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The strategic choice of payment method in corporate acquisitions: The role of collective bargaining against unionized workers

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ABSTRACT

Acquirers facing strong union power tend to acquire target firms with cash rather than equity or a mix of cash and equity. A one standard deviation increase in the union power faced by the acquirer increases the odds of choosing cash payment by a factor ranging from 1.26 to 1.57. The effect is stronger when: the acquiring firm is located in states without the right-to-work laws; the interests of managers are more aligned with shareholders in acquiring firms; and acquiring firms' asset specificity is high. When union power is strong, acquirers making cash payment are associated with a significantly positive announcement return. In addition, they are less likely to experience labor strikes or declines in operating performance, and more likely to obtain wage concessions in collective bargaining in the post-acquisition period than acquirers using other methods of payment. These findings suggest that cash payment allows acquirers to reduce excess liquidity and strengthen their bargaining power with unions.

1. Introduction

In the finance and economics literatures, unionized firms place great emphasis on improving their bargaining power against labor unions. In general, unions attempt to maximize the utility of their members by transferring wealth from shareholders. That is, their interests are not necessarily aligned with shareholder interests (Clark, 1984; Becker, 1995; Vedder and Gallaway, 2002; Klasa et al., 2009). Therefore, if firms have a stronger bargaining position, they can gain concessions from their unions and receive a higher share of the value accrued from the firm's activities. Research has shown that firms take strategic actions to improve their bargaining positions relative to their unionized workers. For example, Bronars and Deere (1991) and Matsa (2010) show that firms strategically use debt financing to shelter income from union demands. DeAngelo and DeAngelo (1991) show that firms manage their earnings downward prior to labor negotiations. Klasa et al. (2009) show that unionized firms hold lower cash reserves to gain a better bargaining position against unions.

This study investigates whether the choice of payment method in corporate acquisitions is affected by the acquirer's strategic consideration in the collective bargaining with unionized workers. Acquisitions are among the largest and most readily observable forms of corporate investment (Harford and Li, 2007; Masulis et al., 2007). Acquisition activities not only exaggerate the conflicts of interest between managers and shareholders of acquirers and target firms (Berle and Means, 1933; Jensen and Meckling, 1976; Shleifer and Summers, 1988; Faccio and Masulis, 2005), but also the conflicts of interest between shareholders and employees in both the acquiring and target firms, because synergies and productivity gains from an acquisition may be achieved by layoffs or wage cut. When acquirers have greater bargaining power with employees, acquisitions create opportunities for acquirers to extract concessions from the workers in the target firm, because acquirers are not bound by the terms of previous agreements (Rosett, 1990; Fallick and Hassett, 1996). However, when employees have more bargaining power, they may thwart labor-unfriendly deals or constrain firms from restructuring decisions after the acquisition, resulting in synergy losses and lower shareholder value in the combined firm (John et al., 2015; Dessaint et al., 2017). Therefore, to realize the full synergy of an acquisition, it is crucial for acquirers to strengthen their bargaining power with current and future employees, particularly those backed by unions.

While a large body of literature has carefully investigated the determinants of payment method for acquisitions, no study to date has considered the strategic role of payment method in the context of the collective bargaining between acquirers and

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employees.[1] This study addresses this gap. We hypothesize that acquirers are more likely to use cash payments when facing powerful unions in the target or acquiring firms. Cash payments, either from internally generated funds or from debt financing, reduce acquirers' financial flexibility, which allows acquirers to take tougher positions and obtain greater concessions from unions during post-acquisition collective bargaining with unions. We empirically test this hypothesis using a sample of U.S. domestic acquisitions from 1990 to 2012.

The empirical results from binomial logistic models are consistent with our expectation. All else being equal, a one standard deviation increase in unionization rate (for the combined firm) faced by the acquirer increases the odds of choosing cash over other (including stock and a mix of cash and stock) payment methods by a factor ranging from 1.26 to 1.57, after controlling for other determinants of payment method and year- and industry-fixed effects. The positive union effect on the likelihood of cash payments still holds when we (i) use labor strength (unionization rate multiplied by the labor intensity of the combined firm) as a proxy for union power; (ii) control for time-varying industry characteristics; and (iii) use multivariate logistic model, where we separately estimate the odds of cash and stock payment over mixed payment.

The positive relation between union power and the probability of cash payment is stronger when the acquiring firm is located in states without right-to-work laws, where unions' bargaining power is stronger. The union effect is also stronger when CEOs obtain more stocks or options as their compensation, and when corporate governance, measured by the BCF index (Bebchuk et al., 2009), is better in the acquiring firms. These results indicate that managers are more likely to enhance the bargaining power against unions when their interests are more aligned with shareholders. We also find that the positive union effect on the likelihood of cash payment is more pronounced in firms with high asset specificity, where the low resale value of assets makes the liquidity shortage following cash payment a more credible case for demanding concessions from the union.

Further analysis shows that when facing strong unions, acquirers choosing cash payment are associated with positive and significant announcement returns. Moreover, in the post-acquisition period, acquirers facing strong unions and choosing cash payment exhibit the following, when compared with those who choose other payment methods: a significant decrease in cash holdings and increase in leverage ratios; a lower probability of labor strikes; a lower wage increase in collective bargaining outcomes; and no significant declines in industry-adjusted or performance-adjusted operating performance. This evidence is consistent with the notion that cash payment allows acquirers to reduce excess liquidity and strengthen their bargaining power with unions.

This study makes three contributions to the literature. First, we document that the choice of payment method is used as a strategic tool in collective bargaining situations during corporate acquisitions. Several previous studies have provided evidence to support the argument that a firm's corporate decisions are affected by strategic considerations arising from bargaining with unions (Bronars and Deere, 1991; DeAngelo and DeAngelo, 1991; Klasa et al., 2009; Matsa, 2010). Particularly, firms tend to maintain low cash holdings and high leverage ratios to strengthen their bargaining power over unionized labor. These studies, however, do not indicate what kind of actions unionized firms take to maintain low cash holdings or high leverage ratios. Dividend increases or share buybacks may not be suitable because they might signal a firm's strong future prospects, which may motivate unions to demand additional benefits (Chen et al., 2015; Chino, 2016). Our study indicates that cash payments in an M&A deal are an ideal strategic choice for firms in order to use low cash levels and high leverage as bargaining chips when facing strong unions.

Second, prior studies on collective bargaining between employers and unions usually assume that managers bargain with unions in the interest of shareholders (Clark, 1984; Becker, 1995; Vedder and Gallaway, 2002; Klasa et al., 2009; Matsa, 2010). However, managers are not always perfectly aligned with shareholders. In some cases, such as corporate takeovers or restructurings, managers and workers may share common interests such as job security (Pagano and Volpin, 2005; Atanassov and Kim, 2009). Our study explicitly considers the effect of managerial incentives on the choice of payment method when acquirers face strong unions, and shows that cash payments are more likely when managerial interests are better aligned with those of shareholders.

Finally, several studies have examined the long-term effects of the payment method in post-acquisition period (e.g., Heron and Lie, 2002; Loughran and Vijh, 1997). Our results suggest that when union power is strong, the choice of cash payments help acquirers enjoy better outcomes after an acquisition.

The paper is organized as follows. Section 2 reviews literature and develops our hypothesis. Section 3 describes the sample and summary statistics. Section 4 details the empirical results. Section 5 concludes.

2. Literature review and hypothesis development

2.1. Bargaining between firms and labor unions

A firm's value is determined by the amount of claims that common shareholders, employees, and stakeholders (e.g., bondholders, suppliers, and customers) receive (Becker, 1995). Hence, each self-interested group attempts to maximize its own welfare within a firm. For instance, workers join labor unions to improve their welfare through wage increases and other benefits provided by the firm.[2] When unionized workers maximize their benefits from a firm, this usually threatens stockholder benefits.[3] Because of the conflicting interests of the two groups, firms take strategic investment or financing actions to improve their bargaining positions with regard to unionized workers (Bronars and Deere, 1991; DeAngelo and DeAngelo, 1991; Klasa et al., 2009; Matsa, 2010).

Bronars and Deere (1991) show that when firms face powerful unions, they reduce investment in specific durable assets, which workers might more easily appropriate. DeAngelo and DeAngelo (1991) find that unionized firms manage their earnings downward prior to negotiation, and reduce dividends or cut managerial compensation during negotiations. They argued that these strategic activities help firms gain labor concessions during collective bargaining.

Klasa et al. (2009) and Matsa (2010) show that firms can improve their bargaining power in relation to unions by issuing more debt or holding smaller cash reserves. By having less financial flexibility, a firm puts a ceiling on the revenues that labor can extract from the firm without forcing it into financial distress.

2.2. Corporate acquisitions, unions, and choice of payment method

Corporate acquisitions are among the largest and most observable forms of corporate investment (Harford and Li, 2007;Masulis et al., 2007). Acquisitions may involve wealth redistribution among

[1] See, for example, Harris and Raviv (1988), Amihud et al. (1990), Martin (1996), Yook (2003), Officer (2004), and Faccio and Masulis (2005) for the determinants of the method of payment in corporate acquisitions.

[2] For example, Lewis (1963, 1986) finds that unionized workers receive higher rates of compensation than nonunion counterparts.

[3] Clark (1984) and Vedder and Gallaway (2002) indicate that the collective bargaining power of labor unions has a substantial impact on a firm's profit distributions. Krueger and Mas (2004) find that labor power affects a firm's productivity.