

The costs and benefits of Board-level Employee Representation (BLER)

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October 29, 2021

Project overview: In this project, we investigate whether granting employees the right to representation on the board of directors improves job quality. Industrial democracy is often mentioned in the public debate as a way to guarantee employee fair treatment in the private sector. Yet, the rarity of such institutional mechanisms and the lack of credible measures of job quality has limited empirical research on the topic. In this project, we propose to empirically estimate the causal effect of Board Level Employee Representation (BLER) on firm outcomes – such as survival, performance, and growth – and employee outcomes, such as wages, absenteeism, and subjective well-being. In other words, we will provide policy makers with a cost-benefit analysis of BLER.

Policy motivation: In the past years, amid rising wage inequality, declining labour share, and increasing work-related mental health issues, protecting employees' rights and fair treatment in the private sector has been high on the agenda: Senator Elisabeth Warren introduced an act requiring employee-elected directors to make up 40% of the board composition to the US Senate in 2019 (the Accountable Capitalism Act). Therefore, a better understanding of the costs and benefits of BLER seems timely to inform the debate. Together with Germany, Finland and Norway, Denmark is one of the few pioneers for BLER

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in the world, and could be used as the business case to inform policy-making in other countries. But while the Danish legislation has been in place since 1973, to date there is no empirical assessment of the causal effect of BLER in Denmark. The few existing empirical studies focus mainly on the German case, which in many ways differs from the Danish legislation.

Research motivation: A fundamental question of industrial relations concerns whether workers should participate in the decision-making of their employers, for instance through representation on the board of directors. On the one hand, early theoretical work suggests that BLER could amplify agency and hold-up problems (Jensen and Meckling, 1979), with workers deriving a rent that ultimately harms investments, profits, and survival. On the other hand, the Exit-Voice theory (Hirschman, 1970) posits that workers' influence in employers' decision-making can participate to solve employer-employees conflicts and therefore increase effort and motivation, and reduce moral hazard, sabotage, and turnover that are otherwise costly.

The Danish context provides an ideal setting to study these questions in a controlled environment allowing a clean identification of causal effects, combined with the availability of unique data on both firm and employee outcomes. First, a clear cutoff in the legislation - employees in firms with more than 35 employees have the right to elect up to 33 percent of board directors - will provide quasi-exogenous variation in workers' right to representation. Second, we will exploit the richness of the Danish register data to study the effect of BLER on firm outcomes such as financial performance, survival rate, and growth, and on employee outcomes, such as wages, absenteeism, sickness leaves, probability of work accident, and probability of exit. Importantly, we aim to collaborate with The National Research Center for Work Environment's (NFA) in order to incorporate several waves of nationally representative surveys on employees' physical and mental health, as well as other characteristics of the work environment. These surveys, undertaken every two years since 2012, cover more than 100.000 unique workers and can be matched with Statistics Denmark employer-employee data (IDA data) as well as firm-level data.

Relative to existing literature, we will contribute in two ways. First, our study will be the first causal assessment of BLER in Denmark. Other recent studies (Gorton and Schmid, 2004; Kim et al., 2018; Jäger et al., 2021) focus mainly on Germany, where employees in firms larger than 2,000 employees are required to elect at least 50% of board directors. In Denmark, the legislation allows (but does not require) employees to elect 33% of board directors, and covers a much greater number of firms, since all firms with more than 35 employees are affected. Second, the availability of detailed data on employees' subjective well-being also constitutes an improvement with respect to the existing literature. Previous studies have been relying only on objective outcomes as measures of employee welfare, such as wages and exits, that are interesting in their own right but provide only a partial assessment of job quality.

The legislation: Since 1973, employees in limited liability and joint stock firms with an average of at least 35 employees in the past three years have the formal right (but not the obligation) to elect board directors. To be implemented, BLER has to be requested by at least 10% of employees in the firm, by a majority of the coordination committee members, or by a union representing at least 10% of the employees. Employees can elect up to one third of board directors.

Empirical strategies: Our main identification challenge is the non-random assignment of employee representation across firms. We will exploit quasi-exogenous variation in employee representation stemming from the 35-employee cutoff established in the Danish legislation. Then, we will implement two empirical strategies to obtain two distinct sets of estimates.

1. **Regression Discontinuity Design:** Our first estimates of interest concern the causal effect of granting employees the right to representation, regardless of whether BLER was ultimately implemented. Theoretically, the mere threat of potential future employee representation may impact workers through enhanced bargaining power (DiNardo and Lee, 2004). From a policy perspective, since BLER is adopted in around 25% of firms covered by the legislation, estimating the effect of granting

employees the right to representation is of interest in its own right. In order to obtain this first set of “reduced form” estimates, we will use a regression discontinuity design, comparing workers and firms slightly above and below the 35-employee cutoff. This research design relies on the assumption that firms are not able or willing to precisely manipulate the number of employees in order to be on either side of the threshold. We have carried out McCrary manipulation tests that cannot reject the validity of this assumption.

- 2. Fuzzy Regression Discontinuity Design:** The second set of estimates we are interested in capture the causal effect of BLER on workers and firms. To obtain these estimates, we will implement a fuzzy regression discontinuity design, using the passing of the 35-threshold as an instrument for BLER. First, we will obtain first-stage estimates capturing the effect of passing the 35-employee cutoff on BLER status. The LATE (local average treatment effect) of BLER will be retrieved as the ratio of the reduced form estimates obtained in the previous step and the first-stage estimates. A requirement for this analysis is that the passing of the 35-employee cutoff predicts a sufficient discontinuity in BLER probability. From our data, we estimate that the probability of BLER increases by 9 to 10 percentage point (with respect to a baseline of around 2%) at the 35 cutoff, with a F-stat well above 10.

Timeline and targeted journals: We will carry on the project as part of our respective PhD and Postdoc positions. By now, we have secured access to many variables of interest through Statistics Denmark, as well as conducted preliminary checks of the validity of the empirical strategy (manipulation test and first-stage effects). We anticipate a process time of 2-3 months for having the survey data from NFA transferred and encrypted to our existing Statistics Denmark project. We plan to have a working paper circulating by summer 2022. Our target journals are top-5 and top-20 economic journals, or top-field economic journals in labour economics or industrial relations (e.g: The Journal of Labor Economics, The Journal of Law and Economics, The International Journal of Industrial Organization).

Budget: We apply for research funds for three activities in relation to the project. First, we will need to transfer and encrypt the NFA survey data to our existing Statistics Denmark project. For this activity we budget approximately 80 K DKK (35 hours \times 2,169 DKK/hour)¹. Second, we will hire a research assistant to conduct part of the data-processing. This is especially needed for the cleaning of the NFA survey data that needs to be adapted to the registers used in our studies. For this activity we budget 80 K DKK (20 weeks \times 20 hours/week \times 180 DKK/hour) for this activity. Third, we budget 40 K DKK for travel expenses to cover conference attendance and network development.

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¹The number of working hours is based on comparable prior requests and the hourly price charged is listed on the Denmark Statistics website (<https://www.dst.dk/da/TilSalg/Forskningservice/priser>). VAT included.