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Sustainable corporate boards with employee representation

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Abstract: We develop a theoretical model of board decision-making in which shareholder representatives, top executives, and employee directors form heterogeneous coalitions to choose between a safe long-term project and a risky short-term one. Board value depends on both the informational contribution of each group and the conflict structure among them. We show that employee representation enhances firm value when employee informational content exceeds a threshold that increases with outsider quality, thereby generating the empirically observed inverted-U relationship between representation and performance. When conflicts of interest arise, minority employee representation can shift the firm's investment choice only when it alters the coalition balance at the margin, and only for an intermediate range of shareholder patience. A further result shows that insider opacity is self-limiting: the maximum level of information withholding that insiders can sustain without losing board representation decreases with both outsider quality and employee representation, creating an endogenous governance discipline. These results provide analytical foundations for moderate codetermination policies and generate empirically testable predictions on the conditions under which employee directors are decisive.

Keywords: agency cost; board of directors; codetermination; conflict of interest; corporate governance; employee representation; shareholder value; stakeholder value.

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1 Introduction

In April 2019, the French Parliament adopted the Loi PACTE (Plan d'action pour la croissance et la transformation des entreprises), a reform designed to foster sustainable growth and long-term competitiveness. Among its provisions, the law strengthened employee participation through both share ownership and board representation. Following the Gallois Report, France required at least one or two employee representatives depending on board size. More broadly, employee board representation remains a central and contested feature of European corporate governance. Germany relies on extensive codetermination, Scandinavian countries use cooperative board models, while Anglo-Saxon economies such as the USA and the UK largely exclude employees from corporate boards.

Existing empirical evidence remains mixed. This discussion is also consistent with classic agency-theory approaches to codetermination and corporate control, in which divergent objectives among shareholders, managers, and employees may affect firm value (Jensen and Meckling, 1979; Tirole, 1986; Pagano and Volpin, 2005). Some studies associate employee representation with stronger monitoring, better information flows, longer-term orientation, and improved firm value, whereas others emphasise coordination costs, agency conflicts, or valuation losses when employee influence becomes excessive. In Germany, FitzRoy and Kraft (1993) and Gorton and Schmid (2004) document valuation losses when labour holds equal representation, while Fauver and Fuerst (2006) find that moderate employee representation can improve firm value. In France,

Ginglinger et al. (2011) show that employee-shareholder directors enhance valuation, and Kim et al. (2018) document improved risk-sharing and employment protection under codetermination. More recent evidence further suggests that the effects of codetermination depend on ownership structure, board access, and institutional context, with generally neutral to mildly positive effects on productivity and stability (Jäger et al., 2022), positive effects in family firms and among long-term investors (Belot and Waxin, 2022), and more ambiguous valuation effects when employee representation becomes large (Eulerich et al., 2022; Silva and Santos, 2022; Harnay, 2024; Rudolf, 2023).

This ambiguity suggests that the value of employee representation cannot be assessed independently of the informational and coalition structure of the board. Employee directors may improve decision-making when they bring firm-specific knowledge, facilitate monitoring, and support long-term investment. This view is consistent with codetermination and stakeholder perspectives emphasising employees' firm-specific information and monitoring role (Freeman and Lazear, 1994; Furubotn and Wiggins, 1984; Gerum and Steinmann, 1984; Blair, 1998; Hopt et al., 1998). However, they may also create coordination costs or weaken board efficiency when their representation becomes excessive. The relevant question is therefore not whether employee directors are intrinsically beneficial or harmful, but under which conditions they enhance firm value and alter the firm's strategic choices.

This paper develops a theoretical model of board decision-making in which shareholder representatives, insiders, and employee representatives differ in their information, preferences, and time horizons. The firm chooses between a safe long-term project and a risky short-term project. Board value depends on the information contributed by each group, while the project selected depends on majority voting and coalition formation. The board is therefore not modelled as a simple aggregation of preferences, but as a governance arena in which heterogeneous directors provide information, form coalitions, and affect the firm's investment horizon.

Our paper also relates to the broader literature linking corporate governance mechanisms, board characteristics, and firm value. Rossi et al. (2015b) show that corporate governance quality is associated with financial performance in Italian listed firms, while Widyaningsih et al. (2017) emphasise the role of governance mechanisms in protecting firm value in concentrated ownership structures. Rossi et al. (2021) further show that board characteristics moderate the relationship between CSR practices and financial performance, and Rossi et al. (2015a) highlight how governance and financing constraints shape strategic decisions in Italian SMEs. These studies support the idea that board composition affects value through information, monitoring, and stakeholder-oriented decision-making.

The model yields three main results. First, employee representation is valuable only above an informational threshold. When employee directors bring sufficiently strong firm-specific information, a moderate level of representation can increase firm value. However, excessive representation crowds out more informative directors and generates an inverted-U relationship between employee representation and board value. This provides an analytical foundation for the idea of an optimal minority of employee directors.

Second, minority employee representation matters through coalition formation. Employee directors do not need to control the board to be decisive. They can affect the firm's investment choice when they alter the marginal balance between competing strategies: doing nothing, incentivising insiders, or recomposing the board. This

mechanism is effective only for an intermediate range of shareholder patience. If shareholders are too short-termist, employee representatives cannot overturn the short-term coalition; if shareholders are already sufficiently patient, employee representation is not decisive.

Third, the model shows that insider opacity is self-limiting. When insiders withhold information, informed outsiders and employee representatives become more valuable because they compensate for the loss of information effectively transmitted to the board. However, excessive withholding eventually undermines insiders' own board representation. A key contribution of the paper is therefore to show that board composition disciplines insider opacity: the more insiders restrict the board's access to information, the stronger the case for alternative sources of information and monitoring.

The paper contributes to three strands of literature. First, it contributes to the corporate governance literature on board composition and firm value by modelling directors not only as monitors but also as heterogeneous information providers. Second, it contributes to the literature on codetermination by identifying the informational and coalition conditions under which employee representation is value-enhancing. Third, it contributes to the stakeholder governance and ESG debate (Hart and Zingales, 2017; Edmans, 2020) by showing that employee representation supports long-term value creation only under specific conditions, rather than as a universal governance remedy.

The model also generates empirically testable predictions. The value of employee representation should be stronger when employees possess valuable firm-specific information; when shareholder patience is intermediate rather than very low or very high; and when insider opacity is high enough to make alternative sources of board information valuable, but not so high that insiders lose their informational legitimacy. These predictions help reconcile mixed empirical findings by showing why employee representation may be value-enhancing in some firms and ineffective or costly in others.

The remainder of the paper proceeds as follows. Section 2 presents the model. Section 3 analyses optimal board composition, first under full insider disclosure and then under partial insider information withholding. Section 4 studies the benchmark case without conflict between shareholders and employees and derives the informational threshold for employee representation. Section 5 introduces conflicts of interest between shareholders and employees. Section 6 relaxes the within-group homogeneity assumption. Section 7 discusses managerial and policy implications, limitations, and future research. Section 8 concludes.

2 Model

We develop a stylised model of board decision-making in which the board chooses between two investment projects that differ in risk and timing. The model proceeds in four steps. First, we define board composition and the informational contribution of each director type. Second, we specify the timing of the investment decision and the expected payoffs of the two projects. Third, we derive the optimal board composition in the absence of conflict of interest. Fourth, we introduce conflicts among board members and study whether employee representatives can alter the coalition that determines the firm's investment choice.

2.1 Board composition

The board of directors is composed of three distinct types of agents: shareholder representatives (outsiders), top executives (insiders), and employee representatives. Each group holds a specific proportion of board seats and is characterised by its own objectives and discount factor.

The first group of board members is made up of outsiders (shareholder representatives). We define outsiders as independent directors elected by shareholders to represent their interests. In line with the standard corporate governance literature, we assume that their interests are perfectly aligned with those of shareholders, leading them to maximise shareholder value. The proportion of outsiders on the board is $\tau_{out} \in [0; 1]$ ¹ and they discount the future at $\delta_{out} \in [0; 1]$ ².

The second component of the board includes insiders who are members of the top management team. While also elected by shareholders, their interests may diverge from those of shareholders, creating potential agency conflicts that may require incentives. They may therefore misbehave and prioritise personal benefits (e.g., reputation, perquisites) over shareholder value. The proportion of insiders on the board is $\tau_{ins} \in [0; 1]$ and their discount factor is $\delta_{ins} \in [0; 1]$.

Finally, the board comprises employee representatives, elected by employees in accordance with the law. Hence, we assume their proportion on the board, $\tau_{er} \in [0; 1]$, to be exogenous and determined by the legal framework³.

We further assume that shareholders have no incentive to exceed the minimum legal requirements for employee representation. One reason is that excessive employee representation may reduce the firm's ability to attract top executives, as suggested by Fauver and Fuerst (2006) to explain why employee representation rarely occurs unless legally required. Their discount factor is $\delta_{er} \in [0; 1]$. Importantly, we assume that employee representatives always act in the employees' best interest, even if having a seat on the board may alter their utility function⁴. The added proportions of the different directors must equal one. Therefore, $\tau_{out} + \tau_{er} + \tau_{ins} = 1$.

Employee representation is treated as exogenous because, in many codetermination systems, the number of employee directors is primarily determined by legal requirements rather than by the firm's unconstrained choice. The model therefore asks how shareholders optimally adjust the remaining board composition, between outsiders and insiders, for a given level of employee representation.

2.2 Investment decision

The firm must choose between two projects that differ in risk and timing. We consider a three-date model. At $t = 0$, the firm makes the investment decision. The first project, denoted $P1$, is a safe long-term project whose payoff is realised at $t = 2$. The second project, denoted $P2$, is a risky short-term project whose payoff is realised at $t = 1$. Both projects require the same investment at $t = 0$, which we normalise to zero.

To isolate the effect of risk and timing on the board's project choice, both projects generate the same revenue R conditional on success. Therefore, they differ only in their probability of success and in the date at which the payoff is realised. Project $P1$ succeeds with probability 1 and pays R at $t = 2$. Project $P2$ pays R at $t = 1$ with probability p , and 0 with probability $1-p$.

2.3 Decision rule

We assume that all directors of the same type (outsiders, insiders or employees) act according to their type and vote for their group's preferred project. The decision is taken on a simple majority rule. In case of equality, the chairman casts the decisive vote. We assume that the chairman is an outsider, which reflects the shareholder-oriented governance benchmark and ensures that tie-breaking favours the shareholders' preferred project.

2.4 Revenue

The revenue R captures the informational quality of the board's decision-making process. In line with the literature on information disclosure, strategic decision-making, and board expertise, this quality is driven by the information and expertise conveyed by the different types of directors (Ansoff, 1965; Diamond and Verrecchia, 1991; Adams and Ferreira, 2007; Harris and Raviv, 2008). Since both projects generate the same payoff conditional on success, board composition affects firm value through the information used to evaluate and select projects rather than through project-specific cash-flow differences. This specification allows us to isolate the governance channel of interest: how the distribution of board seats affects the information effectively available to the board.

We assume that each director group contributes a distinct type of information. Insiders provide firm-specific operational information, outsiders provide independent monitoring and external expertise, and employee representatives provide firm-specific knowledge related to production, organisation, and long-term workforce conditions. The informational contribution of each group is increasing and concave in its board representation, reflecting diminishing marginal returns to within-group information.

To capture these diminishing marginal returns in a parsimonious way, we model the informational contribution of each group using the functional form $\frac{\tau_i}{1 + \tau_i}$.⁵ Thus, the revenue of both projects is:

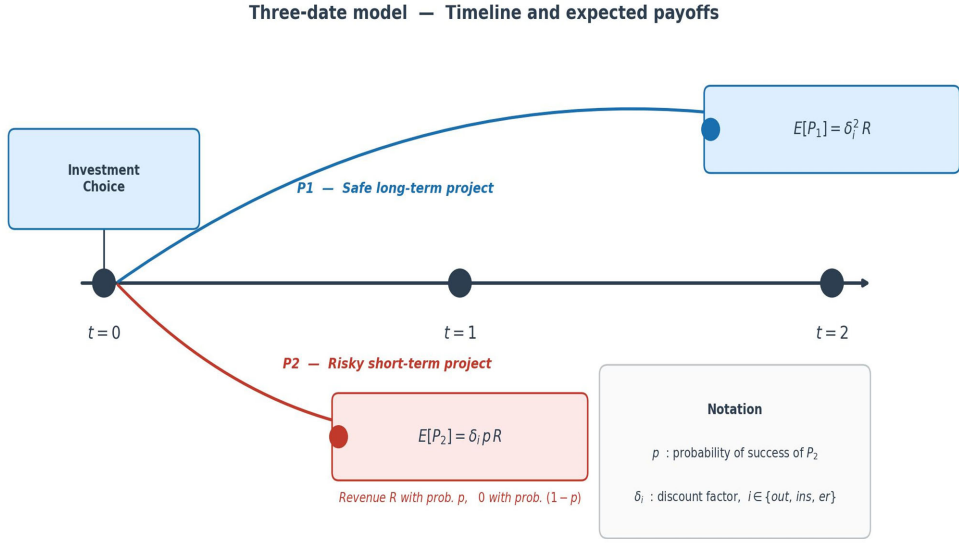
$$R = \frac{\tau_{ins}}{1 + \tau_{ins}} + \alpha_{out} \times \frac{\tau_{out}}{1 + \tau_{out}} + \alpha_{er} \times \frac{\tau_{er}}{1 + \tau_{er}},$$

where $\alpha_{out} \in [0; 1]$ and $\alpha_{er} \in [0; 1]$ measure the informational content of outsiders and employee representatives relative to insiders. We normalise insider information to 1, $\alpha_{ins} = 1$. This normalisation does not imply that insiders possess all relevant knowledge or that outsiders are uninformative. Rather, it sets insider operational knowledge as the benchmark against which other sources of board information are measured. Outsiders may bring industry expertise, financial expertise, or experience from other firms, captured by α_{out} , while employee representatives may bring firm-specific knowledge of production processes, workplace organisation, and long-term employment conditions, captured by α_{er} . This assumption deliberately gives insiders an informational advantage in the benchmark case. Hence, results showing that outsiders or employee representatives become valuable are obtained despite, rather than because of, a favourable assumption toward insiders.

The additive specification is a benchmark assumption. It captures the idea that each group contributes a distinct source of information, while the board composition constraint creates trade-offs across groups. We later relax the full-disclosure implication of this benchmark by allowing insiders to withhold part of their information. In that extension, the information effectively transmitted to the board depends not only on formal board composition but also on insiders' disclosure behaviour.

Figure 1 summarises the timing of the investment game and the corresponding expected payoffs.

Figure 1 The board chooses between a safe long-term project $P1$, which pays revenue R at $t = 2$, and a risky short-term project $P2$, which pays revenue R at $t = 1$ with probability p (see online version for colours)



Note: Expected payoffs are therefore discounted as $E[P1] = \delta_i^2 R$ and $E[P2] = \delta_i p R$.

In what follows, $E[P1]$ and $E[P2]$ denote the discounted expected payoffs of the two projects for a director of type $i \in \{\text{out}, \text{ins}\}$. Since the safe long-term project $P1$ pays R at $t = 2$, its expected payoff is:

$$E[P1] = \delta_i^2 R$$

Since the risky short-term project $P2$ pays R at $t = 1$ with probability p , its expected payoff is:

$$E[P2] = \delta_i p R$$

Equivalently, using the revenue function above:

$$E[P1] = \delta_i^2 \left(\frac{\tau_{ins}}{1 + \tau_{ins}} + \alpha_{out} \frac{\tau_{out}}{1 + \tau_{out}} + \alpha_{er} \frac{\tau_{er}}{1 + \tau_{er}} \right)$$

and

$$E[P_2] = \delta_i p \times \left(\frac{\tau_{ins}}{1 + \tau_{ins}} + \alpha_{out} \frac{\tau_{out}}{1 + \tau_{out}} + \alpha_{er} \frac{\tau_{er}}{1 + \tau_{er}} \right)$$

2.5 Directors' preferences

The preferred project for each director type depends on its objectives and discount factor. For outsiders and insiders, the comparison between the two projects is:

$$E[P1] \geq E[P2] \Leftrightarrow_i^2 R \geq \delta_i p R$$

For $\delta_i > 0$, this condition is equivalent to $\delta_i \geq p$. Thus, outsiders prefer the long-term project $P1$ when $\delta_{out} \geq p$ and the risky short-term project $P2$ when $\delta_{out} < p$.

Similarly, insiders prefer $P1$ when $\delta_{ins} \geq p$ and $P2$ when $\delta_{ins} < p$. Also, we assume that insiders' utility is proportional to firm value, reflecting reputational or private benefits from firm success. This proportionality is captured by a parameter $b > 0$, which does not affect their project ranking but matters when shareholders use incentives to alter insiders' voting behaviour.

Employee representatives are assumed to prefer the safe long-term project $P1$. This benchmark assumption captures the fact that employees are typically less diversified than shareholders because their human capital is tied to the firm. Therefore, they bear a large share of the downside risk of project failure, such as layoffs, wage concessions, or deteriorating working conditions, while capturing only limited upside from risky short-term success.

This assumption does not imply that all employees always prefer safety in practice. Some employees may benefit from short-term bonuses, equity-based compensation, or risky growth strategies. Section 5 relaxes the broader within-group homogeneity assumption and discusses how the results change when only a fraction of a group supports a given project.

Finally, insiders can be incentivised to vote for the shareholders' preferred project. For simplicity, incentives are paid at the same date as the project payoff: at $t = 1$ for $P2$ and at $t = 2$ for $P1$.

3 Optimal board composition

3.1 Optimal board composition under full insider disclosure

We now determine the optimal board composition from the shareholders' viewpoint. Since employee representation τ_{er} is treated as fixed by the legal framework, shareholders choose the remaining allocation between outsiders and insiders. The problem is therefore to determine the proportions τ_{out}^* and τ_{ins}^* that maximise revenue subject to:

$$\tau_{out} + \tau_{er} + \tau_{ins} = 1$$

We first consider the benchmark case without employee representation and without conflict of interest. This isolates the informational trade-off between insiders and outsiders. In this case, insiders fully disclose their information to the board, so that their informational content is normalised to 1, $\alpha_{ins} = 1$.

Proposition 1. In the absence of both employee representation ($\tau_{er} = 0$) and conflict of interest, and when insiders fully disclose their information to the board, a board with a majority of insiders maximises shareholder value.

Proposition 1 reflects the informational advantage assigned to insiders in the benchmark model. When there is no conflict of interest, shareholders prefer an insider-dominated board because insiders provide the highest informational contribution to project valuation. Outsiders remain useful only if their independent information is sufficiently valuable, but their optimal representation remains below one half when employees are absent. This benchmark is deliberately favourable to insiders; the next section shows how insider information withholding weakens this result and makes outsiders more valuable⁶.

3.2 Optimal board composition under partial insider information withholding

We now extend the benchmark model by allowing insiders to withhold part of their information. Let $\rho \in [0, 1)$ denote the fraction of insider information that is not disclosed to the board. We interpret ρ as insider opacity: the higher ρ , the lower the amount of insider information effectively transmitted to directors. Hence, only a fraction $1-\rho$ of insider information enters the board's decision-making process. Keeping employee representation τ_{er} fixed, shareholders choose the optimal proportion of outsiders τ_{out}^* , while the insider share is determined by:

$$\tau_{ins} = 1 - \tau_{er} - \tau_{out}$$

Insider information withholding modifies the trade-off between insiders and outsiders. When insiders disclose only part of what they know, their informational advantage is weakened. Outsiders may therefore become more valuable as independent sources of information and monitoring. This leads to the following proposition.

Proposition 2. In the absence of conflict of interest, when insiders withhold part of their information, board composition disciplines insider opacity. More precisely:

- 1 There exists a minimum level of outsider information α_{out}^{min} required for outsiders to enter the board. This threshold decreases with insider opacity ρ and increases with the proportion of employee representatives τ_{er} .
- 2 For a given level of outsider information α_{out} and employee representation τ_{er} , the optimal outsider share is higher under insider withholding than under full disclosure.
- 3 There exists a maximum admissible level of insider opacity ρ_{max} , above which insiders no longer retain a positive board representation. This threshold decreases with both outsider information α_{out} and employee representation τ_{er} .

Proposition 2 shows that insider opacity changes the logic of board composition. It shifts the focus from the possession of information to its effective transmission. When insiders disclose less, outsiders become easier to justify because they compensate for the loss of effective insider information. Employee representation, by contrast, raises the entry threshold for outsiders because employee directors already occupy board seats and may provide firm-specific information.

The key implication is that insider opacity is self-limiting. For a given α_{out} and τ_{er} , insider withholding increases the optimal outsider share. If insiders withhold too much information, they undermine the informational advantage that justifies their own board representation. Informed outsiders and employee directors therefore jointly discipline insider opacity: it is not a free variable but is bounded by the board composition it seeks to exploit.

4 Absence of conflict of interest between shareholders and employees

In this section, we analyse the benchmark case in which shareholders and employee representatives both favour the safe long-term project $P1$. Since employee representatives are assumed to prefer $P1$, absence of conflict between shareholders and employees requires shareholders to prefer $P1$ as well, that is:

$$\delta_{out} \geq p$$

We then distinguish two cases depending on insiders' preferences. Insiders may either also favour $P1$, in which case the board is fully aligned, or favour $P2$, in which case a conflict arises between insiders and the long-term coalition formed by shareholders and employees.

4.1 Insiders favour long-term

We first consider the case of full alignment. Shareholders, insiders, and employee representatives all favour the long-term project $P1$. Formally:

$$\delta_{out} \geq p \text{ and } \delta_{ins} \geq p$$

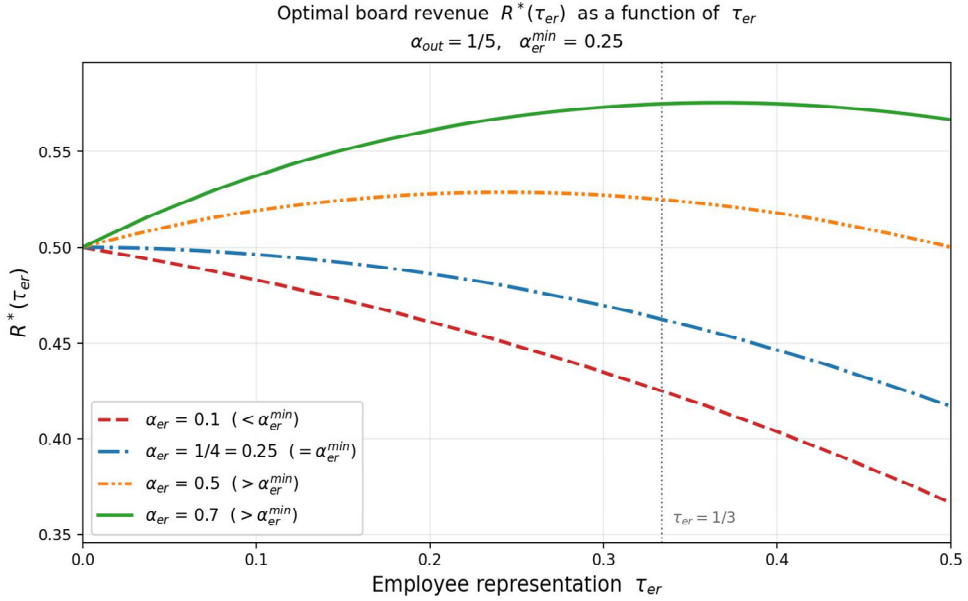
Since the project choice is unanimous, shareholders choose board composition only to maximise the informational revenue R . This setting isolates the informational value of employee representation, independently of any coalition conflict.

Proposition 3. In the absence of conflict of interest, there exists a threshold level of employee informational content α_{er}^{min} above which the optimal proportion of employee representatives is strictly positive. However, this optimal proportion reaches one-third only if employee information quality is sufficiently high, namely if:

$$\alpha_{er} \geq \frac{16}{25}$$

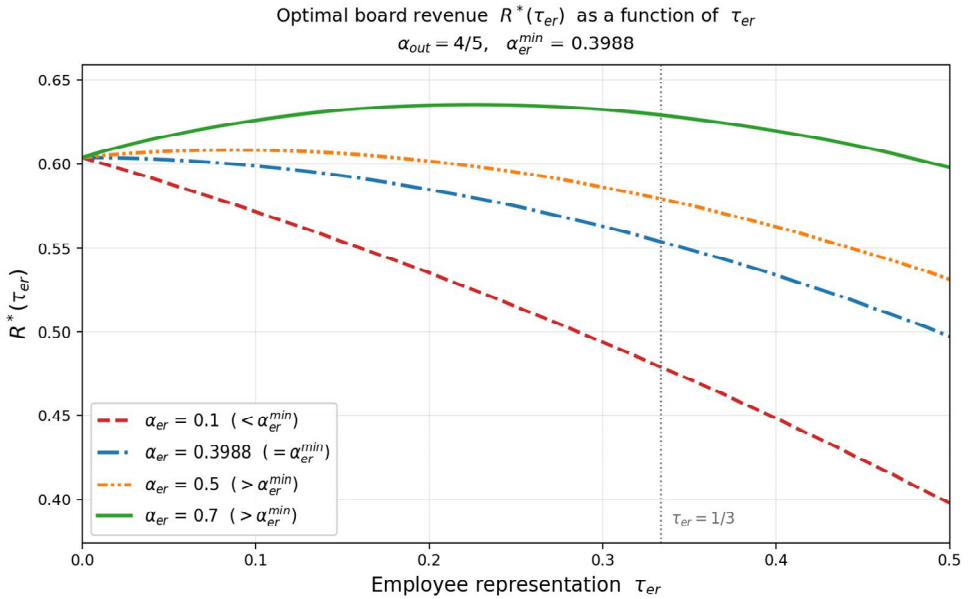
Proposition 3 identifies the informational condition under which employee representation creates value. Employee directors increase board revenue only when their firm-specific information exceeds the threshold α_{er}^{min} . Below this threshold, adding employee representatives reduces board value because it replaces more informative directors without providing enough compensating information.

Figure 2 When outsider information is low ($\alpha_{out} = 1/5$), employee representation becomes value-increasing once α_{er} exceeds its threshold (see online version for colours)



Notes: Below the threshold, revenue decreases with employee representation; above it, revenue first increases and then declines.

Figure 3 When outsider information is high ($\alpha_{out} = 4/5$), the informational threshold for employee representatives is higher (see online version for colours)



Notes: Employee representation improves revenue only if employees bring sufficiently strong information.

The proposition also formalises the optimal-minority logic. Since insider information is normalised to one, employee representatives do not optimally dominate the board. Reaching one-third representation requires $\alpha_{er} \geq 16/25$, meaning that employee representatives must provide at least 64% of the insider informational benchmark. Employee representation is therefore valuable only when employees bring sufficiently strong firm-specific knowledge.

Figures 2 and 3 illustrate the inverted-U logic of the model. Employee representation is value-increasing only when employee information exceeds the relevant threshold. When outsider information is low, this threshold is moderate; when outsider information is high, employee representatives must bring stronger information to justify their seats. Limited employee representation can therefore enhance value, whereas excessive representation reduces revenue by crowding out more informative directors.

This result is strengthened when insiders withhold information. As shown in Annex 4, the informational threshold above which employee representation becomes value-increasing decreases with insider opacity ρ . Employee directors are therefore easier to justify when insiders disclose less, because they partly compensate for the loss of effective insider information. This reinforces the self-limiting nature of insider opacity.

In the following subsection, we analyse the case where insiders' interests differ from those of shareholders and employees.

4.2 *Insiders favour short-term*

We now consider the case in which insiders favour the short-term risky project $P2$, while shareholders and employee representatives favour the long-term safe project $P1$. Formally:

$$\delta_{out} \geq p \text{ and } \delta_{ins} < p$$

This creates a conflict between insiders and the long-term coalition formed by shareholders and employees. If the optimal proportion of insiders does not exceed one half, the conflict has no effect on the project choice: the shareholders-employees coalition can impose $P1$. Formally, the conflict is irrelevant whenever:

$$\tau_{ins}^* \leq \frac{1}{2}$$

At equality, the outsider chairman breaks the tie in favour of the shareholders-employees coalition, so that $P1$ is selected.

When insiders form a majority, however, shareholders face a trade-off between three strategies:

- 1 Do nothing: keep the revenue-maximising insider-dominated board but accept that insiders choose $P2$.
- 2 Incentivise insiders: keep the same board composition but compensate insiders for voting in favour of $P1$.
- 3 Recompose the board: move away from the revenue-maximising board composition so that a coalition of outsiders and employee representatives can choose $P1$, at the cost of losing some insider information.

The trade-off is therefore between information, incentives, and control. Doing nothing preserves the most informative board but lets insiders choose $P2$. Incentivising insiders preserves board composition but requires a transfer. Recomposing the board avoids this incentive cost but reduces insider information. Employee representation matters only if it makes this recomposed long-term coalition sufficiently valuable.

This leads to the following proposition.

Proposition 4. When shareholders and employee representatives favour the long-term project $P1$, but insiders favour the short-term project $P2$, minority employee representation can shift the firm's investment decision from $P2$ to $P1$ only if the shareholders' discount factor lies within an intermediate range:

$$\delta_{out}^{low} \leq \delta_{out} \leq \delta_{out}^{high} \quad 7.$$

The lower cut-off ensures that shareholders are sufficiently patient to prefer a recomposed board choosing $P1$ over an insider-controlled board choosing $P2$. The upper cut-off ensures that shareholders would not already impose $P1$ without employee representatives. Employee representation is therefore decisive only when it changes the comparison between inaction, incentives, and board recomposition.

We now turn to the case where shareholders and employees no longer share the same preferred project.

5 Conflict of interest between shareholders and employees

We now analyse the case in which shareholders and employee representatives no longer favour the same project. Shareholders are short-termist and prefer the risky short-term project $P2$, whereas employee representatives continue to favour the safe long-term project $P1$. Formally:

$$\delta_{out} < p$$

This configuration captures the standard concern that shareholder pressure may induce firms to prioritise short-term returns over long-term value creation. In this setting, employee representation can affect the investment decision only if employee directors help form a viable long-term coalition.

Proposition 5. When shareholders favour the risky short-term project $P2$ ($\delta_{out} < p$) and employee representatives favour the safe long-term project $P1$, minority employee representation can shift the firm's investment decision from $P2$ to $P1$ only if two conditions hold:

- 1 Shareholders' short-termism is intermediate:

$$\delta_{out}^{low} \leq \delta_{out} \leq \delta_{out}^{high}$$

- 2 Insiders' interests are also in conflict with shareholders' interests, that is, insiders favour the long-term project:

$$\delta_{ins} > p$$

The formal proof is provided in Annex 6.

Proposition 5 shows that employee representation can act as a corrective mechanism against shareholder short-termism, but only under restrictive conditions. Employee directors cannot change the firm's strategy by themselves. Their influence arises only when they can form a coalition with insiders who also favour the long-term project $P1$. The result is therefore not driven by employee control of the board, but by the ability of a minority employee block to make the long-term coalition viable.

The intermediate-range condition captures the limits of this mechanism. If shareholders are too short-termist, they still impose $P2$, either by recomposing the board in favour of outsiders or by incentivising insiders. If shareholders are not sufficiently short-termist, the firm would choose $P1$ even without employee representation. Employee directors are therefore decisive only when they change the comparison between the value of the short-term project and the value of a coalition supporting the long-term project.

This result is consistent with evidence suggesting that employee directors can support more conservative and long-term-oriented corporate policies (Overland and Samani, 2022; Rees and Bri  ne, 2024). In the model, this effect operates through coalition formation: minority employee representatives steer the firm toward $P1$ not by dominating the board, but by making a long-term coalition feasible.

6 Heterogeneous preferences within board groups

The previous sections assumed that all directors of a given group vote in the same direction. We now relax this assumption while keeping the informational structure unchanged. Directors of the same group still bring the same type of information, but they may differ in their preferred project.

We focus on insider heterogeneity because insiders play the central informational role in the model. Shareholders and employee representatives are assumed to favour the long-term project $P1$, while only a fraction η of insiders favours the short-term project $P2$. The remaining fraction $1-\eta$ favours $P1$. Thus, the short-term coalition inside the insider block represents only a fraction of total insider representation.

This extension tests whether employee representation remains useful when the conflict with insiders is less severe.

Proposition 6. Suppose shareholders and employee representatives favour $P1$, while only a fraction η of insiders favours $P2$. Then:

- 1 If the fraction of short-termist insiders is too low, employee representation is not necessary to change the project choice. If it is sufficiently high, minority employee representation can shift the firm from $P2$ to $P1$ only if:

$$\delta_{out}^{low, \eta} \leq \delta_{out} \leq \delta_{out}^{high, \eta}$$

- 2 There exists a threshold $\alpha_{er}^{min, \eta}$ above which employee representatives make the recomposed board sufficiently valuable.
- 3 This threshold increases when η decreases and when α_{out} increases: the fewer insiders favour $P2$, the less employee representatives are needed politically; and the more informative outsiders are, the higher the informational contribution required from employee representatives to justify their presence.

Proposition 6 shows that insider heterogeneity weakens the political role of employee representatives. When all insiders favour $P2$, employee directors are useful because they help shareholders form a coalition in favour of $P1$. When part of the insider block already supports $P1$, the need for employee representatives as voting allies becomes weaker.

As η decreases, the range of discount factors for which employee representation changes the project choice becomes narrower. Employee representatives must therefore justify their presence more through information than through coalition formation. This is why the threshold $\alpha_{er}^{min,\eta}$ increases when η decreases.

The same reasoning can be extended to cases where heterogeneity affects the employee or outsider block. If part of the employee block favours $P2$, employees become less reliable long-term coalition partners; if part of the outsider block favours $P2$, the shareholder coalition itself weakens. In both cases, employee representatives remain useful only if they both strengthen the long-term coalition and bring enough information to offset the cost of recomposition.

7 Policy implications

The policy implications follow directly from the three main mechanisms identified above: informational thresholds, insider opacity, and coalition formation. The model does not imply that employee representation is always value-enhancing. Rather, it supports moderate employee representation under identifiable informational and coalition conditions.

Proposition 3 first supports moderate codetermination rather than employee dominance. Employee directors create value only when their firm-specific information exceeds a threshold. Below this threshold, employee representation crowds out more informative directors and reduces board value. Above the threshold, limited employee representation can improve decision-making, but excessive representation eventually becomes costly. This provides a theoretical rationale for minority employee representation, such as the limited board representation introduced in France under the Loi PACTE, rather than parity codetermination as a universal rule.

A complementary implication follows from Proposition 2, which highlights the governance role of transparency and insider opacity. Employee representatives and informed outsiders discipline insider opacity because they provide alternative sources of information when insiders disclose less. The implication is not that opacity mechanically increases the optimal level of employee representation, but that employee directors become easier to justify when insiders withhold information and alternative information sources are needed. Policies that improve board-level information disclosure and strengthen the informational capacity of non-insider directors can therefore complement moderate codetermination.

When preferences diverge, Propositions 4 and 5 show that employee representation matters only when it helps make a long-term coalition viable. In Proposition 4, employee directors support long-termist shareholders against short-termist insiders by making board recomposition less costly. In Proposition 5, they support long-termist insiders against short-termist shareholders. In both cases, employee directors do not need to control the board to affect firm strategy. Their influence arises when they alter the marginal comparison between inaction, incentives, and board recomposition. This

mechanism is effective only in intermediate configurations: if the long-term coalition would prevail without them, employee representation is not decisive; if the short-term coalition is too strong, employee directors cannot prevent the selection of the short-term project.

Overall, the model favours a conditional rather than universal approach to codetermination. Employee board representation is more likely to be value-enhancing when it brings valuable firm-specific information, compensates for insider opacity, and contributes to a viable long-term coalition. These conditions support moderate and context-sensitive codetermination rules rather than uniform mandates.

8 Conclusions

This paper has developed a theoretical model of board decision-making in which employee directors affect firm value through two channels: the information they contribute and the coalitions they help form. The analysis shows that employee representation is neither intrinsically value-enhancing nor intrinsically value-destroying. Its effect depends on identifiable informational and coalition conditions.

Three results follow. First, employee representation creates value only when employee directors bring sufficiently strong firm-specific information. A moderate level of employee representation can improve board decision-making, but excessive representation crowds out more informative directors and reduces value. Second, minority employee representation matters through coalition formation: employee directors become decisive when they alter the marginal comparison between inaction, incentives, and board recomposition, and only for an intermediate range of shareholder patience. Third, insider opacity is self-limiting: when insiders withhold information, outsiders and employee representatives become more valuable as alternative information sources, but excessive withholding undermines insiders' own board representation.

The model generates testable predictions. The value-enhancing effect of employee representation should be stronger when employees hold valuable firm-specific information, when shareholder patience is intermediate, and when insider opacity makes alternative sources of board information more valuable. Future work could endogenise insider opacity, allow for richer within-group heterogeneity, introduce multi-period learning, or calibrate the model using European board data and regulatory changes such as the French *Loi PACTE*.

The central implication is not that employee representation is always beneficial, but that it can be value-enhancing under identifiable informational and coalition conditions.

Appendices/Supplementary materials are available on request by emailing the corresponding author.

Declarations

All authors declare that they have no conflicts of interest.

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Notes

- 1 We only study proportions, assuming the optimal size of the board is determined by other parameters (industry, firm size, etc.). We translate the required/agreed number of employee-representatives on the board into the proportion relative to the optimal size of the board.
- 2 Note that all parameters δ are of the form $\frac{1}{1+r}$ where r is the discount factor. We use δ for simplicity.
- 3 The level of employee-directors on the board is primarily driven by the law. Numerous papers (Atanasov and Black, 2016; McCrary, 2008), have shown that the firms attempt neither to bypass this representation regulation nor to enhance the percentage of employees elected to the board.
- 4 For instance, under the French law, employee representatives benefit from exclusive employment-protection rights.

- 5 This specification is adopted for tractability and to obtain closed-form thresholds. More generally, for any twice differentiable informational contribution function f such that $f(0) = 0$, $f' > 0$, and $f'' < 0$, the revenue function can be written as $R = \alpha_{ins}f(\tau_{ins}) + \alpha_{out}f(\tau_{out}) + \alpha_{er}f(\tau_{er})$ with $\tau_{ins} = 1 - \tau_{out} - \tau_{er}$. The main economic mechanisms highlighted in the propositions (the trade-off between insider and outsider information, the threshold role of α_{er} , and the effect of employee representation τ_{er} on board composition) follow from monotonicity and concavity rather than from the specific functional form.
- 6 This is consistent with the idea that insiders may reduce information asymmetries and monitoring costs because of their superior access to firm-specific information (Heflin and Shaw, 2000; O'Neill and Swisher, 2003; Belghitar et al., 2011; Elbadry et al., 2015).
- 7 The formal proof and the expressions of the two cut-offs are provided in Annex 5.