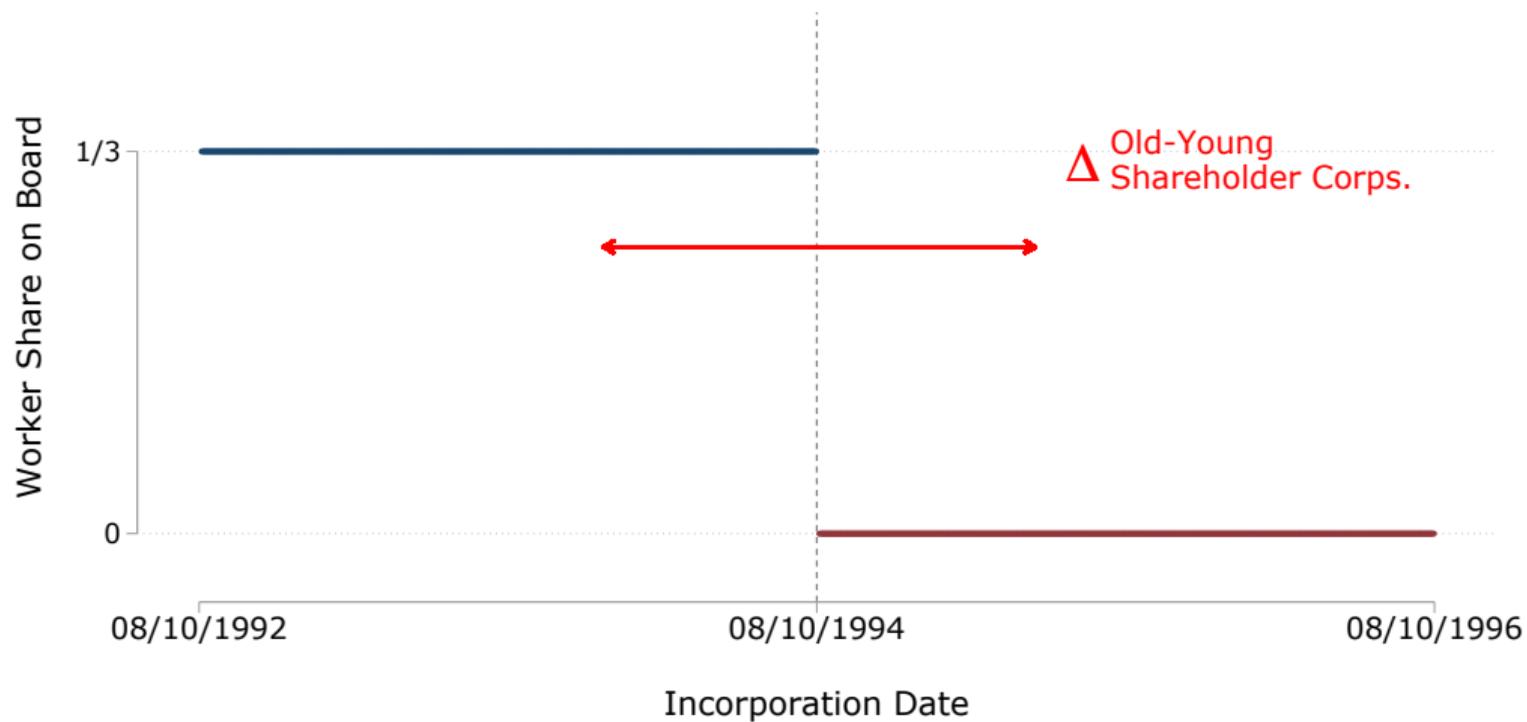
Governance With and Without Worker Representatives



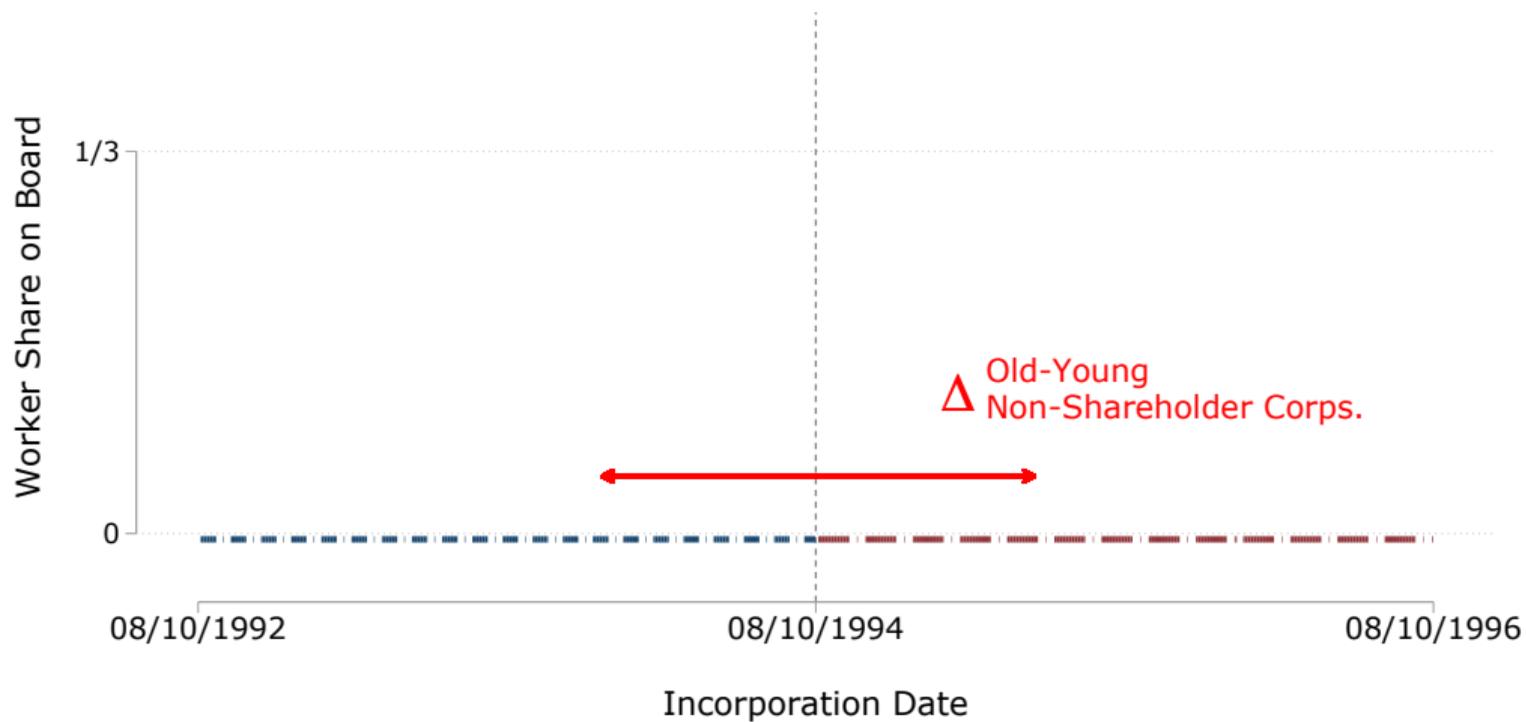
1994 Reform: Lock-In For Old Firms, Abolition in New Cohorts



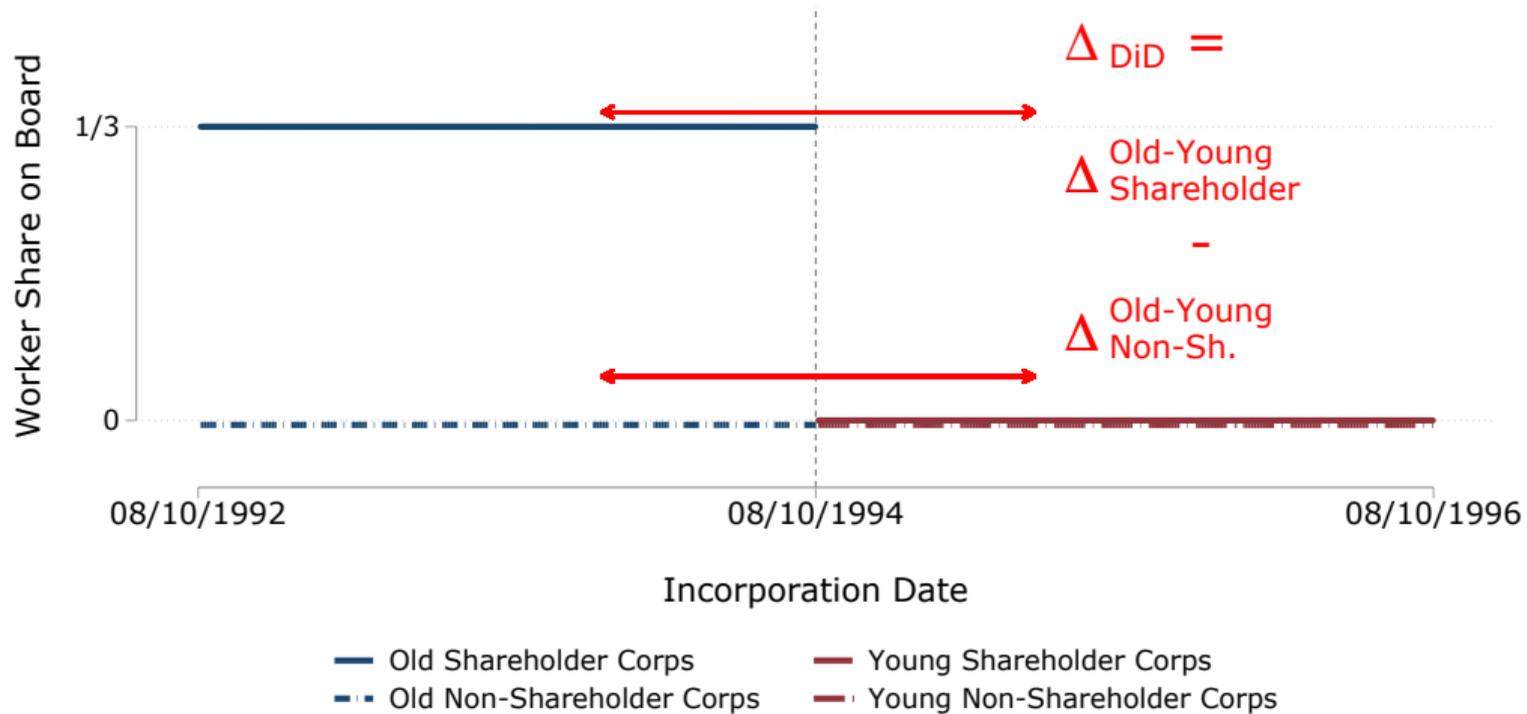
Research Design: Shareholder Corps. Incorporated Before/After



Research Design: Non-Shareholder Corporations As Control Group



Research Design: Difference-in-Differences



Difference-in-Discontinuity Design: Regression Specification

$$Y_{ft} = \alpha + \beta \cdot \mathbb{1}(\text{IncDate}_f < 8/10/94) + \gamma \cdot \text{ShareholderC}_f \\ + \underbrace{\phi_Y \cdot \mathbb{1}(\text{IncDate}_j < 8/10/94) \times \text{ShareholderC}_f}_{\text{Locked Into Shared Governance}} + X'_{ft} \delta + \epsilon_{ft}$$

ϕ_Y : effect of shared governance: 1/3 vs. 0 share

X_{jt} : Year, industry, **industry-by-year** effects

- Main specification: two-year bandwidth
 - Robustness: one and three years
- Standard errors: clustered at the firm level
- Winsorization: 1% level
 - Robustness: none, 2%, 5%

Data

Two main data sources:

1. Bureau van Dijk's Orbis Historical dataset

- Corporate financial and production data based on official registers and company reports

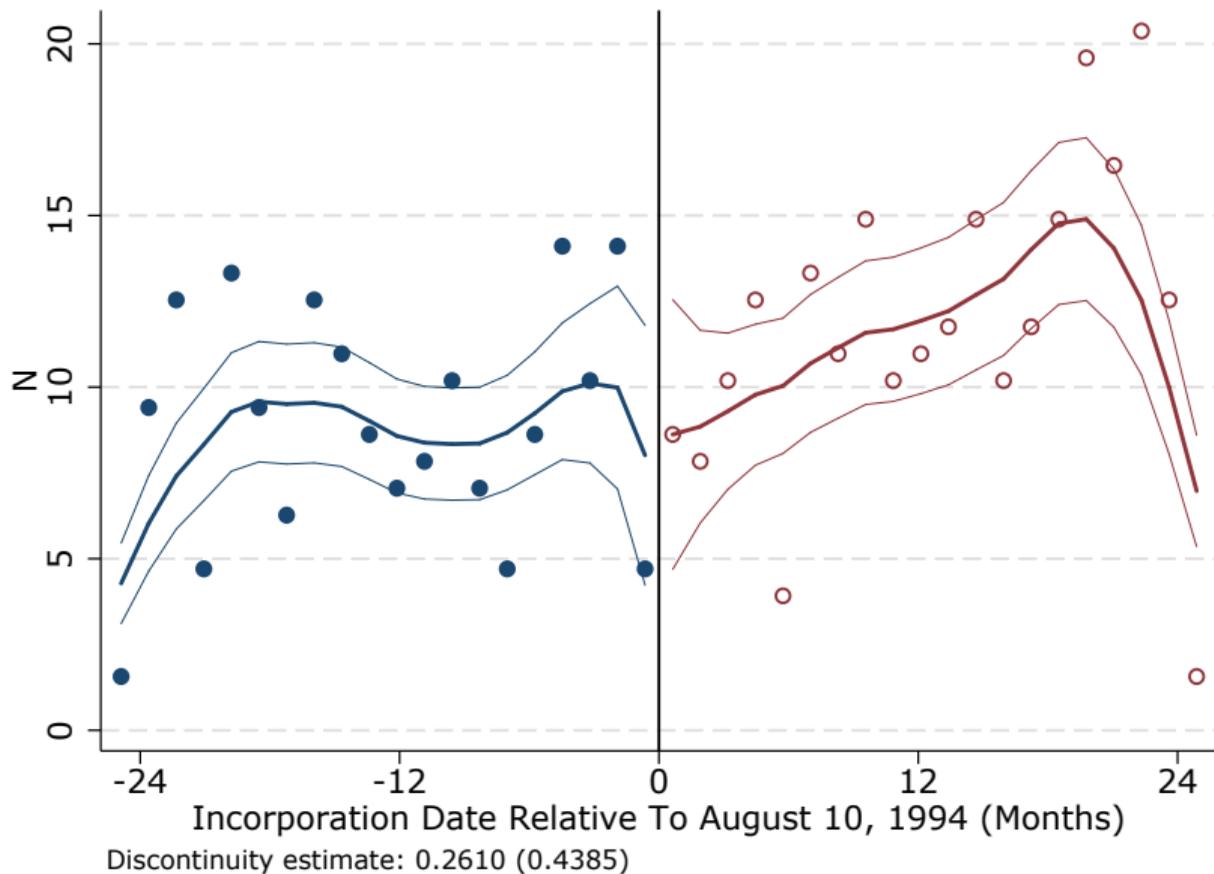
2. Universe of German Social Security Records

- Administrative data on universe of employment subject to soc. sec.
- Matched employer-employee structure
- Matched to Orbis dataset

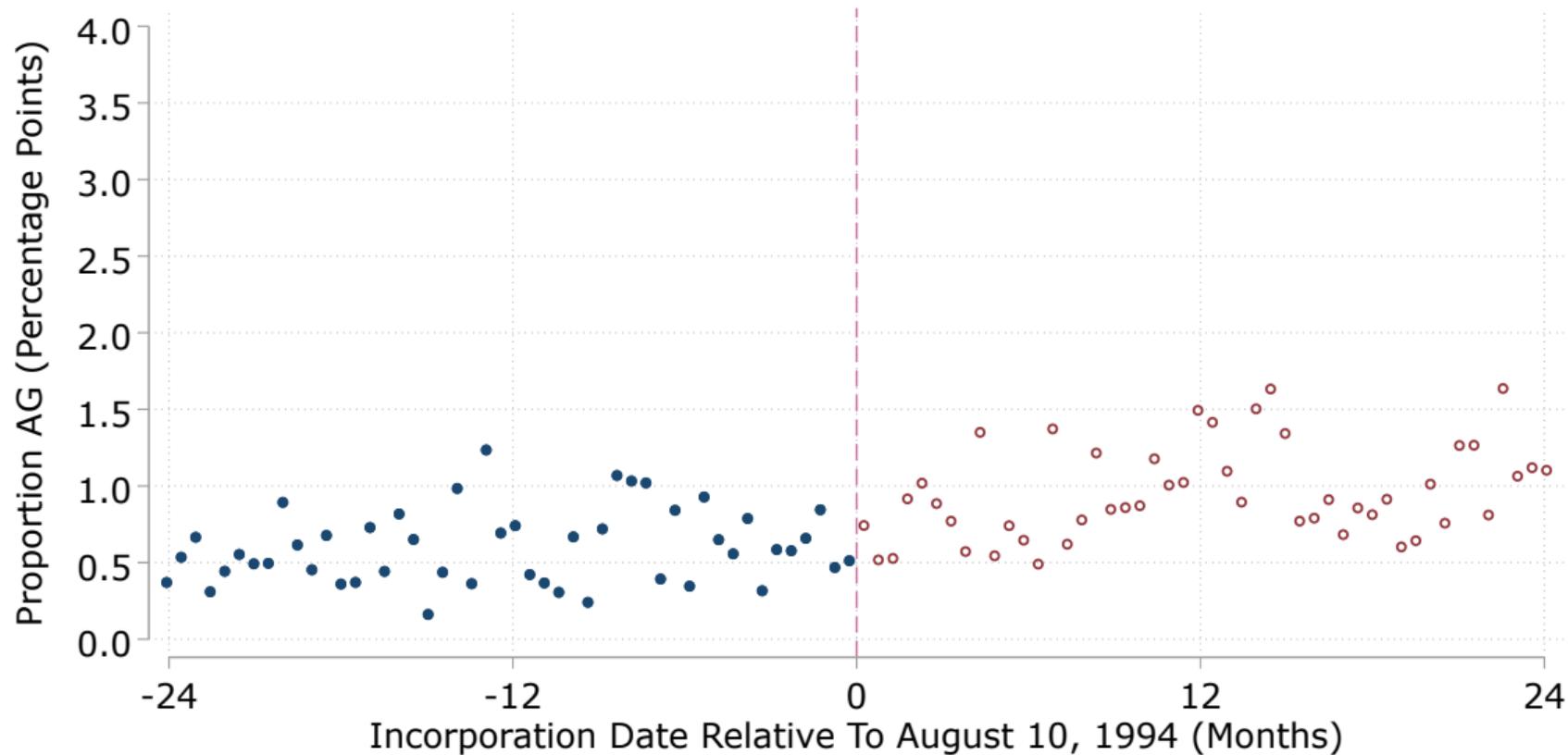
- Additional data sources:

- Mannheim Enterprise Panel (incorporations and exits, 1991 - present), ZEW
- Hoppenstedt Aktienführer (listed corporations)

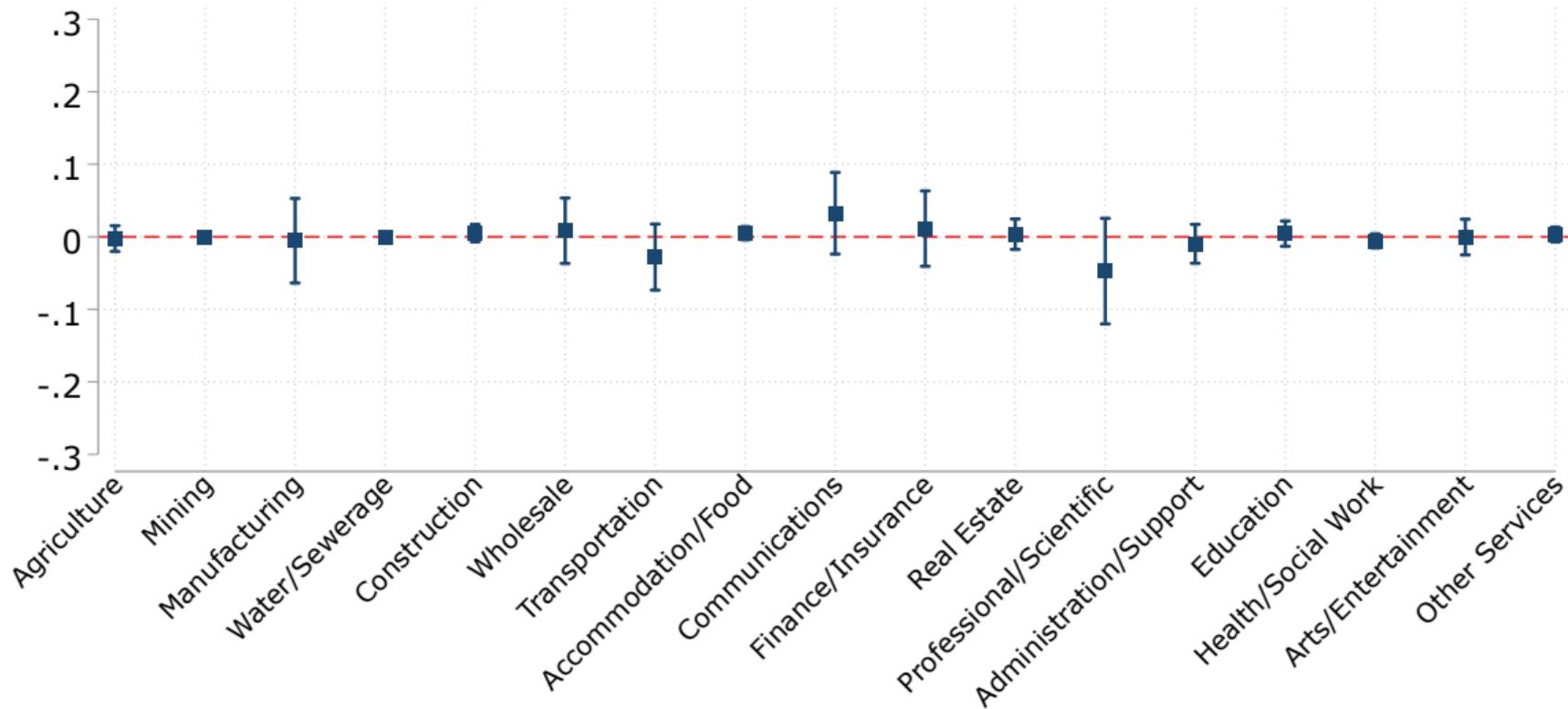
McCrary Test of Incorporations of Shareholder Corporations



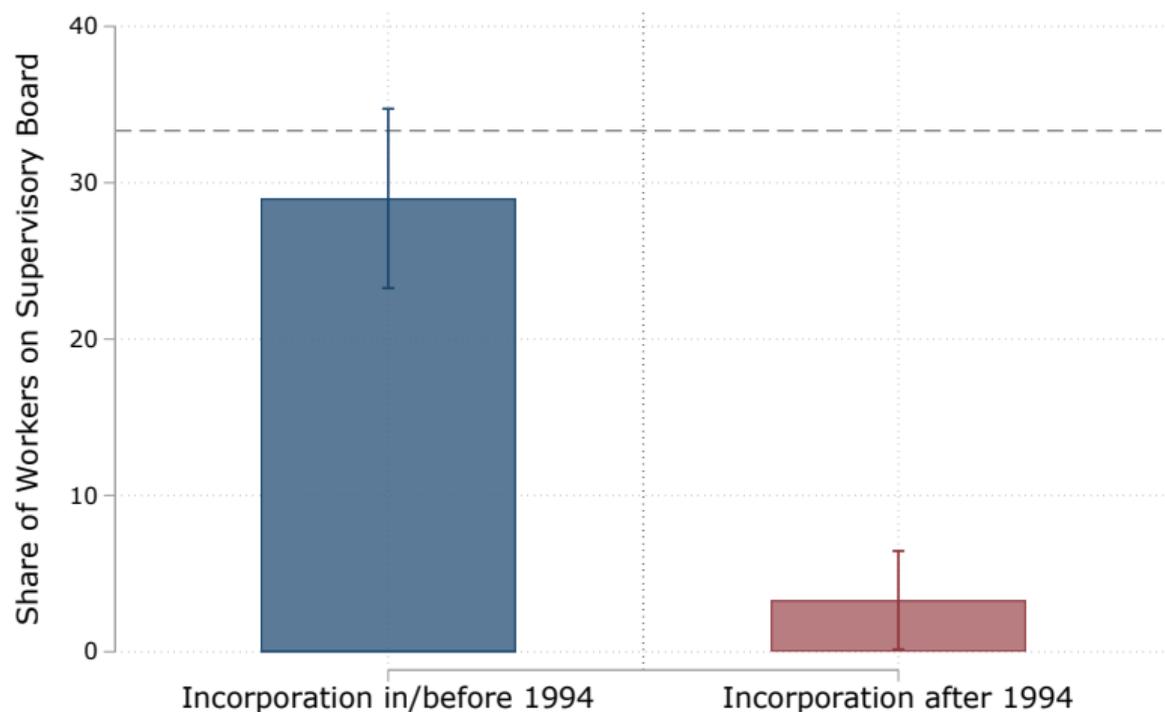
No Differential Selection Into Shareholder Corporations



No Detectable Effects on Industry Composition ($p = 0.91$)



Worker Representation by Incorporation Date



Note: only listed firms (Hoppenstedt Aktienführer) with fewer than 500 employees.

Larger Firms

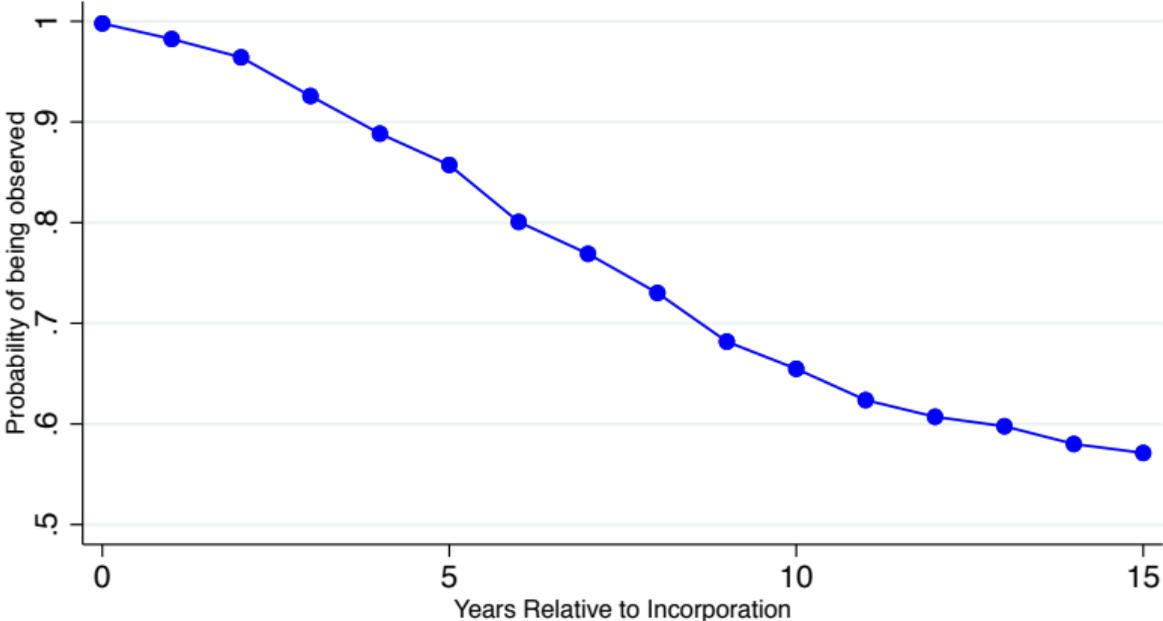
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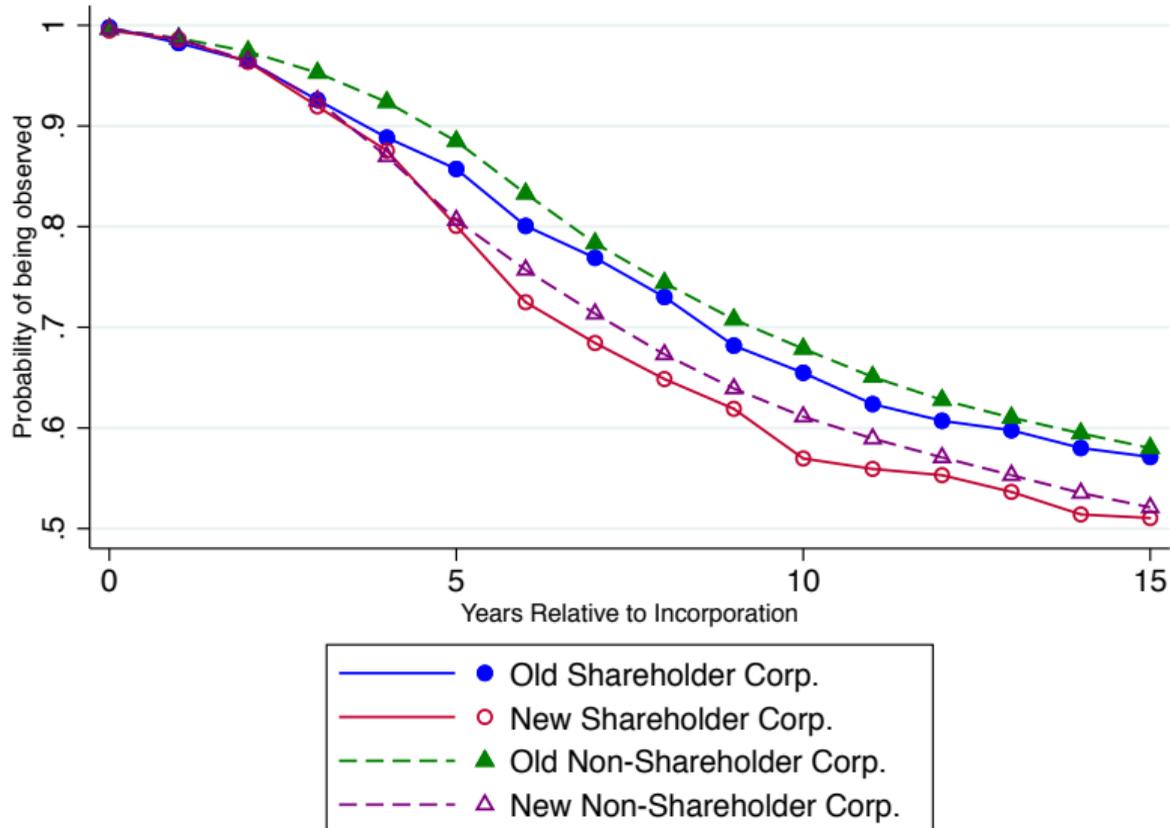
Roadmap for Empirical Results

- ① Firm Survival
- ② Supervisory and Executive Board Composition
- ③ Production and Capital Effects
- ④ Workforce Composition
- ⑤ Financial Outcomes
- ⑥ Profitability

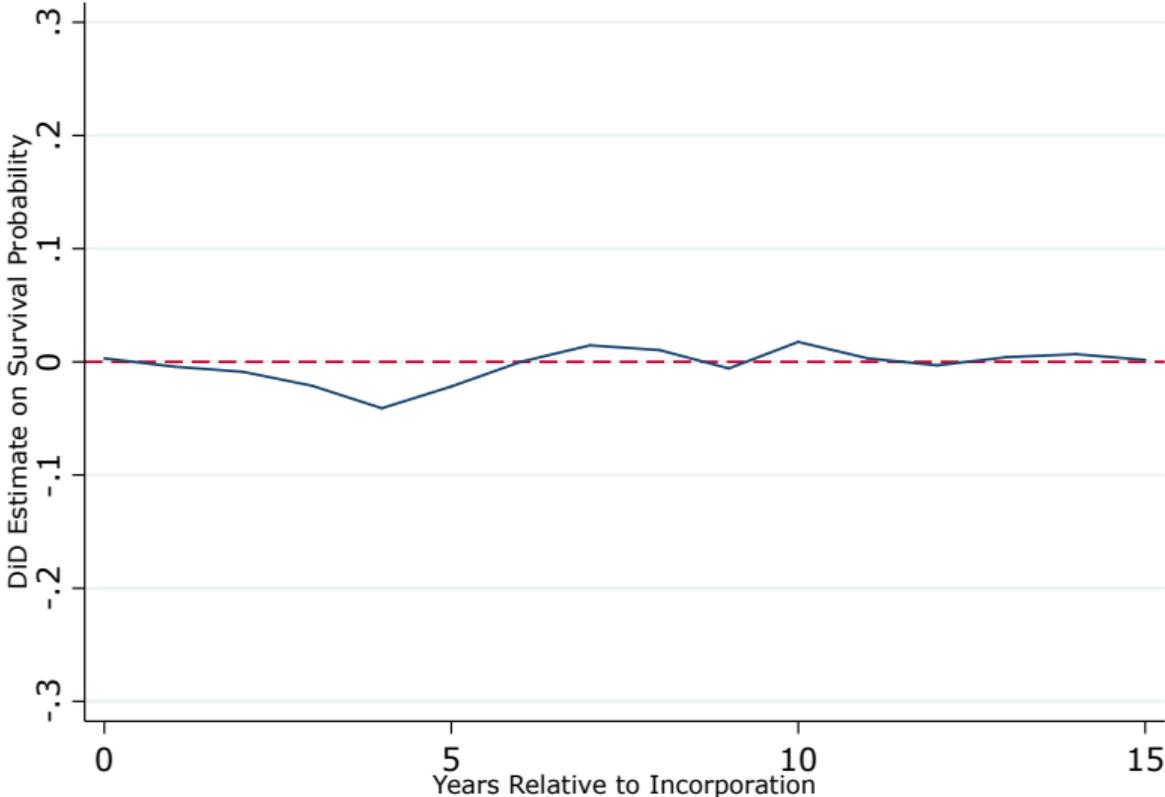
Firm Survival: Old Shareholder Corporations



Firm Survival: All Corporations

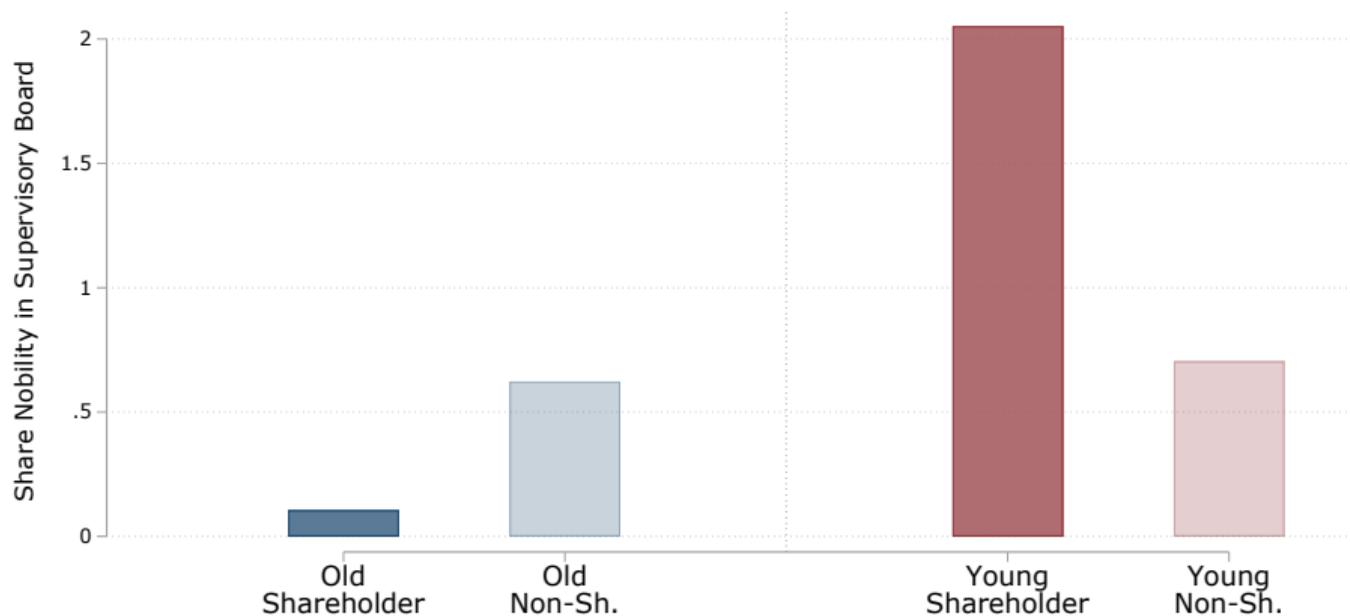


Firm Survival: No Effect of Shared Governance

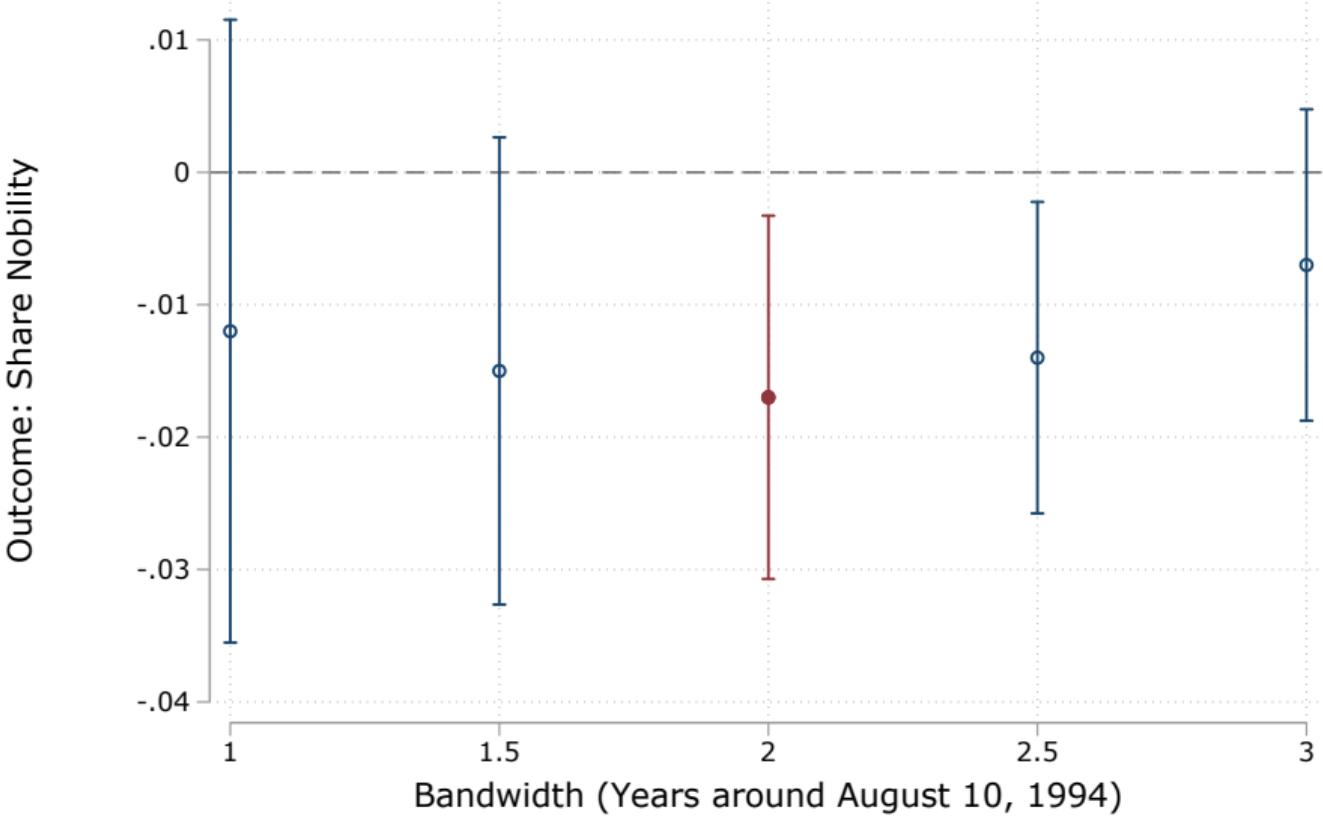


Note: Average DiD effect on exit hazard: 0.0015 (SE 0.004), baseline 0.038

Lower Presence of Aristocrats on Supervisory Board

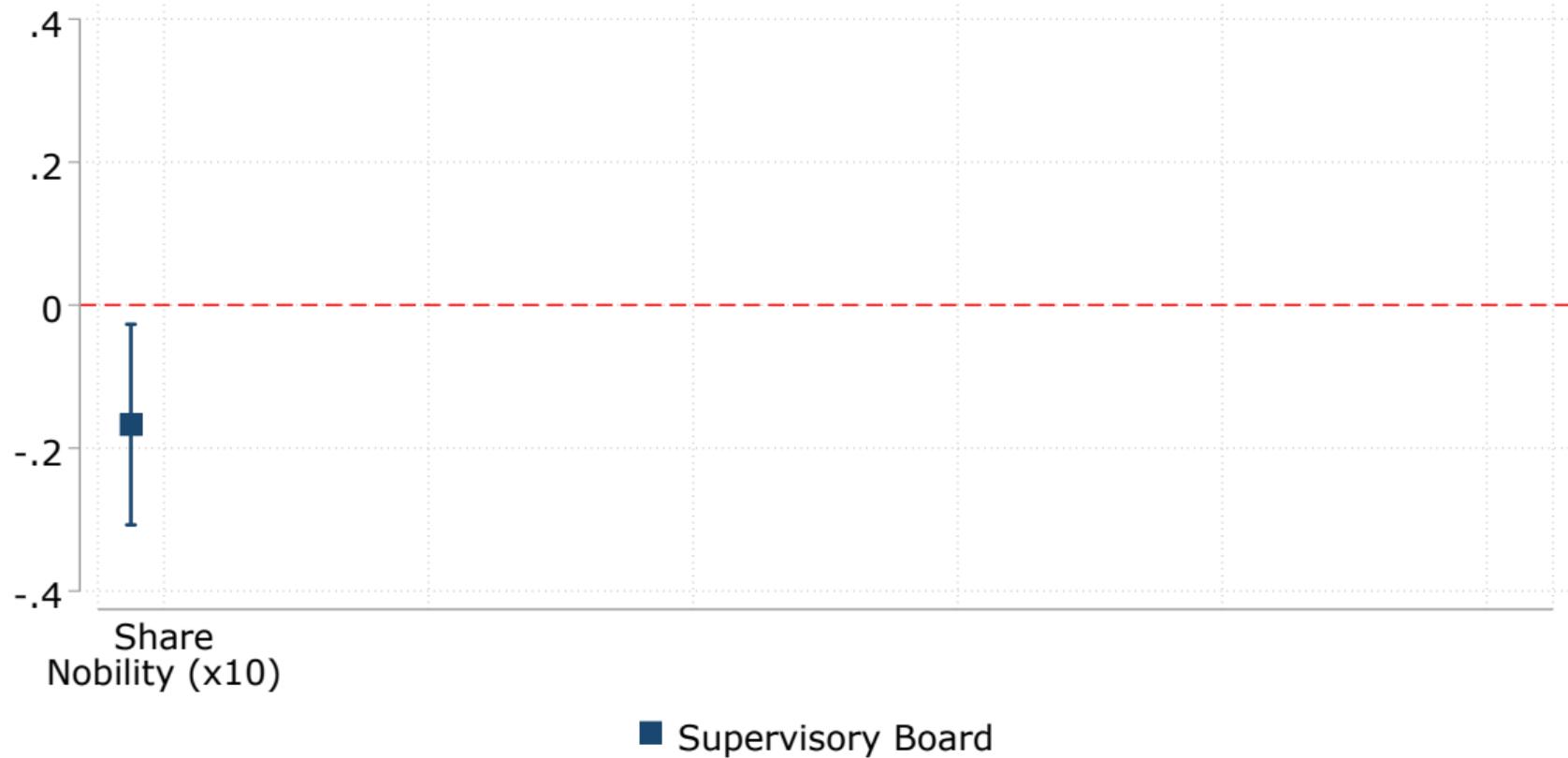


Lower Presence of Aristocrats on Supervisory Board

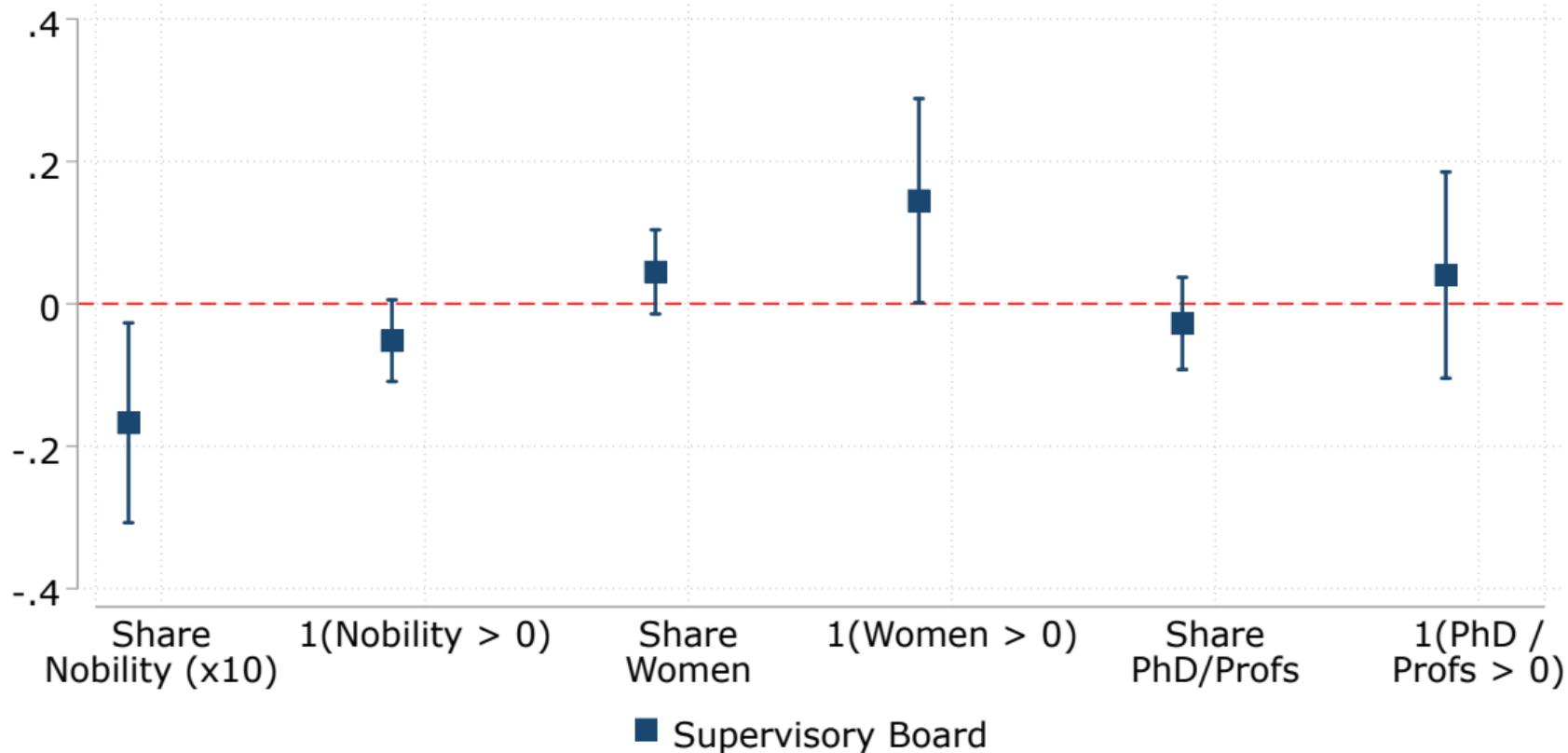


Control Mean, Post-Reform Shareholder Corporations: 0.024

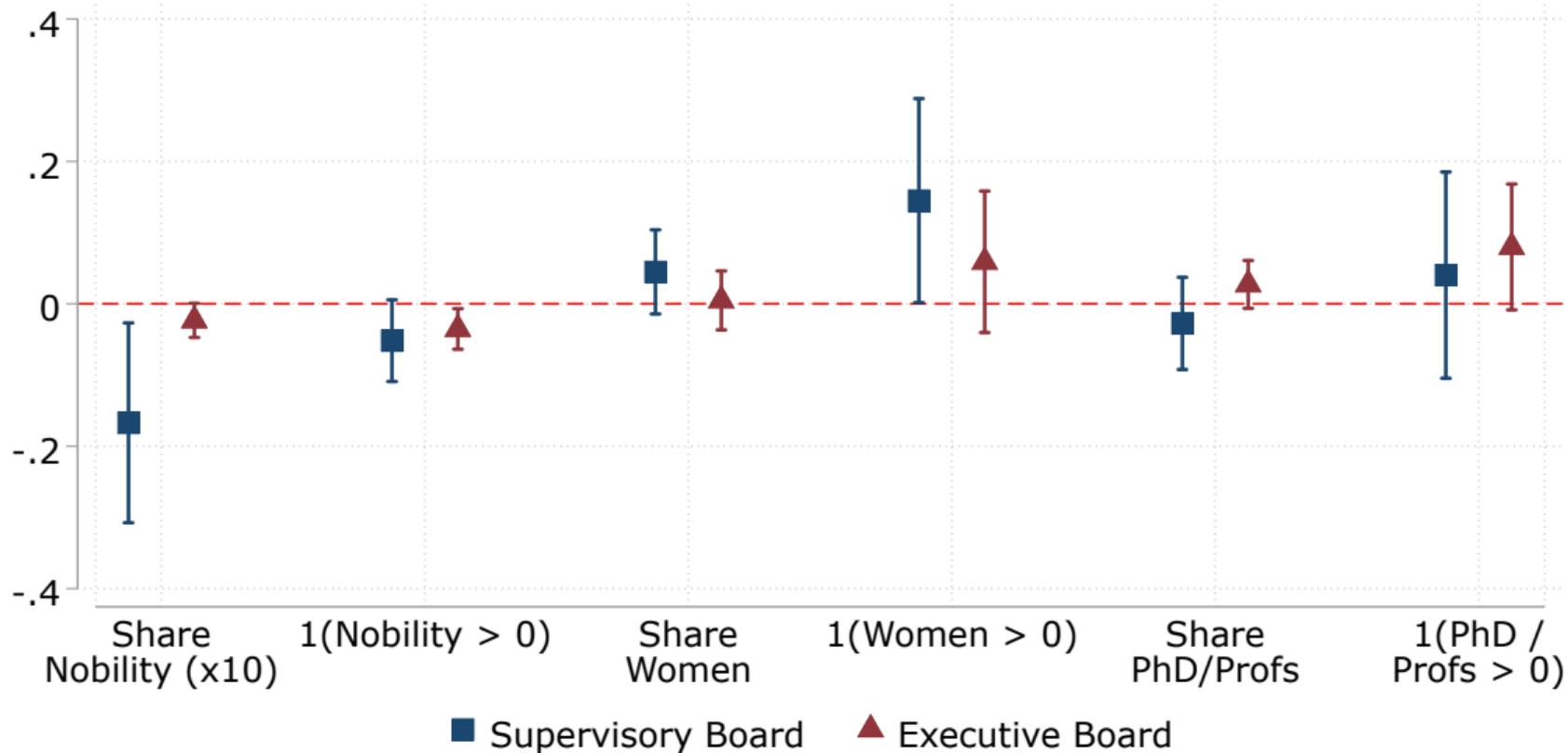
Composition of Supervisory Board



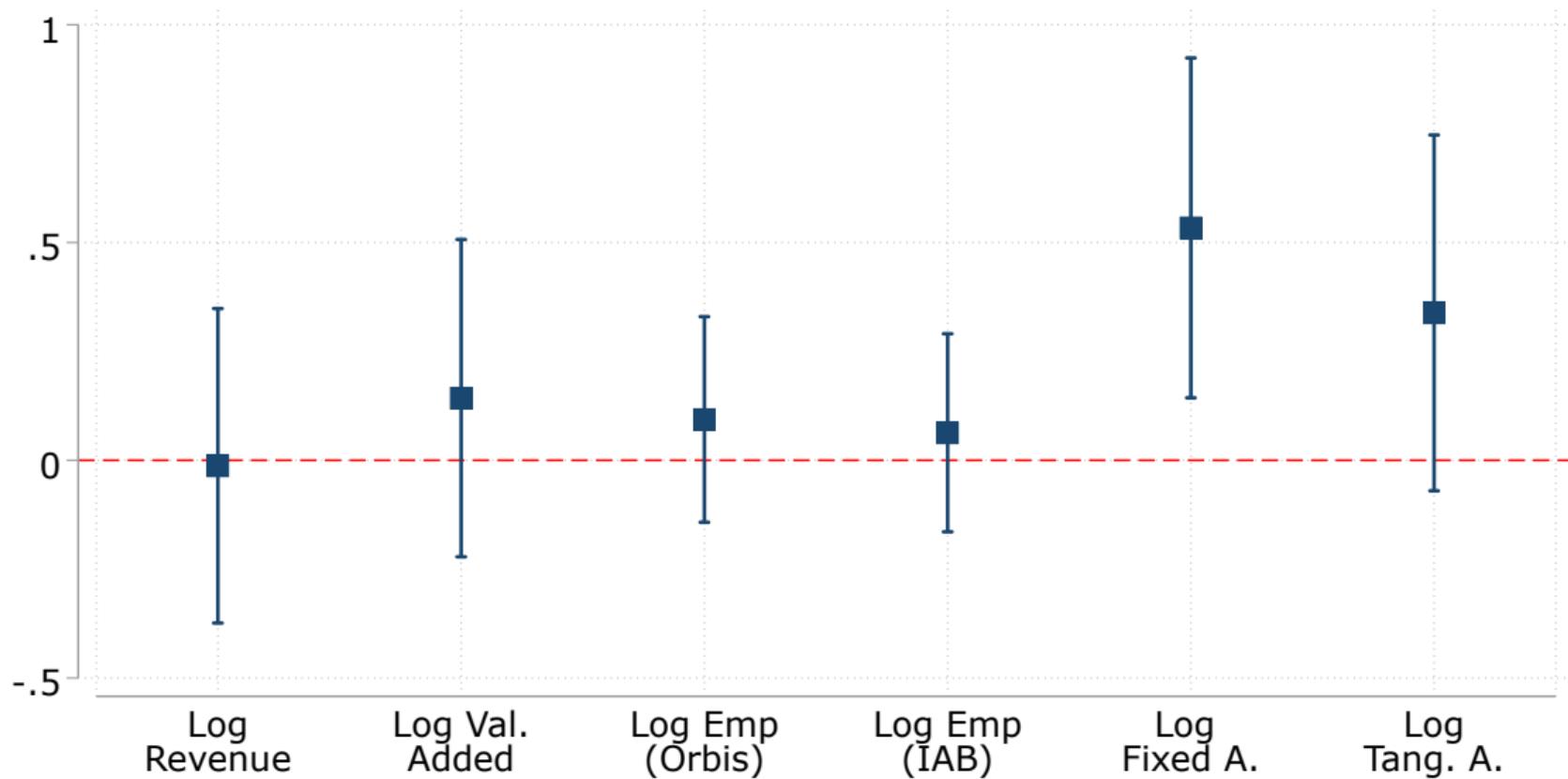
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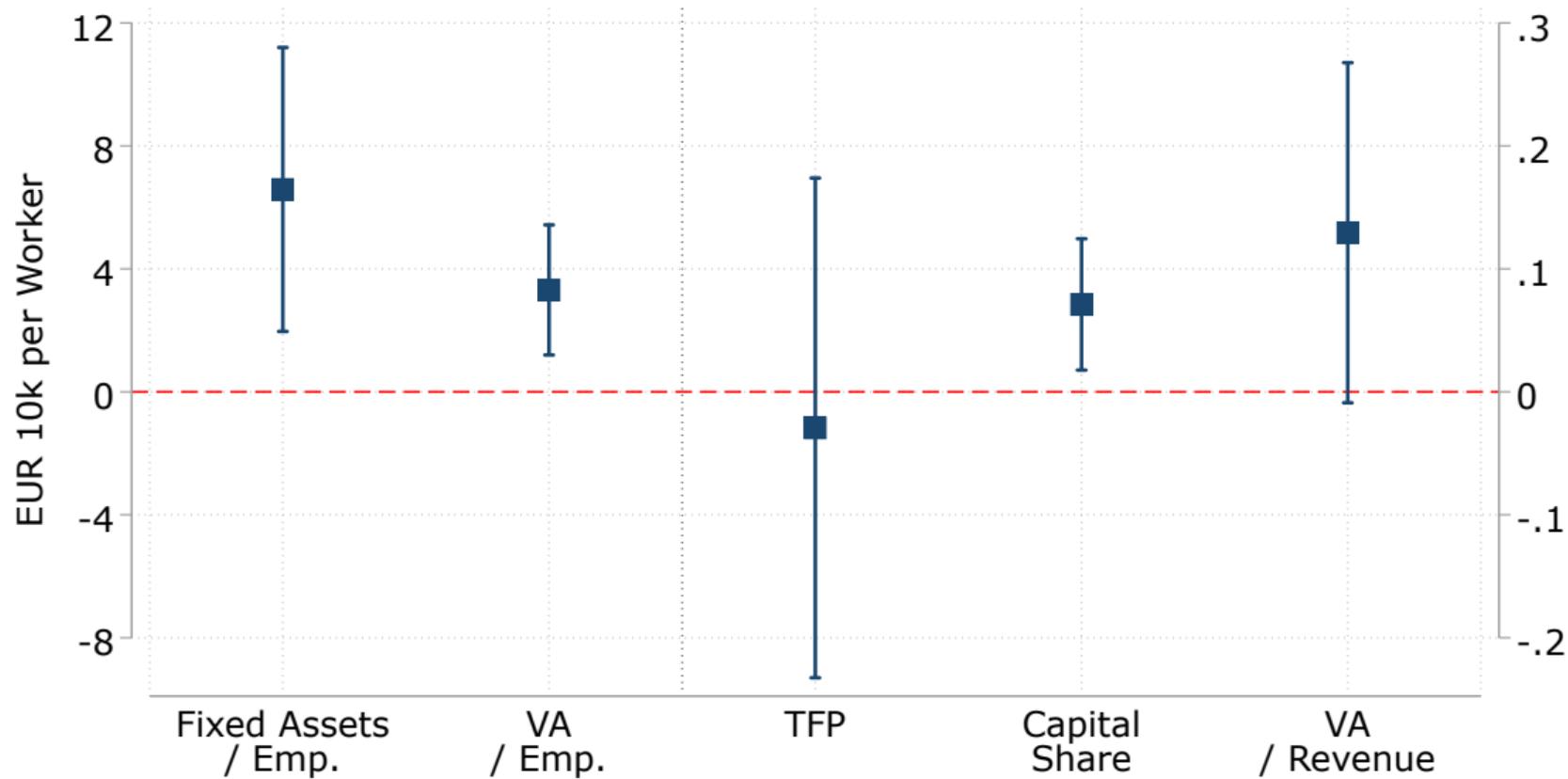
Composition of Supervisory Board and Executive Board (C-Suite)



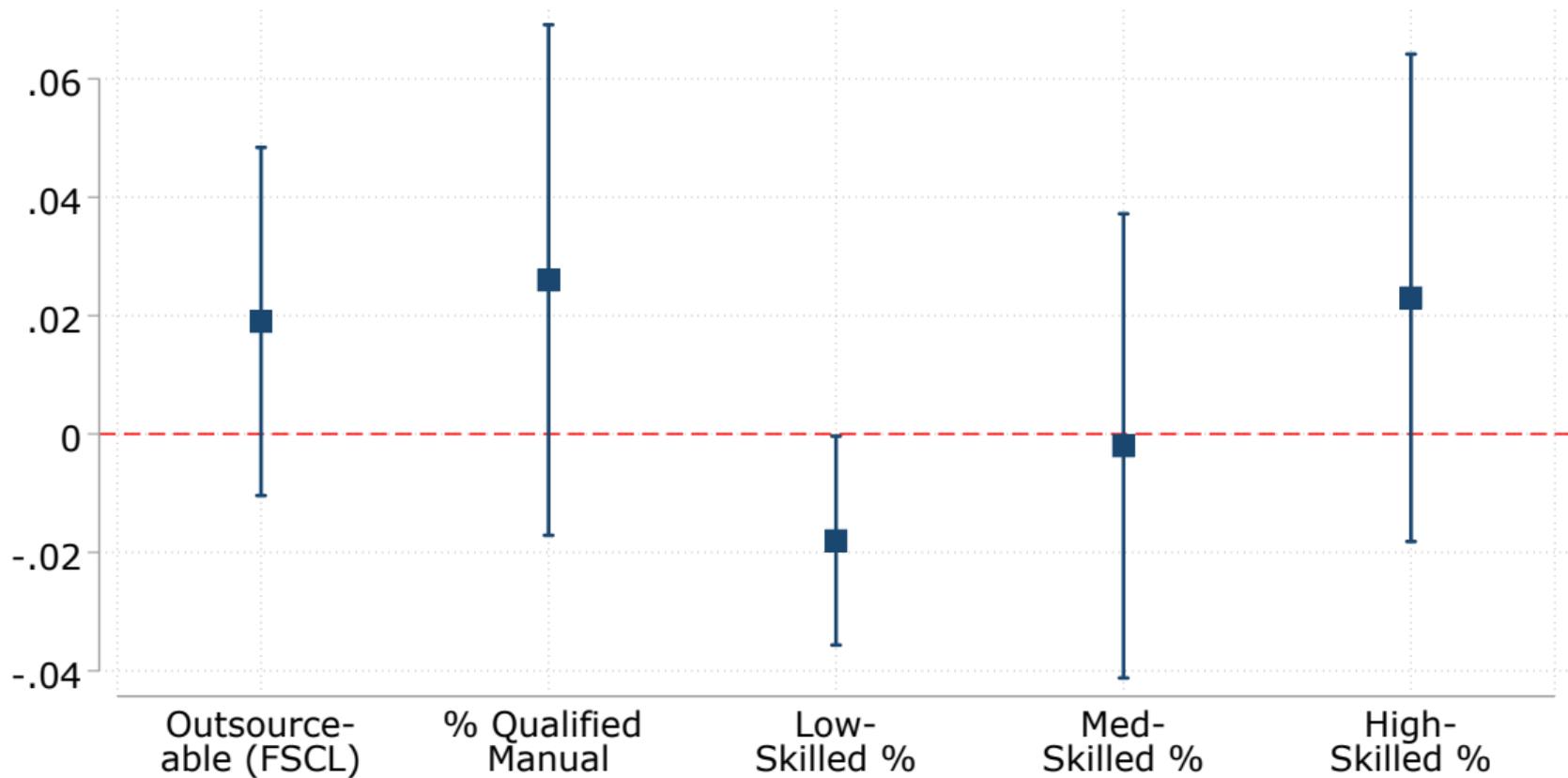
Firm Scale: Output and Inputs



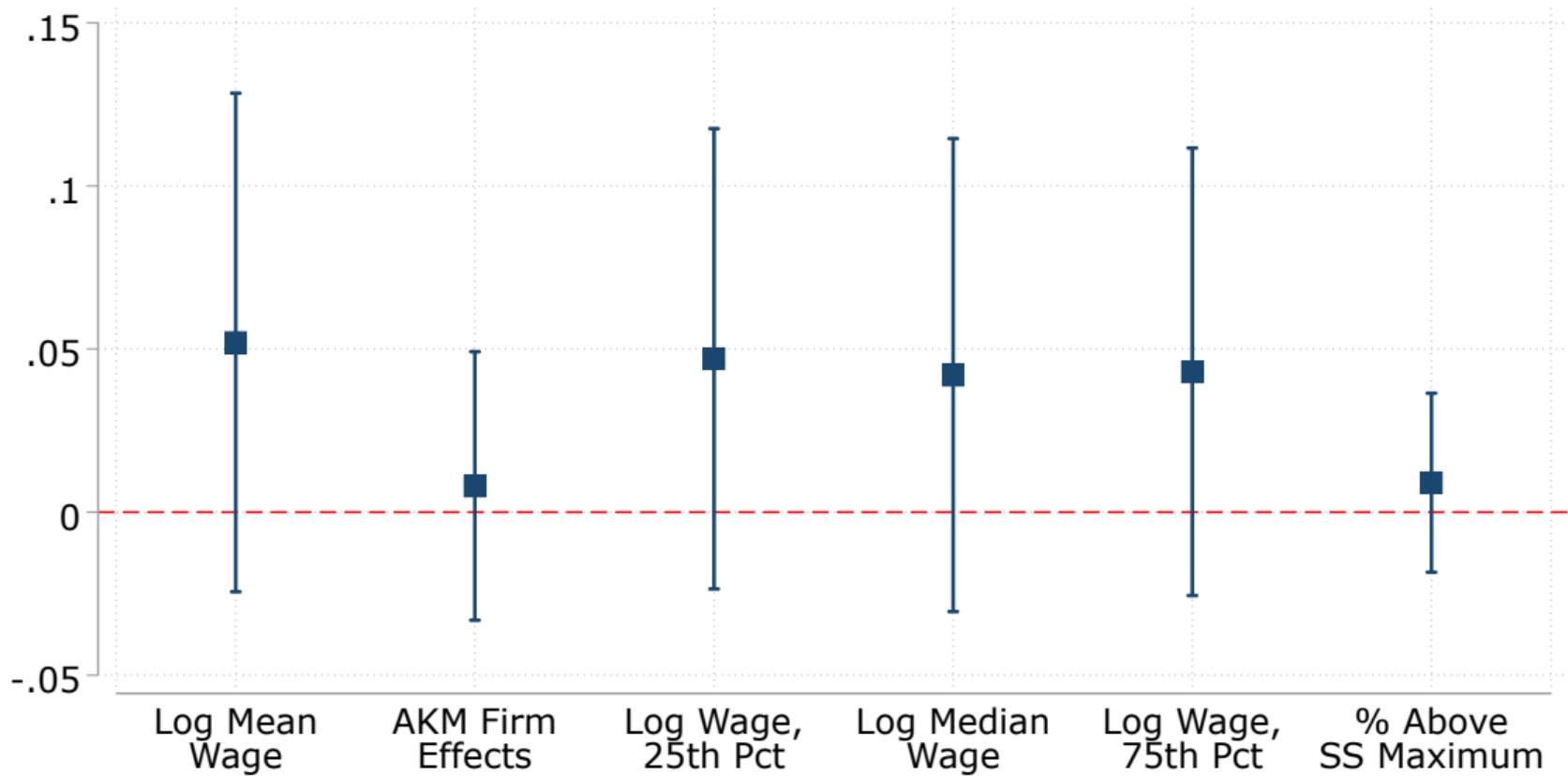
The Production Function



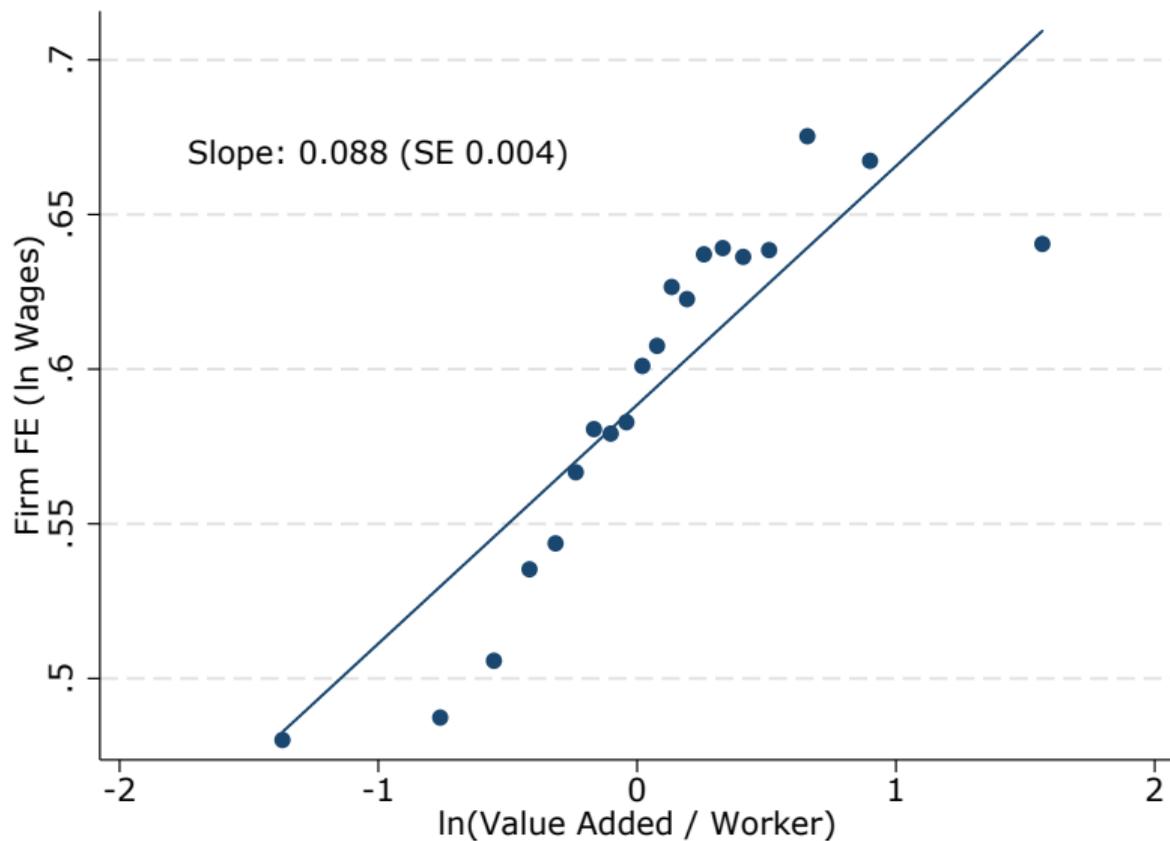
More on the Production Function: Workforce Composition



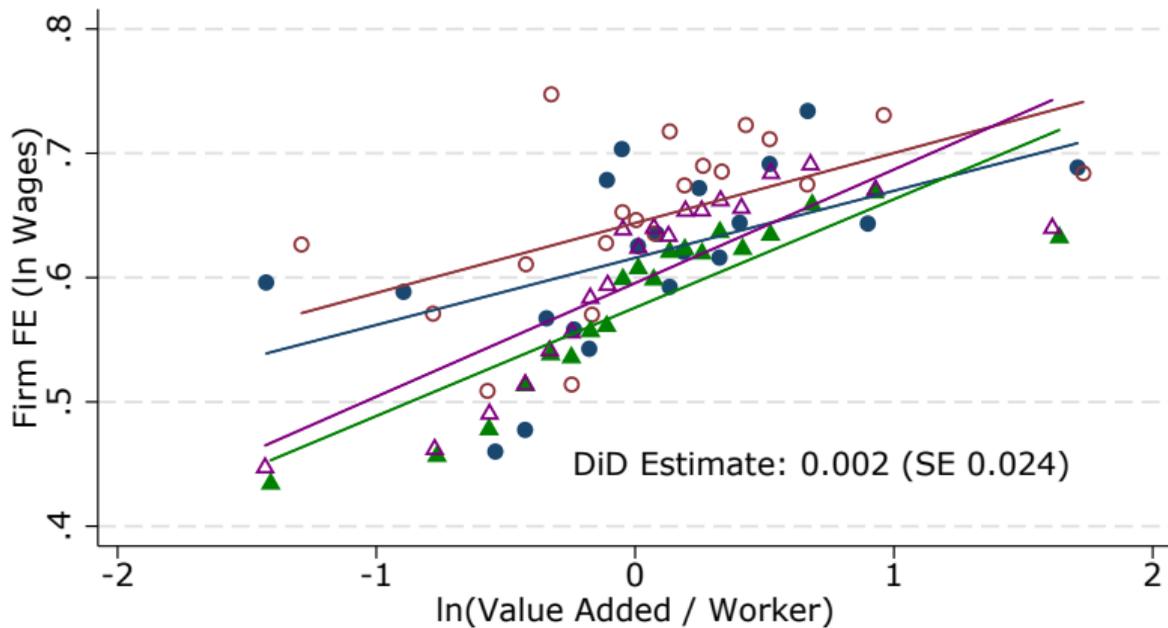
Wages



Rent-Sharing: Firm Effects and Value Added

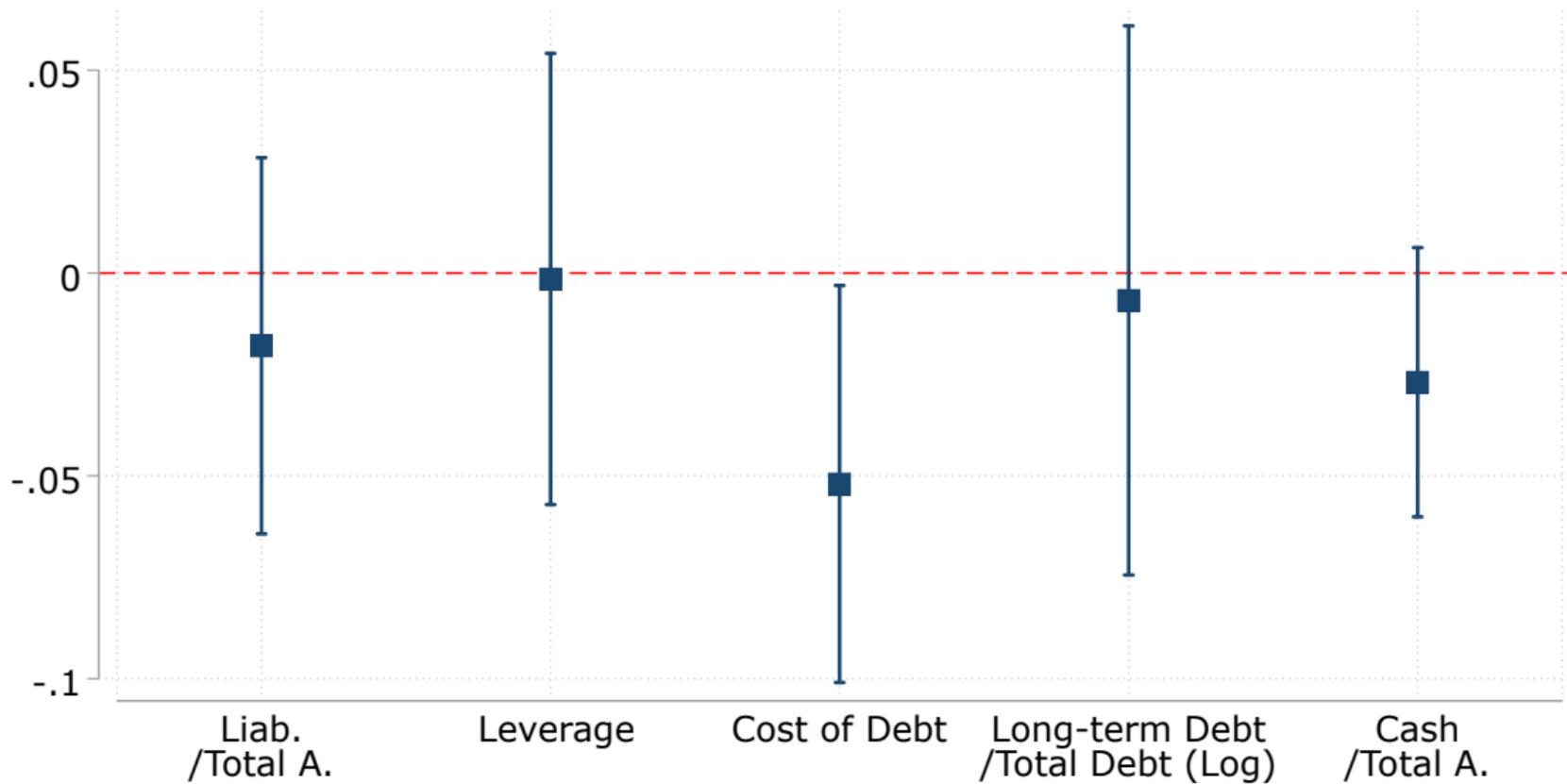


No Differential Rent-Sharing

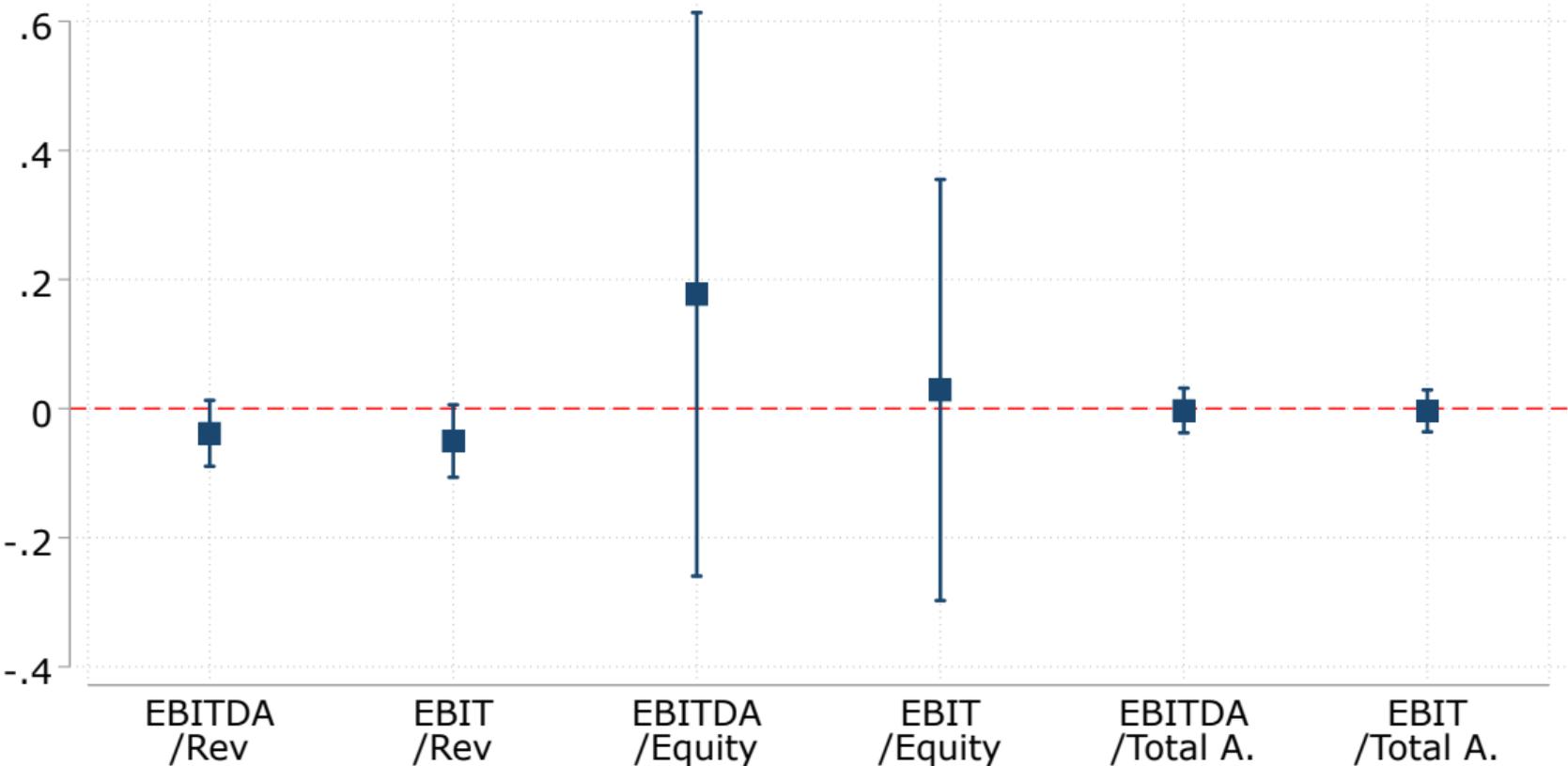


- Old Shareholder Corp.
- New Shareholder Corp.
- ▲ Old Non-Shareholder Corp.
- △ New Non-Shareholder Corp.

Financial Outcomes



No Detectable Effect on Profits



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Effects of Shared Governance: Summary

- Increases capital intensity
- Moderate shift towards higher-skilled and technical occupations
- Higher VA per worker, but no shift in TFP
- No evidence for large wage increases

Interpretation

Hold-up hypothesis empirically rejected

What may account for *positive* effects on investment?

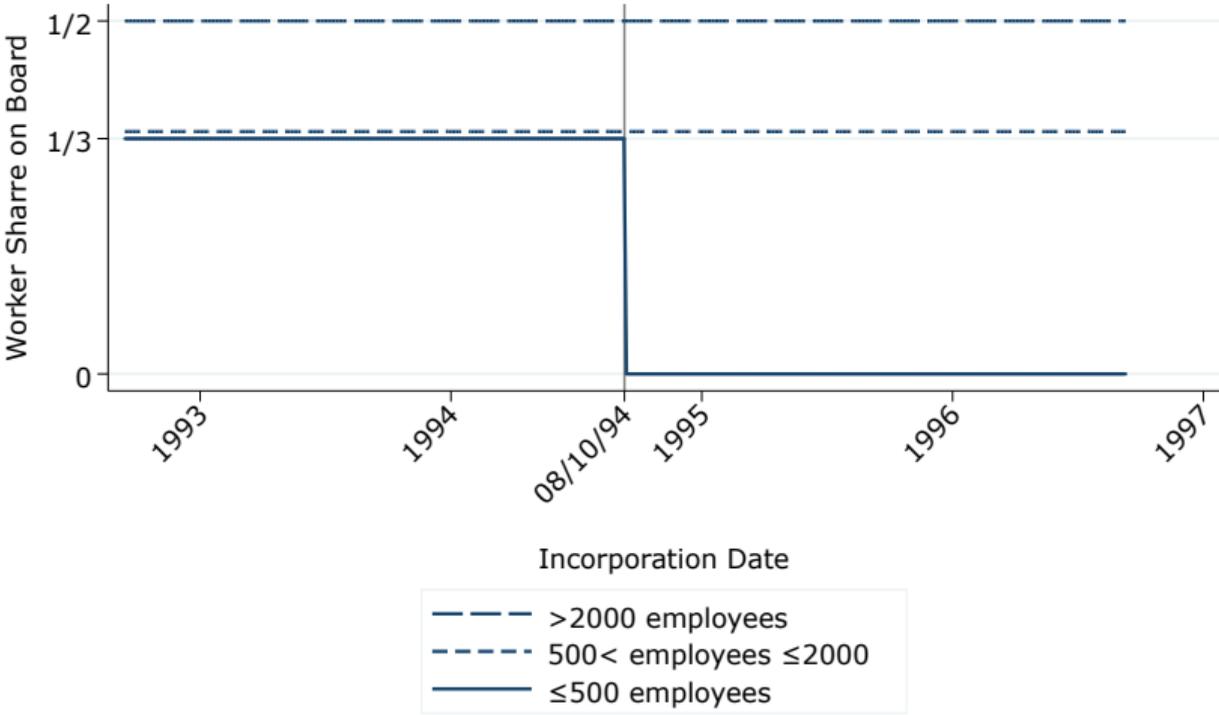
- Workers may have long horizon and preference for investment
- Shared governance may lead to more cooperative solutions

Discussion

- Why not more rent extraction?
- Does shared governance only "work" when labor is moderate?
- Minority involvement of workers in firm governance may "tame" labor
 - Radical labor representatives could be outvoted by shareholders
 - Labor representatives need to be moderates and compromise to successfully build coalitions and exert influence
 - Shared governance may foster more cooperative labor relations

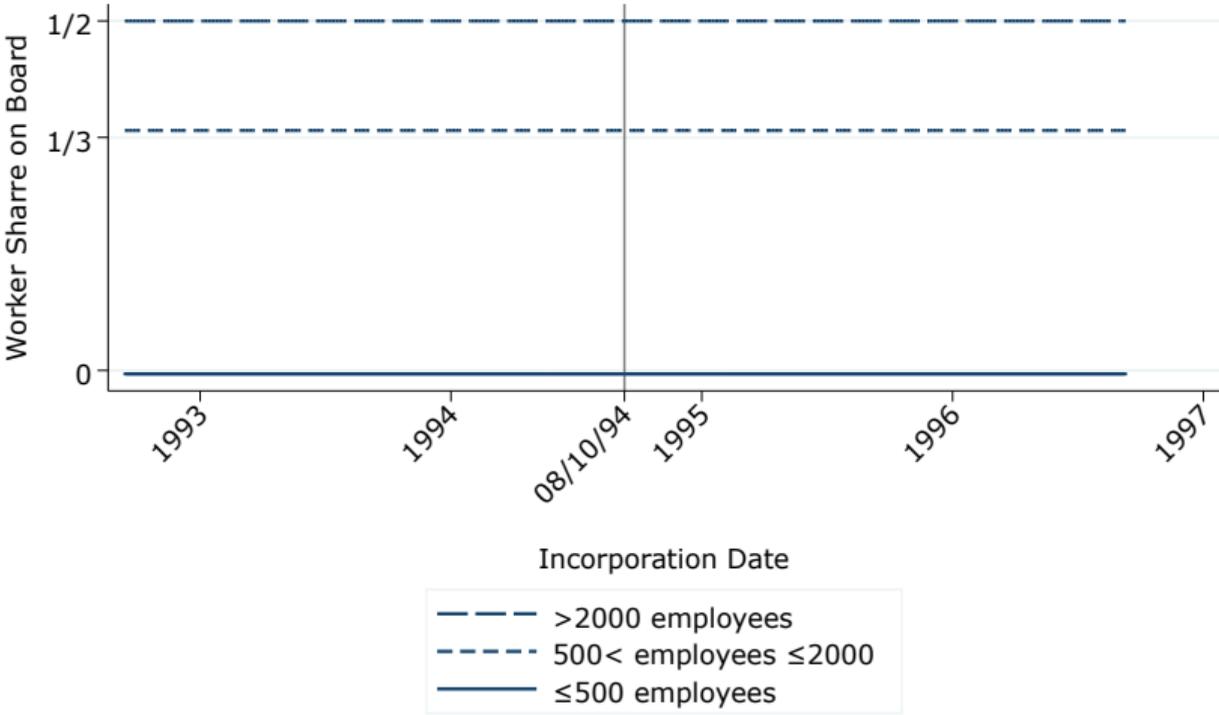
Appendix

Worker Representation in Shareholder Corporations



Note: chairperson (shareholder representative) breaks ties in large firms.

Worker Representation in Non-Shareholder Corporations



Note: chairperson (shareholder representative) breaks ties in large firms.

History of Shared Governance in Germany

- Works Council Act introduced in Weimar republic in 1920
- Post World War II:
 - Industry leaders tainted by direct involvement in Nazi regime
 - Workers' movements considered to be less tainted
 - At the same time: nationalization of major industries in UK
 - Codetermination encoded with landmark acts (1951, 1952)
- 1960s: union movement pushes for full co-determination; social-liberal coalition passes Co-Determination Law of 1976
 - > 2000 employees: 1/2 of supervisory board seats to workers

Worker Representation by Incorporation Date



Note: only listed firms (Hoppenstedt Aktienführer).