Works Councils and Employer Attitudes toward the Incentive Effects of HRM Practices

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Introduction

Works councils provide a highly developed mechanism for non-union worker representation.

In Germany, their rights are defined in the Works Constitution Act.

Workers in establishments with five or more employees may elect a council.

The creation of a council depends on the decision of the workers.

Thus, councils are not present in all eligible establishments.

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Introduction

On some issues, works councils have the right to information and consultation, on others a veto power, and on still others the right to codetermination.

However, the Works Constitution Act does not allow wage negotiations.

The extensive participation rights suggest that works councils have substantial power to shape the HRM policy of firms.

They may even informally extend their influence to issues that are nowhere covered by the Works Constitution Act.

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Introduction

Econometric studies show that works council presence is associated with

- more employer provided further training
- an increased use of performance pay and profit sharing
- an increased use of family friendly practices
- an increased use of flexible working time arrangements
- larger internal labor markets
- higher wages and reduced wage inequality

Do employers consider the increased adoption of HRM practices fostered by works councils as performance-enhancing or do they consider it as useless or even counterproductive?

Introduction

Addressing this question yields deeper insights into the functioning of works councils.

The formal use of an HRM practice does not necessarily mean that the practice is valued by the employer.

The link between works council incidence and the formal use of HRM practices may reflect a redistributive or a trust-building function of codetermination.

Introduction

On the one hand, works councils may contribute to trustful industrial relations.

Trustful industrial relations increase workers' cooperativeness so that HRM practices can be more effectively implemented.

This should result in positive employer attitudes toward the HRM practices.

On the other hand, works councils may engage in rent seeking activities.

They may push through HRM practices that help workers enjoy a quiet life or primarily increase workers' share in the surplus of the firm.

This should result in negative employer attitudes toward the HRM practices.

Introduction

My study examines the influence of works councils on employer attitudes toward a series of HRM practices:

- performance pay
- profit sharing
- paying high wages (above the collectively agreed-upon level)
- promotions
- further training
- giving workers greater scope for decisions (e.g., by delegating responsibilities)

Theoretical Background Discussion

Performance Pay

On the one hand, works councils may increase the incentive effects of performance pay by setting clear performance standards and making performance measurement more transparent.

➔ More positive employer attitude toward performance pay.

On the other hand, works councils may push through performance pay schemes that are just paid on top of the base wage without being effectively linked to workers' performance.

➔ More negative employer attitude toward performance pay.

Theoretical Background Discussion

Profit Sharing

On the one hand, works councils may increase the incentive effects of profit sharing by monitoring the accounting of profit and participating in decisions that influence the financial performance of the firm.

➔ More positive employer attitude toward profit sharing.

On the other hand, works councils may push through profit sharing as an additional pay component that just reflects rent sharing.

➔ More negative employer attitude toward profit sharing.

Theoretical Background Discussion

Paying High Wages

On the one hand, works councils may increase the incentive effects of efficiency wages by implementing a credible just-cause employment policy.

➔ More positive employer attitude toward the incentive effects of high wages.

On the other hand, works councils may push through high wages regardless of the incentive effects.

➔ More negative employer attitude toward the incentive effects of high wages.

Theoretical Background Discussion

Promotions

On the one hand, works councils may increase the incentive effects of promotions by ensuring that the employer's promises are kept and workers with high performance are promoted.

➔ More positive employer attitude toward promotions.

On the other hand, works councils may primarily support internal labor markets to increase workers' insider power.

➔ More negative employer attitude toward promotions.

Theoretical Background Discussion

Employer Provided Further Training

On the one hand, works councils may increase the incentive effects of training by ensuring that training programs are offered that take into account workers' preferences and career concerns.

➔ More positive employer attitude toward training.

On the other hand, works councils may push trough training courses that primarily have an entertainment value or increase workers' outside options.

➔ More negative employer attitude toward training.

Theoretical Background Discussion

Giving Workers Greater Scope for Decisions

On the one hand, works councils may increase the incentive effects of a participatory work organization by ensuring that workers' decisions or proposals are not simply overruled.

➔ More positive employer attitude toward worker participation.

On the other hand, works councils may support only those forms of alternative worker participation that are no substitutes for codetermination.

➔ More negative employer attitude toward worker participation.

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Data and Variables

This study is based on the Hannover Panel.

The Hannover Panel has been widely used to study works councils.

The data set is unique in that it contains information on both works councils and managers' attitudes toward the incentive effects of HRM practices.

The Hannover Panel provides representative data from manufacturing firms in the federal state of Lower Saxony.

Data were collected on the basis of a questionnaire in personal interviews with the owner or top manager of the firm.

The analysis is based on pooled data for the years 1994 and 1997.

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Dependend Variables

Dummy variables for positive management attitudes toward various HRM practices.

The dummy for a particular HRM practice is equal to one if management regards the practice as well suited or very well suited to motivate workers.

The dummy is equal to zero if management regards the practice as not that suitable or not suitable at all.

Explanatory Variables

Key explanatory variable:
Dummy variable for the presence of a works council.

Control variables:
Market strategy, collective bargaining coverage, establishment size, subsidiary status, executive profit sharing, owner-managers, vintage of production technology, share of apprentices, share of blue-collar workers, share of skilled workers, share of university graduates, share of female workers, share of part-time workers, industrial sector within manufacturing.

Estimation Method

Multivariate probit model takes into account that the error terms between the various HRM equations may be correlated.

Recursive multivariate probit model accounts for the potential endogeneity of works council incidence.

In principle, the recursive probit model is identified by its nonlinearity.

Additionally, I impose an exclusion restriction by assuming that establishment age influences works council incidence but not managers' attitudes toward HRM practices.

Estimation Method

Of course, exclusion restrictions are always a matter of debate.

One could imagine that establishment age is associated with inertia and bureaucratic structure influencing managerial attitudes.

However to the extent, we control for bureaucratic structure and inertia by control for establishment characteristics such as R&D and vintage of production technology, we should not expect a direct influence of age.

Note that the validity of an instrument can can depend on the control variables included.

All in all, our attempt to account for endogeneity can be seen as exploratory.

Multivariate Probit

	(1) *Positive attitude toward performance pay*	*(2)* *Positive attitude toward profit sharing*	*(3)* *Positive attitude toward promotions*	*(4)* *Positive attitude toward further training*	*(5)* *Positive attitude toward scope for decision-making*	*(6)* *Positive attitude toward high wages*
Works council	0.1758 [0.049] (0.0953)*	0.2078 [0.077] (0.0874)**	0.3257 [0.113] (0.0894)***	0.3441 [0.117] (0.0941)***	0.2022 [0.053] (0.1006)**	-0.1888 [-0.070] (0.0899)**
N	1,493					
Log likelihood	-5012.80					
Correlation of error terms	Rho21 = 0.1223 (0.0465)***, Rho31 = 0.0203 (0.094), Rho41 = 0.0585 (0.0465), Rho51 = 0.0928 (0.0513)*, Rho61 = 0.0165 (0.0452), Rho32 = 0.1340 (0.0432)***, Rho42 = 0.1028 (0.0439)**, Rho52 = 0.1933 (0.0478)***, Rho62 = 0.0189 (0.0434), Rho43 = 0.2714 (0.0438)***, Rho53 = 0.3374 (0.0446)***, Rho63 = 0.0669 (0.0428), Rho54 = 0.2742 (0.0481)***, Rho64 = 0.0953 (0.0426)**, Rho65 = -0.0318 (0.0454)					

Recursive Multivariate Probit

	(1) Positive attitude toward performance pay	*(2) Positive attitude toward profit sharing*	*(3) Positive attitude toward promotions*	*(4) Positive attitude toward further training*	*(5) Positive attitude toward scope for decision-making*	*(6) Positive attitude toward high wages*	*(7) Works council*
Works council	0.2895 [0.082] (0.1555)*	0.3590 [0.133] (0.1517)**	0.8684 [0.305] (0.1482)***	0.7867 [0.270] (0.1525)***	0.5392 [0.144] (0.1880)***	-0.2882 [-0.107] (0.1514)*	---
Establishment age	---	---	---	---	---	---	0.4624 [0.104] (0.1034)***
Log likelihood	-5571.92						
Correlation between the error term of the works council equation and the error terms of the HRM equations	Rho71 = -0.085 (0.084), Rho72 = -0.109 (0.092), Rho73 = -0.401 (0.093)***, Rho74 = -0.329 (0.093)***, Rho75 = -0.242 (0.117)**, Rho76 = 0.074 (0.091)						
Correlation between the error terms of the HRM equations	Rho21 = 0.138 (0.046)***, Rho31 = 0.047 (0.049), Rho41 = 0.059 (0.048), Rho51 = 0.083 (0.053), Rho61 = 0.013 (0.046), Rho32 = 0.145 (0.044)***, Rho42 = 0.1289 (0.045)***, Rho52 = 0.198 (0.046)***, Rho62 = 0.012 (0.042), Rho43 = 0.305 (0.045)***, Rho53 = 0.350 (0.047)***, Rho63 = 0.054 (0.045), Rho54 = 0.314 (0.050)***, Rho64 = 0.072 (0.043)*, Rho65 = -0.056 (0.047)						
N	1,493						

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Conclusions

The results suggest that works councils do not play a uniform role across all HRM practices.

Works councils play a trust-building role in HRM practices such as training, performance pay and profit sharing in order to increase joint firm surplus.

They play a redistribution role in the wage level in order to increase workers' share in joint firm surplus.

The results conform to the notion that works councils aim at raising worker welfare by increasing both firm surplus and workers' share in that surplus.

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Conclusions

On a broader scale, this study complements examinations analyzing the determinants of the formal presence of HRM practices.

Focusing on the formal presence of HRM practices has two potential limitations.

1.) The formal presence of a practice does not necessarily mean that the practice is effectively used and in fact plays a productive role.

2.) Firms may informally use HRM practices even though the practices have not been formally adopted.

To the extent employer attitudes are important for the effective use of formal or informal HRM practices, this study may help mitigate these limitations.