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BOARD-LEVEL WORKER REPRESENTATION

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Abstract

This chapter reviews the literature on board-level worker representation (BLWR). BLWR refers to workers' legally sanctioned rights to take part in the decisions of their employers' board of directors as full or consultative members, regardless of their underlying equity investments. It provides information about the incidence of BLWR across countries, and the factors that likely contributed to the establishment of this mechanism of employee voice. It reviews theory on the positive and negative impacts of BLWR for workers and firms, summarizes the related empirical evidence, and concludes by pointing to the open gaps as avenues for future research.

JEL Classification: J53; J54

Keywords: board-level worker representation; theoretical and empirical review; cross-country evidence; firm performance; boardroom;

1. Introduction

This chapter overviews the literature on board-level worker representation (BLWR). BLWR refers to workers' legally sanctioned rights to take part in the decisions of their employers' board of directors (supervisory board) as full or consultative members, regardless of their underlying equity investments (Jackson, 2005; for other forms of worker ownership and control, see for example Ben-Ner and Jones, 1995). Companies with worker directors represent a departure from the conventional notion of the corporation, where shareholders (or their representatives) hold exclusive residual control rights (FitzRoy and Kraft, 2005; Putterman, 1982; Ben-Ner and Jones, 1995). This departure has generated quite some interest and divergent views among academics, policy makers and employers, and has recently motivated debates about the introduction of BLWR in Australia, the UK, Canada, and the United States. For example, the U.S. Senator Elizabeth Warren, in 2018, proposed a federal bill that would give the employees of large U.S. firms the right to elect representatives to the boardroom.

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Similarly, during her campaigning for the 2016 Conservative Party leadership election, Theresa May contemplated providing British workers with such an option in order to improve firm governance (for more on the developments in these countries, and Canada and Australia, see Jäger, Noy and Schoefer, 2021a). This renewed interest has been motivated by contemporary world challenges, such as the Great Recession (CEEMET, 2012; Gregorič and Rapp, 2019), concerns about management accountability and corporate governance, and the need to strengthen firm accountability towards employees and other stakeholders during the COVID-19 pandemic, among others (<https://corpgov.law.harvard.edu/2020/06/08/stakeholder-capitalism-and-the-pandemic-recovery/>).

Today, the majority of countries within the European Union (and Norway) already grant the employees of firms of a specific size or type some form of legal right to elect representatives onto the board of directors. In jurisdictions where this is the case, worker directors generally carry the same rights and the same duties as the shareholder-elected board members (shareholder directors). That is, the worker directors are formally required to act in accordance with the interests of the corporation (and shareholders), rather than solely advancing the workers' preferences at the cost of other constituencies (Thomsen, Rose and Kronborg, 2016). In reality, however, worker-elected members probably also promote the workers' interests, and constitute a mechanism that protects firm employees against the opportunistic behavior of the firm managers and other constituencies. Worker-elected directors have diverse knowledge and experiences compared to the shareholder-elected board members, and might perceive strategic issues differently (Adams, Licht and Sagiv, 2011). BLWR, moreover, provides a channel through which firm-specific information is transferred to the board. All this makes it more likely that, in BLWR firms, the workers' concerns are more strongly incorporated in strategic decisions, than is observed in non-BLWR firms (FitzRoy and Kraft, 2005; Aoki, 1984; Fauver and Fuerst, 2006). BLWR could thus be considered a type of organizational (governance) practice, which ensures that workers are, together with the shareholders, explicitly or implicitly recognized as a constituency of the firm, and that their interests are included in the formation of firm policies. Compared to labor unions and other forms of worker participation, BLWR likely constitutes a comparatively stronger and more direct channel of workers' influence over firms' strategies. BLWR also provides rights that are broader than, and somewhat complementary to, those provided by work councils. The latter generally have a more specific focus in terms of, for example, employment conditions, working hours and workplace safety (Gorton and Schmid, 2004; Lin, Schmid and Xuan, 2018; Paster, 2012; Jirjahn and Smith, 2018).

Theoretically, scholars have pointed to both positive and negative economic consequences of workers' participation in board decision making. This has resulted in a number of studies that analyze the differences in the behavior of firms with and without BLWR (see Section 4). Although these studies are fewer in number than, for example, those in the academic literature on work councils and labor unions (FitzRoy and Kraft, 2005), they offer valuable insights on the functioning and economic

implications of this form of employee voice, as well as inspiring a number of interesting avenues for future research.

The aim of this chapter is to outline the main findings within the literature on BLWR (without the ambition to offer an exhaustive review of the literature), and to identify some remaining gaps as topics for further research. It starts with an overview of the incidence of BLWR across the developed countries, and the reasons that might explain the cross-country differences in the regulation and incidence of BLWR. Section 3 overviews the theoretical literature on the economic consequences of BLWR. The key insights of the related empirical findings are presented in Section 4. Here, there are separate discussions of the literature related to the German model of BLWR (4.1), which has been researched most often in the literature, and the evidence from other countries (4.2). Section 5 concludes.

2. Cross-national differences in the incidence and characteristics of BLWR

2.1 BLWR in Europe

A large number of European countries (18 plus Norway) legally provide workers with some form of voice in corporate affairs, by giving them the right to elect some of the members of the board of directors. Germany was the first to legislate workers' rights to participate in supervisory boards, during the 1950s. Other countries followed by legislating these rights during the 1970s and (in the case of new EU states) the 1990s. Specifically, among the 27 (post-Brexit) EU countries and Norway, six countries today provide workers with the right to elect some members of the boards of state-owned firms, and 13 provide for some form of employee board representation in both public and private corporations (Austria, Croatia, Denmark, Finland, France, Germany, Hungary, Luxembourg, the Netherlands, Norway, Slovakia, Slovenia and Sweden). Nine countries provide no opportunities for employee board representation (Belgium, Bulgaria, Cyprus, Estonia, Italy, Latvia, Lithuania, Malta and Romania; <https://www.worker-participation.eu/National-Industrial-Relations/Across-Europe/Board-level-Representation>). At the OECD level, 20 countries grant employees the right to elect members to the boards of public-sector and/or private-sector firms, while 15 countries provide no rights with regards to BLWR in public-sector or private-sector firms (data refer to September 2016; OECD, 2017).

BLWR rules in the countries that have adopted BLWR legislation vary in several aspects. In terms of the scope of the legislation, some countries limit BLWR rights to state-owned corporations, while other countries extend these rights to include private corporations as well. Regulation also differs in terms of the size of the firms to which BLWR applies. In Germany, for example, the right to elect worker directors applies to all corporations with at least 500 employees, while in Scandinavian countries this threshold is much lower, i.e., 25-50 employees. Countries also vary in terms of the strength of the legislation. While, in Germany and a few other countries, all the companies that are

subject to BLWR legislation need to have worker directors on their boards, the employees of Scandinavian firms beyond the specified size have the opportunity but not the obligation to elect their representatives to the board. The countries' legislation moreover diverges in terms of the proportion of worker directors on boards. In most countries, the worker-elected members hold a minority (most often one third) of the board seats. In none of the countries are they granted the majority of votes on the board. The closest to the latter case is the German quasi-parity BLWR model, where workers in corporations with more than 2,000 domestic employees elect half of the board members (although the shareholder-elected chairperson holds the decisive vote in the case of a deadlock) (Conchon, 2011; Fauver and Fuerst, 2006). Countries also vary in terms of the appointment process and the characteristics of those elected to the board. In Germany, labor unions in the large firms elect some of the worker directors from among their members, who are external to the firms on whose boards they sit. In Scandinavian countries, only those that are employed by the firm or associated business groups can be elected to the board (Hansen, 2003). In the Netherlands, employee directors cannot be elected from among those employed by the firm, nor from union representatives, and are thus often politicians or academics. Finally, the countries' legislation also differs in terms of the strength of the rights extended to worker directors (codetermination, consultation, information) and the type of board structure in which employees can exercise their rights, i.e., single-tier or dual-tier boards (Conchon, 2011; Jackson, 2005).

2.2 What explains the introduction of BLWR at the country level?

Despite the fact that a number of European countries formally provide for some form of employee representation on the board of directors, BLWR remains widely debated and contested, with some of the key actors in countries without such regulation strongly opposing the possibility of introducing it (Gold and Waddington, 2019). Across and within the singular countries with and without BLWR, opposing views about the utility of such representation for firms' performance are also exhibited (Conchon, 2011; Paster, 2012). Why is it, therefore, that some countries have BLWR and others do not?

Paster (2012), for example, relies on the Varieties of Capitalism framework (Hall and Soskice, 2001) to argue that the institutions of worker representation, such as BLWR, are more likely to emerge within the so-called cooperative market economies, where various actors rely more heavily on non-market forms of interaction as a way to manage their relationships. Others have pointed to the relevance of cooperative industrial relations for both the institutionalization and functioning of the BLWR mechanism (Jones et al., 2017; Jäger et al., 2021a). Jackson (2005) draws on a qualitative comparative (fuzzy set) analysis approach to search for explanations for the establishment of BLWR legislation in OECD countries. He anticipates that countries with weaker minority investor protection and lower firm reliance on capital markets for financing are more likely to introduce BLWR.

Moreover, greater union strength and coordinated collective bargaining, as well as stronger left-wing political parties, consensus-oriented political systems, and a civil law tradition, are more likely to result in the introduction of BLWR at the country level. After inspecting the cross-country differences in these country characteristics, he identifies two main configurations that have led to the establishment of BLWR rights. Both configurations feature coordinated collective bargaining, some minimum level of ownership concentration and a consensus-oriented political system. The configuration that reflects the Scandinavian model additionally displays strong union density and greater power for center-left forms of government. In Scandinavia, the BLWR legislation presumably emerged more as an agreement between the providers of capital and labor, guided by the aim to strengthen the firm and improve its productivity and efficiency, while at the same time contributing to employment, safety and good working conditions (Edström, 2002; see also Thomsen et al., 2016). The other configuration, which Jackson (2005) labels as the ‘conservative path’ and is characteristic of the Netherlands, Germany and Austria, features weaker unions and left-wing political parties, but also weaker shareholder rights. In Germany, for example, the German Christian Democratic government introduced BLWR legislation more as a political compromise between competing concepts (Paster, 2012) and to ensure legitimacy for the emerging concentration of corporate power (Jackson, 2005). The different paths towards BLWR have likely affected the design of BLWR rights and the attitudes of the various actors within specific countries (employee and employer-related constituencies) towards the worker directors.

3. BLWR and firm outcomes: Theory

3.1 Arguments against BLWR

The literature offers some arguments both in support of and against BLWR. On the *negative* side, scholars underline that—when legally imposed—BLWR ultimately limits the owners’ possibility of creating a governance (organizational) structure that is the optimal solution to the contracting problems inside the firm. Corroborating this point, Jensen and Meckling (1979) point to the scarcity of voluntary initiatives to form participatory types of organizations (such as BLWR) in the contexts where this is formally possible. This scarcity indicates that firms with BLWR and similar participatory organizational forms are likely less efficient than capitalist firms, and that the anticipated benefits of participation in the decision making for the workers are lower than the costs of such participation (*ibid.*). The opponents of BLWR further note that mandatory regulation assigning workers decision (control) rights without a corresponding residual income claim alters the firm’s utility function to the benefit of the workers and the cost of the shareholders. Specifically, when employees hold primarily a fixed claim on the firm (current and retired labor stream of promised wages and benefits) and some influence, they will pressure the management to adopt policies that maximize the value of this claim less the value of the put option of bankruptcy or a similar event that

would reduce or eliminate wages. Consequently, they will push for firm policies that increase a firm's cash flow within the current employees' horizon, that is, against long-term, riskier investments and other shareholder-value-maximization policies (Faleye, Mehrotra and Morck, 2006; Benelli, Loderer and Lys, 1987; Jensen and Meckling, 1979).

If workers are to dominate board decisions, firms with BLWR might, in the long run, face all the challenges that have previously been attributed to labor-managed firms. These include issues related to the negative impact of the workers' horizon on firm investments, conflicts arising from differential workers' preferences (control problem), and reduced monitoring due to the limited transferability of control, among others (Jensen and Meckling, 1979). Worker directors could also be detrimental to the firm because they might form coalitions with entrenched managers, against the shareholders. That is, managers with small equity stakes and a high preference for remaining in control will have a strong incentive to side with the employees in order to create protection against takeovers or other mechanisms that would lead to a change of control (Pagano and Volpin, 2005). BLWR might facilitate the formation of such labor-management alliances, at the cost of the firm's shareholders. Finally, there are direct costs of BLWR, such as the costs of offices, elections, releasing employees from work, and possible delays in board decision making due to disagreements between the worker- and shareholder-elected members of the board (Sadowski, Junkes and Lindenthal, 2000).

3.2 Arguments in support of BLWR

On the positive side, Smith (1991) argues that the efficiency loss will occur in precisely those cases where the decision rights are allocated merely based on wealth or the ability to bear risk (as is the case for capitalist corporations), rather than in cases where these rights are allocated based on decision skills and contribution to the organization. Specifically, when workers have no say in firm decisions, they also have no possibility to secure a return on their investments in firm-specific human capital. Consequently, their willingness to develop these skills and their productivity will be lower than for the workers of firms with BLWR (*ibid.*). Worker directors have the opportunity to ensure that the management does not renege on explicit or implicit agreements with the employees. Thus, BLWR increases the workers' trust in the management, and in turn their willingness to develop firm-specific human capital.

Smith (1991) outlines a number of other examples of managers having the incentive to behave opportunistically and distort organizational objectives away from efficiency, thereby further justifying the implementation of BLWR. For instance, because of the way promotion and compensation systems are designed in organizations, managers might have the incentive to take the credit for workers' contributions, in order to gain promotions and salary improvements. The possibility of such opportunism reduces workers' incentives to invest in innovative solutions and productivity improvements in the first place. BLWR might act as a mechanism through which the employees are able to secure a proper return on these investments, thereby increasing firm innovation, firm-specific

investments, and consequently firm efficiency (Smith, 1991; Furubotn, 1988). The relevance of such mechanisms is likely higher today than in the past, considering the increasing relevance of workers' investments in firm-specific knowledge for firms' competitive advantage (Osterloh, Frey and Zeitoun, 2011). In a similar vein, participatory systems such as BLWR are beneficial when the employees directly partake in the firms' financial outcomes, e.g., through profit (gain) sharing or bonuses. In this case, BLWR again potentially provides the workers with the possibility of having some influence over these outcomes and their resulting personal income (Levine and Tyson, 1990).

BLWR is also expected to improve workers' commitment to the firm, mutual monitoring and cooperation, as well as leading to a better working environment and industrial relations, higher self-esteem of workers and identification with the firm, and higher satisfaction (Cable and FitzRoy, 1980; Putterman, 1982; Smith, 1991; Sadowski et al., 2000; McCain, 1980). BLWR likely increases workers' productivity because employees are more motivated when they have some autonomy and discretion over their jobs (Smith, 1991; Ben-Ner and Jones, 1995; Putterman, 1982). By giving workers a 'voice' in corporate affairs, BLWR potentially reduces turnover rates; this again implies higher firm-specific investments and lower costs of hiring and training (Sadowski et al., 2000; Addison and Schnabel, 2011). In addition, worker directors might act as an 'internal quality control over managerial decisions', thereby curbing rent-seeking managers' opportunistic behavior and the time-horizon problem (Allen and Gale, 2002; Smith, 1991; Jirjahn and Smith, 2018). That is, out of fear of replacement or a salary decrease, managers might provide a less than optimal flow of information to the board (Smith, 1991). Given their age, the remuneration structure and the expected time they will remain in their position, top managers might also be more short-term-oriented than the employees, particularly those workers who make significant firm-specific investments in human capital. Mitigating this problem, worker directors provide valuable operational information that improves the board's ability to monitor the firm's management. They are better able to understand the firm's tacit knowledge base, and can expose managerial incompetence and shrinking, as well as resist the expropriation of private benefits of control by large owners (Smith, 1991; Fauver and Fuerst, 2006; Osterloh et al., 2011).

Further benefits of BLWR relate to the role of worker directors as a 'credibility' mechanism for board decisions that directly affect the employees, since the worker directors are informed and participate directly in the board's decisions. This credibility is often required if workers are to make concessions and cooperate with the management (Freeman and Lazear, 1995; Jirjahn and Smith, 2018). Accordingly, scholars view BLWR as a mechanism that ensures the achievement of cooperative solutions in hard economic times. Specifically, even when wage adjustments represent an efficient solution during bad economic times (and with the need to cut labor costs), such a solution will not be reached if there is high asymmetry of information between management and labor, and if the employees lack information about the state of the firm (Aoki, 1984; Freeman and Lazear, 1995). That is, the employees know that the managers (the board) might be tempted to exaggerate financial

difficulties in order to justify paying lower wages to workers during economic shocks, and might therefore tend to disregard what the management says, even when it is truthful. By participating in board decisions and acting as a credibility mechanism, worker directors increase the likelihood of the two groups reaching a cooperative agreement (ibid.). Furthermore, when workers themselves co-design strategic decisions (in firms with BLWR), they are less likely to renege on the reached agreements ex post by, for example, reducing their efforts following a wage decrease (Mizrahi, 2002).

3.3 Moderating factors

The arguments against and in support of BLWR indicate that both its benefits and costs likely depend on other characteristics of the employee-employer relationship (e.g., Levine and Tyson, 1990; Jäger et al., 2021a). Accordingly, the benefits of BLWR might vary depending on the broader context or type of the corporation. Jackson (2005), as discussed above, provides some insights on the contextual conditions that are more likely to lead to the adoption of BLWR legislation, and thus probably also increase the benefits of BLWR for the firm and society as a whole. Levine and Tyson (1990) further note that successful employee participation in firm decision making depends on the characteristics of the labor, product and capital markets, such as the presence of some form of profit (gain) sharing, job security and long-term employment relations, guaranteed individual rights, and measures ensuring group cohesiveness. When workers partake in firm returns, they receive some compensation for their contribution to firms' decisions (e.g., cost-saving ideas). They will also be more motivated to monitor each other, thereby encouraging higher effort. Participatory systems, such as BLWR, might produce efficient results in contexts where workers do not fear that the cost-saving decisions in which they participate will cause unnecessary job losses. Long-term employment furthermore increases the returns on firms' investments in the development of workers' firm-specific human capital, and their willingness to make such investments, thereby further boosting the benefits of BLWR. Narrow differences in wages and status, and group cohesiveness, boost the efficiency of worker participation by promoting a good atmosphere, trust, and mutual support and monitoring. Finally, in order to exercise their voice in their organization, employees need some assurance that they will not be penalized for speaking up. Participatory systems can therefore work only in contexts with personnel systems governed by the rule of law (ibid.).

In terms of firm characteristics within a given context, the literature suggests that the benefits of BLWR depend on workers' ability to find qualified individuals within the firm who are willing to take on the responsibilities of directorship. The difficulties in finding such individuals in some firms have been put forward as one of the reasons for the moderate percentage of firms that have opted to introduce BLWR in countries where its adoption is voluntary (Rose, 2008; Hansen, 2003; Berglund and Holmén, 2016). Further insights on the conditions that affect the efficiency of BLWR across firms can be found in the literature, as scholars suggest that the net benefits of BLWR depend on the size of

the information asymmetries between the firm insiders (workers) and outsiders (shareholders and their representatives on the board). The benefits of BLWR might also depend on the extent to which the workers internalize the consequences of their control, which is in turn contingent on their sharing in the financial returns and/or making significant outlays of firm-specific investments (Ben-Ner and Jones, 1995; Sadowski et al., 2000; Furubotn, 1988; Jones et al., 2017).

Gregorič and Poulsen (2020) draw on transaction costs theory and the Scandinavian system of voluntary BLWR to investigate the firm and worker-specific characteristics that drive the establishment of BLWR in some firms, and prevent it in others. Using a longitudinal sample of Danish employer-employee matched data, they show that, except for the case of larger and older corporations where BLWR is significantly more common and likely the result of the supportive institutional climate during the late 1970s, workers are more likely to install BLWR in firms that more strongly rely on firm-specific human capital. The probability of observing BLWR is also higher in firms with higher union density, and in firms that are not family-controlled and where the CEO is not part of the board of directors. The authors argue that the scope and efficacy of BLWR are likely higher in such firms. They also show that the employees elect their representatives from among those that have higher education and longer firm-specific experience. These individuals are probably better able to work with the shareholder-elected directors and, in turn, more likely to have an impact on board decisions (*ibid.*). Besides the contextual conditions and firm characteristics, studies further suggest that the benefits and costs of BLWR might also depend on the power that worker directors have on the board. Ben-Ner and Jones (1995), for example, suggest that the workers' participation in decision making increases their productivity only when such participation is relatively restricted. They envisage that employee participation in the firm's decision making will lead to negative productivity effects at more significant levels of employee control, unless the workers internalize the consequences of their influence through their involvement in the firm's ownership (see also Jones et al., 2017).

3.4 Mandated or voluntary BLWR?

The next question addressed in the literature is whether, if implemented, BLWR should be mandatory or voluntary. On the one hand, scholars reason that BLWR should be purely voluntary, as its benefits do not apply equally to different types of firms. Furubotn (1988), for instance, argues that giving the workers a voice on the board of directors is economically justified only in firms where the human resources take on a firm-specific character during the contract of employment and where, by investing in firm-specific assets, the employees become vulnerable to post-contractual opportunism by the employer. In these firms, each worker undertaking these investments should also become a 'partner' in the firm, thereby gaining access to finite-lived non-tradeable equity shares and the associated residual risk, as well as the corresponding control (decision-making) rights (*ibid.*). Sadowski et al. (2000) note that, while BLWR leads to cooperative solutions in some firms, imposing such a

mechanism on all corporations would be costly in firms where the employees were always willing to make concessions in a crisis. Fauver and Fuerst (2006) similarly conclude that mandatory BLWR might be a superior solution to voluntary arrangements (firm-level bargaining) only in the unlikely case that the government knew exactly what the socially optimal level of workers' participation was, or when market inefficiencies motivated firms to adopt out-of-equilibrium solutions.

On the other hand, a number of factors (market inefficiencies) might prevent firms from adopting BLWR even when optimal, thus justifying the implementation of a mandatory model of BLWR. For example, in a voluntary BLWR model, it might be difficult for the workers and shareholders to measure and agree on the relevance of firm-specific human capital (Sadowski et al., 2000; Furubotn, 1988). Workers might give up on the right to install BLWR due to high bargaining costs and their wealth constraints. The latter would prevent the employees from making concessions when such concessions were necessary in order for the employers to support the BLWR (Jirjahn and Smith, 2018). Levine and Tyson (1990) furthermore point to coordination frictions, portraying the introduction of BLWR as a prisoner's dilemma game. By introducing BLWR unilaterally, any firm would expose itself to potential pressure for the erosion of pay differentials and greater protection against dismissals. In turn, such a firm would face the danger of attracting less motivated and less productive employees who likely value employment protection more highly. Assuming that employers cannot determine employees' productivity *ex ante*, such adverse selection would prevent any firm from introducing BLWR (see also Putterman, 1982). Moreover, because of the likely lower pay differences in BLWR firms, these firms might face higher resignation rates among the more productive workers. Introducing BLWR through a legal mandate might also be beneficial from the perspective of transaction (bargaining) costs, as costly negotiations between single employers and employees would be avoided (Sadowski et al., 2000; Jirjahn and Smith, 2018).

Moreover, workers' participation in decision making leads to allocative and distributive effects (Freeman and Lazear, 1995; Jirjahn and Smith, 2018), and these effects are interrelated. Specifically, workers' participation in decision making increases their productivity through higher commitment and firm-specific human capital investments, thereby also increasing the total pie that the shareholders and employees divide. However, while increasing productivity, BLWR also increases the workers' power to demand a disproportionately higher claim of the total (distributive effects of BLWR). The employers will thus likely support BLWR only to the extent that the increase in their total revenues (resulting from the BLWR) is larger than the decrease in their revenues due to the distributive effects of the BLWR. Therefore, they will fail to introduce BLWR (or other forms of workers' codetermination, such as works councils) in cases where workers' participation in decision making would optimize the overall welfare in the sense of Kaldor-Hicks but would be inferior in Pareto terms (Freeman and Lazear, 1995; Sadowski et al., 2000). In support of this claim, we see that, indeed, in Germany and the Scandinavian countries (which have BLWR), the distributive effects have traditionally been mitigated due to collective bargaining. The basic wage levels in these countries

have traditionally been set at the country (industry) level and are thus not explicitly in the domain of BLWR or works councils (FitzRoy and Kraft, 2005; Jäger et al., 2021a).

Finally, although BLWR increases opportunities for employee-shareholder interactions and cooperative agreements, the benefits for individual employees or individual shareholders might be too small, while the costs to the managers or singular workers may be too high, for them to engage in its establishment (Berglund & Holmén, 2016). The shareholders might also refrain from introducing BLWR because of the fear of losing their bargaining power in the event of adverse industrial relations, or because of the difficulties of finding managers who can properly implement BLWR or who can fully understand its benefits for long-term firm performance (Smith, 1991; Putterman, 1982).

4. BLWR and firm outcomes: Empirical evidence

4.1 BLWR and firm outcomes: German model of workers' codetermination

Most of the literature on BLWR focuses on the German model, which is the most highly developed and strongest system of board-level codetermination in Europe (Jirjahn and Smith, 2018, Lopatta et al., 2019). The boards of directors in Germany follow the two-tier board system, meaning that the management and supervisory (governance) functions operate within two formally separated bodies, i.e., the management (executive) board and the supervisory (non-executive) board. German BLWR (board-level employee codetermination) is based on the codetermination regulation from the 1950s and 1970s. In the 1950s, workers in the iron and steel and mining industries were first given the right to elect half of the supervisory board members (1951), while other industries followed a year later, with workers getting the right to elect one third of supervisory board representatives in limited liability corporations (with the exception of family firms). The German Codetermination Law from 1976 extended these rights in firms employing more than 2,000 employees, requiring workers to elect 50 percent of the supervisory board representatives in these firms (quasi-parity codetermination). Worker directors in these firms are in part elected from among those employed in the firm and in part from external union representatives. The chair of the supervisory board is always a shareholder representative and holds two votes in the case of a tie over a board decision. Worker directors in the large firms also elect one member of the management board, i.e., a labor director. The One-Third Employee Participation Act from 2004 and the earlier act from 1952 regulate workers' board participation in smaller companies. According to these acts, workers in firms employing between 501 and 2,000 employees elect one third of members of the supervisory board (e.g., Lopatta et al., 2019; Gorton and Schmid, 2004; Kraft, Stank and Dewenter, 2011).

To analyze the implications of BLWR for firm behavior, a number of studies exploit the timing of the introduction of various codetermination acts, thereby comparing firm behavior before and after the legislation (for cross-country evidence on the impact of codetermination reforms on

macroeconomic outcomes and industrial relations, see Jäger et al., 2021a). Svejnar (1981) studies the change in hourly earnings in the period around the 1951 Coal, Steel and Mining Codetermination Law, which introduced quasi-parity codetermination for companies in the iron and steel and mining industries. In this period, the worker-elected directors also took part in the boards' decisions about industry-wide collective-bargaining wage agreements, leaving the executive labor directors with the opportunity to influence the wages at the firm level (ibid.). The study reports that the codetermination legislation caused an increase in the relative hourly earnings of 6.2 percent on average; these effects were stronger in the iron and steel industry than in the mining industry.

A number of studies rely on the 1976 Codetermination Law, which required the largest firms to change from one-third BLWR to quasi-parity BLWR, where worker-elected directors would constitute half of the supervisory board members. Benelli, Roderer and Lys (1987) study the mean differences between the firms subject and not subject to the 1976 law, before and after its introduction, in terms of labor costs, dividend payout ratios, leverage, capital intensity, profitability and riskiness of corporate investments. Overall, they do not find any robust evidence of the quasi-parity BLWR causing lower stock return variance, or of worker directors significantly affecting other firm policies. One explanation for the absence of effects of the quasi-parity BLWR (according to the authors) is that worker directors might themselves have contradicting objectives, which in turn reduce their willingness and ability to influence firm management (ibid.).

Gurdon and Rai (1990) use the 1976 law change to compare the predictions of the property rights theory (pointing mainly to the negative effects of workers' participation) and the participation theory (pointing to the positive effects of workers' participation). The study is based on 63 questionnaires administered to three groups of West German firms; the groups were defined based on the extent of workers' board representation, from no BLWR to one-third and finally to quasi-parity BLWR. Comparing the changes in the capital-labor ratios between the years 1970 and 1985 for the three firm groups, the authors find no support for the property rights theory's predictions about BLWR causing higher capital-labor ratios. Comparing productivity, however, they observe (in line with the property rights theory) the strongest decline in the productivity of the firms whose workers' participation rights had increased. However, this decline in productivity did not result in lower profitability, as profitability increased the most in the firms that had switched to quasi-parity BLWR. Gurdon and Rai (1990) use the latter result as support for the participation theory, which promotes the 'positive sum game' view of BLWR.

To study the impact of the 1976 law, FitzRoy and Kraft (1993) estimate the translog production function for 112 German firms (among which, 68 were subject to the 1976 law). Drawing on two cross-sectional regressions, before and after the 1976 law, and comparing the size of the coefficient for a dummy identifying the 68 firms that switched to quasi-parity codetermination, the study reports robust negative economic effects of the law in terms of the value added and productivity. This decline, however, did not derive from the law-related increases in labor costs per

employee. The authors conclude that, while quasi-parity BLWR might be costly for private firms, it likely provides some social benefits, such as improved labor relations and cooperation, easing the downward workforce adjustments and reducing the social costs of unemployment. Years later, FitzRoy and Kraft return to the analysis using longitudinal data for 179 manufacturing firms (during 1972-1976 and 1981-1986). The longitudinal nature of the data allows the authors to better control for firm-specific characteristics, thereby improving the identification of the BLWR effects. Differently from their earlier study, the new results show that—despite the recession years and higher labor hoarding in BLWR firms—the strengthening of the BLWR rights led to a significant albeit small increase in workers' productivity (FitzRoy and Kraft, 2005). Along similar lines, Renaud (2007) estimates translog production functions for around 250 German companies over the 1970-2000 period. The study draws on the Hausman-Taylor approach, the difference-in-differences (DiD) estimator, and the 1976 law change, thereby comparing firms with quasi-parity and one-third BLWR. The results show that the introduction of quasi-parity BLWR reduced neither profitability nor productivity in the companies affected by the 1976 law. If anything, the introduction of quasi-parity codetermination increased the profitability and productivity of the companies subject to the 1976 change.

Petry (2018) addresses some methodological weaknesses of previous studies on the 1976 Codetermination Law to analyze the impact of the law on the market value of German corporations. Specifically, he looks at stock market reactions to 11 events during 1974-1979 that represented the major milestones in the history of the 1976 Codetermination Act. Using a sample of 476 publicly listed firms in Germany, among which 124 were subject to the act, Petry (2018) observes that the stock market reacted negatively to the announcement of the legislation. The study reports abnormal announcement returns of approximately -1.5 percent relative to control firms. Petry (2018) also provides some evidence of the negative impact possibly not applying to all industries, and also not to family-controlled firms.

Gorton and Schmid (2004) compare the largest publicly listed German corporations with quasi-parity BLWR to the firms with one-third BLWR, using the regression discontinuity design and exploiting the binary nature of the codetermination variable to separate the BLWR impact from size effects. Using a sample of the 250 largest German publicly listed firms during the 1989-1993 period, they find that, on average, the firms with quasi-parity representation traded at a significantly lower market value (by about 30 percent) than the firms with one-third representation. Corroborating the conclusion that shareholders do not benefit from BLWR, they further show that shareholders in part counteracted the power and influence of BLWR by leveraging up the firm, and by strengthening the incentives of the shareholder-elected board members. Compared to the firms with one-third BLWR, the quasi-parity BLWR firms also employed a significantly higher number of employees and relied less on variable compensation in rewarding their managers.

A later study by Dyballa and Kraft (2015) reports somewhat different results concerning the management compensation in BLWR firms. The authors argue that workers' representatives might be inclined to support performance-based compensation in order to ensure the firm's survival in the long term. Because of their firm-specific knowledge, they might also be better able to monitor managerial performance, which would in turn improve the efficacy of variable-based pay. The authors test this hypothesis using unique panel data on executive compensation over the 2006-2011 period for 405 listed German companies, and the Hausman-Taylor approach. They find a significant positive correlation between the quasi-parity BLWR and the variable share of the compensation of top executives; firms with quasi-parity BLWR give their executives about a 26-percentage-point higher variable share of compensation than other firms.

Along similar lines, Lin, Schmid and Sun (2019) draw on the sample of mid-sized public and private German firms during 1998 and 2006, the regression discontinuity around the 2,000-employee threshold and a DiD approach, exploiting a law change threshold to estimate the impact of quasi-parity BLWR on executive compensation. They argue that, on the one hand, BLWR might reinforce the societal bounds on high-level compensation, thereby reducing the total amount of compensation paid to executives. On the other hand, quasi-parity BLWR might increase executive pay when (1) workers form an alliance with managers, and the worker directors support more generous pay in exchange for better treatment of employees, and/or (2) quasi-parity BLWR reinforces the monitoring of firms' executives and the reliance on performance-based pay. Because of the risk premium on variable pay, this also implies higher overall pay for executives in quasi-parity BLWR firms (*ibid.*). In line with the latter arguments, the authors confirm a positive impact of quasi-parity BLWR on overall executive pay. The firms with quasi-parity worker board representation pay their executives approximately 25 percent more than comparable firms without such representation. Based on further investigation, the authors conclude that the positive impact of BLWR is likely a result of worker-manager alliances, where worker directors support more generous executive compensation in exchange for higher job security.

Underscoring the information-transmission role of the worker directors, Fauver and Fuerst (2006) underline that worker directors positively affect firm value by providing valuable information that improves boards' decisions, thereby potentially also reducing labor-firm confrontation in difficult economic times. These effects should particularly apply to firms with one-third BLWR since—when in a minority—the worker directors have little opportunity and lower motivation to influence the firms' objective function away from shareholder value maximization. Accordingly, the benefits of BLWR, particularly one-third BLWR, are higher in industries that require greater coordination and more information-sharing activities, such as trade, transportation, computers, pharmaceuticals, other manufacturing and construction. Based on these and other results, and a sample of 786 publicly held firms incorporated in Germany and traded on the German stock exchange as of 2003, the authors conclude that “judicious use of labor representation can increase firm value” (*ibid.*, p. 5).

Similarly, Lopatta et al. (2020) view BLWR as a valuable source of insider information. The study builds on a panel of 82 unique firms listed in Germany during 1995-2005, and compares the firms with quasi-parity representation to other German firms. The results indicate that quasi-parity BLWR significantly reduces so-called abnormal net hiring, namely the positive deviation of firms' hiring policies from the hiring optimum. The authors corroborate their results with a number of sensitivity tests and propensity score matching, in combination with the DiD estimator, system GMM (generalized method of moments), and others. In an earlier study, Lopatta, Böttcher and Jaeschke (2018) analyze whether BLWR positively impacts firms' short-term financial policies. The study uses a two-to-one matched sample of 719 firm-year observations of German firms that switched to quasi-parity BLWR during 1987 and 2014 (and a group of control firms), along with the DiD estimator. It shows that the quasi-parity BLWR improves the firms' short-term financial policies by improving the efficiency of their liquidity management and lowering their net working capital. The authors attribute this result to the operational expertise and knowledge that employee directors (as insiders) bring to the board, and their (higher) preference for securing sufficient cash flows in the firm in order to meet wage-related and other obligations.

Drawing on the BLWR's contribution to the information provided to the board, Kraft et al. (2011) look at the impact of BLWR on firm innovation. Theoretically, property rights scholars argue that worker directors are likely to oppose process and product innovation because of their short-term horizon, or a potential negative impact on employment. However, as outlined by participation theorists, the worker directors might also provide important firm-level information to the board, which might boost firms' innovation activity. Expanding these theoretical propositions, Kraft et al. (2011) propose a model of a bargaining firm, where decisions are reached through negotiations between the worker representatives and owners, where the two parties have symmetric bargaining power (but see Kraft, 1998, 2001). Comparing the bargaining (codetermined) firm with the standard profit-maximizing firm, they hypothesize higher R&D expenditures in the codetermined firm. That is, as long as the increase in firm size leads to higher employment, the bargaining firm has an incentive to support process and product innovation because they would both increase firm size. Using data from 1971-1976 and 1981-1990 for 148 firms with more than 2,000 employees, and comparing the number of patents in these firms before and after the introduction of the 1976 Codetermination Law, the authors find no evidence of BLWR slowing down technological progress and reducing innovation. The authors conclude that, rather than opposing technical progress, worker directors likely regard innovation as an opportunity to secure jobs (Kraft et al., 2011).

Uncovering a novel aspect of BLWR, Lin et al. (2018) consider it as a mechanism that mitigates the agency costs of debt and raises firms' ability to obtain bank financing. Because both employees and banks hold predominantly fixed claims on the firm, and because workers invest in firm-specific human capital, workers and banks are risk-averse stakeholders and are interested in the long-term survival and financial stability of the firm. By exposing the employees' interests and

concerns to the board, the employee directors thus also indirectly protect the interests of banks. The authors study the impact of quasi-parity employee representation on firms' financial leverage, based on the regression discontinuity around the 2,000-employee threshold and (alternatively) a DiD approach around the introduction of the 1976 law. Both approaches consistently show that the firms with quasi-parity employee representation have, on average, 5-10 percent higher financial leverage than firms without quasi-parity BLWR. The impact of quasi-parity BLWR is observed particularly in firms with no bank equity ownership and, thus, where banks have limited ability to affect firm policies. In line with the proposed mechanism of interest alignment between workers and banks, the authors show that firms with quasi-parity BLWR enjoy lower loan spreads, longer debt maturities and lower covenants (see also Jäger, Schoefer and Heining, 2021b).

Kim, Maug and Schneider (2018) investigate the role of quasi-parity BLWR as an insurance mechanism for employees. In their model, the employers with quasi-parity BLWR ex ante commit to preserving employment during industry shocks, in exchange for lower employee wages in normal times. The quasi-parity BLWR reassures the workers that the employers will follow through and comply with these promises, thereby reinforcing the implicit insurance contracts between employers and employees, and a more efficient allocation of risk. The authors test these arguments by looking at the differences in firms' responses to industry-level shocks, comparing BLWR firms with quasi-parity BLWR to firms with one-third representation (most of the firms in the control group) or no employee representation. Using detailed employee-employer matched data during 1990-2008 for 142 medium-sized and large firms in the two main German stock indices, the authors observe that, in the quasi-parity BLWR firms, white-collar and skilled blue-collar workers enjoy higher protection against layoffs during industry shocks, than those in firms with one-third or no BLWR. However, unskilled blue-collar workers enjoy no higher employment protection in quasi-parity BLWR firms than in other firms. The authors attribute this to the absence of low-skilled blue-collar workers among the worker representatives on the supervisory boards. In line with their theoretical arguments, they also find that—during normal times—the workers in BLWR firms pay an insurance premium for higher employment protection, in the form of lower wages. Although they operate with higher operating leverage and suffer more in terms of performance (market value) during industry shocks, the quasi-parity BLWR firms on average do not perform any worse than other firms. This suggests that the quasi-parity BLWR provides an increase in employee gains, without significantly damaging the shareholders (*ibid.*).

Besides pointing to the new channels through which BLWR might positively contribute to firms (e.g., Fauver and Fuerst, 2006; Lopatta et al., 2020; Lin, Schmid and Xuan, 2018), a group of more recent studies also revisits the previous evidence on the negative impact of BLWR on selected financial outcomes. Jäger et al. (2021b) exploit the 1994 legal change that cut BLWR rights in some German firms. The 1994 legal change eliminated the obligation for newly incorporated firms (i.e., first incorporated after August 10, 1994) with fewer than 500 employees to introduce one-third

BLWR, while maintaining the obligation for firms incorporated earlier, regardless of their size. The authors rely on DiD analysis, comparing non-micro firms incorporated (from two years) before August 1994 with those incorporated (up to two years) after August 1994. Using a rich data set of firms during 1990-2006, and addressing a variety of empirical concerns, they show that BLWR leads to a significant increase in firms' investments and capital intensity, without a significant impact on employment, except for an increase in the incidence of highly skilled workers. These trends likely reflect an increase in capital formation and a technological shift to capital intensity in production in BLWR firms. BLWR also causes no significant effect on workers' wages or wage inequality, nor on firms' profitability (Jäger et al., 2021b). This suggests that the employees of firms with one-third BLWR do not capture a significantly higher share of the value added than those of firms without BLWR (ibid.).

Balsmeier, Bermig and Dilger (2013) investigate BLWR by re-defining the strength of workers' influence in the boardroom, using power indices from cooperative game theory. These indices take into account the fact that the workers' power on the board might vary depending on the composition and coordination of the actions of the shareholder-elected members. The latter, in turn, depends on the distribution of equity between the different shareholders and can therefore vary over time. The study is based on a sample of 240 firms that were listed for at least two years on one of the three largest German stock indices during 1998-2007. According to the power indices, the employees had no voting power in 41 percent of all firm-year observations. This includes about 39 percent of firms that had at least one worker representative on the board. Through a variety of different specifications and robustness tests, Balsmeier et al. (2013) show an inverse U-shaped relationship between the labor power in the boardroom and both Tobin's Q and the market to book value (shareholder value), with the Tobin's Q being the highest at a BLWR of around 40-46 percent. The positive effects of BLWR are primarily linked to workers' rather than union representatives on the board (ibid.).

Complementing the evidence on the impact of BLWR on firms' financial outputs, a number of more recent studies also look at the impact of BLWR on non-financial performance, such as corporate social responsibility (CSR), in Germany. Sholz and Vitols (2019), for instance, explore the correlation between BLWR and CSR using cross-sectional data for German firms. The authors construct a codetermination index (MB-ix), which is a differentiated measure of the strength of codetermination. The index is based on the various components that define the power of worker representatives on the board: the number and type of worker representatives; the presence of a second deputy chair who is a worker representative; workers' representation on board committees; the degree of fragmentation of worker representation through the internationalization of employment; and the importance of the supervisory board and its involvement in the personnel policy. The authors track the development of this index in 160 of the largest German companies during 2006-2015, reporting quite some variation in the index. They find that (stronger) codetermination positively associates with

substantive but not symbolic CSR policies. The worker directors seem to promote policies in which the employees have an interest, such as environmental issues and workers' security.

4.2 BLWR and firm outcomes: Workers' participation in countries other than Germany

In countries outside Germany, the worker representatives mostly hold a minority (most often one third) of directors' seats. Within the group of studies analyzing BLWR in these countries, Thomsen et al., (2016) examine the strength of BLWR in a sample of Scandinavian publicly listed firms. In Scandinavia, workers have the option (but not the obligation) to appoint worker representatives to the boards of medium-sized and large firms. If they decide to introduce BLWR, the workers elect their representatives from among the employees of the firm (or the business group). Scandinavian law gives the shareholder some opportunity to shape the incidence of worker representatives by varying the number of shareholder-elected members. Accordingly, Thomsen et al. (2016) show that Scandinavian shareholders adjust the total size of the board so as to minimize the power of employee directors on it, thereby concluding that shareholders are 'mildly averse' to BLWR (ibid.). While this evidence suggests that shareholders might adopt actions to reduce the incidence of worker representatives on boards, the study does not propose that shareholders would get involved in costly actions to avoid the establishment of BLWR in the first place. In a later study of Danish public and private corporations, using employer-employee matched data, Gregorič and Poulsen (2020) show that, indeed, a higher ownership concentration does not imply a lower likelihood of the implementation of BLWR. Yet, they do observe that BLWR is less common in family-owned firms, although the negative correlation might be due to the fact that family firms are generally better at managing their employee relations (e.g., Ellul, Pagano and Schivardi, 2018; Sraer and Thesmar, 2007). This attitude of family owners makes it less necessary for the workers to demand BLWR (ibid.).

In terms of the impact of BLWR on firm outcomes outside of Germany, a few studies report no impact or a negative one of BLWR on firms' financial performance (market value). Based on a sample of 226 publicly listed non-financial firms in Sweden during 2001-2007 and a treatment effect model, Berglund and Holmen (2016) find no significant relationship between employee board representation and firm performance, measured by Tobin's Q and ROA (return on assets). Bøhren and Strøm (2010) analyze BLWR as one of the regulatory limitations on firms' discretion in structuring their board of directors. They draw on a sample of non-financial firms listed on the Oslo Stock Exchange in 1989 and 2002 to show that BLWR, expressed by the fraction of employee directors on the board, has a significantly negative impact on firm value, measured by Tobin's Q, ROA and return on stock (ROS). The authors attribute these negative effects to the impact of employee directors on board decisiveness. That is, worker directors have different experiences and perspectives to shareholder-elected members and this might negatively impact the complexity of decisions and increase the time taken to make them (ibid.).

Ginglinger, Megginson and Waxing (2011) look at the impact of worker directors (minority board representation) in French firms. The study draws on a natural experiment and a comprehensive sample of 201 large French firms from 1998 to 2008, differentiating between the worker directors that are appointed to the board by right (BLWR in former state-owned firms) and those elected on the basis of employee ownership (i.e., in firms with at least a 3 percent employee shareholding). Regardless of the reason for their appointment, the worker directors in the French firms always hold a minority of board seats. The study corroborates previous claims about CEOs and shareholders often being reluctant to support the establishment of BLWR. However, it also indicates that, while they reduce payouts and increase the board size and complexity of decision-making, employee directors elected by right have no significant impact on firm value. The worker representation that derives from worker ownership has, however, a positive and significant effect on firm valuation and profitability, particularly at moderate levels of employee ownership. The latter form of BLWR also has no significant impact on the firms' dividends and does not increase the complexity of the board's work.

Domadenik, Prašnikar and Svejnar (2008) study firm restructuring in the transition period in Slovenia during 1996-2000. They use longitudinal data for 157 firms and the system GMM estimator to show that the firms adjusted employment in line with profit maximization, thereby also reducing the rate of hiring when employment exceeded the desired levels. The authors fail to find any support for the claim that employee ownership, insider privatization or employee control through BLWR affected firm restructuring or employment adjustments during the period of transition to a market economy. Moreover, the Slovenian firms' restructuring with respect to investments in fixed assets, R&D, marketing and employee training was also consistent with profit-maximizing behavior. The study also shows that the employee board representation in itself had no significant effect on the firms' restructuring through investments. The authors conclude that "employee control through board representation may provide voice but does not affect restructuring decisions" (ibid., p. 741).

Gregorič and Rapp (2019) analyze BLWR and non-BLWR firm responses to the Great Recession in Scandinavia. They compare Scandinavian publicly listed companies with minority (most often one-third) workers' representation to those without BLWR. Drawing on Aoki (1984) and Freeman and Lazear (1995), they view BLWR as a mechanism that can facilitate the exchange of information between the parties involved, provide credibility to the information exchanged, and ensure an ex-post commitment to negotiated outcomes. Anecdotal and case evidence indeed shows that, during the Great Recession, many companies across Europe implemented actions that reduced labor costs per employee, without decreasing employment, such as internal redeployments, temporary working adjustments and changes in pay systems. Moreover, the implementation of these actions was often conditional on extensive cooperation between employers and employees at the firm level (Glassner, Keune and Marginson, 2011; Svalund et al., 2013). Gregorič and Rapp (2019) corroborate this evidence using longitudinal data on 365 publicly listed non-financial firms during 2004-2010. The authors implement a number of robustness checks to address the endogeneity of BLWR status,

and show that, during the Great Recession, firms with BLWR were significantly less likely to enact crisis-induced employment reductions. Their results further suggest that the preservation of employment in BLWR firms during the crisis was ensured through the implementation of alternative cost-saving measures (e.g., flexible time agreements, reorganizations of bonus systems, temporary layoffs, work-sharing agreements, etc.), resulting in a decrease in labor costs per employee. These adjustments seem to have been stronger in sectors with a below-median level of union density than in sectors with an above-median level of union density, presumably due to a higher incidence of sector-level cooperative solutions emerging in the latter. Finally, in line with the hypothesized cooperative nature of these agreements, the implemented solutions did not come at the expense of shareholder value (*ibid.*).

Advancing the evidence on BLWR's impact on workers' benefits, Blandhol et al. (2020) study the impact of BLWR using a matched panel dataset of all workers, firms and corporate boards of Norwegian private and public firms during 2004-2014. The authors apply a variety of research designs, i.e., the mover design, drawing on individual workers' switches between BLWR and non-BLWR firms, DiD analysis to study differences in firms' responses to idiosyncratic shocks to firm performance, an event study exploiting differences in the timing of BLWR adoption, and the regression discontinuity design, exploiting the specifics of the BLWR regulation. They show that employees in BLWR firms do receive about 4 percent higher wages, on average. The workers in BLWR firms also carry, on average, less earnings risk. The wages of employees in BLWR firms are significantly less sensitive to a 10 percent fall in the value added, compared to the wages of workers in firms without BLWR. However, based on the event study and regression discontinuity results, they furthermore show that the observed effects are not driven by the BLWR, but are rather the result of higher unionization and larger size, that are both characteristics of the firms with BLWR.

Harju, Jäger and Schoefer (2021) build on the 1991 introduction of worker board representation in Finnish companies with at least 150 employees to explore the impact of BLWR on voluntary job resignations, job quality (e.g., job security, healthy, subjective work quality, wages) and firm performance. Differently from other countries with BLWR, the workers' board representation in Finland plays a similar role to shop-floor representatives, as the law provides for ample flexibility and its implementation often takes the form of advisory councils, with worker directors having no formal voting rights on the board. Comparing the turnover and job-quality outcomes of firms with pre-reform employment above and below the policy cutoff of 150 workers, before and after the reform, the authors find that the so-called right of shared governance has a small, if any, effect on job-to-job transitions and other measures of job quality (as perceived by a sample of randomly drawn workers). The introduction of BLWR rights resulted in about a two-percentage-point reduction in involuntary turnover, some additional pay compression and a small overall increase in wages. Overall, the introduction of the right of shared governance resulted in a rather limited increase in the workers' rents. Accordingly, the introduction of BLWR had no negative impact on firm profitability or capital-

labor ratios, and caused a small increase in labor productivity and firm survival. The authors corroborate these findings through surveys and interviews of Finnish shop floor and board-level representatives. They conclude that BLWR in Finland is mostly a mechanism of information sharing and worker-shareholder cooperation, rather than a mechanism for boosting labor power (ibid.).

Concerning BLWR's impact on non-financial outcomes, Lopatta et al. (2020) study CSR and environmental performance for an international sample of firms from 23 OECD countries (including Germany) between 2001 and 2014. They find that the firms with BLWR (i.e., at least one-third employee representation on the board of directors) have better CSR and environmental performance. The authors explain the positive relationship between BLWR and CSR by the specific risk-return function of BLWR. That is, the employees and their representatives have an asymmetric risk function as they only partake in higher profits to a very limited extent and their compensation is normally fixed, but their risk is unlimited, as they would lose their jobs in the case of bankruptcy (see also Lin et al., 2018).

4.3 BLWR in the boardroom: A closer look into the boardroom

Complementing the evidence on the impact of BLWR on firm outcomes, presented in the previous subsections, a number of studies offer more direct evidence on how the shareholders perceive the worker directors' contribution to the board, and on how the worker directors act in the boardroom. Paster (2012), for instance, shows that, despite the fact that employers' organizations persist in arguing against the BLWR system, many employers have actually accepted the system and view worker directors as beneficial. He quotes a few survey studies indicating that the majority of the executives in large firms, when asked, were against the abolition of BLWR. The executives considered one-third BLWR, in particular, as advantageous in facilitating the implementation of difficult measures, such as job cuts (ibid.).

In terms of the workers' impact on boardroom discussion, the evidence overall indicates that, indeed, while worker directors are generally more accountable to the employees than the shareholders, they often work together with the shareholders to the benefit of the corporation. For example, Sadowski, Junkes and Lindenthal (2000) quote the cases of BMW and Salzgitter AG as rather isolated examples of employee representatives going against shareholders' proposals, suggesting that employee and shareholder representatives commonly vote with one voice (see also FitzRoy and Kraft, 2005). Adams, Licht and Sagiv (2011) use vignettes derived from seminal court cases to study how the personal values and roles of directors of Swedish publicly listed corporations translate into their shareholder/stakeholder orientation and, in turn, their decisions on the boards of directors. Based on the responses from a representative sample of these directors in 2005, they conclude that the worker directors are generally less shareholder-oriented than the shareholder-elected members, and would generally side with the employees if their interests contrasted with those of the shareholders.

However, they would also often side with the shareholders. The authors also report some differences in shareholder/stakeholder orientation within the group of shareholder and worker directors, likely reflecting the impacts of diverse values, personal characteristics and equity holdings of worker and shareholder-elected directors (ibid.).

Sinani and Gregorič (2011) sent questionnaires to shareholder-elected and worker-elected directors of all Danish publicly listed firms. Given the low response rate (66 answers in total, among which 20 were from employee-elected members), the results of this survey need to be treated with caution. Yet, the study conveys a similar story to that reported by Adams et al. (2011). Specifically, while the majority of worker directors who responded to the survey stated they were most accountable to the employees, about a third of them claimed to be most accountable to the firm's shareholders. Among the remainder, a predominant number stated that the shareholders were the second most important principal (after the workers). Interestingly, among the shareholder-elected members, a small but relevant percentage also expressed high accountability to the firm's employees. Most importantly, when asked whether they would be willing to support a management proposal to reduce employment if this was crucial to preserving the firm, the majority of worker directors agreed they would support whatever cuts were necessary to restructure the firm (in line with what was shown by Gregorič and Rapp, 2019). These findings suggest that the board of directors acts as a platform for worker-shareholder cooperation rather than as a battlefield on which the two constituencies fight for their share of firm rents. Corroborating this conclusion, the study reports that the shareholder-elected members evaluated worker directors as having the capacity, knowledge and ability to contribute to board discussions on strategic issues, as well as to exert control over management decisions.

Based on a survey of worker directors in Denmark and Norway, Rose and Hagen (2019) report some variation in these workers' perceptions of their ability to have an important role on or make an important contribution to the board of directors. Some (non-negligible) share of worker directors felt that they had a significant degree of influence on the board, particularly when it came to restructuring that involved employee layoffs and other issues of relevance to the employees. However, this was not the case for all directors. The workers' perceived influence seemed to vary with specific firm characteristics (i.e., firm and board size) and individual characteristics. In Norway, for example, the union representatives perceived themselves to have a significantly lower influence than those worker directors who were not union members (ibid.).

Huse, Nielsen and Hagen (2009) study the contribution of employee directors to board discussions, using survey responses from 384 shareholders and worker directors. The authors collect the directors' perceptions of (1) CSR control (board's involvement in health, environment and safety, natural environment and CSR issues); (2) creative discussion (creativity and innovativeness of director suggestions); (3) strategic control (board's involvement in human resource and recruitment policy, organizational and human resources, product quality and customer satisfaction); (4) behavioral control (board's involvement in the evaluation of CEO behavior, compensation and the compensation

system); and (5) budget control (the board's involvement in cost budgets, investment and capital expenditures, liquidity and payments, risk management, sales and marketing budgets). Using a multiple linear regression analysis and a hierarchical approach, the authors show that the presence of employee directors on boards positively contributes to the overall perceptions of directors about the board's creative discussions and its involvement in CSR control and strategic control. The BLWR effects seem to depend on the employee directors' self-esteem (i.e., their feeling of being an equally appreciated member of the board) and diverse background. The study, however, reports a negative relationship between the share of employee directors and the directors' perceptions of the extent of the board's involvement in the evaluation of CEO behavior and compensation. Also, the worker directors, on average, evaluated the board's involvement in control tasks as lower than did the shareholder-elected directors (ibid).

5. Summary

A number of countries across the world allow employees to elect their own representatives to the board of directors. This model of workers' involvement in firms' decision making has been gaining importance over the last decade, in the wake of the Great Recession, governance failures and other economic shocks, such as the COVID-19 pandemic. In light of this increasing interest among policy makers, practitioners and academics, there has been an increase in the number of new studies investigating the economic implications of worker-elected directors for firm behavior. While some of the studies still point to the negative consequences of BLWR for the firm's value, an increasing number of studies point to non-negative effects of BLWR for the employees and the company as a whole. Many of these recent studies draw on better data and follow more advanced empirical strategies to address identification issues. They have also expanded their topics beyond measuring the relationship between BLWR and firm value, productivity and performance, thereby aiming to identify additional mechanisms through which worker directors affect firms.

While empirically supporting a variety of channels through which the worker-elected members of the board contribute to firms, these studies, as well as evidence from practice, point to a number of open gaps as avenues for future research. For example, the field could benefit from further evidence on how the worker-elected directors interact with shareholder-elected board members, and on how they manage the potential conflicts in relation to their accountability (i.e., acting in the interests of the shareholder or the firm) and the constituencies that elected them to the board of directors. Further studies might also look into how the BLWR is implemented (in systems where workers' representation is voluntary) and how and which candidates are more likely to be elected to the board of directors. In this regard, future studies might investigate whether BLWR's impact on the firm and its employees (or a group of employees) varies depending on the characteristics of the candidates elected to the board, including the implications of BLWR for the retention of various types of employees. Additionally,

relatively little is known about how BLWR interacts with other forms of workers' representation, such as works councils and labor unions. These organizational bodies are likely to affect the power and efficacy of BLWR. Further studies could also look into the impact of BLWR on firms' hiring strategies and their ability to attract highly qualified employees. Research could also search for more evidence on the challenges of BLWR in multinational corporations, and the opportunities for workers employed outside of the country of the firm's headquarters to have their interests represented on the board of directors. Finally, researchers could adopt alternative theoretical lenses to broaden the set of outcomes beyond those traditionally studied by BLWR scholars.

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