Labor in the Boardroom

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NBER Summer Institute, Labor Studies

July 22, 2019
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 ↑, turnover ↓
  - Ability to enforce implicit contracts, e.g., through better information

- **Rent-seeking, hold-up and underinvestment**
  - Worker bargaining power ↑ ⇒ wages ↑ and investment ↓
    - 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 ⇒ 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

⇒ 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

Shareholders

Electric

Supervisory Board

Major Decisons

Executive Board

Appoint
Control
Dismiss
Compensation

Report

Shareholders

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Workforce

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

- **Permanent lock-in**
- **Abolition in new corporations**

**Overview**

- **June 1994**
- **08/10/94** Incorporation Date

**Note:** rules for shareholder corporations ≤ 500 employees.
Research Design: Shareholder Corps. Incorporated Before/After

Overview

Δ Shareholder Corps.
Δ Old-Young
01/3 Worker Share on Board
08/10/1992
08/10/1994
08/10/1996
Incorporation Date
Research Design: Non-Shareholder Corporations As Control Group

Overview
Research Design: Difference-in-Differences

\[ \Delta_{\text{DiD}} = \Delta_{\text{Shareholder}} - \Delta_{\text{Old-Young}} - \Delta_{\text{Non-Sh.}} \]

Overview
Difference-in-Discontinuity Design: Regression Specification

\[ Y_{ft} = \alpha + \beta \cdot 1(\text{IncDate}_f < 8/10/94) + \gamma \cdot \text{ShareholderC}_f \]

\[ + \phi Y \cdot 1(\text{IncDate}_j < 8/10/94) \times \text{ShareholderC}_f + X'_{ft} \delta + \epsilon_{ft} \]

Locked Into Shared Governance

\( \phi Y \): 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

Discontinuity estimate: 0.2610 (0.4385)
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.
Overview

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

![Graph showing firm survival probabilities for different types of corporations over years relative to incorporation.](image-url)
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

- Share Nobility in Supervisory Board
  - Old Shareholder
  - Old Non-Sh.
  - Young Shareholder
  - Young Non-Sh.
Lower Presence of Aristocrats on Supervisory Board

Outcome: Share Nobility

Bandwidth (Years around August 10, 1994)

Control Mean, Post-Reform Shareholder Corporations: 0.024
Composition of Supervisory Board
Composition of Supervisory Board and Executive Board (C-Suite)

![Graph showing the composition of Supervisory Board and Executive Board. The graph displays data points for Share Nobility (x10), 1(Nobility > 0), Share Women, 1(Women > 0), Share PhD/Profs, and 1(PhD / Profs > 0). The Supervisory Board is represented by squares, and the Executive Board is represented by triangles.](image-url)
The Production Function

EUR 10k per Worker

Fixed Assets / Emp.  VA / Emp.  TFP  Capital Share  VA / Revenue

-8 -4 0 4 8 12
More on the Production Function: Workforce Composition

Outsource-able (FSCL) | % Qualified Manual | Low-Skilled % | Med-Skilled % | High-Skilled %

(Chart indicating workforce composition data)
Wages

Log Mean Wage
AKM Firm Effects
Log Wage, 25th Pct
Log Median Wage
Log Wage, 75th Pct
% Above SS Maximum
Rent-Sharing: Firm Effects and Value Added

Slope: 0.088 (SE 0.004)
No Differential Rent-Sharing

DiD Estimate: 0.002 (SE 0.024)

Firm FE (ln Wages)

ln(Value Added / Worker)

Old Shareholder Corp.
New Shareholder Corp.
Old Non-Shareholder Corp.
New Non-Shareholder Corp.
Financial Outcomes

- Liab./Total A.
- Leverage
- Cost of Debt
- Long-term Debt/Total Debt (Log)
- Cash/Total A.
No Detectable Effect on Profits

EBIT/Rev  EBITDA/Rev  EBITDA/Equity  EBIT/Equity  EBITDA/Total A.  EBIT/Total A.
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- 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
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

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