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ESSAYS ON LABOR AND CORPORATE FINANCE

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Executive Summary

This dissertation consists of two chapters that relate labor issues and corporate finance. The first chapter investigates the impact of restricting labor mobility on entrepreneurship and capital investment. The second chapter explores a specific mechanism through which corporate social responsibility (CSR), and in particular pro-employee policies, may benefit companies.

Chapter 1 – The Impact of Restricting Labor Mobility on Corporate Investment and Entrepreneurship

Recent research and policy proposals have renewed the debate over labor mobility restrictions.[1] In particular, non-compete agreements have been singled out as barriers to employee mobility that can have far-reaching consequences, from slowing down innovation to preventing workers from accessing economic opportunity.[2] On the one hand, non-competes can prevent knowledge spillovers and competition by keeping workers with valuable knowledge locked inside one company. On the other hand, they can allow existing companies to invest more by giving companies a safeguard on their investment.

The objective of this paper is to empirically document and quantify this potential trade-off. Specifically, it estimates the impact of increased enforcement of non-compete agreements on two components of growth: entrepreneurship, and capital investment.

Approach

Examining this trade-off presents two key empirical challenges.

1- A strategy to get at the causal effect of labor mobility on entrepreneurship and capital investment. Unobserved factors could jointly determine labor mobility and economic outcomes, or economic outcomes could influence labor mobility – we need an approach that addresses these concerns.
2- A way to observe the mobility of a large and diverse set of workers, as well as information on their employment before and after they move.

To address the first challenge, this paper uses eight state-level events that changed the enforceability of non-compete agreements. Non-competes are contract provisions that preclude employees from moving to, or establishing, a competitor for a period of time after leaving their employer. These provisions are wide-spread and especially common in knowledge-intensive occupations: Starr et al. (2016) estimate that 18% of all labor force participants are currently subject to one, with rates as high as 35% among tech workers and engineers.

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[1] Labor mobility here refers to provisions that prevent workers from leaving their employers. Examples of research and policy debate: White House report (2016), Saxenian (1994), Gilson (1999)

[2] The Wall Street Journal, Feb. 2, 2016, "Noncompete Agreements Hobble Junior Employees"; The Washington Post, Feb. 21, 2015, "The Rise of the Non-compete Agreement, From Tech Workers to Sandwich Makers"; The Atlantic, Oct. 17, 2014, "How Companies Kill Their Employees' Job Searches."

The events this paper looks at are seven state Supreme Court rulings and one state law that changed the local enforceability of non-competes between 2008 and 2014. These events are used as "natural experiments": if these somewhat sudden changes to non-compete enforceability are systematically followed by changes in entrepreneurship and capital investment, then it is plausible that the relationship between labor mobility and these outcomes is causal.

To address the second challenge, measuring labor mobility, this paper uses a novel data source: the detailed de-identified employment histories of LinkedIn members.[3] A key advantage of these data is the presence of standardized position-level information such as occupation and seniority. The paper uses these data to pinpoint workers and firms for which non-competes matter the most. Since these tend to correspond to knowledge-intensive activities (Starr et al 2016), the paper refers to these as "knowledge workers" and "knowledge-intensive firms."

The data also contain company-level information such as industry, year founded and size both before and after an employee move. This information is used to isolate moves to competitors and to new and small businesses, which proxy for departures to entrepreneurship.

Finally, the data encompass a wide range of workers in all fifty states and foreign countries. Looking only at active LinkedIn members, the data contain employment paths for 52 million workers in the U.S., or roughly one-third of the U.S. workforce.[4,5]

Results

The paper contains three main results.

1- Departure rates decrease sharply when non-competes become more enforceable
2- Entrepreneurship declines, in terms of both individual departures to entrepreneurship and the number of new firms entering
3- Capital investment at existing firms increases

First, this paper establishes the internal validity of the approach by verifying that non-compete enforcement has a significant impact on labor mobility. The results are shown in Table 1. In the setting of this paper, an increase in non-compete enforceability leads to a 2.6 percentage point drop in the departure rate. This drop is economically large, representing 24% of the average departure rate of 10.8%. The median firm retains 17 more workers every year, relative to the median size of 649 employees. As expected, declines are particularly pronounced for within-industry departures, and for departures to more senior positions, which proxy for moves that build on previous experience. The results are also driven by knowledge workers, that is, workers in occupations where non-competes are most common.

Second, the paper turns to the economic impact of these changes in labor mobility by looking at their impact on entrepreneurship. In Table 2, departures to entrepreneurship are defined as departures to newly founded small businesses. Following stronger enforceability of non-competes, departures from

[3] In 2015, LinkedIn awarded access to its database to a small number of researchers selected through a competitive process called the Economic Graph Challenge. The data contain no name information and numerical member identifiers in the data were hashed.
[4] According to the BLS, the size of the U.S. labor force was 158 million by the end of 2015.
[5] Active members are defined as members who have logged into LinkedIn in the past month.

knowledge-intensive firms to entrepreneurship decrease by 0.65. This represents a large drop, 32%, relative to the average departures to entrepreneurship in the full sample. In turn, entry of small knowledge-intensive firms declines by 16%. The results for new firm entry are shown in Table 3.

Table 1: Employee Departure Rate

The dependent variable is the firm's departure rate in year t in percentage points (1 to 100). In Column (1), the numerator is all departures. In Column (2), the numerator includes only departures where the origin and destination industries are the same. In Column (3), the numerator includes only departures to a more senior position. In Column (4), it includes only departures to a more senior position, in the same industry. The denominator is the same throughout, so each outcome variable has a different baseline average – mechanically, the number is highest in Column (1). Standard errors in parentheses are clustered at the state level. Industry is 4-digit NAICS.

$$100 * \frac{\#\ departures}{\#\ employees}_{it} = \alpha + \beta\{treated_i * post_t\} + \gamma_i + \theta_{jt} + \epsilon_{it}$$

	(1) Departure Rate	(2) Within-Industry	(3) To More Senior Jobs	(4) Within-Industry More Senior Job
Treated*Post	-2.612***	-1.409***	-0.849***	-0.309***
	(0.845)	(0.460)	(0.248)	(0.0948)
Industry-Year FE	Y	Y	Y	Y
Company FE	Y	Y	Y	Y
Observations	9,479	9,479	9,479	9,479
R-squared	0.964	0.963	0.94	0.975

Table 2: Departures to Entrepreneurship

The dependent variable is the number of departures from a given firm to newly-founded companies. In Column (1), this includes only companies with 10 or fewer employees. In Column (2), this expands to companies with 50 or fewer employees, and in Column (3) this includes newly-founded companies of any size. Knowledge Firm is an indicator for firms with a higher than median fraction of knowledge workers. Standard errors are clustered at the state level. Industry is 4-digit NAICS.

$$departures_{it} = \alpha + \beta_1\{treated_i * post_t * knowledge\ firm_i\} + \beta_2\{treated_i * post_t\} + \gamma_i + \theta_{jt} + \epsilon_{it}$$

	(1) New ≤ 10 Employees	(2) New ≤ 50 Employees	(3) New All Sizes
Treated*Post*Knowledge Firm	-0.421**	-0.652**	-14.38
	(0.176)	(0.265)	(13.23)
Treated*Post	0.0737	0.157	13.63
	(0.0813)	(0.243)	(13.59)
Knowledge Firm-Ind.-Year FE	Y	Y	Y
Company FE	Y	Y	Y
Observations	9,785	9,785	9,785
R-squared	0.917	0.927	0.400

Table 3: New Firm Entry

The dependent variable is the number of companies founded within an industry-state-year, scaled by the state's population in millions. In Column (1), this includes only companies with 10 or fewer employees. In Column (2), this expands to companies with 50 or fewer employees, and in Column (3) this includes newly-founded companies of any size. Knowledge sector is an indicator for firms in the following three sectors: professional, scientific and technical services, technology, and education. Standard errors are clustered at the state level. Industry is LinkedIn-defined industry.

$$\frac{firms\ founded}{million\ people}_{sjt} = \alpha + \beta_1\{treated_s * post_t * knowledge\ sector_j\} + \beta_2\{treated_s * post_t\} + \gamma_{sj} + \theta_{jt} + \epsilon_{sjt}$$

	(1) New ≤ 10 Employees	(2) New ≤ 50 Employees	(3) New All Sizes
Treated*Post*Knowledge Sectors	-0.0325*	-0.0590**	-0.0626**
	(0.0189)	(0.0232)	(0.0245)
Treated*Post	-0.00263	-0.000370	0.000343
	(0.00590)	(0.00610)	(0.00560)
Industry-Year FE	Y	Y	Y
Industry-State FE	Y	Y	Y
Observations	31,850	31,850	31,850
R-squared	0.714	0.767	0.768

Table 4: Capital Investment Rate

The dependent variable is net investment scaled by one year-lagged net capital. In Column (1), the regression is a difference-in-differences with all observations pooled. In Columns (2)-(4), the regression is a difference-in-difference-in- differences, or triple differences. In Column (2), the subsample is the set of firms which employ an above-median fraction of knowledge workers. In Column (3), it is the set of firms with an above-median R&D intensity. In Column (4), it is the set of firms in knowledge industries. Standard errors in parentheses are clustered at the state level. Industry is 4-digit NAICS.

$$\frac{Investment}{Capital}_{it} = \alpha + \beta_1\{treated_i * post_t\} + \beta_2\{treated_i * post_t * subsample_i\} + \gamma_i + \theta_{jt} + \epsilon_{it}$$

	(1) I/K	(2) I/K	(3) I/K
Treated*Post	0.0633**	0.0147	0.0256
	(0.0283)	(0.0223)	(0.0265)
Treated*Post*Knowledge Firm		0.0900**	
		(0.0347)	
Treated*Post*High R&D Intensity			0.0530*
			(0.0281)
Industry-Year FE	Y	N	N
Subsample-Industry-Year FE	N	Y	Y
Company FE	Y	Y	Y
Observations	5,053	5,030	5,029
R-squared	0.603	0.641	0.620

The third set of results concerns capital investment at existing firms. Entrepreneurship declines when non-competes are more enforceable, yet it is possible there is an economic benefit for existing firms. In particular, if human capital is hard to replace and its relationship with physical capital is complementary – for example, expensive computers are worth acquiring if the firm can retain talented programmers – then tighter restrictions on labor mobility will increase the rate of capital investment.

Consistent with this hypothesis, the results in Table 4 suggest that in firms that are more highly dependent on human capital, the net capital investment rate rises. Specifically, the estimates indicate that knowledge-intensive firms increase investment by $5-9k for every $100k of capital, or $1.5-2.5 million for the median firm. This represents roughly $100-150k per marginal retained worker.

To understand how the entrepreneurship and investment results relate to each other, the paper proposes a back-of-the-envelope calculation. The idea is that since both outcome responses are estimated within the same natural experiment setting, it is possible to get a rough approximation of the trade-off these estimates imply between increased capital investment on the one hand and decreased firm entry on the other.

First, the paper gauges the aggregate loss of knowledge-intensive entrants in the sample of treated states. It finds that overall, the estimates imply an aggregate loss of close to 3,000 knowledge-intensive entrants across treated states. Second, the paper repeats the approach to gauge the aggregate increase in capital investment in treated states. It finds that overall, the estimates imply an increase of a little over $5 billion in capital investment coming from publicly-held high R&D firms across treated states. The resulting trade-off is approximately $1.5 million of capital investment from publicly-held knowledge-intensive firms for every lost new knowledge-intensive firm entry.

Conclusion

Recent research and policy proposals have renewed the debate over labor mobility restrictions. In particular, non-compete agreements have received a lot of attention, mostly for their potentially negative effects on knowledge spillovers and entrepreneurship. However, non-compete enforcement may be an important tool for firms to safeguard capital investments.

This paper considers the impact of non-compete enforceability on two outcomes: entrepreneurship and capital investment. It uses a series of recent state Supreme Court rulings that changed the enforceability of non-competes in various states, and combines these with detailed data on employee movements from LinkedIn's wide-reaching database of employment histories.

This paper finds that changes in the enforceability of CNCs lead to substantial effects on both entrepreneurship and investment. The effects are particularly pronounced in knowledge-intensive occupations, where the average departure rate drops by a quarter. The median knowledge-intensive firm increases its investment rate by an estimated $2-2.5 million annually. At the same time, the rate of entry of new, small firms in knowledge sectors declines by 16% relative to average.

These results point to an important trade-off of labor mobility, between encouraging the entrance of new firms on the one hand and investment at existing firms on the other hand. While the magnitudes are difficult to quantify, the estimates place the trade-off among knowledge-intensive firms at around $1.5 million in capital investment (just from publicly-held firms) for every foregone entrant.

Chapter 2 – Goodwill Hunting: Corporate Social Responsibility as an Investment

At least ninety-five percent of the 250 largest companies in the world report engaging in some form of Corporate Social Responsibility (CSR).[6] Many of these firms spend large amounts of money on CSR: Disney spent $248.5 million on CSR in 2012 and Microsoft $904 million.[7] Despite this significant investment on behalf of firms, there is little consensus on the link between CSR activity and financial outcomes.

Two schools of thought dominate the debate:

1- Firms can "do well by doing good."
2- CSR is at best a distraction from a firm's main purpose and at worst a way for managers to use other people's money toward their personal projects.

This paper investigates a specific mechanism through which CSR may benefit firms, which can also explain why managers are so public about it. Specifically, the idea is that a firm's socially responsible behavior helps it to accumulate goodwill in its community. If the firm finds itself in a situation where it requires public approval, e.g. when applying for public contracts, it may draw down on this goodwill for preferential treatment. Interviews with managers suggest they view this goodwill benefit of CSR as an important motivation for engaging in social responsibility.[8]

Approach

To address concerns about omitted variables and reverse causality, this paper uses the staggered passage of state laws as a "natural experiment" that lowered constraints on directors' ability to pursue non-shareholder-oriented policies. These laws, called Other Constituency (OC) laws, allow directors to consider the interests of stakeholders other than shareholders. In other words, they allow directors to be responsible to society beyond shareholders.

The passage of these laws provides a good setting for studying CSR for two reasons. First, the laws are explicitly designed to protect directors who consider other stakeholder interests, so they should encourage more of this behavior. Second, there is no evidence that these laws were anticipated or otherwise enacted in states that were following a different economic trend than non-OC states. This allows us to plausibly attribute differences in firm outcomes after the laws' passage (relative to the same differences pre-passage) to the change in law.

The main period when legislatures pass OC laws is 1987-1990. During this period, another set of laws passed that have been associated with corporate changes: Business Combination (BC) laws. The estimations control for the passage of BC laws.

To measure socially responsible behavior itself, this paper looks at workplace characteristics from the Occupational Safety and Health Administration (OSHA. The OSHA data contain information on violations, complaints, and accidents in the workplace and are available at least as far back as 1980. Employees are an important category of stakeholders, so pro-stakeholder policies should be reflected in pro-employee

[6] KPMG, 2011. "International Survey of Corporate Responsibility Reporting."
[7] PR News, January 30, 2011. "How Much the Most Reputable Companies Spend on CSR." Figures are also available from Microsoft and Disney's own Citizenship Reports.
[8] Financial Times, June 22 2011, "License to Operate: Goodwill May Be Key to Gaining Green Light."

outcomes. The hypothesis is *not* that absent the laws, companies are deliberately harming employees. Rather, the hypothesis is that expanded discretion to pursue pro-employee policies result in even lower violations than expected in a standard place of business.

The paper also later uses an index from the Kinder, Lydenburg, Domini & Co (KLD) database covering additional CSR categories that is only available starting in 1991. The KLD index is constructed by scanning public databases and news reports to track company strengths and concerns along multiple dimensions of CSR. This paper considers five categories of CSR tracked by KLD: community, diversity, employee, environment and product.

To proxy for public goodwill, the paper uses data on government contract awards. The data come from Department of Defense contract records kept by the National Archives. The Department of Defense is the single largest contractor within the U.S. government, with contracts representing a wide variety of product markets and suppliers, from food to services to manufacturing parts. The underlying assumption is that governments have an incentive to reflect the preferences of their voters. More practically, the government is likely to be concerned about associating with good corporate citizens (and not associating with bad corporate citizens) for the purpose of being reelected.

These data are merged with Compustat data on publicly-held firms using fuzzy matching on names and other available information.

Results

The paper contains two main results.

1- Employee safety & health measures improve following the passage of OC laws, indicating an improvement in pro-employee policies.
2- Firms incorporated in states that passed OC laws are disproportionately likely to obtain public contracts and contracts of greater value after the laws pass.

The paper first uses OSHA outcomes as a proxy for social responsibility to verify that OC laws have an impact on social responsibility. Table 5 presents the results of a difference-in-differences specification with measures of employee environment quality as the dependent variables. Across the board, violations and other measures of bad behavior appear to decline. These results are consistent across a number of specifications, including controls for employees, assets, and firm fixed effects.

The magnitudes of the estimates are small because most firms have zero violations – however, they represent changes of 20-25% relative to average levels. Relative to standard deviations, coefficient estimates in both panels hover around 1-3% of standard deviation, pointing to the large variation in the distribution of outcomes.

Second, the paper shows that the rise in employee-oriented policies coincides with an increase in public contract awards. Again, results are consistent across a number of specifications. Table 6 presents estimates of the difference-in-differences with total contracting dollars in the dependent variable. Given an average contracting dollar amount of $19 million, the estimates in Table 6 suggest an increase in government contract amounts of 6-7% for the average observation following the passage of OC laws.

To dig into the drivers of this relationship, the paper looks at whether firms had more contracts approved or more valuable contracts. Table 7 presents the results of the same difference-in-differences

Table 5: OSHA Outcomes

The dependent variables are measures of employee conditions in year *t*. Panel A looks at outcomes related to OSHA violations, while Panel B considers other (potentially less subjective) outcomes.

$$OSHA\ outcome_{it} = \alpha + \beta_1\{OC_s * post_t\} + \beta_1\{BC_s * post_t\} + \gamma_s + \theta_{jt} + \epsilon_{it}$$

Panel A: Violations

	(1) # Violations	(2) # Instances	(3) # Serious Violations
OC*Post	-0.223***	-0.560**	-0.0843**
	(0.0735)	(0.275)	(0.0345)
BC*Post	0.145***	0.0257	0.100***
	(0.0378)	(0.312)	(0.0272)
Industry-Year FE	Y	Y	Y
State of Incorporation FE	Y	Y	Y
Observations	240,722	240,722	240,722
R squared	0.175	0.123	0.19

Panel B: Other Behaviors

	(1) # Complaints	(2) Hazardous Substance	(3) # Accidents
OC*Post	-0.0266**	-0.0167**	-0.00530***
	(0.0103)	(0.00779)	(0.00174)
BC*Post	0.0163	0.00168	0.00163
	(0.0101)	(0.00523)	(0.00272)
Industry-Year FE	Y	Y	Y
State of Incorporation FE	Y	Y	Y
Observations	240,722	240,722	240,722
R squared	0.138	0.133	0.102

estimation, but with number of contracts in the dependent variable. Estimates of the coefficient on the presence of an OC law are positive, but only statistically significant above a 90% confidence threshold in the last specification when clustering standard errors at the state of incorporation.[9] The estimates suggest an increase in the number of contracts awarded of 2% for the average observation.

Finally, the paper looks at the average value of contracts. The dependent variable in Table 8 is log of dollars per contract. The sample universe for this regression is substantially smaller since it include only firms with one or more government contracts. Nevertheless, controlling for size (by employees) the estimates suggest an increase in value per contract of 10-13% that is significant above a 95% confidence level.

[9] If clustered at the firm level, estimates throughout are statistically significant, but this does not allow for cross-correlation across firms incorporated in the same state.

Table 6: Total Dollars of Government Contracts

The dependent variable is *ln(1+dollars)*, where *dollars* is the total dollars of government contracts awarded to a firm in year *t*.

$$\ln(1 + dollars)_{it} = \alpha + \beta_1\{OC_s * post_t\} + \beta_1\{BC_s * post_t\} + x_{it} + \gamma_s + \theta_{jt} + \epsilon_{it}$$

	(1)	(2)	(3)	(4)
OC*Post	0.0642*	0.0643*	0.0568*	0.0717**
	(0.0359)	(0.0332)	(0.0302)	(0.0329)
BC*Post	-0.0555*	-0.0607*	-0.0640**	-0.0649**
	(0.0292)	(0.0303)	(0.0298)	(0.0303)
Ln(Employees)		0.305***		0.162***
		(0.0151)		(0.0139)
Ln(Assets)			0.278***	0.158***
			(0.0163)	(0.0195)
Industry-Year FE	Y	Y	Y	Y
State of Incorporation FE	Y	Y	Y	Y
Observations	61,498	50,302	55,390	50,297
R-squared	0.141	0.214	0.203	0.216

Table 7: Number of Government Contracts

The dependent variable is *ln(1+#contracts)*, the number of government contracts awarded to a firm in year *t*.

$$\ln(1 + \#\ contracts)_{it} = \alpha + \beta_1\{OC_s * post_t\} + \beta_1\{BC_s * post_t\} + x_{it} + \gamma_s + \theta_{jt} + \epsilon_{it}$$

	(1)	(2)	(3)	(4)
OC*Post	0.0180	0.0191	0.0164	0.0214*
	(0.0130)	(0.0119)	(0.0108)	(0.0118)
BC*Post	-0.0299**	-0.0331***	-0.0336***	-0.0345***
	(0.0116)	(0.0117)	(0.0116)	(0.0118)
Ln(Employees)		0.102***		0.0561***
		(0.00597)		(0.00395)
Ln(Assets)			0.0922***	0.0507***
			(0.00644)	(0.00670)
Industry-Year FE	Y	Y	Y	Y
State of Incorporation FE	Y	Y	Y	Y
Observations	61,498	50,302	55,390	50,297
R-squared	0.141	0.220	0.208	0.223

Table 8: Dollars per Contract

The dependent variable is *ln(dollars per contract)*, the total dollars per government contract awarded to a firm in year *t*.

$$\ln(dollars\ per\ contract)_{it} = \alpha + \beta_1\{OC_s * post_t\} + \beta_1\{BC_s * post_t\} + x_{it} + \gamma_s + \theta_{jt} + \epsilon_{it}$$

	(1)	(2)	(3)	(4)
OC*Post	0.0963	0.119**	0.0932	0.121**
	(0.0617)	(0.0582)	(0.0563)	(0.0577)
BC*Post	-0.0494	-0.0133	-0.0259	-0.0127
	(0.0528)	(0.0503)	(0.0543)	(0.0499)
Ln(Employees)		0.143***		0.165***
		(0.0190)		(0.0425)
Ln(Assets)			0.128***	-0.0220
			(0.0184)	(0.0422)
Industry-Year FE	Y	Y	Y	Y
State of Incorporation FE	Y	Y	Y	Y
Observations	4,721	4,569	4,697	4,569
R-squared	0.785	0.805	0.798	0.805

Conclusion

Corporate social responsibility has an increasingly important and public place in firms' activities. Among firm managers, the consensus appears to be that doing good is good for business. Yet the literature has failed to provide a compelling – and empirically convincing - explanation for this phenomenon.

This paper explores the possibility that social responsibility is an investment in public goodwill, where goodwill is attractive to companies because it increases their chances of obtaining awards or approval from the public, among other benefits.

To address omitted variable and reverse causality, the paper employs a novel identification strategy that uses the staggered passage of state constituency laws (OC laws) as a natural experiment for improved social responsibility. OC laws, passed mainly in the 1980s and early 1990s, provide protection for directors wishing to pursue stakeholder-friendly policies, such as pro-employee policies.

In this setting, it finds that increases in pro-stakeholder policies are accompanied by increases in public awards in the form of government contracts. The paper first documents that OC laws have a positive impact on social responsibility, by showing that the employee environment systematically improves following the passage of the laws. Concurrently, firms obtain more public contracts and more money from public contracts following the passage of the laws.

The contribution of this paper is to explore a specific channel through which socially responsible behavior can benefit companies: accumulating public goodwill. This does not preclude the existence of other channels. Future work should address alternative channels, such as ability to attract and retain talent, in particular in more recent years.