

ECGI Roundtable on

Board Level Employee Representation

25 October 2017



Hosted by Imperial College, London

The ECGI Roundtable on Board Level Employee Representation took place on 25 October at Imperial College Business School in collaboration with the European Corporate Governance Institute (ECGI). The event focused on the role of employees in corporate governance against the backdrop of the recent UK Green Paper on corporate governance.

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Roundtable Report

by **Adelina Barbalau**



Discussions were structured around introductory briefings from academics and practitioners designed to prompt further interventions and debate between all attendees.

Board Level Employee Representation (BLER) is a reality in many European countries. In some cases BLER is voluntary, in other cases mandatory. The Roundtable, organised by Professors Marco Becht (Solvay School of Economics and Management) and Franklin Allen (Director of the Brevan Howard Centre for Financial Analysis) discussed the different approaches to BLER around Europe with practical examples from the UK and Denmark provided by representatives from companies with employee representation in place.

Employee Involvement in Corporate Governance – The Theory

Franklin Allen



Franklin Allen opened the programme with an overview of the theory underpinning employee involvement in corporate governance. He started by clarifying the academic finance literature view on the separation between ownership and control, and how this gave rise to a range of internal and external mechanisms for corporate control. He then introduced a question that was going to be subsequently touched upon, namely what is the purpose that the corporation should serve, and stressed not only stakeholder but also cross-cultural differences as far as the answer to this question is concerned. He mentioned a number of papers that argued against stakeholder governance on grounds of being biased against innovation (Hellwig, 2000) and of posing problems with correct incentives to managers (Tirole, 2001, 2006), as well as papers that support corporate governance on grounds of facilitating the implementation of stakeholders' concerns (Blair, 1995) and of providing the benefit of internal mutual monitoring (Allen, Gale, 2000). He concluded by noting the separation of academic research from the reality of corporate scandals involving revelation of fraud such as Kobe Steel, Volkswagen and Rio Tinto, which then prompted a number of interventions from attendees.

What is the purpose that the corporation should serve?

BLER in Europe – The Institutional Facts

Lionel Fulton



The institutional facts regarding Board Level Employee Representation (BLER) were introduced by Lionel Fulton, who gave an overview of the BLER picture across the European Economic Area countries (i.e. European Union plus Iceland, Norway and Lichtenstein). He gave a breakdown of the number of EEA countries that have BLER in private and public companies, the number of employees above which BLER starts (i.e. headcount thresholds), the number of board members that are employee representatives as well as the types of boards prevalent in different countries. He also discussed the question of who is chosen, noting that in most cases it is the leading employee representatives within the company but exceptions such as external union representatives exist, as well as the sort of powers that they have, which are usually the same as those of other board members. He then mentioned some regulatory changes that are currently underway and concluded that there is significant country heterogeneity in the legislative framework surrounding BLER at the European level.

There is significant country heterogeneity in the legislative framework

The European Company (SE) and BLER

Horst Eidenmüller



Horst Eidenmüller addressed the question of what can be learnt from the European Company (SE) experience for designing efficient models of BLER. He started by introducing the legal framework, whereby if a company incorporates as an SE, capital and labour must bargain over employee involvement with the implication that SE incorporation is not inconsequential for employee representation. He mentioned a number of studies documenting that companies reincorporate as SE to avoid or mitigate BLER and to streamline corporate governance, as well as event studies indicating that SE reincorporation has a positive effect on firm value. Furthermore, he noted that, taken together, these studies appear to suggest that the rigid German system of BLER (in terms of co-determination rules, board size, allowing only Germans as employee representatives) is not necessarily efficient. He concluded with policy recommendations, namely that there is a clear case to be made for more freedom of contract or flexibility with respect to member states that provide for mandatory BLER regimes. On the other hand, he expressed doubts about mandating any specific BLER model at the European level. The European lawmaker should confine itself to giving European firms the option to experiment with different governance/BLER regimes.

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The European Court of Justice TUI Ruling

Daniela Weber-Rey



Daniela Weber-Rey gave an account of the Ruling of the European Court of Justice in the TUI case concerning the employee participation mechanism set out by the German co-determination act introduced in 1976. She started with a couple of preliminary remarks of relevance to the case, namely that the German co-determination act applies to plants, subsidiaries and branches in Germany (with the implication that employees outside Germany do not count for relevant thresholds and are not represented on German boards) and it covers companies with more than 2000 employees (with the consequence that half of the board members are employee representatives). She then gave a brief account of a case preceding the TUI case, the Deutsche Boerse case on whether employees outside Germany should be included in the headcount threshold that takes a company in the realm of co-determination; the Regional Court decided that it should be the case but a final ruling is yet to be made. As for the TUI case, it was brought to the European Court of Justice on grounds that the German Law on employee participation is not compatible with EU law as it infringes the right of non-discrimination based on nationality (since only the employees of the group employed in Germany may elect the employees' representatives on a company's supervisory board and be elected to that board) and the right to free movement (since employees lose their membership on the supervisory board in the case of transfer to another Member State). The European Court of Justice ruling in this case was that the German Law on employee participation is compatible with EU Law. It rejected the territoriality principle but lacks clarity with respect to many other issues. She concluded by discussing some of the remaining challenges and uncertainties.

BLER from a Comparative Law & Economics Perspectives: Past and Future

Martin Gelter



Martin Gelter discussed BLER from a comparative legal perspective. He first talked about the historical development of the corporation viewed as a separate legal entity and the idea of democratizing the corporation. He then noted that corporate law scholars are prevalently of the opinion that there is no role for employee participation and this opinion is mainly underlined by the idea of shareholder primacy and the view that shareholders are the only residual claimants. He then discussed some arguments why employee participation may be desirable, namely the human capital argument whereby BLER would serve to protect employees from hold-up problems, the ‘varieties of capitalism’ argument whereby BLER is viewed as a complementarity that may or may not match the capitalist institutions in place in a country, as well as the pension argument whereby defined benefit pension schemes essentially expose employees to the credit risk of the firm. He also noted that BLER can potentially leave scope for sensitive information to be withheld from the supervisory report to avoid disclosing it to employees, as well as the fact that BLER would provide an advantage in terms of providing unique information to the supervisory board. The ensuing discussion touched upon the role of social peace and the fact that co-determination and other systems giving high weight to employees tend to come in periods of social unrest.

What is the impact of BLER on corporate behaviour and performance? - The empirical challenges

Ernst Maug



Ernst Maug discussed the empirical challenges inherent to studies assessing the impact of BLER on corporate behaviour and performance. He started by noting that in incomplete, imperfect markets a stakeholder corporate governance system stressing cooperation between management and employees (i.e. co-determination) may allocate resources more efficiently than a shareholder system. He then considered the arguments in favour of and against co-determination, and gave a comprehensive overview of the empirical studies on the subject, which he grouped in three categories: studies examining the impact of co-determination on stock returns, on market-to-book ratios, and on performance ratios. None of these groups provide conclusive evidence regarding the impact of BLER on corporate performance and they are all subject to shortcomings related to data, to the fact that none of those measures fully capture the impact of BLER on firm value and more generally to the presence of multiple dimensions of corporate governance that interact in ways that are difficult to capture. The speaker then discussed an alternative empirical approach, which entails examining companies' revealed preference and in particular he noted that companies never opt to use BLER voluntarily but do not seem to try to avoid it either. He concluded by arguing that the empirical literature is inconclusive but firm behaviour seems to suggest that there are no first order gains from having employee representation or from avoiding employee representation. In the ensuing discussion the issue of board pre-meetings that exclude employees was again brought up.

The Nordic BLER Model in a Comparative Perspective

Steen Thomsen



Steen Thomsen started by stressing the difference between employee representatives and employee elected board members, the latter of whom should represent the interests of the company and not the interests of a particular group. He then compared the German system with the Nordic system, one important point of difference being the share of representation, namely 1/2 in Germany and 1/3 in the Nordic countries. Another important point was that although employee representation is voluntary in the Nordics, most employees choose not to be represented on the board, especially in small companies. From the company's perspective, the arguments against and in favor of employee representation were the tendency of employee representatives not to contribute and the fact that employee representation helps in crisis situations, respectively. In terms of revealed preferences, he presented evidence that companies tend to choose board sizes that minimize employee representation. He concluded by noting that initiatives such as employee as well as gender board representation should not necessarily be judged in terms of impacting firm value but in terms of changing societal values and setting models which engender long term cultural changes. Strictly speaking, because of fundamentals of company law, there are no employee representatives in any country since the employee-elected directors must act in the interest of the company and not in the particular interests of the employees (the same applies to shareholder-elected directors which cannot only take the interests of shareholders into account).

Companies tend to choose board sizes that minimize employee representation

Danish BLER in Practice

Jacob Møllgaard and Amira Laila Bada

Jacob Møllgaard gave an insight into board level employee representation in Denmark by sharing his practical experience as a board member of a Danish bank. He spoke of his role as expert in practical company-related matters, gave assurance about the secrecy of information revealed in the board meetings and said he never encountered an instance of separate board meetings excluding employees. He also shared his experience with the recent privatization of the bank and described the role that he, as an employee representative, plays in terms of facilitating communication between employees and the board.



Highlighting the role that an employee representative, plays in terms of facilitating communication between employees and the board.

The UK BLER Discussion

Peter Montagnon



Peter Montagnon discussed BLER in the UK, and in particular the Green Paper prompted by the prime minister's announcement that UK companies should have employee representation at board level. He started by giving a background of the political climate that preceded the announcement and then highlighted some of the main points of the consultation document. The debate on whether there should be legislation requiring companies to appoint worker representatives on boards was strongly supported by trade unions, an important argument behind this being the fact that employees have a bigger long-term stake in company than executives. However, the majority of responses to the consultation were not sympathetic to the idea of having workers on boards, on grounds that this can potentially undermine the concept of a unitary board. The government's response in the Green Paper was to propose a choice between having one worker representative on the board, a formal employee advisory council or one designated non-executive director. He also noted that the government's response did not mention the sustainability ethics committees that a lot of companies have. He concluded by stressing the importance of employee satisfaction for the future of companies.

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FirstGroup - A UK Plc with BLER

Silvana Glibota-Vigo and Jimmy Groombridge

Silvana Glibota-Vigo and Jimmy Groombridge, deputy company secretary and group employee director respectively of FirstGroup, a public limited company in the UK with BLER, talked about the company's experience with employee representation. Silvana Glibota-Vigo started by giving a brief overview of the company's history and stressed the fact that they had employee directors in the boards of the operating companies since the company's very start in 1989. She explained the process of election, whereby a candidate elected by colleague employees is put forward to the nomination committee for assessment, which will subsequently make a recommendation to the board for shareholders to vote on. She concluded by saying that the group's experience with BLER has been very good and they never encountered any problems. Jimmy Groombridge then took over and described his experience as group employee director on the board. He emphasized the fact that no information was withheld from him while fulfilling his duties as an employee director and he always felt like an integral part of PLC board. He described his role as an essential communication bridge between the board and employees and gave a detailed account of instances in which he acted as a conduit conveying messages from the board to the employees and vice versa.



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About the European Corporate Governance Institute (ECGI)

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The ECGI is an international scientific non-profit association which provides a forum for debate and dialogue focusing on major corporate governance issues and thereby promoting best practice. It is the home for all those with an interest in corporate governance offering membership categories for academics, practitioners, patrons and institutions.

Its primary role is to undertake, commission and disseminate research on corporate governance. Based upon impartial and objective research and the collective knowledge and wisdom of its members, it can advise on the formulation of corporate governance policy and development of best practice. In seeking to achieve the aim of improving corporate governance, ECGI acts as a focal point for academics working on corporate governance in Europe and elsewhere, encouraging the interaction between the different disciplines, such as economics, law, finance and management.

About the Brevan Howard Centre for Financial Analysis

<https://www.imperial.ac.uk/business-school/research/brevan-howard-centre-for-financial-analysis/>

The Centre dramatically enhances Imperial College Business School's expertise in financial economics and strengthens ties with other disciplines including engineering and computational finance. A key objective of the new initiative will be to disseminate rigorous, world-class research to reach and engage business practitioners, policy-makers, legislators and the wider public, as well as other academic experts. The new Centre will serve as a bridge between the Business School and the world of business, aiming to develop a greater understanding and more efficient management of risk, and to promote investment and productivity.

