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The efficiency wage hypothesis and the role of corporate governance in firm performance

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THE EFFICIENCY WAGE HYPOTHESIS AND THE ROLE OF CORPORATE GOVERNANCE IN FIRM PERFORMANCE[1]

As well as a two-fold contribution to the literature as highlighted in their paper“, Financial Disruptions and the Cyclical Upgrading of Labor” (2017:8), and elaborated on by Epstein et al, the reconciliation of two quantitative limitations of current general equilibrium theories constituting part of such contribution, this paper highlights the need to incorporate other theories such as those relating to the economics of the firm – in explaining firm performance – given the previously highlighted limitations of “canonical models”.

The inability to account for variables which are independent of exogenously or endogenously determined factors and which are outside their model, also necessitates the incorporation of other theories and factors to be taken into account in arriving at more accurate conclusions which determine firm performance.

Key words; efficiency wage hypothesis, pro cyclicality, financial cycles, firm performance, corporate governance

Background and Review of Literature

According to Yellen (1984: 200), The models surveyed (in her paper) are variants of the efficiency wage hypothesis, according to which, labor productivity depends on the real wage paid by the firm. If wage cuts harm productivity, then cutting wages may end up raising labor costs. Hence, she argues, rather decrease wages – in a bid to employ more workers – as well as raise firm’s revenue, firms are rather reluctant to do this since it would, overall, result in lower productivity.[2] In applying this to the dual labor markets, she adds that the Efficiency Wage Hypothesis applies to the primary sector – whilst under the secondary sector where anyone can obtain a job at a lower pay, the market is addressed to an extent as a result of employees who are willing to accept lower wages – even though this does not fully address involuntary employment.

Other Theories to Be Considered

Principal Agent Theory

Fama(1980). “Agency Problems and the Theory of the Firm” Journal of Political Economy, Vol 88, pages 288-307

Theory of the Firm
Jensen and Meckling (1976). “Theory of the Firm: Managerial Behaviour, Agency Costs, Ownership Structure.” Journal of Financial Economics, Vol 3 305-360

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[1] Jim DiGabriele and Marianne Ojo

[2] “That any reduction in the wage paid would lower the productivity of **all** employees already on the job”.

Corporate Governance Theory
Corporate Governance and Firm Performance (Bhagat and Bolton)

Moral Hazard Considerations

How employers can effectively design contracts – particularly long term contracts – such that they:

1) Do not unduly encourage lax attitudes by employees:
Who regard themselves as being too important (to the company) to be fired – hence overly conveying the assurance of job security

2) Whilst also incorporating necessary incentives and considerations into such contracts.
Loyalty schemes, bonuses, perks have their place of importance – so also motivation and morale amongst employees. Justifications for rewarding and encouraging certain "prized" employees than others vital. Newly employed workers should also be appreciated where they have demonstrated or possess skills which are as important as those that have been acquired by longstanding firm employees.

Corporate Governance and Firm Performance

According to Bhagat and Bolton (2007:8), efforts to improve corporate governance should focus on stock ownership of board members - since in their opinion, it is positively related to both future operating performance – as well as the probability of disciplinary management turnover in poorly performing firms. Of further interest, are observations made in relation to the negative relationship which exists between board independence and future operating performance, which in their view, could place board independence in a position of merit – where such is targeted as a means of "disciplining management of poorly performing firms".

"Greater stock ownership by the board", they further add, "would help internalize costs (and benefits) associated with greater disclosure as highlighted by Hermalin and Weisbach (2007) (cited) at the decision making (board) level."

Conclusion

With an increasingly digitalized and intertwined global economy, fueled by increased and advanced information technologies, as well as impacting sectors of ecommerce on the financial – and indeed conglomeratized sectors, new and evolving forms of risks have necessitated the skills and expertise of specialists such as forensic accounting experts – as a means of addressing gaps resulting from inabilities of traditional audit techniques to effectively address and manage such risks – particularly in a timely manner. Further ,whether risks such as risks of corruption - as varies according to different cultures and environments can effectively be managed by auditors, also constitutes growing interest.

Herein lies a growing role and the forging of a more formidable identity by forensic accountants. See also (Huber and DiGabriele). Understanding different cultures – in efforts aimed at addressing fraud and corruption, is not only essential to current jurisdictional and

collaborative efforts, but also vital to addressing and managing cross service sector risks – as well as newly evolved risks associated with globalization and conglomeration.

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