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Ownership and control rights in democratic firms – a republican approach

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ABSTRACT
Workplace democracy is often defined, and has recently been defended, as a form of intra-firm governance in which workers have control rights over management with no ownership requirement on their part. Using the normative tools of republican political theory, the paper examines bargaining power disparities and moral hazard problems resulting from the allocation of control rights and ownership to different groups within democratic firms, with a particular reference to the European codetermination system. With various qualifications related to potentially mitigating factors, such as workforce and shareholder composition or risk aversion and reallocation, the paper contends that forms of workplace democracy in which workers control and own the firm, such as cooperativism, are preferable to other forms, such as codetermination, in which ownership and control rights are formally separated.

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KEYWORDS Workplace democracy; ownership; control rights; codetermination; republicanism

1. Introduction

The separability of ownership and control rights is commonly assumed in both the theory and practice of democratic firms. In political theory, democratic firms are usually defined as those whose governance is organized such that workers have control rights over management with no equity investment requirement. For instance, Hsieh (2008, p. 82) contends that, 'a guarantee of the worker's right to participate in governance is independent of any requirement of ownership on the part of workers'.[1] And Ciepley (2013) has further claimed that the attempt to bundle ownership and control rights together in democratic firms, as advocated by Dahl (1985)

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[1]Of course, this definition does not exclude worker ownership. Yet it takes for granted that workplace democracy, as such, does not require it.

and distinctive of cooperative firms, not only obscures the distinction between the two. It also reinforces shareholders' exclusive control over management in non-democratic firms. The separation has also been extensively put into practice. Democratic firms are often associated with cooperativism, in which workers control *and* own the firm. Yet most existing schemes of employee participation – such as works councils or the European codetermination system, which are often deemed as normatively superior to cooperativism, as Anderson (2017) has recently argued – require no equity investment on the part of workers.

The paper employs the normative tools of republican political theory to examine this separation, even though it draws conclusions that hold true, as I shall argue, regardless of whether one endorses the republican view or not. Republicanism, which revolves around the idea of political liberty as non-domination, has significantly informed recent analyses of workplace governance (Anderson 2015; Breen 2015; Cabrelli and Zahn 2017; González-Ricoy 2014; Hsieh 2005; McDonnell 2008). Workers' control rights are sometimes justified on this view as a means to ensure that their interests are appropriately tracked in workplace governance. By granting them a binding say on board decisions, so republican advocates of workplace democracy often argue, control rights reduce the possibility of arbitrary, uncontrolled managerial interference. Yet, notwithstanding extensive argumentation to this effect, republican authors, and political theorists in general, have done virtually no work to examine the appropriate allocation of control rights and ownership in democratic firms. The paper aims to fill this gap in our understanding of the prospects and limitations of workplace democratisation. It more specifically inspects the complications that the formal allocation of ownership and control rights to different groups within the firm faces due to bargaining power imbalances and moral hazard problems arising from this separation, with a focus on large democratic companies. The paper concludes that worker ownership, and not only democracy, are required in such companies – other things equal and with proper qualifications related to potentially mitigating factors, such as workforce and shareholder composition or risk aversion and reallocation.

The paper is divided into five further sections. Section 2 provides the notions of ownership and control rights used throughout the paper, and introduces cooperativism and codetermination as the two main forms in which democratic firms may differently allocate them. Section 3 briefly introduces the republican normative framework used in the remainder of the paper. Section 4 examines bargaining power imbalances resulting from the formal separation of ownership and control rights, as well as the social, economic, and firm-specific factors that may mitigate such imbalances. It also surveys the existing empirical evidence from the German codetermination system, which I use to critically discuss Ciepley's influential defence of the separability of ownership and control rights. Section 5 inspects incentive problems arising from the separation, and discusses the extent to which factors such as the existence of quasi rents, heterogeneous risk bearing, and performance-sensitive remuneration may mitigate such problems. A conclusion takes stock of the previous discussion.

2. Ownership and control rights

Democratic firms are often introduced as a third way between capitalist and socialist firms, which are often distinguished along the dimension of firm ownership, being private in the former case and public in the latter. However, firms may also vary along another dimension – namely, control rights over management – which, as we shall see, is conceptually different, and can be formally unbundled, from the dimension of ownership (see Ciepley 2013; Dow 2003).

Before looking into how this may be done, the specific meaning of control rights and ownership bears clarifying. Throughout the paper, control rights will refer to *ultimate* and *formal* control rights over management of the firm. In large enterprises, control over those aspects of management that remain unspecified by contracts with input suppliers is typically allocated to managers. These are hired and fired by the board of directors, whose members are in turn appointed by those to whom ultimate control rights are formally assigned (in publicly traded corporations, typically shareholders). Hence understood, control rights are formal, in the sense that they may sometimes entail little actual, de facto control over management, as famously noted by Berle and Means (1932). In this paper, control rights will be hence understood: as the bundle of formal ultimate rights to appoint and hold the board of directors accountable.

Ownership of the firm, on the other hand, will here refer to stock ownership. In incorporated firms, ownership of non-human assets, such as physical assets, does not rest with capital suppliers. Contrary to much scholarly and public discourse, shareholders do *not* own the firm. Corporate assets are locked in: their ownership lies with the legal person of the corporation. What shareholders instead own is a piece of stock, which entails a right – a claim-right, in Hohfeld's (1919) terms – over corporate residual earnings, i.e. the net income that remains with the firm after all output is sold and all input is paid for, and a power-right to sell it. And while stockholding typically also encompasses control rights over management in the above particular sense, these can be formally unbundled. Ownership of the firm and control rights are distinct bundles of rights that can be, and indeed

Table 1. Firms by types of ownership and control rights.

	Private ownership	Public ownership
Control by capital	Capitalist firm	Socialist firm
Control by labour	Private democratic firms	Public democratic firms

often are, formally separated and allocated to different groups.[2] Since the purpose of the paper is to show that such separation is problematic when put into practice, we use a notion of ownership that does not entail this from the outset. We instead assume that these two dimensions may be formally disentangled and combined in a number of ways.

The following matrix follows from some of the possible combination of the two dimensions of ownership and control rights hence defined (see Table 1).

The first row displays capitalist and socialist firms. These firms differ in whether assets are privately or publicly owned, yet have control by capital in common. By contrast, both types of firms in the second row, whether privately or publicly owned, are controlled by workers. One historical instance of public democratic firms as defined here is found in Tito's Yugoslavia, where capital was supplied by the state yet management of existing firms was significantly controlled by workers within each firm.[3] In this paper, I shall instead focus on the first column of the second row – to wit, private democratic firms – which may be further separated out into two different groups, depending on how ownership and control rights are allocated. In some democratic firms, workers have control rights yet capital is supplied by external investors. In some others, workers have control rights *and* supply capital. Consider the German codetermination system and cooperativism as the most significant instances, respectively, of these two models.

Neither is the German system the only existing form of codetermination, nor is codetermination the only system where workers enjoy board representation with no equity investment requirement. Yet, unlike other forms of codetermination, such as those existing in numerous European countries, and unlike other forms of employee participation, such as works councils, the German system is the only one in which workers share board representation with shareholders on a near-parity basis.[4] The German Codetermination Act, in force since 1976, makes compulsory for all limited liability firms with over 2000 workers to have a two-tier board structure.

[2]For further elaboration of this point, see Ciepley (2013) and Landemore and Ferreras (2016).

[3]For a theoretical model along these lines, see Schweickart's (1992) idea of economic democracy.

[4]In the 1970s the European Community drafted the Fifth Directive on company law, proposing a two-tier codetermination system similar to the German system. The Directive has gone through a number of major revisions ever since, though it has never been adopted. For the description of codetermination, I rely on Dow (2003, section 4.3), Gorton and Schmid (2000), and Fitzroy and Kraft (2005).

The management board directly runs the firm, making daily decisions, while the supervisory board makes more general decisions, such as the ratification of important investments or the approval of the annual budget and dividend pay-outs. Members of the supervisory board – which in public firms also appoint the members of the management board, hence holding ultimate control rights, are elected separately, and evenly represented, by shareholders and workers (with blue-collar and white-collar workers in turn electing their board representatives separately).

Representation in German codetermined firms, it must be noted, is often said to be merely 'near-parity'. On the one hand, shareholders and workers are evenly represented in the supervisory board, in the sense that, even though the size of the board varies proportionally to the number of employees, the ratio of shareholders' representatives to employees' representatives remains constant. And these, in turn, elect board members separately and in proportion to their numbers. Yet, on the other hand, the chairman of the board, who has a tie-breaking vote, is elected from the group of shareholders. It is thus stylised to consider German codetermination as a system where ownership and control rights are formally separated. However, it is still the most developed instance in this respect, and I will henceforth focus on it.

While workers in codetermined firms are granted control rights *qua* workers, with no equity investment required on their part, workers in cooperatives have control rights *and* supply capital, typically through debt contracting or by drawing upon their own savings. Cooperatives are certainly not the only firms in which workers are granted control rights *qua* owners.[5] Yet they are the most democratic ones, and certainly the most extended ones, as they are owned and controlled, on an equal basis, by all the firm's workers and only by them.[6]

Of course, only rarely we find cooperatives in which all workers, and only workers, enjoy equal ownership and control rights. As Elster (1989, pp. 99–104) notes, non-working owners, non-owning workers, and unequal allocations of shares are common. First, a portion of cooperatives' equity often comes from private investors, who are hence

[5]The US Employee Stock Ownership Plans (ESOPs) also provide workers with ownership, which ranges from minority stock ownership with little or no control rights at all to voting equity shares that provide workers with ample control rights over board decisions. ESOPs have rapidly expanded throughout the United States over the last decades, amounting to 11,000 firms in 1999 and including twelve among the 400 largest firms. However, it is questionable whether ESOPs qualify as a form of workplace democracy proper, given that control rights remain largely in shareholders' hands. Further, the system is strong in the US but not elsewhere. For these reasons, I do not consider them. See Dahl (1985, pp. 92–93; Dow 2003, p. 81; Hansmann, 2000, p. 69).

[6]According to the International Cooperative Alliance, cooperatives employ 280 million people across the world, which amounts to 10% of the world's working population. See https://ica.coop/en/facts-and-figures (Accessed March 15, 2018).

assigned control rights.[7] Second, large portions of workers in cooperatives are often salaried employees, who lack control rights as a result, rather than full cooperative members.[8] Finally, even though the principle of 'one worker, one vote' tends to hold, shares are often unevenly allocated. Since such deviations are not unusual, it is worth bearing in mind that the above definition of cooperativism as a system in which all workers, and only them, own and control the firm is also stylized.

3. Republicanism at work

Republican political thought has been much revived in the last four decades. However, despite significant recent contributions to the examination of democratic workplace governance, neo-republican authors, and political theorists in general, have done little work to inspect the relationship between, and proper allocation of, ownership and control rights in democratic firms. In this section, I draw on analyses of the relationship between ownership and political liberties by classic republicans, which I then apply to the relationship between ownership and control rights in democratic firms in Sections 4 and 5.

Two are the reasons why I focus on this particular strain of political thought. The first is that the analyses of the relationship between ownership and political rights by classic republicans, which were critical to their political thinking, are particularly insightful for the examination of the issue at hand, as we shall see. The second is that republican thought is especially well equipped, as we shall also see, to grasp why power imbalances are problematic for the appropriate exercise of control rights even when those at the upper end of an uneven distribution of power do not abuse their advantage. However, as I will attempt to show, the complications that the formal separation of ownership and control rights generate, albeit inspected here through a republican lens, remain true regardless of whether one endorses the republican view or not, or so I shall attempt to show. In other words, the bargaining disparities and moral hazard problems that Sections 4 and 5 will examine, although particularly apparent from a republican standpoint, require no endorsement of this particular view to hold true. Hence, those familiar with, or uninterested in, republicanism should be able to skip this section and turn to Sections 4 and 5, where the substantive chunk of the paper is located, with little regret.

[7]In Spain, for example, non-member contributions are allowed to up to 45% of the total equity capital. See Cooperatives Act 26/1999 of July 16.

[8]For example, nearly two in three workers of the Mondragón Cooperative Corporation, one of largest and most successful cooperative groups worldwide, lack membership. See https://www.mondragon-corporation.com/experiencia-cooperativa/faqs/ (Accessed March 15, 2018).

Republicanism, which dates back to the Roman republic and importantly informed political action in the modern era, revolves around the notion of political liberty as the absence of domination, which is in turn defined as the ability to interfere with someone else's choices *arbitrarily*, i.e. without having to track the interests of, or being controlled by, the party on whom the interference is visited.[9] Slavery provides the classic instance of domination. For the slave is subject to the ever-present threat of being interfered with at the master's will or discretion, without the master having to take into account the slave's will.

Two peculiarities of this notion bear noting. The first is that not all forms of interference, but only those that occur at the interferer's discretion, are dominating and hence freedom diminishing. When the interference is subject to the interferee's control, because it occurs on terms that she commands, it need not reduce the interferee's freedom. The second peculiarity is that the mere possibility of arbitrary interference is sufficient for domination, as domination obtains whenever an agent has the power to arbitrarily interfere in someone else's choices, whether she actually exercises such power or not. On this view, political freedom is modally demanding, in the sense that it requires absence of arbitrary interference under both actual and non-actual circumstances. In brief: on the republican view, political unfreedom obtains whenever someone (a slave, in the above example) is subject to someone else's power to interfere in her choices at whim, i.e. on terms that are uncontrolled by the interferee, whether the powerful party actually exercises such power or not.

On this view, workers' control rights are sometimes defended as a means to ensure that workers' interests are adequately tracked, hence bounding managerial discretion, in the decision-making process internal to the firm. Unlike market exchanges between independent contractors, the employment contract comprises the voluntary submission of the employee to the authority of the employer. Markets use the price system to allocate resources, while in the firm resources are allocated by authority, with the employee agreeing 'to obey the directions of an entrepreneur within certain limits' (Coase 1937, p. 391), and the employer retaining residual authority, i.e. authority over those aspects of the relationship that remain unspecified in the employment contract. The employment relationship is problematic, on the republican view, because the employer is in a position to exercise such authority arbitrarily, whether she actually exercises it or not.

In principle, a detailed description of the contractual terms, combined with thorough workplace legislation, could rule out managerial

[9]For comprehensive analyses of republicanism, see among others Pettit (1997, 2012), Skinner (1999), Domènech (2004), and Lovett (2010).

arbitrariness, rendering workplace democratization trivial as a result.[10] However, two limitations arise in practice (Hart 1988). To start, it would be prohibitively costly for the parties to anticipate the terms of the relationship for all possible states of the world – and for the legislator to anticipate all potential abuses. In addition, and given the changing nature of the productive endeavour, it would also be undesirable to do so if a flexible and efficient production process is to be maintained. Guaranteeing workers a binding say over management is often justified, thus, to minimise that the incomplete nature of labour contracts results in arbitrary interference in domains in which employees' interests are likely to be significantly affected. These include direct command (e.g. by favouritism in allocating overtime or verbal abuse), the definition of working conditions (e.g. by capricious rescheduling of working hours, discrimination in promotion and compensation), or the setting of firm policies (e.g. through production planning or relocations).

The purpose of this paper is not to examine this argument in favour of workers' control rights, something contemporary republicans have extensively done.[11] Let us here assume that the argument is convincing. My purpose is rather to inspect the difficulties raised by the formal separation of ownership and control rights in democratic firms. To this effect, let us next consider the understanding of the relationship between ownership and political freedom in classic republicanism.

Even though slavery has traditionally served as the benchmark case of domination, classic republicans were also concerned with various other forms of unfreedom, including those encompassing children, women, and wageworkers. For instance, as Wood (1991, p. 58) has noted, during the American colonial and early republican period, when republican political thought was mainstream, these relationships were euphemistically referred to as relations of 'friendship'. Progenitors were the 'friends' of their descendants, men of their wives, and patrons of their journeymen. The reason for this was that, unlike the latter, the former were in a position to interfere at whim, with no control by the interferee, in the latter's choices. As Robert Filmer put it in the seventeenth century, 'The father of a family governs by no other law than by his own will' (Wood 1991, p. 49).

A critical reason why classic republicans considered that the former dominated the latter is that the former owned property, whose allocation they perceived as the main source of domination. Slavery, parenthood, marriage, and wage labour were relations where those who did not own property (slaves, children, wives and journeymen) were taken to be dominated

[10] I am grateful to an anonymous reviewer for pressing me to clarify this point.

[11] See Hsieh (2005) and González-Ricoy (2014). For an alternative republican defence of workplace democracy, see McDonnell (2008).

by those on whom they materially depended.[12] Classic republicans often used this condition to deny political rights to the former. For example, Kant (1970, p. 78) famously argued that 'The only justification required by a citizen … is that he must have some property … to support himself'. In brief, classic republicans typically established property ownership, and material independence more generally, as a necessary condition (yet by no means as a sufficient one, for single women who owned property, for instance, were also typically denied suffrage) for accessing political rights.[13]

Among the reasons offered to justify this requisite, two stand out for present purposes.

The first is that those who lacked property were easily influenced by those on whom they depended to make a living. For example, accordingly to John Adams (1776), in a letter to James Sullivan, 'very few men who have no property, have any judgment of their own. They talk and vote as they are directed by some man of property, who has attached their minds to his interest'. Had those who lacked property been granted political rights, it was often argued, the only beneficiaries would have been those on whom they depended, whose political influence would have hence increased. 'Give the votes to people who have no property', Governeur Morris for example claimed, 'and they will sell them to the rich' (cited Keyssar 2009, p. 18).

The second reason that classic republicans offered was that ownership served as a proxy for having stable interests in the community – a 'stake in society', as it was often phrased – and was an incentive to exercise political rights responsibly. Unlike those who did not own property (in a largely rural economy, characteristically real estate), property holders were taken to directly feel the consequences of the laws, as taxes were largely levied from them, and to face strong incentives to responsibly exercise their political rights as a result. As a defender of property qualifications argued at the 1829–1830 Virginia constitutional convention, 'Evidence of common, permanent interest, is only to be found in a lasting ownership of the soil of the country … and the man who acquires, or is the proprietor of it, connects his fate by the strongest of all ties, with the destiny of the country' (cited Steinfeld 1989, p. 358).

With these two reasons in mind, we turn to the issue at hand in the next two sections. As we shall see, these reasons provide a fruitful framework to address the difficulties that democratic firms face when ownership and

[12]For example, Cicero (1913, p. XLII) famously defined the wage received by manual labourers as 'a pledge of their slavery'.

[13]See Gundersen (1987, p. 65). Harrington (1992, p. 269) denied bi-conditionality in this regard when he claimed: 'The man that cannot live upon his own must be a servant; but he that can live upon his own may be a freeman'.

control rights are formally separated. Before proceeding, however, it bears noting that, while most classic republicans offered these reasons to exclude those who lacked property from access to political rights, a democratic strain can also be found in the republican tradition. This strain includes, during the early American republic, the Duane-Leib faction of the Pennsylvania Jeffersonians or workingmen intellectuals such as Stephen Simpson and Thomas Skidmore (see Gourevitch 2014; Shankman 2004). Such radical republicans did *not* question the link between ownership and political rights. Yet, instead of denying an equal distribution of political rights, due to widespread material dependence, they advocated that everyone be granted material independence, via ownership redistributive schemes, such that voting rights could be universalised.

4. Bargaining power imbalances

Let us now turn to the implications of the above discussion for the separability of ownership and control rights in democratic firms, which, as we shall discuss below, has been recently defended by political theorists such as Ciepley (2013) and Landemore and Ferreras (2016). As noted in the previous section, republicanism has traditionally taken those who lack ownership to be easily influenced by those on whom they depend. As Alexander Hamilton (Madison, Hamilton and Jay 2001, p. 408) succinctly put it, 'a power over a man's subsistence amounts to a power over his will'. In democratic firms in which ownership and control rights are formally separated, this can happen due to the influence of ownership on power allocation.

As illustration, consider a firm in which workers enjoy control rights with no equity investment requirement on their part. As capital suppliers, shareholders retain the right to sell their stocks and to collectively terminate the firm. This is public knowledge: workers know this and shareholders know that they know it. Now, while employees may in principle exercise such control rights as they deem more appropriate for their interests, their decisions are likely to be importantly influenced by shareholders' implicit yet ever-present threat of selling their shares en masse or terminating the firm. More specifically, from a republican standpoint, shareholders need not threaten employees with so doing. Certainly, employees' decisions are likely to be influenced if shareholders explicitly do so, or if the probability of this occurring is high. However, employees' decisions are also likely to be influenced just by the fact that shareholders have the ability to exercise these rights, whether they ever threaten to do it or not.[14]

[14]Here, I stand with Skinner rather than with Pettit. For Skinner, republican (or neo-Roman) freedom depends both on actual and possible interference, while for Pettit it predominantly depends on the latter. On either view, workers' decisions are likely to be influenced by the ability of

How decisive this influence is for the net bargaining situation of the two parties depends on a number of additional factors that may mitigate or reinforce such influence. For example, Axel Gosseries (2012) has argued that shareholders' influence on employees' voting behaviour could be eluded by the use of secret ballot, which enables the latter to express their preferences with no coercion. However, while secret ballot is no doubt critical to ensure anonymity and prevent influence by intimidation or bribery, it is unlikely to prevent, by itself, the influence of power imbalances on voting behaviour. For instance, if workers are aware that voting against *x* can induce shareholders to sell their shares en masse or even terminate the firm, many are likely to change their mind and vote for *x*. In short, secret ballot falls short of solving the problem raised by power disparities, and does not ensure that workers' interests are adequately tracked in the decision-making process internal to the firm.

Other contextual factors may prove more relevant in mitigating or reinforcing intra-firm power disparities. These factors may be firm specific, including heterogeneity in workforce composition, which is likely to negatively correlate with employees' ability to use their control rights in coordination. For example, since blue-collar and white-collar employees are likely to have heterogeneous goals, they may fail to compose a unified block in opposition to shareholders' objectives, which – albeit also heterogeneous due to differences of tax status, risk preferences, and liquidity – are typically more unified around the goal of wealth maximization.

Similarly but on shareholders' end of the bargaining relation, the presence of block shareholders, which significantly differs across firms, sectors, and countries, is also likely to importantly define shareholders' bargaining power. For example, block holding is marginal en the US, with only 20% of listed firms in 1984 having at least one non-officer who owned 10% or more of the stock. Yet it is widespread in Germany, such that in the late 1980s 85% of companies, from a sample of 171, had a single stockholder owning at least 25% of the stock (Gorton and Schmid 2000, p. 11).

Contextual factors may also be social, such as the range and quality of welfare provision, including unemployment benefits, public health care and housing, or a basic income.[15] And they may be macroeconomic, including the existing unemployment rate, which may render job loss less costly, when the 'reserve army' is low, hence strengthening employees' bargaining position.

shareholders to sell their shares en masse or terminate the firm. Yet, contra Pettit (2002), employees' freedom is also diminished when shareholders actually exercise these rights, or when this is more likely to happen.

[15]According to Barry (2005, p. 212), for example, a basic income 'is the most practicable (perhaps the only practicable) way of counteracting the excessive power of employers over workers'.

These factors may no doubt significantly mitigate or reinforce power disparities between shareholders and employees. And their salience should be seriously taken into account in assessing the prospects of workplace democratisation with no ownership restructuring. Two qualifications are in order, however. First, since most of these factors – certainly the social and economic ones noted above – affect workers' ability to quit as a means to improve their bargaining position, their importance may be mitigated or even cancelled out by further factors that, even if costless exit was possible, can lock employees in. Some of them may be easy to compensate for, such as quasi rents yielded by seniority privileges or searching and transition costs from one job to another. Some others, not so much, including sunk costs incurred by developing firm-specific human capital, social ties with co-workers and customers, or psychological costs of quitting work altogether, work being a fundamental source of social esteem and self-respect.

Second, even though contextual factors such as the ones above may sometimes mitigate power disparities resulting from the separation of ownership and control rights, their importance should not obscure the point advanced here. Namely, that control rights on their own, i.e. in the absence of accompanying property rights or mitigating contextual factors, need not translate into actual control, as their exercise is likely to be significantly influenced by the ownership structure of the firm.

This is a view that Dahl (1985) famously held in his defence of alternative ownership arrangements – including individual stock ownership, collective employee ownership, or state ownership – as a necessary condition for workplace democracy. And it is a view that David Ciepley (2013) has recently attempted to rebut. As Ciepley notes, no natural persons, including shareholders, own the corporation, whose assets are owned by the legal person of the corporation and by no one else. As a result, control rights need not be bundled together with stock ownership. They can, and according to him should, be unbundled and allocated to different groups within the corporation – a possibility that, Ciepley posits, Dahl's identification of ownership and control rights obscures, hence reinforcing the view that, in non-democratic firms, shareholders *qua* owners of the firm should have exclusive control over management.[16] Ciepley argues as follows:

> Contrary to Dahl's impression, this arrangement [in which the firm owns itself] makes the corporation a perfectly suitable vehicle for worker self-government, because it completely removes the issue of ownership from the question of who controls. A corporate charter could make the employees

[16]Landemore and Ferreras (2016) advance a very similar claim, even though they remain explicitly agnostic about the implications of this claim for the ownership structure that would be more appropriate for firms in which workers are allocated control rights. I hence focus on Ciepley's view.

> the electors of the board – or place employee representatives on the board, as in Germany – without violating any of the property rights of shareholders (2013, p. 150).

Now, one thing is whether this is formally possible or not. It certainly is. And Ciepley is right in claiming that the popular view that shareholders own the corporation, which often encompasses the further normative claim that only shareholders should be granted control rights, is unwarranted. Since ownership of the corporation does not rest with shareholders, but with the legal person of the corporation, there is no necessary reason why this particular group should be allocated exclusive control rights, which could be shared with, or entirely allocated to, employees. Quite another thing, however, is whether this formal reallocation translates into actual control by employees or not. Available evidence from German codetermination, which Ciepley approvingly cites as an instance of the feasibility of such separation, offers reasons for scepticism.

As seen above, by granting board representation to employees with no equity investment requirement on their part, the German system of codetermination has successfully shown, for over 40 years, the formal separability of ownership and control rights. Yet, while the available empirical evidence on the German experience is mixed, it suggests that employees' have gained little effective power as a result of the 1976 Codetermination Act. Several studies find small or no incidence of codetermination on issues presumably of interest to workers, such as employees' total pay or capital intensity. For example, FitzRoy and Kraft (1993, 2005) find some incidence on productivity and return on shareholders' equity but no incidence on labour costs per worker. Gorton and Schmid (2000) find statistically significant incidence on the market-to-book ratio of equity and the return on assets of codetermined firms, yet find no incidence on matters directly related to employees' interests, such as having more lines of business to diversify risk, hence protecting themselves from the risk of job loss in the case of firm failing. Finally, Benelli, Loderer and Lys (1987) find no statistically significant effects on employees' pay, variability of salaries, or capital intensity, and conclude that 'there is no evidence that employees use codetermination to affect firm policies' (1987, p. 566).

Further, it has often been suggested that the limited effect of German codetermination on employees' effective power is the result of legal manoeuvring in the aftermath of the 1976 legislation. This includes breaking firms into pieces below the 2000 employees threshold to avoid the new legislation and delegating decisions to committees where workers lack parity. It also includes shifting approval from the supervisory board to the shareholder meeting and modifying the corporate charter to reduce the number of issues requiring approval by the supervisory board, with the effect of rendering supervisory boards largely superfluous (see Dow 2003, pp. 86–87). However, this further supports the view that ownership significantly entails control, whether formally bundled together or not. For capital suppliers are able, by legal manoeuvring or direct influence, to exercise ultimate control over the firm when they formally lack exclusive control rights.

In brief, it is certainly possible to formally separate control rights and ownership, particularly in incorporated firms, in which no one owns the corporate assets but the corporation itself, as Ciepley contends. And it is also true that the common view according to which shareholders ought to enjoy exclusive control rights because they own the corporation is *eo ipso* unwarranted. However, Ciepley's criticism of Dahl's view, according to which ownership restructuring is a necessary condition for workplace democracy, is similarly unwarranted. By arguing that worker self-government may be realised by merely allocating control rights to employees in the corporate charter – something that would infringe no property right, given that shareholders own stocks but certainly not the corporation – Ciepley obscures, instead of clarifying, the relationship between stock ownership and control rights in democratic firms. For, in so doing, he neglects the influence that the former has on the latter, a view that the existing evidence from German codetermination supports.

It bears stressing, however, that the point must be a qualified one, as the available evidence is not only mixed, as noted above. The limited effects of German codetermination on employees' effective control may also result from particularities of the German system, such as the fact that in Germany many decisions are made through industry-wide collective bargaining or in the works councils of individual plants (which are formally separated from codetermination) or because supervisory boards in Germany have always been weak. Further, contextual factors such as the ones discussed above, as well as effective state action to reduce legal manoeuvring, may mitigate the influence of ownership over control. For these reasons, conclusions on this matter, even if consistent with the concern expressed here, should be cautiously taken with a grain of salt.

5. Moral hazard

We now turn to incentive problems resulting from the formal separation of control and ownership in democratic firms. As noted above, classic republicans justified property requirements to access political rights, and some of them hence favoured property redistribution, not only because they assumed that those who lacked property were likely to be influenced by those on whom they depended. They also believed that property holders borne greater risk and had stronger incentives to behave responsibly in

Table 2. Control rights and risk bearing.

	Control rights	Risk bearing
Workers in non-democratic firms	No	Low
Workers in cooperatives	Yes	High
Workers in codetermined firms	Yes	Low

political decision-making. In democratic firms this can happen due to the influence of the ownership structure of the firm on risk allocation.

To illustrate, consider again a firm in which the governance structure is altered such that employees and shareholders share control rights, but not ownership, on a parity basis. Further assume, not unrealistically, that heterogeneous interests and information asymmetries between shareholders and employees exist. On these conditions, employees have a binding say over management of the firm. Yet, unlike shareholders – or workers in cooperative firms – who have a claim over residual earnings, they receive a fixed salary and bear less risk. Accordingly, they have an incentive to use their control rights, in combination with their private information, opportunistically so as to maximise their own payoff. Table 2 compares the allocation of workers' control rights and risk bearing in this case with that of cooperatives and of non-democratic firms.

Of course, since individuals whose income or wealth is contingent on an unknown state of the world bear risk, input suppliers other than shareholders, including labour suppliers, also bear risk. Employees in the above scenario still have, as workers in cooperatives do, a long-term interest in the performance of the firm, and its survival, to avoid job loss. Yet, with the qualifications about risk aversion and risk allocation that we shall discuss below, they bear lower risk than workers in cooperatives do, for two main reasons. First, the risk they bear is more diversified, given that they have made no equity investment in the firm and face lower costs in the event of bankruptcy than workers in cooperatives, who risk losing their investment *and* their jobs if this occurs, do.

Second, employees' income stream is fixed and certain. Unlike workers in coops, they have no entitlement over residual earnings, which they can only be claimed after all input suppliers, including labour suppliers, have been paid for and are by definition unknown. For these reasons, they face stronger incentives to use their private knowledge opportunistically in exercising control rights. For example, if a decision about a variable related to productivity has to be made, workers may favour investment in human capital rather than in machinery at the expense of firm's future profits. As Hansmann (1996, p. 12) puts it, 'if those with control had no claim over the firm's residual earnings, they would have little incentive to use their control to maximise those earnings, or perhaps even to pay out the earnings received'.

Two types of qualifications – one related to risk aversion, another one to risk allocation – are in order, however.

To start, we have so far assumed that employees are not risk averse. However, a number of factors may induce higher aversion to job loss, hence rendering employees less prone to opportunistic exercise of control rights. Quasi rents yielded by seniority privileges or firm-specific human capital are one of these factors. With regard to seniority privileges, a study cited by Gorton and Schmid (2000, p. 20) shows that long-tenured employees that are fired due to no fault of their own, such as plant closing, typically earn 15–25% less on their next jobs. In addition, the development of firm-specific skills may also yield quasi rents, hence increasing the costs of job loss due to dismissal if firm performance is poor or in the event of bankruptcy.

Factors other than quasi rents may also affect risk aversion resulting from the costs of job loss, such as the social and economic variables examined in the previous section. For example, if the unemployment rate is high, or if social benefits are lacking, job loss may be more costly and risk aversion, other things equal, higher. When this occurs, incentives for opportunistic exercise of control rights are weaker, and moral hazard resulting from the formal separation of ownership and control rights may be less salient as a result.

In response to this first qualification, three points bear noting. First, factors yielding quasi rents, such as the above-mentioned firm-specific specialisation or seniority privileges, greatly vary within and across firms, such that while some employees may have strong incentives not to exercise control rights opportunistically, some others may not. In other words, while moral hazard problems arising from the separation of control and ownership may be significantly mitigated in the case of some firms and employees, they may nonetheless be significant in some others cases.

Second, and more importantly, however mitigating these factors or the social and economic factors mentioned above might be, they are likely to remain constant across democratic firms in which ownership and control rights are formally separated and those in which they are not. It may be objected that this not always holds true, for cooperatives have been shown to exhibit higher survival rates, at least in the short and medium term (Olsen 2013; Park, Kruse and Sesil 2004). Accordingly, it may be argued that, if the probability of job loss is lower in coops than in codetermined firms, employees in the latter should be more risk averse and less, rather than more, prone to opportunistic exercise of control rights, other things equal. However, while it is certainly true that cooperatives exhibit higher survival rates, this relative advantage is small and, in any case, has only been shown in comparison to nondemocratic firms, rather than to codetermined firms, in relation to which no comparative study to my knowledge exists.

Third, even if the advantage existed, and was significant, or if the incentive effects of quasi rents were homogenously distributed across employees in codetermined firms, none of this would compensate for the enormous incentive effects of the ownership structure of cooperative firms, in which workers supply both labour and capital and bear significantly higher risk than employees in codetermined firms as a result.

Let us now turn to the second type of qualification, which is related to risk reallocation. Since it is possible to share risk through efficiency-enhancing incentive schemes – including year-end bonuses that are sensitive to company performance, profit sharing plans, employee compensation tied to stock price, or remuneration partly in shares – moral hazard problems in the exercise of control rights may be accordingly reduced. Now, even though these schemes may no doubt reduce opportunism in the exercise of control rights, they do so only because they exhibit ownership-like properties. And they do it only partially, to the extent that employees' claim over corporate earnings remains partly fixed.

The following dilemma hence arises. If, on the one hand, employees' compensation remains partly fixed, the effect of these efficiency-enhancing incentives in reducing opportunism in the exercise of control rights remains partial. And if, on the contrary, workers' income is made entirely dependent on residual earnings, then there is little difference with having a share in the ownership of the firm, and the difference between shareholders and workers dissolves. In any event, the view according to which control rights with no equity requirements results in moral hazard problems remains intact.

6. Conclusions

The separation of ownership and control rights, which is much assumed in the theory and practice of democratic firms, faces two significant complications, which have been examined here using the tools of republican political theory but hold true, I hope to have shown, regardless of whether one endorses republicanism or not. The first is that, where formal separation occurs, employees' control rights are likely to result in negligible effective control due to shareholders influence over board decisions. The second is that, where effective control in combination with asymmetric information occurs, opportunistic behaviour is likely to obtain, given that employees with control rights have no claim over residual earnings and bear low risk. While these complications may be mitigated by economic, social, and firm-specific factors, by factors yielding quasi rents that may lock workers in, such as firm-specific skills or seniority privileges, and by efficiency-enhancing incentive schemes, these factors also have limitations, as the paper has shown.

Of course, the alternative – i.e. the allocation of control rights and ownership to the same group, as cooperativism does – may also have its own drawbacks, which I have not discussed here. Further, the evidence gathered in support of the two claims advanced in the paper is largely restricted to large companies and may not similarly apply to small or medium enterprises. As a result, while reasons favouring cooperativism over codetermination are compelling, these reasons are *pro tanto* and limited to certain kind of firms. A conclusive examination of the appropriate allocation of ownership and control rights in democratic firms commands the careful inspection of competing considerations as well as of evidence relating to smaller firms.

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