Parity Co-determination at the board level and Labor Investment Efficiency – Evidence of German listed firms

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Abstract

This study investigates whether parity co-determination at German supervisory boards is positively related to labor investment efficiency. We focus on labor, as it is an important production factor and labor investment decisions are not easily reversible in the short-term, given that hiring and firing costs can be very high in European economies. Labor investment proxies for deviations from a firm's optimal level of investment in labor in the form of over-and underinvestment (hiring more employees than required to run profitable projects – over-hiring – or retaining employees who are occupied on non-profitable projects – under-firing). As labor representatives have the legal right to have 50 percent voting rights at the supervisory board level (parity co-determination), we expect them to contribute insider knowledge to the supervisory board but also gain access to internal documents which decreases information asymmetry and potentially reduces agency conflicts between the management on the one hand, and investors (outsiders) or capital suppliers on the other. Reduced information asymmetry in turn increases the firm's labor investment efficiency. We measure labor investment efficiency as the abnormal net hire and use a sample of German listed firms between 1994 and 2015. Results indicate a positive relationship between parity co-determination and labor investment efficiency. Our results are interesting for stakeholders, especially for politicians, managers, shareholders and employees that may not be aware of the importance of co-determination for the efficiency of the firm and for firms that are considering circumventing German legislation.

Keywords: Labor investment efficiency ● Co-determination ● Two-tier board system ● Underhiring ● Overhiring ● Employee representation ● Supervisory

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