Do Corporate Liquidity and Repurchase Policies Respond to Unionization at Major Customer Firms?

Annie Le and Anup Agrawal
The University of Alabama

Abstract

We employ a regression discontinuity design (RDD) to identify the causal effects of labor unionization at a major customer firm on its supplier's cash holdings and stock repurchases. We empirically test for two opposite, non-mutually-exclusive effects: shielding vs. specific investment. We find that overall, the shielding effect dominates: dependent suppliers reduce cash holdings by 3% of total assets (or 22% of the sample mean) and increase repurchases by 0.5% of total assets (or 38% of the sample mean) to shield the firm from rent-seeking by newly unionized customers. These effects are larger when the customer (1) is more important to the supplier, (2) has greater market power, (3) is located near the supplier, and (4) has had a shorter business relationship with the supplier. But for suppliers with greater specific investment or longer relationship with the customers, the specific investment effect dominates: suppliers increase their financial flexibility to incentivize the customer to preserve the customer's relationship-specific investment.

Motivation

- Prior studies find that labor unions affect various corporate policies of unionized firms.
- Little attention has been paid to the spill-over effects of labor unions on a key stakeholder of focal firms, namely suppliers.
- We fill this gap in the literature by examining the effect of labor unions at major customer firms on two flexible financial policies of suppliers: cash holdings and stock repurchases.

Hypotheses: Shielding vs. Relationship-specific Investment

Shielding Effect: *A supplier will reduce its cash holdings and/or increase stock repurchases following the unionization of a major customer firm to shield itself from rent extraction by its customer.*

Relationship-specific Investment Effect: *A supplier will increase its cash holdings and/or decrease stock repurchases following unionization at a major customer firm to induce the customer to maintain its relationship-specific investment.*

Annie Le
University of Alabama, Tuscaloosa
Email: ntle1@crimson.ua.edu
Phone: 225-439-9082

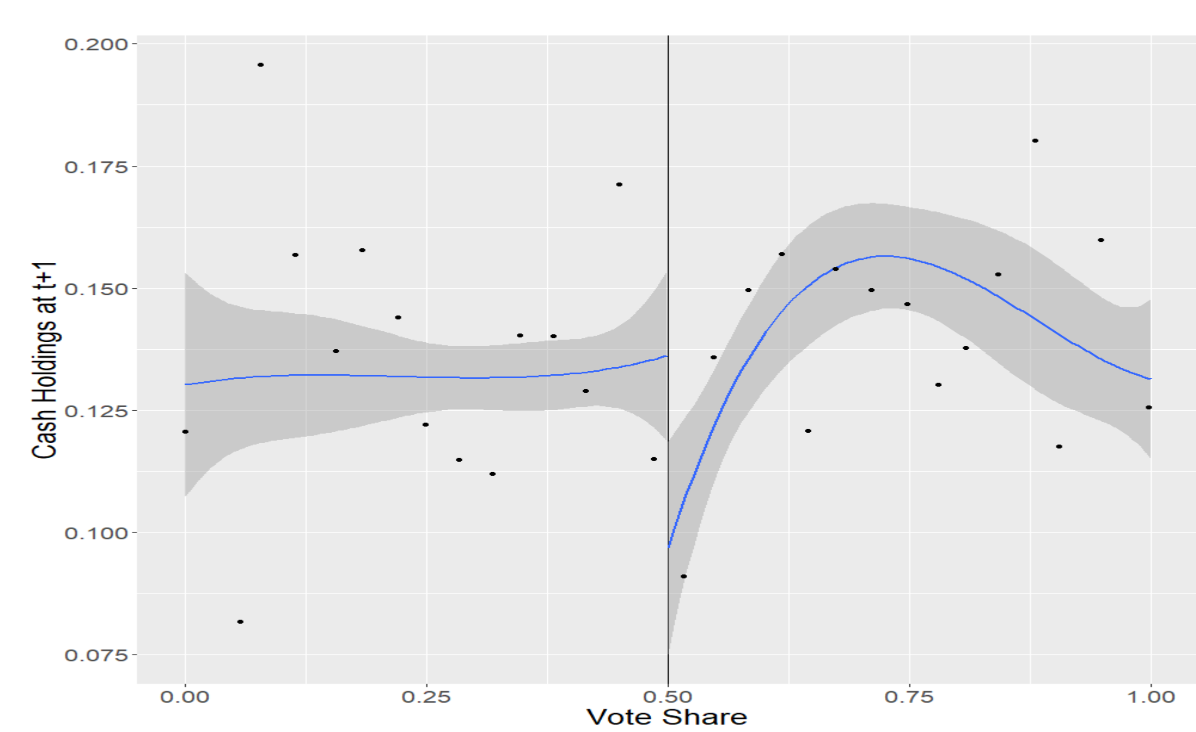
Data and Methods

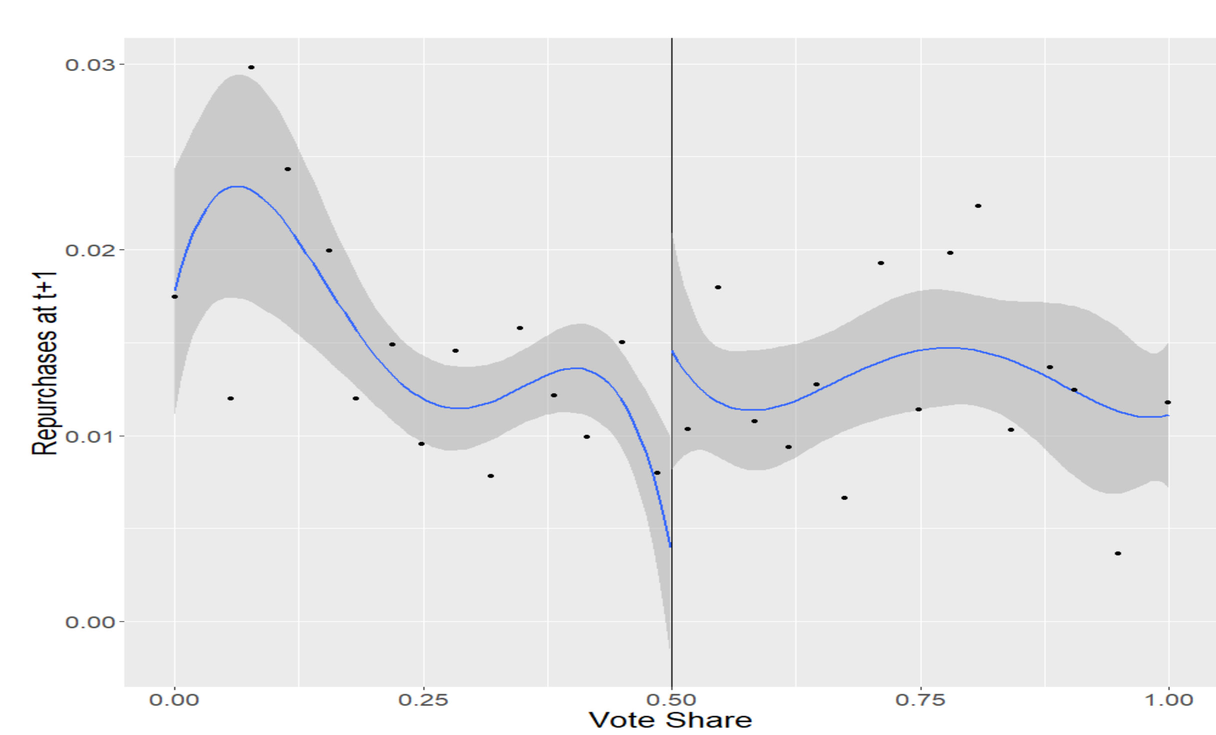
- We construct a dataset that consists of 1,269 union elections in 328 firms, affecting 2,181 dependent supplier firms, i.e., firms that depend on ≥10% of their sales on the unionizing customer firm.
- A union wins if the vote share for the union is at least 50 percent of the total votes cast, which enables a sharp RDD.

$$\text{Unionization} = \begin{cases} 1, & \text{if } Vote\ share \geq 0.5 \\ 0, & \text{if } Vote\ share < 0.5 \end{cases}$$

- Using RDD, we compare the cash holdings and stock repurchases of suppliers with unionizing customers to suppliers without unionizing customers.
- We estimate local linear regressions within a narrow range around the vote cutoff point of 0.5 using optimal bandwidths selected by Calonico et al.'s (2020) data-driven method.

RDD Plots





Results

We find that following labor union formation at major customers, dependent suppliers:

- ↓ their cash holdings by 3.0% of total assets or 22.4% of the sample mean.
- ↑ their repurchases by 0.5% of total assets or 38.5% of the sample mean.

Overall, the shielding effect dominates.

	Cash holdings	Repurchases
Unionization	-0.030***	0.005**
	(0.008)	(0.002)
Observations	1,747	1,566
Kernel Dist.	Triangular	Triangular
Optimal Bandwidth	0.090	0.083

Conclusion

We examine the causal effect of labor unionization of customer firms on their dependent suppliers' choice of financial flexibility.

We test for two competing and opposite effects: shielding and relationship-specific investment.

Overall, the shielding effect dominates: suppliers reduce their cash holdings or increase repurchases to shield their firm assets from rent extraction by their newly unionized customer.

The shielding effect is even larger when the unionizing customer

- is located near the supplier,
- has had a shorter relationship with the supplier,
- accounts for a greater share of supplier sales or
- has higher market power.

The specific investment effect dominates when

- Suppliers produce highly specialized products or services.
- Suppliers with long-term relationships with customers.

References

Calonico, Sebastian, Matias D. Cattaneo, and Max H. Farrell. "Optimal bandwidth choice for robust bias-corrected inference in regression discontinuity designs." *Econometrics Journal* 23.2 (2020): 192-210.