Is there an Information Risk in the Governance System when Workers are in the Boardroom?

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Motivation

"U.S. corporations must ensure that no fewer than 40% of their directors are selected by the corporation's employees."

U.S. Senator and Democratic presidential candidate Elizabeth Warren (August 15, 2018)

"The concerns of workers, not just stockholders should be a part of board decisions."

U.S. Senator and Democratic presidential candidate Bernie Sanders (June 5, 2019)

Business Roundtable




Significant philosophy shift

Moving away from shareholder value maximization towards shifting the focus to all stakeholders – employees, customers and society

(*The Wall Street Journal 2019*; *The New York Times 2019*)




Statement on the Purpose of a Corporation (*August 19, 2019*)

Letter to CEOs

"The more your company can show its purpose in delivering value to . . . its employees . . . the better able you will be to compete and deliver long-term, durable profits for shareholders."

Chairman and Chief Executive Officer of BlackRock Larry Fink in his 2021 "Letter to CEOs"

Walmart | Do you want workers on the board?

3,916 votes

2,379,343,435 votes

Main concern

The risk that workers will share confidential company information!

Outside directors vs. inside directors

- Outside directors (i.e., shareholders, bank representatives, politicians) have **asymmetric information** (e.g., *Jensen, 1993; Armstrong et al., 2010*)
- Managers have **self-interested incentives** to limit disclosures to outside directors (e.g., *Verrecchia, 2001*; *Holmstrom, 2005*; *Adams et al., 2010*)
- Outside directors selectively disclose information *(e.g., Bishop et al., 2017)*

“The only people who leak more to the press [than outside board members] are prosecutors”

John C. Coffey, Columbia Law Professor

And workers???

It is unclear whether they are “insiders” or “outsiders” in their role as members of the board

Workers in the boardroom

- The interests of workers are unlikely to **always align** with those of management
- Worker representatives act **self-interestedly**, at least when workers' incentives are **in conflict** with management incentives *(e.g., Gleason et al. 2021)*

The benefits

- Workers could increase transparency by **disclosing information** to the employees they represent,
- Workers add valuable **first-hand knowledge** to the board

Decrease in information asymmetry

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The risk

- Information **leakage** (even without violating security laws
- Worker representatives could disclose information **selectively**

Increase in information assymetry

Research question

- **Broad research question**:

  Do worker decision rights harm shareholders?

- **Narrow research question**:

  Do firms with worker representatives on their board have a more transparent information environment compared to firms without worker representatives?

H1: Firms with worker representation on corporate boards exhibit a better information environment compared to firms without worker representation.

Institutional Setting

Mandatory worker representation on corporate boards in Germany:

- **Legal threshold** of 500 domestic workers: one-third of the firm’s board seats are assigned to worker representatives
- Worker representatives **vote** on the board **without having invested** any money in the firm
- Worker representatives are elected by a firm’s domestic workers and represent and **protect their interests**
- **Fiduciary responsibility** resides with all board members and thus also with any appointed worker representative
- Worker representatives are **white-collar workers** and **skilled blue-collar workers**, but not unskilled blue-collar workers (*Kim et al. 2018*)
- Worker representatives are **trained** in governance and **highly qualified**: 90 percent of the German firms have at least one worker on the audit committee (*Drinhausen & Eckstein 2018*)

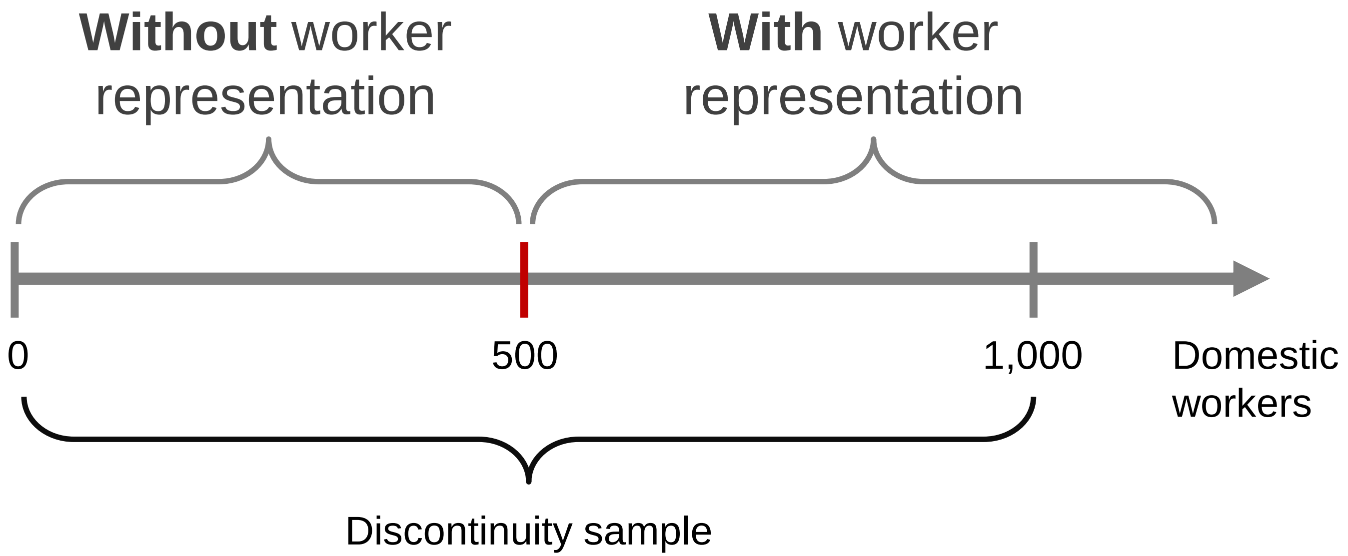
Research Design

H1: Firms with worker representation on corporate boards exhibit a better information environment compared to firms without worker representation.

$$
\begin{aligned}
FORECAST\_ERROR_{i,t} = \beta_0 &+ \boldsymbol{\beta_1}\ \boldsymbol{WORKER\_REP_{i,t}} + \beta_2\ SIZE_{i,t} + \beta_3\ ROA_{i,t} \\
&+ \beta_4\ LEV_{i,t} + \beta_5\ MTB_{i,t} + \beta_6\ NUMEST_{i,t} \\
&+ \beta_7\ EARN\_CHANGE_{i,t} + \beta_8\ RETURN\_VOLATILITY_{i,t} \\
&+ \beta_9\ AGE_{i,t} + \beta_{10}\ SALES\_GROWTH_{i,t} + \beta_{11}\ R\&D_{i,t} \\
&+ \beta_{12}\ GOV_{i,t} + YEAR\_FE + INDUSTRY\_FE + \varepsilon_{i,t}
\end{aligned}
$$

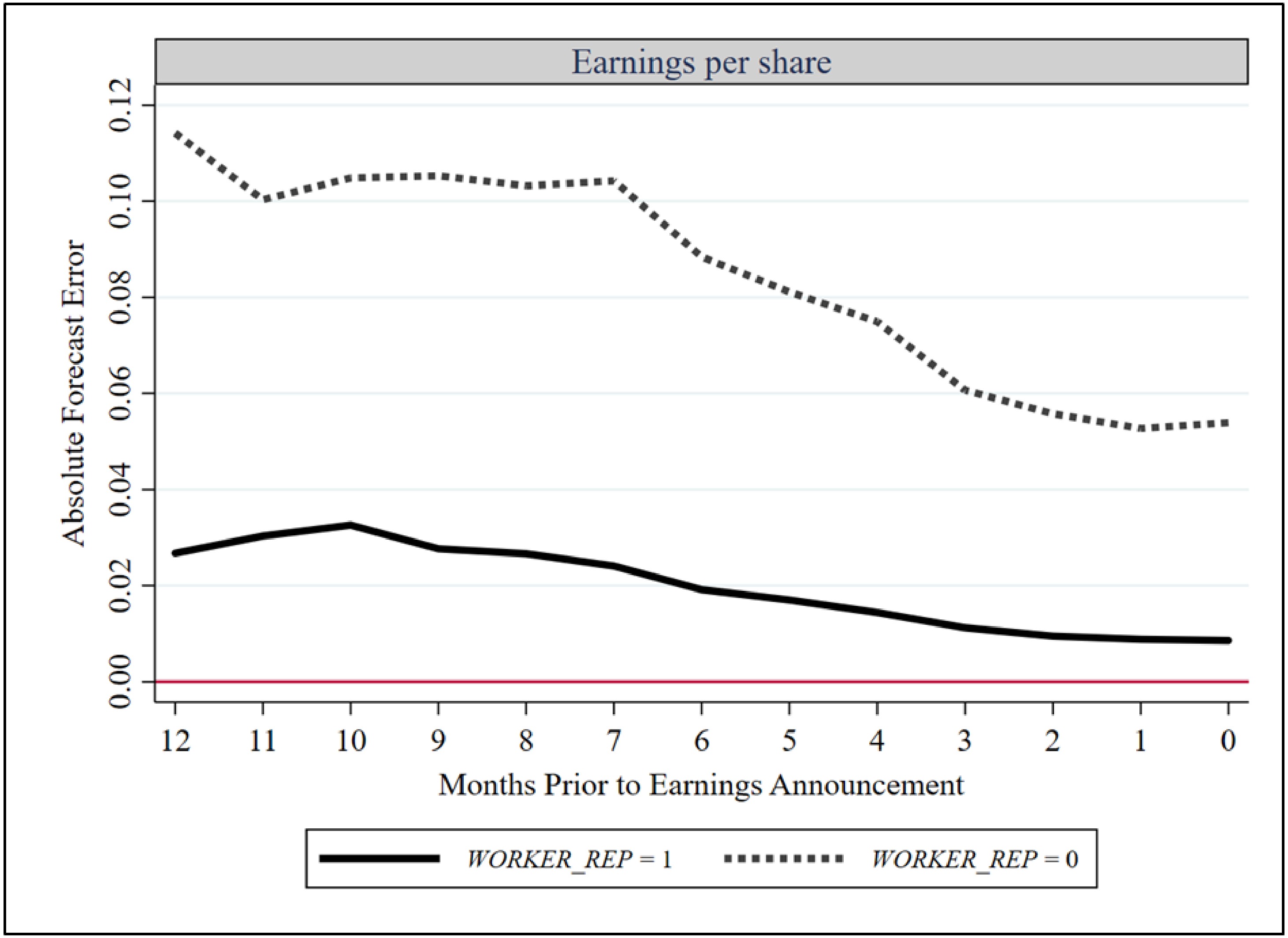
$$
FORECAST\_ERROR_{i,t} = \left| \frac{IBES\ Actual\ Earnings - IBES\ Median\ Consensus}{Stock\ Price_{begnning\ of\ the\ year}} \right|
$$

Regression discontinuity design



Firms with and without workers on boards around this threshold are similar with respect to firm size . . .

Worker representation and analyst forecast accuracy



Main results

*FORECAST_ERROR_*	(1) *FIRST*	(2) *LAST*
Intercept	0.290***	0.155***
	(3.85)	(3.76)
WORKER_REP	-0.081***	-0.044***
	(-4.08)	(-4.12)
Controls	*YES*	*YES*
YearFE	*YES*	*YES*
IndustryFE	*YES*	*YES*
N	801	801
Adj. R^2	24.0%	23.3%

Analyst forecast dispersion

	(1)	(2)
*DISPERSION_*	*FIRST*	*LAST*
Intercept	0.118***	0.070***
	(3.57)	(2.79)
WORKER_REP	-0.011*	-0.019***
	(-1.71)	(-3.09)
Controls	YES	YES
YearFE	YES	YES
IndustryFE	YES	YES
N	722	730
Adj. R^2	22.4%	24.5%

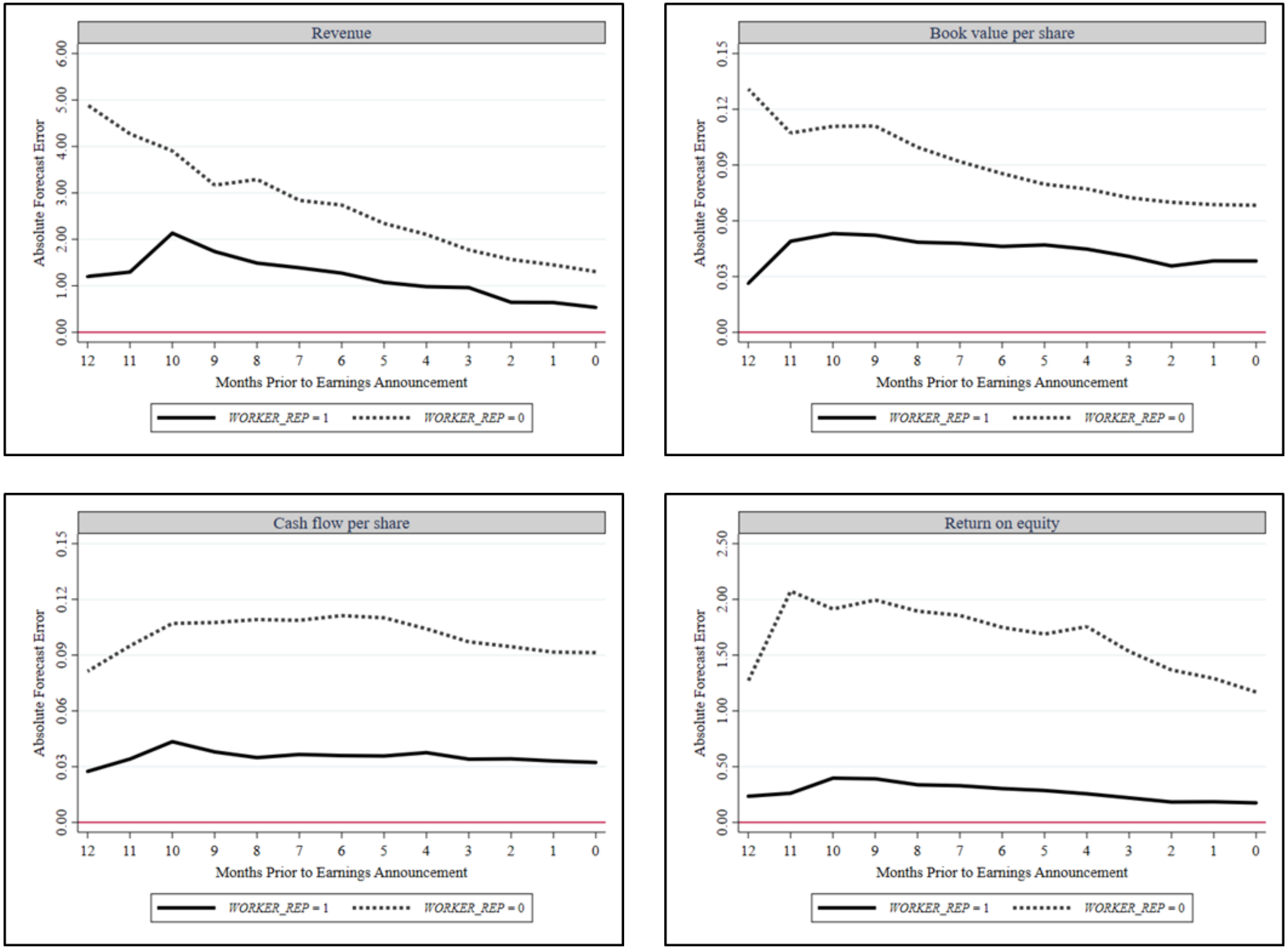
Industry-level earnings shocks

- Helps address **endogeneity** concerns
- Uses **shocks** to earnings at the industry-level
  - Information is more important in times of poor performance, downturn, and negative market sentiment *(Lim, 2001)*
  - Prediction: Transparency is higher for firms with worker representatives when negative shocks occur
  - *Proxies for SHOCK*: Indicator variable equal to one if earnings of population of German firms in the same industry decrease
    - **2.5 percent**
    - **10.0 percent**

Industry-level earnings shocks

Earnings shock of:	≥ 2.5%		≥ 10.0%	
	(1)	(2)	(3)	(4)
*FORECAST_ERROR_*	*FIRST*	*LAST*	*FIRST*	*LAST*
Intercept	0.285***	0.129***	0.288***	0.131***
	(5.64)	(4.86)	(5.70)	(4.96)
WORKER_REP	-0.045**	-0.018**	-0.044**	-0.018**
	(-2.31)	(-2.08)	(-2.34)	(-2.16)
SHOCK	0.049**	0.028**	0.059**	0.033***
	(2.32)	(2.52)	(2.48)	(2.64)
*WORKER_REP*SHOCK*	-0.045*	-0.034***	-0.057**	-0.040***
	(-1.73)	(-2.78)	(-2.04)	(-2.93)
N	801	801	801	801
Adj. R^2	19.3%	19.3%	19.5%	19.6%

Forecasts of other financial statement items



Worker representation and insider trading

	(1)	(2)	(3)	(4)	(6)
	CAR [-10;-1]	CAR [-5;-1]	CAR [0;1]	CAR [0;2]	CAR [0;10]
No Workers (N = 360)					
	-0.015***	-0.008***	0.008***	0.010***	0.018***
	(-3.42)	(-2.26)	(3.75)	(3.83)	(3.72)
Workers (N = 87)					
	0.011	0.005	0.012***	0.020***	0.036***
	(1.63)	(0.99)	(4.62)	(6.24)	(6.28)
Difference					
	-0.026***	-0.013*	-0.004	-0.010**	-0.018*
	(-2.79)	(-1.72)	(-0.91)	(-2.03)	(-1.88)

Potential channels

- Our findings indicate that firms with worker representation have **lower forecast errors**, consistent with **more transparent information environments**
- However, our results do not point to a **specific channel** for better transparency
- We hand-collect data to examine several **potential channels** for why firms with worker representation have a more transparent information environment than firms without worker representation
- We consider three broad categories of information:
    - **Internet and social media:** website size, number of tweets …
    - **Financial statement disclosure:** Prime Standard, segment disclosure …
    - **Management guidance:** amount, form, and type of management guidance …
- Our analysis of possible channels suggests firms with worker representation provide not only more but also **more detailed management guidance**
- They are also more likely to provide **more detailed financial statement disclosures**, specifically segment information

Key Takeaways

- Firms have **more transparency** and **less information asymmetries** when workers participate in corporate decision-making
- Our results are **strong and consistent** when we use
  - placebo tests,
  - smaller bandwidth (i.e., ± 400, ± 300, ± 200, ± 100)
  - analysts' forecast dispersion,
  - exogenous industry-level earnings shocks,
  - alternative forecast measures
- No evidence consistent with an increase in selective disclosure from worker representatives
- Evidence helps **policymakers** and regulators to evaluate proposed reforms to **introduce** worker representation in the **United States**