

THE ROLE OF EMPLOYEES IN GLOBAL CORPORATE GOVERNANCE

ISABEL FLAY*

I. INTRODUCTION

Employees are stakeholders in a corporation and are interested in the outcome of decisions that affect them directly and indirectly. It is important for employees to have a role in corporate governance and the ability to participate in the decision making of the corporation in order for them to protect their interests as unsecured creditors. The purpose of this paper is to determine what influence or control employees have over decision making in regard to the management of the corporation they are employed by. I propose to conduct a comparative analysis of the role of employees in corporate governance in: Germany, Japan, the United Kingdom and New Zealand. I further propose to consider the possibility of global harmonization or convergence of one model of employee participation: by looking at the impact of globalization on corporate governance generally; two attempts that have been made to harmonize company law over multiple nations; as well as the advantages and disadvantages of doing so. I will then conclude that certain models of governance are successful within their respective cultures but may not easily be adopted by other jurisdictions. In theory convergence and harmonization of law may evoke illusions of consistency and certainty; in practice a multitude of barriers would arise to prevent such a system being implemented and succeeding. Firstly, I will introduce this topic by defining corporate governance; introducing the stakeholder theory with a particular emphasis on employees; including the interests employees can protect by participating in corporate governance; and the benefits of undertaking a global comparative analysis.

Corporate governance is an ambiguous term with many variations depending on the historical and cultural background of the country defining it. In its narrow sense corporate governance refers to 'the system by which companies are directed and controlled';¹ and the systems by which those in control are held accountable.² In its wide sense corporate governance refers to the entire corporate sector, as well as the impact on society and everything within.³ Somewhere in between these two extreme definitions is the concept of corporate governance as viewed and shaped in light of the distinctive background of each country.⁴ Despite the different backgrounds, in general, the underlying concept of corporate governance as defined by each country is basically the same: systems of legitimacy of corporate power; accountability of those in control; method of governance

* LLB Honours student, University of Waikato.

1 Jonathan Charkham, *Keeping Good Company: A Study of Corporate Governance in Five Countries* (1995) 1.

2 John Farrar, *Corporate Governance: Theories, Principles and Practice* (2nd ed, 2004) 3.

3 *Ibid* 6.

4 *Ibid*.

and decision making; regulation of the corporation; and the role of the corporation in society.⁵ Corporate governance is the totality of the structure and relationships among the core groups involved in fostering competitive performance and achieving the key objectives of the corporation.⁶

Internal corporate structures are organized differently from country to country; the key difference is the emphasis each company puts on different stakeholders. Corporate governance also concerns the management of a corporation as influenced by its many stakeholders. In particular it refers to the process of decision making, including the resolution of conflicts of interest between various stakeholders, control rights and intervention in order to determine how important decisions are made.⁷ The indirect effect of this is that employees have an important role in corporate governance. The 'stake' employees have in a company is created by their 'input of human capital particularly of long-term employees who have worked to consolidate specialist skills attributable to the company to assist with maintaining a successful business'.⁸ Employees need to participate in governance in order to protect their stake in the corporation (which is largely remuneration in return for labour); this is achieved through their power to influence decision making over certain aspects of the corporation's activities. The success of the corporation therefore effectively protects employee interests and it should be expected that employees have a right to some control and influence over decision making to ensure that their interests are adequately protected.⁹

By participating in corporate decision making employees are able to protect their entitlement to receive remuneration for their services. Employees are unsecured creditors of a company, and therefore they are generally not given the highest priority when a company is put into receivership. A creditor is someone to whom the company owes money; a secured creditor is someone who has a secured interest (such as a mortgage) in the debt owed by the company; an unsecured creditor does not have such protection.¹⁰ Employees are creditors if the company owes them money in return for the services and labour they have provided.¹¹ Except in systems that give priority to employees,¹² they must join the queue with the other unsecured creditors in order to receive any of the insolvent company's assets, after the secured creditors have received their share.¹³ It is not uncommon for employees and other unsecured creditors to miss out or receive a lesser amount than they were entitled to.¹⁴ Employees rely on the company not only for employment and weekly wages,¹⁵ but also for other entitlements such as annual leave, sick leave and redundancy payments. Employees generally have no other recourse and no voice in winding up of the company and

5 Ibid 504.

6 Adrian Davies, *Best Practice in Corporate Governance: Building Reputation and Sustainable Success* (2006) 3.

7 Stefan Prigge, 'A Survey of German Corporate Governance' in Klaus Hopt, et al (eds), *Comparative Corporate Governance: The State of the Art and Emerging Research* (1998) 945-6.

8 Andrea Corfield, 'The Stakeholder Theory and its Future in Australian Corporate Governance: A Preliminary Analysis' (1998) 10 *Bond Law Review* 213, 214.

9 John Boatright, 'Employee Governance and the Ownership of the Firm' [2004] 14 *Business Ethics Quarterly* 2.

10 Australian Securities & Investment Commission, *Information Sheet 54: Receivership: a guide for creditors* (2008) 1 <<http://www.asic.gov.au>> at 25 February 2008.

11 Ibid.

12 Ibid.

13 Ben Dunstan, *Protecting Employee Entitlements in an Insolvency* (2000) Allens Arthur Robison 'Introduction' <<http://www.aar.com.au/pubs/insol/insolfeb00.htm>> at 25 February 2008.

14 Ibid.

15 Ibid.

possess little bargaining power; yet they stand to lose the most.¹⁶ Employees usually enter into their employment contracts without intentionally assuming any risk that their employer may go into receivership and be unable to remunerate them.¹⁷ By permitting employees to participate in corporate decision making they are able to individually participate in ensuring the success of the company and the protection of their interests.

Comparative law is important because it enables us to gain a better understanding of our own national law so we can work toward improving it; as well as assisting our understanding of other countries and cultures for development of favourable international relations.¹⁸ One can draw upon the experience of all nations and broaden awareness of contemporary world realities and the need for co-existence of nations.¹⁹ 'Comparative corporate governance involves comparing different national systems of corporate governance';²⁰ by looking at the significant features in a society which has developed successful law we can improve our own. Global harmonization of employee participation in corporate governance would require the development of a legal framework satisfactory to all countries. Such a development would require a close analysis of the current of laws, cultures, and practices within each society to determine the underlying fundamental aspirations which will be needed to provide the basis of any successful harmonization attempt.²¹

II. GERMANY

Employees have an important role in German corporate governance; they participate in decisions that affect them directly through workers councils, as well as those that affect the corporation through union representation on the supervisory board.²² The German corporate governance system is characterized by the two-tier (management and supervisory) board; with codetermination between employees and shareholders on the supervisory board.²³ This system is concerned with the long-term success of the company, and was developed for reasons of social governance,²⁴ protection of public interest as extending beyond shareholders,²⁵ and to reduce employee alienation.²⁶

16 Gordon Johnson, *Insolvency and Social Protection: Employee Entitlements in the Event of Employer Insolvency* (2006) Organisation for Economic Co-operation and Development 2 <<http://www.oecd.org/dataoecd/42/38184691.pdf>> at 3 February 2008.

17 Ibid.

18 John Brierley and Rene David, *Major Legal Systems in the World Today* (1985) 4-9.

19 Ibid 17.

20 John Farrar, 'In pursuit of an appropriate theoretical perspective and methodology for comparative corporate governance' (2001) 13 *Australian Journal of Corporate Law* 1, 2.

21 See generally, Farrar, *Corporate Governance: Theories, Principles and Practice* (2nd ed), above n 2, 498-515.

22 Katharina Pistor, 'Codetermination: A Sociopolitical Model with Governance Externalities' in Margaret Blair and Mark Roe (eds), *Employees and Corporate Governance* (1999) 165-6.

23 Marc Goergen, Miguel Manjon, and Luc Renneboog, 'Corporate Governance in Germany' in Kevin Keasey, Steve Thompson, and Mike Wright (eds), *Corporate Governance: Accountability, Enterprise and International Comparisons* (2005) 315.

24 Farrar, *Corporate Governance: Theories, Principles and Practice* (2nd ed), above n 2, 465.

25 Klaus Hopt, 'The German Two-Tier Board: Experience, Theories, Reforms' in Klaus Hopt, et al (eds), *Comparative Corporate Governance: The State of the Art and Emerging Research* (1998) 230.

26 Farrar, *Corporate Governance: Theories, Principles and Practice* (2nd ed), above n 2.

Germany has a consensual approach to decision making²⁷ and encourages labour participation by treating employees as stakeholders. By participating directly in corporate decision making,²⁸ employees have some degree of influence and control within the corporation.²⁹ The idea of bringing political democracy into economic life and creating institutional democracy means that employees are given a voice and an important role in the functioning of the corporation.³⁰ A traditional key concept of German corporate culture is the assumption that the corporation exists to benefit the community as a whole, and thus the continuation of the company is of utmost importance, leaving shareholder profit as a secondary, long term, aspiration.³¹ The role of employees in German corporate governance is one of influence and control over corporate decision making in a cooperative and stakeholder maximizing atmosphere.

The modern concept of codetermination goes back to 1919, and the general concept of worker participation goes back to the 1830s.³² The Nazis in 1933 put an end to the work councils and unions that were in place at the time;³³ the current system of employee participation in corporate governance arose out of the aftermath of World War II. Trade unionists and occupational authorities 'vowed that the nation never again would fall into the dictatorial pattern of the Third Reich'.³⁴ After the catastrophic experience the nation faced under the Nazi dictatorship, Germany became even more passionate about democracy.³⁵ Since then Germany 'has been leading a peaceful revolution in industrial relations'.³⁶

Success of the corporation depends on cooperation between two distinct organs in the two-tier board; the Vorstand and Aufsichtsrat.³⁷ It is mandatory for companies with over 500 employees to separate the management and supervisory functions of the board.³⁸ The Vorstand is the management tier and 'is responsible for independently managing the enterprise. In doing so, it is obliged to act in the enterprise's best interests and undertakes to increase the sustainable value of the enterprise'.³⁹ It is also responsible for developing and implementing strategy;⁴⁰ ensuring all laws are complied with⁴¹ and appropriate risk management is in place.⁴² The Aufsichtsrat is the supervisory tier of the board; its role includes not only appointing the management tier but also 'to advise

27 Sigurt Vitols, *German Corporate Governance in Transition: Implications of Bank exit from monitoring and control* (2005) Wissenschaftszentrum Berlin für Sozialforschung 13 <http://www.wzb.eu/gwd/into/pdf/vitols/vitols05_gcg_transition.pdf> at 6 February 2008.

28 James Furlong, *Labor in the Boardroom* (1977) 1.

29 Christel Lane, 'Changes in Corporate Governance of German Corporations: Convergence to the Anglo-American Model?' (Working Paper No 259, ESRC Centre for Business Research, University of Cambridge, 2003), III.3.

30 Furlong, above n 28, 2.

31 Jonathan Charkham, *Keeping Better Company: Corporate Governance Ten Years On* (2nd ed, 2005) 30-32, 94.

32 Furlong, above n 28, 15.

33 *Ibid* 16.

34 *Ibid* 2.

35 *Ibid* 28.

36 *Ibid* 1.

37 Charkham, *Keeping Better Company*, above n 31, 62.

38 *Ibid* 44.

39 *German Corporate Governance Code 2002 – The Cromme Code* (GER) s 4.1.1.

40 *German Corporate Governance Code 2002 – The Cromme Code* (GER) s 4.1.2.

41 *German Corporate Governance Code 2002 – The Cromme Code* (GER) s 4.1.3.

42 *German Corporate Governance Code 2002 – The Cromme Code* (GER) s 4.1.4.

regularly and supervise the Vorstand in the management of the enterprise. It must be involved in decisions of fundamental importance to the enterprise'.⁴³

The supervisory tier is balanced by the codetermination of shareholders and employee representatives.⁴⁴ Under the traditional codetermination model, one-third of the supervisory board was comprised of workers' representatives, and employers were not allowed to be representatives on the management board.⁴⁵ Depending on the size of the company, employee representation can be up to fifty per cent of the supervisory board.⁴⁶ The chairman, who is a shareholder representative, has the casting vote if a deadlock is reached.⁴⁷ 'Since the supervisory board appoints the management board members, workers can indirectly influence the management'.⁴⁸ The ideology of codetermination is that labour and capital have equal importance and therefore should have an equal voice in running the company; in that regard employees are as much a part of the company as shareholders. This model of corporate governance does not prevent companies giving orders to employees, but aspires to ensure 'democratic legitimation' through consent from employees.⁴⁹

The current law regulating governance of listed companies is the German Corporate Governance Code which aims to make the system transparent and understandable.⁵⁰ Non-listed companies are also advised to respect the code. As with any system, German corporate governance has positive and negative aspects evident when it is scrutinized from different perspectives. Employee representation has been criticized as causing weakness in the control function of the supervisory board through fractionalization; the holding of separate meetings;⁵¹ as well as being inefficient in making decision due to the time taken to collaborate and make informed decisions. Nevertheless, the German system of employee representation and concern for long-term interests has been a successful system of corporate governance for more than four decades.⁵² In general, the social consensus is that 'codetermination is a great achievement because it contributed to, if not caused, social peace between labor and capital'.⁵³ The success of the innovations in this system are evident as Germany is rich,⁵⁴ has a successful economy,⁵⁵ as well as 'one of the lowest strike rates among major Western industrialized nations'.⁵⁶ Furthermore, codetermination has proved to be efficient as it is rare for employee representatives to vote against measures which are important to the future of the company.⁵⁷ As well as giving employees the right to participate in decision making, co-

43 *German Corporate Governance Code 2002 – The Cromme Code* (GER) s 5.1.

44 Goergen, Miguel and Renneboog, above n 23, 307.

45 Thomas Conlon, 'Industrial Democracy and EEC Company Law: A Review of the Draft Fifth Directive' [1975] *International and Comparative Law Quarterly* 348, 352.

46 Davies, above n 6, 22.

47 Goergen, Miguel and Renneboog, above n 23, 303.

48 Takeo Hoshi, 'Japanese Corporate Governance as a System' in Klaus Hopt, et al (eds), *Comparative Corporate Governance: The State of the Art and Emerging Research* (1998) 855.

49 Furlong, above n 28, 134.

50 *German Corporate Governance Code 2002*, above n 39, para 1.

51 Hopt, above n 25, 247.

52 Diane Denis and John McConnell, 'International Corporate Governance' in Kevin Keasey, Steve Thompson and Mike Wright (eds), *Corporate Governance: Accountability, Enterprise and International Comparisons* (2005) 260.

53 Pistor, above n 22, 188.

54 Furlong, above n 28, 134.

55 Conlon, above n 45, 351.

56 Furlong, above n 28, 134.

57 Hopt, above n 25, 247.

determination also promotes trust, cooperation, and harmony; employers believe that an informed and trusted employee is more likely to have the best interest of the company at heart.⁵⁸ Therefore 'workers can influence the management through other institutional arrangements without formally owning the firm'.⁵⁹

III. JAPAN

Employees play an important role in Japanese corporate governance and informally participate in decision making by virtue of their stakeholder status. The key characteristics of the Japanese model of corporate governance are based on a stakeholder philosophy,⁶⁰ the roots of which can be traced back to German origins.⁶¹ The concepts of 'obligation', 'family' and 'consensus' are the main characteristics that affect Japanese attitudes towards corporate governance.⁶² The corporate ownership structure traditionally involved clusters of companies and cross-shareholdings consisting of developed, longstanding, stable relationships within the group of companies and their main bank.⁶³ The traditional company was a merchant house wherein the relationship between employers and employees was similar to a family situation; and it was thought that employees should stay with one company for life.⁶⁴ Lifetime employment involved long-term commitment and reciprocal obligations from both the corporation and employees.⁶⁵

Technically the shareholders own the corporation, but it is commonly thought that the corporation is owned by the employees and is operated in their best interest.⁶⁶ Profit is recognized as essential for the survival and successful functioning of the company, but is not the primary aspiration.⁶⁷ It is not uncommon for a company, in financial difficulty to cut dividends before firing employees.⁶⁸ The need to appeal to employees is also recognized, as it is common for employees to recruit the employer and not vice versa. 'At the extreme, 'star' employees can hold the company to ransom'.⁶⁹ The Japanese style of management has a collaborative approach to decision making,⁷⁰ which reflects the consensual nature of the company.⁷¹ The pride in this Japanese style of management is reflective of the rising productivity levels, especially between 1964 and 1983.

58 Charkham, *Keeping Better Company*, above n 31, 39.

59 Hoshi, above n 48.

60 Sanford Jacoby, *The Embedded Corporation: Corporate Governance and Employment Relations in Japan and the United States* (2005) 1.

61 Hiroko Kiguchi, 'Japan' in George Dallas (ed), *Governance and Risk: An Analytical Handbook for Investors, Managers, Directors, and Stakeholders* (2004) 414.

62 Charkham, *Keeping Better Company*, above n 31, 108.

63 Kiguchi, above n 61, 411.

64 Rodney Clark, *The Japanese Company* (1979) 17.

65 Charkham, *Keeping Better Company*, above n 31, 108.

66 Hideki Kanda, 'Notes on Corporate Governance in Japan' in Klaus Hopt, et al (eds), *Comparative Corporate Governance: The State of the Art and Emerging Research* (1998) 892.

67 Charkham, *Keeping Better Company*, above n 31, 111.

68 Kanda, above n 66, 893.

69 Davies, above n 6, 28.

70 James Abegglen and George Stalk, *Kaisha: The Japanese Corporation* (1985) 181.

71 Charkham, *Keeping Better Company*, above n 31, 109.

'[T]he old truth remains: the pace of economic growth depends largely on the growth of each worker's output'.⁷²

The role of employees as important stakeholders in Japanese corporate governance enables them to influence decision making without formal representation on the board.⁷³ The various stakeholders monitor management of the corporation to ensure their 'promises' are kept; as a result management tends to direct the business towards the interests of the stakeholders with the highest bargaining power.⁷⁴ Consideration of employees in this way has allowed them to influence major corporate decisions at critical times. Traditionally, employees were the main controlling group in a corporation.⁷⁵ Employees were able to secure their interest against other stakeholders by being selected as directors and managers of the corporation; wherein they had employee support so long as their actions were generally consistent with the interests of employees.⁷⁶

In the post-war era, practices such as 'flexibility of work organization, employee participation in management, and high levels of investment in working training...'⁷⁷ were supported as complementary to 'lifetime employment, seniority-based pay, and enterprise unions'.⁷⁸ Furthermore, employees were given the capacity to influence by the company investing in firm specific skills and employee training that was said to 'reinforce employee strategies for internal participation in firm's decisions'.⁷⁹ Employees were seen as an important part of the 'family' whereas it was considered that shareholders could be 'here today and gone tomorrow'.⁸⁰ Employees in a Japanese corporation therefore had influence over the decision making in a variety of indirect ways and their needs were seen as being more important than those of other stakeholders.⁸¹

Japan has endured ongoing economic problems over the last decade and was unable to swiftly engineer a sustainable recovery. This was caused by the collapse of the 'bubble economy' in 1989 and 1990. Since then Japanese corporate governance has been placed under scrutiny and changes have been initiated to remodel the Japanese corporate landscape.⁸² The changes implemented by the Japanese Commercial Code offered companies an alternative to the traditional structure:⁸³ the 'three-committee' system, which requires companies to have a nominating, audit and compensation committee in addition to at least one executive officer.⁸⁴ Companies must now opt for the 'three-committee' system or stay with the traditional system and have a corporate auditor; the majority of companies thus far have stayed with the traditional system.⁸⁵ Boards of directors are now

72 Abegglen and Stalk, above n 70.

73 Hoshi, above n 48, 861.

74 Zenichi Shishido, 'Japanese Corporate Governance: the Hidden Problems of Corporate Law and their Solutions' [2000] 25 *Delaware Journal of Corporate Law* 189, 194.

75 Hoshi, above n 48, 861 and 881.

76 *Ibid* 881.

77 Jacoby, above n 60, 5.

78 *Ibid*.

79 Ruth Aguilera and Gregory Jackson, 'The Cross-National Diversity of Corporate Governance: Dimensions and Determinants' [2003] 28 *Academy of Management Review* 447, 457.

80 Charkham, Keeping Better Company, above n 31, 114-115.

81 Kiguchi, above n 61, 410.

82 *Ibid* 410.

83 *Commercial Code 2004* (Japan: Nishimura and Partners, 2004) art 12.5.

84 *Ibid*.

85 Charkham, Keeping Better Company, above n 31, 137.

smaller and contain directors from outside the company;⁸⁶ ex-employees and ex-directors must have a 5 year cooling off period before they can be considered ‘outsiders’.⁸⁷ Stable cooperation between employees and management has been a prominent feature of Japanese corporate governance for many years;⁸⁸ in the traditional model, many of the board members were ‘directors-with-employee-functions’. This gave employees another channel to influence corporate decision making. The ‘three-committee’ system will ‘significantly affect the internal promotion system and the acceptance of ‘directors-with-employee-functions’ practice’.⁸⁹

Other aspects of corporate governance that have changed are, inter alia: less lifetime employment; post-war consensus has weakened; cross-shareholdings have reduced; the role of the banks has decreased; and there is more pressure on companies to improve dividends.⁹⁰ The legislative changes are seen as positive improvements to corporate governance and accountability; reflecting much of the Western world.⁹¹ However, not everything about the traditional system has changed; the fabric of society is still important and the company is still viewed as both a social and economic construct.⁹² The current law governing companies in Japan is the Company Law which was passed in 2005.⁹³ This law integrates the previous complex and scattered laws relating to commercial law: ‘corporate restructuring; stock based incentive plans, committee-based management style; and many other rules...’⁹⁴ into one succinct code. The new law gives companies a ‘variety of ways to reorganize themselves to maximize value by swift decision making’.⁹⁵

IV. UNITED KINGDOM

The United Kingdom model of corporate governance is known as the Anglo-Saxon model,⁹⁶ and is characterised by the separation of ownership and control and an active stock market.⁹⁷ This system of corporate governance has generally prioritized shareholders over other stakeholders.⁹⁸ In an environment where takeovers are feared, directors put the interests of shareholders above those of other stakeholders to get them the high, short-term, returns they desire.⁹⁹ This is often achieved

86 Ibid 131.

87 Ibid 139.

88 Takashi Araki, ‘Corporate Governance, Labour, and Employment Relations in Japan: The Future of the Stakeholder Model?’ in Howard Gospel and Andrew Pendleton (eds), *Corporate Governance and Labour Management: An International Comparison* (2005) 274.

89 Ibid 278.

90 Charkham, *Keeping Better Company*, above n 31, 149.

91 Ibid.

92 Ibid 150.

93 *Company Law 2005* (JAP).

94 Charkham, *Keeping Better Company*, above n 31, 152.

95 Ibid.

96 Martin Hopner, Gregory Jackson and Antje Kurdelbusch, ‘Corporate Governance and Employees in Germany: Changing Linkages, Complementarities, and Tensions’ in Gospel and Pendleton (eds), *Corporate Governance and Labour Management: An International Comparison* (2005) 86.

97 Farrar, *Corporate Governance: Theories, Principles and Practice* (2nd ed), above n 2, 464.

98 Howard Gospel and Andrew Pendleton, ‘Markets and Relationships: Finance, Governance, and Labour in the United Kingdom’ in Gospel and Pendleton (eds), *Corporate Governance and Labour Management: An International Comparison* (2005) 64.

99 Ibid.

by controlling labour costs through job cuts and laying off employees.¹⁰⁰ Corporate governance is recognized as ‘a system by which companies are directed and controlled...’¹⁰¹ wherein directors should be able to exercise freedom in driving the company forward ‘...within a framework of effective accountability’.¹⁰² The overriding aspiration of a company is ‘the preservation and the greatest practical enhancement over time of their shareholders’ investment’.¹⁰³ Stakeholders, such as employees, are essential to the success of the company and the attitude of companies towards them has recently improved. In Victorian times employees were treated as ‘tangible assets, and companies did not seek to foster their relationships with them’.¹⁰⁴ Modern legislation has improved the relationship between management and employees; which resulted in more of a collaborative approach to running a company.¹⁰⁵ The Companies Act of 1985 provided that:¹⁰⁶

[t]he matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company’s employee in general, as well as the interests of its members.

The United Kingdom has taken a step in the process of improving corporate governance by codifying its first statement of director’s duties in the Companies Act 2006 (UK).¹⁰⁷ The director’s duties, previously existing by virtue of the common law, are now enacted into a statutory form which reflects the enlightened shareholder approach: wherein:¹⁰⁸

the purpose of the company is to create value for the benefit of shareholders but this should be done by taking a long-term view of the company, and thus the relationships which the company has with suppliers, employees, the community and so on have to be fostered.

This model of corporate governance is said to be ‘enlightened’ ‘...when it proceeds on the basis that a company’s potential for success can best be realized through maximizing the relationships which the company enjoys with stakeholder groups’.¹⁰⁹

Section 172 of the Companies Act 2006 (UK) states:¹¹⁰

(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to: ... (b) the interests of the company’s employees.

Therefore employees are indirectly able to influence corporate decision making by having their interests considered by the directors (who make the decisions). Despite the fact that directors have a duty to have regard to relevant interests, they unfortunately are not compelled to take any action in furthering those interests. There is no element of enforcement for this section, and thus no way to hold directors accountable. Directors have discretion in deciding appropriate weight to give the

100 Ibid 66.

101 Kevin Keasey, Helen Short and Mike Wright, ‘The Development of Corporate Governance Codes in the UK’ in Kevin Keasey, Steve Thompson, and Mike Wright (eds), *Corporate Governance: Accountability, Enterprise and International Comparisons* (2005) 22.

102 Ibid.

103 Ibid.

104 Justice Mary Arden, ‘Companies Act 2006 (UK): A New Approach to Directors’ Duties’ (2007) 81 *Australian Law Journal* 162, 164.

105 Ibid.

106 Ibid 167.

107 Ibid 163-4.

108 Ibid 165.

109 Ibid.

110 *Companies Act 2006* (UK) s 172.

matter 'for the purpose of promoting the success of the company as a whole'.¹¹¹ As a result this section may not improve the quality of the decision making process because it creates an air of uncertainty from the lack of guidance given to assist determining what to have regard to.¹¹² However, directors are reminded to look at the long term effects of their decisions, and consider any effects it may have on important stakeholders.¹¹³ Therefore, s 172 may have a positive effect on the quality of decision making as companies become conscious of employees and their contribution to the success of the company.¹¹⁴

V. NEW ZEALAND

Corporate governance in New Zealand is an Anglo-American system.¹¹⁵ New Zealand is physically located far from the world capital centres and the implications of globalization have been both beneficial and detrimental to the economy. New Zealand relies on exporting and foreign investments for economic growth;¹¹⁶ but is also exposed to the negative effects of the global stock market, such as 'Black Monday' in 1987.¹¹⁷ Since 1984 New Zealand has been undertaking deregulation and has gone from one of the 'most regulated societies in the free world, to the world's freest market economy'.¹¹⁸ The present relationship employees have with New Zealand companies is of a contractual nature, with some statutory protection. The Employment Relations Act 2000 enables employees to contract with a company; and the Human Rights Act 1993, Injury Prevention, Rehabilitation and Compensation Act 2001 and administration rules pursuant to income tax legislation, govern the obligations employers owe to employees.¹¹⁹ The board of directors, must consist of at least one director,¹²⁰ and is collectively responsible for running the company.¹²¹ Unless an employee is also a shareholder or director of the company they do not generally have any rights to participate in corporate decision making, and are not permitted to attend or vote at meetings.¹²² Section 126 of the Companies Act 1993 states that an employee may, for certain purposes, be held to be a director if they take an active role in running the company; or if they have been delegated any director duties or powers.¹²³ The role of employees in corporate governance in New Zealand is mainly to provide human capital.

The stakeholder theory of corporate governance involves social considerations and recognition that long-term success and maximization of corporate profit is dependant on stakeholders with whom the corporation has created interdependencies.¹²⁴ The stakeholder theory has not been codi-

111 Arden, above n 104, 167-8.

112 Ibid 170-171.

113 Ibid 170.

114 Ibid 173.

115 Farrar, *Corporate Governance: Theories, Principles and Practice* (2nd ed), above n 2, 460.

116 Mark Fox and Gordon Walker, 'Globalization: Meanings and Implications' in Brent Fisse, Ian Ramsay, and Gordon Walker (eds), *Securities Regulation in Australia and New Zealand* (2nd ed, 1998) 4.

117 Ibid 16.

118 Ibid 4 and 18.

119 Susan Watson, et al (eds), *The Law of Business Organisations* (4th ed, 2003) 90.

120 *Companies Act 1993* (NZ), s 150.

121 Watson, above n 119, 197.

122 Ibid 90.

123 Ibid 90 and 195.

124 Corfield, above n 8.

fied into law in New Zealand. Directors are instructed to act in good faith and in what they consider to be the best interest of the company and its shareholders.¹²⁵ The Act enables shareholders, former shareholders, or entitled persons to initiate legal action against the directors if they are not performing their duties properly or are not acting in a manner which is in the best interest of the company. Employees are unable to bring an action in support of their stakeholder interest as they are not 'entitled persons'.¹²⁶ In the event a company is put into receivership, employees in New Zealand are currently entitled to a priority amount of up to NZ\$6,000 (New Zealand dollars) as creditors of the company. The priority sum is in respect to arrears of salary or wages, and holiday pay¹²⁷ (but excludes redundancy payments), accrued within the four months prior to insolvency.¹²⁸ This means that although employees may not be able to protect their interest by managing the company, they are given some protection in that their claim ranks ahead of unsecured creditors and certain other preferential creditors.¹²⁹

VI. GLOBAL HARMONIZATION

The modern concept of globalization refers to a global 'perspective which arises from the increased interdependence of national institutions and national economies'.¹³⁰ Although the term 'globalization' is commonly used synonymously with internationalization, technically the two have different meanings. 'The essential distinction is that globalization denotes a process of *denationalization*, whereas internationalization refers to the co-operative activities of *national* actors'.¹³¹

In terms of globalization, national boundaries are eroded and considered irrelevant; whereas internationalization is concerned with the interests of separate nations.¹³² Globalization has motivated countries to observe and consider each other's systems and laws comparatively and constructively.¹³³ In an era of globalization, it becomes increasingly difficult to determine who is to provide regulation when there are no clear boundaries.¹³⁴ While it is important for governments and regulators to focus on the interests of their own nation, the idea of harmonization of relationships and rules with other jurisdictions is an important implication of globalization.¹³⁵ Globalization is making it increasingly easier and more important for countries to conduct comparative analysis of the way other systems operate. For success and competitiveness it is important for a nation to continually review its own system; regardless of how successful they may appear in

125 *Companies Act 1993* (NZ) ss 131, 169.

126 *Ibid* ss 2, 164, 170, 172, 174.

127 See, Ministry of Economic Development Manatu Ohanga, *How does bankruptcy affect a business & employees?* (2007) <<http://www.insolvency.govt.nz>> at 25 February 2008.

128 See, Ministry of Economic Development Manatu Ohanga, *Employee-Related Claims* (2001) [7.1] <http://www.med.govt.nz/templates/MultipageDocumentPage_6137.aspx> at 25 February 2008.

129 MED, *How does bankruptcy affect a business & employees?*, above n 127.

130 Fox and Walker, above n 116, 5.

131 *Ibid* 6.

132 *Ibid*.

133 Farrar, *Corporate Governance: Theories, Principles and Practice* (2nd ed), above n 2, 482.

134 Fox and Walker, above n 116, 10.

135 *Ibid* 10-11.

comparison to other nations.¹³⁶ Therefore an important question faces each nation: which model of corporate governance ‘...best serve[s] its interests in an era of globalization’?¹³⁷

There have been attempts to harmonize the law in relation to employee participation in corporate governance globally. Two examples are: the unsuccessful European Economic Community (the ‘EEC’) attempt to implement compulsory establishment of a two-tier board; and the Organization for Economic Co-operation and Development (the ‘OECD’) recommendations for countries to apply to their own diverse cultures. The EEC was established in 1957 by the Treaty of Rome,¹³⁸ which later became the European Community by the Maastricht Treaty signed in 1992.¹³⁹ The EEC has been successful in company law harmonization in regard to finance and accounts; but has not had as much success with corporate governance.¹⁴⁰ The aim of the draft Fifth Directive was to make boards responsive to employees by replacing classic single boards with compulsory two-tier systems;¹⁴¹ ‘a supervisory board responsible for controlling the management board; and a management boards responsible for managing the daily activities of the company’.¹⁴² This was a direct attempt to move towards the German system of supervisory board codetermination,¹⁴³ and would enable employees to participate in running the company.¹⁴⁴ Critics have suggested that ‘the EEC should refrain from formulating a single company structure based on the results in one country’.¹⁴⁵ Unfortunately this system would not have allowed any leeway for countries to adapt the concept so as to best suit the needs of their own nation.¹⁴⁶ The Directive was accordingly dropped after it did not attract the positive resonance as had been hoped.¹⁴⁷

Members of the OECD signed a convention in 1960 wherein member countries agreed to promote policies designed to contribute and help with, inter alia, achieving sound economic expansion; high sustainable economic growth, employment and living standards of member countries.¹⁴⁸ Germany, Japan, the United Kingdom and New Zealand are all members of the OECD. The OECD has developed Principles of Corporate Governance that offer ‘non-binding standards and good practices as well as guidance on implementation’.¹⁴⁹ The OECD recognizes that there are a variety of corporate governance systems, and there is no single framework appropriate for

136 Farrar, *Corporate Governance: Theories, Principles and Practice* (2nd ed), above n 2, 498.

137 *Ibid* 483.

138 Conlon, above n 45, 349.

139 *The Maastricht Treaty*, opened for signature 7 February 1992, OJ C 191 (entered into force 1 November 1993).

140 Farrar, *Corporate Governance: Theories, Principles and Practice* (2nd ed), above n 2, 470.

141 Conlon, above n 45, 348-9 and 358; *The Treaty Establishing the European Economic Community*, opened for signature 25 March 1957, 298 UNTS 3 (entered into force 1 January 1959).

142 *Ibid*.

143 Charkham, *Keeping Good Company*, above n 1, 271.

144 Conlon, above n 45.

145 *Ibid* 359.

146 *Ibid*.

147 Elmar Gerum, and Helmut Wagner, ‘Economics of Labour Co-Determination in View of Corporate Governance’ in Klaus Hopt, et al (eds), *Comparative Corporate Governance: The State of the Art and Emerging Research* (1998) 352.

148 *Convention on the Organisation for Economic Co-operation and Development*, opened for signature 14 December 1960.

149 OECD, *The OECD Principles of Corporate Governance* (2004) 4.

all countries.¹⁵⁰ The Principles are not binding on member countries, but are recommendations¹⁵¹ the OECD has developed in light of the growing awareness of the need for good corporate governance.¹⁵² The flexibility of the Principles enables countries to use them as a basis which they can develop and apply to the extent appropriate for their traditions and market conditions;¹⁵³ that are reflective of the economic, social, legal and cultural circumstances of the respective countries.¹⁵⁴ The OECD covers five main areas, one of which is the role of employees.¹⁵⁵ The respective Principle recommends that '[p]erformance-enhancing mechanisms for employee participation should be permitted to develop'.¹⁵⁶ Mechanisms suggested for enhancing employee participation may benefit companies directly and indirectly 'though the readiness by employees to invest in firm specific skills'.¹⁵⁷ One of the suggestions given to enhance employee participation is employee representation on boards.¹⁵⁸ The Principles represent a consensual view of '...the most important core elements of a good corporate governance framework'.¹⁵⁹ These Principles look good in theory, but as they are only optional and without any mechanism for enforcement, the benefits of implementing them may not be realized.

The idea of harmonization or convergence of law on a global scale would provide certainty and consistency in an increasingly globalized world where many large companies operate on a multi or trans-national level and are listed on foreign stock exchanges. Each country has developed its respective model of corporate governance slowly over time on the background of its unique history and culture. This makes it difficult to implement a completely new system of governance from a foreign country with a different background. It would be unfair to simply replace one system with another; each country has different values and aspirations in terms of corporate governance and social considerations; and each system has positive and negative aspects; this does not mean a radical change is necessary.

In a stakeholder theory the interests of multiple stakeholder groups may conflict, and will need to be balanced against each other. In a system where the interests of shareholders are paramount; exerting corporate social responsibility toward employee stakeholders will help to serve their financial aspirations. 'Corporate governance does not exist in a vacuum'.¹⁶⁰ Employees who are able to participate in corporate decision making will be able to serve their own interest, in keeping the company solvent, contemporaneously with serving shareholder interests. Corporate governance systems are constantly evolving as conditions change and practices continue to vary

150 OECD, *Improving Business Behaviour: Why we need Corporate Governance* <<http://www.oecd.org>> at 3 February 2008.

151 *Ibid.*

152 William Witherell, *Corporate Governance: A Basic Foundation for the Global Economy* (2000) (Summer) *OECD Observer* 24, 26 <<http://www.oecdobserver.org/news/fullstory.php/aid/317>> at 3 February 2008.

153 OECD, *Improving Business Behaviour: Why we need Corporate Governance*, above n 150.

154 OECD, *The OECD Principles of Corporate Governance*, above n 149, 13.

155 Witherall, above n 152.

156 OECD, *The OECD Principles of Corporate Governance*, above n 149, 47.

157 *Ibid.*

158 *Ibid.*

159 Witherell, above n 152.

160 John Farrar, *Corporate Governance Theories, Principles and Practice* (3rd ed, 2004) 10.

across nations and cultures.¹⁶¹ The idea of harmonization is to have one single model of corporate governance and one law to regulate it.¹⁶²

There is no single universal model of corporate governance. Nor is there a static, final structure in corporate governance that every country or corporation should emulate. Experimentation and variety should be expected and encouraged.

There are many theoretical advantages of harmonizing the role of employees in corporate governance. Global harmonization will enable equal treatment and participation for employees regardless of which company or country they are working in. Providing for employee participation in corporate decision making supports the stakeholder theory and gives employees a voice. Companies will receive all the subsequent benefits associated with the stakeholder theory, as well as an incidental improvement in shareholder returns. Although there is currently no single system of corporate governance that can readily be applied globally, there are certain common elements which provide the basis for good corporate governance.¹⁶³ Many laws may naturally merge together as cultures merge together: as a result of the totality of globalization and internationalization eroding more boundaries and more nations cooperating. With immigration, emigration and the ability to communicate¹⁶⁴ and travel faster each nation is increasingly being exposed to other cultures and governance systems which they can observe and learn from. The community to be considered, in light of the stakeholder theory, is constantly expanding and global harmonization will be looking more attractive as an efficient way to reduce transaction costs and time associated with international dealings.

To implement one model of employee participation for global harmonization, important considerations need to be taken into account. International consensus of every country would need to be attained and any agreement will need to be ratified and enacted into domestic law, with enforceability mechanisms for the model to have any effect. Cultural factors are dominant in corporate governance,¹⁶⁵ and contribute to the ongoing difficulty in establishing one mandatory system of employee participation that satisfies all nations. Regardless of how successful a system is within the culture it was created in, it will not necessarily be easily transferred to another nation to the same effect.¹⁶⁶ For example, codetermination in Germany acted as a remedy to help revive democratic forces after the disastrous war. Furthermore, the system of employee representation in codetermination of the supervisory board was tested in the coal and steel industries for a quarter of a century before application on a national basis.¹⁶⁷ It is unlikely that this background would be matched by many other nations.¹⁶⁸ The German system of codetermination ‘...is part of a broader system of industrial governance...’¹⁶⁹ which may only work in that context alone. A further example is:¹⁷⁰

161 Farrar, *Corporate Governance Theories, Principles and Practice* (2nd ed), above n 2, 498.

162 Ibid.

163 OECD, *The OECD Principles of Corporate Governance*, above n 149, 13.

164 Farrar, *Corporate Governance: Theories, Principles and Practice* (2nd ed), above n 2, 475.

165 Ibid 470.

166 Furlong, above n 28, 135.

167 Ibid 162.

168 Ibid.

169 Paul Davies, ‘A Note on Labour and Corporate Governance in the U.K.’ in Klaus Hopt, et al (eds), *Comparative Corporate Governance: The State of the Art and Emerging Research* (1998) 373.

170 Araki, above n 88, 280.

the Japanese employee-centered stakeholder model [which] relies heavily on a number of customary practices, such as long-term cross-share ownership, internal promotion of management and the existence of 'directors-with-employee-functions', long-term (lifetime) employment, and voluntary joint management-labour consultation.

Considerable modifications may be required in order for one system of employee participation in corporate decision making to be successfully transferred to another nation,¹⁷¹ or harmonized globally.

VII. CONCLUSION

In conclusion the role of employees in corporate governance varies from country to country. As unsecured creditors, it is important for employees to have a role in corporate governance and participate in corporate decision making in order for them to protect their interests. Enabling employees to participate in corporate decision making has been successful in Germany where employees are represented on the supervisory tier of the board, which appoints and effectively controls the management board. Employees therefore have a huge amount of influence over corporate decision making. In Japan employees are seen as important members of the company despite the recent structural changes. The traditional model saw employees stay with one company for the duration of their lifelong career, and the company was basically run in the best interest of the employees. In both German and Japanese corporate governance systems employees are able to protect their interest by participating in running the company. The United Kingdom, which previously did not accommodate any rights of participation for employees, has now voluntarily adopted legislation in that regard. Recently, common law directors' duties were codified into statute, permitting directors to take account of the interests of stakeholder employees. The situation in New Zealand is much the same as the traditional United Kingdom system wherein employees currently have no rights to participate in running the company. However, New Zealand employees are provided with some protection for their entitlements in the event of the company going into receivership or liquidation. New Zealand has the advantage of utilizing comparative analysis techniques and is able to comparatively look at other systems to determine the implications of adopting corporate social responsibility into its corporate governance system.

Employees are important members of a company; the growth and output of a company largely depend on the growth and output of the employees. Although shareholder investments are important to enable the company to operate, the running of the company is then largely left up to the directors and employees. Therefore the company, in many respects depends, on its employees more than its shareholders. Comparative analysis is an important aspect in terms of reviewing a nation's system of corporate governance. It enables one to determine which systems and models of employee participation have been successful in terms of the historical and cultural backgrounds that produced them; and anticipate the possible implications that model may have if it was adopted by other nations. By comparing the backgrounds of the nations of the world and what in particular made them succeed or fail is of utmost importance when considering whether corporate governance can be harmonized globally. It is important for nations to be autonomous and develop their own specific laws which they perceive will meet the interests of their citizens, and not have any foreign laws imposed on them. Globalization is making the ability to undertake comparative analysis more accessible and efficient; thereby enabling nations to undertake a review of their own

171 Furlong, above n 28, 3.

system in light of other systems in the world. Corporate governance systems are evolving over time; as are national cultures as they migrate to other nations and adapt to the cultures within that nation, whilst incidentally spreading their own cultural values. In that regard, both corporate governance systems and cultures may evolve in sync, and merge together in due course as each nation adapts and adopts the successful aspects of other systems. The result would effectively be multiple similar systems throughout the world with the same underlying goals and principles. Only when global corporate governance is at that stage will harmonization be possible.