

## Co-determination

### **Works council pays off**

**(Hans-Böckler-Stiftung)**

*Often works councils do not only benefit employees but also the firms' profitability. This is shown by an expertise on the state of co-determination research.*

Companies with a works council are often more productive and more innovative, they have a lower fluctuation and more family-friendly personnel policies. This is the result of recent empirical studies on the economic effects of co-determination. Uwe Jirjahn, a professor at the University of Trier, has evaluated the state of research, supported financially by the Hans Böckler Foundation. His main conclusion is: Even if studies do not always reach unequivocal results, the overall picture of the effects of co-determination is positive.

The explanation: Works councils can facilitate a high-trust relationship between staff and management. Thus human resource policies can be more responsive to the interests of their staff. If a flexibilisation or re-structuring of the company is planned, the works council serves as a buffer between employees and the executive management.

The studies have examined numerous relationships. The following are the most interesting:

**Productivity:** The tenor of most studies is that works councils have a positive effect on company performance. However, distribution conflicts at the firm level can be disruptive. In other words, if employees are too busy distributing the pie, e.g. because there is no binding collective agreement or because a profit sharing scheme was not specified clearly beforehand, they can contribute less to the growth of the pie.

Some studies cannot detect any effect of co-determination on company performance. However, these neglect the fact that further factors can distort the results, says Jirjahn. For example, works councils are established more often in cases when companies are already in trouble.

**Wages:** In companies with a works council the gender pay gap is smaller. Wage dispersion between qualified and less qualified workers diminishes, too. In the case of temporary shocks - such as a short-term stagnation of new orders - employee representatives keep wages stable. If the shock persists, they facilitate wage adjustments to avoid lay-offs or even a bankruptcy.

**Profitability:** A number of studies observe a negative relationship between the existence of works councils and profitability. However, this is due to the fact that profitability is often assessed subjectively by the management. If an objective measure of the profitability is applied, the relationship between works councils and profitability proves clearly positive. This is particularly true of companies that are covered by a collective agreement.

**Innovation:** Researchers cannot detect any influence of works councils on the development of completely new products. However, there is a positive relationship between the introduction of successor products or functionally improved products and co-determination. This means that information provided by employees or their representatives ensures improved products.

**Investment:** Works councils do not have any direct influence on investment in general. The situation is different in the case of spending on environmental protection: When it comes to the introduction of eco-friendly production techniques, investment into downstream technologies (e.g. filtration), waste disposal, recycling and training employees to work in a more eco-friendly way, co-determination has a consistently positive effect. One explanation provided by the researchers: Employees might be interested in a reduction of local pollution because the latter directly affects them at their work place or their families in their nearby homes. By pooling these interests the works council contributes to corporate environmentalism.

**Employment:** Several studies show that co-determination coincides with a lower fluctuation. This is particularly true for companies that are covered by a collective agreement. If distribution conflicts at plant-level can be reduced, this also benefits the staff, Jirjahn concludes. With improved working conditions the incentive to leave the company diminishes. Another study shows that the existence of a works council also makes it easier to fill vacancies.

Studies on employment growth reach mixed results. If estimations are carried out separately for different types of companies, however, there is a positive effect of the works council in companies which apply team work, team incentives and further professional training.

**Family-friendly personnel policies:** Employee representation has a positive effect on the balance of work and family life. This is particularly true if there is a high share of women in the company. Individual employees may be shy to express their interest in a family-friendly personnel policy, because the employer might interpret their interest negatively as a signal of particularly extensive family obligations. A collective representation of employees' interests mitigates these problems.

**Further professional training:** Empirical studies also provide evidence of a positive influence of works councils on the company-financed training of employees. If there is worker representation, further professional training boosts productivity to a larger extent. This is how Jirjahn explains the phenomenon: Employees have to make an additional effort to ensure that such a measure translates into operating income. They seem to be more willing to do so if there is a works council, because an employee representation, which has a say in decision-making and caters to the needs of the staff, enhances the employees' motivation. This can help to make further professional training more effective and give companies increased incentives to finance it.

Working time models: Both shift work and working time accounts are more common in companies with a works council. The employee representatives can ensure that the preferences of workers will be taken into account more actively when such working time models are designed. Then employees are more likely to accept models which mean additional strains, the economics professor explains the connection. The employees' willingness to co-operate depends on the extent to which their interests are taken into account.

Performance incentives: Performance-related pay, too, is more likely in companies with a works council. This suggests that employees are more likely to agree to variable compensation if they can trust in the calculation of performance-related compensation according to transparent criteria, says Jirjahn. And if they believe that the management will not raise the performance standards unduly.

Team work: In a flexible production process individual workers are no longer responsible for clearly defined activities, but take over a broad range of very diverse tasks. With such heterogeneous work places the representation of employees' interests is likely to become more difficult for works councils. Some research findings on team work back this assumption. However, team work is only one element in a modern production system, the economist argues. An overall concept consisting of monetary group incentives, further professional training, team work and regular meetings of management and employees is affected positively by the combination of a works council and a binding collective agreement.

The legal framework will also determine whether co-determination can continue to realise its potential, Jirjahn summarises the research findings. "An undifferentiated deregulation of the labour market, which allegedly serves an increase in flexibility, might actually result in the contrary and leave important resources for the preservation and creation of productivity unused."

*Source: Uwe Jirjahn: Ökonomische Wirkungen der Mitbestimmung in Deutschland: Ein Update, Arbeitspapier 186, Hans Böckler Foundation 2010*