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The strategic use of corporate cash holdings in collective bargaining with labor unions ☆

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ABSTRACT

We provide evidence that firms in more unionized industries strategically hold less cash to gain bargaining advantages over labor unions and shelter corporate income from their demands. Specifically, we show that corporate cash holdings are negatively related with unionization. We also find that this relation is stronger for firms that are likely to place a higher value on gaining a bargaining advantage over unions and weaker for those firms in which lower cash holdings provide less credible evidence that a firm is unable to concede to union demands. Additionally, we show that for unionized firms increases in cash holdings raise the probability of a strike. Finally, we show that unionization decreases the market value of a dollar of cash holdings. Overall, our findings indicate that firms trade-off the benefits of corporate cash holdings with the costs resulting from a weaker bargaining position with labor.

1. Introduction

Firms often take strategic actions to improve their bargaining position with input suppliers. For instance, horizontal mergers can be used to improve the buying power of the merged firm vis-à-vis suppliers of input goods (e.g., Robinson, 1933; Snyder, 1996; Shahrur, 2005). Firms also strive to improve their bargaining position against labor, since labor costs usually represent a large fraction of a firm's total costs. Bronars and Deere (1991) show that firms can strategically use financial leverage to shelter income from labor unions' demands. Further, DeAngelo and DeAngelo (1991) find that unionized firms manage their earnings downward prior to labor negotiations. They contend that this allows managers to gain concessions from unions by creating the perception that the firm's competitive viability is threatened by current economic conditions.

In this paper, we investigate whether firms' cash holding policies are affected by strategic considerations that arise in the bargaining between the firm and its unionized workers. We hypothesize that lower reported cash holdings improve firms' bargaining positions against unions. By implementing a policy of holding less liquid assets in the presence of a union, a firm can make a more credible case that the risk of liquidity shortages threatens

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its competitive viability, a situation that would be exacerbated by granting additional concessions to the union. Thus, we predict that firms facing stronger unions strategically hold smaller cash reserves to improve their bargaining position and shelter corporate income from union demands. Also, we predict that because a larger cash balance weakens a firm's bargaining position and allows unionized workers to capture a larger fraction of firm profits, the contribution of cash holdings to firm value is lower in firms that face a strong union.

The anecdotal evidence suggests that corporate cash holdings indeed play an important role in collective bargaining with unions. For instance, in 2006 General Motors was faced with a strike by workers at Delphi, the auto-parts supplier which it owns. *The Economist* reported that because Delphi's workers knew that General Motors had a cash balance of approximately $20 billion "they hope the threat of a strike will prompt GM's management to dip into its cash reserves to compensate them for accepting lower pay and benefits".[1] Similarly, at the end of 1995 the United Auto Workers pointed out that Chrysler was sitting on a cash balance of $7.5 billion and demanded that it was time "the company repay its 73,000 hourly and salaried workers for the concessions they made to help keep the automaker afloat through the 1980s".[2] Finally, in 2005 Delta was able to use its falling cash balances to trigger a provision in the contract with its pilots' union which would allow Delta to seek pay cuts from the pilots.[3]

In our empirical tests we use a firm's industry unionization rate, defined as the percentage of workers in the firm's industry that belong to a union, as our primary proxy for whether the firm is likely to bargain with a powerful union that represents a large fraction of the firm's workers. Over the 1983–2005 period we find strong support for the hypothesis that firms facing more powerful unions strategically hold smaller cash reserves to improve their bargaining position and shelter income from unions' demands. Specifically, we show that firm-level cash holdings are negatively associated with industry unionization rates and also show that changes in cash holdings are negatively related with changes in unionization rates. Further, in industry-level analyses we find that average industry cash holdings are negatively associated with industry unionization. These results hold after controlling for profitability, the ease with which firms can access external capital markets, growth opportunities, leverage, capital intensity, import penetration levels, whether a firm recently had an initial public offering (IPO), and a number of other control variables.

For a smaller sample for which we have estimates of firm-level unionization rates, we confirm the finding of a negative association between cash holdings and unionization. We also study the effect of unionization on cash holdings using two industry case studies. These case studies provide further evidence that unionized firms hold less cash than do their non-unionized rivals, and additionally show that firms reduce their cash holdings after they become unionized.

To better understand the nature of the negative relation between unionization and corporate cash holdings, we examine how this relation is affected by the importance that firms are likely to attach to gaining a bargaining advantage over unions. If this relation is driven by firms that face strong unions strategically maintaining low cash balances to improve their bargaining position, then it should be more pronounced when a strong bargaining position against unions is more valuable. Prior work indicates that labor demands are larger in more concentrated industries due to a higher persistence of economic profits, and that unions capture a greater proportion of the available economic rents in these industries (e.g., Salinger, 1984; Karier, 1985). Also, extant work shows that in states that have right-to-work laws, which prohibit unions from making membership or payment of union dues a condition of employment, union bargaining power is reduced (e.g., Ellwood and Fine, 1987; Holmes, 1998). As well, the importance of gaining a bargaining advantage against unions and minimizing labor costs should be greatest for firms in industries in which labor costs represent a large fraction of total costs. Consistent with expectations, we find that the negative effect of industry unionization rates on cash holdings is more pronounced for firms in more concentrated industries, for firms principally located in states with no right-to-work laws, and for firms in industries in which labor costs represent a larger fraction of total costs.

To further determine if the negative relation between cash holdings and industry unionization rates is the result of collective bargaining issues, we examine the effects of factors that impact the bargaining advantage provided by a small cash balance. If this negative relation arises because firms that face strong unions hold less cash to gain a bargaining advantage, then this relation should be less pronounced for firms in which smaller cash reserves are less credible evidence that the firm cannot concede to unions' demands. DeAngelo and DeAngelo (1991) show that dividend cuts enable firms to obtain concessions from unions by convincing rank-and-file union members that shareholders themselves are forced to make sacrifices to alleviate the firm's financial difficulties. Along the same lines, if a firm is a dividend-paying firm that disburses free cash flows to shareholders, it can less credibly use a small cash balance to induce the union to accept a labor contract favorable to the firm. Likewise, a small cash balance provides less of a bargaining advantage for firms that can easily raise external capital to alleviate cash shortfalls. Also, firms that are closer to financial distress can more credibly argue that because of their low cash reserves they are unable to provide concessions to unions. Consistent with these ideas, we find that the negative relation between cash holdings and unionization rates is less pronounced for dividend-paying firms and for firms with higher bond ratings. We also show that this negative association is more pronounced for firms that that are

[1] See, "Last tango in Detroit? General Motors, Delphi and the unions" *The Economist*, April, 2006, p. 70.

[2] See Nichole M. Christian, "UAW gets tough with cash-rich Chrysler," *The Wall Street Journal*, January 11, 1996, p. B1, column 3.

[3] See Evan Perez, "Delta tells pilots union it may seek concessions as cash dwindles," *The Wall Street Journal*, August 22, 2005, p. A2, column 4.