WHEN LABOR HAS A VOICE: THE IMPACT OF EMPLOYEE OWNERSHIP ON CEO DISMISSAL

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When do Chief Executive Officers (CEOs) get dismissed? The most obvious answer would be that CEOs of organizations that perform poorly are more likely to be dismissed than do CEOs of organizations that perform well. Surprisingly however, extant research examining the relationship between prior firm performance and CEO dismissal rates has produced mixed and sometimes contradictory findings. As a result of these mixed findings, several studies have focused on a number of factors which may moderate the relationship between firm prior performance and CEO dismissal. This paper builds upon and extends previous research examining the moderating impact of ownership structure on the relationship between firm prior performance and CEO dismissal by suggesting that employee ownership may decouple firm prior performance from CEO dismissal. Indeed, under specific conditions, employee owners have an incentive to push corporate policies away from, rather than toward, shareholder value maximization (Faleye, Mehrotra & Morck, 2006). In such cases, employee ownership might be used by the CEO to reduce the efficiency of internal and external corporate control mechanisms, and hence, to prevent his or her own dismissal even in the presence of poor firm performance (Gordon & Pound 1990; Chang & Mayers, 1992; Chaplinsky & Niehaus, 1994; Park & Song 1995; Faleye et al, 2006). We suggest that CEOs are willing to do so because it allows them to initiate and sustain implicit contracts with employee owners (Breton & Wintrobe, 1982). Such implicit contracts enhance collusion and mutual protection between CEOs and employee owners.

Hypothesis 1: E*mployee ownership moderates the relationship between firm prior performance and CEO dismissal. More specifically, the dismissal likelihood of CEOs of poorly performing firms is negatively related to the level of employee ownership.*

We also suggest that the moderating effect of employee ownership on the relationship between firm prior performance and CEO dismissal is further enhanced if employee owners have a voice on the board of directors. Employee stock ownership grants, in particular situations, non-executive employees a sit on the board of directors. This is likely to increase voting power and maneuvering margins of entrenched employees and entrenched CEOs, and as a result, makes CEO dismissal more difficult (Gordon & Pound 1990; Pugh, Jahera & Oswald, 1999).

Hypothesis 2: *The moderating effect of employee ownership on the relationship between firm prior performance and CEO dismissal is stronger for firms with employee (non-executive) board representation than for firms without employee (non-executive) board representation.*

Finally, we argue that the moderating effect of employee ownership on the relationship between firm prior performance and CEO dismissal is weakened in the presence of large outside blockholders. Large outside shareholders have not only a strong economic justification to monitor and control management behaviour, but also the power to do so (Shleifer & Vishny, 1986). As a result, the likelihood of dismissal of poorly performing CEOs increases in the presence of large outside shareholders, despite potential resistance of employee owners.

Hypothesis 3: *The moderating effect of employee ownership on the relationship between firm prior performance and CEO dismissal is weaker for firms with large outside blockholders than for firms without large outside blockholders.*
Hypothesis 4: *The moderating effect of employee ownership on the relationship between firm prior performance and CEO dismissal is weaker for firms with large proportion of outside directors than for firms with low proportion of outside directors.*

METHODS

Our sample included 189 randomly selected firms from the SBF 250, the French index of leading 250 companies listed on the Paris stock exchange. Out of these 189 firms, 104 firms had employee stock ownership during the period of study 2001-2005, inclusive. All variables included in our models were measured using secondary data (Thomson One banker, Worldscope, News reports, Reference Documents filed with the AMF (the French Stock Exchange Commission,) Dafsa, and Euronext databases).

DATA ANALYSIS AND RESULTS

We tested our hypotheses using event history models (Allison, 1984) since our dependent variable, which captures CEO dismissal events, is discrete and time varying (2001-2005). In total, we conducted six different regressions models to test our four hypotheses. Our baseline model included only control variables. The second regression tested the main effects of employee ownership and firm performance. The third regression tested the interaction effect between employee ownership and firm performance. The fourth, fifth and sixth models tested the two-way interaction effects of board employee representation, large outside blockholding and proportion of outside directors respectively. Our results suggest that the probability of CEO dismissal in case of poor performance depends upon the level of employee ownership, and board employee representation.