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# Workers on Board
## the case for workers' voice in corporate governance

TUC

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Workers on Board: The case for workers' voice in corporate governance

by Janet Williamson, Senior Policy Officer, TUC

# Foreword by France O’Grady, TUC General Secretary

The British disease of short-termism has hampered our prosperity for too long. As the recent financial crash demonstrated only too well, an economy based on low rates of investment and short-term shareholder returns is simply not fit for purpose. The economic model that dominated over recent decades has delivered neither economic success nor social justice. It has led to poor productivity, low pay and wages falling as a share of GDP which in turn depresses demand and ultimately damages business too.

One root cause of these long running problems is the UK’s outdated corporate governance system, and the overwhelming priority it gives to shareholder interests and shareholder value. Corporate governance rules have failed to keep pace with the new world of share ownership. Today, over 40 per cent of UK shares are now held by shareholders overseas. And UK institutional investors generally spread their investments across hundreds if not thousands of companies, increasingly relying on short-term share trading to generate gains. Defending the best long term interests of a company and holding corporate Britain to account cannot be left to shareholders alone.

It’s time to take a fresh look at the role that wider stakeholders should play in our corporate governance system – including those companies often describe as “our greatest asset”. Workers could play a vital role in making their companies fit for purpose in the 21st century and help build genuine economic democracy. No company can succeed without dedicated and skilled staff, and no one knows a company better than its workforce. After all, whose interests are better aligned with long-term company success than the working people whose livelihoods and communities depend on it?

The majority of other EU countries, including many of the most successful, have well-established systems for workers to be represented within corporate governance, usually through representation on company boards. The TUC believes that corporate governance is in urgent need of reform and the time has come for the UK to join the mainstream and put in place its own system of worker representation, up to and including board level.

Giving workers a voice in company decision-making would be one important step toward creating the long-term corporate culture we desperately need if a stronger and fairer economy is to be a reality. Our long-run economic problems are well evidenced; now is the time to start shaping the solutions.

*"The presence of employee directors on the FirstGroup board is invaluable. The few drawbacks are greatly outweighed by the benefits and having this two-way channel of communication has positively impacted on the running of FirstGroup."*
**Martin Gilbert**, outgoing Chair of FirstGroup

*"It would be very desirable if there were more workers on boards."*
**Vince Cable MP**, Secretary of State for Business, Innovation and Skills, Hansard, 23 January 2012

*"Britain's potential has been held back by short-termism, hitting our ability to compete internationally in an increasingly globalised world. We are already developing a proper industrial strategy for government and Labour has backed significant changes to underpin long-term goals, such as ... putting employees – who often have longer-term priorities – on company boards."*
**Chuka Umunna MP**, Labour's Shadow Business Secretary, press release, 5 March 2013

*"Putting employees on board committees is something that obviously everybody would like to see happen. The closed shop of boards and board committees needs to change and we are taking measures to promote diversity."*
**Baroness Wilcox**, Conservative Peer, Hansard, 31 January 2012.

# Introduction

This paper explores the issue of workers' voice within corporate governance.

Company law and corporate governance in the UK prioritise the interests of shareholders over those of workers and other stakeholders. In addition, the UK – unlike the majority of other European countries – has no mechanism for worker voice or representation within its corporate governance system. There are no formal systems for ensuring that the interests of workers are taken into account in company decision-making, nor that the views of the workforce are heard or understood by company boards.

The TUC has long been critical of the priority given to shareholders in the UK's corporate governance system and has argued for many years that company law should be reformed to give greater priority to long-term company success and stakeholder interests alongside those of shareholders. However, even with these reforms, workers would still have no rights to representation or voice within corporate governance in the UK.

This paper argues that alongside reforms to remove the priority currently given to the interests of shareholders, mechanisms for workers' voice should be introduced into the UK's corporate governance system.

# Shareholder primacy in the UK's corporate governance system

## A crisis of corporate governance

There is now widespread public and political recognition that in the run-up to the financial crisis bank boardrooms made a series of decisions that were disastrous not only for the wider economy but also for their workforce, their customers and indeed their shareholders. The crisis therefore shone a light on the hitherto little-scrutinised world of corporate governance and the decision-making processes followed by company boards. As a result, there is also recognition that shareholder oversight of these decisions was at best lacking and at worst hampered by short-termism and conflicts of interests.

There have been two main public policy responses to the flaws in corporate governance revealed by the financial crisis. Firstly, in July 2010 the Financial Reporting Council published the Stewardship Code[1], which sets out standards that are expected of investors in relation to the companies whose shares they own. Secondly, the *Kay Review of Equity Markets and Long-Term Decision Making*[2], published in July 2012, proposed a number of reforms, including the adoption of Good Practice Statements by company directors, asset managers and asset holders, the establishment of an investors' forum and reform of both company directors' and asset managers' pay.

The TUC has long argued that short-termism is not restricted to the financial sector, but has persistently affected the quality of board decision-making more broadly, as demonstrated by the UK's long-run record of low investment, poor productivity and low pay, creating problems for both our economy and society[3]. We welcomed these reforms as small steps towards encouraging a long-term approach to company decision-making.

But while we recognise that these reforms have the potential to improve the workings of equity markets, even if fully implemented they would leave the basic principles of the UK's corporate governance system largely unchanged. The TUC therefore believes that more fundamental reform of corporate

1 www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx
2 John Kay, *The Kay Review of UK Equity Markets and Long-Term Decision Making Final Report*, 2012 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/34732/12-917-kay-review-of-equity-markets-final-report.pdf
3 See *TUC Economic Report Number 5*, February 2013, available at www.tuc.org.uk/tucfiles/522/EconomicReport5.pdf

governance is long-overdue and is now a matter of urgency if we are to build a stronger, more productive economy and avoid further crises in the future.

## Shareholder rights and interests

The UK's current corporate governance system is based on what can be termed 'shareholder primacy' or 'shareholder value'. There are two key elements to this: shareholder rights and directors' duties.

Shareholders are the only group with significant rights in relation to how companies are run. Shareholders, and shareholders alone, elect company directors, now annually in the FTSE 350, at company AGMs. Shareholders have had an advisory vote on company remuneration reports since 2003, and a binding shareholder vote on some aspects of executive remuneration is being introduced in October 2013. Shareholders can propose resolutions at company AGMs and can vote on all resolutions. They can convene EGMs. Shareholder representatives can and do engage regularly with company boards, using meetings, letters and phone calls to make their views known. This engagement is seen as exerting a discipline on company boards which makes it an essential part of our corporate governance system; thus a common response from Government and others in response to corporate misdemeanours is that 'it's a matter for the company and its shareholders'.

In the market for corporate control, shareholders again hold all the cards. Despite the major impacts that mergers and takeovers can have on all stakeholder groups, in particular workers, and indeed the company itself, the decision as to whether a merger or takeover goes ahead rests with shareholders alone.

However, the most fundamental right that shareholders enjoy is that under UK company law, directors' duties require them to promote the success of the company for the benefit of its members as their primary aim. In so doing, directors are required to have regard to the long-term consequences of their decisions, the interests of employees, supplier and customer relationships, and community, environmental and reputational impacts. However, these factors are to be considered in so far as they contribute to shareholder interests, rather than in their own right.

Directors' duties were codified for the first time in the Companies Act 2006, following the recommendations of the Company Law Review[4] in 2001. The justification put forward by the Company Law Review for requiring directors to prioritise the interests of shareholders was that in the long-term the interests

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4 The Company Law Review was set up by the in-coming Labour Government in 1999. It was tasked with carrying out a fundamental review of company law, including an examination of in whose interests companies should be run. Its final recommendations were set out in *The Company Law Review Steering Group, Modern Company Law for a Competitive Economy Final Report*, 2001

of shareholders converge with those of other stakeholders. According to this argument, long-term shareholder interests are best served by companies that develop a long-term strategic approach to company success, which will benefit all stakeholders and the wider economy. It is clear both from Parliamentary debate and from the Company Law Review's own reports that the intention behind the formulation used was to encourage companies to take the 'high road', rather than the 'low road', to business success.

But in practice, it is far from clear that the duties have had any positive impact on corporate behaviour, either in encouraging company directors to consider the impact of decisions on their stakeholders or in promoting a long-term approach to decision-making. There is also evidence that directors continue to regard their legal duty as being to maximise short-term shareholder interests. For example, a study carried out for the Association of Chartered Certified Accountants or ACCA found that executives generally regarded their duty as being to maximise their company's share price over the short-term[5].

## Weaknesses of shareholder primacy

The changing patterns of share ownership in recent years present a major challenge to the reliance on shareholder engagement within the UK's corporate governance system. In the 1960s, the majority of shares in UK companies were owned by individuals, many of whom took a reasonable level of interest in the companies whose shares they owned. By the 1980s, the majority of shares were owned by UK institutional investors such as pension funds and insurance companies. Today, this has changed again. The most recent figures from the Office for National Statistics (ONS) figures show that by the end of 2010, UK pension funds and insurance companies held just 5.1 per cent and 8.6 per cent of UK equities respectively, the lowest percentages since the survey started in 1963.

Thus by 2010, UK pension funds and insurance companies between them held just 13.7 per cent of UK equities, sharply down from a combined total of 43 per cent in 1998 and 26 per cent in 2008. In contrast, while individuals held 11.5 per cent, investors from outside the UK owned 41.2 per cent of UK listed shares[6].

It will by definition be harder for investors from outside the UK to develop the kind of engaged relationships with UK companies that are required if the UK's corporate governance system is to work as intended. Language, culture, proximity and availability of information all make engagement much more

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5 Collison et al, *Shareholder Primacy in UK Corporate Law: An Exploration of the Rationale and Evidence*, Certified Accountants Educational Trust (London), 2011

6 Office for National Statistics (ONS) (2012) *Ownership of UK Quoted Shares 2010*, available at: www.ons.gov.uk/ons/rel/pnfc1/share-ownership---share-register-survey-report/2010/stb-shareownership-2010.html Please note that the 2010 figures are not directly comparable with earlier figures because of methodological changes.

straightforward within a national context in comparison with engaging with companies abroad. This is reflected in the TUC's Fund Manager Voting Survey: in the 2012 Survey, all 27 investor respondents said they voted all their UK shares, while just seven voted all their overseas shares (with a further five stating that they voted a significant proportion)[7]. In addition, the dominance of overseas shareholders reduces the extent to which national societal expectations, for example, on executive pay or environmental impacts, will affect companies via their shareholders. The potential impact of national debate and consensus on corporate standards is considerably reduced if a large proportion of shareholders is unaware of it or feels no responsibility to take account of it.

However, engagement between UK investors and companies is also problematic. In contrast to individual domestic shareholders, who tend to hold shares in a limited number of companies in which they take a strong interest, institutional investors generally hold highly diversified portfolios. This means that for institutional investors, the sheer number of companies whose shares they own presents considerable practical obstacles to the quality and quantity of their engagement. The Investment Management Association (IMA) says that on average its members hold shares in around 450 different companies, and for many it will be in the thousands. The TUC's Fund Manager Voting Survey asks respondents each year about the size of their corporate governance and responsible investment teams. The 2012 Survey reported a reduction in staff focussing on these areas since the previous year. It found that the vast majority – 22 of the 28 respondents – had teams of less than ten people, and all but two had teams of less than twenty people[8]. However dedicated and skilled such staff may be, it cannot be possible for them to engage effectively with all the companies whose shares their funds own across the wide range of issues for which shareholders are ultimately responsible.

The IMA's own survey makes it clear that its members are wary of too weighty expectations being placed on their governance role: 'The fact that UK investors now own a smaller proportion of UK companies has implications for the corporate engagement role that investment managers play in the governance of companies. There is concern amongst investment managers that there should not be unrealistic expectations of what they can achieve through engagement.'[9]

The other side of this coin is that the shareholders of a large listed company will number in the thousands if not the tens of thousands. Bizarrely, given the central role of shareholders in corporate governance, it can be difficult for a company even to get full information on who holds their shares. This fragmentation is in contrast to many Continental European countries, where

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7 TUC Fund Manager Voting Survey 2012, available at www.tuc.org.uk/tucfiles/457/Fund%20manager%20survey%202012.pdf

8 ibid

9 Investment Management Association, Asset Management in the UK 2009-2010, July 2010

more concentrated shareholdings are the norm. Systems that support concentrated shareholdings are often viewed unfavourably by UK investors, the argument being that the existence of a dominant shareholder will weaken the influence of other shareholders. However, in countries where such patterns are more common, concentrated shareholdings facilitate engaged and long term relationships between companies and investors far better than the fragmented and diversified pattern of UK shareholding.

This issue was recognised by John Kay in his review of equity markets, and one of his recommendations was that fund managers should hold smaller portfolios of shares[10]. However, how this might come about as a result of Kay's proposals is not at all clear, given that the importance placed by fund managers on 'diversifying risk' continues to exert a strong pressure for diversified shareholdings.

Significant though these practical challenges to the effective operation of shareholder engagement are, there is a yet more fundamental problem with shareholder primacy. As noted above, the justification put forward by the Company Law Review for the privileged position of shareholders within the UK's corporate governance system was that in the long-term the interests of shareholders converge with those of other stakeholders and that long-term shareholder interests are best served by companies that develop a long-term approach to company success. However, this convergence of interests only holds true if shareholders are long-term investors whose economic interest in a company is in receiving dividend payments over a significant period of time. If, on the other hand, the shareholder is a short-term share trader whose economic interest is in selling the company's shares for more than they bought them for, their interest will be in short-term strategies to boost the company's share price, regardless of the impact on long-term, organic company growth. In this case, the investor's interests will not coincide with those of other company stakeholders, nor, crucially, with the long-term interests of the company itself. If the investor is shorting the stock, their interests will actually be diametrically opposed to those of other company stakeholders, including long-term shareholders, and indeed the company, as they will stand to gain if the company's share price falls. In this scenario, it is impossible to justify why shareholders are the group whose interests companies are required to promote, and why shareholders have the ultimate say over how companies are run.

Increasingly, even so-called long-term investors rely on strategies based on share trading, rather than long-term shareholding, to generate income from share ownership. Share trading is essentially a zero sum gain in terms of overall economic gain, as for each beneficiary of a transaction there will also be a loser. However, unless substantial reform of the way in which asset managers operate takes place, including in the area of contracts and incentives for

10 John Kay 2012, op cit

individual fund managers, the likelihood of fund managers adopting longer-term approaches to share ownership appears remote.

Investors' increasingly short-term approach to their shareholdings and reliance on strategies based on share trading rather than long-term share ownership cuts a deep hole in the UK's corporate governance system and leaves the arguments for shareholder primacy in tatters. But while this is divergence between the interests of short-term share traders and long-term company interests is a fundamental issue it was not addressed by either the Stewardship Code, which treats all investors the same, nor by the Kay Review.

The TUC strongly believes that there is is no logical reason why our corporate governance should prioritise the interests of share traders over those of other stakeholders, nor why share traders should occupy such a privileged position in terms of their rights in relation to companies. Fundamental reform of our corporate governance system is necessary and increasingly urgent.

## Proposals for addressing shareholder primacy

The TUC believes that directors' duties should be reframed to make directors' primary duty the promotion of the long-term success of the company, rather than prioritising shareholders' interests as at present. Serving the interests of shareholders and the different stakeholder groups currently included in Section 172 of the Companies Act 2006 should be secondary to this central aim. This would be closer to the original intention behind the directors' duties when they were codified for the first time in the Companies Act 2006. A possible formulation (based on the existing wording with minor changes) would be:

'The directors of the company are required to act in good faith to promote the long-term success of the company, and in so doing, should have regard to the need to:

i. deliver fair and sustainable returns to investors
ii. promote the interests of the company's employees
iii. foster the company's relationships with suppliers, customers, local communities and others, and
iv. take a responsible approach to the impact of the company's operations on human rights and on the environment.'

The TUC also believes that shareholders' corporate governance rights in relation to companies should be subject to a minimum period of share ownership, which we have suggested should be two years. This would help to curtail the role of short-term share traders in corporate governance.

But while the reforms set out above would be a significant improvement on the status quo, they would still leave shareholders as the only group with any significant rights in relation to corporate governance. The TUC further believes that if the voices of other key stakeholders are to be given due regard, wider reform will be necessary, as this paper now goes on to discuss.

# The case for workers' voice in corporate governance

The recognition fuelled by the financial crisis of the weaknesses of shareholder-value corporate governance systems has created a more propitious climate in which to promote the compelling case for workers' participation within corporate governance than has been the case for many years. There are growing numbers of voices calling for some sort of workers' participation in corporate governance and increasing discussion across the spectrum from political parties to investment and corporate governance groups of what this might mean in practice.

What follows is a brief discussion of:

- the case for workers' voice in corporate governance
- how workers' participation operates in other European countries
- UK practice that is relevant to this area
- the challenges and opportunities that could arise for unions.

## Benefits of economic democracy

As set out in the first section of this paper, the UK's shareholder dominated corporate governance system is at best ineffective and at worst dysfunctional. The TUC has long argued that corporate governance is in urgent need of reform. We believe that workers' representation on boards is one of the innovations our companies and economy need.

There are many factors behind the economic success of countries like Germany, Denmark, Austria and Sweden, and no one would argue that workers' participation is the only one. Nonetheless, the fact that countries with strong workers' participation rights perform better on a wide range of factors than those with weak workers' participation rights, is worthy of serious consideration by unions, companies and policy makers alike. The table below compares countries with high standards of worker participation (i.e., widespread rights and practices for board representation, workplace representation and collective bargaining) with countries with comparatively low standards. It shows that those countries with stronger participation rights score more highly across a range of important measures, including R&D expenditure, employment rates, educational participation among young people and educational achievement among older workers. What is more, these countries achieve both stronger economic success and a more equitable economic settlement: poverty and inequality rates are lower and use of low carbon energy higher than in countries with weaker participation rights.

**The European Participation Index (2008–2009 data)**

| Europe 2020 headline indicator | Group I Countries with stronger participation rights* | Group II Countries with weaker participation rights** |
|---|---|---|
| Employment rate by gender, age group 20-64 (2009) | 72.1 | 67.4 |
| Gross domestic expenditure on R&D (GERD) (2008) | 2.2 | 1.4 |
| Share of renewables in gross final energy consumption (2008) | 12.3 | 6.1 |
| Energy intensity of the economy (2008) | 171.2 | 181.7 |
| Early leavers from education and training (2009) | 14.0 | 16.1 |
| Tertiary educational attainment by gender, age group 30-34 (2009) | 36.6 | 31.1 |
| Population at risk of poverty or exclusion (2008) | 19.1 | 25.4 |

*Group I countries: Austria, Denmark, Finland, France, Germany, Greece, Luxembourg, the Netherlands and Sweden
**Group II countries: Belgium, Bulgaria, Cyprus, the Czech Republic, Estonia, Hungary, Ireland, Italy, Lithuania, Latvia, Malta, Poland, Portugal, Romania, Slovakia, Slovenia, Estonia, UK.
Source: Sig Vitols (2010), available at www.worker-participation.eu/About-WP/European-Participation-Index-EPI

While correlations do not in themselves prove causality, the evidence shows there are important reasons to believe that workers' representation on boards does contribute to company success elsewhere and would do so if introduced in the UK.

There are many reasons behind the positive impacts that worker representation can bring. Workers' interests are well-correlated with the long-term interests of the company, so worker voice can help boards to prioritise the long-term success of the company in decision-making, rather than being distracted by short-term financial engineering, as occurred for example in the financial sector in the run-up to the crisis. At the same time, by ensuring that companies take better account of workers' interests in their decisions, workers' representation on boards can contribute to improvements in the quality of working life for company workers, which can in turn boost productivity.

Workers also bring with them in-depth knowledge of how the company operates and are well-placed to contribute to a range of strategic and operational discussions that are central to board decision-making. As well as bringing the voice of workers to bear on company decision-making, their experience of working for the company is likely to give them understanding of the need to foster positive relationships with other stakeholders such as customers, suppliers and so on, relationships that are also critical to company success and where a short-term approach can do a lot of damage. Indeed, a Danish study found that employee representatives were more likely than shareholder representatives to take broader stakeholder interests into account, not just the interests of workers but also environmental impacts and community interests[11].

A study based on interviews with worker board representatives in 13 European companies presents a picture of worker representatives making a genuine difference to the way in which decisions are made, with their role contributing to 'the formation of a more balanced corporate strategy'[12]. Examples of their influence included cases where the worker representatives had recognised the risks of a merger strategy and had combined with some of the shareholder representatives to defeat the proposal; the rejection of plans for a new office block on grounds of cost; and a situation where a worker representative had argued against plans for outsourcing using arguments about exchange rates and other market factors that turned out to be right and convinced shareholder board representatives to reject the plans. The study shows that the influence of worker board representatives is based both on their role as a member of a key stakeholder group with in-depth knowledge of the day to day workings of their company and also on a sophisticated knowledge and understanding of the markets in which their company operates the and economic challenges it faces[13]. It also demonstrates that workers do not operate as lone adversarial voices, but often in partnership with others on the board in raising issues of shared concern.

The value of worker representatives is recognised by company representatives and other board members. A survey of Swedish managing directors and company chairpersons showed that 61 per cent of managing directors found the impact of worker board representation on the company positive, while just nine percent found it negative. Company chairpersons had a still more

11 Caspar Rose, "Medarbejdervalgte bestrelsesmedlemmer I danske virksomheder" in *Tidsskrift for Arbejdsliv*, 2005

12 Michael Gold, "Taken on Board: An evaluation of the influence of employee board-level representatives in company decision-making across Europe", *European Journal of Industrial Relations* 17(1), 2011

13 ibid

favourable view, with 69 describing the impact as positive while just five percent described it as negative[14].

## Risk and representation

Supporters of shareholder primacy sometimes argue that shareholder interests should be prioritised by companies because shareholders bear the greatest risk in relation to companies. This argument is contradicted by the reality, in which institutional investors hold highly diversified portfolios precisely to spread their risk, whereas the vast majority of company workers will depend on one company for continued employment.

The TUC believes that far from it being shareholders who bear a disproportionate risk in companies, it is employees who bear the greatest exposure. Few workers can simply leave one job and walk into another. They invest their labour, time, skills and their commitment in the company they work for, and cannot diversify this risk. If this investment goes wrong, for whatever reason, workers and their families pay a heavy price – the loss of employment and loss of income, skills, confidence and health that this can bring. All too often redundancy can mean the end of someone's working life, particularly for older workers.

If carrying risk gives rise to rights to representation and the protection of interests, this supports the case for workers' representation within corporate governance.

## The importance of voice

The most fundamental argument for workers' voice in corporate governance is very simple. Workers' interests are affected by the priorities and decisions of company boards and it is a fundamental matter of justice that they should be represented within those discussions.

For those in full-time employment, work takes up a very significant proportion of their waking time. Yet workers in the UK have very few rights in terms of their ability to influence this critically important part of their lives. Just as citizens of a country have a democratic right to influence the way in which their country is governed through selecting a representative to participate in its governance, so workers in a company should have the democratic right to select representatives to participate in their company's governance.

This doesn't mean that workers would or should exercise control. Even in the EU countries with the most extensive worker level board representation,

14 Klas Levinson, "Employee representatives on company boards in Sweden", *Industrial Relations Journal 32:3*, 2001. The question put to respondents was "What are your experiences of employee board representation and its advantages or disadvantages for the company?"

workers are not in a position to overrule a majority position from other board members. Having a voice does not mean having a veto.

## Worker representation on company boards in Europe[15]

In much of the rest of Europe, worker representation on company boards is an established and valued part of the corporate governance system. It is sometimes thought in the UK that worker representation on boards is a uniquely German phenomenon, but in reality it is countries like the UK that are in the minority in having no mechanism for workers' representation within its corporate governance system.

- Fourteen of the 28 EU Member States plus Norway (i.e. 14 out of 29) have significant rights for workers to be represented on company boards. These countries are Austria, Croatia, the Czech Republic, Germany, Denmark, Finland, France, Hungary, Luxembourg, the Netherlands, Norway, Sweden, Slovenia and Slovakia.
- In addition, there are five countries in which workers have more limited rights to board representation, mainly in state-owned or privatised companies. These are Greece, Ireland, Poland, Portugal and Spain.
- This means that in 19 out of 28 EU member States plus Norway (i.e., 19 out of 29) have some provision for workers' representation on company boards. If the analysis is narrowed to the European Union, 18 out of 28 Member States have some form of provision for worker representation on company boards.
- In the other ten countries there are no provisions for workers' representation on company boards. In addition to the UK, these are Belgium, Bulgaria, Cyprus, Estonia, Italy, Latvia, Lithuania, Malta and Romania. However, it is worth noting that in two of these countries, Bulgaria and Romania, there are other provisions for workers' voice in corporate governance.

There is no one model of workers' representation on boards across Europe, and the way in which workers' participation rights operate varies from country to country. These variations include:

- how worker representatives are nominated and elected
- who is eligible to become a worker board representative
- which companies are covered by requirements on workers' board participation
- the proportion or number of worker representatives required per board
- the board structure (unitary or two-tier) to which workers' participation rights apply.

15 This section draws extensively on a TUC report written by Aline Conchon, *Workers' Voice in Corporate Governance: A European Perspective*, TUC, 2013

In terms of how workers are selected, in a majority of countries, unions have nomination rights or are involved in the nomination of candidates in some way. There are also examples of Works Councils having nomination rights (sometimes alongside union nomination rights). In nearly all countries, candidates are elected by the workforce, but there are also a few countries where the appointment is at the company AGM (for example, the Netherlands and Hungary).

In the four Nordic countries, workers or unions need to trigger the worker participation rights; they do not apply automatically in all cases. Norway is an interesting case as workers' participation rights apply to all companies with over 200 employees, but below this threshold the rights need to be triggered by workers or unions.

In terms of eligibility, a majority of countries stipulate that worker representatives must be company employees. However, there are variations, and Austria restricts eligibility to Works Council members and a number of countries have no restrictions on eligibility. In Germany and Luxembourg, eligibility varies according to sector, and is restricted to trade union representatives in some sectors, while in others it is restricted to company employees. The Netherlands is a distinct case in which the representative cannot be a company employee, nor a trade union representative. The role is therefore carried out by people sympathetic to the labour movement but one step removed from it, such as academics.

The scope of requirements on workers' participation varies greatly. In most countries the rights apply to both private and listed companies, but four countries restrict rights to PLCs (the Czech Republic, France, Luxembourg and Slovakia). As has already been mentioned, there are five countries where workers' participation rights are restricted to state-owned or privatised enterprises.

The size of company covered by workers' participation rights varies significantly from country to country, and also in some cases within countries according to sector. In eight countries, workers' participation rights apply at state-owned enterprises regardless of company size. There are also two countries – Austria and Croatia – in which workers' participation rights apply to all PLCs regardless of size. However, most countries do apply a minimum size threshold for the application of workers' participation rights, especially for their private sector companies. These vary from 25 to 50 employees in six countries (Sweden, Denmark, the Czech Republic, Slovenia, Slovakia and Norway); 50 to 500 employees in seven countries (Croatia, Finland, Hungary, the Netherlands, in Austrian private limited companies and certain sectors in Germany and Spain); and to 1,000 employees in Luxembourg. The highest threshold is found in France, which in May 2013 adopted a law extending mandatory worker representation on boards to PLCs with at least 5,000 employees in France or 10,000 employees worldwide.

In terms of the number or proportion of worker representatives, again there are significant variations. The most common provision is that worker representatives should make up one third of the board. There are four countries where worker representatives make up half the board in some cases (Germany in companies with over 2,000 employees and in the Czech Republic, Slovenia and Slovakia where allowed for in company articles). However, even in these cases, workers cannot exert a blocking or binding vote against the whole of the rest of the board; in Germany and Slovenia the Chair, who always comes from the 'shareholder side', has a casting vote in the case of a tie.

There are also significant variations in terms of the corporate governance systems of the different countries involved. It is important to note that workers' rights to representation on boards apply in countries that operate with a unitary board structure (like the UK) as well as in countries that operate with a two-tier or supervisory board structure. This has particular relevance in the context of the UK corporate governance debate, where hostility (frequently based on second-hand anecdotes) is often expressed towards dual or two-tier boards systems.

Five countries – Sweden, Norway, Spain, Greece and Ireland – combine a unitary board structure with established worker participation rights. There are also nine countries where the unitary and two-tier board systems operate alongside each other and companies can choose which they adopt (Croatia, Denmark, Finland, France, Hungary, Luxembourg, the Netherlands, Portugal and Slovenia). In seven of these, workers' participation rights apply regardless of whether the company has a unitary or two-tier board, but in Hungary and Slovenia workers' participation rights apply differently according to the board structure adopted by the company.

Importantly, in all the countries where it exists, workers' representation on boards operates alongside unions carrying out their traditional role of directly representing their members' interests through collective bargaining (although as discussed above in many countries where workforce representatives must be company employees, it is very common for those employees to be union representatives or at least union members).

Overall, while worker representation on boards is very much the norm across Europe as a whole, there is considerable diversity in the way it operates and the form it takes. This is a useful counteraction to the argument that introducing worker representation on boards in the UK would somehow involve the 'imposition' of a 'foreign' system onto our own. In reality, workers' participation can operate in a huge variety of ways, and works well across a wide range of very different corporate governance systems.

In considering possible options for workers' board participation in the UK, there is much to learn from the existing systems across different countries, but it is clear that this is not something that lends itself to 'one size fits all'. There may nonetheless be elements from particular systems that could work well in the UK. It would be entirely possible to combine elements from different existing systems with new provisions to create a workers' participation framework that was uniquely suited to the UK context.

## Other mechanisms for worker voice in corporate governance in Europe

There are other mechanisms for worker voice in corporate governance that exist in some European countries, sometimes alongside board representation rights. These are referred to very briefly below.

- Worker 'consultative' representative in boardrooms
  There are four countries where workers have the right to attend and speak at board meetings and receive papers but cannot vote. In France, Norway and Sweden, this operates (in certain cases) alongside full board representation rights. It also exists in Romania, which does not have full board representation rights for workers.
- Worker involvement in selection of top management team
  In certain cases in Slovenia, Germany and Poland, the workforce is entitled to appoint or elect a member of the management team.
- Worker representation at the Annual General Meeting (AGM)
  Provisions exist for workers in certain cases to attend and/or submit a resolution to the company AGM in France, Sweden, Bulgaria, Hungary and the Netherlands.

If these additional mechanisms for workers' voice in corporate governance are included, there are 21 countries in Europe where workers have the right to be represented in some way within the governance of their company. While in most instances these non-board representation rights operate alongside workers' representation on boards, both Bulgaria and Romania have rights for workers' representation in corporate governance that operate in the absence of the right to full board representation. Again, there may be lessons for the UK here as to wider structures that could be adopted as we progress towards board level representation rights.

## UK precedents for workers' participation in corporate governance

In contrast to the European experience discussed above, workers and unions in the UK currently have no participation rights in relation to corporate governance. However, there are other areas in which unions and workers are well-practiced in carrying out a representative role which has parallels with board representation.

## Collective bargaining

Clearly, collective bargaining is the bread and butter of trade unions. While the role of union negotiators involved in collective bargaining with an employer is very different from that of a board representative, there are some important parallels that can be drawn.

Union representatives involved with collective bargaining recognise that company success is a prerequisite to providing good quality jobs for their members. There are numerous examples of unions working with employers to develop strategies to promote company success.

Opponents of workers' representation on boards sometimes argue that confidentiality would be an issue. In reality, there are times currently when union negotiators are put in the difficult position of being told confidential information about a company's situation that they are required not to pass onto their members. While being unable to pass information to members is challenging for union representatives in any situation, whether on a board or in a bargaining relationship, union representatives have demonstrated time and time again that when it is necessary for their role they are able to reconcile those concerns.

## Trade union member nominated trustees[16]

In trust-based pension schemes, scheme members have the right to nominate one third of the trustee board that is responsible for the scheme. A significant proportion of member-nominated trustees are union members and in some cases they are directly appointed by unions. All trustees have a fiduciary or legal duty towards scheme members, regardless of whether they are employer or member nominated trustees. However, both research and anecdote suggest that employer and member nominated trustees can at times take different approaches to the issues facing pension schemes and that member-nominated trustees play a very important role in securing positive long-term outcomes for fund members[17].

## Workplace green representatives

"Greenworkplaces" is a flagship project developed by the TUC and its affiliates across the public and private sectors.[18] There are around 1,200 trade union environmental or green representatives, working with their employers to promote green initiatives at their workplace. Projects and proposals are generally initiated by the union green representatives, and while some are one-off initiatives to tackle a specific area, others develop into to joint union-management green groups working to reduce the climate impact of their workplace on an ongoing basis. Projects have delivered significant energy and

16 The TUC organises a Trustee Network for trade union Member Nominated Trustees, with a regularly newsletter, annual Trustee Conference and other information alerts and events
17 Susan Sayce, *Pension Trusteeship and Diversity in the UK*, paper presented at the International Employee Relations Association Conference, Nijimingen, 2008
18 Six unions have their own green networks, and the TUC provides a regular newsletter, environmental training courses and holds an annual conference for union green representatives

cost savings, boosting job security for the workforce at the same time. For example, the Magor Brewery in Wales has seen its water usage drop by 46 per cent , its electricity usage drop by 49 per cent and heating bills drop 23 per cent, saving over £2m, since the Unite union initiated a company-wide focus on saving energy three years ago[19].

### Existing worker board representation

First Group has had an employee director since the company was created in 1989. The current employee director, who has recently taken over the role, is a union member and the company recognises unions as well as having an employee director on its board. Each division at FirstGroup elects their own employee director, and this group elects the employee director for the main board from their ranks.

Martin Gilbert, outgoing Chair of FirstGroup, described the company's experience in the following terms[20]:

"The presence of employee directors on the FirstGroup board is invaluable. The few drawbacks are greatly outweighed by the benefits and having this two-way channel of communication has positively impacted on the running of FirstGroup."

### Worker representatives on European Works Councils

Companies with 1,000 or more employees, including at least 150 in two or more Member States, are required to establish European Works Councils (EWCs). EWCs are bodies representing employees of companies operating across borders in different Member State. Their purpose is to inform and consult employees on transnational matters.

Around ten million workers across the EU have the right to information and consultation on company decisions through their European Works Council members. There are currently 155 EWCs set-up under UK law and there will be a UK presence on some other European Works Councils, so the number of UK EWC representatives is probably in the hundreds.

19 TUC, *Green Unions at Work* 2012
20 Speaking on 13 June 2013 at a PIRC seminar, Employees in Corporate Governance

# Making worker board level representation work in the UK

This is a challenging agenda for unions in the UK, as despite the precedents set out above, representation on company boards would be a new role for many workers and unions.

When the Report of the Bullock Committee[21] was discussed by the TUC General Council in 1977, there were different views expressed, with Jack Jones of the TGWU leading support for Bullock's recommendations, while others argued that, given the CBI's opposition, there should be a staged approach to enacting the principle of industrial democracy.

Much has changed since 1977. Union density is now 14.1 per cent in the private sector, and collective bargaining coverage is 16.9 per cent . The UK's shareholder value corporate governance system has revealed severe cracks in the light of the financial crisis. There is a new appetite across the political spectrum for re-examining the way companies operate and the priorities and rights that govern our economic system.

The TUC has called for worker representation on remuneration committees since 1995. This position has gained much wider support in recent years, and is now supported by the High Pay Centre, the Labour Party and the Local Authority Pension Fund Forum, among others. Worker representation on boards is a step beyond this measure, but the principle of workers being represented in significant company decision-making processes is the same.

The TUC therefore now believes that workers should be represented on company boards as full board members and that a legal requirement to establish a system for this should be implemented.

Worker directors would have the same rights and duties as other company directors, but be selected by and from the workforce. As this paper has shown, this would not require moving away from the UK's unitary board system, but could be incorporated within it.

21 Report of the Committee of Inquiry on Industrial Democracy, January 1977

## Addressing the challenges

There are a number of concerns that have been expressed by unions and employers as to how worker representation at board level could work in the UK, which are discussed in turn below.

### Co-option or influence?

In the past, fears have been expressed within the union movement that worker representation on boards could lead to unions being marginalised in their central organising and collective bargaining role. It has also been argued that workers would simply become 'co-opted' into management, or part of a system in which workers may continue to be exploited and which cannot be overturned from within.

Looking at the position of workers and unions across Europe provides useful evidence on this. As noted above, in all the countries in which workers have participation rights, union organisation and collective bargaining operate successfully alongside it. In many cases, unions are in fact an essential part of the system, with nomination and other rights in relation to workers' participation.

It is absolutely true that workers' participation on boards will not put an end to every redundancy, every bad corporate decision, and every hostile takeover. But it is equally true that having a voice at the decision-making table can give workers and unions the opportunity to have a real influence and to make a concrete difference to the culture and priorities of company boards and the lives of company workers.

Workers' representation is not a substitute for promoting union membership and collective bargaining across the private sector: the two go together and should be seen as part of a dual strategy to promote and protect the interests of workers. Alongside board representation, there is a vital need to boost union membership and collective bargaining rates, especially in the private sector. But while the promotion of board representation rights could give new impetus and potential gains to the organising agenda, it would never replace it.

There is a vital need to boost opportunities for workers' representation and voice in companies below board level. Given this, there is a strong case for introducing worker representation on boards as part of a wider package of reforms to strengthen information and collective consultation rights within the workplace. Introduced alongside strengthened information and collective consultation rights, worker representation on boards could be part of a new era of increased worker involvement and voice. The TUC will be developing proposals for reform in the wider area of workplace democracy in the coming months.

### Confidentiality and accountability

Many opponents of worker level board representation raise concerns as to whether workers could be trusted to treat confidential information appropriately. But the TUC believes this is simply not a significant barrier. The worker board representatives interviewed in the study referred to above were united in agreement that confidentiality and handling sensitive information was one of the greatest challenges they faced in their role[22]. However, they nonetheless managed to navigate this challenge, using a variety of strategies to comply with the confidentiality requirements of the board while reporting to and engaging with their colleagues. For example, one worker representative circulated information removing certain figures; another clarified in detail with management exactly what they could and could not pass on; another presented information in a more general form when producing a newsletter for staff; and another simply made clear to colleagues that the information he was passing on did not include confidential items.

As argued above, union representatives in the UK already navigate the complexities of confidentiality in their collective bargaining role and also when sitting on statutory and other bodies such as the Low Pay Commission and ACAS. Were worker board representation to be introduced, it would also be possible to develop guidance that would help worker representatives negotiate the balance between being accountable to and keeping in touch with their colleagues in the workplace and maintaining confidentiality requirements where necessary.

Just as pension fund trustees, whether nominated by employers or members, share a fiduciary duty[23] to scheme beneficiaries, so all company directors whether elected by shareholders or workers would share the same set of directors' duties. While the TUC believes that directors' duties should be reformed (as set out above), we do not believe that the current duties would prevent workers from playing a productive role on company boards. As already noted, workers are well placed to contribute to strategies to promote the long-term success of their company.

## Training and networks for worker board representatives

Concerns can also be expressed as to the skills and support that worker representatives would need to undertake their roles effectively. Of course, worker representatives on company boards would want training and the opportunity to meet and discuss their experiences with other worker representatives, and were this to be required the TUC is committed to working with unions and other organisations to fulfil this role.

The TUC already has experience of organising a network for trade union member-nominated pension fund trustees and providing networking opportunities for green representatives. It would be a natural role for the TUC to take the lead in this area and develop a network for worker board representatives. The TUC would also work with appropriate organisations to devise and deliver a training programme for worker board representatives that

22 Michael Gold 2011, op cit
23 A fiduciary duty is a legal obligation of one party to act in the best interests of another

helped them understand their role and gain the skills to analyse company information and participate in company decision-making effectively.

### Getting the details right

There would also, of course, be significant details that would need to be worked out were board level worker representation in the UK to become a reality. But this is not a barrier to implementation; as with any new area of policy, research and consultation could help to develop an appropriate UK policy solution.

The TUC is developing more detailed policies in relation to how workers representation in corporate governance could work in practice, and we recognise that there are a number of important issues relating to how workers' representation on boards could be implemented that would need to be debated and resolved. These include:

- the selection and eligibility criteria of worker board representatives
- the number or proportion per board of proposed worker representatives
- the organisation of training for worker representatives
- rights to time-off for board duties and appropriate compensation
- links with other mechanisms for information and consultation, including those facilitating feedback and discussion with colleagues.

# Conclusion

This paper has examined the flaws in the UK's current corporate governance system based on shareholder primacy and argued that corporate governance reform is necessary and urgent. There are three proposals put forward: reform of directors' duties so that directors' primary duty is to promote the long-term success of their company rather than prioritising shareholder interests as at present; making shareholder rights dependent on a minimum period of shareholding of two years; and establishing a mandatory system for the representation of workers on company boards.

Despite the precedents discussed in the paper, representation within corporate governance would be a new role for workers, employers and unions. Change is almost by definition unpredictable and innovation always carries risks as well as opportunities. However, failure to change and to grasp opportunities also carries significant risks: of persistent corporate short-termism, stagnating economic performance and a continued unequal distribution of the gains of growth.

Accommodating worker representatives on boards would of course present challenges to companies and existing board members. Yet it is also provides a great opportunity for UK companies to test their decision-making processes and priorities against the views of those who have most to gain and lose from company success or lack thereof – their workforce.

The TUC believes that economic democracy is an essential component of economic success and economic justice. Unions have a proud history of standing up for the vulnerable in society, championing struggles for justice and progressive reform and, above all, representing workers. Our role in making the case for workers' representation in corporate governance will form an important part of our case for progressive economic change in the years ahead.

The TUC produces regular reports on economic and social issues, providing up to date analysis and commentary on key policy debates.

You can also read TUC policy officers' comments on the issues in the report series and the ongoing economic situation at the TUC public policy blog:
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