Institutional Investor

Five Questions: Do Companies Hide Good News During Labor Talks?

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Public companies usually trumpet good news far and wide, with one suspected exception: quarters leading up to labor negotiations. To find out if looming labor negotiations actually do trump good news that ordinarily lifts stock prices, researchers based in Hong Kong, Australia and Macau turned sights on South Korea.

Data from more than 300 South Korean companies, many with brand names well known to U.S. consumers, furnished the grist for "Do Managers Withhold Good News Against Labor Unions?" by Richard Chung at Griffith University in Australia, Bryan Byung-Hee Lee at University of Macau, Woo Jong Lee at the Hong Kong Polytechnic University and Byungcherl Charlie Sohn at the City University of Hong Kong.

Institutional Investor contributor Steven Mintz asked B. Charlie Sohn about the research and its implications.

1. What led you and your co-authors to companies in South Korea?

In the U.S. individual companies do not report how much of the workforce belongs to unions. Census data can supply industry-level average unionization rates, but you get nontrivial errors when you try to measure how union strength affects a company's operating results, its financing, investment and firm value. Korean companies, on the other hand, must disclose the number of union members in their work force every year. Using those data, we can compute unionization rates at the firm level to see the impact on financial performance.

A second reason to use Korean workforce data is the credibility of threats by its labor unions. In Korea, labor unions have a long tradition of resisting military dictatorship during 1970s and '80s and still keep this heritage. They are often militant in their strikes, making threats more credible to the management. This credibility means we can investigate the tendency to withhold good news in a more uniform way, surer that the vast majority of managers see very similar threats.

2. Does the tactic work?

Historically, yes. Hiding good news is an effective way to constrain wage increases during labor negotiations. The effect is most pronounced in financially distressed companies and labor intensive industries like cargo transportation, metal and machinery, automobile manufacturing.

3. Does suppressing good news harm shareholders?

We found that stock prices decrease significantly during the second quarter when most Korean firms conduct labor negotiations. This decrease is more pronounced for unionized firms than nonunionized firms. In this sense, shareholders appear to be hurt by distorted disclosure policy. However, stock prices bounce back to a normal level when firms disclose news they withheld until labor negotiations are over. But this practice adds volatility to a company's market value. Considering the well-known principle that volatility lowers firm value, given the same level of expected future cash flows, a distorted disclosure policy can decrease shareholders' wealth in the long run.

4. Is the opposite true; do companies rush to share bad news to offset union demands?

We believe so. Managers not only withhold good news but also promote bad news to offset union's demands. We are revising our paper now by manually classifying each disclosure into good or bad news, and so far we've found that the unionized firms increase the level of bad news disclosure during the second quarter and disclose smaller number of bad news in the third quarter to a greater extent than the nonunionized firms, although this pattern is weaker than the corresponding good news analysis.

5. Does the pattern yield an arbitrage opportunity every spring for investors willing to buy the stock of Korean companies with strong unions?

That's impossible to predict with certainty. But in principle, if there are no entry barriers, no transaction costs, no other market frictions, there should be an opportunity to make money using such a strategy. Any meaningful opportunities would diminish over time, and that length of time could be months, days or even seconds.