Chapter Nine

A stakeholder approach to corporate governance: Employee representatives on boards of management

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From the late 1980s, renewed business and political attention has been directed internationally to the issue of corporate governance. This has been fuelled by a series of corporate collapses, persisting into the twenty-first century with the spectacular case of WorldCom, amidst claims of directors' fraud and lack of responsibility by auditors.

Australia has not been immune from large corporate collapses, calling into question the due diligence of directors and auditors, such as the cases of HIH insurance, One.Tel and Ansett. These cases raise important public policy questions concerning the structure of corporate governance, not least whether input from a broader range of stakeholders, including employees, might give earlier warning of potential problems and help in developing solutions.

A series of reports into corporate governance during the 1990s focused on the functions of directors, stakeholder/board relationships and executive remuneration (Cadbury Commission 1992; Goodijk 2001, pp. 179-80). Voluntary codes of governance were subsequently adopted in the USA, Europe and Japan by stock exchanges and by the World Bank (2000) and OECD (1999), with limited apparent impact on corporate behaviour. However, a fundamental limitation of these codes has been their narrow focus upon strengthening the position of shareholders.

Corporate governance needs to recognise interests other than the shareholders, such as those of employees, the wider community and the environment. An exclusive focus on profitability may hinder development of longer-term policy and due recognition of the social responsibility of the company. Sir Adrian Cadbury recognised the broad range of stakeholders when he stated that

> Corporate governance is holding the balance between economic and social goals and between individual and communal goals. The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society. The incentive to corporations is to achieve their corporate aims and to attract investment (World Bank 2000, preface).

In the 'stakeholder-model' of corporate governance, the workers' representatives also play an active role in the process of strategic decision-making at corporate level (Goodijk 2001, pp. 179-80). With the continuous process of mergers and company reorganisation, the growing global character of business, and the potential for loss of employee entitlements, this issue has assumed critical proportions in a country such as Australia, where there is no public policy recognition of a stakeholder approach to corporate governance.

Employee representatives on boards of management (ERB), or employee directors, represent a significant form of employee involvement in the governance processes of organisations practiced widely overseas. However, the incidence of ERB varies greatly. Where employee directors sit alongside shareholder representatives, their roles, proportion of the board, and method of selection also vary significantly. The next section of this chapter surveys international practices in ERB, before evaluating their effectiveness as a form of employee participation and examining the situation in Australia.

International practices

Western European countries have the most developed systems for employee membership of boards. A statutory basis for employee representatives on company boards exists in eight countries: Denmark, Sweden, Norway, Finland, Austria, Germany, France, and Luxembourg. Ireland, Greece and Portugal have similar provisions applying to state-owned enterprises only

(Blanpain 1993, p. 26; Knudsen 1995, p. 8; Strauss 1998a, p. 32). Other efforts to extend the general practice of ERB by legislation in Europe have been unsuccessful, in Britain in the late 1970s and in Spain in the 1980s (Clegg 1979, pp. 439-43; Knudsen 1995, pp. 53-4, 76-7).

In many European countries ERB functions within a dual board structure consisting of a management board and a supervisory board. The latter's role is to oversee the everyday management decisions of the company, appoint members of the management board, and develop broad company policy. It is on the supervisory board that specific rights for employee representation exist in Denmark, Austria and Germany. Representatives of employees sit on the management boards of Sweden and Luxembourg. In Norway and France employees have representatives at both levels.

Germany has the oldest commitment to the principle, dating back to 1922. West Germany legislated in 1951 for parity employee representation on supervisory boards of firms in the coal, iron and steel industries. Employees elect these representatives, and unions may appoint a labour director to the management board. The Works Constitution Act of 1952 provided for one third elected employee representation on supervisory boards for other firms with over 500 employees. The 1976 Act on Workers' Codetermination improved the elected employee representation on supervisory boards to 50 per cent for all firms with 2,000 or more employees, and in 1995 this was extended to the public sector (Knudsen 1995, pp. 32-4, 44-5; Blanpain 1993, p. 26). In 1986 it was estimated that 30.5 per cent of all employees were covered by ERB provisions, but this proportion fell to 24.5 per cent in 1996 (Report of the Commission on Codetermination, 1998).

The Scandinavian countries also enjoy extensive ERB. In 1973 Denmark introduced ERBs for company boards of public limited liability companies. Since 1980 employees have been entitled to one third of supervisory board members in companies with 35 or more employees. Employee representatives are elected by all employees, including middle managers, and have the same rights and obligations as other board members. Representation rights require initiation by a ballot achieving at least 50 per cent employee support for the process (Knudsen 1995, pp. 90-1). In 1991 Finland enacted similar legislation (Kauppinen 1994, pp. 260-1). Norway has provided for employee representatives on both the supervisory and management boards of companies with over 30 employees. These representatives make up one third of directors at both levels and enjoy the same rights and responsibilities as other board members (Dølvik and Stokland 1992, p. 150).

Sweden also initiated employee representation on company boards in 1973. The local union may appoint at least two directors to the boards of private sector companies employing over 25 employees, with the proviso that employee directors are always to be in a minority. This right has been utilised in most larger and medium-sized forms, but more rarely in smaller organisations. Employee directors in Sweden enjoy the same status as other board members, except that they may not participate in discussions concerning collective bargaining or industrial action (Edlund and Viklund 1993, pp. 47-8; Levinson 2001, pp. 264-74).

In a number of former Communist eastern European countries employee representation also exists on company boards. The Hungarian Labour Code of 1989 provides for a third of the supervisory board members to be elected by employees in privatised firms employing over 200. Poland has similar provisions for private sector firms, and in both cases state enterprises retain substantial ERB (Kollonay-Lehoczky, 1997, pp. 171-85; Héthy 1993, p. 82; Nagy 1996, pp; 14-5; Sewerynski 1996, pp. 106-7). In the former Yugoslavian republic of Slovenia workers' participation in organs of the company is more extensive as a result of the tradition of self-management. Employees' representatives constitute at least a third of members of supervisory boards in companies up to 1,000 employees, and half in larger companies. In addition, a labour director is required on the management board of companies with 500 or more employees, to represent workers in personnel issues and matters of social policy (Kavcic 1997, p. 223).

Outside continental Europe systematic approaches to ERB are rarer. It is often the result of initiatives for statutory authorities or public enterprises. In Britain this phenomenon grew from the 1960s (Taylor 1980, p. 164). Usually these are union-nominated representatives. However, as a consequence of widespread privatisation of public sector enterprises, in developed economies such as Britain, as well as developing economies in Africa, the incidence of ERB has declined in recent years. This has been an indirect consequence of World Bank and IMF policies insisting on privatisation as a pre-requisite for economic aid in developing nations (Musa 2001, pp. 233-7). Where employee representatives on company boards occur in the private sector without statutory requirement, it has usually been a result of agreements between unions and management. For example, in the USA from the 1980s steel and airline companies included union-nominated directors on their boards in response to economic crisis, often alongside 'concession bargaining' by the unions to keep the companies afloat. (Strauss 2001, pp. 97-118; McKersie 2001, pp. 480-93).

Evaluation of effectiveness of international practices

ERB may be evaluated in two ways: first, as a form of employee participation in decision-making; and secondly, as a contributor to effective corporate governance. A number of limitations frequently have been identified with ERB as a form of employee participation in practice (Strauss 1998b, pp. 139-40).

a) Limited powers

In only few circumstances do employee representatives constitute a majority on the board, so that any union or employee expectations of wielding significant direct power in this environment are unlikely to be satisfied. Frequently, key decisions are not even made at the board level, and typically the board's major function is to ratify management decisions. Management exercises a significant degree of power through controlling the agenda and flow of relevant information. Management representatives might also meet in caucus prior to board meetings, which then become formalities. ERB's impact is more likely to be felt in improved transparency, information flow between management and employees, and in broad social or industrial relations policy approaches, rather than in 'wins' for employee representatives on specific issues.

b) Limited knowledge or skills base

In order to participate effectively in governance processes, some technical skills may be required. However, a fundamental dilemma commonly facing employee board representatives is their lack of background in evaluating accounting, legal, marketing and strategic data. On the other hand, it might be noted that few board directors with a business background would enjoy expertise in all of these areas. The problem may be dealt with by adequate induction and training processes for board members, and by maintaining a balance of expertise in different fields on the board.

c) Confidentiality

By custom or rule board members are expected to respect partial or total confidentiality concerning board deliberations. The potential of sensitive information reaching competitors is sometimes a concern of employers, especially where there are employee representatives reporting to national unions, but for employees the practice of confidentiality potentially hinders communications from their representatives. However, in those countries which practice extensive forms of employee board representation, the issues associated with confidentiality do not appear often to have become serious practical problems.

d) Communications

Observers have noted difficulty in communications frequently between ERBs and the employees whom they represent. However, this need not be an intrinsic problem which cannot be addressed in structural ways, such as creation of forums for reporting back, ERB membership of employee bodies such as union executives and works councils, or, in a less structured manner, through use of email.

e) Role conflict

A major issue facing ERBs is whether they are primarily representing employees' interests, which might be short term, or whether they are co-managers, primarily representing the welfare of the organisation as a whole. The manner in which this role conflict is constructed usually assumes that employees' interests are separate from, or even 'outside' those of the firm, and that managers' perceptions of what is best for the firm are necessarily free of self-interest and short-term objectives. Both assumptions are contestable theoretically and empirically. Nevertheless, role conflict is frequently experienced by ERBs in practice. Retrenchment and union-management issues are particularly likely to generate role conflict. One strategy adopted in Sweden and in some cases in the USA, has been for ERBs to absent themselves from deliberations directly relating to industrial relations matters.

It seems that these issues are dealt with best in those countries which approximate the stakeholder model of corporate governance more systematically. In Germany and some other European countries ERBs are only one manifestation of representative employee participation, with others including employee works councils and strong unions. The overwhelming theme of recent research which examines multiple forms of participation is that they are mutually supportive and work best as part of a broader system: participation begets participation. (Gollan and Markey 2001, p. 324). In cases such as those in the USA, where ERB has been introduced piecemeal and as a result of economic crisis, many of the disappointments associated with the practice of board representation seem more likely to emerge.

German structures of corporate governance have successfully fostered cooperative industrial relations. Employee representatives have tended to accept managerial prerogative in financial and production issues, in exchange for social concessions such as redundancy payments and redeployment policies. Nor has the existence of labour directors fundamentally altered management practice. They usually specialise in administration of social policies and personnel administration, contributing significantly to 'developing modern, employee-friendly personnel management styles' (Knudsen 1995, pp. 44-5). However, their loyalty to joint management decisions and the company as a whole transcends any sectional role as employee representatives, and the unions accept this situation generally. Together with the works councils, this codetermination system is credited with contributing significantly to German industry's competitiveness (Report of the Commission on Codetermination, 1998).

Other European examples also have offered positive outcomes. In Denmark the measures for ERB initially encountered resistance from some employers, and shareholder-elected directors sometimes held separate meetings to circumvent the provisions. However, studies have indicated strong support from employees, even though many felt that power effectively remained concentrated on company boards and that employee representatives were hindered by their secrecy obligation. Little impact on management practices has occurred, but there is wide acknowledgement that the system has generated greater employee understanding of management goals (Knudsen 1995, p. 91). For Sweden, Edlund and Viklund note that 'the right of representation on company boards has mainly come to be regarded as a means of keeping the union informed, rather than a means of directly influencing corporate decision-making'. Recent surveys have indicated a high degree of satisfaction with the system on the part of management, labour directors and unions (Edlund and Viklund 1993, pp. 47-8; Levinson 2001). Knudsen summarises the European experience thus:

> One should not underestimate the more invisible consequences of board-level representation. There is hardly any doubt that this institution increases the mutual information and understanding between the two parties, thus promoting a more trustful industrial relations climate less prone to conflict. At the same time, the relatively undramatic experience of participation at board level has defused the original attitudes of the parties to this issue (Knudsen 1995, pp. 103-4).

Australia, like the USA and Britain, has no statutory requirement for ERB. Systematic data relating to employee representation on Australian boards does not exist, nor is there a body of research literature examining the role and practices of ERB. However, we may elicit some idea of the incidence of ERB in the 1990s from the Australian Workplace Industrial Relations Surveys (AWIRS) of 1990 (Callus *et al.*, 1991) and 1995 (Morehead *et al.*, 1997). These surveys are based on workplaces with 20 or more employees, rather than organisations, which limits the inference of general conclusions.

AWIRS 1990 revealed that only 7 per cent of all workplaces surveyed had ERB (Callus *et al.* 1991, p. 125). Five years later this had grown to 13 per cent. No significant correlation was found between ERB and union presence or size of the workplace. However, there were significance levels of 99 per cent for correlations between ERB and public/private sector and industry.

Table 1 (see p. 131) shows that one in five public sector workplaces had ERB, twice as many as in the private sector. The industries where ERB occurred most frequently were education, health and community services and communication services, although not government administration. These industries are all dominated by public sector agencies. Government administration workplaces normally come under the control of public service departments which are not governed by a board structure, but are directly responsible to ministers. Health and community services and communication services, on the other hand, are characterised more by statutory authorities or corporations which are governed by boards: for example, area health services and Australia Post.

Education is more mixed, since it includes universities, which are clearly statutory authorities governed by boards (called councils), but also schools and TAFE colleges which have boards but do not enjoy the full autonomy of a statutory authority. Strictly speaking, these do not count as examples of employee representation on corporate boards of management in the sense that has been discussed here. Their exclusion would significantly reduce the incidence of ERB for the public sector.

Public sector influences also accounted for cultural and recreational services scoring relatively highly for ERB. In the subsection for libraries, museums and the arts, ERB occurred in 23.3 per cent of cases.

The relatively high incidence of ERB in the private-sector-dominated industries of property and business services, wholesale trade, and construction is not easy to explain, but otherwise the trends illustrated in Table 1 are not unexpected. Australian governments have instigated ERBs for statutory authorities and corporations from at least the 1950s, particularly at the state government level. In 1952 a trade union representative was included on the board of the newly established NSW Electricity Commission. Other state electricity authorities followed suit over the next few years, and in NSW the state dockyard and the railways also included ERBs, as did the State Superannuation Board (Baird 1978, p. 259). From the 1970s this became more common. State ALP governments did this as a matter of policy, led by the South Australian ALP Government of the 1970s. At the federal level ERBs also appeared on statutory authorities such as the ABC, Qantas and the Reserve Bank, particularly under the Federal ALP Government from 1983-96. In the last two of these instances, however, this was the result of appointment of a union official to a board vacancy, rather then the creation of a board position specifically for an employee representative.

Table 1: Percentage of workplaces with employee representatives on board by industry and sector

Industry	Percentage
Mining	2.7
Manufacturing	9.1
Electricity, Gas and Water Supply	6.8
Construction	11.4
Wholesale Trade	13.1
Retail Trade	5.9
Accommodation, Cafes and Restaurants	8.8
Transport and Storage	3.1
Communication Services	20.0
Finance and Insurance	6.9
Property and Business Services	14.9
Government Administration	7.2
Education	53.6
Health and Community Services	22.6
Cultural and Recreational Services	13.1
Personal and Other Services	9.7
Sector	
Private	9.9
Public	20.1
All workplaces	13.1

Source: Australian Workplace Industrial Relations Surveys (AWIRS) of 1995 (Morehead et al., 1997).

It is likely that the degree of public sector ERB has declined in recent years as a result of political choice and the process of corporatisation and privatisation of many public sector agencies. For example, in NSW the corporatisation of the TAB led to a board restructuring which lost employee representatives in the process. This occurred in a number of cases in Victoria under the Kennett Liberal Government during the 1990s. At the federal level similar processes have seen the loss of an employee representative on the Qantas board. Some of this loss of public sector ERBs is also the result of political choice, in the case of the Victorian Kennett Government and the post 1996 Federal Liberal/

National Government. The Reserve Bank, for example, no longer has an ERB. This case is an indication of how brittle the practice is when it relies on the *ad hoc* good grace of government, rather than structured positions.

Conclusion

The contemporary corporate governance debate warrants broadening to encompass consideration of ERBs. It seems a particularly apposite moment to examine forms of corporate governance which both recognise employees as legitimate stakeholders, and potentially provide internal corporate means for monitoring the activities of boards of directors and managers. European practice suggests that ERBs may play effective roles in corporate governance, to the benefit of management, employees and organisations as a whole, in the private as well as public sectors, in association with other extensive forms of employee participation, such as works councils and union representation.

European practices in ERB would not be easy to transport to Australia. The unitary board structures in this country do not lend themselves easily to some of the most significant models, such as in Germany, where ERB is based on a dual board structure. The Scandinavian experience offers more realistic possibilities for Australia, with ERB on management boards. Unlike Sweden, however, the Australian system could not realistically be based upon union-nominated ERB, since union coverage of the workforce is only about 27 per cent in Australia, and only 11 per cent in the private sector. A hybrid system of employee-elected representatives constituting a significant but minority bloc on management boards seems the best approach for Australia. This could be achieved by federal legislation under the corporations power of the Commonwealth Constitution, without significant extra costs to employers. Legislation is necessary to generalise the benefits of ERB, to provide equity in rights and obligations of ERBs between different companies, and to remove the process from the control or influence of either management or unions, and so contribute to building trust on both sides.

It is a manifestation of the narrowness of the corporate governance debate in Australia that no official data is collected concerning ERB, nor has it attracted the attention of researchers. In the first instance, therefore, we need to know more about the

13 per cent of workplaces, including almost 10 per cent in the private sector, which do practice ERB. What are the achievements in these cases, what structures work best, and how might they be encouraged? To what extent is ERB disappearing in the public sector? These are the issues for which we need data and intensive case studies. Only then can the issue enter the debate on corporate governance in an informed way.

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