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Employee representation and financial leverage☆

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Abstract

We analyze how direct employee voice affects financial leverage. German law mandates that firms' supervisory boards consist of an equal number of employees' and owners' representatives. This requirement, however, applies only to firms with more than two thousand domestic employees. We exploit this discontinuity and the law's introduction in 1976 for identification and find that direct employee power increases financial leverage. This is explained by a supply side effect: as banks' interests are similar to those of employees, higher employee power reduces agency conflicts with debt providers, leading to better financing conditions. These findings reveal a novel mechanism of direct employee influence.

Keywords: Capital structure, Financial leverage, Employee representation, Labor rights, Bank ownership

JEL: G32, J50

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