
The crisis: catalyst for stronger worker participation in corporate governance?

Summary
of the report of the SEEUROPE Network

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Norbert Kluge and Sigurt Vitols

Conference reader, 24 and 25 November 2010

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europaan trade union institute

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Introduction

Many critics of the long-term trend towards “shareholder capitalism“ in and outside of Europe assumed that a serious economic crisis would lead to a major public reaction and demand for a more “stakeholder” oriented form – or even for the end – of capitalism. This belief was most apparent at the height of the crisis in early 2009, when some commentators spoke of the imminent demise of financial capitalism. Even the mainstream US publication Newsweek declared at the time that “we are all socialists now.”

However, by mid-2009, the end of the first “financial market panic” phase of the crisis as well as the political setbacks of left parties in the European Parliament and some national elections has led to a sobering reassessment of this assumption. It has become apparent that the temporary collapse of the financial system did not lead to an “automatic” transformation of capitalism. Instead, a transformation in a more social direction requires a longer period of public discussion and understanding of alternatives to shareholder capitalism and the embracement by left parties and trade unions of these alternatives.

The main features of the reform debate on the EU and G20 level are broadly familiar. However, developments at the national level in Europe are less well known, particularly in the smaller countries. This report focuses on the results of a survey of developments at the national level in Europe. This survey is based on the responses of national expert members of SEEUROPE, a research network established to observe the evolution of the SE (European company) as well as broader issues of worker participation in the EU and EEA. Currently these areas include 30 countries. Specifically, national experts were surveyed on four main issues related to corporate governance:

- **Worker participation:** is there a discussion on worker participation and the crisis in corporate governance? Are there demands for strengthening the role of workers in governance, particularly for board level employee representation (BLER)?
- **Corporate governance:** is there any public debate critical of the shareholder model? Are there demands for a stronger stakeholder orientation in company governance, either through corporate governance codes or legislation?
- **Management remuneration practices:** is there public criticism of either the level or structure of management remuneration? Are there demands for greater transparency and regulation?
- **Company disclosure requirements:** are there demands for greater transparency in company reporting, especially on so-called ESG (environmental, social and governance) issues?

As a general conclusion one can say there has been no major system transformation – either towards a full “stakeholder” model or a radicalization of the shareholder model. However, there are interesting developments in some countries which can be described as incremental steps in the direction of a

stronger stakeholder orientation. This is particularly the case in the area of corporate governance codes and management remuneration. Finally, there are some indications that, in some countries, a strengthened partnership approach at both company and national level has been developed to deal with the crisis.

Worker participation

For a better understanding of why the link between crisis, national debates on corporate governance and worker participation were made, one should recall that legal provisions for the presence of employee representatives in company boardrooms (although very different from country to country) can be found in 17 out of the 27 EU member states and in Norway. The involvement of supervisors and non-executive directors elected, appointed or, at least, proposed by the workforce or its trade unions is a feature of the corporate governance in most EU member states. This is not only designed as a prolongation of social interest representation at company board level. This can be seen e.g. in countries like the Czech Republic or Hungary where one third employee representation on the supervisory board is required by national law. Most interesting in this regard might be the system of company supervision for Dutch companies: The law insists strictly on the “independence” of supervisors, which also applies to supervisors nominated for the board by the works council. The history of the German co-determination system, which to many outsiders appears to be the most extensive system for involving social interests, shows that even this model is deeply rooted in the concept of integrating societal considerations in the management of companies. This is the core idea of the German “Montan Mitbestimmung” built on the idea of “economic democracy”.

This is not an effort to retrieve traditional concepts from the last century and to adapt them to the situation today. But an alternative is sorely needed after the failure of the “transparency” model favored in the last decade, which only focuses on the special importance of shareholders and executive managers for the functioning of a company. This model fails to pose the question of the usefulness of inserting employee voice effectively at the top level of companies or about improving the tools for worker participation for the purpose of broader stakeholder orientation in countries where this exist. Moreover, meanwhile we see a lot of well known “big players” at the transnational level which adopted the European company statute (SE) form and, through this, accepted the strong participation of employee representatives from various countries in which they do business in their boardrooms.

Thus, it is difficult to understand why, according to the reports available from the SEEUROPE experts, this link does not play an appreciable role in the discussions on how to improve corporate structures, even in countries where worker participation is an evident feature in the everyday life of a company. Perhaps after having been dominated by the shareholder approach for such a long time the potentialities have been buried. Today, worker participation in boardrooms seems to be a “forgotten resource” which is not easy to rediscover.

Reports from some countries leave an ambivalent picture: In *Luxembourg* there is a lively public debate on how to tackle the economic and social repercussions of the crisis in that country. The current debate did not specifically touch upon the issue of worker participation as a single, prioritized subject. But this issue is part of a debate focused on the future of Luxembourg's social model with its consensus-seeking tripartite mechanism, the financial burden of social spending, and how to find or invest in new economic activities if the growth stemming from the monolithic financial sector will diminish in the future. It seems to be that, at least, the trade unions bring worker participation at board level into this discourse.

In contrast, a rather negative direct impact from the current financial and real estate crisis can be observed in *Spain*. The only places where workers' participation is found is in traditional regional savings banks. They are strongly threatened by the financial crisis and are urged to merge and to convert themselves in more ordinary financial institutes. Even the government is organising mergers of the regional savings banks, which may strengthen their financial capital but also undermine their links to the regions and their social networks. These developments tend to undermine the traditional participative stakeholder structure of these savings banks.

We observe another negative development in company law in *Poland*. In the private companies a new draft Law (of 19.1.2010) introduces important changes which result in weakening of the position of the employee representatives on boards and a strengthening the rights and possibilities of the shareholders general meeting.

On the positive side of the ledger, in Germany the social democratic party (SPD) fraction in the Bundestag has demanded the extension of board level employee representation along a number of dimensions. First, the mandatory minimum level for the application of parity and one third employee board membership should be cut in half (from 2,000 to 1,000 and from 500 to 250 domestic employees, respectively). Second, a catalogue of decisions that must be approved by the supervisory board should be included in company law. Third, true parity along the "Montanmitbestimmung" model should be introduced by giving equal weight to capital and employee representatives. Finally, codetermination laws should apply to a broader range of company types, including firms with a foreign legal form. These are basically along the lines of demands that have been made by the German trade union federation DGB, and which were reiterated at its congress in May of this year.

It might be easy to understand that, in times of crisis, trade unions are overloaded by very practical tasks for helping their members keep their jobs or to tackle increased workplace instabilities caused by the financial crisis. However, it is highly noticeable that policy makers greatly underestimate the potential of employee involvement and of mutual trust within companies to achieve necessary changes. It has been left to the social partners and industrial relations to try to keep running companies under adverse circumstances. It might be easy to understand that many of the necessary concessions which have

been made by employees would have never been accepted without the functioning of interest representation – including its political support by trade unions. Also the company board level has been used to find reliable social compromises which helped to develop future company perspectives without losing the competence of the work force necessary for such a future.

As we are still in the eye of the hurricane, it is perhaps too early to do a proper assessment of the contributions by worker participation and to draw conclusions on their future role to improving corporate governance. However, evidently we can see momentum for development namely in those countries where obligatory worker participation plays a relevant role. Remarkably, with the feeling of being reasonably successful in dealing with the consequences of the crisis, leading German politicians and even company leaders showed their appreciation of the beneficial co-determination system in public. For instance Peter Loescher, CEO of Siemens, approved of co-determination explicitly: “I believe that it was exactly this crisis which proved once more that this is an important competitive advantage in the international context.” More specifically, e.g. the new rule in Germany requiring decisions on executive remuneration to be made by the entire supervisory board (and not only to committees of the body) will also put employee representatives in a position to reflect on their concepts and demands because they are asked to agree. In light of the debate on how to make the behavior of executive managers more beneficial for the company – and not only for their shareholders – this duty of employee representatives in company boardrooms may lead to a more general debate also within trade unions aiming to develop an own policy in this field: The crucial question here is: How can managers be encouraged to see their decisions in a more long term perspective to make their companies sustainable?

Corporate governance codes and laws

In most European countries the debate on corporate governance is a fairly new phenomenon, in many of these about a decade old. In these countries corporate governance was traditionally a matter for companies to decide (*laissez-faire* approach) and transparency was low. The main alternatives for influencing corporate governance practice are: 1) voluntary codes and 2) binding rules (e.g. through legislation, decrees by regulatory bodies, or court decisions). A hybrid system is the so-called “comply or explain” approach, in which companies are required to follow a rule or provide information on a specific item (“comply”), or else explain why they have not fulfilled the requirement. However, without significant penalties for insufficient explanations, the “comply or explain” approach essentially ends up being a voluntary approach.

The crisis appears to have stimulated debate in many countries to have clearer and stricter rules on corporate governance, and to have encouraged the process somewhat towards adopting codes for the first time in some countries and for giving codes a more binding character in others. For example:

- In Belgium for example a widely publicized study showed that only 44 percent of listed companies followed the recommendations of the Code Lippens.
- In Bulgaria a code developed in 2006/7 by a group led by the Bulgarian Stock Exchange was given a more formalized character in 2009 in the form of a National Commission for Corporate Governance, and the code was given a binding character for listed companies in the prime segment of the stock exchange (top 20).
- In Cyprus the Central Bank issued a binding directive that had a major effect on the corporate governance of banks
- In Portugal a draft new Corporate Governance code extends the areas addressed, including management remuneration
- In Romania a new Corporate Governance Code for listed companies was adopted in 2009 by the Bucharest Stock Exchange, which contains more extensive recommendations than the old code from 2001.

Management remuneration practices

In many European countries management remuneration practices have traditionally been dealt with in great secrecy. Disclosure requirements in many countries were limited to total remuneration for the board, and many items such as non-financial benefits, pension provision, “golden handshakes” and similar items were typically not disclosed. A first step in regulating management remuneration is thus the requirement of transparency on remuneration both at the individual level (at least for the highest paid executives) and on detailed components of this remuneration (salary, bonus, stock and stock option compensation, non-financial compensation, pension contributions, etc.). A second step is to have rules regarding the levels of compensation as well as the formulas for determining these components.

There is now a widespread belief that excessive executive compensation and a bias towards short-term performance contributed to the crisis. This has stimulated debates in many European countries about the need for stricter rules in this area. In some countries corporate governance codes have become more specific in their recommendations and in other countries legislation has been approved resulting in a more binding approach in this area:

- Germany has taken a big step in passing an *Act on the Adequacy of Remuneration* in 2009, which includes a number of important provisions, e.g. orienting management pay towards the “normal” pay in similar companies; requiring remuneration to be oriented towards long-term sustainability; possibility for the reduction in remuneration in case of bad performance; an overall cap for remuneration; and responsibility of the whole supervisory board for decisions on remuneration of the executive board.
- In Portugal the Parliament also approved a law requiring remuneration transparency in listed companies, investment funds and public companies above a certain size.

- In France a state decree has set rules for remuneration in state-owned companies. A board is also supposed to review top earners in the financial sector. Finally, the state has also declared mandatory certain provisions of a new version of the Corporate Governance Code, e.g. that severance pay is limited to two times annual pay or that the granting of stock options should be clearly linked to performance.
- In Belgium new recommendations have been included in the Corporate Governance Code (Code Lippens) and also in legislation, which requires that a remuneration committee be established in the board of directors as well as a greater level of transparency in reporting on individual manager remuneration.
- In Hungary the courts ruled that state companies have to publish information on management remuneration.
- In Poland the new Good Practices Code of the Polish Stock Exchange requires that remuneration of directors should be related to the tasks and responsibilities of the person as well as the size and performance of their company.
- In Sweden the government made a request to the board of directors of 53 state owned companies to renegotiate management remuneration agreements.

Company disclosure requirements (especially ESG)

Under the motto “the first step to improving a company’s practice is to know what it is doing” the issue of company reporting on non-financial performance has become increasingly significant. Frequently the term ESG (environmental, social and governance) reporting is used to cover these non-financial indicators. A mandatory system of ESG reporting on a broad range of standardized indicators, with external auditing/verification, is a central part of the concept of the “sustainable company” (Kluge/Vitols).

The current leading ESG reporting standards have been developed by the Global Reporting Initiative (GRI), a multi-stakeholder organization which includes trade union representatives in its governance structure.

For the most part ESG reporting in Europe is on a voluntary basis, with the partial exception of listed companies in some countries (e.g. France, Austria). Although there have been widespread demands for better reporting on management remuneration and risk management systems (particularly in banks), better ESG reporting appears to be on the agenda more so in the EU than at the national level. Trade unions in some countries have demanded mandatory ESG reporting. Company surveys show that, even in the countries where reporting is mandatory for some types of firms, company practice in this area is unsatisfactory. However, given the predominance of financial issues in the crisis, we must wait to see whether ESG reporting becomes a more important item on the public agenda in the future.

Conclusion

This review shows that the crisis has not left national systems unaffected. However, the transformation of capitalism away from shareholder value in the direction of a more social outcome has been far from automatic. More efforts to spread alternative concepts to shareholder value must be undertaken in order to inform further initiatives to overcome the crisis.

Europe should therefore use its competence for setting rules and habits for facilitating the use of the freedoms provided by the European internal market to also underline societal expectations on companies (and their financiers). As a guideline for further discussion it should be made clear that European law in the field of corporate governance obliges companies to show that they sought commitment and involvement from their employees on the transnational level. In this regard, employees should not be treated worse than e.g. minority shareholders.

A largely unexplored area in the survey is to what extent a stronger “partnership” approach to dealing with the crisis has been developed at the company and national level. Although not covered directly by the survey, some answers indicate that management and worker representatives have developed pacts or alliances both at the national level (e.g. to support more generous financing of short-time work) and at the company level to develop solutions to avoid large-scale layoffs. It may be that the crisis has laid the foundation for a longer-term approach here.

Note: a compilation of the company reports can be downloaded from the section of the ETUI Worker Participation website dedicated to the SE:
<http://www.worker-participation.eu/European-Company>

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