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PRIVATELY ORDERED PARTICIPATORY MANAGEMENT: AN ORGANIZATIONAL FAILURES ANALYSIS

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American industrial enterprises long organized their production processes in rigid hierarchies in which production-level employees had little discretion or decisionmaking authority. Recently, however, many firms have adopted participatory management programs purporting to give workers a substantially greater degree of input into corporate decisions. Quality circles, self-directed work teams, and employee representation on the board of directors are probably the best-known examples of this phenomenon.

These forms of workplace organization have garnered considerable attention from labor lawyers and economists, but relatively little from corporate law academics. This is unfortunate, both because the tools routinely used by corporate law academics have considerable application to the problem and because employee participation is ultimately a question of corporate governance.

According to conventional academic wisdom, perceptions of procedural justice are important to corporate efficiency. Employee voice promotes a sense of justice, increasing trust and commitment within the enterprise and thus productivity. Workers having a voice in decisions view their tasks as being part of a collaborative effort, rather than as just a job. In turn, this leads to enhanced job satisfaction, which, along with the more flexible work rules often associated with work teams, results in a greater intensity of effort from the firm's workers and thus leads to a more efficient firm.

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Although this view of participatory management has become nearly hegemonic, the academic literature nevertheless remains somewhat vague when it comes to explaining just why employee involvement should have these beneficial results. In contrast, my article presents a clear explanation of why some firms find employee involvement enhances productivity and, perhaps even more important, why it fails to do so in some firms.

Despite the democratic rhetoric of employee involvement, participatory management in fact has done little to disturb the basic hierarchial structure of large corporations. Instead, it is simply an adaptive response to three significant problems created by the tendency in large firms towards excessive levels of hierarchy. First, large branching hierarchies themselves create informational inefficiencies. Second, informational asymmetries persist even under efficient hierarchial structures. Finally, excessive hierarchy impedes effective monitoring of employees. Participatory management facilitates the flow of information from the production level to senior management by creating a mechanism for by-passing mid-level managers, while also bringing to bear a variety of new pressures designed to deter shirking.

I. The Fall of Taylorism and the Rise of Participatory Management 4
A. *Scientific Management: Taylorism and its Ilk* 4
B. *The Switch to Participatory Management* 5
C. *A Taxonomy* 6
1. *Quality of Work Life* 7
2. *Quality Circles* 7
3. *Gain-sharing* 9
4. *Self-directed Work Teams* 9

II. The Conventional Wisdom 10

III. Organizational Failures and Participatory Management 20
A. *Participatory Management as Fad* 21
B. *An Organizational Failures Account* 23
1. *The Function of Hierarchy* 23
a. *Hierarchy and Information* 24
b. *Hierarchy and Agency Costs* 26
2. *Participatory Management and the Transaction Costs of Processing Information* 28
a. *Observation: The Problem of Persistent Information Asymmetries* 29
b. *Communication and the Costs of Irreversibility* 30
c. *Economizing on Transaction Costs through Participatory Management* 32
i. *Quality of Work Life* 33
ii. *Quality Circles* 33
iii. *Gain-sharing* 35
iv. *Self-directed Work Teams* 36
v. *Summary* 38
3. *Participatory Management as an Agency Cost Constraint* 38
a. *Self-monitoring* 40
b. *Peer Pressure* 43
c. *Evidence for the Monitoring Hypothesis* 47

IV. Implications 50
A. *Spatial Boundaries: One Size does not Fit All* 51
1. *The Nature of the Workplace* 52
a. *Information Processing* 52
b. *Monitoring* 56
2. *Firm Culture* 59
B. *The Future of Participatory Management* 62
1. *Company Union?* 63

2. *Board Representation?* 66
a. *The Trendline* 68
b. *The Theoretical Story* 69
i. *Arrow's Equality of Information Condition* 71

ii. *Arrow's Identicality of Interest Condition* 73
iii. *The Inefficiency of Multiple Constituencies* 74
iv. *Why Only Shareholders?* 81

V. Conclusion 87

Participatory management is a system of industrial relations purporting to involve employees in workplace decisionmaking. In its various guises,[2] participatory management has been adopted by thousands of U.S. corporations. It is widely endorsed by business leaders, academics, politicians, and even some union leaders.[3] Yet despite a mountain of book and articles on the topic, participatory management also remains poorly understood.

The legal literature is especially disappointing. Most of it is concerned with purely doctrinal issues of labor law.[4] Most of the rest is concerned with "ought" rather than "is" questions. In particular, the literature is heavily weighted towards the question of government intervention--should the government mandate participatory management--with a strong bias on favor of government mandates.[5] Relatively little attention has been paid to the "is"

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[2] "Participatory management" and "employee involvement" are herein used interchangeably as generic terms covering any program purporting to give employees a role in corporate decisionmaking. "Employee participation" refers to programs utilizing direct involvement by all affected workers, while "employee representation" refers to programs utilizing indirect involvement through worker representatives.

[3] See, e.g., Allan D. Gilmour, *Union Management Cooperation*, 43 LABOR L.J. 513, 516 (1992) (participatory management has been endorsed by the Collective Bargaining Forum, a group of national union leaders and senior corporate managers).

[4] To be sure, labor law has significant implications for participatory management. Employee involvement plans implicate at least four core labor law doctrines: (1) the prohibition of company unions; (2) exclusive representation; (3) the distinction between workers and managers; and (4) the distinction between mandatory, permissive, and illegal bargaining subjects. THOMAS A. KOCHAN ET AL., THE TRANSFORMATION OF AMERICAN INDUSTRIAL RELATIONS 234 (rev. ed. 1994). The extent to which these doctrines impede the development of participatory management is a question that remains unsettled, as well as being a subject outside the scope of this Article, but it seems fair to say that litigation under the labor laws still poses some threat to the further expansion of participatory management. See generally Michael H. LeRoy, *Employer Domination of Labor Organizations and the Electromation Case: An Empirical Public Policy Analysis*, 61 GEO. WASH. L. REV. 1812, 1815-22, 1826-32 (1993); Audrey Anne Smith, Comment, *The Future of Labor-Management Cooperation Following Electromation and E.I. DuPont*, 35 SANTA CLARA L. REV. 225 (1995). But see James R. Rundle, *The Debate over the Ban on Employer-Dominated Labor Organizations: What is the Evidence*, in RESTORING THE PROMISE OF AMERICAN LABOR LAW 161, 173 (Sheldon Friedman et al. eds. 1994) (no evidence that the NLRA threatens employee involvement programs "of the type employers say they must have to be competitive").

[5] I do not mean to suggest that "ought" questions are irrelevant or unworthy of inquiry. To the contrary, my earlier article, *Participatory Management Within a Theory of the Firm*, 21 JOURNAL

questions: Why have so many firms voluntarily adopted some form of participatory management? And, perhaps of even greater import, why have so many firms later abandoned employee involvement? How is participatory management evolving and what forms is it likely to take in the future? This article is intended to fill that gap by exploring those questions.

Corporate decisionmaking long was one of the most fiercely guarded management prerogatives. Over the last several decades, however, new forms of industrial relations have developed that purport to involve employees in the decisionmaking process or even to devolve decisionmaking responsibility to them. Why has authoritarian decisionmaking given way to participatory decisionmaking? The conventional wisdom claims that workers worker morale and, hence, productivity improves when they participate in the decisions that affect them. I intend to test that claim. To what extent does participatory management in fact devolve decisionmaking to employees? Does doing so enhance productivity?

I conclude that the conventional wisdom lacks explanatory power. As it turns out, participatory management is well-suited for some firms but poorly-suited for many others. In analyzing the economic function of participatory management, I offer the complementary hypotheses that participatory management may promote efficient flows of information within the firm and/or provide efficient mechanisms for monitoring employees. In turn, these hypotheses provide guidance for differentiating those firms in which participatory management is likely to succeed from those in which it is likely to fail. My hypotheses also shed light on the question of why U.S. firms generally do not involve employees in strategic policymaking even if they involve employees in decisions about day-to-day operations.

Part I traces the demise of so-called scientific management and the rise of participatory management as an important alternative system of industrial relations. Part II sets out and evaluates the conventional wisdom. Part III is the heart of the article, in which I develop my hypotheses about the function of privately ordered participatory management. In Part IV, I explore the resulting implications for the future of participatory management.

I. THE FALL OF TAYLORISM AND THE RISE OF PARTICIPATORY MANAGEMENT

This article is principally concerned with labor relations in U.S. industrial corporations. Hierarchy was their historic watchword. Over the last two decades, however, participatory management has emerged as a putative challenger to traditional corporate hierarchies. As we shall see, the extent to which participatory management schemes actually intrude upon the older hierarchial style of management in fact varies rather dramatically.

OF CORPORATION LAW 657 (1996), was concerned mainly with economic "ought" questions, especially the question of whether the government should mandate some form of participatory management.

A. *Scientific Management: Taylorism and its Ilk*

Pre-Industrial Revolution workplaces were characterized by persistent information asymmetries favoring workers and a resulting high degree of control by those workers. Craftsmen were highly trained, knew a great deal about the production processes, and accordingly could control the production process.[6] With the coming of the Industrial Revolution, and assembly line production, however, it became possible to redesign the workplace so as to shift control to managers.

In the early part of this century, Frederick W. Taylor developed the most famous form of what came to be called "scientific management."[7] Taylor wanted to reverse the information asymmetry so that it favored managers rather than workers. Workers who knew more than management about the production process could shirk by controlling the pace of production.[8] Preventing shirking thus required that not only decisionmaking, but also access to information, be management's sole prerogative.

Taylor required managers to use time and motion studies to identify the ideal method of performing each step in the production process.[9] Managers then were to impose that method on workers. To achieve this goal, Taylor adopted three core principles: (1) distillation of craft knowledge into work rules taught to employees; (2) advance planning of production processes by management; and (3) elimination the need for thinking or learning by workers.[10] These principles were implemented by industrial engineers and management experts, who broke down a given production process into a large number of small steps, each allocated to a single worker, who was closely supervised.[11] Hence the narrow job descriptions typical of Taylorism, because shirking easily can be detected when employees are charged with performing but a single task. Hence also Taylorist compensation schemes based on the old maxim: "a fair day's pay for a fair day's work,"[12] which was possible precisely because the employees' narrow job descriptions and close supervision allowed pay to be closely linked to productivity.

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6 See Thomas Earl Geu & Martha S. Davis, *Work: A Legal Analysis in the Context of the Changing Transnational Political Economy*, 63 U. CIN. L. REV. 1679, 1685-87 (1995).

7 JOHN L. COTTON, EMPLOYEE INVOLVEMENT 4-5 (1993).

8 Katherine Van Wezel Stone, *Labor and the Corporate Structure: Changing Conceptions and Emerging Possibilities*, 55 U. CHI. L. REV. 71, 141-42 (1988).

9 Julius G. Getman and F. Ray Marshall, *Industrial Relations in Transition: The Paper Industry Example*, 102 YALE L.J. 1803, 1808 (1993).

10 COTTON, supra note , at 5; Geu & Davis, supra note , at 1690.

11 PAUL C. WEILER, GOVERNING THE WORKPLACE: THE FUTURE OF LABOR AND EMPLOYMENT LAW 196 (1990).

12 Richard E. Walton, *From Control to Commitment in the Workplace*, HARV. BUS. REV., Mar./Apr. 1985, at 76, ___.

B. *The Switch to Participatory Management*

According to conventional wisdom, Taylorism no longer works. Conventional wisdom offers three explanations for Taylorism's alleged demise: Today's workers demand a more democratic workplace. Advances in industrial technology demand greater worker expertise and discretion, as does the need for flexibility to respond to the rapid economic changes associated with global competition, which makes it harder for management to retain the informational advantage over shop floor employees critical to the success of Taylorist workplaces. Finally, the nature of work has changed in ways inconsistent with the principles of Taylorism. In response to these trends, some corporate managers began looking for new ways of motivating and organizing workers. In the last few decades, participatory management emerged as a leading contender for the title.[13]

Even in Taylorist workplaces, of course, employees participate somewhat in corporate decisionmaking. Informal employee involvement, in fact, is as old as employment relationships. The inherent and unavoidable link between management and labor necessarily gives the latter some ability to influence the former, even if only by withholding their service in whole or part. Beyond strikes, slow-downs, and boycotts, employees directly affect employer decisions through collective or individual bargaining and do so indirectly through lobbying legislatures for laws constraining employer discretion or mandating employer conduct.

Participatory management differs from these forms of employee involvement in some important ways. It institutionalizes employee involvement by creating formal mechanisms through which employee voices can be heard by corporate decisionmakers and, in some cases, by giving employees a say in the making of firm decisions. At least in theory, participatory management transforms Taylorist hierarchies into something more democratic.

For purposes of evaluation, employee involvement programs in capital-owned firms usefully divide into two basic categories: operational participation and strategic participation.[14] "Operational participation" refers to programs in which employee involvement is limited to day-to-day issues of productivity and working conditions at the plant level. Operational participation includes

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[13] Taylorism never had the field to itself, of course. As to its various competitors, see Peter F. Drucker, *The Emerging Theory of Manufacturing*, HARV. BUS. REV., May/June 1990, at 94.

[14] The discussion herein is restricted to capitalist-owned firms; i.e., those in which employees lack significant ownership interests. Although employee ownership obviously has great potential for affecting the corporate governance structure, it is largely irrelevant to this article. While employee-owners reasonably might expect a voice in corporate decisionmaking, such an expectation takes on a quite different, and rather more interesting, cast when employees lack significant stockownership. This article therefore largely ignores questions relating to employee ownership.

programs like quality circles and self-directed work teams--Saturn's well-known work teams will doubtless come to mind as an example of the phenomenon.

"Strategic participation" refers to programs in which employees participate in major policy decisions, such as those traditionally thought of as falling within the realm of corporate governance. In contrast to the widespread nature of operational participation, which according to some estimates exists in as many as 30,000 U.S. firms, strategic participation is rare and rudimentary in the United States. Accordingly, this article emphasizes operational participation. The model of operational participation developed herein, however, has significant implications for the viability of strategic participation and considerable explanatory power with respect to the absence of strategic participation in the United States. Those implications are sketched in the final part of this article.

C. *A Taxonomy*

Operational participation schemes come in a variety of flavors. Some address issues of firm-wide scope, while others are concerned only with a small part of the production process within a particular plant. Some provide indirect participation through worker representatives, while others provide direct participation. Some are voluntary, while some are mandatory. The degree of worker autonomy they provide also varies widely, although they uniformly prohibit employee involvement in strategic or policy decisions.

What follows is a basic taxonomy of the main forms of participatory management. Participatory management has never been a particularly well defined concept but in recent years has become even more confused with the proliferation of new forms and hybrids.[15] Participatory management is also closely linked with other management developments, such as empowerment, flattened hierarchies, downsizing, restructuring, and the like. All of which requires that any taxonomy be suggestive, rather than comprehensive. My intent is to offer sufficient detail to provide a framework for the analysis that follows, while avoiding getting bogged down in innumerable details and variations on the theme.

1. *Quality of Work Life*

Quality of work life programs--commonly known as QWL--are probably the most common form of employee involvement, but also the hardest to define because the name has been used to describe so many different programs. In its most common form, QWL consists of small volunteer groups that study plant- or even firm-wide problems, developing recommendations to be passed on to those corporate managers with decisionmaking jurisdiction over the relevant area.

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[15] David J. Glew et al., *Participation in Organizations: A Preview of the Issues and Proposed Framework for Future Analysis*, 21 J. MGMT 395 (1995).

The focus tends to be on working conditions and related work life concerns, although some include productivity and quality issues within their jurisdiction.[16] QWL is usually an indirect form of participation organized on a representative basis, especially groups with plant- or firm-wide jurisdiction.[17] In unionized firms or plants, a comparable function is sometimes performed by a so-called labor-management cooperation committee. These joint union-management committees, typically with equal labor and management representation, meet for consultation on issues of department- or plant-wide concern.[18]

2. *Quality Circles*

Quality circles commonly consist of a small group of employees (typically under 15) meeting on a regular basis on company time to discuss problems in their work environment. The emphasis is on productivity and product quality.[19] Members of a given quality circle usually come from a single department,[20] in contrast to the plant- or firm-wide committees typical of QWL. Employee enrollment in a quality circle program is usually voluntary, with participation by 25% of a plant's work force being typical.[21]

Unlike QWL's broad jurisdictional purview, discussions within quality circles are typically limited to production processes. A common task is the design of workplace procedures. Recall that under Taylorism, management developed standardized work procedures and enforced employee compliance with them. At NUMMI (GM's joint venture with Toyota), quality circle-like groups of workers designed their own standardized procedures. As one worker

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[16] Martin T. Moe, *Participatory Workplace Decisionmaking and the NLRA: Section 8(a)(2), Electromation, and the Specter of the Company Union*, 68 N.Y.U. L. REV. 1127, 1159 (1993). Job enrichment programs somewhat resemble QWLs, except that they focus on individual employees, enhancing their responsibility and autonomy. COTTON, supra note , at 141-142.

[17] WEILER, supra note , at 209-10.

[18] LeRoy, supra note , at 1815 n.15; Moe, supra note , at 1157-58.

[19] COTTON, supra note , at 59. Quality circles are typically limited to manufacturing and some service workplaces. For discussion of a quality circle-like program more commonly used in knowledge and technical settings, see Eileen M. Van Aken et al., *Affinity Groups: The Missing Link in Employee Involvement*, ORG. DYNAMICS, Mar. 22, 1994, at 38, ___; see also David E. Bowen and Edward E. Lawler, *The Empowerment of Service Workers*, SLOAN MGMT REV., Mar. 22, 1992, at 31 (describing variants of participatory management used in service firms).

[20] COTTON, supra note , at 61.

[21] COTTON, supra note , at 59; GUILLERMO J. GRENIER, INHUMAN RELATIONS: QUALITY CIRCLES AND ANTI-UNIONISM IN AMERICAN INDUSTRY 9 (19__) ("Failures are seldom reported, although they occur frequently."); David I. Levine and Laura D'Andrea Tyson, *Participation, Productivity, and the Firm's Environment*, in PAYING FOR PRODUCTIVITY: A LOOK AT THE EVIDENCE 183, 189 (Alan S. Blinder ed. 1990).

explained, "we all work out the objectively best way to do the job, and everyone does it that way."[22]

Quality circles are often associated with so-called Total Quality Management, perhaps the best known management fad of the last decade. In fact, however, TQM's proponents usually draw a sharp distinction between the employee involvement aspects of TQM, which involve the use of cross-functional problem-solving teams, and quality circles. Despite their insistence on these denominational distinctions, TQM teams and quality circles are sufficiently similar to justify treating them as variations on the same theme.[23]

Quality circles have undergone many changes in recent years. One important trend is the demise of permanent quality circles and their replacement by temporary problem-solving teams.[24] An important sub-set of quality circles has evolved in the direction of self-directed work teams, which are discussed below. In such cases, participation in the circle is usually mandatory and typically involves the entire work force.[25]

3. *Gain-sharing*

Quality circles usually do not offer financial rewards for ideas.[26] In contrast, gain-sharing plans are based on that very premise, paying employees bonuses for ideas that lead to improved productivity. Gain-sharing plans generally apply to all non-management employees and encompass almost any aspect of the firm.[27] Some forms do not directly provide substantial monetary rewards to the person who came up with the idea, but rather to the whole work-force.[28] Some forms (such as so-called Scanlon plans) link financial rewards to other forms of employee participation, while others (such as so-called Improshare plans) lack any explicit employee participation process beyond the ability to provide suggestions.[29]

4. *Self-directed Work Teams*

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[22] Accord Paul S. Adler and Bryan Borys, *Two Types of Bureaucracy: Enabling and Coercive*, 41 ADMIN. SCI. Q. 61, ___ (1996) ("TQM's emphasis on work process codification seems to contradict EI's focus on increasing employee discretion").

[23] On TQM and the use of quality circle-like teams therein, see generally J. Richard Hackman and Ruth Wageman, *Total Quality Management: Empirical, Conceptual, and Practical Issues*, 40 ADMIN. SCI. Q. 309 (1995).

[24] This appears to be especially true of TQM firms. Id. at ___.

[25] See, e.g., GRENIER, supra note , at 46 (in plant that was the principal subject of his study, attendance at team meetings is effectively mandatory).

[26] COTTON, supra note , at 59.

[27] Id. at 89.

[28] See id. at 90 (describing the Scanlon plan).

[29] Id. at 92-94.

Taylorism was designed for the classic assembly line in which the product moved past a succession of workers, each of whom carried out one task. Because each worker's tasks were so narrowly confined, workers (at least in theory) had neither the need to exercise judgment nor the knowledge necessary to make informed decisions. Whether or not the Taylorist ideal was effective in its classical setting, a question to which we shall return later, it is said to be inapt for modern production techniques. Many manufacturing firms are moving away from the classic assembly line towards discontinuous production processes involving small "modules" centered around a set of tasks.[30] Many such firms have moved towards team rather than individual labor. When work teams obtain some degree of self-governance, they become the most important species of participatory management: the self-directed work team.

A self-directed work team is a shop-floor participatory management scheme involving a small group of employees (typically no more than 12-15) organized around a specific area, product, or plant.[31] The team is authorized to make collective decisions about the sort of day-to-day work issues that would be made by a foreman in a Taylorist workplace.[32] The team may also have some human resources and/or customer relations functions.[33]

Job rotation within the team and constant training is typical.[34] Each team member is trained to perform most or even all of the team's tasks.[35] The team's training will include such business-oriented issues as market share and product costs.[36]

Self-directed work teams are designed for production environments in which group labor is required. If employees primarily work on individual projects, team organization is unnecessary and may prove counter-productive.[37] This probably explains why some companies have dispensed with formally designated work teams. Instead, they have moved towards so-called employee self-management in which employees become their own managers.[38] In its most extreme form, such firms have very flat (almost nonexistent) hierarchies, small production facilities organized so that each worker has direct lines of communication with almost every other worker, and monitoring by peers rather than supervisors.[39] Work requiring group effort is carried out by temporary, self-developing teams.[40]

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30 Drucker, supra note , at ___.

31 COTTON, supra note , at 174.

32 Id.

33 Id. Accord Levine and Tyson, supra note , at 190.

34 Moe, supra note , at 1159.

35 Walton, supra note , at ___.

36 Id.

37 See *Why Doesn't This Team Work*, HARV. BUS. REV., Nov./Dec. 1994, at 26, ___.

38 Frank Shipper and Charles C. Mann, *Employee Self-management Without Formally Designated Teams: An Alternative Road to Empowerment*, ORGANIZATIONAL DYNAMICS, Jan. 1992, at 48.

39 Id.

40 Id.

II. THE CONVENTIONAL WISDOM

Conventional wisdom claims that Taylorism no longer works. Instead, as the story goes, a new--more productive--system of industrial organization is required; namely, participatory management. Upon close examination, however, the conventional wisdom lacks a coherent account of why participatory management is, at least for some firms, a more efficient system of industrial relations than Taylorism.

Although various theories have been advanced to explain the alleged demise of Taylorism and the rise of participatory management,[41] the only account deserving extended treatment is derived from the organizational behaviorist school of industrial relations out of which participatory management first emerged. In contrast to Taylorism's rigid hierarchy and close monitoring of workers, organizational behaviorists posit that management should induce employees to accept the firm's goals and to cooperate in achieving them.[42] These theorists claimed that management could induce workers to do so only by

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[41] As noted above, the other two principal theories are that the nature of work has changed in ways incompatible with Taylorism and that participatory management is a necessary response to international competition. See, e.g., COTTON, supra note , at 6; WEILER, supra note , at 32; Getman and Marshall, supra note , at 1810. There is no doubt that work in the United States is changing. See infra notes TBA and accompanying text. But those who cite these changes as an explanation for the emergence of participatory management rarely offer any link between the two phenomena. In contrast, my hypotheses offer a very simple link: the cited changes in the nature of work have made it harder to monitor employees in certain settings. Participatory management thus emerges as an adaptive response to those changes, providing a new mechanism for deterring employee shirking.

The international competition version of the conventional wisdom posits that participatory management is necessary to make United States industries more competitive with those of other nations--most notably Germany and Japan--in which forms of participatory management are widespread. See, e.g., Robert B. Reich, *Entrepreneurship Reconsidered: The Team as Hero*, HARV. BUS. REV., May / June 1987, at 77. There are two notable problems with such reasoning: First, it lacks a good explanation for why German and Japanese industrial relations deserve the credit for their competitive success. Second, it overlooks the inconvenient fact that the United States is more competitive than either Germany or Japan. As to both points, see **[x-ref PM]** As to competitiveness, more recent data confirms my earlier conclusions. According to a recent competitiveness ranking by the International Institute for Management Development, the United States ranked first in both 1996 and 1997. In contrast, Japan fell from fourth place to ninth and Germany fell from tenth to fourteenth.

[42] Andrew A. Lipsky, Comment, *Participatory Management Schemes, The Law, and Workers' Rights: A Proposed Framework of Analysis*, 39 AM. U. L. REV. 667, 672 (1900).

alleviating the latter's feelings of alienation and powerlessness.[43] In turn, psychological studies purportedly showed managers could do so by offering democratic organizational structures and self-directed work. Participatory workplaces, according to these studies, were more productive workplaces.[44]

The basic thesis seems to be that by including employee voice in the decisionmaking process participatory management causes workers to view their tasks as being part of a collaborative effort, rather than as just a job. In turn, this leads to enhanced job satisfaction and greater commitment to the enterprise, which results in a greater intensity of effort from the firm's workers and thus leads to a more efficient firm:

> Through both role and process empowerment, [i.e., participatory management] employees gain an increased sense of ownership over their own work processes. As a result, they are less inclined to be absent, to be late, to seek transfers, or to provide grudging minimal performances. Empowered workers exercise greater discretion over the character of their own organizational involvement, possess a greater sense of identification with their organizations, and correspondingly work both more productively and with greater personal satisfaction.[45]

One might think it unlikely that such rhetorical flourishes could be exceeded, but consider the following extreme exemplar of the conventional wisdom: In describing W. L. Gore & Associates, which is organized along the employee self-management variant of self-directed work teams, a pair of commentators opined: "Gore has gone beyond the ideal of a democratic, capitalistic organization to an egalitarian, participative, entrepreneurial society. The values of Rousseau,

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[43] Id.

[44] COTTON, supra note , at 7-9.

[45] Jeffrey Gandz & Frederick G. Bird, *The Ethics of Empowerment*, 15 J. BUS. ETHICS 383, ___ (1996). Accord *Introduction, Special Project: Labor--Management Cooperation*, 41 VAND. L. REV. 539, 541-42 (1988) ("the more that workers participate in the operations of the business, the more workers feel their individual contributions add to the quality and success of the product. The desired results are a more congenial collective bargaining relationship and a more competitive product."); Charles B. Craver, *The Vitality of the American Labor Movement in the Twenty-first Century*, 1983 U. Il. L. Rev. 633, 638-39 (workers demand "enlightened employment environments" that offer "greater control over their work and more opportunities for self-actualization and intellectual fulfillment"); Getman and Marshall, supra note , at 1865 (similar); Geu & Davis, supra note , at 1731 ("greater worker satisfaction probably depends on ... greater control of one's work ... and at least a participatory voice in even the strategic decisions of enterprise. It appears that if the United States is to be competitive in the global economy, the workplace must change to accommodate these needs."); Charles D. Watts, Jr., *In Critique of a Reductivist Conception and Examination of "The Just Organization,"* 50 Wash. & Lee L. Rev. 1515, 1517-18 (1993) (noting similar arguments).

Locke, Smith, and Jefferson are embodied in Gore's culture and operating systems."[46]

The foregoing view of participatory management "became nearly hegemonic in the 1980s."[47] Yet, allowing for a few ideologically-motivated exceptions,[48] we can dismiss almost outright the democratic and communitarian rhetoric of the conventional wisdom.[49] The fact that management retains control over most decisions, especially the sort of policy decisions that are the grist of the corporate governance mill, is particularly instructive. It confirms that participatory management and participatory democracy have little to do with one another. Some participatory management programs (but not all) may have some democratic forms, but none have democratic reality so long as management retains decisionmaking control. Why then have firms adopted participatory management? In an important sociological study of corporate managers, Michael Useem concludes that a plethora of corporate changes, including both downsizing and participatory management, are motivated by management's desire to raise shareholder values.[50] While I might quibble with

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[46] Shipper & Manz, supra note , at ___.

[47] Mike Parker, *Industrial Relations Myth and Shop-Floor Reality: The Team Concept in the Auto Industry*, in INDUSTRIAL DEMOCRACY IN AMERICA: THE AMBIGUOUS PROMISE 249, 256 (Nelson Lichtenstein and Howell John Harris eds. 1993).

[48] Ben & Jerry's is probably the best-known U.S. example. See, e.g., Jennifer J. Laabs, *Ben & Jerry's: Caring Capitalism*, http://deming.eng.clemson.edu/pub/tqmbbs/cases/b&j1.txt.

[49] A more sophisticated communitarian argument is that employee involvement promotes trust between workers and managers. See, e.g., Marleen A. O'Connor, *A Socio-economic Approach to the Japanese Corporate Structure*, 50 WASH. & LEE L. REV. 1529 (1993); cf. Alan Hyde, *In Defense of Employee Ownership,* 67 CHI-KENT L. REV. 159, 191-94 (1991) (advancing a trust-based justification for employee-ownership). I am dubious that participatory management builds trust between managers and employees. Instead, to the extent participatory management builds trust it does so mainly between co-workers. Unlike many trust-based accounts, my analysis suggests that the trust-building elements of participatory management have a purely instrumental basis. (In fairness, it should be noted that Marleen O'Connor's version of the trust story is advanced as "ought" argument for a new for of participatory management that does not exist in the current marketplace. But I am also dubious that even her form of participatory management can build trust.) I may develop this argument in more detail in the future, but the gist of it is quite simple. Trust arise from shared values and is most likely to arise in homogeneous groups. The erosion of trust in the corporate workplace is thus explicable on two grounds: the diversification of the workplace and the loss of shared values formerly held by both managers and workers. In any event, I am also dubious that representative participation builds trust. At the risk of being trite, one notes that representative democracy has not prevented many American citizens from developing a profound distrust of their government, as evidenced in its most extreme form by the militia movement.

[50] MICHAEL USEEM, INVESTOR CAPITALISM 145-49 (1996).

Useem's emphasis on the role of institutional investors, the evidence recounted below confirms that participatory management is an economic--not a political or moral--phenomenon.[51]

Assuming that participatory management is about productivity, we are constrained to inquire into why should it be the case that "empowered workers" "work both more productively and with greater personal satisfaction." The participatory management literature remains somewhat vague when it comes to explaining how and why employee involvement has these beneficial results.[52] At the risk of being flippant, one can summarize much of the literature as follows: Participating employees are happy employees and happy employees are productive employees. Ergo, participating employees are productive employees. Unfortunately for the conventionally wise, the evidence simply does not support this claim.

To be sure, there is some evidence that participatory management has positive productivity effects. But the evidence is highly tenuous and far from conclusive. At the outset, it must be admitted that any discussion of empirical evidence in connection with participatory management is fraught with peril.

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[51] Insofar as participatory democracy-based claims have appeared in the academic literature, they are properly characterized as normative rather than descriptive. "The leftist vision [of participatory management] adopts socialist rhetoric and presents cooperation as a new weapon in the struggle for industrial democracy and workers' rights." Wilson McLeod, *Labor-Management Cooperation: Competing Visions and Labor's Challenge*, 12 IND. REL. L. J. 238 (1990) (demonstrating that the conventional wisdom lacks explanatory power). Participatory management thus becomes a mere extension of class warfare designed to serve as the entering wedge that will lead to "genuine workplace democracy." Id. at 262. One routinely encounters this "vision" in the participatory management area. Most academic commentary on participatory management is "inspired by New Left visions of participatory democracy, in which, as the critical legal scholar Karl Klare has put it, 'the struggle [is] to make the workplace a realm of free self-activity and expression.'" David Brody, *Workplace Contractualism in Comparative Perspective*, in INDUSTRIAL DEMOCRACY IN AMERICA: THE AMBIGUOUS PROMISE 176, 177 (Nelson Lichtenstein and Howell John Harris eds. 1993). Cf. Stone, supra note , at 170 ("labor-management cooperation is more of an ideology than a meaningful description of employee participation. It is an ideology that evokes a vision of the good--a world where labor and management work together to improve productivity, restore American competitiveness, and increase social wealth, all the while sharing the bounty fairly and equitably.")

[52] See Henry Hansmann, *When Does Worker Ownership Work? ESOPs, Law Firms, Codetermination, and Economic Democracy*, 99 YALE L.J. 1749, 1769 (1990) ("The voluminous literature advocating worker ownership--or, more broadly, 'economic democracy,' 'worker participation,' or 'labor management' is often vague about the virtues of this alternative form of organization."); see generally McLeod, supra note , at 245-54 (demonstrating that the conventional wisdom lacks explanatory power).

Flaws abound in the literature.[53] Lots of interesting questions are still unanswered by any study, let alone a methodologically sound one.[54] As to those questions that have been addressed, studies differ radically in their specification and measurement of dependent and independent variables.[55] Methodologies differ widely ranging from collections of anecdotes that scarcely rise above the level of testimonial to rigorous econometric studies.[56]

Even as to methodologically rigorous studies, there is good reason to doubt the quality of the data sets. Failures tend to be under-reported.[57] Hidden costs are ignored.[58] Many data sets are inherently subject to a selection bias to the extent that they focus on firms that have adopted participatory management. Such firms are a self-selected group, whose predispositions may affect the success of participatory management.

With those caveats in mind, I turn to the data--which is most charitably described as mixed. John Cotton's important review of the literature concluded that studies of participatory management are all over the map, ranging from finding no benefit to inconclusive results to finding substantial gains.[59] Most

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[53] It is hard even to find agreement as to such basic questions as the extent to which participatory management has actually penetrated the American economy. According to one commonly cited estimate, about 30,000 U.S. employers have some form of participatory management, including about 80 percent of the largest 1000 firms. LeRoy, supra note , at 1813; Devki K. Virk, Note, *Participation with Representation: Ensuring Workers' Rights in Cooperative Management*, 1994 U. ILL. L. REV. 729, 730 n.3. According to the Department of Labor, however, only 37% of a nationally representative sample of 700 firms had a majority of their workers engaged in two or more "high performance work practices," which include participatory management programs. U.S. DEPARTMENT OF LABOR, HIGH PERFORMANCE WORK PRACTICES AND FIRM PERFORMANCE 1 (1993).

[54] See generally Glew, supra note (noting many open empirical questions).

[55] Chris Doucouliagos, *Worker Participation and Productivity in Labor-managed and Participatory Capitalist Firms: A Meta-analysis*, 49 IND. & LAB. REL. REV. 58, ___ (1995).

[56] See generally Ray W. Coye and James A. Belohalv, *An exploratory Analysis of Employee Participation*, 20 GROUP & ORG. MGMT 4 (1995) (review of empirical research noting various methodological difficulties with existing studies). A particularly significant methodological problem is that many studies are derived from self-appraisals by managers. COTTON, supra note , at 46 (with specific reference to QWL); see, e.g., Paula B. Voos, *Managerial Perceptions of the Economic Impact of Labor Relations Programs*, 40 IND. & LAB. REL. REV. 195 (1987). Given that those same managers presumably were responsible for adopting the program in the first place or report to those who adopted it, management-derived data is likely to be biased so as to justify their decision, which makes the frequency of negative outcomes especially telling.

[57] GRENIER, supra note , at 9 ("Failures are seldom reported, although they occur frequently.").

[58] Cotton, supra note , at 64 (with specific references to studies of quality circles).

[59] COTTON, supra note , at 14-17.

other reviews and meta-analyses have reached similar conclusions.[60] The Department of Labor's 1993 report on High Performance Work Practices, for example, relied on a meta-review of 29 studies, only 14 of which reported that operational participation had significant positive effects on productivity, two of which found negative effects, while 13 found no statistically significant effects.[61] DOL further concluded that employee involvement is most likely to have positive effects when linked with other high performance programs (such as skills training and pay for performance),[62] which may suggest that the latter have effects swamping those of employee involvement. In addition to the reviews and meta-analyses summarized here, there is a wealth of studies of individual forms of participatory management programs. As described below, these are also equivocal. The best evidence for positive productivity effects appears to be found in connection with gain-sharing and self-directed work teams. As I argue below, this evidence does not lend much support to the conventional wisdom, but rather is consistent my alternative hypotheses.

In sum, there seems to be no conclusive documentation that using employee involvement consistently leads to long-term economic benefits. As one review of the empirical evidence concludes, "while participation *may* improve productivity, participation does not consistently have this effect and, in some cases, is actually less effective than nonparticipation."[63] This interpretation of the data is supported by the high failure rate of employee involvement programs.[64]

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[60] See, e.g., KOCHAN ET AL., supra note , at 146-77 (summary of case studies showing generally positive, but variable results); Coye and Belohlav, supra note , at ___ (summary of studies reporting beneficial outcomes); Doucouliagos, supra note , at ___ (worker participation in decisionmaking in participatory capitalist firms positively correlated with productivity, but only weakly); Juravich, supra note , at ___ ("research on a direct link between EI and economic outcome has been quite mixed"); Edwin A. Locke et al., *Participation in Decisionmaking: When Should it be Used?*, 14 ORG. DYNAMICS 67-68 (1986)(review of 50 studies found no clear evidence that participatory management resulted in any higher productivity than authoritarian decisionmaking); Arnold E. Perl, *Employee Involvement Groups: The Outcry over the NLRB's Electromation Decision*, LABOR L.J., April 1993, at 195, 204-06 (summarizing studies finding positive economic effects).

[61] DOL, HIGH PERFORMANCE, supra note , at 5-6.

[62] DOL, HIGH PERFORMANCE, supra note , at 6-9.

[63] Locke et al., supra note , at 69 (emphasis in the original).

[64] See JOHN F. WITTE, DEMOCRACY, AUTHORITY, AND ALIENATION IN WORK: WORKERS' PARTICIPATION IN AN AMERICAN CORPORATION 104 (1980) (over time, apathy sets in); Amal Kumar Naj, *Some Manufacturers Drop Efforts to Adopt Japanese Techniques*, Wall St. J., May 7, 1993, at A1, A12 ("Also going out of style in the U.S. are 'quality circles'"); Special Report, *Employee Participation and Labor-Management Cooperation in American Workplaces*, CHALLENGE, Sep. 1995, at 38, ___ (studies show high failure rates); Voos, *Economic Impact*, supra note , at 198-99 (study of unionized Wisconsin firms with

The conventional wisdom lacks any explanation for the highly equivocal nature of these findings. Upon closer review of the data, moreover, the conventional wisdom's logic fails almost completely. Participating workers are not necessarily happy workers and happy workers are not necessarily productive workers.

The participatory management literature generally treats employees as having many voices, but a single taste:

> The opportunity to speak and be heard is a vital factor of employees' self-esteem and sense of contribution to the firm. ... [W]ork organizations in which widespread participation is the norm may also contribute to the performance goals of the firm by making better decisions, because many points of view are considered in the decisionmaking process.[65]

In other words, employees represent many different points of view, but all have a taste for participating in corporate decisionmaking.

Yet, the taste for participation is scarcely universal. One need not accept Eric Fromm's views on the psychological craving for authority[66] to believe that some workers will prefer hierarchial workplaces in which decisionmaking is reserved to management to workplace democracy.[67] Consider the empirical data on union involvement, which suggests that apathy is common. Only a very low percentage of a union's members actively participate in its affairs.[68] In his important case study of an early self-directed work team, John Witte contended

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various types of participation programs; 20 percent of quality circle and similar operational participation programs had been cancelled, as had 29 percent of gain-sharing programs); Virk, supra note , at 751 n.127 (three-quarters of participatory management programs dissolve within five years); see also infra notes TBA and accompanying text (discussing especially high failure rate for quality circles).

65 Karen L. Newman, *The Just Organization: Creating and Maintaining Justice in Work Environments*, 50 WASH. & LEE L. REV. 1489, 1498 (1993) (footnotes omitted). Accord Craver, supra note , at 673.

66 ERIC FROMM, ESCAPE FROM FREEDOM 164-68, 173-78 (1941). Fromm asserts that in modern society "anonymous" authority has displaced older forms of overt authority. Anonymous authority is camouflaged as common sense, psychic health, public opinion, and the like. Id. at 167. "Anonymous authority is more effective than overt authority, because one never suspects that there is any order which one is expected to follow." Id. at 168. In a very real sense, Fromm's model of anonymous authority thus captures my hypotheses about the economic function of participatory management.

67 See Joseph E. Stiglitz, *Incentives, Risk, and Information: Notes Toward a Theory of Hierarchy*, 6 Bell J. Econ. 552, 571-72 (1975) (argues that some employees will prefer coercive hierarchies); see also WITTE, supra note , at 40-41 (describing cultural factors that predispose workers to accept hierarchy and direction); see generally Glew, supra note , at ___-___ (summarizing studies of personality differences and similar factors affecting the outcome of participatory management).

68 WITTE, supra note , at 25. Contra WEILER, supra note , at 30.

from such evidence that "there is little reason to suspect that most workers would either endorse participation or become actively involved if the opportunity arose."[69] To the contrary, Witte posits that workers generally accept hierarchial authority and perceive obedience to authority as an integral part of their job: "for the majority, disobedience is unthinkable."[70]

Although there is some more recent evidence that American workers in fact desire a greater voice with respect to shop floor issues, such as work content and schedules,[71] there is still both empirical and anecdotal support for Witte's pessimistic prediction. A recent study of transportation firms found that long-term use of employee involvement initiatives in TQM firms increased stress and decreased employee fulfillment--exactly contrary to the conventional wisdom.[72] A study of "empowered" employees versus a control group of unempowered employees within a single insurance company found no statistical difference between the two groups on such productivity-related issues as motivation or even on some job satisfaction measurements.[73] Only about half of the participants in Witte's own case study were willing to change jobs in order to get more participation and that rate declined rapidly if doing so would require longer hours or lower pay.[74] In unionized plants, rank and file workers have

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[69] WITTE, supra note , at 25.

[70] Id. at 38. Accord Hyde, supra note , at 202 (employees are "conditioned to accept managers").

[71] See WITTE, supra note , at 25-31. Witte's data show lowest worker interest with respect to strategic decisions and personnel matters. The more recent and more comprehensive Families and Work Institute survey found equivocal results. On the one hand, 55% of workers who had changed jobs within the preceding five years listed control over work content as a "very important" factor in deciding to take their current job. ELLEN GALINSKY ET AL., THE FAMILIES AND WORK INSTITUTE'S NATIONAL STUDY OF THE CHANGING WORKFORCE: HIGHLIGHTS 15 (1993). On the other hand, as already noted, only 6% of all workers listed control over work content and schedule as a measure of personal success. Id. at 13. (In both cases, multiple responses were allowed.) Other polling results vary, although most show that more than half of workers desire participation in decisionmaking. Tom Juravich, *Empirical Research on Employee Involvement: A Critical Review for Labor*, 21 LAB. STUD. J. 51, ___ (1996) (62% of workers wanted to influence training decisions, while 52% wanted influence over implementing new work); Special Report, supra note , at ___ (more than 80% want to participate in decisionmaking). But note that none of this data supports the proposition that one size fits all.

[72] Ronald D. Anderson et al., *Relationships of Work Improvement Program Experience and Logistics Quality Management Factors*, 36 TRANSPORTATION J. 20 (1996) (noting possible confounding factors).

[73] Alan J.H. Thorlakson and Robert P. Murray, *An Empirical Study of Empowerment in the Workplace*, 21 GROUP & ORG. MGMT 67, ___ (1996) (noting possible confounding factors).

[74] WITTE, supra note , at 34. In fact, there is good evidence that many workers prefer pay to participation or, at least, are more effectively motivated by pay than by involvement in decisionmaking. x-ref PM

often resisted collective bargaining agreements that included employee involvement. [75] In firms adopting self-directed work teams, ten to twenty percent of employees will resist the change because they prefer a mundane job to the greater responsibility and higher expectations associated with team membership.[76] Other studies have found even higher rates of resistance: Participation rates in voluntary participatory management programs range from a low of 33% to a high of 68% of the eligible workforce.[77] Conversely, a study of nonparticipating employees found interest in volunteering for employee involvement programs ranged from a low of 15% to a high of 63%.[78] Anecdotal evidence suggests that firms using participatory management techniques are expending considerable effort in selecting employees who are psychologically equipped to work under those conditions,[79] which is precisely what one would expect if some workers are not temperamentally suited for participatory workplaces. The existence of differing tastes among workers, and the importance of that factor for the viability of participatory management within a given firm, is similarly suggested by evidence that workforce demographics are correlated with the effectiveness of participatory management.[80] The point is made most colorfully, however, by quoting a NUMMI worker: "Kaizening [a component of NUMMI's employee involvement program referring to continuous job improvement] is supposed to be creative, but I mean how many times can you sit there and Kaizen a job after you've done it for four and one-half years? ... [J]ust keep me in a job and I'll do it the way you want me to do it."[81]

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[75] Parker, supra note , at 259.

[76] COTTON, supra note , at 196.

[77] Robert W. Miller and Frederick N. Prichard, *Factors Associated with Workers' Inclination to Participate in an Employee Involvement Program*, 17 GROUP & ORG. MGMT 414, ___ (1992).

[78] Id. at ___.

[79] Edward E. Lawler, *The New Plant Revolution Revisited*, ORG. DYNAMICS, Sept. 22, 1990, at 4, ___. See also Timothy Aeppel, *Missing the Boss: Not All Workers Find Idea of Empowerment as Neat as it Sounds*, WALL ST. J., Sept. 8, 1997, at A1, A8 (describing elaborate hiring process used by one participatory management firm). Aeppel's article offers a case study of participatory management at Eaton Corporation's South Bend, Indiana, plant. Aeppel concludes that not all workers desire "empowerment." Id.

[80] Robert Drago, *Share Schemes, Participatory Management and Work Norms*, 23 Rev. Radical Pol. Econ. 55, 59 (1991) (study of participation schemes in Australia finding that such programs are more effective when the work force is homogeneous); see also Glew, supra note , at ___ (women and minorities tend to view themselves as not participating in decisionmaking). Management demographics also appear relevant, in light of findings that female managers tend to provide more frequent opportunities for employee involvement than male managers. Glew, supra note , at ___; Judy B. Rosener, *Ways Women Lead*, HARV. BUS. REV., Nov./Dec. 1990, at 301, ___("women encourage participation").

[81] Parker, supra note , at 266. NUMMI is the well-known GM-Toyota joint venture.

Why do some workers prefer hierarchy? Studies of formalization--the creation of written rules, procedures, and instructions--suggest that it reduces role conflicts and ambiguity, which increases work satisfaction and reduces feelings of alienation and stress.[82] Employee involvement can trigger role stress because many employees lack the quasi-management skills--agenda building, conflict management, and problem solving--required for successful employee involvement.[83] Alienation can result from the greater workload and negative changes in peer group relationships experienced by some participants in employee involvement.[84]

Workers who respond well to formalization are poor candidates for participatory management, and vice-versa. This hypothesis is supported by findings that the success of a participatory management program largely depends on the personality of workers and managers.[85] Workers with weak desires for independence are unaffected by employee involvement, while those with strong independence drives get increased job satisfaction from it.[86] Based on the various studies recounted above, both types of workers appear to be present in the American workplace. Whether the taste for participation or for hierarchy is more common is hard to say from the evidence to date, but at the very least the "checkered history of job enrichment efforts has taught us not to assume that everyone wants more autonomy, challenge, and responsibility at work."[87]

If participating workers are not necessarily happy workers, what about the claim that happy workers are productive workers? It lacks support, as well. Over two decades ago, Nobel economist Kenneth Arrow opined that "the empirical evidence, such as it is, points to very little relation between the morale of workers and their performance."[88] The intervening years have done little to change that conclusion. A more recent literature review likewise concluded that there is "simply no direct connection between job satisfaction and subsequent productivity."[89]

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[82] Adler and Borys, supra note , at ___.

[83] See *Why Doesn't This Team Work*, HARV. BUS. REV., Nov./Dec. 1994, at 26, ___ (J. Richard Hackman opines that "[t]here are people who just don't have the skills needed to work constructively in teams--and who are unable or unwilling to acquire those skills."). Several empirical studies have confirmed that training in these skills is an essential component in successful employee involvement." Coye & Belohlav, supra note , at ___ (summarizing studies).

[84] Glew, supra note , at ___.

[85] COTTON, supra note , at 18.

[86] Id. See also Glew, supra note , at ___ (summarizing studies finding that individuals with a strong need for independence and low need for authority showed the most productivity gains from participatory management, while workers who need authority favor structured hierarchy).

[87] Bowen and Lawler, supra note , at ___.

[88] KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 76 (1974).

[89] Locke et al., supra note , at 71. Accord KOCHAN ET AL., supra note , at 87(same); OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM 270 (1985) (same); Juravich,

In sum, the conventional wisdom lacks explanatory power. The links between participation, job satisfaction, and productivity remain unproven. The conventional wisdom also fails to take into account that one size rather clearly does not fit all. An alternative explanation appears to be in order.

III. ORGANIZATIONAL FAILURES AND PARTICIPATORY MANAGEMENT

Perhaps the problem is that we are assuming participatory management has an economic function. What if it is just a fad? In fact, the two possibilities are not contradictory: Both stories have considerable truth. If so, much of the data reviewed above becomes explicable. Participatory management works well for a sub-set of firms, but is often adopted by fad following managers of firms for which it is poorly suited.

The analysis that follows is premised on a variant of what Oliver Williamson termed the "organizational failures framework."[90] Central to each of the hypotheses advanced below is the notion that the rational actor model must be supplemented by an awareness of human frailty. In a zero transaction cost world populated by rational actors, firm decisionmaking would be untroubled by considerations of uncertainty, complexity, or opportunism. In a world where such concerns prevail, however, adaptive mechanisms are called into play. Bureaucratic hierarchies are one such response; I contend that participatory management is yet another, which in fact fulfills the same functions as does hierarchy.

A. *Participatory Management as Fad*

The business section of every decent bookstore overflows with books on how to manage corporate employees. Management consultants proliferate. Scarcely a day goes by without the appearance of some new management theory that is going to restore competitiveness, while solving any number of social ills on the side. Participatory management in one form or another is among the most common themes in this burgeoning industry.

Is it possible that rational managers would chase fads? And, if so, is participatory management just another fad? Today's corporate managers are pulled in contradictory directions by an ever-growing cadre of consultants with

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supra note , at ___ (based on research to date no proof that "happy workers are necessarily more productive"); Watts, supra note , at 1518 ("I do not see the propagation of just or participative organizations that one would expect if these benefits [i.e., increased job satisfaction etc...]" were as significant as the proponents of participatory management suggest); cf. Hyde, supra note , at 201 (the literature on employee-owned firms does not demonstrate that ownership motivates employees through "diffuse psychological mechanisms").

[90] OLIVER E. WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS 20-40 (1975).

conflicting recommendations.[91] Some recommend TQM, while others push participatory management.[92] Some urge managers to go "lean," while other urge them to go "team."[93] Some even urge managers to go back to traditional command and control models.[94] Just as some consumers have to have the latest product fads, some managers seem to have to have the latest industrial relations fad. As a result, some firms repeatedly make radical shifts in the way their firms make decisions.[95]

The proliferation of management fads is hardly surprising from the supply side. As one manager observed, "Like the fashion industry, the management industry systematically depends on continuous change and newness. The gurus are in a perpetual state of competition for lucrative consultancies, grand speaking fees, and next month's books on the bestseller list."[96] But whence comes the demand for these new fashions?

Herd behavior, which refers to the tendency to imitate the actions of others, ignoring one's own information and judgment with regard to the merits of the underlying decision,[97] provides an answer. Corporate managers are scarcely immune to herd behavior; to the contrary, the faddish aspects of participatory management suggest the possibility that herd behavior is relevant to the demand side of the equation. An American Society for Training and Development report, for example, observed that many companies adopt team-based management structures, *inter alia*, "in response to success stories from other

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91 Adler and Borys, supra note , at ___.

92 Id.

93 Id.

94 See, e.g., Martin M. Broadwell, *Why Command & Control Won't go Away*, TRAINING, Sep. 1995, at 62. Broadwell acknowledges the faddish nature of participatory management, however, by opining that the way to become a successful management consultant is to propose pushing "the responsibility for all decisions down to the hourly workers. Remember to snarl when using 'command and control' as an expletive." Id.

95 One manager observes: "I have myself encountered management by objectives, participatory management, self-governing groups, team-building, consensus management ..., strategic planning, corporate turn-around, the vital corporation, the slim corporation, management by walking around, benchmarking, the 5 minute manager, total quality management and ISO quality certification. Most recently I have read about 180 degrees management and--a month later--360 degrees management." Michael v. Cotta-Schønberg, *Performance Measurement in the Context of Quality Management*, http://sun1.lib.cbs.dk/people/mcs/perform.html. See also Edward E. Lawler and Susan A. Mohrman, *Quality Circles after the Fad*, HARV. BUS. REV., Jan./Feb. 1985, at 64, ___ ("quality circles are, as everyone knows, a fad").

96 Cotta-Schønberg, supra note . For a news account quoting the views of numerous management consultants on participatory management, most of whom claimed that the basic concept is not a fad, but some of whom acknowledged that some of its forms are faddish, see Cathy Ligon, *Management Fads*, OAKLAND BUS., May 1987, at 16.

97 Marcel Kahan and Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U.L.Q. 347, 355-56 (1996).

companies."[98] Another study reported: "In a number of cases we studied, the CEO of the company had seen a TV program or read a magazine article praising circles and decided to give them a try."[99]

Herd behavior is partly attributable to cognitive biases, especially the conformity effect. When one's decisions are publicly observable by peers, conformity has a positive psychic pay-off, whose existence has been experimentally demonstrated.[100] But there is also an agency cost phenomenon at work. Following the crowd may have a pay-off even if the chosen course of action fails. Because even a good agent can make decisions resulting in a bad outcome, the market evaluates the agent by looking at both the outcome and the action before forming a judgment about the agent. If a bad outcome occurs, but the action was consistent with approved conventional wisdom, the hit to the manager's reputation is reduced.[101] This phenomenon explains both the tendency to follow fashion and the growing importance of management consultants. When a manager follows a management consultant's advice in selecting a human relations system, he is buying insurance against a bad outcome. Hence, the observation that U.S. managers "have abdicated their responsibility to a burgeoning industry" of consultants.[102]

B. *An Organizational Failures Account*

A fad-based account admittedly has considerable traction. But it does not appear to tell the whole story. In my view, participatory management has a real economic function, which--contrary to the conventional wisdom--is precisely the same as that of Taylorism: monitoring workers and ensuring efficient information flows.[103]

1. *The Function of Hierarchy*

Public corporations are characterized not by participatory democracy, but by hierarchies in which decisions are made on a more-or-less authoritarian basis.[104] Despite the flattening of corporate hierarchies in recent years due to

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98 Marha A. Gephardt and Mark E. Van Buren, *Building Synergy: The Power of High Performance Work Systems*, TRAINING & DEVELOPMENT, Oct. 1996, at 21, ___.

99 Lawler and Mohrman, supra note , at ___.

100 See generally Kahan and Klausner, supra note , at 363-65.

101 Kahan and Klausner, supra note , at 356.

102 Nitin Nohria and James D. Berkley, *Whatever Happened to the Take-Charge Manager*, HARV. BUS. REV., Jan./Feb. 1994, at 128.

103 An alternative hypothesis is that participatory management is just a fancy system of union avoidance. McLeod, supra note , at 259. Although this may be true in some cases, my account suggests a valid economic rationale for employee involvement.

104 ALFRED D. CHANDLER, JR., THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS 8 (1977) (Over time, corporate hierarchies have proven to possess

corporate downsizing and the widespread adoption of employee involvement, most workplaces are still highly bureaucratic.[105] In order to understand the function of participatory management, and its possible future evolution, we must first understand the economic functions of hierarchy and bureaucracy.[106]

A well-accepted explanation of corporate hierarchies rests on the efficient specialization of labor within the firm. Bounded rationality, as well as the practical costs of losing time when one shifts jobs, makes it efficient for corporate constituents to specialize.[107] Managers specialize in the efficient coordination of other specialists.[108] In order to reap the benefits of managerial specialization, all other corporate constituents should prefer to specialize in functions unrelated to decisionmaking, such as risk-bearing (shareholders) or labor (employees), delegating decisionmaking to managers. The difficulty, of course, is that a specialization of labor-based analysis of hierarchy sheds little light on participatory management. To the contrary, such an analysis suggests that participatory management--by diluting the benefits of specialization--should be highly inefficient.

An organizational failures-based explanation of hierarchy, however, offers an efficiency-based rationale for participatory management. Specifically, I focus on two sets of organizational failures: The first relates to the transaction costs of gathering, transmitting, and processing information within a firm. The second entails the agency costs that follow from the human tendency towards opportunism.[109] The proposition that hierarchy reduces both sets of costs is not novel, of course; my new claim is that participatory management should be understood within this framework. The task is to identify those environmental and human conditions under which participatory management is a superior transaction cost economizing device than either bureaucratic hierarchy or markets.

"a permanence beyond that of any individual or group of individuals who worked in them.").

[105] Adler and Borys, supra note , at ___.

[106] The discussion herein focuses on the need for hierarchy, while taking for granted the fact that public corporation decisionmaking typically takes place not through participatory democracy but through more-or-less authoritarian directives. Consideration of why that should be the case is deferred until the final substantive section of this article. See infra notes TBA and accompanying text.

[107] ROBERT C. CLARK, CORPORATE LAW 802 (1986).

[108] For more elaborate justifications of managerial specialization, both of which also relate to the costly nature of information, see Harold Demsetz, *The Theory of the Firm Revisited*, 4 J. L. Econ. & Org. 141, 156-60 (1988); Stiglitz, supra note , at 574-76.

[109] Transaction cost and agency cost economics are both part of what Williamson terms the efficiency branch of New Institutional Economics. WILLIAMSON, CAPITALISM, supra note , at 26-29. Although the two bodies of literature have different emphases, see id., they are largely complementary and are used as grist for the mill herein without attempting rigorous separation. Hence my preference for Williamson's older organizational failures terminology, which is less restrictive than the transaction cost terminology.

a. *Hierarchy and Information*

Every organization needs a transaction cost economizing mechanism for providing information to those with the power to make decisions. In complex organizations, hierarchy is the usual choice. Hierarchy's efficacy derives from the concept of bounded rationality, which posits that decisionmakers are rational actors but that their cognitive powers are limited. Among other things, bounded rationality implies that decisionmakers can only gather so much information from so many inputs before being overloaded.

Branching hierarchies are a highly efficient adaption to bounded rationality. They limit the span of control over which any individual manager has supervision to a small number of subordinates. Specifically, branching hierarchies put people into small groups, each member of which reports information to the same supervisor. That supervisor is likewise a member of a small group that reports to a superior and so on up to the top. Such an organizational system gets reliable information to the right decisionmaker more efficiently than any other organizational system.[110] Not surprisingly, some form of branching hierarchy therefore tends to be found in most public corporations: they could not make decisions without it.[111]

Other features commonly associated with hierarchial organizations enhance the transaction cost economizing effect of hierarchy. Information processing and decisionmaking skills are neither widely nor equally distributed,[112] which has significant implications for hierarchial decisionmaking:

> Top-level decisions have multiplicative effects on productivity in management technologies where authority is limited by a span of control and where monitoring resources are partially economized through lengthy chains-of-command. These multiplicative effects imply that more capable top-level decisionmaking can have enormous effects on the organization and imply that the socially efficient assignment of personnel to positions is hierarchical in ability. The most capable people should control the most resources and direct the largest organizations. Less capable and less energetic

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[110] For a detailed defense of this proposition, and corporate hierarchies generally, see CLARK, supra note , at 801-16. No implication is intended that information is always funneled to the top of the hierarchy or that all decisions are made there. To the contrary, all corporate hierarchies are characterized by a degree of decentralization of decisionmaking, with numerous decisionmakers at various levels within the hierarchy being tasked with particular areas of responsibility. Indeed, firms most appropriately might be described as a set of many overlapping hierarchies. Roy Radner, *Hierarchy: The Economics of Managing*, 30 J. Econ. Lit. 1382, 1412 (1992). The point is only that branching hierarchies are an efficient means of ensuring that information flows to the correct supervisor. See id. at 1384.

[111] WILLIAMSON, CAPITALISM, supra note , at 164.

[112] WILLIAMSON, HIERARCHIES, supra note , at 52.

> people should be assigned to lower-level positions in large firms or higher-level positions in smaller firms.[113]

Hence, the widely observed phenomena of ports of entry and internal promotion ladders.[114] New members generally enter a hierarchy at low level positions--ports of entry--with higher level positions being filled by internal promotion. This practice has several functions, one of which appears to be an adaptive response to bounded rationality. By giving firms a form of experience-rating, it allows them to ensure that top-level decisions are in fact made by those with the fewest limits on their cognitive powers.

b. *Hierarchy and Agency Costs*

Organizing production within a firm creates certain costs, of which the class known as agency costs is the most important for our purposes.[115] A sole proprietorship with no agents will internalize all costs of shirking, because the proprietor's optimal trade-off between labor and leisure is, by definition, the same as the firm's optimal trade-off. Agents of a firm, however, will not internalize all of the costs of shirking: the principal reaps part of the value of hard work by the agent, but the agent receives all of the value of shirking.[116]

Shirking is simply the inevitable consequence of bounded rationality and opportunism within agency relationships. Armen Alchian and Harold Demsetz offered the useful example of two workers who jointly lift heavy boxes into a truck.[117] The marginal productivity of each worker is very difficult to measure and their joint output cannot be easily separated into individual components. In such situations, obtaining information about a team member's productivity and appropriately rewarding each team member are very difficult and costly. In the absence of such information, however, the disutility of labor gives each team member an incentive to shirk because the individual's reward is unlikely to be closely related to conscientiousness.

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[113] Rosen, supra note , at 85. Accord WILLIAMSON, HIERARCHIES, supra note , at 52. Put another way, economies of scale in the information transmission process can be achieved by elite control of organizations. Kenneth J. Arrow, *Scale Returns in Communication and Elite Control of Organizations*, 7 J. L. Econ. & Org. (s.i.) 1 (1991).

[114] As to which, see WILLIAMSON, HIERARCHIES, supra note , at 77-78.

[115] Agency costs are defined as the sum of the monitoring and bonding costs, plus any residual loss, incurred to prevent shirking by agents. Eugene F. Fama and Michael C. Jensen, *Separation of Ownership and Control*, 26 J. L. & Econ. 301, 304 (1983).

[116] The obligatory reference is Michael C. Jensen and William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure*, 3 J. Fin. Econ. 305 (1976).

[117] Armen A. Alchian and Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 Am. Econ. Rev. 777, ___ (1972). For a detailed treatment of the incentive effects pursuant to which rational agents will shirk, see Radner, supra note , at 1405-07.

Although agents ex post have strong incentives to shirk, ex ante they have equally strong incentives to agree to a corporate contract containing terms designed to prevent shirking.[118] In any organization, however, the familiar triad of contracting problems--uncertainty, complexity, and opportunism--precludes the organization and its agents from entering into the complete contract necessary to prevent shirking by the latter.[119] In large organizations, these transaction cost barriers to contracting are compounded by the equally familiar litany of collective action problems associated with bargaining in large number contexts. Accordingly, organizations rely not on ex ante contracting but on ex post governance--creating mechanisms for detecting and punishing shirking.[120] Specifically, managers of such organizations are tasked with monitoring the organization's members: management meters the marginal productivity of each member and responds as necessary to prevent shirking.

Just as hierarchy emerged as an essential component of the information processing aspects of managing large organizations, it also plays an equally essential role in the monitoring component of the managerial function. This is especially evident in the most important form of business organization: the M-form corporation. Such firms have two defining characteristics: many distinct operating units and management by a hierarchy of salaried executives.[121] The board of directors delegates responsibility to senior management and monitors their performance.[122] The senior managers in the firm's central office delegate

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118 Alchian and Demsetz, supra note , at ___; Jensen and Meckling, supra note , at ___.

119 Transaction cost economics offers a more robust account of the costs associated with bargaining that can be reduced through hierarchial ordering of production within a firm, among which are informational asymmetries, bilateral monopolies, as well as incomplete contracting. Oliver E. Williamson, *Introduction*, in THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT 3, 4 (Oliver E. Williamson and Sidney G. Winter eds. 1991). In particular, Williamson emphasizes that uncertainty and complexity do not provide a sufficient explanation for the emergence of ex post governance structures. Instead, one also must introduce some form of asset specificity, of which the most important for present purposes is the firm-specific human capital of the firm's agents. WILLIAMSON, CAPITALISM, supra note , at 30-32. For a critique of the transaction cost literature in this area, see Demsetz, supra note , at 144-54.

120 No implication is intended that ex post governance structures are noncontractual. Nexus of contracts theory that firms consist of a set of explicit and implicit contracts, which by definition are both incomplete and unenforceable. Instead of attempting to execute a complete contract, which would be too costly, many contract terms are intentionally left open for subsequent decisions imposed by employer fiat. The parties to the corporate contract presumably accept this consequence of relying on implicit contracts because the resulting reduction in transaction costs benefits them all. The firm's employees thus can be said to voluntarily enter into a relationship in which they agree to obey managerial commands, while reserving the right to disassociate from the firm.

121 CHANDLER, supra note , at 1.

122 Oliver Williamson, *Corporate Governance*, 93 YALE L.J. 1197, 1225 (1984). I ignore the problem of management-captured boards, as well as the question of the extent to which the board's function is limited to monitoring or also encompasses managing,

responsibility to managers of operating units.[123] In turn, the managers of each operating unit are responsible for monitoring the productivity of their unit.[124] The process continues down to the foreman on the shop floor. Creating such a branching hierarchy addresses the problems of uncertainty, bounded rationality, and shirking faced by monitors by breaking the firm team into discrete segments, each of which is more readily monitored than the whole. At each hierarchial level, the responsible monitor is responsible for supervising only a few individuals, which usefully limits and focuses his task.

2. *Participatory Management and the Transaction Costs of Processing Information*

At first glance, Taylorism appears to provide precisely the sort of hierarchial structure that should lend itself both to efficient transmission of information and monitoring of line employees. What then are we to make of participatory management? One answer is that rumors of scientific management's demise may yet prove grossly exaggerated.[125] A more interesting answer, however, would be that participatory management can be explained in a way that is consistent with transaction cost and agency cost economics. I suggest that participatory management is an adaptation to economic changes that have impacted the corporate functions previously performed by hierarchial bureaucracies. This section focuses on participatory management as a substitute for hierarchy's information processing function; a subsequent section will focus on it as a substitute for hierarchy's monitoring function.

It is convenient to classify the costs of decisionmaking into four categories: observation--the gathering of information; memory--the storage of information; computation--the manipulation of information; and communication--the transmission of information.[126] Insofar as my story about participatory management relates to efficient decisionmaking, it focuses on the first and last of the foregoing categories. Specifically, I claim that participatory

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both of which I have treated elsewhere. Stephen M. Bainbridge, *Independent Directors and the ALI Corporate Governance Project*, 61 GEO. WASH. L. REV. 1034 (1993).

[123] The central office is critical to understanding monitoring in M-form corporations. The monitoring mechanisms described in the text could be accomplished through a simple pyramidal hierarchy of the sort found in U-form corporations. The M-form corporation adds to this structure a rationalization of decisionmaking authority in which the central office has certain tasks and the operating units have others, which allows for more effective monitoring through specialization, sharper definition of purpose, and savings in informational costs. WILLIAMSON, CAPITALISM, supra note , at 320.

[124] Williamson, *Corporate Governance*, supra note , at 1219-20.

[125] See Robert D. Smither, *The Return of the Authoritarian Manager*, TRAINING, Mov. 1991, at 40.

[126] Roy Radner, *Bounded Rationality, Indeterminacy, and the Theory of the Firm*, 106 ECON. J. 1360, 1363 (1996). Agency costs could be regarded as a fifth category, especially because monitoring employees obviously entails gathering and processing information about them, but the monitoring function is conventionally treated as a distinct issue and I will follow convention in this regard.

management is a mechanism for gathering information from employees and efficiently transmitting it to appropriate decisionmakers.

a. *Observation: The Problem of Persistent Information Asymmetries*

Although firms have more information than workers about some aspects of production, as Taylor intended, scientific management never succeeded in shifting the information asymmetry entirely in management's favor. Workers still have more information than their supervisors about many aspects of production. Management will rarely have good information about the ease with which workers could increase their personal productivity, for example. Equipment may have unique properties that can become known only through use. In some settings, workers may also have superior information about changes in workplace organization, job descriptions, or work flows that would increase firm productivity. In service industries, front-line workers often have a very good sense of customer attitudes.[127] Management also may not have very good information about worker preferences, such as the trade-offs workers would be willing to make between such matters as safety, work rates, wages, job security, and the like.[128] Put more generally, in many (but not all) settings workers develop firm- and task-specific skills and knowledge that are not transparent to management.[129]

Asymmetries of this sort are especially likely to persist when disclosure of such information would be adverse to the employees' interest, such as by allowing the firm to utilize fewer workers or to demand greater employee effort.[130] So long as it is in the workers' self-interest to conceal such information from managers, some information asymmetries therefore will persist no matter how efficient the firm's hierarchy is at transmitting information.

Conversely, the conventional wisdom does have a point when it claims that workers increasingly are called upon to make informed production decisions. This requirement implicates an information asymmetry favoring managers. As Taylorism intended, management typically controls much of the information necessary to make such judgments. Data about costs, productivity, competition, and the like usually reside well above the shop floor.[131] In some firms, however, decisions requiring access to such data is now being made on the shop floor. Taylorist hierarchies are poorly-suited, however, to deliver that information to the relevant decisionmakers.

b. *Communication and the Costs of Irreversibility*

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[127] Bowen and Lawler, supra note , at ___ (citing bank tellers as an example).

[128] Hansmann, supra note , at 1766; Hyde, supra note , at 198.

[129] Williamson's term "information impactedness" captures the relevant concept: transaction-specific information known to one party that cannot be costlessly discened by or disclosed to other parties to the transaction. WILLIAMSON, HIERARCHIES, supra note , at 31.

[130] Hansmann, supra note , at 1766.

[131] See Gee & Davis, supra note , at 1695.

The empirical observation that most U.S. workplaces remain bureaucratic hierarchies,[132] coupled with the economic analysis of hierarchy, suggests that such hierarchies have significant survival value. Yet, there is considerable evidence that the virtues of hierarchy can become vices over time. Of particular concern for present purposes is the problem of irreversibility.[133]

There are a number of inherent tendencies within any hierarchial organization, including nominally profit-maximizing corporations, driving them towards unnecessary creation of excessive layers of bureaucracy. First, managers have well-known incentives to prefer empire-building to profit-maximization. In part, this phenomenon is driven by the psychological rewards of empire-building, but in many organizations the compensation regime reinforces these tendencies by adding pecuniary rewards for those who build large sub-enterprises around themselves. Second, managers find it psychologically easier to hire new employees than to discharge those workers who have become part of the firm's "family and culture."[134] Third, some legal rules, such as planting closing laws, raise the costs of contracting the firm.[135] Finally, there is a transaction costs explanation for irreversibility. Creation of new information pathways is costly, which encourages reliance on existing transmission paths. As a result, it is difficult to reverse initial commitments to a particular information pathway.[136] Accordingly, new information pathways are unlikely to be created as replacements for existing flows, but rather only when entirely new sources of information are necessary, which causes hierarchies to resist contraction.

Because these tendencies are only partially constrained by the familiar arsenal of legal and market forces directed at all forms of shirking, firm expansion is difficult to control--let alone reverse. Layers of bureaucracy therefore tend to grow over time in a process only weakly constrained by external forces. Management guru Peter Drucker offers the impressive anecdotal example of a self-evaluation by one large defense manufacturer revealing that as many as 6 out of 14 management layers had no useful purpose.[137]

As the irreversibility syndrome progresses within a firm, information transmission and processing tends to break down. The most obvious source of inefficiency is the systemic distortion associated with long path lengths. Because the amount of systematic distortion to which messages are subjected is directly proportional to the length of the average path they follow, as is powerfully

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[132] See supra text accompanying note TBA.

[133] See generally Saul Levmore, *Irreversibility and the Law: The Size of Firms and Other Organizations*, 18 J. Corp. L. 333 (1993).

[134] Id. at 337.

[135] See generally id. at 347-49.

[136] ARROW, supra note , at 41.

[137] Peter F. Drucker, *The Coming of the New Organization*, HARV. BUS. REV., Jan.-Feb., 1988, at 45, 46.

illustrated by the childhood game in which a secret message is whispered down a line of players,[138] longer paths equate to less accurate information and poorer decisions. The pervasiveness of this the problem is suggested by Drucker's observation that "whole layers of management neither make decisions nor lead. Instead, their main, if not their only, function is to serve as 'relays'--human boosters for the faint, unfocused signals that pass for communication in the traditional pre-information organization."[139]

The inevitable distortion created by long average paths is bad enough, but it is not the only potential source of information distortion in corporate hierarchies. Information overload and the tendency to filter information through one's preconceived notions are significant sources of distortion in information flows.[140] The latter phenomenon is especially important. Standard routines based on prior learning significantly reduce transaction costs, but they ossify over time. Bureaucrats tend to go about their work mindlessly, processing new data the same way such information has always been handled, and thus missing important new developments. Worse yet, even if new data is recognized, it is explained away or otherwise marginalized if it is inconsistent with preconceived notions. A related, but more culpable, form of shirking arises out of the incentives each manager has to filter out negative information that reflects poorly on his performance or that of his subordinates.[141] Each of these potential sources of distortion is compounded by the creation of unnecessary hierarchial layers, if only because each such layer adds another manager through whom information must pass.

c. *Economizing on Transaction Costs through Participatory Management*

My first hypothesis thus is that participatory management emerged as an adaptive response to failures by the corporate hierarchy to efficiently process information. Unlike the conventional wisdom, which opines that participatory management is intended to create a more democratic workplace, I hypothesize that participatory management is, in part, an attempt to economize on the transaction costs created when irreversibility afflicts a Taylorist workplace without surrendering the core principle of Taylorism--management control of

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[138] CLARK, supra note , at 804.

[139] Drucker, supra note , at 46.

[140] ARROW, supra note , at 74-75.

[141] See generally Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause other Social Harms)* at 21-27 (forthcoming) (discussing impediments to efficient upwards transmission of negative information within firms). Still another problem arises because employees or managers who inside trade on the basis of confidential corporate information have incentives to engage in behavior that distorts the accurate and timely transmission of information. Stephen Bainbridge, *The Insider Trading Prohibition: A Legal and Economic Enigma*, 38 U. FLA. L. REV. 35, 50-53 (1986).

the production process. Specifically, participatory management creates a mechanism by which management can by-pass the corporate hierarchy to tap the undistorted knowledge of production workers and other lower-level employees.[142] There have always been informal relationships within firms providing non-hierarchial interconnections between managers and workers.[143] It seems reasonable to assume that such connections provide a mechanism for reducing informational asymmetries, as well as average path lengths, but become more difficult to create and sustain as additional layers of bureaucracy separate decisionmakers from sources of information about the shop floor. Participatory management thus appears to be a way of restoring the functions of these informal relationships by recreating them in a systematic way.

Given the generally deplorable state of the empirical evidence, and the lack of any empirical evidence specifically testing my hypothesis, I cannot directly prove it. But I find support in a number of sources: Descriptions (albeit sometimes anecdotal) of extant programs allow us to draw inferences about their functions. Commentary in both the management and union literature is often quite instructive. Finally, a number of sociological and psychological studies have given us a good (albeit anecdotal) picture of how workers perceive these programs. All of these sources, along with the quantitative data--such as it is--become grist for the mill.

If my hypothesis is correct, we would expect participatory management to focus on generating production-related information and, perhaps, delegating production decisionmaking to shop-floor level teams. At the same time, however, participatory management programs would not surrender meaningful power over strategic (or even tactical) policy to employees in the process of tapping them for information. A review of the major forms of employee participation programs confirms that this is precisely what one observes in the real world.

i. *Quality of Work Life*

The information gathering function of QWL is obvious. Recall that one information asymmetry involves the tradeoffs workers are willing to make between benefits and work. QWLs concerned with quality of life issues appear to be directed at that asymmetry. In contrast, problem-solving QWLs and joint labor-management committees address issues as to which informational asymmetries about production matters are likely, such as changes that could

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[142] The information-gathering function of participatory management has been noted by several observers, albeit without incorporation into a comprehensive story about why some firms voluntarily adopt participatory management. See, e.g., WEILER, supra note , at 207; Hyde, supra note , at 198-99; Marleen A. O'Connor, *The Human Capital Era: Reconceptualizing Corporate Law to Facilitate Labor-Management Cooperation*, 78 CORNELL L. REV. 899, 913 (1993); Parker, supra note , at 265.

[143] CLARK, supra note , at 815.

improve shop-floor productivity.[144] QWL also often includes a strong training component, in which workers are educated about the firm and its competitive situation. As such, QWL also potentially addresses the second category of information asymmetries discussed above; i.e, those in which managers hold information workers need to make informed production decisions. QWL's training programs, moreover, may inculcate workers with a desire to help the company achieve its competitive goals.

QWLs using representative, rather than direct, participation, often rotate employee members on a regular basis.[145] This process presumably brings onto the committee employees with new information that can be tapped, while also improving downwards flows of information by sending back to the shop floor employees with greater knowledge about the firm and the issues affecting it.

ii. *Quality Circles*

Quality circles are quite explicitly directed at gathering input from line employees about production processes. At Otis Specialty Paper, Inc., for example, ad hoc circles are convened to solve production problems and provide input on changes in the production process.[146] Recall also the NUMMI example in which quality circles were used to design standardized work procedures.[147]

Many features of quality circles confirm their information gathering function. Quality circle training focuses on training both individuals and groups to process and communicate information.[148] Once implemented, quality circles (like problem-solving QWLs) encourage employees to communicate more freely with supervisors.[149] In at least some firms, management also reviews meeting minutes or directly observes meetings.[150]

Interestingly, management-initiated quality circles solve more problems and solve them faster than employee-initiated circles.[151] This suggests that circles are most useful when put to management-intended purposes. At the same time, however, manager-dominated quality circles are not as successful as those in which managers play a less dominant role.[152] This evidence supports my hypothesis: if the point of quality circles is to give management access to

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144 Levine and Tyson likewise observe labor-management consultation committees have an almost purely information transmission function. Levine and Tyson, supra note , at 190.

145 WEILER, supra note , at 208.

146 Getman and Marshall, supra note , at 1851.

147 See supra notes TBA and accompanying text.

148 COTTON, supra note , at 83.

149 QWL Study, supra note , at 30.

150 COTTON, supra note , at 63.

151 Id. at 74.

152 Id.

employee-held information,[153] that purpose is negated when managers take over.

The information gathering function is especially explicit in TQM, which places great emphasis on collecting data and solving problems.[154] The goal is continuous learning about and improvement of the production process.[155] Quality circles are an integral part of this management style. Under TQM, quality circles are sometimes divided into two types. One is the "steering arm," which identifies the organization's main problems. The other is the "diagnostic team," which tries to find solutions to the identified problem. In both cases, teams are composed of those "people who can provide access to the data necessary for testing potential solutions and who are critical to implementing the solutions developed."[156] Once the teams are formed, three techniques are used to extract production information from the team members: Brainstorming is used to generate lists of ideas, with a strong emphasis on creative thinking. Flowcharts of the production process are drafted by team members to help eliminate inefficient steps in the process. Cause and effect diagrams are used to match problems to the probable causes.

As my hypothesis predicts, however, quality circles do not devolve real decisionmaking power to employees. To the contrary, the managerial literature on quality circles strongly emphasizes the need for management to retain ultimate decisionmaking control.[157] After discussing a problem, a quality circle may make recommendations to management,[158] but typically has no power to direct that the recommendation be implemented.[159] In contrast, management retains a considerable degree of control over the quality circle itself; management readily can punish quality circles that tackle the wrong problems or make poor recommendations.[160] As one critic of quality circles observed, they provide "an ideal structure for controlling decision making while management's power to implement decisions is maintained."[161]

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153 The information gathering function of quality circles is occasionally recognized in the management-oriented literature. See, e.g., Lawler and Mohrman, supra note , at 64 ("Management can use quality circles on a limited basis to collect ideas of employees closest to the work ....").

154 Hackman and Wageman, supra note , at ___.

155 Id.

156 Id.

157 GRENIER, supra note , at 128.

158 COTTON, supra note , at 59.

159 Id. at 61.

160 See COTTON, supra note , at 81; see also RAYMOND L. HOGLER AND GUILLERMO J. GRENIER, EMPLOYEE PARTICIPATION AND LABOR LAW IN THE AMERICAN WORKPLACE 114-15 (1992) (case study in which a quality circle was terminated because union sympathizers usurped control of the group's agenda); Lawler and Mohrman, supra note , at ___ ("management can easily eliminate [circles] if they become troublesome").

161 GRENIER, supra note , at 12. Accord WEILER, supra note , at 33-34; Hyde, supra note , at 198.

iii. *Gain-sharing*

Gain-sharing programs are the most blatant example of using employee involvement as a means of tapping employee knowledge. This is especially true of Improshare and similar programs, which do not have explicit employee involvement programs, but rather focus solely on monetary rewards. In these plans, there is not even the slightest effort to camouflage the information gathering function of the plan.

Gain-sharing appears to be a highly successful response to informational asymmetries. Research on gain-sharing is sketchy, but generally shows that such plans improve productivity, employee attitudes, and labor-management relations.[162] Managers reportedly perceive gain-sharing as giving them more influence within the firm and a greater ability to get work done.[163] In general, gain-sharing plans report success rates of 50 to 80%.[164]

iv. *Self-directed Work Teams*

Self-directed work teams are a particularly powerful means of eliminating information asymmetries favoring workers. The team's decisionmaking agenda is limited to precisely the information asymmetry we have observed: the day-to-day carrying out of a specific task. Unlike other types of participatory management, which attempt to elicit impacted information from workers, self-directed work teams encourage workers to voluntarily incorporate that information into the team's decisionmaking process. The small size of the team further eliminates some of the transaction costs giving rise to hierarchy: twelve people is a small enough group that information can be shared and decisions made by consensus. As discussed below in more detail, moreover, the team structure encourages members to share information within the team.

Several aspects of the self-directed work team are especially instructive with respect to their information processing function. Although branching hierarchies usually should be the most effective means of transmitting information within a firm, it may be more efficient in some cases for two production workers to share information than to wait for the information to flow up the chain of command and for decisions to flow back down. When such situations are identified, self-directed work teams provide a mechanism for putting low-level employees into contact with each other to share information. A study of computer controlled technology, for example, found that production

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[162] COTTON, supra note , at 96-100.

[163] Id. at 102.

[164] Id.

time decreased when shop-floor workers were allowed to collaborate in writing their own control programs.[165]

Information is sometimes impacted not because workers refuse to disclose it, but because the transaction costs of collecting and disseminating that information are too high. Information of the sort asymmetrically held by workers is a likely candidate for inclusion in this category. Workers with unique equipment or process knowledge may lack the communication skills necessary to impart such information to others. Alteratively, the information may be of the "learning by doing" sort, which can be experienced more easily than it can be transmitted.[166] In such cases, the self-directed work team may economize on transaction costs by delegating both training and decisionmaking to the workers who hold such information.

Finally, recall that the training of self-directed work teams includes business-oriented issues such as market share and product costs. Teams also are often given client contact rights. At Otis Specialty Paper, Inc., for example, line workers are given direct customer contact, which facilitates the production process, by giving workers more information about meeting customer requirements.[167] This aspect of team production appears to respond to the second category of information asymmetry; i.e., that in which production information needed by self-directed workers is held by managers.

Self-directed work teams are also a powerful response to the adverse effects of irreversibility on information processing. Complex organizations commonly respond to distortion in information transmission by delegating decisionmaking downward to specialists close to the original source of the requisite information,[168] thereby minimizing path lengths. Instead of a simple pyramidal hierarchy, in which all information flows to the top, corporations can minimize the information distorting effects of hierarchy by conferring semi-autonomous status on divisions of the firm and allowing them to make those decisions most efficiently made at the operating level. Self-directed work teams extend that adaptive response to an even greater extreme.[169] Decisionmaking

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[165] DOL, HIGH PERFORMANCE, supra note , at 31. The prediction that such sharing mechanisms can also be highly inefficient, however, is borne out by findings that collaborative problem-solving committees have only an ambiguous association with productivity improvements in unionized firms and were negatively associated with productivity in nonunionized firms. Id.

[166] See WILLIAMSON, HIERARCHIES, supra note , at 62.

[167] See Getman and Marshall, supra note , at 1851.

[168] Robert J. Haft, *The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation*, 80 Mich. L. Rev.. 1051, 1054 (1982).

[169] Oliver Williamson describes a corporate structure based on selective intervention that resembles this model. WILLIAMSON, CAPITALISM, supra note , at 133-35. Williamson develops his model in the context of vertical integration, dealing with the supply of goods. My argument here is that employee involvement is a labor market manifestation of the same phenomenon.

about some day-to-day production processes is delegated all the way down the hierarchy to the production team on the shop floor.

In some firms, the introduction of self-directed work teams appears to actually reverse the seemingly irreversible growth of corporate bureaucracy. Self-directed work teams are often implemented simultaneously with the elimination of a number of levels of hierarchy within the team and the reassignment of managerial roles to the teams.[170] I speculate that the major reengineering of production entailed in shifting to self-directed work teams provides a form of political cover that allows senior managers to overcome the tendencies towards unconstrained expansion.

v. *Summary*

As noted at the outset of this section, one nearly universal characteristic of operational participation is a lack of meaningful employee control over the outcome of the decisionmaking process.[171] Even the seemingly autonomous self-directed work teams give employees little input into policy or strategic decisions, especially those related corporate governance matters.[172] The sorts of employee involvement programs studied herein thus function as supplements, not replacements, for traditional hierarchies.[173] This is consistent with my hypothesis. On the one hand, inefficient information flows created by excessive hierarchy call for alternative information channels, which these programs provide. On the other hand, nothing about such inefficiencies requires changes in either the allocation of policy and strategic decisionmaking authority to managerial specialists or the basic hierarchial structure of large corporations.

Williamson contends that selective intervention does not allow integration that "realizes adaptive gains but experiences no losses." Id. at 161. This is so because of the potentially adverse effects of integration on managerial incentives. Id. Similar adverse incentive effects are to be found in selective intervention in the internal labor market through participatory management, which may help explain the high failure rate observed in employee involvement programs.

[170] Alan Jenkins, *Teams from "Ideology" to Analysis*, 15 ORG. STUD. 849, ___ (1994).

[171] Given the emphasis in the PM literature on the Japanese model, it is instructive that the quality circle-like features of Japanese firms are "not intended to increase workers' autonomy but [only] to help them find out problems in the production line so that no defective goods will be produced." McLeod, supra note , at 255 n.99 (quoting Haruo Shimada of Keio University, Tokyo).

[172] Fama and Jensen argue that delegation to agents with valuable relevant information is a transaction cost-minimizing tactic for complex organizations in which information is widely diffused. Fama and Jensen, supra note , at 308. The agency costs inherent in this delegation process are can be reduced by separating decision management (initiation and implementation) from decision control (monitoring). Id. This economic model is an apt generalization of my hypothesis about participatory management.

[173] Van Aken et al., supra note , at ___. These commentators' view of quality circles and similar employee involvement programs--which they refer to as "the parallel organization--is consistent with the hypotheses advanced herein: "The parallel organization co-exists with the formal organization structure and is intended to facilitate communication, coordination, and opportunities for change." Id.

Accordingly, if my analytical framework is correct, we would not observe such changes and, as demonstrated, we in fact do not see such changes.

3. *Participatory Management as an Agency Cost Constraint*

Taylorism sought to prevent shirking by assembly line workers through a radical division of labor creating jobs of such limited simplicity and scope that shirking was relatively easy to detect.[174] Many modern manufacturing jobs, however, do not lend themselves to the sort of carefully confined structure contemplated by Taylorism. Recall the trend towards modular manufacturing using work teams. This phenomenon, which contributed to the emergence of self-directed work teams, is part of a broader trend away from requiring workers to specialize in a single, predetermined function.[175] Instead, workers are increasingly organized in teams--self-directed or not--responsible for a broad array of production operations.[176] Team members often rotate jobs, further developing their expertise, which promotes flexibility. Such teams create a monitoring problem reminiscent of Alchian and Demsetz's truck loading example: Although the team's joint productivity may be subject to measurement, it is nonseparable. Accordingly, the productivity of individual team members cannot be measured on an output basis and may be quite costly to measure from an input perspective. The monitoring problem is especially severe when assessing individual productivity requires something more than mere effort measurement. Measuring individual productivity might require, for example, assessing whether the employee cooperates with other team members in both day-to-day activities and in helping the team respond to changed circumstances or emergencies.[177]

The challenge presented to Taylorism by team production is especially pronounced when team members develop idiosyncratic working relationships with one another. The idea of firm-specific human capital is a basic tenet of transaction cost economics, of course, but consider the possibility the team members may develop team-specific human capital. There is empirical evidence, for example, that self-directed work teams often become quite insular.[178] This phenomenon may be explained, at least in part, by team members becoming specialized to one another. In such settings, replacing one team member will

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[174] Daniel M. G. Raff and Peter Temin, *Business History and Recent Economic Theory: Imperfect Information, Incentives, and the Internal Organization of Firms*, in INSIDE THE BUSINESS ENTERPRISE: HISTORICAL PERSPECTIVES ON THE USE OF INFORMATION 7, 11 (Peter Temin ed. 1991) (describing Henry Ford's approach to industrial organization).

[175] WEILER, supra note , at 200.

[176] Id.

[177] See WILLIAMSON, CAPITALISM, supra note , at 244.

[178] Charles Hecksher, *The Failure of Participatory Management*, ACROSS THE BOARD, Nov. 1995, at 16 (empirical studies).

have ripple effects throughout the team by means of a sort of reverse synergy having substantial negative productivity effects.

A different challenge for Taylorism arises out of the shift from heavy manufacturing to office and service employment. Although some service jobs can be structured along Taylorist principles,[179] much white collar and knowledge work cannot. Service and knowledge workers need considerable discretion and flexibility, which makes monitoring of their work efforts far harder than was the case in turn-of-the-century assembly lines.

A third challenge to Taylorism comes from the changing nature of workers. Although I contend that the conventional wisdom errs in ascribing universality to the taste for participation, there is no doubt that some workers prefer a more democratic workplace than Taylorism offers. Such workers doubtless respond poorly to the close supervision typical of Taylorist workplaces. New methods for motivating and monitoring such workers might enhance productivity.

Although the conventional wisdom contends that participatory management marks a departure from the traditional monitoring functions of corporate hierarchy towards a more democratic model, I contend that on close examination employee involvement looks like old wine in new skins. As might be inferred from the fact that participatory management generally does not divest management of ultimate control, it appears to have an important monitoring function. Hence, my second hypothesis about participatory management is that it is an adaptive response to the changing nature of production, creating new mechanisms for preventing shirking by employees. Specifically, participatory management facilitates management's efforts to monitor production workers by creating incentives for self-monitoring by individual workers and encouraging peer pressure.[180]

These two hypotheses are complementary, rather than competing. For example, shirking includes worker conduct that preserves information asymmetries. Workers who fail to offer suggestions for improving work processes, for example, are shirking just as much as those who take too many coffee breaks. The irreversibility syndrome also links the two hypotheses. Just as multiple layers of hierarchy impede the flow of information within the firm, they also make it more costly to monitor labor. As firms expand, the time intensive process of directly supervising inputs obviously becomes more costly simply because there are a larger number of inputs to be observed. A more

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[179] See infra notes TBA and accompanying text.

[180] Self-monitoring and peer pressure are supplemented by so-called cooperation cops who monitor the shop-floor and reinforce the participation program's effects. Parker, supra note , at 272. In many participatory management programs, these team leaders are also responsible for designing and adjusting the job responsibilities of other team members. In effect, they have been converted into managerial supervisors, even though they remain union members (in a unionized setting) and nominally are still line employees. Id. at 265. Guillermo Grenier's description of participatory management as a co-optation of worker leaders, which enhances management's control over the work force, thus seems well-taken. GRENIER, supra note , at 129.

important consideration, however, is that monitoring employees and imposing penalties for shirking is one of the information processing activities negatively affected by the development of the excessive hierarchy associated with the irreversibility phenomenon.

a. *Self-monitoring*

The U.S. automotive industry contains many of the most visible quality circle and self-directed work team programs. One of the key components of the team process in that industry is said to be the ability of an employee to "pull the cord," bringing the assembly line to a halt. Doing so, of course, immediately alerts team leaders and managers of the source of production problems. Close monitoring of specific employees is thus made possible.[181] The critical element for our purposes, however, is the system's reliance on self-monitoring by employees. Workers are expected to constantly monitor the quality of the work and to take immediate responsive action when flaws or other production problems arise.

This well-known example usefully illustrates my point. Despite the conventional wisdom's emphasis on autonomy and participation as sources of job satisfaction and morale, participatory management serves in large part as a means of promoting self-monitoring by workers. Consider the concept of "employee empowerment," which despite its democratic connotations is sometimes revealingly defined as "getting workers to do what needs to be done rather than doing what they are told."[182]

Participatory management takes advantage of traits deeply ingrained into the psyche of American workers. According to the Families and Work Institute's survey of worker attitudes, 52 percent of the respondents defined success as getting personal satisfaction from doing a good job, in comparison to only 6 percent who defined it as having control over work content and schedule.[183] Participatory management affirmatively encourages such attitudes through efforts to build "team spirit" and commitment to the group. The idea is to get workers to identify with the company and the plant.

The goal of instilling team spirit is to shift each team member's utility function as it relates to production and leisure, discouraging shirking by reducing the disutility of labor.[184] Team sports provide a logical and useful analogy. In team athletics, one often suspects that some members of the team are not putting out maximum effort.[185] At the same time, it can be very difficult to determine whether a player is shirking, slumping, or hurt. In these sports, team spirit is strongly encouraged, not so much because of any intrinsic value it may

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181 See Parker, supra note , at 268-69.

182 Thorlakson and Murray, supra note , at ___.

183 GALINSKY, supra note , at 13.

184 See Alchian and Demsetz, supra note , at ___.

185 Thomas S. Ulen, *The Coasean Firm in Law and Economics*, 18 J. Corp. L. 301, 310 (1993).

have, but as a mechanism for reducing shirking.[186] A player instilled with team spirit will give his all for the team, instead of shirking. (In its most extreme form, the same phenomenon is seen in soldiers who give their lives to save those of their comrades.) The phenomenon is so well-recognized that there is a vast popular and scholarly literature on how to coach athletic teams effectively.[187]

Just as team spirit promotes athletic success, identification with a work team appears to encourage productivity, especially when pay and job security are linked to the team's performance.[188] Studies confirm that commitment to a work team translates into a willingness to help other team members and improve team performance.[189] It is thus scarcely surprising that there is now a similar literature on managing work teams, much of which uses sports analogies to emphasize the need for team spirit and group identification.[190] Indeed, many management consultants now explicitly describe the leadership function within firms as "coaching" rather than directing.[191]

The team sports analogy is especially instructive with respect to TQM firms. Just as pep rallies were once a staple of college athletics, TQM firms commonly use "quality days" to celebrate firm achievements.[192] TQM's proponents contend that social approval and recognition are important methods of motivating workers. [193] Unlike the conventional wisdom's normative claims, however, note that TQM's use of such devices is explicitly instrumental, as a mechanism for more effectively monitoring production workers.

Participatory management is not limited to promoting team spirit, however. It also tries to promote self-monitoring by inculcating management's quality and productivity goals into workers. QWL often includes a training program, providing paid educational leave, in which employees are taught

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186 Alchian and Demsetz, supra note , at ___.

187 Ulen, supra note , at 310.

188 See Brian O'Reilly, *The New Deal: What Companies and Employees Owe One Another*, Fortune, June 13, 1994, at 44, 50.

189 James Wallace Bishop and K. Dow Scott, *How Commitment Affects Team Performance*, HRMAGAZINE, Feb. 1997, at 107.

190 See, e.g., MARSHALL SASKIN & KENNETH J. KISER, PUTTING TOTAL QUALITY MANAGEMENT TO WORK (1993); JOHN H. ZENGER ET AL., LEADING TEAMS: MASTERING THE NEW ROLE (1994).

191 See James A. Belasco and Ralph C. Stayer, *Why Empowerment doesn't Empower: The Bankruptcy of Current Paradigms*, BUS. HORIZONS, Mar. 1994, at 29, ___ (citing examples and adopting analogy); see also Gephardt and Van Buren, supra note , at ___ ("Managers become coaches ..."). A recent management guide co-authored by former Miami Dolphins head coach Don Shula vividly brings to life the analogy between athletic and work teams. DON SHULA AND KEN BLANCHARD, EVERYONE'S A COACH: YOU CAN INSPIRE ANYONE TO BE A WINNER (1995).

192 Hackman and Wageman, supra note , at ___.

193 Id.

about their industry and company.[194] Recall that training of self-directed work teams similarly includes education about business issues such as market share and product costs. Although these training programs are partially explicable as a response to the information costs associated with hierarchy, they are also a means of reorienting worker attitudes to be more favorably disposed towards management's productivity and competitiveness goals and thus reducing shirking.[195] A study of employee quit rates and commitment attitudes found that participatory programs "breed identification with the values and goals of the firm."[196] Interestingly, however, at least one case study has shown that commitment to a work team increases productivity, but commitment to the firm did not.[197] If generalizable, this latter finding confirms that self-monitoring is a powerful monitoring device, but it also suggests that firms should prefer self-directed work teams to other forms of participatory management and should concentrate their efforts on building loyalty to the team rather than to the firm.[198]

b. *Peer Pressure*

Employees who work together acquire at low cost information about one another, which is not readily available to managers.[199] In cases in which this information asymmetry is especially pronounced, traditional Taylorist monitoring structures may be rendered wholly ineffectual. If such employees can be motivated to monitor one another, however, peer pressure may substitute for managerial monitoring. Some forms of participatory management, most noticeably self-directed work teams, are well-suited for creating substantial peer pressure.

As with self-monitoring, peer pressure takes advantage of widely-shared traits among U.S. workers. The Families and Work Institute's survey is again instructive. Thirty percent of the respondents defined success as earning the respect or recognition of their supervisors and peers.[200] Such employees are likely to engage in self-monitoring, but are also vulnerable to peer pressure.

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194 COTTON, supra note , at 36-38.

195 See McLeod, supra note , at 254-55.

196 James R. Lincoln and Arne L. Kaleberg, *Commitment, Quits and Work Organization in Japanese and U.S. Plants*, 50 IND. & LAB. REL. REV. 39, 56 (1996).

197 Bishop and Scott, supra note , at 107.

198 The potential downside to such an approach is that increased team productivity may not translate into increased firm productivity. Recall the evidence that self-directed work teams may become insular. Such teams may fail to deal effectively with outsiders and even expend resources on power struggles with other teams. See Hecksher, supra note , at 16 (empirical studies); Raghuram G. Rajan and Luigi Zingales, *The Tyranny of the Inefficient: An Enquiry into the Adverse Consequences of Power Struggles*, NAT'L BUREAU ECON. RESEARCH WORKING PAPER 5396 (Dec. 1995) (theoretical demonstration of inefficient power struggles by sub-units of an organization).

199 Fama and Jensen, supra note , at 310.

200 GALINSKY, supra note , at 13.

Indeed, as to such employees, the peer pressure generated by operational participation programs should prove a powerful motivating force.

This prediction is borne out by Guillermo Grenier's well-known case study of a quality circle program in which workers were given responsibility for making discipline decisions with respect to their fellow employees. "Although this responsibility was largely illusory," as my hypothesis predicts, it proved an effective means of generating peer pressure for greater productivity.[201] Workers were required to provide written evaluations of their fellow team members, which were used to determine raises.[202] The circles also identified and openly discussed individual employees who had problems constituting "counterproductive behavior."[203]

Because the firm's workers had some of the forms of decisionmaking power, while ultimate authority remained in management's hands, the quality circles studied by Grenier closely resembled self-directed work teams. As such, Grenier's work points towards an explanation of the ambivalent empirical data relating to quality circles. Studies of employee attitudes find that quality circles positively affect program-specific attitudes (such as the perception of influence), but also find a negative impact on general employee attitudes (such as job satisfaction and organizational commitment).[204] About half of the studies of the effect of quality circles on firm productivity find positive effects, but half find no effect.[205] Many favorable studies could not show causal links between participation and productivity.[206] Only one study tried to measure changes in product quality resulting from a quality circle program; it found no effect.[207]

Although the effectiveness of quality circles remains open to question as a matter of solid empirical data, there is a growing body of anecdotal evidence suggesting that long-term quality circles generally are not successful.[208] Estimates of the failure rates for quality circles range from a low of one-third to a

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201 See GRENIER, supra note , at 17.

202 Id. at 47.

203 Id. at 47-48. As with the quality circles studied by Grenier, some of the self-directed work teams studied by Witte involved group discussions of "disciplinary problems" within the team. WITTE, supra note , at 118. In theory, at least, Witte's teams had even more monitoring power, since they had the power to both hire and fire by majority vote. Id. at 110. Management writers Belasco and Stayer report an anecdote in which employees reported a drug abuse problem among fellow workers, which was dealt with by the quality of work life committee. The committee adopted a drug treatment program for those workers who requested help and fired those who did not. Belasco and Stayer, supra note , at ___.

204 COTTON, supra note , at 70.

205 Id.

206 GRENIER, supra note , at 127.

207 COTTON, supra note , at 70.

208 Id. at 79.

high of 60%.[209] Whatever the cause of these failures, a question on which we shall speculate in a moment, quality circles arguably have flopped as a management tool.[210] According to some observers, they are an unstable organizational structure waiting to self-destruct.[211]

In contrast, the data on self-directed work teams is far more positive. As recently as 1990, self-directed work teams were one of the rarer types of participatory management, although they were expected to grow in popularity rapidly.[212] More recent data confirms that expectation, suggesting that as many as 70% of U.S. companies now have at least some of their employees organized into some variation on the work team theme.[213] In particular, firms are shifting from quality circle to self-directed work team programs.[214] Preliminary data, moreover, suggest self-directed work teams add substantially to productivity.[215]

As with any small group of people closely associated with one another, self-directed work teams entail considerable potential for peer pressure. But the structure of self-directed work teams at many firms strongly reinforces that potential. Many firms base compensation on team productivity, rather than individual achievement.[216] Other firms allow the team itself to make compensation decisions based on an individual's contribution to the team's productivity.[217] At some firms, team members publicly (perhaps electronically) post individual and team goals, report their own daily progress, and comment on other workers' progress.[218] Eaton Corporation, for example, requires workers

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[209] COTTON, supra note , at 78; see also Special Report, supra note , at ___ (over half of quality circles begun in early 1980s failed to survive).

[210] COTTON, supra note , at 78; Naj, supra note , at A12 (quality circles are "going out of style"). Naj refers to the trend towards dismantling quality circles as "a stunning admission of failure." Id. at A1.

[211] COTTON, supra note , at 79.

[212] Id. at 173. The extent to which self-directed work teams have penetrated the American economy is a matter of some dispute, Moe, supra note , at 1159 n.211, probably because of definitional problems. As the Grenier example suggests, some programs referred to (and presumably counted) as quality circles resemble self-directed work teams.

[213] Thomas J. Bergmann and Kenneth P. DeMeuse, *Diagnosing Whether an Organization is Truly Ready to Empower Work Teams: A Case Study*, 19 HUMAN RESOURCE PLANNING 38 (1996).

[214] Naj, supra note , at A12; Special Report, supra note , at ___ (some quality circles evolve into self-directed work teams).

[215] COTTON, supra note , at 181-183. See also id. at 189 (table summarizing results).

[216] See COTTON, supra note , at 193 (firms converting to self-directed work teams often change compensation schemes to team-based or performance bonus systems).

[217] Belasco and Stayer, supra note , at ___. This aspect of self-directed work teams is similar to the use of gain-sharing or other profit-sharing plans coupled with quality circles or QWL. Coupling quality circles with gain-sharing provides workers with both the tools for mutual monitoring and the incentive to do so. In settings where line employees can monitor and motivate their fellow workers more effectively than can supervisors, but team production is either unnecessary or undesirable, this form of participation may prove an efficient alternative to both Taylorism and self-directed work teams.

[218] Id. See also *Why Doesn't This Team Work*, HARV. BUS. REV., Nov./Dec. 1994, at 26, ___ (opining that management must "[r]equire the team members to determine how to

to point out each other's mistakes and, in some cases, to publicly acknowledge their mistakes before the rest of the workforce.[219] Indeed, Eaton on two occasions put the question of whether errant employees should be fired to a vote of the workforce.[220] All of which is dressed up in empowerment camouflage, but appears to have a strong monitoring component.

An interpretation of this evidence consistent with the hypotheses advanced herein is that quality circles fail because they lack a monitoring component or put no teeth into team members' ability to monitor one another.[221] In such cases, quality circles can only serve information transmission purposes. We have known at least since Taylor's time that informational asymmetries about production processes arise precisely because workers have strong incentives to withhold information from management that might prevent shirking or otherwise be used to the workers' disadvantage. As noted above, this was the rationale for Taylorism's emphasis on discouraging workers from thinking about their job or its place in the production process. Quality circles may not offer sufficient incentives to overcome the strong bias against voluntary disclosure of information asymmetrically held by workers.[222] Quality circles therefore ought to be subject to displacement by programs that can both more effectively resolve informational asymmetries and provide enhanced

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hold themselves mutually accountable for achieving their goals."). In service and other office-oriented business settings, the rise of firm-wide computer networks offers additional monitoring mechanisms. Shared computer resources offer other team members (not to mention managers) a powerful tool with which to observe the performance of individual team members. Wilke, supra note , at A7.

[219] Aeppel, supra note , at A1.

[220] Id.

[221] An alternative explanation for the failure of quality circles is put forward by Lawler and Mohrman, supra note , at ___, who opine that quality circles fail because the low-level managers who must act on the circle's reports sometimes fail to do so. Their interpretation is not inconsistent with my general hypothesis that participatory management is a response to inefficient hierarchies. If low and mid-level managers are refusing to implement quality circle recommendations, both inefficiencies associated with hierarchy are present: we have an information processing problem caused by managerial shirking. Fully implemented self-directed work teams typically are associated with a substantial flattening of the corporate hierarchy. See Lawler, supra note , at ___ (self-directed work teams associated with elimination of staff as mid- and low-level management tasks reassigned to teams). By eliminating the need for low and mid-level managers, self-directed work teams thus reduce these inefficiencies.

[222] Anecdotal evidence suggests that quality circles have relatively limited useful lifespans. Although they may initially provide employers with useful information, over time they appear to lose their effectiveness as employees become bored and/or jaded. TQM therefore firms now tend to use short-term quality circles directed at fairly specific problems. Hackman and Wageman, supra note , at ___. My analysis thus explains Levine and Tyson's finding that quality circles often have short-lived benefits, while programs that provided more substantive employee involvement with real decisionmaking power had longer term benefits. Levine and Tyson, supra note , at 203-04. Substantive decision-making as Levine and Tyson define it does not go beyond the very limited autonomy allowed to self-directed work teams. Levine and Tyson, supra note , at 190. If self-directed work teams are a superior form of participatory management, as my analysis suggests, Levine and Tyson's findings are consistent with my hypotheses.

monitoring mechanisms to prevent shirking, which is precisely what my analysis suggests self-directed work teams have done.[223]

c. *Evidence for the Monitoring Hypothesis*

As we have just seen, the structure of participatory management in today's workplace strongly supports my theory that such programs have an important monitoring function. Is there other evidence that supports my hypothesis? Assume that constraining shirking by production employees is consistent with both the interests of the firm and the self-interest of its managers. Further assume that although constraints on shirking may be in the firm's production employee's interest ex ante, once employed they will perceive more effective constraints on shirking as inconsistent with their self-interest.[224] Granting those assumptions, if participatory management has an important monitoring component, we would expect it to be a top-down phenomenon strongly supported by managers and opposed by workers.

The evidence is consistent with this hypothesis. Privately-ordered operational participation is almost uniformly a creature of management. Recall also the strong emphasis in the management-oriented literature on the need for managers to retain ultimate decisionmaking control. Indeed, the management-oriented literature frequently hints as the monitoring component of participatory management. Managers are urged, for example, "to make people responsible for the own performance," and to manage "so that individuals own the responsibility to solve production problems."[225]

In contrast, unions often (albeit not always) resist participatory management.[226] Union resistance perhaps could be explained away as mere rent-seeking by an interest group threatened by change, but, as we have seen, there is evidence that individual employees often resist participation. In many firms, management has therefore resorted to quite aggressive tactics to secure worker

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[223] My interpretation is consistent with that advanced by management consultants Belasco and Stayer, who opine that participatory management programs in which workers identify problems for management to solve tend to devolve into "bitch sessions," while employee involvement programs that lead workers to "own" the problem are more likely to succeed. Belasco and Stayer, supra note , at ___.

[224] Cf. MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE 44 (1994) ("Capital could seek profits by getting highly motivated managers who sweat the labor force.").

[225] Belasco and Stayer, supra note , at ___. See also *Why Doesn't This Team Work*, HARV. BUS. REV., Nov./Dec. 1994, at 26, ___ ("Teams need mutual or joint accountability in addition to individual accountability. The entire team must believe that is can succeed or fail only as a team."); see generally Thorlakson and Murray, supra note , at ___ ("Many of the motivational techniques utilized over the years have incorporated employee involvement in participative decisionmaking to some degree.").

[226] McLeod, supra note , at 236.

acceptance of participatory management, purportedly including threats to transfer work or close plants unless the programs are implemented.[227]

The logical inference to be drawn from this evidence is that managers perceive participatory management as being in the firm's interest, while workers recognize that participatory management may have consequences adverse to their interests. This inference is supported by the arguments made against such programs by union sympathizers.[228] Because participatory management programs leave ultimate decisionmaking authority in management's hands, some critics see it as simply a new mechanism for perpetuating managerial control and enhancing management's supervisory powers. Guillermo Grenier, for example, contends that the "trick" to participatory management "is to make workers feel that their ideas count and their originality is valued while disguising the expansion of managerial prerogatives into the manipulative arena of pop psychology."[229] Wilson McLeod likewise contends that all forms of participatory management share "a common management-oriented heritage and ideological vision" intended to get workers to identify with the company's goals and to accept management's competitive imperatives.[230] Other commentators reach similiar conclusions.[231]

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[227] Id. Michael LeRoy's survey data on manager and union leader attitudes towards participatory management gives some specific content to these generalizations. LeRoy found that both managers and union leaders had generally positive views of joint consultation committees, but that managers had more strongly positive views of such committees. LeRoy, supra note , at 1838. Accord Adrienne E. Eaton, *The Survival of Employee Participation Programs in Unionized Settings*, 47 IND. & LAB. REL. REV. 371, ___ (1994) (management had consistently more positive views of participatory management than did union representatives). As to quality circles, LeRoy found more sharply divergent views: Employers perceived quality circles as having a desirable effects on productivity and other measurements, while unions tended to disagree. LeRoy, supra note , at 1841-42. Particularly striking is LeRoy's finding that management respondents believed that joint labor-management committees increased the extent of worker participation in decisionmaking, but union leaders disagreed with that proposition. LeRoy, supra note , at 1838. Also striking is LeRoy's finding that some union leaders perceived management as having used an employee participation program dishonestly. Id. at 1845-46.

[228] This inference is further supported by John Cotton's observation that American experiments with employee involvement focus on the departmental and individual level, in contrast to European models that focus on the company and plant level. COTTON, supra note , at 25. This is precisely what one would predict to be the case if participatory management in this country is a top-down mechanism for resolving inefficiencies created by excessive hierarchy and European employee involvement programs spring from ideological motives.

[229] GRENIER, supra note , at 131. See also id. at 13 ("the real issue is one of managerial power and control.").

[230] McLeod, supra note , at 235 (footnotes omitted).

[231] See, e.g., Getman and Marshall, supra note , at 1869 (participatory management often used "to get employees to work harder for the same or less pay"); Christopher Gunn, *Workers' Participation in Management: Capital's Flexible System of Control*, 26 REV. RAD. POL. ECON. 119, 125 (1994)

It is also instructive that participatory management has gone hand in hand with other changes in working conditions, such as just in time inventories,[232] collectively referred to by their critics as "management by stress." In the last two decades, this system has come into wide-spread use, imposing a variety of pressures on employees to boost productivity.[233] Participatory management fits into this system by imposing, through the mechanisms just discussed, pressure on workers for punctuality, attendance, and high productivity under heavy demands.[234]

This is especially evident in TQM firms. Although employee involvement is an integral part of TQM, it is not intended to promote the sort of worker autonomy contemplated by the conventional wisdom. To the contrary, under TQM employee involvement looks more like Taylorism than a participatory democracy: "Under TQM, much energy is spent identifying the 'best' work practices, those that bring work processes under the greatest possible control. ... Once such practices are identified and documented, they are diffused throughout the organization and standardized, with the result that work-unit members may end up with very little discretion about how they perform their tasks."[235]

Perhaps the most telling support for my hypothesis, however, comes from evidence that line employees often see through the rhetoric that surrounds employee participation, recognizing that it is designed to have a monitoring function. As an Eaton Corporation employee explained, for example, her co-workers were not "standing watching me, but from afar they were watching me."[236] More generally, two of the most frequently cited reasons for the failure of quality circles are that employees see them as a "management ploy" to enhance productivity while cutting overtime and jobs and that most companies

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(participatory management is used to force workers to internalize the firm's goals); HOGLER AND GRENIER, supra note , at 7 ("By embedding managerial power within a context of 'group autonomy,' employers can advance their own goal of deflecting potential threats of collective worker action and maintaining a less visible, but certainly no less effective, structure of bureaucratic power."); Juravich, supra note , at ___ (citing studies of increased worker stress in participatory management workplaces); Parker, supra note , at 250; see also WITTE, supra note , at xi ("most American experiments in [participatory management] have taken advantage of the symbolic value of 'democracy' while not applying the basic principles of democracy," most notably the principle of equality).

[232] Just-in-time manufacturing involves a significant reduction in worker autonomy. Janice A. Klein, *The Human Costs of Manufacturing Reform*, HARV. BUS. REV., Mar./Apr. 1989, at 60.

[233] Parker, supra note , at 261.

[234] See COTTON, supra note , at 50.

[235] Hackman and Wageman, supra note , at ___. Indeed, Hackman and Wageman observe that TQM reminds them of scientific management, while deploring the latter's motivational costs. Id. Accord Adler and Borys, supra note , at ___ ("TQM's emphasis on work process codification seems to contradict EI's focus on increasing employee discretion").

[236] Aeppel, supra note , at A1.

treated quality circles as a way of improving productivity without fundamentally changing the firm's hierarchial structure.[237]

IV. IMPLICATIONS

What are the spatial limits of participatory management? Is it a universal truth or merely one of an array of industrial relations choices among which firms should pick and choose? What are the evolutionary limits of participatory management? Will it remain a top-down phenomenon differing from Taylorism more in form than in substance, or will it evolve into true participatory democracy for the workplace? The conventional wisdom implies no boundaries for participatory management; indeed, it lacks any account of why boundaries should exist or where they are likely to be found. In contrast, my analysis not only implies the existence of boundaries, but also suggests where to look for them.

A. *Spatial Boundaries: One Size does not Fit All*

J. Richard Hackman, an organizational psychologist prominent in the management literature on participatory management, relates an amusing anecdote about his seminal book on self-directed work teams:[238] The publisher declined to use his initial title, GROUPS THAT WORK, because only four of the 33 case studies actually worked in the sense of being an effective team.[239] Hackman ultimately became a leading proponent of so-called contingency theories of team production, which attempt to define the conditions under which this

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[237] GRENIER, supra note , at 9. Greinier's observation suggests another reason that self-directed work teams may be superior to quality circles. If employees recognize that participatory management serves mainly as a vehicle for tapping their knowledge and for monitoring them to prevent shirking, they may intuitively recognize that participatory management thereby creates a new opportunity for management to appropriate quasi-rents previously accruing to employees. Cf. KOCHAN ET AL., supra note , at xiv ("When there is no decentralization of managerial authority to complement work practice changes, workers become frustrated by the appropriation of, or lack of attention to, new ideas generated on the shop floor and also feel aggrieved by a perceived inequality of sacrifice."). Giving employees a meaningful, but narrowly-constrained decision-making role would act as a bond against such appropriation, by giving them a voice in decisions that might adversely affect their interests. Alternatively, and perhaps more likely, it may simply be the case that giving employees the forms of decisionmaking power, especially with respect to disciplinary matters, may make peer group monitoring more effect in comparison to the relatively toothless monitoring tools provided by quality circles.

[238] J. RICHARD HACKMAN, TEAMS THAT WORK (AND THOSE THAT DON'T) (1990).

[239] Allan Church, *The Power of Teamwork--Fact or Fiction*, http://cmit.unomaha.edu/TIP/TIPOct96/church.htm (quoting remarks by Hackman).

organizational form is likely to be most effective. At present, while the popular (and legal) literature persists in ascribing universal truth status to participatory management, the academic management literature has generally adopted some variant of Hackman's contingency theories.[240]

Contingency theory's claim that one size does not fit all is validated by the empirical evidence on participatory management's failure rate. Many firms adopt employee involvement on an experimental basis. We also know that there is a high failure rate for operational participation. In sum, what is happening on the ground is best described as limited and piece-meal experimentation with employee involvement, rather than the fundamental shift in the nature of workplace relationships claimed by the conventional wisdom.[241]

What are the indicia of success or failure for participatory management? If my analysis is correct, firms that adopt some variant of participatory management just because it is faddish to do so are unlikely to succeed. At least, they do so only by blind luck. Firms that adopt a specific participatory management program in response to a recognized organizational failure are more likely to succeed.

1. *The Nature of the Workplace*

Although the conventional wisdom claims that the changing nature of work requires a move towards participatory management, it lacks a convincing explanation of why this should be the case. The oft-cited shift from heavy manufacturing to knowledge and service employment, for example, has little explanatory power. To be sure, knowledge and service employment is harder to structure according to the dictates of Taylorism than is work on a manufacturing production line. Many of the industries in which participatory management has been tried, however, are those involving heavy manufacturing. The automobile industry is a good example of this phenomenon. In addition, non-participatory mechanisms for monitoring the performance of office and service employees easily could be developed. Indeed, at least in some areas, service employees in fact can be organized as though they worked on a Taylorist production line.[242] In contrast to the conventional wisdom, my hypotheses offer an explanation for the link between the changing nature of work--or, more precisely, the changing nature of the workplace--and the success or failure of participatory management.

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[240] See Jenkins, supra note , at ___; see generally Glew, supra note , at ___ (discussing importance of contextual factors as a determinant of success or failure of participatory management); cf. Hyde, supra note , at 203 (conceding that the efficiency of employee ownership will vary among firms). Even some participatory management enthusiasts acknowledge that it falls short of universal applicability. See, e.g., Bowen and Lawler, supra note , at ___ ("business does not lend itself to universal truths"); Walton, supra note , at ___ ("Some environments ... are better suited than others to the commitment model.").

[241] KOCHAN ET AL., supra note , at xi.

[242] See, e.g., Bowen and Lawler, supra note , at ___ (describing Taylorist-like production line approach to service employment at McDonald's).

a. *Information Processing*

In predicting whether participatory management is likely to succeed in a given firm, we might begin by asking whether the workplace in question is one in which branching hierarchies are likely to promote or impede efficient information processing. Firm size is a highly relevant, albeit not dispositive, consideration in this regard. As a rule of thumb, small firms (albeit ones large enough to require some hierarchy) tend to be autocratic.[243] In small firms with a limited range of production processes, information asymmetries may be less persistent. By virtue of having fewer layers of bureaucracy between themselves and the shop floor, it may be less costly for decisionmakers to gather information directly from production workers. Their small size ensures short path lengths for transmitting information, thereby minimizing systemic distortion.At the very least, bounded rationality is less of a concern precisely because there is less information to gather.

We thus might expect that a firm's exposure to the bloated bureaucracy associated with the irreversibility phenomenon would be a strong predictor of participatory management's efficacy. Unfortunately, I have been unable to find any empirical evidence directed at this question. Pondering the question from a theoretical perspective grounded in transaction cost and agency cost, however, proved instructive.

I began by hypothesizing that a critical factor might be the extent to which external forces checked the growth rate of a firm's hierarchy. In turn, this suggested a link between two of the most important corporate phenomena of the last 15 years: participatory management and corporate restructuring. Recall that complex organizations commonly respond to distortion in information transmission by delegating decisionmaking downward to specialists close to the original source of the requisite information, thereby minimizing path lengths. I speculate that self-directed work teams are an extreme example of this phenomenon, but no such speculation is required with respect to restructurings. The wide-spread corporate down-sizing and restructuring during the 1980s in fact is best explained as a reaction to the excess growth of corporate bureaucracies during the preceding decades. Whether down-sizing was undertaken by incumbent managers in order to stave off a hostile tender offer or

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[243] Kevin G. Salwen, *Workplace Friction: To Some Small Firms, Idea of Cooperating with Labor is Foreign*, WALL ST. J., July 27, 1993, at A1 (in small companies, workplace democracy "can run smack into autocracy"); Smither, supra note , at ___ (small businesses tend to be authoritarian). Interestingly, firm size is also relevant in Japan, where small and medium-sized firms tend to have neither consultation committees nor the other institutions necessary to make participation successful. Motohiro Morishima et. al., *Industrial Democracy in Selected Pacific Rim and European Countries* 9, presented to the Conference on Industrial Democracy Issues for the 21st Century, Univ. of Illinois, April 12, 1995.

by a raider after a successful takeover, eliminating unnecessary bureaucracy was a major corporate goal in the 1980s.[244] In a corporate restructuring, the management hierarchy, especially the central office, is typically targeted for major pruning. In his important case study, Michael Useem cites the anecdotal example of a firm that cut its corporate staff by over 90 percent during the 1980s.[245] More generally, Stephen Margulis reports that 85 percent of the Fortune 1000 firms have now downsized their white collar workforce, eliminating almost 6 million white collar jobs.[246]

Although the down-sizing and irreversibility phenomena are facially incompatible, they can be reconciled at a deeper level. Recall that irreversibility arises in part because management's incentives are skewed in favor of expansion. The hostile takeovers of the 1980s and, according to some (such as Useem), pressure from institutional investors gave management counter-incentives favoring downsizing. At the same time, the transaction cost schedule that favored expansion shifted in favor of down-sizing when the corporate embrace of advancements in information-processing technology made down-sizing technologically feasible without running afoul of bounded rationality.[247]

From this perspective, participatory management is merely one manifestation of a broader pattern of reaction against excessive bureaucratization. I therefore initially speculated that firms that underwent a major restructuring during the 1980s are less likely to suffer from excessive hierarchy, and the resulting faults giving rise to the need for participatory management, than are firms that did not. As the story went, the resistance to elimination of hierarchial layers implied by the irreversibility syndrome suggested that some firms would not restructure and others would not do so in a sufficiently radical way. Accordingly, additional adaptive responses to excess bureaucracy were necessary. Participatory management provides such a response by giving management a mechanism for by-passing the hierarchy to obtain information at the source. My initial hypothesis thus was that participatory management was less likely to be found in firms that had not restructured.

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[244] See generally MICHAEL USEEM, EXECUTIVE DEFENSE: SHAREHOLDER POWER AND CORPORATE REORGANIZATION 58-88 (1993) (describing corporate decentralization and devolution of authority during the 1980s as a response to shareholder and market pressures).

[245] Id. at 80.

[246] Stephen T. Margulis, *Bad News, Good News about Downsizing,* MANAGING OFFICE TECHNOLOGY, April 1994, at 23.

[247] See Drucker, supra note , at 45-47 (changing work force demographics and information-processing technology are rendering old-style hierarchies both ineffective and unnecessary); John R. Wilke, *Computer Links Erode Hierarchial Nature of Workplace Culture,* WALL ST. J., Dec. 9, 1993, at A1 (discussing the ability of computer networks to break down workplace hierarchies).

The empirical evidence on this point is scanty, but suggests that participatory management is often initiated more-or-less simultaneously with a down-sizing restructuring.[248] In one well-known example, General Electric instituted its Workout program to provide employees with an opportunity to make suggestions about how the firm could do more work with fewer workers.[249] Another firm adopted a gain-sharing program in which some of the money saved by the down-sizing was set aside to reward workers who came up with useful suggestions.[250]

These examples appeared to call for a new hypothesis in which restructuring and participatory management are complementary rather than competing adaptations to the irreversibility syndrome. Restructurings can have strongly negative morale effects, especially when the restructuring includes a significant downsizing of the workforce. Retained workers frequently experience a survivor's syndrome, whose symptoms include risk aversion, demoralization, loss of commitment, and high stress levels.[251] This phenomenon appears to be one reason that the expected economic benefits of a restructuring often fail to materialize.[252] Here is where the emphasis on group cohesion in the participatory management literature comes into play. By building team spirit, participatory management helps off-set the negative morale effects associated with a restructuring.

Restructurings can also disrupt internal information flows. The most obvious effect of the layoffs associated with a downsizing restructuring is the loss of the departed workers' expertise and knowledge,[253] but their more subtle effect is to break up the informal mechanisms by which managers and workers bypass hierarchy.[254] One party (or both) to an informal bypass may be laid off. Lost trust and enhanced risk aversion may result in a communication breakdown even if both parties remain with the firm.[255] Once severed, these informal links are slow to heal. Informal relationships of the sort at issue here typically develop around social interactions such as company sporting events, outings, car pools, and break rooms. By one estimate, a strong internal organization can take three to seven years to evolve.[256] In the low morale post-restructuring environment, the longer estimate seems perfectly plausible.

Participatory management's information gathering and transmission effects provide a systematic way of replacing and reestablishing the informal mechanisms damaged by a major downsizing. By bringing together employees

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248 Gandz & Bird, supra note , at ___.

249 Joel Brockner, *Managing the Effects of Layoffs on Survivors*, CAL. MGMT REV., Jan. 1992, at 9.

250 Id.

251 Margulis, supra note , at 23.

252 Id.

253 Margulis, supra note , at 23.

254 Hecksher, supra note , at ___.

255 Id. at ___.

256 Van Aken, supra note , at ___.

from various areas of the plant or firm, a quality of work life program or quality circle may facilitate reestablishment of the "grapevine" within the firm. Until then, the information-extracting function of such programs replaces the disrupted informal communication channels.[257]

A final speculation is that managers bold enough to embark on a major down-sizing may also be bold enough to try shaking up the workplace by introducing participatory management. Hence, although it initially seemed counter-intuitive, I now suspect that participatory management and restructuring may go hand-in-hand. Indeed, there is some evidence of a correlation between the economic success of downsizing restructuring and the introduction of participatory management.[258]

b. *Monitoring*

The agency cost component of my account also has substantial predictive power. Again, firm size is a relevant, but not dispositive, consideration. Incentive and production structures tend to parallel one another, with the degree of centralization depending in large measure on firm size.[259] Smaller firms tend to have highly centralized production structures, with centralized incentive schemes focusing on direct monitoring of labor inputs. In contrast, larger firms tend to have decentralized production structures, with decentralized incentive schemes that focus on monitoring of outputs.[260]

A more important set of considerations, however, is suggested by Oliver Williamson's transact costs-based account of workplace organizations. Williamson suggests a four-category classification system based on two factors: firm-specific human capital and the separability of work functions.[261] Some jobs require employees to make small investments, if any, in firm-specific human capital. Others require substantial investments in such capital. Flipping hamburgers at McDonald's comes to mind as an example of the former, while designing chips for IBM comes to mind as an example of the latter. Similarly, while some jobs allow individual inputs to be monitored at low cost, other jobs entail nonseparable team labor in which individual inputs are costly to measure. McDonald's and IBM are again illustrative.

Taylorism works well in Williamson's "internal spot market," a category that captures situations in which workers invest little in firm-specific human

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[257] My point is not that participatory management is superior to informal networks. To the contrary, I suspect that Charles Hecksher is correct in asserting that quality circles and the like cannot substitute for personal relations with trusted colleagues and superiors. Hecksher, supra note , at ___. My point is only that in a downsized firm in which those personal relations have been severed, participatory management is better than nothing and may contribute to their reestablishment.

[258] Margulis, supra note , at 24.

[259] Shailendra Raj Mehta, *Why Do Firms Decentralize When They Expand* 1-2 (Nov. 1992) (unpublished manuscript, on file with author).

[260] Id. at 14.

[261] WILLIAMSON, CAPITALISM, supra note , at 245.

assets and perform separable tasks. Subject to the constraints imposed by the irreversibility phenomenon, hierarchial monitoring of such employees is likely to be highly efficient. Each worker's output can be closely monitored because the tasks are separable. Inefficient workers are subject to the low-cost sanction of dismissal because neither firm nor worker has any efficiency-based incentive to maintain an employment relationship in the absence of investments in firm-specific worker's human capital. It is precisely because McDonald's workplace has these characteristics that it is able to rely on Taylorist-like production and monitoring methods, even though it is in a service industry.

Taylorism also works reasonably well in Williamson's "obligational market," which describes settings in which workers have substantial investments in firm-specific human capital but perform separable tasks. What changes in such firms is not the nature of monitoring, which remains one of close supervision by a managerial hierarchy, but rather the nature of the sanctions for shirking. Both the firm and the employee now have incentives to preserve the employment relationship. Although the investment in firm-specific human capital is a sunk cost, such investments result in a first-mover advantage creating an incentive to preserve the relationship so as to capture on-going efficiencies. As a result, shirking will be sanctioned through less draconian means than simple dismissal.

I speculate that Taylorism is less well-suited to an obligational market than an internal sport market due to a factor Williamson fails to explicitly consider--employee tastes. A central reason that one size does not fit all, of course, is that employee tastes differ. Some employees have a strong taste for hierarchy, while others have a strong taste for participation. John Witte's case study demonstrated that activist employees, defined as those most likely to seek an active role in participatory management, were atypical in a number of significant respects.[262] They tended to be younger, more politically active, and better educated than their peers.[263] They also tended to be far more ambitious than their peers, while simultaneously being less tractable to supervision.[264] I speculate that such employees may gravitate towards jobs entailing form-specific human capital. At the very least, there may be a correlation between a willingness to invest in general human capital by pursuing an advanced education and a willingness to invest in firm-specific human capital by pursuing training. If so, their tastes will affect the vitality of Taylorism within obligational market firms. Indeed, such firms might be able to lower labor costs by shifting to participatory management, and its emphasis on self-monitoring and peer pressure, to attract such workers.

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[262] WITTE, supra note , at 54.

[263] Id. Subsequent studies in other settings have almost uniformly confirmed Witte's findings. See Miller and Prichard, supra note (reporting own results and summarizing those of other studies); see also Glew, supra note , at ___ (quality circle members tend to be more highly educated than nonmembers); Special Report, supra note , at ___ (white collar workers had higher levels of interest in participation than blue collar workers).

[264] WITTE, supra note , at 55-56.

Taylorist monitoring may also work reasonably well in firms characterized by Williamson's "primitive teams," which arise when human assets are not firm-specific but tasks are nonseparable.[265] Despite the increase in monitoring costs associated with nonseparable tasks, Taylorism may still be superior to participatory management for primitive teams. If I am correct in speculating that employees with a taste for participation tend to gravitate towards jobs requiring firm-specific human capital, employees with a taste for hierarchy may gravitate towards jobs favoring general human capital. The increase in monitoring costs associated with many jobs requiring primitive teams also not be significant. Alchian and Demsetz's famous truck loading example involves a primitive team: there is little that is firm specific about loading boxes on a truck. In the truck loading example, a foreman with the power to fire shirkers provides an effective and low-cost monitoring device. In turn, the foreman is subject to hierarchial monitoring little different from that in a classic Taylorist production line.[266] Finally, the self-monitoring and peer pressure monitoring tools participatory management furnishes may be poorly suited to the primitive team context. Workers who do not invest in firm-specific human capital have no economic incentive to commit to the firm or team as participatory management requires.

All of which stands in sharp contrast to Williamson's fourth category, the "relational team," which arises where workers make large investments in firm-specific human capital and their productivity is costly to measure because of task nonseparability. Williamson predicts that under these conditions firms will "engage in considerable social conditioning of employees, while also offering them "considerable job security" and "assurance against exploitation."[267] I contend that participatory management (especially self-directed work teams)

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[265] WILLIAMSON, CAPITALISM, supra note , at 246.

[266] This example suggests a potential expansion of my agency cost account. Although my analysis has thus far focused on workers, self-directed work teams also appear to be a rather elegant solution to a core agency cost problem; namely, who will watch the watchers. In any team organization, one must have some ultimate monitor who has sufficient incentives to ensure firm productivity without himself having to be monitored. Otherwise, one ends up with a never ending series of monitors monitoring lower level monitors. Alchian and Demsetz, supra note , at ___. The problem is compounded in large firms because, as a corporate hierarchy grows additional layers, shirking by monitors begins to have repercussive effects throughout the firm. Shirking by a senior manager significantly affects the productivity of everyone below him in the hierarchial structure. See Mehta, supra note , at 7-10. In an important theoretical contribution, Alchian and Demsetz tried to solve the watchers problem through the residual claimants device. If the constituent entitled to the firm's residual income is given final monitoring authority, he is encouraged to detect and punish shirking by the firm's other inputs because his reward will vary exactly with his success as a monitor. Unfortunately, their elegant theory breaks down precisely where it would be most useful. Because of the separation of ownership and control, it simply does not describe the modern publicly-held corporation. Although shareholders hold the residual claim, market and legal constraints preclude them from exercising any meaningful monitoring role. Firms moving to self-directed work teams may have cut the resulting "who will watch the watchers" Gordian knot by simply eliminating the need for watchers.

[267] WILLIAMSON, CAPITALISM, supra note , at 246-47.

offers the substance of the first half of this equation, but only the form of the latter.

Task nonseparability implies an increase in monitoring costs viz-a-viz the classic Taylorist production line. But it is the presence of firm-specific human capital that is dispositive. Employee tastes are again a relevant consideration, suggesting that Taylorist monitoring techniques may be too oppressive in this context. In contrast to the simple jobs likely to be entailed in primitive team settings, such as the Alchian and Demsetz example, my intuition is that jobs requiring workers to make firm-specific human capital investments tend to be complex. If so, external monitors (such as the trucking company foreman), may not be able to efficiently monitor team production except perhaps on the grossest output basis. As discussed above, dismissal is an unattractive sanction as to employees who have made firm-specific human capital investments. At the same time, employees who invest in firm-specific human capital have an economic incentive to preserve the employment relationship, so as to continue reaping the rents created by their first-mover advantage, and thus are more likely to develop the commitment to firm or team that makes peer pressure and self-monitoring effective. All of these factors suggest that it is this final category of Williamson's classification system that Taylorism is most likely to be displaced by participatory management.

Taylorism is even more likely to be displaced by participatory management, specifically by self-directed work teams, when team members become specialized to one another. Recall the concept of team-specific human capital introduced above. Team members may develop a sort of synergy as they develop idiosyncratic ways of working with each other. If so, no member of the team can be replaced without having a highly disruptive effect on the entire team. Williamson predicts, without much in the way of explanation, that "[m]ore complex teams in which mutual motivation and internal monitoring are encouraged are apt to take shape in such circumstances."[268] My analysis both explains and validates Williamson's prediction.

In the presence of team-specific human capital, dismissal clearly becomes a sanction of last resort. Because such teams can become insular, moreover, even external sanctions falling short of dismissal may have ripple effects throughout the team. We know, for instance, that insular teams may fail to deal effectively with outsiders and even expend resources on power struggles with other teams.[269] Such a team may respond to external monitoring efforts by "circling the wagons" around the intended subject of sanctions.

Indeed, external monitoring may be wholly inefficacious with respect to such teams. Under the specified conditions, an individual's marginal contribution to the team's productivity may be impervious to measurement. As such, Taylorist monitoring hierarchies will be unavailing even with respect to employees with a taste for hierarchy. Instead, under these conditions, the peer

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[268] Id. at 245.

[269] See supra note TBA.

pressure and self-monitoring encouraged by participatory management should be a more efficient means of constraining shirking.

2. *Firm Culture*

Assume a firm whose workforce is organized into teams carrying out nonseparable tasks. Assume the firm's workers make substantial investments in firm-specific human capital. Assume the firm is still struggling with a bloated bureaucracy. My analysis thus far suggests that such a firm is a plausible candidate for participatory management. Why might participatory management nevertheless fail in such a firm?

One possibility is that the firm faddishly adopted the wrong form of participatory management. Perhaps it embraced quality circles, even though it appears that self-directed work teams have a significant transaction cost advantage over the former. Such a firm's quality circles are likely to fail or, perhaps even more likely, to evolve into work teams. But I contend that participatory management can fail even in a firm that seems like a good candidate and chooses wisely.[270]

When Bill Gore founded W. L. Gore & Associates (the maker of, inter alia, Gore-Tex), he adopted a "lattice" system of employee self-management. The lattice system is a radical form of employee involvement, which verges on a true participatory democracy, but which also resembles a very large self-directed work team. Although Gore & Associates has been quite successful, Gore acknowledgeS that the lattice system would not work in many firm cultures. As he opines, "established companies would find it very difficult to use the lattice. Too many hierarchies would be destroyed."[271] He further opineS that the lattice system works best in start-ups so organized from the outset.[272]

The empirical evidence confirms Gore's intuition that employee involvement is almost certain to fail if firm culture is not receptive to participation.[273] Irene Goll found, for example, that competitive pressures and other business environment considerations were not positively correlated with adoption of participatory management programs, but that corporate ideology, especially as it relates to corporate social responsibility, was positively

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[270] Even among firms whose culture is somewhat receptive to employee involvement, overly ambitious changes in firm decisionmaking structures may prove self-defeating. By way of analogy, it is observed that TQM may fail when the changes are "so ambitious and involve such fundamental alteration of the social system that ... the organization cannot accommodate to them." Hackman and Wageman, supra note , at ___.

[271] Shipper & Mann, supra note , at ___.

[272] Id.

[273] See generally COTTON, supra note , at 79 (with specific reference to quality circles); QWL STUDY, supra note , at 39-40 (QWLs need both strong team leaders and highly visible support from top management and union leaders); Glew, supra note , at ___-___ (summarizing studies of firm culture showing it to be a critical factor).

correlated to their adoption.[274] Coye and Belohlav found statistically significant relationships between the degree of employee involvement and both the number of participatory management programs offered by the firm and the average participation in those programs.[275] John Cotton reports that most consultants in the quality circle field posit that some firms are not ready for operational participation in terms of corporate culture.[276]

Firm cultures are highly path dependent creatures, which can prove quite resistant to change.[277] As a result, an inhospitable firm culture can prove a potent and long-lasting barrier to successful employee involvement. In particular, I speculate that firms with strongly entrenched hierarchies and/or a long history of adversarial labor relations are poor candidates for successfully involving employees in decisionmaking.

An illustrative anecdote comes from the paper industry: Both International Paper and Otis Specialty Paper asked their respective employees to cooperate in preparing a job handbook. Otis' culture emphasized labor--management cooperation. International Paper's culture emphasized adversarial labor relations and included a recent history of prolonged and violent strikes. Otis' employees cooperated as requested and the handbook became part of the firm's participatory management program. International Paper's employees refused to cooperate reportedly because they believed the project was intended not to introduce participatory management but to provide training manuals to be used by replacement workers in the event of a strike.[278]

The paper industry anecdote suggests one way firm culture affects the viability of participatory management: A long history of adversarial relations precludes the "we're all in this together" attitudes participatory management needs to foster. A tradition of intra-firm competition can have similar effects.[279] Firm culture will also impact management decisionmaking about employee involvement. Firm culture is likely to affect not only the basic decision to adopt employee involvement, but also to influence the choice of which program to adopt. Firms with a strong ideological commitment to participatory democracy are likely to adopt very different programs than those firms doing so for purely

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[274] Irene Goll, *Environment, Corporate Ideology, and Employee Involvement Programs*, 29 Indus. Rel. 501, 507-08 (1990).

[275] Coye and Belohlav, supra note , at ___ (employee involvement being measured for this purpose by four factors: information sharing, training, decisionmaking, and rewards).

[276] COTTON, supra note , at 86. Accord *Why Doesn't This Team Work*, HARV. BUS. REV., Nov./Dec. 1994, at 26, ___ (Michael Garber); cf. Wilke, supra note , at A7 (effectiveness of computer networks in breaking down corporate hierarchies depends in large measure on firm culture, with competitive cultures impeding sharing of information).

[277] ARROW, supra note , at 55-57.

[278] Getman and Marshall, supra note , at 1879. For another anecdote on the importance of firm culture, this one contrasting UPS and Federal Express, see Bowen and Lawler, supra note , at ___.

[279] Although linking of computers in firm-wide networks has sometimes helped break down corporate hierarchies, firms with competitive environments find that some employees are unwilling to share information with potential in-house competitors. Wilke, supra note , at A7.

instrumental reasons.[280] Finally, firm culture has indirect effects by affecting worker tastes.

Firm culture not only forms employee tastes, but it also is formed by them. Recall the evidence that employee tastes differ. The management-oriented literature on participatory management confirms that not all employees are well-suited for employee involvement.[281] J. Richard Hackman, for example, opines: "Every organization has some members who make their best contributions as solo performers."[282] Indeed, Hackman further opines that some employees are "team destroyers," who can prevent employee involvement from succeeding.[283] The prevalence of such workers in a firm will go a long way towards determining whether its culture will prove receptive to participatory management.

It is worth noting that worker resistance to participatory management is neither irrational nor deserving of condemnation. Behavioral patterns that are learned over many years, and reinforced by past rewards, are exceedingly difficult to change.[284] As such, firm culture becomes a shorthand for a path dependent explanation for resistance to participatory management. Introduction of participatory management within a firm typically entails substantial change, which will threaten vested interests in the workforce. Self-directed work teams threaten the seniority--and even the jobs--of foremen and other supervisory employees. Surviving supervisors are thrust into new positions as "team consultants" rather than bosses, with new and demanding responsibilities. Gain-sharing, pay for skills, and team-based compensation all threaten traditional seniority-based compensation. Training may be resisted by some workers: the old dogs who don't want to learn new tricks. The job rotation and stress on "continuous improvement" characteristic of self-directed work teams in a TQM environment will threaten those workers who prefer a more mundane set of job responsibilities. All of which serves to confirm that cultural conditions may undermine participatory management even if conditions are otherwise appropriate for it.

B. *The Future of Participatory Management*

With the spatial limits of participatory management defined by one size does not fit all-based parameters, I turn to the temporal bounds of participatory management. How is it likely to evolve? I consider two possibilities: First, that participatory management may evolve into a company union. Second, that

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280 Glew, supra note , at ___.

281 See, e.g., *Why Doesn't This Team Work?*, HARV. BUS. REV., Nov./Dec. 1994, at 26, ___ ("not every group of multi-skilled, well-intentioned people can or should function as a team.").

282 Id.

283 Id.

284 Gandz & Bird, supra note , at ___.

participatory management may evolve towards something like the German system of codetermination. I conclude that neither possibility seems very probable.

1. *Company Union?*

Before participatory management became widespread, formal employee involvement in corporate decisionmaking took place primarily through unions. It therefore may be instructive to compare the economic function of unions and participatory management. Such a comparison might illuminate the future of participatory management.

A once dominant view of unions asserted that their primary purpose was to capture monopoly rents for workers in the form of higher wages and superior benefits.[285] More recent work, however, suggests that unions serve a transaction cost economizing function.[286] This analysis begins with the familiar assumption that some workers make firm-specific investments (in human capital and otherwise) whose value is linked to the success of the firm and which are subject to opportunistic appropriation by the firm.

Investments in transaction specific assets create quasi-rents that are subject to expropriation through opportunistic behavior by one of the contracting parties.[287] In the employment setting, the problem is usually framed as one involving breach of implicit contracts.[288] Consider an employee who invests considerable time and effort in learning how to do his job more effectively. Much of this knowledge will be specific to the firm for which he works.

Employees will invest in firm-specific human capital, however, only if rewarded for doing so. An implicit contract thus comes into existence between the employee and the firm. On the one hand, employees promise to become more productive by investing in firm-specific human capital. They bond the performance of that promise by accepting long promotion ladders and compensation schemes that defer much of the return on their investment until the final years of their career. Accepting deferred compensation, in which salary or wages rises with seniority, provides such a bond because the employee will carry out his side of the bargain in order to avoid being terminated before compensation rates rise at the end of his career. In return, the firm promises job security. There must be some credibility to that promise. Otherwise, fear of losing the sunk cost of investing in firm-specific human capital will lead the employee to ex ante decide on a sub-optimal level of investment in such capital.

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285 WILLIAMSON, CAPITALISM, supra note , at 252.

286 See id. at 254-56 (describing efficiency-based functions of unions).

287 See generally Benjamin Klein et al., *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J. L. & ECON. 297, 298 (1978).

288 See generally Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPPERDINE L. REV. 971, 1006-08 (1992); see also authorities cited id. at 1007 n.149.

The long-term nature of the relationship between employees and corporations forces them to rely on implicit, rather than explicit, contracts. Bargaining is costly, especially where future contingencies are hard to predict. The longer the contractual term, the more costly bargaining becomes. Implicit contracts can be readjusted as needed and thus save all the parties bargaining costs. The implicit nature of these contracts, however, leaves employees vulnerable to opportunistic corporate actions. Because they rely on moral and market sanctions, rather than legal sanctions, there is no direct remedy for breach of such agreements. The employees' investment in firm-specific capital thus creates a bilateral monopoly, because that investment deters them from exercising the exit option available to employees who have not made such investments. In turn, this allows for expropriation of the quasi-rent created by their investment in such human capital. Recall that the employees' implicit contract involves delaying part of their compensation until the end of their careers. If the firm fires its workers before the natural end of their careers, replacing them with cheaper young workers, or obtains wage or other concessions from the existing workers by threatening to displace them or to close the plant, the employees will not receive the full value of the services they provided to the corporation. In effect, a portion of their firm-specific human capital has been appropriated by the firm.

Although firms may sometimes have ex post incentives to appropriate firm-specific investments by workers, the plausible assumption that workers value job security holds out the prospect of reduced labor costs if firms can credibly promise to refrain from subsequent appropriations. A firm that makes such a promise can bond it by signing a collective bargaining agreement with a union. Collective bargaining gave employees a voice in decisions that affect them. Union monitoring helps ensure compliance by the firm with its contractual obligations. The seniority system, with its ports of entry, internal promotion ladders, and protection from lay-offs, offers job security. Grievance procedures allow for dispute resolution. All of which serves to make the firm's basic promises more credible.

In contrast, participatory management--as it exists on the ground today--is a top-down phenomenon imposed by management--sometimes over strong resistance from line workers and low-level supervisors--for purposes that differ but little from those of Taylorism. Given the decline of private sector unionism and the collective action problems that preclude unorganized workers from effectively bargaining with managers, moreover, employee involvement is likely to remain a management-based phenomenon. As Oliver Williamson observes, however, the mutual interest of workers and firms in the transaction cost benefits of unionization should have--and sometimes did--lead to the development of company unions before they were outlawed by the Wagner Act.[289] If the ban on company unions were lifted, would participatory management evolve to take over some of the functions traditionally performed

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[289] WILLIAMSON, CAPITALISM, supra note , at 255.

by unions?[290] I see no evidence that participatory management today serves to protect workers from appropriation of firm-specific human capital or, for that matter, from any other form of management exploitation. Nor do I see any evidence that it is evolving in that direction.[291]

If operational participation performed a monitoring function similar to that of unions, this would provide a partial explanation for union opposition to them. In the main, however, this monitoring function is more commonly performed in nonunion firms by formal complaint resolution systems.[292] Participatory management programs generally do not provide employees with any mechanisms for holding management accountable for its actions.

In theory, participatory management might enhance job security by encouraging employees to invest in firm-specific human capital and thereby enhancing the first-mover advantage that discourages firms from discharging them. But I am aware of no empirical evidence that participatory management--in the absence of employee ownership or a strong union--has encouraged such investments or otherwise promoted job security. To the contrary, there is evidence that participatory management succeeds when employees are other forms of credible job security promises.[293] Although quality circles have a very high failure rate, their survival rate appears to be higher in unionized settings.[294] There is also evidence that quality circles tend to be more effective in unionized firms.[295] I speculate that this finding is consistent with the hypotheses set out herein; perhaps workers are less likely to withhold information when they do not fear opportunistic conduct by management and, further, that the presence of a union--not the presence of a quality circle--is what provides workers with the necessary reassurance.

It is also instructive that participatory management has a far more circumscribed jurisdiction than that accorded unions. Many acts of opportunism

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[290] It is worth reemphasizing that my purpose here is solely descriptive not normative. In this article, I am not considering the ought question of whether participatory management should be "reformed" so as to provide workers with union-like protections.

[291] Granting that Congress has considered repealing the ban on company unions, by virtue of a presidential veto it remains in place. Although such a repeal would permit participatory management to evolve towards a company union, I am aware of no evidence that such an evolution is intended by the proponents of the repeal. Instead, their purpose appears to be the removal of a legal obstacle to current employee involvement programs.

[292] See KOCHAN, supra note , at 83. Union grievance procedures are said to be more likely to provide employees with far greater procedural protections than are participatory management programs, even when the latter provide a grievance resolution mechanism. See Virk, supra note , at 754-57.

[293] Michael Grant and Jean Harvey, *Unions and Productivity: Convergence or Divergence in Perceptions?*, 22 INT'L STUD. MGMT & ORG. 93 (1992).

[294] Special Report, supra note , at ___.

[295] William N. Cooke, *Employee Participation Programs, Group-Based Incentives, and Company Performance: A Union-Nonunion Comparison*, 47 IND. & LAB. REL. REV. 594 (1994); Juravich, supra note , at ___.

are firm-wide in nature (e.g., plant closings). Protection against such acts cannot be achieved at the shop floor level, but only at senior policymaking levels. This is presumably why German-style codetermination vests employees with participation both at the plant level through the works council and at the firm level through the supervisory board. As I demonstrate in the next section, however, U.S.-style participatory management is unlikely to evolve to include strategic participation.

In the meanwhile, participatory management as it exists today lacks jurisdiction over issues extending beyond the shop floor and, moreover, has a very limited jurisdiction even in that area. Quality circles rarely deal with the sorts of issues--hiring, firing, and terms of employment--in which opportunism is likely. In any event, their role is merely advisory. Quality of work life programs deal with some terms of employment, but they also are typically limited to an advisory role. Self-directed work teams have some control over terms of employment and even hiring, but their jurisdiction is limited to the individual team in question and management, in any event, retains ultimate control.

Management's retention of ultimate control is inconsistent using employee involvement as a solution to the problem of employer opportunism. Williamson speculates that the rarity of pre-Wagner Act company unions might be explained on such grounds as lack of knowledge of their benefits. In contrast, I speculate that company unions were rare because management's control of such unions deprived them of the credibility necessary for them to be an effective bond of the firm's promises. "Workers will not feel protected if management can exercise great discretion over them. Sooner or later, management will end the cooperative relationship by making unilateral decisions."[296] Yet, if my analysis of participatory management is correct, management retention of ultimate decisionmaking control is an essential element of any program's effectiveness.

2. *Board Representation?*

Our attention thus far has centered on operational participation, which involves employees mainly in shop floor-level productivity and working conditions issues. The normative literature on participatory management, however, typically urges a far more expansive role for employee involvement. Theodore St. Antoine writes sympathetically of the prospect for German-style codetermination in this country.[297] Marleen O'Connor goes beyond mere sympathy for this idea, affirmatively urging not only that corporate law mandate employee participation committees resembling German works

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[296] Getman and Marshall, supra note , at 1813.

[297] Theodore J. St. Antoine, *Federal Regulation of the Workplace in the Next Half-Century*, 61 CHI.-KENT L. REV. 631, 660-61 (1985).

councils, along with a duty to disclose corporate information to employees,[298] but even that director fiduciary duties be created running to employees.[299] Other scholars have made similar proposals.[300] My interest in this paper is not assessing the normative value of such proposals, but rather asking whether market forces might result in participatory management evolving towards codetermination.

Our attention thus shifts to strategic participation, which involves employees in major policy decisions, including those falling within the realm of corporate governance. Strategic participation exists in a number of countries,[301] but the best-known example remains the German codetermination system of works councils and supervisory boards.[302]

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298 O'Connor, *Human Capital*, supra note , at 961-63.

299 Id. at 954-61.

300 See, e.g., Mark F. Nowak, *Worker Participation and its Potential Application in the United States*, 25 LAB. L.J. 148 (1984) (calling for "grafting" European-style codetermination onto the collective bargaining structure); Lewis D. Solomon and Kathleen J. Collins, *Humanistic Economics: A New Model for the Corporate Social Responsibility Debate*, 12 J. CORP. L. 332 (1987) (proposing various legal changes designed to promote a humanistic economy through employee participation).

301 In Germany alone, there are at least four different statutory models of participatory management. Klaus J. Hopt, *Labor Representation on Corporate Boards: Impacts and Problems for Corporate Governance and Economic Integration in Europe*, 14 INT'L REV. L. & ECON. 203, 204 (1994). Some other member-states of the European Union also have some form of employee representation, and there have long been proposals to develop harmonized company laws or even a European Union-wide company law that would provide for employee representation. See generally Terence L. Blackburn, *The Societas Europea: The Evolving European Corporation Statute*, 61 FORDHAM L. REV. 695, 743-55 (1993). Unless otherwise indicated, discussion of codetermination in this Article focuses on the 1976 German codetermination statute, which applies to corporations having more than 2,000 employees.

302 Codetermination includes a dual board structure: a supervisory board that appoints a managing board, with the latter actively operating the firm. Workers are represented only on the former. COTTON, supra note , at 118. The supervisory board concept is difficult to translate into terms familiar to those trained exclusively in U.S. forms of corporate governance. Its statutory mandate is primarily concerned with the appointment and supervision of the managing board. Hopt, supra note , at 204. In theory, employees and shareholders are equally represented on the supervisory board. In practice, however, the board is often controlled either by the firm's managers or a dominant shareholder. Id. One of the employee representatives must be from management, and shareholders are entitled to elect the chairman of the board, who has the power to break tie votes. Morishima et. al., supra note , at 23. If push comes to shove, which it reportedly rarely does, id., shareholders thus retain a slight but potentially critical edge.

In many respects, work councils more closely resemble U.S. operational participation programs than U.S. strategic participation schemes. Works councils are

In contrast, strategic participation in the United States is rare and rudimentary.[303] The most famous U.S. example remains UAW president Douglas Fraser's 1979 election to Chrysler's board of directors. The Chrysler experiment was not met with enthusiastic endorsement by other union leaders or managers.[304] While generalization is thus risky, it is possible to identify a number of important differences between strategic participation in the United States and German codetermination. As is the case in Germany, strategic participation in U.S. firms is uniformly organized on a representative basis, usually involving employee representation on the board of directors. In contrast to the German supervisory boards, with their one-half employee membership, however, U.S. boards usually have a very small minority (typically one to three members) of worker representatives.[305] U.S. companies also usually have substantial management representation on the board, which is not true of German supervisory boards.[306] The critical difference, however, is the way in which employee representation comes into force. In the United States, employee representation is almost always the result of concessionary bargaining with a union.[307] In contrast, German codetermination was created by sweeping statutory mandates.[308]

The final substantive task of this Article is to ask whether the foregoing situation is likely to change. Does my analysis shed any light on the future of strategic participation in the United States?

a. *The Trendline*

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concerned with issues affecting individual plants, rather than the whole firm. In theory at least, works councils have considerable control over shop floor and other issues that affect the personnel of a particular plant. Id. at 21-23. Depending on the nature of the issue at hand, the council may be entitled to provision of information, consultation with management, or codetermination. Id. at 21. Their statutory mandate ranges from such minor issues as individual personnel grievances to such major concerns as the introduction of new technology or plant closings. Id. at 21-22. There is empirical data suggesting that works councils have a significantly negative impact on productivity. COTTON, supra note , at 121. I am concerned herein principally with the supervisory board component of the German system and its U.S. analogues.

303 Everett M. Kassalow, *Employee Representation on U.S., German Boards,* MON. LAB. REV., Sept. 1989, at 39.

304 Clyde W. Summers, *Codetermination in the United States: A Projection of Problems and Potentials,* 4 J. COMP. CORP. L. & SEC. REG. 155, 155 (1982).

305 Kassalow, supra note , at 40.

306 COTTON, supra note , at 127.

307 Kassalow, supra note , at 39.

308 Id.

In assessing whether market forces alone could lead towards codetermination, the near universal link between government mandates and strategic participation is highly instructive. As the Fraser example implies, voluntary adoption of some form of strategic participation is not unknown, but it is very rare. Instead, strategic participation on a wide scale uniformly has been established through national legislation.[309] In the absence of any documented market failure, it is fair to infer from this evidence that codetermination is less efficient than the Anglo-American tradition of excluding workers from board representation.

This impression is confirmed by the evolutionary trendline in this country. Market forces are driving participatory management away from codetermination, not towards it. QWL had some firm-wide aspects, including some broad policy questions. Quality circles sometimes had fairly broad mandates, although less so that than QWL. Self-directed work teams are almost entirely insular, with their emphasis limited to issues of team productivity.

b. *The Theoretical Story*

Why do large corporations use a representative body--the board of directors and its subordinate managers--to make decisions rather than being run as a participatory democracy? And why do only shareholders get to elect the board? My answer to those questions begins with the description of organizational decisionmaking economist Kenneth Arrow set out in THE LIMITS OF ORGANIZATION.[310] All organizations must have some mechanism for aggregating the preferences of the organization's constituencies and converting them into collective decisions.[311] Arrow identified two basic mechanisms for carrying out this task: "consensus" and "authority."[312]

Consensus is utilized where each member of the organization has identical information and interests, which results in preferences that are easily aggregated and thus permits relatively easy collective decisionmaking. In contrast, authority-based decisionmaking structures arise where group members have different interests and amounts of information. Because collective

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[309] COTTON, supra note , at 114; Hopt, supra note , at 203-04; Jan Svenjar, *On the Theory of a Participatory Firm*, 27 J. Econ. Theory 313, 313 (1982).

[310] Arrow, supra note . For the seminal application of Arrow's work to corporate governance, which strongly influenced the following analysis, see Michael P. Dooley, *Two Models of Corporate Governance*, 47 Bus. Law. 461 (1992).

[311] The need for a decisionmaking mechanism arises because both the explicit and implicit contracts that make up a firm are necessarily incomplete. Intra-corporate relationships are not fully contractible due to the presence of uncertainty, bounded rationality, and opportunism. The existence of non-contractible aspects to the relationship formally requires only the existence of a decisionmaking mechanism, however, it does not specify the mechanism. Greg Dow and Louis Putterman, *Why Capital (Usually) Hires Labor: An Assessment of Proposed Explanations*, Brown Univ. Dep't of Econ. Working Paper 96-21 at 15 (Sep. 1996).

[312] ARROW, supra note , at 69-70.

decisionmaking is impracticable in such settings, authority-based structures are characterized by the existence of a central agency to which all relevant information is transmitted and which is empowered to make decisions binding on the whole.

Decisionmaking systems in small business firms typically resemble Arrow's consensus model.[313] The default rules of American partnership law, for example, are a virtually ideal exemplar of a consensus-based decisionmaking mechanism.[314] As firms grow in size, however, consensus-based decisionmaking systems become less practical. In very large firms, such as public corporations, we observe an almost purely authority-based decisionmaking structure.[315]

The utility of an authority-based decisionmaking structure to large corporations is partially a collective action phenomenon. Consider a simplified firm that has 50,000 shareholders. At the most basic level, the mechanical difficulties of achieving consensus amongst 50,000 decisionmakers preclude including all of them as active decisionmakers. Would they all gather in a football stadium for weekly meetings?

Assume a technological solution to such mechanical problems. Large firms nevertheless would still require an authority-based decisionmaking structure. Authority's necessity arises because neither of Arrow's conditions for using consensus--equality of information and identical interests--is likely to be met in large organizations. In the sections that follow, I take up each of Arrow's conditions sequentially. In each case, I begin with an employee-owned firm with many thousands of employee-shareholders. After demonstrating that Arrow's conditions cannot be satisfied in such a firm,[316] I then turn to the more complex

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313 I speculate that self-directed work teams group employees with homogeneous interests into sub-units that can use consensus as a decisionmaking mechanism. This hypothesis is consistent with the use of peer pressure to create greater homogeneity of interest. It is also consistent with the frequently observed flattening of management structures observed in firms moving to self-directed work teams. The creation of consensus-based decisionmaking units within the firm may reduce the need for an authority-based hierarchy.

314 Dooley, *Two Models*, supra note , at 466-67.

315 In the modern public corporation, shareholders essentially have no power to initiate corporate action and, moreover, are entitled to vote on only a very few corporate actions. Under the Delaware code, for example, shareholder voting rights are essentially limited to the election of directors and approval of charter or by-law amendments, mergers, sales of substantially all of the corporation's assets, and voluntary dissolutions. As a formal matter, only the election of directors and amending the by-laws do not require board approval before shareholder action is possible. See Del. Code Ann. tit. 8, §§ 109 and 211 (1990). In practice, of course, even the election of directors (absent a proxy contest) is predetermined by the existing board nominating the next year's board.

Formal decisionmaking power resides mainly in the board of directors. The Delaware code provides that the firm shall be "managed by or under the direction of" the board of directors. Del. Code Ann. tit. 8, § 141(a) (1990). This formulation allows the board to delegate virtually all management functions to senior corporate officers, who in turn of course will delegate most decisions to subordinate employees. At the same time, however, it allows permits the board to manage the corporation if the directors choose to do so.

316 The rarity of employee-owned firms and their tendency to revert to the capitalist model is typically explained by reference to the deleterious consequences of losing both one's employment and

public firm in which employees and shareholders constitute separate constituencies to demonstrate that Arrow's conditions are even less likely to be met in this type of firm.

i. *Arrow's Equality of Information Condition*

Assume an employee-owned corporation with 5,000 employee-shareholders. Could such a firm function as a participatory democracy? Not if we hoped that each participant would make informed decisions.

As a practical matter, of course, our employee-shareholders are not going to have access to the same sorts of information. Assuming at least some employees serve in managerial and supervisory roles, they will tend to have broader perspectives, with more general business information, while line workers will tend to have more specific information about particular aspects of the shop floor.

As our discussion of persistent information asymmetries suggests, this disparity of access to information will prove highly intractable. A rational decisionmaker expends effort to make informed decisions only if the expected benefits of doing so outweigh its costs.[317] In a firm of the sort at bar, gathering information will be very costly. Efficient participatory democracy requires all decisionmakers to have equal information, which requires that each decisionmaker have a communication channel to every other decisionmaker.[318] As the number of decisionmakers increases, the number of communication channels within the firm increases as the square of the number of decisionmakers.[319] In a firm of 5,000 employees, participatory democracy thus

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investment capital when an employee-owned firm fails. As the story goes, the capitalist model provides a more efficient allocation of risk-bearing. See, e.g., Charles P. Rock and Mark A. Klinedinst, *Worker-Managed Firms, Democratic Principles, and the Evolution of Financial Relations*, 26 J. ECON. ISSUES 605, 608-09 (1992); Hansmann, supra note , at 1774-75. I do not intend to quibble with that account, but suggest that my story provides a complementary explanation for preferring the capitalist model.

[317] See CLARK, supra note , at 391. An even more critical problem may be Jeffrey Gordon's persuasive demonstration that voting within a corporation is subject to Arrow's impossibility theorem, in the sense that voting on most matters of day-to-day policy would result in cyclical majorities. Although I have somewhat more confidence in information- and incentive-based arguments for the board's authority than Gordon appears to have, he does present a convincing argument that corporate law's authority-based board of directors system is explicable in very large measure as a device for avoiding the cycling problem by restricting owner voice. Jeffrey Gordon, *Shareholder Initiative and Delegation: A Social Choice and Game Theoretic Approach to Corporate Law*, 60 U. CIN. L. REV. 347 (1991).

[318] CLARK, supra note , at 805.

[319] WILLIAMSON, HIERARCHIES, supra note , at 46.

would result in a ratio of almost 2,500 communication channels *per person*.[320] Bounded rationality makes its doubtful that anyone could process so many information flows, but even if they were willing to try, members of such a firm could not credibly bind themselves to reveal information accurately and honestly or to follow prescribed decisionmaking rules.[321]

In addition to the transaction costs associated with making an informed decision, which by themselves are doubtless preclusive of participatory democracy in the large firm setting, the opportunity cost entailed in making informed decisions is also high and, even more important, readily apparent. In contrast, the expected benefits of becoming informed are quite low, as an individual decisionmaker's vote will not have a significant effect on the vote's outcome. Our employee-owners thus will be rationally apathetic.[322]

Under such conditions, Arrow's model predicts that the firm will tend towards authority-based decisionmaking. It will be "cheaper and more efficient to transmit all the pieces of information to a central place" and to have the central office "make the collective choice and transmit it rather than retransmit all the information on which the decision is based."[323] Accordingly, the corporation's employer-owners will prefer to irrevocably delegate decisionmaking authority to some central agency, such as a board of directors.

Now introduce the complication of separating capital and labor. Nothing about such a change economizes on the decisionmaking costs outlined above. Instead, as described below, labor and capital often have quite different interests, which increases decisionmaking costs by introducing the risk of opportunism. In particular, capital and labor may behave strategically by withholding information from one another.

The analysis here reprises the discussion of persistent information asymmetries. Recall that employees have a strong incentive to withhold information that might enable capital--or its representatives--to increase productivity at the employee's expense. Operational participation offers mechanisms for extracting such information from employees, while providing them with only such information as management wishes to divulge. In contrast, the information flow under strategic participation likely would favor workers. It is hard to imagine that having a few employees on the board would do much to resolve the sort of production information asymmetries to which operational participation is directed, but it is very easy to imagine that having employees on the board would give workers access to information shareholders would prefer to keep confidential.

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320 CLARK, supra note , at 805.

321 Radner, supra note , at 1384. Williamson further argues that participatory democracy incurs inordinate decisionmaking expenses even in small group settings. WILLIAMSON, HIERARCHIES, supra note , at 46-47.

322 Cf. CLARK, supra note , at 390-92 (discussing rational shareholder apathy).

323 ARROW, supra note , at 68-69.

This prediction is consistent with the pattern observed under the German version of codetermination, which has been described as a mechanism by which employees gain access to information about the firm.[324] Unlike operational participation, which enhances upward (and perhaps sideways) flows of information, however, codetermination is said to direct information downwards.[325] As described below, this pattern results in persistent information asymmetries and conflicts that significantly impairs boards of directors' corporate governance function.

ii. *Arrow's Identicality of Interest Condition*

Again begin by assuming an employee-owned firm with 5,000 employee shareholders. Is it reasonable to expect the similarity of interest required for consensus to function in such a firm? Surely not.

In some cases, employees would differ about the best way in which to achieve a common goal. In others, individual employees will be disparately affected by a proposed course of action.[326] Although the problems created by divergent interests within the employee block is not insurmountable, as the German experience indicates,[327] such differences at least raise the cost of using consensus-based decisionmaking structures in employee-owned firms.[328]

The existence of divergent interests within the employee group is consistent with the empirical evidence. Labor managed firms tend to remain small, carefully screen members, limit the franchise to relatively homogeneous groups, and use agenda controls to prevent cycling and other public choice problems.[329] All of these characteristics are consistent with an attempt to minimize the likelihood and effect of divergent interests.[330]

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[324] Kassalow, supra note , at 40.

[325] COTTON, supra note , at 116, 119; Morishima et al., supra note , at 23. See also Hansmann, supra note , at 1813 ("Codetermination ... evidently has not led to a true sharing of control between labor and capital in Germany. Rather, its primary function appears to have been simply to provide workers with more credible information about firm policy."); Garth L. Mangum and Stephen L. Mangum, *Assessing Alternative Employment-Relations Systems*, CHALLENGE, July 1993, at 29, ___ (codetermination's "major contribution is access to inside information about company progress and policy.")

[326] Henry Hansmann, *Worker Participation and Corporate Governance*, 43 U. TOR. L. REV. 589, 593 (1993).

[327] See infra notes TBA and accompanying text.

[328] See generally Hansmann, supra note , at 1780-82.

[329] Dow and Putterman, supra note , at 63-64.

[330] It is instructive that W. L. Gore & Associates, which is perhaps as pure a participatory democracy as one is likely to find in an American workplace, places great emphasis on smallness. None of the company's facilities are allowed to grow beyond 150-200 employees, a policy that developed when its founder realized he no longer knew all the workers in the original plant. Shipper and Mann, supra note , at ___. Although the stated purpose of the policy is to maintain a close-knit atmosphere, id.,

Now again complicate the analysis by separating capital and labor. Although employee and shareholder interests are not always incongruent, they often conflict. Consider, for example, the downsizing phenomenon. Recall the effects of a restructuring to which we have already alluded: Substantial reductions in force, reduced job security, longer work weeks, more stress, and diminished morale.[331] From the shareholders' perspective, however, the market typically rewards restructurings with substantial stock price increases.[332] The general divergence of interest suggested by this example looms large as a bar to the use of consensus in capitalist firms.

iii. *The Inefficiency of Multiple Constituencies*

The analysis to this point merely demonstrates that corporate decisionmaking must be made on a representative, rather than on a participatory, basis. As yet, nothing in the analysis dictates the U.S. model in which only shareholders elect directors. One could plausibly imagine a board of directors on which multiple constituencies are represented. Indeed, imagination is not required, because the supervisory board component of German codetermination provides a real world example of just such a board. Upon close examination, however, neither empirical evidence nor theory lend much support to the proposition that market forces will lead U.S. firms to emulate their German counterparts.

Strategic participation through representative mechanisms has been found to have the least impact on productivity and employee attitudes of any participatory management scheme.[333] Indeed, many studies of codetermination have shown it to have negative productivity results.[334] One recent meta-analysis of codetermination studies confirmed these findings, concluding "that worker participation in decision making imposed by government decree is negatively associated with productivity."[335]

Why does codetermination not lead to efficiency gains? In Kenneth Arrow's terminology, the board of directors serves as a consensus-based decisionmaking body at the top of an authority-based structure. Recall that for consensus to function, however, two conditions must be met: equivalent

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notice that the policy also minimizes the collective action problems created in large plants. The same policy of smallness was adopted by Semco S/A, a Brazilian corporation with strong workplace democracy. See Ricardo Semler, *Managing without Managers*, HARV. BUS. REV., Sep./Oct. 1989, at 76.

331 MICHAEL USEEM, INVESTOR CAPITALISM 164-65 (1996). Useem asserts these factors are somewhat off-set by greater autonomy and more challenging assignments. I quibble with Useem's assumption that workers view more challenging assignments and greater autonomy as goods. See supra notes TBA and accompanying text.

332 Id. at 145-46.

333 COTTON, supra note , at 232.

334 Id. at 119.

335 Doucouliagos, supra note , at ___.

interests and information. Neither condition can be met when employee representatives are on the board.

The two factors are closely related, of course. Indeed, it is the divergence of shareholder and employee interests that ensures that employee representatives will be deprived of the information necessary for them to function. Because of the board's position at the apex of the corporate hierarchy, employee representatives are inevitably exposed to a far greater amount of information about the firm than is normally provided to employees. As the European experience with codetermination teaches, this can result in corporate information leaking to the work force as a whole or even to outsiders. In the Netherlands, for example, the obligation of works council representatives to respect the confidentiality of firm information "has not always been kept, causing serious concerns among management which is required ... to provide extensive 'sensitive' information to the councils."[336] The validity of this concern is confirmed by other commentators.[337]

One result of lost confidentiality is sure to be worker demands for higher wages. This prediction is supported by an empirical study finding that provision of financial and other business information to employees of non-unionized firms had a negative effect on firm profitability, which was attributed to higher wages demanded by the informed employees.[338] In a unionized firm, management will be especially reluctant to inform union members on the board of information that might aid the union in collective bargaining. In a unionized industry, moreover, management may be unwilling to disclose information to union members on the board that the union might use for pattern bargaining or even disclose to competitors.

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[336] Tom R. Ottervanger and Ralph M. Pais, *Employee Participation in Corporate Decision Making: The Dutch Model*, 15 INT'L LAW. 393, 399 (1981).

[337] See, e.g., Hopt, supra note , at 206 (noting leaks by employee representatives). Cf. Summers, *Codetermination*, supra note , at 172 ("[f]or codetermination to fulfill its functions, confidentiality cannot be rigidly enforced"). Although Clyde Summers asserts that disclosure of confidential corporate information to employees through their representatives would pose few problems for U.S. corporations, he ignores (among other things) the multitudinous problems such disclosure would create under the federal securities laws governing such matters as mandatory disclosure and insider trading. Cf. Hopt, supra note , at 206 (noting case of German union president and employee representative on the supervisory board of Daimler-Benz who used inside information to buy about 1 million shares).

[338] Morris M. Kleiner and Marvin L. Bouillon, *Providing Business Information to Production Workers: Correlates of Compensation and Productivity*, 41 IND. & LAB. REL. REV. 605, 614-15 (1988). See also Stuart Ogden, *The Limits of Employee Involvement: Profit Sharing and Disclosure of Information*, 29 J. MGMT STUD. 229 (1992) (British employers reluctant to provide disclosure of financial information for fear of stimulating workers to make demands re pay and working conditions).

Given that providing board level information to employee representatives appears clearly contrary to shareholder interests, we would expect managers loyal to shareholder interests to withhold information from the board of directors in order to deny it to employee representatives, which would seriously undermine the board's ability to carry out its essential corporate governance roles. This prediction is borne out by the German experience with codetermination. German managers sometimes deprive the supervisory board of information, because they do not want the supervisory board's employee members to learn it.[339] Alternatively, the board's real work may be done in committees or de facto rump caucuses from which employee representatives are excluded.[340] As a result, while codetermination raises the costs of decisionmaking, it may not have much effect on substantive decisionmaking. This prediction is borne out by the Scandinavian experience with codetermination, where it reportedly has had little substantive effect on corporate decisionmaking.[341]

Although Arrow's equality of information criterion is important, in this context the critical element is the divergence of shareholder and employee interests. In the legal literature, this problem is usually presented in terms of a role conflict: when an employee representative is seated on the board, his strongest ties are to the workers he represents, but under current law he is obliged to prefer the interests of shareholders.[342] Some scholars deny the existence of importance of the role conflict.[343] Katherine Stone argues, for

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339 ROE, supra note , at 177; Hopt, supra note , at 206.

340 Summers, *Codetermination*, supra note , at 166.

341 Tove H. Hammer et al., *Worker Representation on Boards of Directors: A Study of Competing Roles*, 44 IND. & LAB. REL. REV. 661, ___ (1991).

342 For an overview of the conflict of interest and other corporate law doctrines posing problems for labor representatives on the board of directors, see Helen S. Scott, *Union Directors and Fiduciary Duties Under State Corporate Law*, in LABOR LAW AND BUSINESS CHANGE: THEORETICAL AND TRANSACTIONAL PERSPECTIVES 115, 116-26 (1988).

343 Clyde Summers argues that the conflict of interest faced by employee representatives on the board is no more pronounced than that faced by directors who de facto represent other constituencies (such as the common situation in which a representative of a large creditor is given a board seat). Summers, *Codetermination*, supra note , at 169. Summers further argues that corporate law has a well-developed set of tools for dealing with conflicted interests on the board. Id. at 169-70. Others argue that even under the existing regime, in which employee representatives are elected by shareholders, the role conflict is negated by an implicit understanding on the part of shareholders that employee members have moral, if not legal, obligations to the employees. This argument was made by UAW President Douglas Fraser when he was elected by Chrysler's shareholders to the board of directors. "Fraser believed he represented the workers and was reported to have said that he had 'no intention of representing Chrysler's shareholders.'" Scott, supra note , at 126. Fraser apparently believed that the resulting conflict of interest was mitigated by the informed consent of the Chrysler shareholders who elected him. Id. at 127-28.

example: "The fiduciary duties of both union officers and of corporate directors are creatures of positive law, and the scope and content of such duties could be redefined in such a way as to make them consistent."[344] Stone's argument is fundamentally flawed because she treats the conflict of interest as being created, and thus subject to remediation, by law. Because of her *lex centric* approach, she fails to recognize that an economically significant conflict would still be present even if law "reform" eliminated any legal conflict.

Although the interests of shareholders differ as amongst themselves, as do those of employees, individual constituents of the corporation are more likely to share interests with members of the same constituency than with members of another constituency. Allowing board representation for employees thus tends only to compound the problem that gives rise to an authority-based hierarchial decisionmaking structure by bringing the differing interests of employees and shareholders directly into the board room.[345] The resulting conflicts of interest inevitably impede consensus-based decisionmaking within the board. Worker representatives tend to prefer greater labor advocacy than traditional directors, no doubt in large part because workers evaluate their representatives on the basis of labor advocacy, which also results in role conflicts.[346] This conflict would be exacerbated in heavily unionized industries, in which representatives of a single union might sit on the boards of multiple firms within the industry. The union would be concerned with the best interests of all of its members. In the extreme case, the demise of one firm might redound to the greater good of the greatest number by benefiting union members who work at competing corporations. This creates the potential for perverse incentives on the part of union representatives on the board.

The importance of this conflict is confirmed by the German experience with codetermination. Klaus Hopt reports that the conflicts of interest faced by employee representatives on the supervisory board remain a serious, but unresolved concern.[347] According to Hopt, employee representation slows the finding of a consensus on the supervisory board and creates a built-in polarization problem.[348] As predicted above, he also reports it is standard practice for employee and shareholder representatives to have separate pre-meeting caucuses.[349]

Pre-meeting caucuses by employee representatives is probably an adaptive response to the above-noted heterogeneity of employee interests, but it

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344 Stone, supra note , at 149.

345 The difficulty, of course, is not merely that the interests of employees and shareholders diverge, but rather, as our discussion of Arrow's work suggested, that different classes of employees are likely to have divergent interests. As we have seen, this seriously compounds the problem of aggregating constituency preferences.

346 COTTON, supra note , at 128; see also Hammer, supra note , at ___("Workers define the worker director role as including labor advocacy.").

347 Hopt, supra note , at 206.

348 Id. at 207.

349 Id. at 208.

contributes to difficulty in building consensus across interest groups by hardening positions.[350] As a result, labor representatives often act and vote as a block.[351] Apparently in response to these problems, many German firms have used various corporate governance devices to limit the power and function of the supervisory board on which labor representatives sit.[352] In particular, board committees have been heavily weighted in favor of shareholder representatives.[353] All of which, of course, is consistent with the prediction that codetermination will lead to the board's work being done outside the boardroom.

The problem with codetermination is not only that the conflict of employee and shareholder interests impedes the achievement of consensus, but that it results in a substantial increase in agency costs. Central to Arrow's theory of authority-based decisionmaking structures is the notion that authority must be exercised responsibly.[354] This element of Arrow's model is related to agency cost economics in the sense that the irresponsible use of authority is a form of shirking. Placing employee representatives on the board of directors seems likely to encourage this form of shirking.[355]

The most obvious problem is the possibility that employee representation will permit management to pursue its own self-interest at the expense of both shareholders and employees by playing worker and shareholder representatives off against each other. Legal and market accountability mechanisms constrain this tendency, but because they are not perfect there remains the possibility that self-interested managers may throw their support behind the side of the board whose interests happen to coincide with those of management in the issue at hand.[356] Because employee representation on the board weakens a key accountability mechanism, as developed below, this conflict is especially serious.

This conflict is well-known, of course, but there is a more subtle problem that is often overlooked. Corporate employees have an incentive to shirk so long as their compensation does not perfectly align their incentives with those of the firm's shareholders. In turn, knowing of this phenomenon, the firm's shareholders should expect management to reduce the compensation of the

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[350] Katharina Pistor, *Co-determination in Germany: A Socio-Political Model with Governance Externalities* at 36 (Sep. 1996).

[351] Hopt, supra note , at 208.

[352] Pistor, supra note , at 38.

[353] Id. at 41-43.

[354] ARROW, supra note , at 65, 73-77.

[355] See Frank H. Easterbrook and Daniel R. Fischel, *Voting in Corporate Law*, 26 J. L. & ECON. 395, 405 (1983). ("The inclusion of multiple groups (say employees in addition to shareholders) would be a source of agency costs. People who did not receive the marginal gains would be influencing corporate discretion, and the influence would not be expected to maximize the wealth of the participants as a group.").

[356] See William J. Carney, *Does Defining Constituencies Matter?*, 59 U. CINC. L. REV. 385, 420-24 (1990).

firm's employees by the amount necessary to off-set the expected degree of employee shirking. Because ex ante wage adjustments rarely are fully compensatory,[357] due to bounded rationality and the resulting use of incomplete contracts, the firm's shareholders should expect management to monitor the employees and punish ex post those who skirk. Would it not seem odd that those who are to be monitored should be allowed to choose the monitors? One of the accountability mechanisms that aligns managerial and shareholder interests is monitoring by the board of directors. Allowing employee representation on the board necessarily reduces the likelihood that the board will be an effective monitoring device. Because shareholders "could seek profits by getting highly motivated managers who sweat the labor force," workers have an interest in supporting rules that free management from accountability to shareholders.[358] Managerial shirking of its monitoring responsibilities thus will often redound to the workers' benefit, which suggests that employee representatives on the board of directors are less likely to insist on disciplining lax managers than are shareholder representatives. If employees are entitled to voting representation on the board of directors, monitoring by the board and its subordinate managers will be less effective, which will cause agency costs to rise.

The prediction that agency costs rise when employees are represented on the board is supported by evidence from the German experience with codetermination. It is widely reported, for example, that labor's presence on the supervisory board impedes cost cutting measures that adversely affect workers.[359] Codetermination is also said to impede the market for corporate control as an accountability mechanism by making hostile takeovers more difficult.[360]

Although it is sometimes asserted that employee representation would benefit the board by promoting "discussion and consideration of alternative perspectives and arguments,"[361] my analysis suggests that such benefits would come at high cost. In addition, there is reason to doubt whether those benefits are very significant. Michael Dooley opines that workers will be indifferent to most corporate decisions that do not bear directly on working conditions and benefits: "As to the majority of managerial policies concerning, for example, dividend and investment policies, product development, and the like, the typical employee has a much interest and as much to offer as the typical purchaser of

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357 Benjamin Klein, *Contracting Costs and Residual Claims: The Separation of Ownership and Control*, 26 J. L. & ECON. 367, 368 n.2 (1983).

358 ROE, supra note , at 44.

359 ROE, supra note , at 214; Hopt, supra note , at 208; Roberta Romano, *A Cautionary Note on Drawing Lessons from Comparative Corporate Law*, 102 Yale L. J. 2021, 2031 (1993).

360 ROE, supra note , at 214. Indeed, this is cited as one explanation for the failure of German firms to reincorporate elsewhere in response to codetermination. Hopt, supra note , at 213.

361 Robert Howse and Michael J. Trebilcock, *Protecting the Employment Bargain*, 43 U. TOR. L. REV. 751, 769 (1993).

light bulbs."[362] Dooley's argument is supported by a number of empirical studies. John Witte's case study, for example, found that workers who did not desire participation often cited a lack of managerial expertise as the reason.[363] John Cotton's review of the literature concluded that participatory management is most effective when it is directed at "one's everyday work, not [at] deciding policy issues of the entire organization."[364] Sagie and Koslowsky found that "subordinate participation in tactical decisions (those dealing with working methods), as opposed to strategic decisions (those dealing with the initiation of a new product or service), was a better predictor of an increase in change acceptance, work satisfaction, effectiveness, and time allotted to work."[365] All of which tends to suggest that employee representatives add little except increased labor advocacy to the board.

iv. *Why Only Shareholders?*

My analysis thus far demonstrates that public corporation decisionmaking must be conducted on a representative rather than participatory basis. It further demonstrates that only one constituency should be allowed to elect the board of directors. The remaining question is why market forces in the U.S. favor shareholders as the chosen constituency, rather than employees. Answering that question is the task of this section.

A straight-forward answer derived from the Arrow-based paradigm upon which my account rests returns to the divergency of interests within constituency groups. Although investors have somewhat different preferences on issues such as dividends and the like, they are generally united by a desire to maximize share value.[366] Board consensus therefore will be more easily achieved if directors are beholden solely to shareholder interests, rather than to the more diverse set of interests represented by employees. In view of the evidence that German labor representatives can resolve the conflicting interests of their constituencies and vote as a block, however, I am disinclined to give this explanation too much credence.

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[362] Michael P. Dooley, *European Proposals for Worker Information and Codetermination: An American Comment*, in HARMONIZATION OF THE LAWS IN THE EUROPEAN COMMUNITIES: PRODUCTS LIABILITY, CONFLICT OF LAWS, AND CORPORATION Law 126, 129 (Peter E. Herzog ed. 1983). Accord Locke et al., supra note , at 70 (including employees in decisionmaking for which they lack information leads to poor decisions and bad morale).

[363] WITTE, supra note , at 36-37.

[364] COTTON, supra note , at 233. See also id. at 235 (discussing the ideal PM program).

[365] A. Sagie and M. Koslowsky, *Organizational Attitudes and Behaviors as a Function of Participation in Strategic and Tactical Change Decisions: An Application of Path-Goal Theory*, 15 J. ORG. BEHAVIOR 37 (1994).

[366] See generally Hansmann, supra note , at 1782-83 (using costs of collective decisionmaking to explain inefficiency of worker-owned firms).

A related but perhaps more telling point is the problem of apportioning the vote. Financial capital is fungible, transferable, and quantifiable. Control rights based on financial capital are thus subject to low cost allocation and valuation. In contrast, the human capital of workers meets none of these criteria. While one-person/one-vote would be a low cost solution to the allocation problem, it appears highly inefficient given the unequal distribution of reasoning power and education. If the most competent people and/or those with the most at stake should have the most votes, some more costly allocation device will be necessary.

A standard law and economics explanation for vesting voting rights in shareholders is premised on the fact that shareholders are the only corporate constituent with a residual, unfixed, ex post claim on corporate assets and earnings.[367] In contrast, the employees' claim is fixed ex ante through agreed-upon compensation schedules. This dichotomy has two implications of present import. First, as noted above, employee interests are too parochial to justify board representation. Only shareholders have an economic incentive to care about the size of the residual claim, which means that only they have an incentive to elect directors committed to maximizing firm profitability.

Second, because the employee's claim is fixed, they have an incentive to shirk. As we have seen, vesting control rights in the employees would increase their incentive to shirk. In turn, the prospect of employee shirking lowers the value of the shareholders' residual claim. As a result, if the parties could bargain over the distribution of control rights, shareholders would bargain for control rights, so as to ensure a corporate decisionmaking system emphasizing monitoring mechanisms designed to prevent shirking by employees, and employees would be willing to concede such rights to shareholders.

To be sure, collective action problems preclude the shareholders from exercising meaningful day-to-day or even year-to-year control over managerial decisions. Unlike the employees' claim, however, the shareholders' claim on the corporation is freely transferable. As such, if management fails to maximize the shareholders' residual claim, an outsider can profit by purchasing a majority of the shares and voting out the incumbent board of directors. Accordingly, vesting the right to vote solely in the hands of the firm's shareholders is what makes possible the market for corporate control and thus helps to minimize shirking. As the residual claimants, shareholders thus would bargain for sole voting control, in order to ensure that the value of their claim is maximized. In turn, because all corporate constituents have an ex ante interest in minimizing shirking by managers and other agents, the firm's employees have an incentive to agree to such rules.[368] The employees' lack of control rights thus can be seen

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[367] I am relying here mainly on FRANK H. EASTERBROOK AND DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 66-72 (1991); and Easterbrook & Fischel, supra note .

[368] According to the Coase Theorem, rights will be acquired by those who value them most highly, which creates an incentive to discover and implement transaction cost minimizing governance forms.

as a way in which they bond their promise not to shirk. Their lack of control rights not only precludes them from double-dipping, but also facilitates disciplining employees who shirk. Accordingly, it is not surprising that the default rules of the standard form contract provided by all corporate statutes vest voting rights solely in the hands of common shareholders.[369]

This account rests on the shareholders' status as the corporation's residual claimants. Professor Bernard Black has recently suggested that workers, among many other corporate constituencies, also hold a residual claim on the corporation.[370] He further observes that standard contractarian analysis posits a link between residual claims and control rights. Black then asks why the residual claims of workers are not linked to control rights. If Black's analysis leads scholars to revisit the question of why certain types of control rights are associated with certain constituencies, it may spark a useful debate. In general, however, I do not accept the terms he has set for the debate. In the first instance, Black begins with an idiosyncratic definition of residual claim. The residual claim concept is usually linked to bankruptcy and liquidation concepts: the shareholders' claim is to the residue left after all fixed claims have been satisfied. Instead, Black defines a residual claim as any interest in which "the expected value of a contracting party's future dealings with the firm increases as the firm's value increases, and decreases as the firm's value decreases."[371] In other words, Black has slipped the residual claim concept loose from its liquidation priority origins and redefined it as simply an asset whose value depends on the value of the firm. In the second instance, Black overemphasizes the importance of "formal control rights"; i.e., the right to vote. Corporate governance encompasses a far richer set of governance devices, many of which serve to protect the value of employee claims that depend on the value of the firm.

Black's critique of the standard account indirectly suggests one failure in the latter; namely, its failure to consider the role of employee investments in firm-specific human capital. Whether the value of an employee's claim in the firm depends on the value of the firm, at least in the absence of impending insolvency, turns on the degree of firm-specificity entailed in the claim. The value of continued dealings with an employer to an employee whose work involves solely general human capital does not depend on the value of the firm

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Although shareholders and employees obviously do not bargain, a basic premise of the law and economics account is that corporate law provides them with a set of default rules reflecting the bargain they would strike if they were able to do so.

[369] To be sure, the vote allows shareholders to allocate some risk to prior claimants. If a firm is in financial straits, directors and managers faithful to shareholder interests could protect the value of the shareholders' redsidual claim by eliminating prior claimants. Downsizing is a highly visible example of this phenomenon. Downsizing reduces the size of the prior claims on the corporate pie, even if it does nothing to expand the size of that pie. All of which raises the question of why employees do not get the vote to protect themselves against this risk. The answer is two-fold. First, as we have seen, multiple constituencies are inefficient. Second, as addressed below, employees have significant protections that do not rely on voting.

[370] Bernard Black, *Corporate Law and Residual Claimants* (draft Nov. 1996).

[371] Id. at 5.

because neither the employee nor the firm have an incentive to preserve such an employment relationships. If the employee's general human capital suffices for him to do his job at Firm A, it presumably would suffice for him to do a similar job at Firm B. Such an employee resembles an independent contractor who can shift from firm to firm at low cost to either employee or employer.[372] As with an independent contractor, however, it seems unlikely that a substantial change in the value of the firm will affect the value of the employee's fixed claim on the firm's assets and earnings.

My argument is illustrated in an extreme form by the temporary employment phenomenon. Temporary workers are often employed, *inter alia*, in settings requiring little firm-specific human capital.[373] At the same time, however, some jobs require and reward substantial investments in general human capital. Wages of professional nurses working on a temporary basis, for example, are higher than those of permanently employed nurses.[374] Although a temporarily-employed nurse might expect future dealings with a given employer, it seems unlikely that the value of those dealings depends to any considerable extent on the employer's value as a firm. If the firm does very well, how likely is it that the gains will flow to temporarily-employed nurses? If the firm does so poorly that it can no longer pay the nurse, he will move at low cost to his next temporary job.

In contrast, as we have already seen, an employee who invests in firm-specific human capital has an incentive to preserve the relationship. This incentive arises because investing in firm-specific human capital bestows a first-mover advantage on the employee. Winners of initial employment contracts who invest in firm-specific human capital acquire a nontrivial information advantage over potential replacements.[375] As a result, the employment relationship begins in competition but may evolve into a bilateral monopoly. An employee who acquires a first-mover advantage thus commands monopoly rents. In turn, the present value of the expected stream of future rents is likely to vary with the value of the firm. In the extreme case, if the employer fails, the present value of the employee's rents falls to zero. Accordingly, although Black does not adopt the terminology of transaction cost economics, his analysis can be recharacterized as the familiar problem of protecting firm-specific human capital from opportunistic appropriation by rent-seeking managers.

In response to that risk, the employment relationship has evolved a variety of governance devices. Board of director representation is not among them, at least for the moment. The interesting question thus is why certain types

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[372] This is not to say that exit is cost-less for either employees or firms. All employees are partially locked into their firm. Indeed, it must be so, or monitoring could not prevent shirking because disciplinary efforts would have no teeth. The question is one of relative costs.

[373] Lewis M. Segal and Daniel G. Sullivan, *The Temporary Labor Force*, ECON. PERSP., Mar, 1995, at 2, ___.

[374] Id.

[375] WILLIAMSON, HIERARCHIES, supra note , at 34.

of governance devices are linked to certain types of claims. Transaction cost economics, with an assist from the related literature on agency costs, offers a highly nuanced answer to that question.

Oliver Williamson focuses on the question of whether parties to the corporate contract have invested in transaction specific assets, which are those whose value in a given use is far greater than their value in the next-best use.[376] Parties to the corporate contract fall into one of three possible categories with respect to investments in transaction specific assets. Those at "node A" are invested only in non-transaction specific assets and, accordingly, their interests are adequately protected by contracts across markets. Those at "node C" have invested in transaction specific assets, which leaves them vulnerable to exploitation. Williamson argues that node C constituencies develop safeguards against exploitation, such as specialized governance structures for dispute resolution. "Node B" constituencies resemble node C constituencies, in that they also have invested in transaction specific assets, but differ from them in that node B constituencies have not developed specialized safeguards against exploitation.

Williamson views the board of directors as a governance structure designed to protect the interests of node B constituents.[377] Node C constituents do not need board representation in order for their interests to be protected, because they have developed their own specialized governance structures to prevent exploitation of their investment in transaction specific assets. Board representation of Node C constituencies would also impose costs, among which are the costs of supplying information and the risk of opportunistic behavior by the node C representatives.[378]

Many corporate employees fall into the node A category, whose interests can be adequately protected by across-market contracts. These employees have little firm-specific human capital, which provides little opportunity for exploitation. Indeed, mobility may be a sufficient defense against opportunistic conduct, because node A employees can quit and be replaced without productive loss to either employee or employer.[379] Put another way, because there are no appropriable quasi-rents in node A employment relationships, rent seeking by management is not a concern.

Corporate employees who make firm-specific investments in human capital are likely to fall into node C. Various specialized governance structures have arisen to protect such workers. Among these are severance pay, grievance procedures, promotion ladders, and the like.[380] As we have seen, providing such mechanisms in fact is the chief economic function of unions. Williamson's

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376 Williamson, *Corporate Governance*, supra note , at 1202.

377 Id. at 1205.

378 Id. at 1206-07. In other words, the same costs I have identified above. See supra notes **tba** and accompanying text.

379 Id. at 1207.

380 Id. at 1208.

analysis in fact has been criticized for relying too much on collective bargaining, given the vast number of non-unionized U.S. workers.[381]

Collective bargaining obviously does not protect nonunionized workers, but such protections are nevertheless provided by both legal and market forces. As private sector unions have declined, the federal government has intervened to provide through general welfare legislation many of the same protections for which unions might have bargained.[382] The Family & Medical Leave Act grants unpaid leave for medical and other family problems. OSHA mandates safe working conditions. Plant closing laws require notice of layoffs. Civil rights laws protect against discrimination of various sorts. Even such minor matters as offensive horseplay have come within the purview of federal law.

In sum, transaction cost economics suggests that board representation is not an efficient means of protecting employee investments in firm-specific human capital. Employee representation imposes substantial costs, while the benefits are small. In general, employees do not need board representation because they have no investments in firm-specific human capital to exploit or they are adequately protected by alternative governance mechanisms.

In contrast, according to Williamson, shareholders are a paradigm of the node B constituency that requires board representation. The shareholder's investment in the firm is a transaction specific asset, because the whole of the investment is both at risk and turned over to someone else's control.[383] At the same time, shareholders are poorly positioned to develop the kinds of specialized governance structures that characterize node C constituencies. Unlike employees, whose relationship to the firm is subject to periodic renegotiation, shareholders have an indefinite relationship that is rarely renegotiated, if ever. The dispersed nature of shareownership also makes bilateral negotiation of specialized safeguards difficult. The board of directors thus is an essential governance mechanism for protecting shareholder interests.[384]

One fairly obvious objection to Williamson's argument is that fully diversified shareholders have relatively little stake in the success or failure of a particular firm. Williamson's anticipatory response to this objection is that "it does not follow that stockholders as a group have a limited stake in the firm. What is available to individual stockholders may be unavailable to stockholders in the aggregate. ... Stockholders as a group bear a unique relationship to the firm."[385] Put another way, while the investments of any particular shareholder do not appear firm-specific, stockownership in general is a transaction-specific investment, because investors put up capital that is both at risk and under someone else's control. In the absence of adequate protections against

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381 Gottesman, supra note , at 92-93; see also Stone, supra note , at 158-59.

382 Geu & Davis, supra note , at 1696.

383 Id. at 1209.

384 Id. at 1210.

385 Id. at 1210.

appropriation of their investment by managers and other firm constituencies, investors will not invest, and capital formation will be impeded.

If the foregoing analysis is correct, why do we nevertheless sometimes observe employee representation? An explanation consistent with my analysis lies close at hand. In the United States, employee representation on the board is typically found in firms that have undergone concessionary bargaining with unions. Concessionary bargaining, on average, results in increased share values of eight to ten percent.[386] The stock market apparently views union concessions as substantially improving the value of the residual claim, presumably by making firm failure less likely. While the firm's employees also benefit from a reduction in the firm's riskiness, they are likely to demand a quid pro quo for their contribution to shareholder wealth. One consideration given by shareholders (through management) may be greater access to information, sometimes through board representation.[387]

From this perspective, board of director representation is a way of maximizing access to information and bonding its accuracy.[388] The employee representatives will be able to verify that the original information about the firm's precarious financial situation was accurate. Employee representatives on the board also are well-positioned to determine whether the firm's prospects have improved sufficiently to justify an attempt to reverse prior concessions through a new round of bargaining.

This conclusion is indirectly supported by a study finding that company disclosure of financial and similar information to production workers was positively related to the level of wages and benefits, but unrelated to productivity, in both union and non-union firms.[389] To be sure, the study found no empirical evidence for the proposition that information was provided to employees to obtain wage concessions,[390] but the study was not focused on firms that gave board representation in return for bargaining concessions.

We may thus infer that managers of healthy firms resist providing employees with the greater access to information that board representation entails because doing so would transfer wealth from shareholders to employees. This inference is supported by the fact that proponents of labor law reforms designed to promote worker interests often include requirements that healthy firms provide detailed information to workers.[391]

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[386] Brian E. Becker, *Concession Bargaining: The Impact on Shareholders' Equity*, 40 IND. & LAB. REL. REV. 268 (1987).

[387] It is instructive that firms converting from an investor-owned to an employee-owned capital structure often do so during economic recessions. Hyde, supra note , at 173.

[388] See Williamson, *Corporate Governance*, supra note , at 1209.

[389] Kleiner and Bouillon, supra note , at 614-15.

[390] Id. at 612.

[391] See, e.g., WEILER, supra note , at 288; Michael H. Gottesman, *In Despair, Starting Over: Imagining a Labor Law for Unorganized Workers*, 69 Chi.-Kent L. Rev. 59, 76-78 (1993); Joel

V. CONCLUSION

My task in this article has been to answer a series of descriptive questions, leaving normative prescriptions for another day: Why do firms adopt it as an industrial relations tool? Why does it seem to fail so often? How will it evolve? The legal literature is remarkably uniformative with respect to such questions. In the law reviews, most of the literature is devoted to technical issues of labor law. The extant normative literature likewise is unconcerned with understanding employee involvement as it exists on the ground today, but instead almost uniformly takes one of two tracks: calling for participatory management to be banned so as to save unions or calling for the government to mandate some academic's ideal version of employee involvement. The management and economic literature is more helpful, but much of it scarcely rises above bald assertions that employee involvement is a warm fuzzy that makes everybody happier, more self-actualized, and more productive. As I have tried to demonstrate herein, such explanations fail to explain.

I have long suspected that an analysis grounded in the law and economics tools of modern corporate governance scholarship might prove enlightening. As it turns out, of course, in view of the paucity of U.S. examples of strategic participation, employee involvement is not a traditional corporate governance problem. Participatory management does not involve employees in policy decisions, but rather limits their involvement to day-to-day shop floor issues. As it also turns out, however, staple law and economics tools--transaction costs and agency costs--did have considerable explanatory power.

I have advanced two hypotheses about employee involvement that appear to be consistent with the evidence.[392] In both, participatory management is treated as an adaptive response to incentives that sometimes lead corporate managers to create excessive and redundant hierarchy. In the first, participatory management offers a solution to the information distortion caused by

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Rogers, *Reforming U.S. Labor Relations*, 69 Chi.-Kent L. Rev. 97, 118 (1993). For a critique of one such proposal, see Dooley, *American Comment*, supra note , at 130-38.

[392] I do not claim that participatory management's performance of these functions necessarily results from conscious management decisions. One of the many difficulties with the existing empirical literature is the almost total absence of any research on the question of managerial motives. Nobody seems to have asked the seemingly central question "why did you, Mr./Ms. Manager, adopt this program"? Glew, supra note , at ___. In his case study of an early QWL program, John Witte observed that the decision by firm management to retain ultimate control over the decisionmaking process, despite the introduction of participatory rhetoric and forms, emerged not from a pre-engineered management plan, but as a natural component of the evolutionary process. WITTE, supra note , at 86. Witte observes that this is a devastating finding, because it suggests that the same difficulties can be expected to recur in other experiments with participatory management. Id. I similarly argue that the information-gathering and monitoring functions described herein would likely emerge irrespective of management's intentions.

unnecessary bureaucratic layers. In the second, participatory management offers new mechanisms for preventing shirking by employees. My hypotheses management are complementary, rather than competing; improved information flows within the firm, for example, facilitate efficient monitoring. As I have demonstrated, they provide a more convincing explanation for the observed behavior of employee involvement programs than the participatory democracy rhetoric that usually dominates discourse in this area.[393]
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[393] Developing these hypotheses suggested insights not only about participatory management, but also about the tools used to study them. Much of the agency cost literature implicitly assumes a Taylorist model of monitoring: a hierarchy of monitors supervising subordinates that runs from the board of directors down to the assembly line. Studying participatory management illustrates that monitoring is a far richer phenomenon that includes multiple mechanisms, many of which are non-hierarchial. In particular, from studying participatory management we learn that there are ways of constraining shirking that involve neither close supervision by a specialized monitor nor ex post contractual enforcement mechanisms.