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**Working Paper**

## The governance of offshoring and its effects at home: The role of codetermination in the international organization of German firms

Working Paper, No. 40/2014

**Provided in Cooperation with:**

Berlin Institute for International Political Economy (IPE), Berlin School of Economics and Law

*Suggested Citation:* Bramucci, Alessandro; Zanfei, Antonello (2014) : The governance of offshoring and its effects at home: The role of codetermination in the international organization of German firms, Working Paper, No. 40/2014, Hochschule für Wirtschaft und Recht Berlin, Institute for International Political Economy (IPE), Berlin

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# The governance of offshoring and its effects at home: The role of codetermination in the international organization of German firms

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Working Paper, No. 40/2014

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**The governance of offshoring and its effects at home**  
**The role of codetermination in the international organization of German firms**

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**Abstract**

This paper focuses on the links between labor market institutions and offshoring, with specific reference to the role of codetermination in shaping the international operations of German firms. We use case studies to illustrate how works councils deal with three important aspects of offshoring processes: the timeliness of information they receive from the management, the negotiation of compensation mechanisms and the design of alternative strategies. While we found no evidence of works councils impeding offshoring, there are elements to suggest that they may influence the way such decisions are taken, and moderate their effects on employment in the home country.

**JEL codes:** F21, J53, L22

**Keywords:** Offshoring; Labor market institutions; Codetermination

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**Acknowledgments:**

First of all, we would like to thank our interviewee for sharing their personal experience with us. Then, we would like to thank Peter Pawlicki at IG Metall in Frankfurt am Mein for providing us the right contacts for the case studies and Dr. Martin Behrens (WSI) and Prof. Dr. Jürgens Ulrich (WZB) for their precious suggestions during the earliest stage of the research. A special thank goes to Thomas Obst for his assistance during the interview process.



## 1. Introduction

In recent years, the debate around offshoring has mounted as this phenomenon is instinctively associated by the wider public with a whole series of negative outcomes such as de-industrialization, unemployment and increasing wage inequality. The empirical literature investigating the home country effects has indeed delivered a variegated picture. Overall effects seem to differ significantly across sectors: offshoring of service activities are associated with relatively higher positive effects on employment and production at home than in the case of manufacturing. Moreover, effects seem to differ significantly according to whether they are observed at the level of individual firms or micro-sectors, or at the level of larger aggregates, where important cross-sectoral compensation mechanisms are at work. Extant literature on the effects of offshoring on output and employment at home assumes that such effects are mediated by the characteristics of institutions in general and of labor market institutions in particular. It remains that the institutional mechanisms underlying such effects are still largely unexplored and understanding them requires a careful examination of micro-level governance of offshoring processes.

In this paper, we examine the role of a specific labor market institution, namely “codetermination” (*Mitbestimmung*) in shaping decision making of German firms in the strategic area of offshoring<sup>1</sup>. Unlike other European countries, Germany has stronger codified elements of workers’ representation, both at plant and managerial level and thus represents a reference point for the investigation of the impact of labor market institutions on offshoring decisions. Using both scattered evidence and illustrative case studies, we will show that, while codetermination may not impede offshoring, it might influence its direction and intensity, contributing to moderate effects on firms’ activities at home with particular attention to the protection of home employment.

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<sup>1</sup> Extant literature acknowledges some differences between the terms *offshoring* and *outsourcing*. Kierkegaard suggested a distinction based on two criteria: location and ownership (Kierkegaard, 2005). From this perspective, outsourcing involves activities that are not owned by the investing firm and may either be located within the home country (also called insourcing) or abroad. Offshoring involves activities that are carried out in foreign locations that take place either within firm boundaries (captive offshoring) or across firm boundaries (external offshoring). A similar definition of outsourcing and offshoring is suggested in the OECD report on offshoring and employment (OECD, 2007). Unless otherwise specified, we will use the term *offshoring* in its more general and comprehensive meaning, to identify all activities controlled by the firm abroad. Cross-border relocation that involves plants shut-down at home replaced by activities abroad, can be considered as a special case in this broad definition of offshoring.

We focused on three aspects of codetermination that appear to play a key potential role in the governance of offshoring decisions: the timeliness of information delivery, the negotiation of compensation mechanisms and the promotion of alternative strategies. We believe that, according to the actual importance and combination of these three aspects, offshoring decisions may take on different configurations and directions. We conducted interviews with the head of the works council of three firms in the metal-mechanic and electro-technical sectors located in south-west Germany. As will be shown later, this particular choice was influenced by two factors. Firstly, in the manufacturing sector codetermination at plant level has one of the highest coverage. Secondly, the manufacturing sector, and in particular the production department, has and the higher propensity to relocate abroad.

The paper will be structured as follows. In section 2, we will review some of the extant empirical literature examining how offshoring can affect home country activities, and the role of home labor market institutions in shaping these effects. Section 3 and 4 will provide an overview of how “codetermination” works in Germany and will illustrate constraints and opportunities that this institution presents when offshoring decisions are taken. Section 5 will then illustrate some evidence of the links between codetermination and offshoring relying on the results of previous researches conducted on this matter. Section 6 will present original evidence obtained from the field work we carried out through interviews conducted with a small sample of German companies involved in offshoring activities to explore how codetermination practices have affected their decision to offshore. Section 7 will conclude.

## **2. How offshoring affects economic activity at home**

Although offshoring is often dispraised in the public debate, a closer examination of the economic empirical literature shows that the labor market outcomes of offshoring are quite mixed. Negative effects on home output and employment can be expected when offshored activities substitute for the activities at home. However, offshoring may also be used to complement the home activities, to gain access to valuable technology, or to supply foreign markets, hence inducing positive effects on the home economy, for example, in terms of output and productivity gains (Wagner, 2009; Amiti and Wei, 2004; 2005), of innovation performances (Narula and Zanfei, 2005; Dachs et al 2013) and of increasing of head quarter activities (Barba Navaretti and Falzoni, 2004).

Much attention has been paid to investigate the impact of offshoring on employment and skill composition of workers. Offshoring can influence economic activity at home by changing the international division of labor, the skill intensity and composition of the workforce. The transfer of labor-intensive tasks abroad requiring unskilled workers increases the level of high-skilled workers at home where high-skill intensive activities are concentrated. While this might improve the overall level of productivity and increase average wages at home, low-skilled workers will be penalized as less qualified and routine tasks are easier to offshore than high-skilled labor tasks (Feenstra and Hanson, 1996; Helg and Tajoli, 2005; Castellani et al. 2008; Geishecker and Görg, 2008). Most empirical works on the effects of offshoring on output and employment at home implicitly assume that such effects are mediated by the characteristics of institutions in general, and of labor market institutions in particular. Broadly speaking, this implicit assumption connects to a rather extensive theoretical literature emphasizing that institutions play a pivotal role in explaining the nature, direction and effects of international trade (Belloc, 2006; Levchenko, 2007).

Some empirical studies have analyzed more explicitly the influence of labor market institutions in the home country on the processes through which offshoring displaces production activities and jobs. Using industry-level data for 11 OECD countries and 20 industries in the period 1980-2002, Hijzen and Swaim (2010) found evidence that a higher level of employment protection weakens the elasticity of labor demand to offshoring. More specifically, some studies have shown that offshoring decisions are affected by the industrial relations and the organizational home context in which offshoring firms are embedded. Mazzanti, Montresor and Pini (2006) analyzed a dataset composed by 500 firms in the Italian province of Reggio Emilia and found that unions may be able to impede or limit offshoring, and when it occurs, to be informed and involved. In a subsequent research based on the same dataset, Mazzanti, Montresor and Pini (2008) confirmed that industrial relations, in particular the role of trade unions, influence outsourcing but only with respect to ancillary activities with lower business relevance. Only when employees and employers act together in the decision-making process, outsourcing of higher added value activities might be hampered (Mazzanti, Montresor and Pini, 2008).

In a similar vein but with a different geographic focus and methodological approach, Bain and Taylor (2008) examine trade union responses to the 2000-2004 wave of call centers offshoring from the UK to India and evaluate the relative efficacy of these responses in



influencing the intensity of delocalization. The authors found that when unions are able to deploy credible threats of strike actions, they obtain stronger protection of jobs, although for a limited period of time (Bain and Taylor, 2008).

In the case of Germany, indirect evidence can be drawn from studies on the role of institutional settings in shaping investment decisions and economic performance. A specific combination of training and educational systems, corporate and plant level industrial relations together with the cooperation of financial institutions appear to reduce the propensity of German firms to lay-off workers or relocate business activities even under adverse business cycles (Hall and Soskice, 2001).

Empirical literature has also investigated the general macro and microeconomic effects of a specific labor market institution such as codetermination (Addison, 2009; Jirjhan, 2010). In particular, Addison et al. (2005), used establishment-level data from the German Federal Labor Agency (IAB) to estimate the impact of the foundation (or dissolution) of a works council on new investment in tangible capital. The study found that the formation of a works council does not have a negative effect on investment and firm performance, nor does its dissolution have favourable effects (Addison et al., 2005). In another research, Addison et al. (2011) using (IAB) establishment level panel data investigated determinants and employment effects of outsourcing (as a special case of offshoring strategies) in the presence of works councils. The research constructed two measures of outsourcing and found no conclusive evidence of these processes negatively affecting jobs. This finding appears to hold for all the analyzed industries. Second, outsourcing seems to have negative effects for the manufacturing industry, balanced by positive effects on the service industry. Third, there is no evidence of outsourcing leading to the closure of the establishment (Addison et al., 2011).

Evidence on the actual involvement of German works councils in the discussion and implementation of offshoring issues is rather sparse and mostly descriptive. As we shall illustrate in greater detail (Section 5), some studies using data produced by the Institute of Economic and Social Research at the Hans-Böckler Foundation (*Wirtschafts- und Sozialwissenschaftliches Institut*, WSI) show that works councils have to deal with these matters, although only a minority of them actually assisted to relocation and could eventually intervene in the process (Alhers et al; 2007; Behrens and Kädtler, 2008). Kleipzig et al. (2012) developed specific considerations on best practices to be followed in offshoring cases and drew some practical advices to be used in negotiation rounds. These authors identify

some key issues that need to be addressed to improve the works councils' ability to influence offshoring decisions. However, Kleipzig et al.'s (2012) contribution does not provide a systematic analysis of these aspects. It rather offers a methodological guidance to support works councils' action with a well-organized set of arguments and communication techniques.

The studies above have shed some light on the role of labor market institutions in investment and economic performance in general, and in international investment in particular. While there is some, rather limited, evidence that labor market institutions may moderate the impact of offshoring on economic activities at home, there is even scantier evidence on the mechanisms through which these moderating effects may occur. This paper contributes to filling this gap by analyzing concrete cases of codetermination in the design and implementation of offshoring strategies. Following some of the insights offered by descriptive studies on the German case (and particularly by Kleipzig et al., 2012), we will focus our investigation on the three aspects of the governance of offshoring: the delivery of information to the works council, the negotiation of compensation mechanism and the formulation of alternative proposals.

### **3. The institution of codetermination in Germany**

#### **3.1. Definition, history and functioning**

Germany certainly represents an interesting, and largely unexplored, case for the investigation of how labor market institutions may influence investment decisions, including offshoring strategies. While various forms of participation of employees in different aspects of corporate governance have had a significant diffusion in a number of European countries in the post WWII period, the German case certainly represents a landmark in this respect<sup>2</sup>.

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<sup>2</sup> Rights of employees to be represented in works councils or supervisory boards of various sorts are being explicitly recognized in the legislation of 14 EU countries, while they have a limited coverage with respect to State owned enterprises only, in the case of four additional countries (Spain, Greece, Ireland and Portugal). No such recognition is present in the legislation of three core EU countries, namely the UK, Belgium and Italy. A substantial draw back from the coverage of previously recognized rights of participation has been recently experienced in the cases of Malta, Czech Republic and Poland. Efforts to define minimum standards of workers participation at the EU level have long been underway after the European Commission issued the plan "Modernizing Company Law and Enhancing Corporate Governance in the European Union" in 2003. See Telljohran (2013) and Kowalsky (2013) for an overview of the diffusion of participatory forms of corporate governance across European countries and at the ETUC level.

The term codetermination (*Mitbestimmung*) refers to the legally recognized right of employees to be consulted and (in some cases) participate in the organization of working conditions as well as in the economic planning of the company (Page, 2011). According to the size and the legal entity of the firm, the German model of codetermination ensures employment participation in the decision making process at the plant level, through the activity of the works council (*Betriebsrat*), and at the corporate or group level, where the workforce is represented in the supervisory board (*Aufsichtsrat*) by elected employees (*Unternehmensmitbestimmung*).

Page (2011) lists four objectives for codetermination: equality of capital and work, democracy in the economy, social development and control of economic power. The main goal of codetermination is to settle conflicts and disputes between employees and employers by the use of dialogue and co-decision. As Addison (2009) noted, codetermination is a specific characteristic of the so-called *Rheinish* capitalism, a form of capitalism which puts strong emphasis on coordinated market economy, cooperation between labor and capital and long-term economic and social success.

The long history of codetermination can be traced back to the German Constituent National Assembly held in 1848 in Frankfurt am Main, when workers began to demand the right to establish workers committees to monitor and improve working and living conditions at the workplace. This right obtained formal recognition in the Weimer Constitution in 1919 and it was subsequently enforced with the “Works Council Act”. During the Nazi regime, all codetermination rights were expressly denied only to be resumed in 1946 under the “Allied Control Council Act n.22”. In 1951, parity codetermination was introduced at supervisory board level in the coal, iron and steel industry, and in 1952, the Works Constitution Act (*Betriebverfassungsgesetz*) extended the right to all companies in the private sector. In 1956, codetermination was extended to companies of the public sector (*Personalvertretungsgesetz (Bund/Länder)*) and in 1976 the “Codetermination Act” (*Mitbestimmungsgesetz*) established parity-level board level codetermination for companies with more than 2000 employees. In 2004, the “Third Part Act” (*Drittelbeteiligungsgesetz*) modernized the 1952 Works Constitution Act by introducing one-third board level representation for all companies in the private sector with more than 500 workers.

### **3.2. Plant and board level codetermination**

The works council is the principal governing body of codetermination at plant level. According to the Works Constitution Act of 1952 (and its subsequent revision of 2001), the works council acts for the good of employees, working in a “spirit of mutual trust” with employer, employer’s association as well as trade unions represented at the workplace (Works Constitution Act § 2 (1) WCA). The primary aim of the works council is to resolve conflicts between employees and employers with collaborative strategies. As stated in the WCA, works council representatives and the employer “discuss the matters at issue with an earnest desire to reach agreement and make suggestion for settling their differences” (§ 74 (1) WCA, p. 28).

Employees have the right to elect a works council in every establishment with more than 5 permanent workers, with at least three workers entitled to full voting rights (§ 1 (1) WCA). The initiative to elect the works council must be taken exclusively by employees, independently from the influence of other institutions. Unions can be indirectly represented in works councils by affiliated councillors (the percentage of works council members associated to one of the unions of the German Federal Confederation DGB *Deutscher Gewerkschaftsbund* ranges from 80 to 95 percent, Page 2011). Expenses of the works council are borne entirely by the employer (§ 39 (1) WCA), as well as salaries of the full-time works councillors whose number and election is regulated by the WCA<sup>3</sup>. Meetings of the works council are organized every calendar quarter. The employer may be invited to join the session and made aware in advance of the topics on the agenda. Once a year the employer is requested to report in front of the works council about the overall business situation at the company (§ 43 WCA).

Employees in the European Union have the possibility to set up a European Works Council (EWC) with minimum power of regulation, including information and consultation rights. Employees have the right to establish a EWC in companies with at least 1000 employees in the European Union, in a minimum of two different countries and with at least 150 employees each. Furthermore, since 2004 companies in the European Union have the possibility to be

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<sup>3</sup> The minimum number of employees at the establishment to elect at least one full-time works councilor is of 200 workers (§ 38 (1) WCA).

registered as European Company (*Societas Europea* or *SE*) where employees are entitled to the right to establish a works council with a similar functioning to the EWC<sup>4</sup> (Heiner, 2007).

Coverage of codetermination in the country is rather heterogeneous. Remarkable differences are found between former Eastern and Western regions and across sectors, where coverage of codetermination in the manufacturing and financial sector is at the highest levels. The following table offers an overview of the works council diffusion in the country.

*Table 1. The diffusion of works council in Germany in 2011 (data in percent)*

*Table 1a)*

| Percentage of firms and employees covered by works councils by size class |                  |                    |                     |                     |                |                    |
|---|------------------|--------------------|---------------------|---------------------|----------------|--------------------|
|   | 5 – 50 employees | 51 – 100 employees | 101 – 199 employees | 200 – 500 employees | >500 employees | Total >5 employees |
| West Germany  |                  |                    |                     |                     |                |                    |
| Companies with w.c.   | 6                | 38                 | 62                  | 78                  | 88             | 10                 |
| Employees with w.c.   | 10               | 38                 | 63                  | 79                  | 92             | 41                 |
| East Germany  |                  |                    |                     |                     |                |                    |
| Companies with w.c.   | 6                | 37                 | 58                  | 72                  | 92             | 9                  |
| Employees with w.c.   | 11               | 39                 | 59                  | 75                  | 92             | 36                 |

*Table 1b)*

| Percentage of firms and employees with works council by industry |                                      |        |         |       |                                |      |   |  |                      |   |                      |
|--|--------------------------------------|--------|---------|-------|--------------------------------|------|---|--|----------------------|---|----------------------|
|  | energy/<br>water/<br>waste/<br>mines | manuf. | constr. | trade | transport/<br>whare-<br>houses | ICT. | financial<br>and<br>insurance<br>services | tourism.<br>and<br>related<br>services | health/<br>education | self-<br>empl. in<br>econ/fin<br>services | total<br>>5<br>empl. |
| West Germany   |                                      |        |         |       |                                |      |   |  |                      |   |                      |
| Companies with w.c.  | 55                                   | 16     | 3       | 10    | 16                             | 14   | 27  | 2                                      | 10                   | 7   | 10                   |
| Employees with w.c.  | 86                                   | 68     | 18      | 31    | 55                             | 46   | 69  | 12                                     | 42                   | 30  | 44                   |
| East Germany   |                                      |        |         |       |                                |      |   |  |                      |   |                      |
| Companies with w.c.  | 18                                   | 12     | 3       | 9     | 10                             | 8    | 28  | 7                                      | 14                   | 10  | 9                    |
| Employees with w.c.  | 65                                   | 48     | 13      | 23    | 34                             | 21   | 72  | 16                                     | 53                   | 33  | 36                   |

Source: Elaboration from Ellguth and Kohaut (data from IAB Establishment Panel, 2011)

The second level of codetermination includes the presence of worker's representatives on the supervisory board. German corporate law establishes a two-tier system of corporate governance where the managing board and the supervisory board are two separate bodies. The managing board has executive powers whereas the supervisory board plays a non-executive

<sup>4</sup> The possibility of German companies to be registered as SE poses important challenges to the institution of codetermination as it represents a way of circumventing stricter German legislation on employees' representation; on the contrary, the possibility of developing the instrument of the EWC offer new perspectives for the development of stronger systems of representation at the European level. Due to insufficient space, it is not possible to present the topic in details. For a better understanding of the role played by EWCs see Whittall et al. (2007).

role but is entitled to appoint executive managers and to define their contract salary. The supervisory board monitors business operations (it has to be informed annually about business policy and corporate planning and more regularly about business operations) and eventually launches investigations. Workers representatives at board level are elected by the works council and remain in charge for four years. They become full members of the board and are entitled to full voting power. While operating as board members, workers representatives still speak for the interests of the workforce and not for the general “company interests” (Page, 2011). In 80 percent of the cases, board members elected by the works council are affiliated to labor unions (Addison 2009).

The proportion of board seats reserved for employees’ representatives varies according to size and legal entity. With the Codetermination Act, workers obtained the right of “quasi parity” codetermination (differently from the “full parity” in the coal and steel industry) so defined because the chairman is nominated by shareholders whereas the vice chairman by workers representatives. In addition, the 1977 Codetermination Act introduced one seat for a managerial employee and assigned the right of veto to workers representatives in the nomination of the labor director (Addison, 2009). Figure 1 clarifies under which laws codetermination at company level is determined, based on legal entity and number of employees.

Figure 1. The legal framework of German co-determination: The Coal, Iron and Steel Industry Co-determination Act, the Co-determination Act of 1976 and the Third Pact Act of 2004

Fig. 1a) Private enterprises (except coal, iron and steel companies)

| Object and/or legal form  | Number of Employees*  |                               |           |                                  |
|---|-----------------------|-------------------------------|-----------|----------------------------------|
|   | 0-500                 | 501-1000                      | 1001-2000 | over 2000                        |
| Individually owned firms/<br>OHG general partnership/<br>KG limited partnership |                       |                               |           |                                  |
| GmbH & Co. KG   |                       |                               |           | Codetermination Act of 1976 (§4) |
| Mutual insurance society with supervisory board                                 |                       | Third Pact Act (§1 (2) Nr. 4) |           |                                  |
| Registered cooperatives   |                       | Third Pact Act (§1 (2) Nr. 5) |           | Codetermination Act of 1976 (§1) |
| GmbH (limited liabilities companies)  |                       | Third Pact Act (§1 (2) Nr. 3) |           |                                  |
| KGaA (partnership limited by shares)  | No Codetermination ** | Third Pact Act (§1 (2) Nr. 2) |           |                                  |
| AG (joint stock companies)  |                       | Third Pact Act (§1 (2) Nr. 1) |           |                                  |

Fig. 1b) Coal, iron and steel companies according to § Coal, Iron and Steel Industry Co-determination Act

| Object and/or legal form             | Number of Employees   |                               |   |           |
|--------------------------------------|-----------------------|-------------------------------|---|-----------|
|                                      | 0-500                 | 501-1000                      | 1001-2000   | over 2000 |
| AG (joint stock company)             | No Codetermination ** | Third Pact Act (§1 (2) Nr. 1) | Coal, Iron and Steel Industry Co.dem Act (§ 1 II) |           |
| GmbH (limited liabilities companies) |                       | Third Pact Act (§1 (2) Nr. 3) |   |           |

Source: Page 2011

\* Possibly additions according to the respective relevant rules for groups

\*\* Only the general partner (GmbH, AG) is liable to practice codetermination, whereby under §4 of the Co-determination Act the employees of the limited partnership are numbered among those of the general partner

#### **4. Rights of the works council and governance of offshoring**

The works council is granted numerous rights, ranging from the basic right of information to the right of cooperation, the right of codetermination, the right of opposition up to the strongest form and, the right of veto. Such a heterogeneous group of rights covers three distinguished areas dealing with social, human resources and economic matters. As noted by Heiner (2007), the primary objective of codetermination is not democratization of the work place. As defined by the WCA, the works council acts in the best interest of the establishment and for the promotion and safeguard of employment (§80 (1) WCA). The works council is entitled to the right to be consulted before any dismissal is carried out, and must be provided with “sufficient” information about whom, when and for what reason somebody is dismissed. Any notice of dismissal without previous communication has to be considered null and void (§ 102 (1) WCA).

The works council can exercise the right of opposition (and in some cases) of veto on dismissal decisions<sup>5</sup>. To the extent that offshoring decisions determine circumstances expressly ruled in the WCA, the works council has the power to oppose layoff decisions. However, apart from these circumstances, there is virtually no possibility of impeding the dismissal of workers that are associated with relocation strategies. German law states that the outsourcer has the right to dismiss employees for business reasons when a company’s unit is closed and its function transferred to an external recipient (ILO, 2007). By contrast, the employer cannot impose any binding rule without previous agreement with the works council in those aspects of the working organization not covered by the collective agreements or other previous regulation. These aspects include the organization of working hours and breaks, holidays, job bonuses, the application of methods to control workers behavior and performance (Page, 2011).

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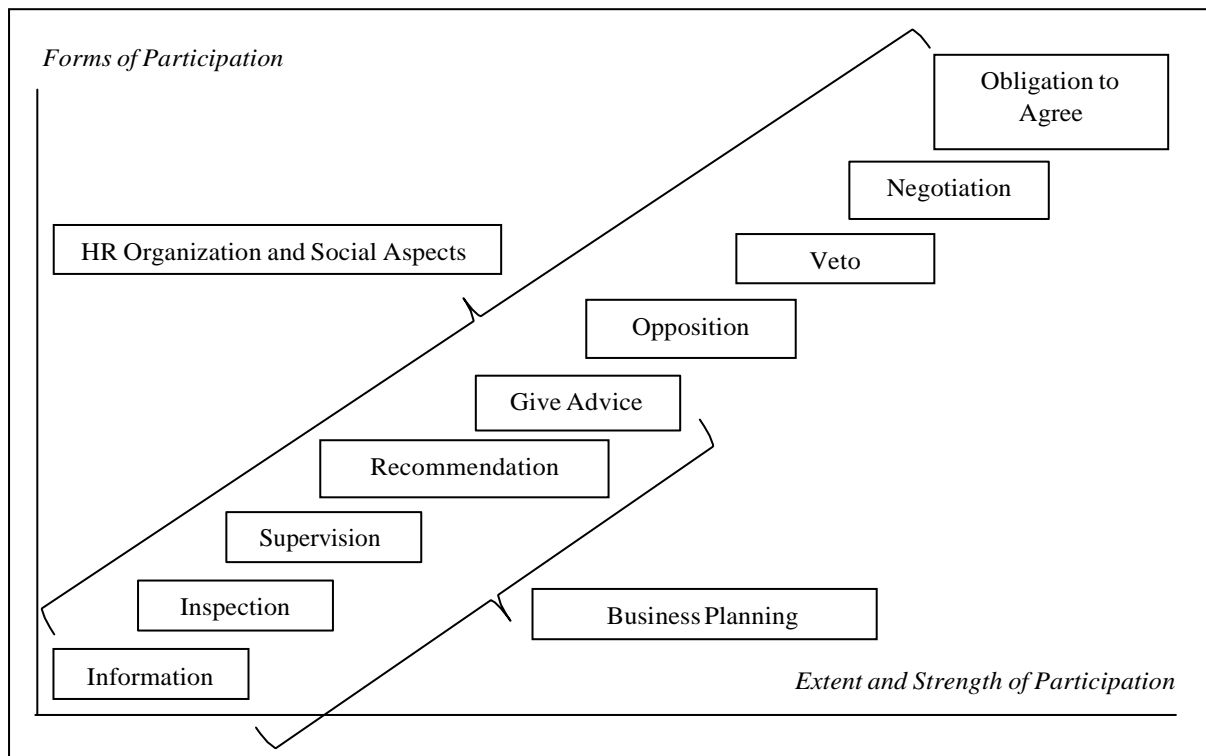
<sup>5</sup> The right of the works council to make opposition to dismissal decisions applies in case: 1) social aspects of the dismissal have been insufficiently evaluated; 2) guidelines for the selection, transfer and dismissal of employees, previously agreed between employer and works council, have not been observed; 3) transfer and re-skilling opportunities can be pursued within the company; 4) a change in contractual terms can be agreed with the employee (§102 (3) WCA). In personnel matters, and in specific circumstances, the works council can exercise the right of veto under the following circumstances: (a) breaches in acts, safety regulation or collective agreements; (b) selection guidelines have not been observed; (c) dismissals is not clearly and objectively justified; (d) the dismissal decision has not been notified to the works council (Page 2011).



Even though works councils can hardly interfere with corporate strategies and economic planning, section 90 of the WCA establishes that the works council has the right to be informed in advance, and with all necessary documents, about plans concerning alteration of the working organization, procedure, operations, plants and job organization at the establishment (§ 90 (1) WCA). Similarly, section 111 establishes that the works council in all enterprises with more than 20 employees has the right to be informed in advance about the alterations of company activities that endanger employment, such as the reduction of operations, the transfer of departments, amalgamation or split-up of departments. In establishments with more than 100 employees, the works council has the additional right to appoint an ad hoc finance committee (*Wirtschaftsausschuss*) with power to access all relevant documents and with the right to inform the works council about changes in the economic planning (§ 106 WCA). The finance committee must be informed in “full and good time” about “rationalization plans, reduction of operations or closure of establishments or part of establishments, the transfer of establishments or parts of establishments” (§ 106 WCA, pp. 43 – 44). When the alteration of the working organization leads to employment reduction, the works council has the right to request appropriate actions to compensate distress caused to laid-off employees (§ 91 WCA). In respect to this, section 92 of the WCA makes explicit mention of the case of “spin-off of operations or outsourcing” and provides the works council with the specific right to present valid alternatives (§ 92a WCA).

Strong power is granted to works councils in dealing with compensatory measures. Section 112 of the WCA establishes that management and works council have to negotiate for reconciliation of interests (*Interessenausgleich*) in case restructuring plans involve employment reduction and a for a “social compensation plan” (*Sozialplan*) to provide financial compensation (§ 112 WCA). In case employer and works council cannot reach an agreement, the case can be submitted to a conciliation committee (*Einigungsstelle*) chaired by an independent figure where interests of both parties are equally represented (§ 76 – 112 WCA). Figure 2 offers an overview of the rights of the works council according to extension, strength and form of participation.

Figure 2. Rights of the works council



Source: elaboration from Page 2011

As we have shown, the WCA establishes the right to be informed, to be consulted, to formulate alternative proposals and to negotiate social compensation plans for laid-off employees. However, the charter is rather ambiguous concerning the actual possibility of the works council to participate in the business organization of the firm. In this respect, two observations can be made. First of all, the time reference for the delivery of information to the works council is rather vague. In the WCA, this is described in generic terms (in due time, in good time) and does not specify any time limit for the disclosure of the relevant information on the restructuring event. Companies may be inclined to communicate with works council at short notice in the attempt to limit the manoeuvring space for the organization of counteractions. If on the one hand, consultation rights play a role in the governance of offshoring processes, on the other hand, any potential influence can be weakened, or even annulled, if the employer does not allow enough time to examine relevant documents. Second, the WCA does not guarantee that alternative proposals are taken into consideration. The employer has a large degree of discretion concerning the actual level of collaboration with the works council.

Given this particular institutional context, it is certainly difficult to identify the extent to which the works council is able to actually influence management. Further evidence on this is found in the report published in 2007 by the International Labor Organization (ILO) following the 15th Meeting of European Labor Court Judges where representatives from 13 different countries were asked to present the institutional framework regulating offshoring in their home countries. As we have seen, in Germany the works council does not have any specific right to participate in or co-determine the economic planning of the company. However, thanks to general participatory rights, and to the much more extensive rights covering social and human resource matters, the works council can influence the management decisions of relocating or outsourcing of the production of intermediate inputs previously produced in-house (ILO, 2007). Moreover, it has been noticed that establishment level agreements signed by the works council can easily exceed the domains ruled by codetermination laws (Addison, 2009); in practice trade unions are often in a position to stimulate works councils to provide the employer with alternative proposals also beyond the limits imposed by the WCA (Haipeter, 2013; Klepzig et Al., 2012).

## **5. Illustrative evidence on codetermination and its potential role in offshoring**

### **5.1 How frequently works councils deal with offshoring**

In this section, we provide some descriptive evidence on the involvement of works councils in matters concerning offshoring in Germany, based on two surveys conducted by the Institute of Economic and Social Research of the Hans-Böckler Foundation (*Wirtschafts- und Sozialwissenschaftliches Institut WSI*). Since 1998, the WSI conducts a national survey every two years investigating working conditions and business organization from the workforce perspective. The survey involves a representative sample of 2000 companies with a minimum of 20 employees from all industrial sectors and with different dimensions.

Data from the 2005 survey (*WSI Befragung von Betriebs- und Personalräten 2004/05*) shows that 50 percent of the interviewed works councils had experience of restructuring projects (*Umstrukturierung*). In more than 16 percent of the cases (n. 324) works councils declared to have discussed about the partial or total relocation of company operations. However, only half

of the works council declared that the relocation event effectively took place whereas the remaining half stated that relocation remained only a matter for debate.

First of all, the survey found considerable differences between former Eastern and Western regions. In former West Germany, relocation talks are held more frequently than in the former East and decisions are implemented more quickly. Since western companies are better established in economic and organizational terms, they might accomplish restructuring plans in a shorter time<sup>6</sup>. Second, one can notice a remarkable difference in both potential and actual relocation strategies across sectors (see Table 2a). Ahlers et al. (2007) suggest that labor intensive sectors are more likely to discuss and subsequently implement relocation strategies towards cost-competitive production regions or to get closer to their end market. Conversely, companies in the construction or transport sector may want to remain close to their location of origin rather than investing in long-distance relocation (see Table 2a). Third, the size of the company appears also to influence relocation. On the one hand, the share of bigger firms involved in offshoring strategies is larger. On the other, small businesses exhibit a higher propensity to transform relocation talks into actual relocation moves. This fact might have something to do with the lighter governance architecture of smaller enterprises and with the limited capacity of workers representatives to influence managers (see Table 2b).

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<sup>6</sup> It is important to notice here that companies in better economic conditions prefer relocation strategies than firms experiencing financial unease (Ahlers et al., 2007).

Table 2. Selected results of the WSI 2005 survey. Works Council responses, in % (n=sample)

Table 2(a)

|                                   | Relocation (n. 2007)  |       | Geography (n. 180) |        | Department (n.180) |     |       |
|-----------------------------------|-----------------------|-------|--------------------|--------|--------------------|-----|-------|
|                                   | Actual implementation | Talks | Germany            | Abroad | Production         | R&D | Sales |
| Raw materials/industrial goods    | 9                     | 19    | 47                 | 52     | 68                 | 1   | 3     |
| Investment and durable goods      | 23                    | 35    | 64                 | 36     | 49                 | 7   | 38    |
| Consumer goods                    | 14                    | 26    | 58                 | 42     | 68                 | 0   | 31    |
| Construction                      | 2                     | 8     | -                  | -      | 5                  | 26  | 8     |
| Trade (and repairs)               | 1                     | 6     | 87                 | 13     | 45                 | 12  | 41    |
| Transport and communications      | 14                    | 21    | -                  | -      | 31                 | 0   | 72    |
| Banking and insurance             | 22                    | 33    | 97                 | 3      | 12                 | 7   | 49    |
| Other private and public services | 1                     | 3     | 94                 | 6      | 8                  | 6   | 14    |
| Total                             | 9                     | 16    | 72                 | 28     | 53                 | 3   | 26    |

Table 2(b)

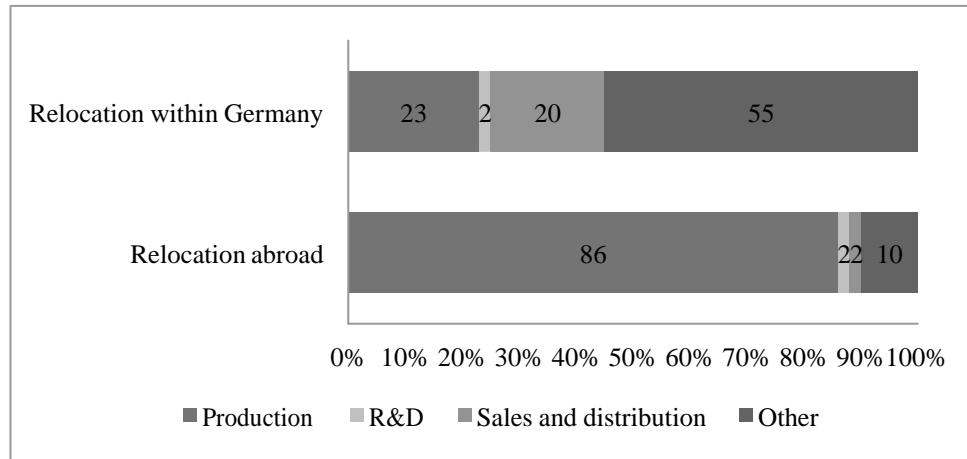
|                          |      |      |     |    |
|--------------------------|------|------|-----|----|
| 20-49 employees          | 10,7 | 11,2 | 92  | 8  |
| 50-99 employees          | 7,6  | 17,5 | 100 | 0  |
| 100-199 employees        | 16,7 | 6,5  | 44  | 56 |
| 200-499 employees        | 24,5 | 10   | 57  | 43 |
| 500-999 employees        | 13,3 | 27,1 | 67  | 33 |
| 1000-1999 employees      | 20   | 44   | 61  | 37 |
| More than 2000 employees | 22,2 | 44,4 | 93  | 7  |
| Total                    | 9,3  | 16,2 | 72  | 28 |

Source: WSI Works Council Survey, 2005 (authors' elaborations from Ahlers et al., 2007)

Another important fact that emerges from the 2005 survey is the geographic destination of the relocation endeavour. Only 28 percent of the relocating firms transferred operations abroad. However, there are remarkable differences across sectors. A large majority of companies in the trade, service and banking sector relocated operations within national borders whereas the largest fraction of companies in the manufacturing industry relocated abroad (Table 2a). Germany has much higher labor costs compared to Eastern European and Asian countries and labor-intensive industries are more likely to redirect investment towards low-wages regions. Consistent with this interpretation, the survey found that when it comes to the relocation of single operations or business functions, the large majority of production activities are moved

abroad whereas office functions, such as sale, distribution and logistics are mostly relocated within national boundaries (Ahlers et al., 2007) (Figure 3)<sup>7</sup>.

Figure: 3. Relocated company department, Works council responses, in %



Source: WSI Works Council Survey, 2005 (Ahlers et al., 2007)

In the survey conducted by the WSI in 2007 works councils were asked to distinguish between outsourcing (*Ausgliederung*) and relocation (*Standortverlagerung*). The former identifies the assignment of production activities to an external supplier whereas the latter the shut-down of a plant (or parts of it) and the subsequent relocation, either abroad or within national borders<sup>8</sup>. Similar to the 2005 survey, the research found that 16 percent of the interviewed works councils dealt with relocation, even though only in 23 percent of the cases the company actually relocated. Outsourcing played a slightly more significant role as 23.4 percent of the works councils discussed it but only in 17.7 percent of the cases the outsourcing project was actually implemented (Ziegler, 2008).

<sup>7</sup> Certainly this has to do with the limited role of codetermination and collective bargaining in the former Eastern regions as shown in Table 1 and in a much more detailed fashion in Ellguth and Kohaut (2011).

<sup>8</sup> The foreign component of relocation activities (*Standortverlagerung*) partially overlaps with the general definition of “offshoring” we adopted in this paper (see Footnote 1).

Table 3. Relocation and outsourcing according to branch and size. Works Council responses, in % (n = sample size)

|  | Relocation | Outsourcing |
|--|------------|-------------|
| Total (n. 2070)                                  | 7,7        | 11,5        |
| Service (n=159 rel.; n=495 out.)                 | 7,0        | 11,7        |
| Industry   | 8,8        | 11          |
| From 20 to 99 employees (n=159 rel.; n=495 out.) | 5,7        | 7,6         |
| From 100 to 499 employees                        | 8,3        | 13,2        |
| 500 and more                                     | 14,2       | 22,8        |
| Abroad (n=159 rel.; n=495 out.)                  | 19,9       | 5,6         |
| Germany  | 68,7       | 85          |
| Both destinations                                | 11,5       | 9,4         |

Source: WSI Works Council Survey, 2007 (authors' elaborations from Ziegler, 2008)

## 5.2 The actual involvement of the works council in the offshoring plan

In the 2007 survey, the objective of the investigation was not only to quantify the extent of the phenomenon but also to understand the degree of involvement of the works council with the definition of the strategy. More than half of the works councils (58 percent) found that relocation had positive implications for workers, while only one third of the works councils (36.2 percent) had the same opinion about outsourcing (Ziegler, 2008). In order to formulate sound counter-strategies, works councils had to be able to first distinguish between cases in which the intent of the manager is the actual reorganization of the firm from cases in which the threat of relocation may hide other objectives. As a matter of fact, the threat of job loss exerts enormous pressure on employees who are ready not only to deliver better working performances but also to renounce financial bonuses and to accept cuts in wages (Ziegler, 2008). However, data from the 2007 WSI survey shows that works councils achieved good results in influencing these strategies. Only two thirds of the relocation talks have been implemented and only half of them in the case of outsourcing. This indicates that the works council was able to impede relocation and outsourcing with different instruments and countermeasures, such as protest actions and strikes, negotiations and pressure from trade unions (Ziegler, 2007). The following figure illustrates the most used techniques to tackle undesired relocation strategies.

Figure 4. Activities of the works council vis-à-vis relocation and outsourcing strategies. Works Councils responses, in % (n=83 for relocation; n=485 for outsourcing)



Source: WSI Works Council Survey 2007 (Ziegler, 2008)

In 2006, the WSI conducted an additional edition of the survey, this time focusing on the intensity of the restructuring activity and the participation of the works council. The survey found that 60.1 percent of the works councils formulated alternative strategies to relocation and 51.4 percent to outsourcing (Behrens and Kädtler, 2008)<sup>9</sup>. Upon closer examination, it appears that 33.5 percent of the alternative proposals formulated on relocation were not taken into consideration whereas a vast majority of proposals were at least partially considered (55.3 percent were partially considered and 11.2 percent were kept in high consideration). The picture is even more clear-cut in the case of outsourcing. Only 20.1 percent of works council proposals were not considered at all, 80 percent received partial consideration and 19 percent were kept in high consideration (Behrens and Kädtler, 2008). See Table 4 for a summary of the most important findings on the consideration given to works councils proposals.

Table 4. How frequently suggestions of the works council are taken into consideration. Works Council responses, in % (n=sample size)

|                     | Not considered | Partially considered | Widely considered |
|---------------------|----------------|----------------------|-------------------|
| Outsourcing (n=358) | 20,1%          | 60,3%                | 19,6%             |
| Offshoring (n=293)  | 33,5%          | 55,3%                | 11,2%             |

Source: Authors' elaborations on data from Behrens and Kädtler, 2008

<sup>9</sup> In this survey, outsourcing is defined as *vergeben von Aufgaben nach außen*, literally: assignment of tasks outside.



It thus appears that outsourcing and offshoring represent important issues to be dealt with in codetermination practices, and the opinions and suggestions expressed by the work councils are actually influential in the decision making process concerning these topics. Furthermore, negotiations between works councils and management have seen both parties making concessions and requests. The works councils obtained concessions in terms of compensation payments, financial bonuses, skill upgrading and in the general commitment of employment stability. On the other side, the works councils accepted managers' requests to introduce changes in the organization of activities in the home establishment, including longer working times and working weekends (Behrens and Kädtler, 2008). Behrens and Kädtler (2008) observed that, in general, the degree of participation of the works council is not only regulated by law but it is the expression of the peculiar participation practices at the firm level, where the management may consider it appropriate to involve the works council beyond the rights established by the WCA. In some cases, the works council may receive information and participation opportunities in subject areas not included in the WCA, in return for future concessions in other areas (Behrens and Kädtler, 2008). Rehder (2005) argues that the involvement of the works council in bilateral concessions with the employer is not the direct consequence of the increasing internationalization of German companies but the result of the so called "business alliance" established since the Nineties in the German system of industrial relations. In times of unstable economic conditions, both works council and management are willing to accept and grant concessions to each other, in order to restore competitiveness and stabilize employment levels. If on the one hand, employees are ready to accept flexible working conditions and cuts in wages, on the other, the employer commits him/herself to refrain from layoffs for business reasons and to guarantee investments for the continuation of the activity (Rehder, 2005)<sup>10</sup>. Kwon (2012) argues that in the German automotive industry, employees, works councils and trade unions have been able to establish a compromise in the planning of globalization strategies, based on the combination of cross-border production with an overall upgrading of the domestic manufacture. The German automotive industry is a specific case in which codetermination practices seem to have a high degree of relevance. This is certainly the case of Volkswagen, whose works council is highly involved in the

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<sup>10</sup> In the industrial relation literature in Germany, the term "co-management" was coined to indicate the capacity of the works council to think first in terms of good for the company and consequently of employees (Rehder, 2005). The term has been subject of a long debate until it assumed negative connotations as the works council was found to be more involved in the downsizing of the workforce rather than influencing the organization of work for the good of employees (Haipeter, 2013).

yearly “planning” of investment decisions (Jürgens, 2002). Thanks to the high involvement of the works council, the company has limited outsourcing practices and has rather developed a policy of internal capabilities improvement based on an overall upgrading of home R&D potential. However, as Jürgens (2002) has pointed out, the distinctive characteristics of the company’s corporate governance, characterized by long-term oriented capital with the participation of the regional government, the low pressure exerted by shareholder investors and the long established tradition of the codetermination system, made Volkswagen a peculiar case.

Further scattered evidence shows that the works council devotes a lot of attention to the development of alternative strategies to counter offshoring decisions. A good example is offered by the campaign “Better not cheaper” of the union IG Metall. The campaign aimed to revamp the role of unions and works councils in developing and negotiating alternative business strategies, also beyond the constraints imposed by the WCA (Haipeter, 2013). The IG Metall’s campaign is just one example of the efforts made in support of workers representatives. As mentioned above (see Section 2), Kleipzig et al. (2012), developed specific models to help works councils in the design of alternative strategies to influence (or in the best case prevent) offshoring. Kleipzig et al.’s models are conceived as well-organized sets of arguments and communication techniques that can be deployed by the works council during the negotiation round. If managers are interested in increasing competitiveness by reducing labor costs and do not fully consider pros and cons of the relocation, the task of the works council is to inform managers about possible negative consequences of the relocation abroad.

This is particularly true, the authors write, for managers of small and medium size firms that often overvalue the benefits of relocating operations to low wages countries. A wrong offshoring investment might also drive the company bankrupt if the firm does not have sufficient financial means to repatriate activities. As Kleipzig et al. (2012) argue, this is consistent with the growing evidence of German firms returning home after offshoring<sup>11</sup>. Kleipzig et al. also developed three different information scenarios that turned out to be

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<sup>11</sup> Kinkel and Maloca (2012) analyzed the Modernization and Production survey 2009 of the Fraunhofer-Institut für System und Innovationsforschung (ISI) and found that in Germany relocation is at the lowest level since 15 year. Between 2007 and 2009, only 7 percent of German companies have relocated abroad and during the current economic crisis many companies decided to backshore production to Germany. To every third offshoring action one backshoring has followed (Kinkel and Maloca, 2012).

particularly useful in the realization of our case studies. These three scenarios lay the foundation of Kleipzig et al.' negotiation strategy: 1) late notification, which can potentially generate conflicts between managers and works councils; 2) last minute communication, which leaves little time for the works council to formulate alternative strategies; 3) timely communication, which leaves the works council the necessary time to prepare sound alternative proposals and to receive support from external consulting agencies. In fact, this study helps identify some key issues that have emerged also from other works on codetermination in Germany, but have never been fully explored in the case of offshoring and of relocation practices in particular. We will illustrate case studies that will focus and shed more light on these themes.

## **6. An Empirical Study on Codetermination and its effect on Offshoring**

### **6.1 Models of offshoring and research questions**

As shown, extant literature has investigated the degree of involvement of works councils in the definition of offshoring strategies (Behrens and Kädtler, 2008; Haipeter 2013) and has paid some attention to the counter proposals and alternative strategies used by the works council in the negotiation process (Ziegler, 2007; Behrens and Kädtler, 2008; Klepzig et al., 2012). However, there is no explicit evidence on the mechanisms through which works councils actually impact on offshoring governance and how they can shape its effects on the home economy.

Our case studies aimed at highlighting the role of three aspects of codetermination that, as shown in previous chapters, appear to play a potentially key role in effecting offshoring decisions. First, we shall consider the role of timing in supplying information to works councils on strategic decisions. As illustrated earlier, the very possibility of works councils to influence decision making strongly depends on how timely the right to be informed about investment plans is exerted. Second, we will highlight how and to what extent compensation mechanisms have been negotiated to counter the actual or potential negative effects of offshoring decisions. To some extent, efforts to obtain compensation mechanisms can be expected to take place even in the absence of adequate notice by management to the works council. However, as we shall see, the timing of information disclosure on offshoring decisions plays an important role in the actual design and implementation of such

compensation mechanisms. Third, we will examine case study evidence on the role played by works councils in providing suggestions on how offshoring strategies should be prevented or designed in a way that creates less (or no) damages to the workforce in the home country. This role can be played by works councils only in the presence of timely and appropriate information on the management intention to offshore its activities. However, case studies can highlight other factors facilitating works councils in carrying out this more pro-active role. It is important to stress that different combinations of these roles of works councils (receivers of timely information, stimulators of compensation mechanisms, and promoters of alternative strategies) are likely to determine a different impact of codetermination on offshoring decisions. The more works councils cover the second and third roles, the more they can be expected to influence the rate and direction of offshoring strategies.

Figure 5. Roles played by works councils in dealing with offshoring strategies

|                | <b>Role 1</b><br>Receiving<br>Information | <b>Role 2</b><br>Negotiating<br>Compensation<br>Mechanisms                                  | <b>Role 3</b><br>Promoting<br>Alternative<br>Proposals | Effects on<br>Offshoring<br>Decisions |
|----------------|---|---|--|---------------------------------------|
| <b>Model 1</b> | No timely info                            | Compensation<br>mechanisms<br>(financial)   | No alternative<br>proposals                            | Weak or None                          |
| <b>Model 2</b> | Timely info                               | Compensation<br>mechanisms<br>(financial and<br>contract extension)                         | Not considered   | Moderate                              |
| <b>Model 3</b> | Timely info                               | Compensation<br>mechanisms<br>(financial; contract<br>extension; re-<br>skilling, transfer) | Taken into<br>consideration                            | Strong                                |

We conducted interviews (approx. 30 min.) with works council members in three German companies belonging to the investment goods sector, more precisely the metal-mechanics and electro-technical industry. The choice to analyze companies in this sector was dictated by two main reasons. First, the investment goods sector is one of top industries in terms of works councils coverage (see Table 1 above). According to data reported in Table 1, other sectors such as the financial and banking industry also have large codetermination coverage. However, and here we come to the second selection criterion, according to data from the 2005 WSI survey international relocation mostly affects the production department of the manufacturing sectors whereas the relocation of other non-productive business functions appears to happen mostly within national borders (Figure 3). As noted earlier, this factor might be influenced by the difference in collective bargaining and codetermination coverage between former Eastern and Western *Länder* but also certainly by language barriers that firms would encounter in relocating sensitive business functions (call-centers, bookkeeping) to a non-German speaking country.

The selection of the case studies has been made with the support of a union member at the headquarters of the German union IG Metall in Frankfurt am Main<sup>12</sup>. IG Metall is the historic German trade union that represents workers primarily in the manufacturing industry. We asked our counterpart about the possibility to get in contact with a reasonable number of heads of works councils who had experience during his\her mandate of relocation abroad of the company or of some single company's unit, whom we could contact for interviews according to the research lines illustrated earlier. We provided our counterparts with a short description of our research project and with our models of offshoring typologies in order to have a more selected range of case studies of the different combinations of works council roles that we envisaged (Figure 5). We also decided to analyze medium-sized companies as it is comparatively easier to detect changes in the business structure and organization. Based on these criteria, we singled out three cases, which can be considered as a good basis for a qualitative analysis of the roles played by works councils in the development of offshoring strategies.

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<sup>12</sup> After we managed to establish a first contact with one union member from the DGB headquarter in Berlin, we were re-directed to the department "Work and Innovation" at the IG Metall headquarter in Frankfurt.

All interviews were conducted between July and August 2013 with heads of works councils, face-to-face meetings were organized around a set of five open-ended questions aiming at highlighting the key issues illustrated above. First of all, we asked when the works council received the relevant information about the offshoring investment. Second, we inquired whether the works council decided to collaborate or to oppose the decision. Third, we tried to explore more in depth the participation of the works council in the governance of offshoring by asking whether any alternative or counter proposal was elaborated by the works council and which proposals, if any, have been taken into account by the management. Furthermore, we were interested to know whether a financial and/or non-monetary plan was established to compensate dismissed employees e.g. in terms of skill upgrading or general upgrading of activities at the plant or company level. Fourth, we tried to investigate whether the negotiation process involved only the works council or whether the case escalated to the supervisory board. If this was the case, an additional area to be explored was the role played by employees' representatives at board level<sup>13</sup>. Fifth and finally, we asked about the final result of the offshoring negotiation, and whether changes were introduced in the way the company is organized at home, as a consequence of offshoring decisions.

## **6.2 Three case studies on codetermination and offshoring**

The three companies we analyzed come from the Stuttgart area, in the region of Baden-Württemberg in Southwest Germany. All three companies have relocated part of their production in the previous years. The interviewees asked not to disclose the identity of their employing company. For this, we shall only briefly describe the nature of the business in which they are involved without revealing information that might raise confidentiality issues. Figure 6 offers illustrative evidence on the characteristics of each of these companies while at the same time protecting their anonymity.

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<sup>13</sup> According to a survey conducted among board level workers representatives, conflict arisen during supervisory board meetings concern for 41 percent the closure of establishment and for 23,1 percent the relocation of activities abroad (BöcklerImpuls 14/2006).

Figure 6. General information on the three case studies

|               | <b>Foundation</b> | <b>Corporate Governance</b>  | <b>Prior international experience</b>   | <b>N. of employees and sales</b>                       |
|---------------|-------------------|--|---|--|
| <b>Case A</b> | 1926              | Family owned business  | Production sites in France Germany and China; subsidiaries in Sweden, Switzerland, China, Spain and Austria   | 650 employees worldwide<br>100 Mil. ! (50% exp. share) |
| <b>Case B</b> | 1904              | Family owned business  | Subsidiaries in Italy and Hong Kong   | 520 employees worldwide<br>36 Mil. ! (80% exp. share)  |
| <b>Case C</b> | 1905              | In 2010 36,85 percent of company's shares acquired by a competitor | 38 production sites and three R&D centers in Europe, USA, Asia and South-America; in Europe production sites in France, Spain, Germany, Czeck Republic and Slovakia | 15000 employees worldwide<br>3.3 Bil. ! (in 2008)      |

Source: Company websites and Annual Reports

The first case study concerns the automotive division of a company producing communication devices for cable networks, satellite receiver systems and communication systems for mobile radio communication and mobile reception. The specialized automotive division develops and manufactures antennas and electronic devices for the automotive industry. The company was founded in 1926 and since then has remained under the direct control of the founding family. The firm began to establish its international position in 1976, when it founded its first subsidiary in Switzerland. Nowadays the company has established manufacturing sites and distributors in Europe, Africa and China, with a total of 650 employees, with an export share of over 50 percent and a total worldwide turnover of 100 million Euros. This company has been involved in the process of relocation of car antenna production to Poland. We interviewed the head of the works council. We shall refer to this as case A.

The second case study concerns a company supplying a variety of high precision metal components produced with innovative self-made moulding machines, with a clientele ranging from renowned companies in the automotive industry, medical technology and telecommunications sector. The company is specialized in the manufacturing of high precision metal parts used in the assembly of spectacle frames such as springs, hinges and screws. The firm was founded in 1904 and has remained under the complete control of the founding family. In its long history, the company has registered more than 150 patents worldwide. This high number of patents is justified by the strong investment in research and

development which amounts to a quarter of annual turnover. In 2011, the company registered 36 million Euros in sales, 80 percent of which was generated via export to the international market. In 2004, the company acquired a majority stake in a joint venture in China with about 300 employees and relocated the manufacture and assembly of spectacle hinges to China. The company had previously established international production sites and subsidiaries in Italy and Hong Kong. We shall refer to this as case study B.

The third case concerns one of the world's leading manufacturers and suppliers of air conditioning and engine cooling systems for the international automotive industry. The company was founded in 1905 and became an international supplier in 1969 when it established subsidiaries in the US and France, following the international organization of the major French and American car producers. In 2008, the company registered 3,3 billion Euros in sales with an international network of facilities employing 15000 workers in 17 development plants, 28 production and 12 joint ventures in 38 countries on four continents. In Europe, the company has plants in Germany, France and Spain as well as in Eastern European countries such as Slovakia and Czech Republic. We interviewed the head of the works council of the German establishments, who is also the head of the European works council. We shall refer to this as case study C.

Our interviews were important in shedding light on the three key roles of works councils synthesized in Figure 5, namely works councils as pure information receivers (Role 1), works councils stimulating the adoption of compensation mechanisms (Role 2) and works councils promoting alternative strategies (Role 3).

#### *Role 1: Works council as pure information receiver*

The case studies exhibit significant differences in the timeliness of information delivery. In Case A, the works council received very short notice on offshoring decisions. Communication of the dismissal of 45 workers employed in the production of auto antennas occurred on Thursday 12 of March 2008. According to manager's communication, the dismantling of the production was planned to be completed by the end of the month. However, the first production line was removed the following weekend. Employees affected by this decision were unemployed on the following Monday. The works council expressed immediate disapproval of the timeliness of this decision and tried to impede the transfer of the machinery by appealing to the labor court. Management had not informed the works council about the



relocation plan in “due time” as prescribed by law, thus had violated the regulation on the information and participation rights. However, due to lack of time and the unexpected celerity in the removal of the production line it was not possible to proceed with any legal action. During the weekend, employees tried unsuccessfully to stop the transfer of machineries by protesting directly in front of the factory gates.

While case B could not be examined in this regard, as offshoring practices took place in 2004 and our interviewees had no memory of how timely information was, case C offers useful evidence on a very different attitude of the company management where necessary information was provided in time. In case C, the German works council received information about the restructuring plan of plants located in the Stuttgart area in April 2013. Restructuring plans concerned an overall re-organization of the production activity in the Stuttgart area in a time frame up to 2016. This re-organization included the reduction from three to two establishments and the dismissal of 374 workers. Alleged reasons were the poor performance of one of the three plants together with the very high local labor cost. The works council was already aware of the restructuring plan because other establishments in Bavaria, Spain and France had undergone the same process. The restructuring plan involving the Stuttgart region is part of a broader process started two years earlier involving the gradual reduction of production in the Western European establishments and the consequent expansion of the activities in Eastern Europe. Production can be moved easily from one location to the other because all the plants manufacture the same product with the only difference being that Western establishments produce components for the higher segment of the auto industry and the Eastern establishment for the medium and lower segment. When the company receives new commissions, managers try to shift production toward Eastern European establishments unless workers in the German, Spanish and French plants are willing to accept reductions in wages and in the general working conditions. When the interview was conducted (August 2013) it was not possible to discern whether this process of international re-organization had any connection with the take-over of the company. In 2010, a major international competitor from Germany acquired over 36 percent of the company shares and demonstrated a strong interest in acquiring the majority.

## *Role 2: Works council negotiate compensation mechanism*

Although case A is characterized by too short notice to develop an effective counteraction, the works council was able to negotiate a social compensation plan for laid-off employees, including a short extension of the termination date of the contract and a monetary compensation. However, compensation mechanisms were quite weak, reflecting the low commitment of the company to codetermination practices. The relocation of the auto antennas production involved the dismissal of 45 employees, 23 of which had short term contracts and 22 had permanent contracts. For temporary workers and for workers employed by external working agencies, the works council could not obtain any sort of compensation. To our question whether other forms of compensation were designed, for instance in terms of re-skilling measures, we received a negative answer. The works council tried to request the transfer of the dismissed employees to another position within the same company, but there were no free available positions matching their technical skills. As our interviewee pointed out, it was not possible to reach an agreement on anything more than compensation for full-time workers. Indeed, frictions between managers and the works council hampered the negotiation round.

In case C, compensation mechanisms were designed by the company and the works council in a more collaborative and constructive way. At the time, the works council did not try to limit the construction of new plants in Eastern Europe because the workforce was benefiting from this growth in terms of job stability, and did not envisage any negative effects for the working conditions in the home establishments. Negotiations on working conditions appear to proceed hand in hand with a more general codetermination process wherein both managers and workers appear to obtain some benefits. While top management takes advantage of lower conflicts with labor force, workers obtain guarantees that qualified tasks will remain in the home country. However, since the offshoring event to Eastern Europe, employees in the German plants diminished as part of the process of optimization of the production. Workers received skill upgrading measures and improved their ability to solve mechanical and other technical problems associated with the manufacturing process. According to the works council, if on the one hand such up-skilling measures imply higher wages for more qualified workers, on the other hand these qualification measures pave the way for the reduction of personnel.

### *Role 3: Works council promoting alternative strategies*

In case A, the works council tried to put forward alternative proposals to optimize production costs at home. After the company experienced a strong decline in sales due to the loss of an important order from a top automobile manufacturer, management decided to relocate part of the auto antenna production to Poland in order to reduce costs and increase competitiveness. However, the works council argued that it was possible to keep home production competitive simply by optimizing production time. In addition, employees were ready to renounce production bonuses and other monetary benefits. Despite the negotiation attempt, management did not give serious consideration to the alternative plan. After the company relocated the auto antenna production line to Poland, the new establishment became an independent supplier. The remainder of cable and antenna components production then moved to Tunisia in an attempt to further reduce production costs. According to our interviewee, auto producers exert enormous pressure on component suppliers to cut production costs: only the research and development department for auto antennas remains in Germany today whereas production activities have been relocated to lower cost countries<sup>14</sup>. Our interviewee added that the relocation of production to Poland was followed by the reduction of staff at the twin company, active in manufacturing satellite and cable telecommunications technologies, despite the excellent financial results obtained in the previous business year. This reflects the strategy to substitute manual work with automated processes. The overall result was that the works council had very limited capacity to influence the nature and direction of offshoring strategies.

As for case B, we have mentioned earlier that offshoring practices towards the Chinese partners took place in 2004 and that the works council maintained a very limited amount of information on this event. We must admit that this lack of information poses a severe limitation to our knowledge of the offshoring governance processes. Nevertheless, the fact that there is limited memory of how these strategies were organized is a partial result by itself. It appears that the works council was actually unable to follow the procedures and codify knowledge about this experience in spite of its importance for employment and production activities at home. Furthermore, we were able to deduce two additional insights. First, the company maintained the research and development department at home which emphasizes the

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<sup>14</sup> Since the company has a one-tier board, we omitted the fourth question.

fact that the firm was mainly interested in reducing production costs. Second, the interviewee confirmed that the works council does not have access to information on the activities in the Chinese establishment. This emphasizes the limited scope of codetermination when it comes to offshoring beyond the European horizons.

Given the shortcomings in case B, the greater (potential) impact of works councils on offshoring strategies is once again revealed by case C. The works council requested the support of an external consulting institute and, together with the union IG Metall, decided to hold the position that all three plants in the region should remain operative. At the time of the interview the parties had not defined a framework for negotiation. The works council was ready to cooperate only in the case that management would present a plan including continuation of the activity in the three establishments. With the support of the external institute, the works council prepared a set of alternative suggestions to ensure continuity of activity in the region. First, it suggested that new technologies under development in Stuttgart would remain in the home establishment. Second, it proposed that the outperforming plant would be converted from a factory of series production to a factory for the production of replacement parts. Third, it argued that specific activities such as moulding and injection of plastic materials where the establishments show considerable competitive advantage would be increased. Although it is not possible to say which of the alternative proposals will be actually taken into account, first signs give the works council the impression that management is willing to consider these proposals with all due attention. When the interview was conducted, it appeared likely that a job security agreement (*Standortsicherungsvertrag*) would soon be signed, ensuring employment in the three plants until at least 2015. Nevertheless, one could not exclude that this decision was taken just to avoid frictions in view of the imminent take-over of the company. The table below summarizes the main results of the three case studies.

Figure 7. Summary of the results of the interviews with the works council

|  | <b>Case A</b>  | <b>Case B</b>                            | <b>Case C</b>   |
|--|--|--|---|
| <b>Manufacturing activity involved</b> | antennas and electronic devices for the automotive industry        | high precision components for spectacles | air conditioning and engine cooling systems for cars and trucks   |
| <b>Reason for offshoring</b>           | high labor cost at home (strong pressure exerted by car producers) | high labor cost at home                  | initially serving the local market; then labor cost saving  |
| <b>Delivery of information</b>         | Two weeks in advance   | Not recorded                             | six months in advance (already available from other European establishments)  |
| <b>Compensation mechanisms</b>         | social compensation plan and extension of the termination date     | Not recorded                             | Under discussion ( <i>Standortsicherungsvertrag</i> until 2015)   |
| <b>Counter proposals</b>               | renounce production bonuses and reduce breaks                      | Not recorded                             | renounce production bonuses, reduce breaks, improve injection and moulding performance, production of replacement parts |

## 7. Conclusion

The discussion above highlighted that codetermination might play a role in shaping the international organization of firms. While we found no evidence of works councils impeding offshoring decisions, there are elements to suggest that they may affect rate and direction of such decisions with particular attention to the relocation of those activities that endanger employment conditions in national establishments.

Our case studies showed how differences in the timeliness of information delivered to works councils gives rise to different negotiation possibilities. One of the cases examined is characterized by a considerable involvement of the works council, not only as a mere information receiver, but also as a contributor to the design of compensation mechanisms, and more importantly, as a promoter of alternative strategies. From this perspective, case C appears to be the closest to Model 3 illustrated in Figure 5. The other cases could be considered as a mix of Models 1 and 2. Case A is characterised by a lack of timely

information disclosure and by the fact that the works council was not able to design alternative proposals. Case B can hardly be used to draw any clear-cut implications, given the severe limitation of data available. At best, it might be taken as an illustrative case of the problem of information codification and storage: works councils might in fact be unable to keep track of internationalisation processes over time and hence have a limited capacity to intervene with appropriate and well informed negotiation practices. Hence, while in case C the works council seems to significantly influence the nature and direction of offshoring strategies, in the other two cases, works councils appear to have a rather limited impact on the offshoring investment.

These differences in outcomes are partially endogenous to the models we identified: the involvement of works councils in extensive and comprehensive information flows can favor further involvement in effective negotiations. Other factors favoring the actual participation of works councils in offshoring may have to do with the historical commitment of the firm in codetermination practices and with the actual skill composition of the works council itself. The role of codetermination practices in shaping offshoring decisions and their consequences also reflects the evolution of firms, their overall strategies and competitive position. Once again, case C is illustrative from this point of view. In this case, the actual outcomes of negotiations are most likely to be influenced by the process of corporate restructuring and by the eventual take-over of the company.

Interviews provided only limited evidence on the factors we mentioned, i.e. the propensity of firms to get involved in codetermination practices, their overall strategic evolution and competitive position, and the skill level of works council's members. Future research will definitely have to pay great attention to these aspects.

Extensions of the analysis are certainly needed also in other directions. The availability of detailed longitudinal datasets makes it possible to carry out quantitative analyses on codetermination and offshoring. From this perspective, specialised datasets from the annual survey of the German Federal Office for Employment (IAB Establishment Panel) would be a perfect source. It remains that fully understanding the mechanisms through which labor market institutions in general, and codetermination in particular, affect offshoring will require a careful combination of both quantitative and qualitative analyses.

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Imprint

Editors:

Sigrid Betzelt

Trevor Evans

Eckhard Hein

Hansjörg Herr

Martin Kronauer

Birgit Mahnkopf

Achim Truger

Markus Wissen

ISSN 1869-6406

Printed by

HWR Berlin

Berlin September 2014