

Strategic Leverage and Employee's Rights in Bankruptcy

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How can firms "protect" themselves from greedy employees?

- An old question
 - that recently got attention from the blooming field of "labor and finance"
 - which argues for the strategic role of fixed claims (debt)
- An important question
 - as we also want to know how firms set capital structure
- Yet, surprisingly, there is no agreement in the literature on what this strategy is:
 - More debt when high bargaining power (Matsa, 2010) \approx "true" strategic channel
 - Less debt when high bargaining power if renegotiation is possible (Simintzi et al, 2010) \approx debt capacity channel
- This paper sorts things out by testing one against the other:
 - Strategic channel wins

- "Bargaining power" is multi-dimensional:
 - Not just the commonly used EPL
 - But gather fantastic data on all the nuances of the balance of power between workers and creditors
(workers' seniority, gov't insurance fund, workers' rights and their impairment in reorganization, ease of renegotiation, etc)
 - And incorporate all of them into one single model
- Or in fact two alternative models currently in the paper ("strategic" vs "debt capacity")
 - Philosophically, the test of the "strategic" model is great: not just against zero, but against a specific alternative theory
 - But it can probably get sharper if the two models are combined into one general model.

T1: Generalize the model

- "Strategic" vs "debt capacity" are the two extremes.
- To combine the two, one could introduce an (exogenous) probability of renegotiation directly.
 - When it increases: "debt capacity" is more likely, so $EPL \uparrow \rightarrow Debt \downarrow$
 - When it decreases: "strategic" is more likely, so $EPL \uparrow \rightarrow Debt \uparrow$
- Such reconciliation has testable empirical implications:
 - Calls for an interaction between EPL and the probability of renegotiation
 - ..which in the data can be proxied by the "ease of renegotiation"

Empirical specification

- You'd guess they run debt on (country-level) bargaining power, seniority, etc, but they don't:
 - This could suffer from all sorts of (country-level) omitted variables
- Instead do something more subtle: identification through the economic mechanism

$$D_{ijt} = \lambda_0 S_{ijt-1} + \lambda_1 \text{Seniority}_c S_{ijt-1} + \lambda_2 \text{BPower}_c S_{ijt-1} + \lambda_3 \text{Rights}_c S_{ijt-1} + \delta' X_{ijt-1} + \phi' X_{ct} + \mu_i + \mu_t + \epsilon_{ijt}$$

- Compare debt response to exogenous "asset value" or "profitability" shocks in countries with high and low bargaining power
- This comes directly from the model
- Is more likely to pass through the endogeneity police

E1: Types of contracts

$$D_{ijt} = \lambda_0 S_{ijt-1} + \lambda_1 \text{Seniority}_c S_{ijt-1} + \lambda_2 \text{BPower}_c S_{ijt-1} + \lambda_3 \text{Rights}_c S_{ijt-1} + \delta' X_{ijt-1} + \phi' X_{ct} + \mu_i + \mu_t + \epsilon_{ijt}$$

- One such omitted variable could be the (country-level) composition of employee contracts (temporary vs permanent)
 - Countries differ dramatically in these
 - The model is (yet) silent, but intuitively more temporary labor force should mitigate the effect of profitability shocks on debt, or even on seniority on top
 - Adding $\lambda_4 \text{Contracts}_c S_{ijt-1}$ or $\lambda_5 \text{Seniority}_c \text{Contracts}_c S_{ijt-1}$
 - Data available at OECD
 - My homework suggests there are some correlations of this variable

E2: The level of identifying variation

$$D_{ijt} = \lambda_0 S_{ijt-1} + \lambda_1 \text{Seniority}_c S_{ijt-1} + \lambda_2 \text{BPower}_c S_{ijt-1} + \lambda_3 \text{Rights}_c S_{ijt-1} + \delta' X_{ijt-1} + \phi' X_{ct} + \mu_i + \mu_t + \epsilon_{ijt}$$

- Coefficients of interest λ are identified from country-specific variation.
 - This means we have 30 real observations to identify 3 (and sometimes more) parameters of interest: overfit?
 - Cluster errors at country level

E3: Transmission of shocks

$$D_{ijt} = \lambda_0 S_{ijt-1} + \lambda_1 \text{Seniority}_c S_{ijt-1} + \lambda_2 \text{BPower}_c S_{ijt-1} + \lambda_3 \text{Rights}_c S_{ijt-1} + \delta' X_{ijt-1} + \phi' X_{ct} + \mu_i + \mu_t + \epsilon_{ijt}$$

- Implicitly assumes that transmission of asset value and profitability shocks to debt is the same in all countries.
 - In the model it is naturally the same
 - But empirically countries may differ in what the "same" shock means: depending on how a \$1 increase in asset value (or revenue) translates into an \$ a increase in collateral (or in expropriable assets) and then into an \$ $a \cdot b$ increase in debt.

- Results with profitability shock use commodity prices proxy in a subset of firms from extraction and mining
 - Could feed the rest of the firms through an input-output table (employing additional cross-industry variation in the severity of the "same" shock).
- Anecdotal evidence of employee bargaining in various countries?
- Saturate the empirical model completely by having firm and country-industry-year fixed effects.

- A well-motivated paper on a hot topic that attempts to put some order on the universe of the opposing results in the literature
- Unique and interesting data that makes us think about so many dimensions of capital-labor balance of powers
- A nice model-inspired identification strategy
- An enjoyable read