
Employment Policy and Corporate Governance

By Abe and Shimizutani

Discussion by:

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Objectives of the paper

- How changes in the composition of board of directors and ownership structure affect employment practices?
 - Do companies with more outside directors layoff more employees?
 - Does foreign ownership matter?
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Theoretical background

- Important issue as several theories suggest that labor practices and corporate governance are related
 - Labor protection and maximization of shareholder value are substitute
 - Perotti and Von Thadden (forthcoming, JPE)
 - Pagano and Volpin (AER, 2004)
 - **Pagano and Volpin (JF, 2004)**
 - The paper should relate to this literature!
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Data sources

- Interesting dataset
 - Management survey on restructuring activities
 - Questions on perceived excess or shortage of employment
 - Have employees being laid off?
 - Have employees being put in early retirement?
 - Has the company refrained from new hiring in order not to fire old (not suited?) employees?
 - Information on board composition
 - Financial information
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Empirical findings

- Empirical findings as stated by the authors
 - Firms with a larger fraction of outside directors fire (and put in early retirement) employees to a larger extent
 - “Firms with high ROA use all measures to reduce labor costs”
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Causality

- Huge endogeneity problems
 - “Firms with high ROA use all measures to reduce labor costs”
 - Or more likely: **Firms have high ROA because they use all measures to reduce labor costs**
 - Just use ROA as a control variable and do not make any claims!

Causality II

- Firms with a larger fraction of outside directors fire (and put in early retirement) employees to a larger extent
- Board composition is endogenous
- Omitted factor problem
 - Companies may have characteristics that lead to more outside directors and employees' layoffs (Eg, fast changing sectors need employees with new skills)
- Authors recognize the endogeneity problem and use lagged board composition as an instrument
 - Problem
 - If present and past board composition are correlated, they may be determined by the same omitted factor (i.e., this cannot be a good instrument)

Suggestions

- More descriptive analysis
 - Do companies with relatively more outside directors differ from the rest of the sample
 - Better use of the survey questions
 - Do companies with more inside directors declare to have more excess employment (and refrain from hiring because of this)?
 - Any situation in which board turnover can be considered exogenous?
 - A plane crash
 - Some other companies/banks in the keiretsu fail and board members are withdrawn from the keiretsu firms that continue to operate?
 - Distinguish early retirement and layoffs
 - The first may be an extreme form of labor protection
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