Global Unions Discussion Paper

Workers' Voice in Corporate Governance - A Trade Union Perspective

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Foreword

The implosion in December 2001 of Enron, the US company that was for many a model of corporate governance, wiped out overnight over 6,000 jobs and attendant health care and retirement savings – for many workers their entire life savings. It also took with it Arthur Andersen, one of the world's biggest auditing and business services firms. For his part, Kenneth Lay, Enron's CEO, received a salary in 2000 of $53 million, along with $123 million of exercised stock options and a further $361 million in unexercised stock options.

If Enron had been an isolated case, the apologists for US corporate governance might have claimed that problems were due to a few "bad apples". However, corporate scandals continue to occur, and not just in the USA. In Europe too, governance related scandals have occurred (Vivendi, Ahold, Parmalat). They result from a failure of public policy – the implementation by governments and regulatory authorities of flawed systems of corporate governance and accountability that fail to stop the looting of companies by their elites. Indeed, much of the damage is done by means that are perfectly legal. The regulatory bite has progressively weakened in the face of changes to the form and structure of the modern corporation. These have been accompanied by a *laissez-faire* approach to issues of governance and accountability, by governments and by the bodies that are supposed to ensure broader market integrity, including financial market players, the auditing profession, analysts and rating agencies.

To some extent, national governments have taken regulatory action to help restore public confidence in the corporate sector - often following an outcry by employees and their trade unions. Yet this action has tended to focus on narrow aspects of governance, for example, on ensuring more thorough and credible company audits. More worrying is the fact that only a handful of governments has undertaken a comprehensive review of corporate governance or taken broad-based action, backed by effective regulation, to institute needed reforms. These should include giving workers and workers' capital a real voice in company decision-making procedures and creating new instruments allowing them, their organisations and responsible investors to act as brakes on the excesses of unaccountable management.

Trade unions will continue to campaign for an effective national and international framework of rules and standards for good corporate governance and accountability, and market integrity, along with a regulatory system to ensure implementation and enforcement. Within this framework, we will go on pressing for effective measures to rein in the absurdly high salaries paid to Chief Executive Officers (CEOs). It cannot be right that in the USA, for example, while a CEO earned 40 times the average wage of the company's workers in 1980, she or he now earns around 530 times that, at a time when workers are suffering real cuts in wages, health care benefits and pension provisions. Though the US situation is extreme, executive remuneration is out of control around the globe – and measures to curb those excesses are key to restoring public faith in corporate governance.

This discussion paper addresses the current crisis of corporate governance and proposes a framework for public policy reforms on corporate governance. It contests the myths surrounding the governance of modern corporations, identifies the problems, and proposes a

proactive public policy response and a corresponding trade union agenda. Its aim is to assist the Global Unions' campaign for both national and international corporate governance reforms that will create sustainable corporations for the modern world.

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Part One: The governance of the modern corporation in crisis

1. Corporate power and responsibilities in an era of globalisation

1. This report focuses on the governance of large corporations, in particular publicly listed companies whose equity is traded on stock markets. They can wield a disproportionate amount of power and influence over the decisions that affect all of our lives, in the workplace, in the community and in political and economic decision-making circles at national, regional and international levels. Corporations have internationalised their activities and assets, transforming their internal production chains and governance systems, allowing them to evade national accountability regimes and to juggle different systems for their own ends. That process of internationalisation, encouraged by governments seeking foreign investors to finance their economic growth, has gone hand in hand with "regulatory competition" between national and regional jurisdictions. Companies can pick and choose the less demanding jurisdictions for their operations. The winners are few and the losers are many, among them the true purpose of the corporation as a wealth-creating vehicle for society. While large corporations are allowed to evade their direct responsibilities (through complex legal arrangements and the global supply chain), the real decision-making power is concentrated at the top.

1.1 The cost of regulatory competition

2. More than a quarter of global economic activity is now controlled by just 200 companies and, of the world's biggest 100 economic entities ranked by asset value, 51 are multinational corporations.[1] Including intra-firm transfers, multinationals account for over two thirds of international flows of trade and investment. Concentration has increased with the growth of mergers and acquisitions, especially cross-border deals, which accounted for 80% of global foreign direct investment flows between 1998 and 2000.[2] The share of stock-market capitalisation relative to GDP in the OECD area rose from 50% in 1995 to 116% in 2000. Government policy is now geared to attract, and indeed favour, inward investors by means of domestic deregulation, market-opening measures, bilateral investment agreements, and so on.

3. The internationalisation of corporations has led to increasing "regulatory competition" between countries and regional blocs. Foreign investment strategies have shifted over the past decades; since the 1980s wholly-owned subsidiaries in third countries have been supplanted by global supply chains in which large corporations source their inputs via contractual arrangements with local firms in developing and transition countries. Unchecked, such a system gives them tremendous leverage over their suppliers, while freeing them from any responsibility for the suppliers' activities. The acceleration of offshoring - the transfer,

[1] IPS 2000
[2] OECD 2002

through foreign direct investment or sub-contracting, of all or part of the production of goods and services to another country with the intention to re-import them to the home country - has heightened the sense of job insecurity amongst many groups of workers.

4. Such "competition" has the inherent risk of undermining corporate responsibilities to key corporate stakeholders. A company can establish its seat in a less demanding jurisdiction in terms of transparency of its operations, shareholder rights , credit enforcement, taxation, environmental and social rights. This also enables corporate decision-makers to evade the company's broader accountability to society to pay taxes on which society depends for meeting its material needs. The OECD itself has carried out extensive work with member states to address company exploitation of legal tax avoidance devices such as "double invoicing", "transfer pricing", and "profit skimming". Harvard University economist Mihir Desai has calculated the difference between the profits that US corporations reported to the Internal Revenue Service in 1998, and the profits that accountants certified in the annual reports the companies issued to their shareholders. The difference is a staggering $154 billion in 1998 alone, resulting in $54 billion of lost tax revenue.[3]

1.2 Concentration of power and blurring of responsibility lines

5. Internationalisation creates a growing disconnection between lines of corporate responsibility – to workers, shareholders, other stakeholders – and lines of corporate power. Companies are able to evade their responsibilities through increasingly sophisticated legal and contractual arrangements, including pyramid groups[4], licensing, and other forms of partnership. In fact, it is no longer necessary to own a company to exert effective control over its management. The traditional assumption that corporations operate as a single legal entity is less and less relevant. They have become "moving targets"; the boundaries of their responsibilities may be blurred, not clearly disclosed to citizens and sometimes hidden from public oversight.

6. In addressing these issues, much of the debate up to now has focused on the public regulation of markets, either by the state or multilateral organisations. By contrast, insufficient attention has been paid to the legal and regulatory framework governing the internal operations of the corporation and its responsibility toward stakeholders – that is, corporate governance. This framework is also a lynchpin of wider market integrity. In addition, the internal workings of a corporation are often seen as a "black box", where the primary objective of the board of directors is to maximise profit and shareholder value, and to minimise costs, irrespective of the fiduciary duty to act in the interests of the company as a whole. Before looking at this issue, and the fallout from corporate scandals, it is worth considering the foundations of the "modern corporation".

[3] Desai 2002
[4] cascade of shareholding and complex web of crossholdings which typically allow deviation of cash flows and ownership rights from voting rights.

2. The public mission of the modern corporation

7. The corporation is often viewed in public debate as a purely private association of owners whereby investors and entrepreneurs organise spontaneously in private partnerships to produce and sell products or services and take advantage of market conditions. But it is more than a private association. The corporation is established as a matter of public policy to serve the public purpose of creating wealth to satisfy the needs of society. It is the public purpose of the corporation that legitimates government regulatory action. Regulation of the internal constitution of corporations is needed to align the private purpose of corporate constituents – investors, managers and workers – to generate profit with the overall purpose of creating social wealth that benefits citizens and society as a whole, including consumers, creditors, suppliers, customers, local communities, and so on. Thus there is a public mission for the corporation to fulfil.

2.1 The limited liability of the corporation, and separation of ownership and control

8. While corporate governance regimes may differ, modern corporations nevertheless share a common characteristic that is central to their governance: their liability is limited. The limited liability or joint stock company emerged as a response to the needs of capitalist expansion during the industrial revolutions that began to sweep the world in the nineteenth century. This breakthrough in the legal and economic arrangements affecting investors and entrepreneurs was a driver of the first wave of globalisation at the turn of the twentieth century. Limited liability allows the "unlimited growth" of the company's assets compared to the initial capital invested. Because investors do not bear full responsibility for corporate risk, but only that corresponding to the value of their stockholding, the potential cost of corporate failure is passed on to society at large.

9. Besides creating a liability gap between the corporation's inherent risk and its shareholders' exposure, the limited liability principle systematised the separation of ownership and control of the corporation. Because shareownership of the modern corporation is collective, individual shareholders cannot exercise full ownership rights, and control of company operations has to be delegated to a "third party" – its management. However, this separation of ownership and control aggravates the "principal–agent" problem. Aligning the incentives of the manager ("agent") with those of the shareholders ("principals") is not straightforward and cannot be addressed by market forces alone. There may, for example, be a conflict of interest concerning where and how to invest. A multitude of shareholders are not in a position to decide on the allocation of assets of the corporation, since they lack detailed knowledge of the company, its operations and the specific industrial environment. For their part, managers may not impartially consider the risk associated with a given investment because they do not have a stake in the firm that matches their power.[5] Thus internal mechanisms of reporting and accountability are needed to ensure coincidence of interests between managers and owners. Historically, Berle and Means in 1932 were first to acknowledge the key challenge of modern corporations in addressing separation of ownership

[5] One can assume that corporate governance is far more complex in large corporations than in small businesses, because of the diversity and number of stakeholders.

and control.[6] The "principal-agent" problem can only be overcome by legislation, operating alongside the internal governance regime of corporations, to determine the balance of power between various stakeholders and the mechanisms of reporting and accountability. These mechanisms define the governance of the corporation.

2.2 Diversity of national systems of corporate governance

10. There are different ways to achieve a regulatory framework that creates the checks and balances needed to ensure corporate responsibility to stakeholders. That diversity – and historically, different societal choices of nations – explain why the legal form of corporations varies across countries. This reflects the form in which the corporation is granted its "licence to operate" within its markets. That licence is in turn governed by the various regulatory frameworks put in place by law, collective agreements and codes covering internal and external stakeholders.

11. Corporate governance literature often groups national regimes in two distinct "spheres" the Anglo-American system on the one hand and the Rhineland and Japanese systems on the other. Such classification in two groups is of course simplistic, particularly within the EU. It is nevertheless indicative of the broad spectrum of national jurisdictions that exist. The two are compared on core aspects of corporate governance (law, market organisation, labour, etc.). Anglo-American systems are characterised by liquid and lightly regulated markets for both capital and labour. By contrast, and notwithstanding some differences between them, continental Europe and Japan are characterised by a relatively high and concentrated ownership of large companies, with banks, families and insurance companies being the dominant providers of corporate capital. This is accompanied by a stronger tradition of social dialogue between management and trade unions. The following schemas provide a simplified comparison of the two systems as well as an overview of their respective evolution during the twentieth century.

Labour management and corporate governance in the Anglo-American and the Rhineland spheres

Anglo-American		**Systems**		**Rhineland**
Common law	<	Law	>	Civil law
Liberal	<	Market organisation	>	Co-ordinated
High	<	Labour market turnover	>	Low
External	<	Acquisition of labour skills	>	Internal
Decentralised, company level	<	Collective bargaining	>	Centralised, sector level
Non-existent	<	Internal worker representation	>	Existent

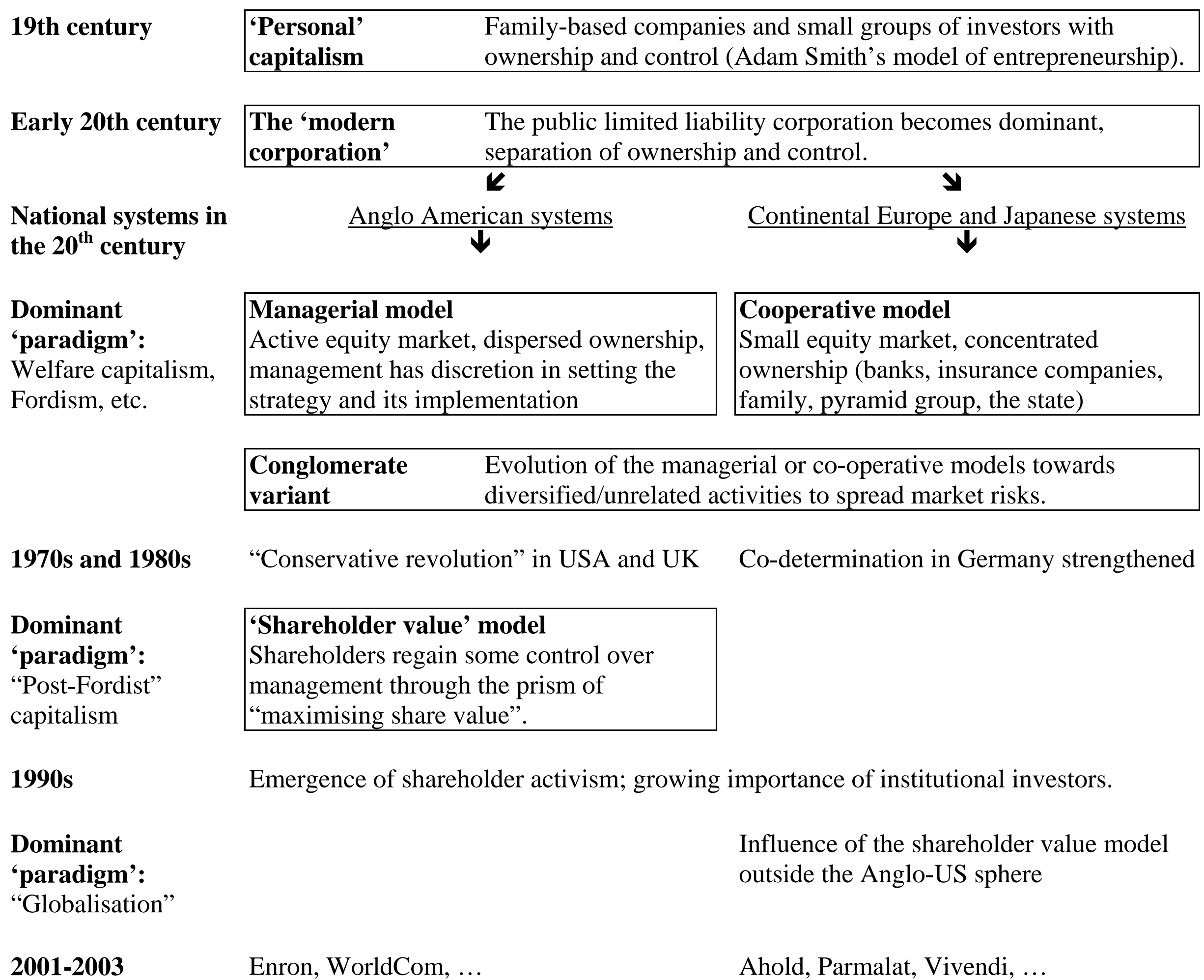
Source: Adapted from Gospel and Pendleton 2005

12. The picture becomes blurred in developing countries, although their corporate governance frameworks often reflect those of former colonial powers. Developing countries rely more on informal instruments and institutions of corporate governance, and thus have

[6] Berle and Means 1932

their own perspective. Basic assumptions of corporate governance in the industrialised world simply do not match the reality of developing and transition countries, notably in regard to "principal-agent" problems. As argued by Charles Oman, "the key potential conflict of interest tends not to be between managers and shareholders *per se* but between dominant owner-managers on one hand and minority shareholder and other investors on the other."[7]

Historical overview of national systems of corporate governance



Period		
19th century	**'Personal' capitalism** – Family-based companies and small groups of investors with ownership and control (Adam Smith's model of entrepreneurship).	
Early 20th century	**The 'modern corporation'** – The public limited liability corporation becomes dominant, separation of ownership and control.	
National systems in the 20th century	Anglo American systems	Continental Europe and Japanese systems
Dominant 'paradigm': Welfare capitalism, Fordism, etc.	**Managerial model** Active equity market, dispersed ownership, management has discretion in setting the strategy and its implementation	**Cooperative model** Small equity market, concentrated ownership (banks, insurance companies, family, pyramid group, the state)
	Conglomerate variant – Evolution of the managerial or co-operative models towards diversified/unrelated activities to spread market risks.	
1970s and 1980s	"Conservative revolution" in USA and UK	Co-determination in Germany strengthened
Dominant 'paradigm': "Post-Fordist" capitalism	**'Shareholder value' model** Shareholders regain some control over management through the prism of "maximising share value".	
1990s	Emergence of shareholder activism; growing importance of institutional investors.	
Dominant 'paradigm': "Globalisation"		Influence of the shareholder value model outside the Anglo-US sphere
2001-2003	Enron, WorldCom, …	Ahold, Parmalat, Vivendi, …

2.3 The "shareholder value" model and the rise of institutional investors

13. The overview of the historical development of national systems demonstrates the diversity that has characterised corporate governance. Over the past decades however, public debates have taken an unhealthy turn with the predominance of one model, the "shareholder value" model. In this model, the corporation is defined as a "nexus of contracts" between the company and its management on one side, and those having a claim on the company on the

[7] Oman 2001

other. Accordingly, the corporation is defined as a succession of contracts between the private interests of stakeholders. In fact, the model assumes that the corporation does not exist *per se* as an autonomous institution with its own self-justifying interest. Shareholders are said to have a unique relationship with the company because their return on investment (dividends, value of the share) cannot be established by contract in advance. As the only constituent whose investment is entirely firm-specific (as opposed to "generic" investment governed by a contractual relationship), they have a residual claim on the company, which gives them exclusive control rights. All other stakeholders are said to have their interests protected by fixed contracts (labour contract, creditor contract, etc.) and therefore need not be represented in the company beyond contract negotiation. Accordingly maximising the interest of shareholders equals maximising the interests of the corporation and its stakeholders. The duties of managers and directors are confined to the maximisation of shareholder value and, where that breaks down, correction is assured by the equity market, which acts as a market for corporate control. That threat is said to be a permanent incentive for executives to maximise shareholder value.

14. On the surface the theory is elegant and simple, but when put into practice it has unintended consequences. Prioritising shareholder value leads to rampant short-termism and underinvestment, as resources are diverted away from the long-term interests of the corporation.[8] Companies cannot be run as a spot market of contracts; they would end up as a cabal of lawyers in perpetual negotiations. Furthermore the market for corporate control is flawed as a correction mechanism for corporate failure. And, most damagingly, the model excludes other corporate constituents, such as workers, from the corporate governance debate.

15. The rise of the shareholder value model was facilitated in the 1980s by institutional investors who then became pre-eminent capital market players. Pension funds, one type of institutional investor, have seen their assets relative to GDP across the OECD rise from 38% in 1981 to 144% in 1999, with a portfolio mix that has shifted towards equities – increasingly foreign, and in ever riskier emerging markets – and away from government and corporate bonds. Altogether an amount totalling around US$11 trillion dollars assets under management, representing working families' retirement income and savings, is invested and re-invested in global equity markets. [9]

16. For far too long those investors have delegated their investment policy to asset managers, whose interests – which are determined by the structure and components of their fees – have lain in short-term profits, not in the long-term interests of their beneficiaries. In the absence of proper regulation and market incentives, the needs of the ultimate owners of collective investment schemes, workers and households, have become secondary to the needs

[8] For an analysis of corporate governance changes towards the "shareholder value" model, and their impacts on workers and other corporate constituencies in the USA in the 1980s, see Lazonick and O'Sullivan 1997.

[9] In the USA, pension fund assets amounted to US$6.35 trillion in 2001, roughly a third of total financial assets of US institutional investors. In continental Europe the top 100 pension funds today hold assets amounting to 2.34 trillion Euros (almost US$3 trillion). In countries where public pension systems are still the norm institutional investors are nevertheless important, especially life insurance companies. In Germany, Italy and France these institutional investors taken together had US$4.2 trillion-worth of financial assets under management in 2001 (OECD 2003a). Outside the OECD, pension fund assets share relative to GDP has risen from 26% to 52.5% in Chile, and from 41% to 56% in Malaysia from 1993 to 2001 (IMF 2004)

of the financial investment industry itself. It is the asset managers who compete for contracts to manage the funds, and not the governing bodies of institutional investors, who decide how, where and in what form the money is invested. They are then judged on their performance relative to other funds when those contracts come up for renewal. Furthermore, market incentives are skewed to short-term financial performance, relative to competing funds. Institutional investors' interest lies not in the sustainability of the investments, but in short-term financial returns, with the ultimate sanction of selling those equities if and when "things go wrong". The only brakes on this system are the workers' pension fund trustees. As will be seen, a growing number of trade unions are training trustees to put in place a different investment regime.

3. The fallout from the governance crisis of corporations and capital markets

17. The story of the changing nature of the corporation does not end there. The unending series of corporate scandals, starting with Enron in 2001, has forced a rethink of the governance of large corporations. The impact has been felt in all areas of financial, economic, political and social life. Not only are corporations driven by rampant short-termism, they are also exposing themselves to governance failures, management greed, endemic conflicts of interests affecting capital market "gatekeepers". Some of the damage is calculable, but for the affected workers it is immeasurable. The headlines have focused for the most part on the trillions of dollars of investment finance wiped out through the destruction of corporate value. A few corporate heads may have been forced to resign – though always with huge rewards for failure. But that has to be set against the thousands of workers who have lost their jobs, or faced the insecurity and uncertainty of company bankruptcy procedures where their needs are usually the last to be met. Non-unionised Enron workers were sold "401K" pension plans where they bore all of the risk, which moreover were loaded with Enron stock. Their retirement savings sank with the company. As their jobs and pensions went so did their health care coverage, forcing many into penury.

18. The causes of the crisis are manifold, to judge from financial press headlines: fraudulently inflated financial results, false declarations of pre-tax profits, misuse of corporate funds to inflate stock value, misuse of corporate funds for private interests, inappropriate company loans to directors, improper profiting from share launches (IPOs – initial public offerings), cashing in stock by directors just before bankruptcy, tax evasion, money laundering, and so on. A wedge has been driven between the private interests of the corporate elites within these firms and the wider public interest. Here, three structural factors are singled out: (i) dysfunctional and self-serving boards of directors, (ii) endemic conflicts of interests fuelled by gaps in capital market regulation, and (iii) weak, if not absent, enforceable regulation.

3.1 Self-serving boards

19. The dysfunctional structure of boards of directors is a major determinant of recent corporate scandals. It is a closed world of interlocking directorships, of cronyism, where "old

boy" networks agree to reproduce themselves and to exclude others (especially women).[10] Oversight of their activities and decision-making, and responsibility to other corporate stakeholders, are aggressively discouraged. Corporate executives have taken advantage, for too long believing they could get away with almost anything provided they delivered improvements to the bottom line. They also have a vested interest in opposing regulatory reforms that allow responsible shareholders to have a meaningful say in the election of directors, and to make shareholder resolutions binding on the board.

20. The wave of scandals has also revealed the dangers of the "imperial CEO". At the time of the wrongdoings affecting their respective companies, Dennis Kozlowski (Tyco), Calisto Tanzi (Parmalat), Jean-Marie Messier (Vivendi), Kenneth Lay (Enron), John Rigas (Adelphia), Anne Mulcahy (Xerox), Richard Scrushy (HealthSouth) and Samuel Waksal (ImClone) had one thing in common: they were both the CEO and Chair of the board of directors. This is an unhealthy situation for the governance of the corporation. The Chair is supposed to play a leading role in supervising implementation of the strategy of the company by the CEO, which is hardly possible when they are one and the same.

3.2 Unregulated capital markets and endemic conflicts of interest

21. A further lesson can be derived from the endemic conflicts of interest that now exist within the auditing profession, others providing business services such as analysts and rating agencies, and the corporations they serve. The liberalisation of financial services markets from the 1980s onwards saw auditing firms becoming providers of other business services, some of which conflicted with the core business of auditing. A subsequent wave of mergers and acquisitions created the "Big Five": PricewaterhouseCoopers, Ernst & Young, KPMG, Deloitte Touche and Arthur Andersen. To win or retain consulting business, auditors may do only a cursory audit of their client firms; many accounting frauds that have come to light are relatively straightforward. Independence and objectivity have been sacrificed to gaining further business.

22. In the USA in recent years, another source of corporate fraud based on conflicts of interest has been misreporting of financial revenues by the management. Figures from the US Securities and Exchange Commission (SEC) indicate that over half of reported corporate irregularities are for "improper revenue recognition". The surge in the number of financial restatements by publicly listed companies since the mid-1990s can be causally linked to the phenomenal growth of equity-based CEO compensation, including stock option schemes. CEOs have a vested interest in inflating corporate revenues in the short term to maximise the value of their stock options.[11] This system was encouraged by large institutional investors in the 1990s because it appeared to be the only mechanism to ensure alignment of incentives between management and shareholders in a dispersed ownership structure (i.e. no controlling

[10] A US study has found that, of the nearly 7,700 board directors of Fortune 1,000 companies, "each director, on average, can reach every other director through 4.6 intermediaries and …each board can contact every other board in 3.7 steps" (Davis, Yoo and Baker 3003) This close "neighbourhood" is also supported by powerful informal networks, including alumni associations. In France in 2002, 31% of directors of listed companies originated from only two top civil-service schools. (A.N. 2003)

[11] Coffee 2003

shareholders with leverage over the CEO). By contrast, in Europe concentrated ownership has allowed controlling shareholders to plunder the productive assets of their companies, as was the case with the Parmalat bankruptcy.

3.3 Weak enforceable regulatory frameworks

23. Prior to the recent wave of corporate scandals, public policy promoted the development of self-regulatory corporate governance codes and standards, with an observed tendency to devolve rule-setting from parliament to regulatory bodies. The response of industrialised country governments to the Asian financial market crisis was to mandate the OECD to develop a set of non-binding Principles of Corporate Governance. However, the follow-up systems of monitoring and implementation focused on developing and transition countries, and attempts by the TUAC, among others, to extend them to OECD countries were not successful.

24. An OECD survey of developments in corporate governance systems[12] indicates that, with few exceptions, the majority of reform efforts (around 30 in the last few years) have followed the self-regulatory path. Yet according to the *Wall Street Journal*, self-regulatory bodies charged with oversight authority failed to unearth the vast majority of recent scandals.[13] That *laissez-faire* approach has failed all corporate constituents, not least workers and shareholders, who in the case of pension funds have little option but to litigate to recover retirees' lost income.

25. Governments in countries with developed private pension systems have also experimented with different mechanisms to encourage responsible shareholder activism, but in a limited and *ad hoc* way. For example, welcome moves have been made by some governments to require institutional investors that have activist policies to disclose them, or to disclose their proxy voting records. However, that does not always cover the need, for example, to allow responsible shareholders directly to nominate directors for election to the board or to vote on individual directors, or to have the resolutions that are passed at annual general meetings made binding on management.

[12] OECD 2003b
[13] The Wall Street Journal, 8 October 2004

Part Two: Workers' voice in corporate governance

1. The need for a trade union platform on corporate governance

26. Properly regulated and governed, the corporation is an effective institution for the creation of wealth. But it must be accountable to society for the way that goal is achieved. The description and explanation of the crisis provided in the first part of this report indicates why corporate governance is important to workers and the day-to-day work of trade unions, and why current regulations fail to ensure that corporations fulfil their wealth-creating mission. The internal structures and strategies of companies have changed with the globalisation of product, service and capital markets, and those changes imply new challenges for workers and trade unions. In particular, the labour movement needs to be concerned with the internal constitution of the corporation rather than rely simply on public regulation of markets or on governments to protect workers' rights at national or international levels. Corporate governance is crucial in determining both how companies operate and create wealth, and also how that wealth is divided between investors, corporate management, stakeholder groups and wider society. A role for trade unions engaging in public policy debate is even more necessary given the weak government response following the Enron crisis. Trade unions should recognise that corporate governance relates to every aspect of their work, be it organising workers, collective bargaining, or public policy advocacy.

27. One priority area for trade unions should thus be to improve their knowledge of the internal dynamics of large corporations. Small changes in corporate governance mechanisms that are not necessarily "visible" from the outside – such as separation of CEO and Chair-of-the-board functions – can make a difference to the output of company operations. This knowledge should extend to the entire global supply chain, web of partnerships and fictional legal arrangements – from the OECD-based headquarters to the plant in China – that help management to avoid responsibilities while concentration of power is maintained. Trade unions have already engaged corporate governance related strategies. Workers have a complex relation to publicly traded corporations. Trade unions represent workers as employees, of course, but they also represent them as shareholders and as citizens. They have done so in different ways, reflecting different national regimes: in Germany, and more broadly in Continental Europe, by defending worker representation within companies, in the US, and where pre-funded retirement systems are predominant (pension funds), by ensuring active stewardship of workers' capital invested in companies. A central concern of the labour movement is how to coordinate the roles of employee representative and shareholder representative to hold corporations accountable. Such emphasis on corporate governance in unions' activities might also encourage corporate social responsibility (CSR) initiatives. What is needed is to ensure that a stronger emphasis on binding regulation sets clear standards and that the social responsibilities of corporations do not rest solely on voluntary initiatives

1.1 The firm-specific investment of the worker

28. A first step in building such knowledge is to reassert workers as core constituents of the corporation and to make sure their firm-specific risks and investments are recognised, irrespectively of differences among national regulatory frameworks. In response to the shareholder value model, several scholars have developed an alternative "stakeholder" approach to the corporation, notably Margaret Blair in the mid-1990s.[14] A number of researchers have developed variants of the "stakeholder" approach but to date the most compelling analysis has been provided by the work of the late John Parkinson.[15] The starting point is to contest the assumption that control rights should be exclusively in the hands of shareholders. Instead, corporations, as quasi-public bodies, should be accountable to the interests of all relevant stakeholders. Here, the notion that shareholders bear residual risk is disputed. The issue is how and why *other* constituents must have control rights that complement their contractual relationships. Workers in particular acquire firm-specific expertise, knowledge of the assets they use and of the organisation and its "culture", which cannot be transferred and valued on the labour market, at least not at its true value. The value of this investment evolves over time, and the combination of human capital and corporate assets can generate firm-specific innovation. As noted by Gavin Kelly and John Parkinson:

> "Firm-specific risk arises when stakeholders undertake investment which creates capital that is of value, or will retain most of its value, only within the context of a given firm. […] The simple case in which employees undergo training that allows them to operate a piece of machinery that is peculiar to a single company will illustrate the implications of firm-specificity. In such a case the employees are exposed to firm-specific risk, since the human capital that results from the acquisition of specialised skills will be worth little or nothing outside the company. Not only that, the employees' human capital and the machine become co-specialised, that is, the economic rent generated by each factor depends on the performance of the other in such a way that it becomes impossible to disentangle the respective contributions of the parties. […] Once it is recognised that parties who make co-specialised investments receive returns, an element within which is not a fixed character, it becomes clear that protecting the interests of such parties through contract is no more feasible than protecting the interests of shareholders in that way".[16]

29. Fixed contractual relationships between employees and the firm do not adequately protect workers' interests, nor are they incentives to maximise firm-specific investment in human capital or ensure workers' commitment to the company and its strategy. The implication of the stakeholder approach for corporate governance is that workers, like other stakeholders whose interests are not fully protected by law and contract, bear residual risk in the corporation. They too can claim a representative role in governance. Their risk stems from specific capital invested in the corporation, financial capital for shareholders, labour (or human capital) for workers and managers. In fact the nature of workers' investments is much more 'sunk' than shareholders who typically spread their investments over many companies

[14] Blair 1995
[15] Parkinson 2003
[16] Kelly and Parkinson 2000

precisely to diversify their risk. If stakeholders are not represented, they will under-invest in the enterprise for fear of being expropriated by those who are represented. Such under-investment compromises firm performance and weakens its capacity to face up to crisis and manage change. Thus under-representation of workers in corporate governance violates the public purpose for which corporations exist.

30. By contrast, external stakeholders such as creditors invest "generic" resources in the corporation – that is, resources that do not lose value if transferred outside the company –and have their interests fully protected by law and contractual relationship. Other stakeholders – local communities, consumer groups, interest groups, the environment, wider civil society – do not invest as such in the corporation, but can be exposed to its activities. As regards suppliers, the nature of their investment (specific or generic) may vary. Suppliers who have a diversified client portfolio and are not dependent on one client company are assimilated to external stakeholders. On the other hand suppliers who may tool a whole plant to supply the needs of one major customer do make firm-specific investments.

The internal and external stakeholders of the corporation

Stakeholders	**Regulatory framework**	**Accountability mechanisms**
Constituencies of the corporation (making firm-specific investments): Workers, shareholders, management, dependent suppliers	Capital market regulation, corporate law, labour law	Fixed contract and residual control rights
External stakeholders making generic investments or exposed to the activities of the corporation: Creditors, diversified suppliers, clients Local public authorities, communities Consumer and other interest groups	Broader regulatory framework	Fixed contracts and wider "social" contract with society

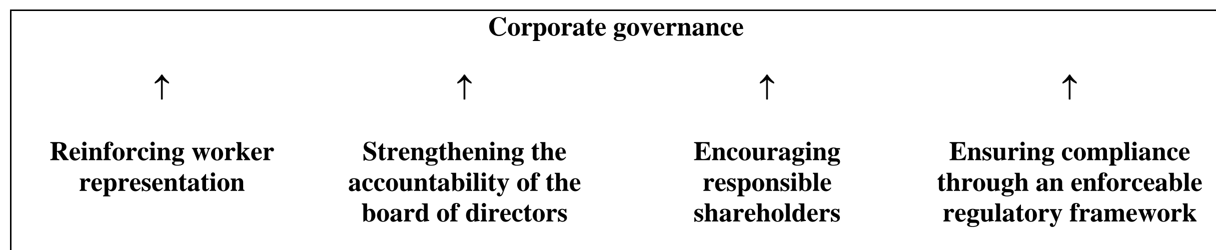
1.2 A trade union framework of corporate governance

31. The challenge facing public policymakers is to implement a broad range of reforms that can restore trust to modern corporations. Piecemeal and *ad hoc* solutions, even where welcome, are insufficient. Root-and-branch regulatory reforms and reviews are required to ensure that corporations are properly accountable to society to serve the public purpose of creating wealth. Beyond that fundamental requirement to society at large, corporations must be regulated for their particular responsibility to stakeholders contributing firm-specific assets as outlined above. Finally, there is a responsibility that all companies have to all parties who are affected by corporate activities. Some of these responsibilities are mandated by law and others by voluntary CSR programs.

32. The role of government is to craft an overarching regime of interlocking regulatory frameworks that serve the twin objective of corporate accountability to society and responsibility to its core constituencies. Full compliance of the corporation with enforceable laws and regulations under which the corporation and its subsidiaries operate (labour, corporate, competition, tax laws, safety and health standards, etc.), forms the basis upon which the accountability of the corporation and the protection of stakeholders' interests can be considered. From there, an effective corporate governance framework should define the responsibility mechanisms for core constituencies, including workers' interests representation within the decision-making process and collective bargaining. Finally, outreach to stakeholders should complement the broader accountability framework with initiatives that are not necessarily legally required but are expected by society for corporations to contribute fully to wealth creation. Together they form the basis for a four-tier structure of corporate accountability: (i) compliance with laws and regulations, (ii) an effective corporate governance framework, (iii) collective bargaining and, finally, (iv) broader social and environmental initiatives and outreach to external stakeholders.

33. These four tiers constitute a mutually reinforcing package that public policy reforms should simultaneously focus upon and that trade unions should seek to implement. They set out two ways in which a stronger worker voice is currently operationalised: reinforcing worker representation within the company and encouraging responsible shareholders. The two are not mutually exclusive, and trade unions will campaign around one or both of these systems, depending on national circumstances. More importantly, both strategies have as a common objective to ensure well functioning and accountable boards of directors.

Key targets for the governance of corporations



2. Reinforcing worker representation in corporate decision-making

34. Collective bargaining is central in any system of checks and balances that gives workers a voice in corporate decision-making. Collective bargaining is not commonly thought of as corporate governance, but it is. Collective bargaining is much more important to corporate governance, certainly, than bondholder issues, particularly considering the firm-specific investments which workers make to the success of the corporation. Trade unions at the enterprise level and above do more than simply bargain over wages. They negotiate over broader workplace terms and conditions affecting their members. They may also negotiate

pension and health-care entitlements, and the systems that govern their provision.[17] These non-wage bargaining issues are often handled through workplace committee structures that report to the board, and whose negotiated outcomes frequently guide board decision-making.

35. Traditional collective bargaining has been challenged by the internationalisation of corporations. Workers and their organisations are disadvantaged in having to negotiate separate agreements with management in different countries and sites. That concern may well be directly addressed in the future through the growing number of International Framework Agreements (IFAs) - negotiated agreements between Global Union Federations (GUFs[18]) and individual large corporations. About 29 such agreements now cover over 2.6 million workers, and their numbers are increasing. Rather than being detailed collective agreements, these instruments are enabling frameworks built around commitments by the corporations concerned to implement and respect the core labour standards of the International Labour Organisation (ILO). However, these agreements could evolve to cover a broader range of issues, including workers' rights within the decision-making processes of large corporations.

International Framework Agreements

Year	**Nb workers**	**Country of origin**	**Corporations**
1998	333 000	Germany	Faber-Castell, Freudenberg, Hochtief, Volkswagen,
1999	339 000		DaimlerChrysler, Leoni, GEA, Rheinmetall, Bosch, Prym,
2000	403 500		BMW, Gebr. Röchling
2001	1 109 500	France	Danone, Accor, Carrefour, Renault, EDF, Rhodia
2002	2 014 300	Sweden	IKEA, Skanska, SKF, H&M, SCA
2003	2 391 250	Italy	Merloni, Eni, Impregilo
2004	2 962 850	Norway	Statoil, Norske Skog, Vedeikke
Aug 2005	3 390 750	Spain	Telefonica, Endesa
		Netherlands	Ballast Nedam, EADS
Global Union Federations		Greece	OTE Telecom
ICEM, IFBWW, IMF, IUF		Denmark	ISS
& UNI		New Zealand	Fonterra
		Russia	Lukoil
		South Africa	Anglo Gold
		USA	Chiquita

Source: Hellmann & Steiert 2005

36. As a contractual relationship between workers and corporations, collective bargaining addresses a core dimension of the relations between them. In a majority of industrialised countries, however, workers are also recognised by law (or by those same collective

[17] Unionised workers in the USA are up to 28% more likely to have employer-provided health insurance than those not covered by a collective agreement.

[18] the Global Union Federations are Education International (EI), International Federation of Building and Wood Workers (IFBWW), International Federation of Chemical, Energy, Mine and General Workers' Union (ICEM), International Federation of Journalists (IFJ), International Metalworkers' Federation (IMF), International Textile, Garment and Leather Workers' Federation (ITGLWF), International Transport Workers' Federation (ITF), International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers' Association (IUF), Public Services International (PSI) & Union Network International (UNI).

agreements) as having the right to be represented in company decision-making, through works councils and/or the board of directors. Developing worker representation strategies has been an important theme for European trade unions, most notably the European Trade Union Confederation (ETUC) and its research centre, the European Trade Union Institute (ETUI).[19] There may be scope for a renewed reflection on, leading to modernization of, existing worker representation mechanisms.

2.1 Works councils

37. Works councils constitute the principal mechanism for worker representation within corporate decision-making procedures, and are found across continental Europe. They are usually composed of elected worker (sometimes but not necessarily via unions) and management representatives. Though varying across countries their typical mandate is to deal with direct workplace issues, including workplace organisation and hours, restructuring, the introduction of new technologies, health and safety at work, and other employment conditions. The prerogatives of worker representatives vary from information (the right to be informed by the management) to consultation (the right to be informed and express views) to negotiation (the right to a veto on certain issues). In some countries, works councils may receive substantial financial support to undertake cultural and leisure activities for employees. Furthermore, as from 2005, European Union countries have to guarantee a generalised right to information and consultation for all workers, subject to limitations on the enterprise size.

38. The European Works Council (EWC) directive 1994 has added a regional dimension. It requires all companies operating across the EU, irrespective of their home base, and employing more than 1,000 workers in at least two countries, to set up European-wide information and consultation bodies with employee representatives. Of the more than 1,800 companies estimated to be covered by the directive in 1994, around 600 have established one or more EWCs. Approximately 10 million European workers are represented in such bodies. EWCs should not be considered as a European practice alone. More than a third of corporations with EWCs have their headquarters outside the EU, predominantly in the USA, and compliance with the directive is often higher for corporations from countries with lower levels of social dialogue.

The OECD Guidelines for Multinational Enterprises

The OECD Guidelines for Multinational Enterprises – alongside the ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy – constitute the most advanced international agreements to ensure social responsibility of business. Negotiated by governments, they include information and consultation rights for workers. The Guidelines state the need to respect human rights and observe the core labour standards of the ILO - but they go much further. They set out prescriptions for attitudes to union recognition, employment conditions, procedures for plant closures, and health and safety issues, to mention only a few elements. They also specify procedures for prior consultation and negotiation regarding changes in company activities.

[19] http://etui.etuc.org/

Although the OECD Guidelines are not legally binding, they set out government expectations for how their companies (that is, companies based and originating in the 38 signatory countries) should behave wherever they operate. These companies account for 85% of global foreign direct investment. The Guidelines may be "voluntary" in the sense that they are not binding, but they are not optional for management. They are political commitments by governments, backed by government implementation mechanisms, the National Contact Points. This is the key difference between the Guidelines and other instruments labelled as "corporate social responsibility" codes of conduct.

2.2 Board-level employee representation

39. Board-level employee representation constitutes a distinct form of direct worker representation. It differs from works councils in that it provides employee input into overall company strategic decision-making, rather than information and consultation on day-to-day operational matters. It operates via worker or union representatives who sit on the supervisory board, board of directors, or similar structures. Within the OECD, 16 countries (out of a total of 30) have generalised provisions or sector-specific agreements for board-level employee representation.

40. Board-level representation is designed to improve communication and decision-making between the board, the CEO and employees, who can inform the board on practices that may not be known through the traditional company hierarchy. They can give first-hand information concerning the situation within the company, and advance response to decisions that may affect the workforce, while providing early information to works councils on strategic moves planned by the company. Board-level representation is also an opportunity for employees to discuss and negotiate alternative company strategies that secure socially acceptable outcomes, within the objective of financial sustainability. Furthermore, board representation is important to ensure the accountability of the board and of the CEO. Employee representatives are by definition independent directors from the management. They can usefully provide information to other non-executive directors and, having "independence of mind", are likely to be more willing than other directors to question the CEO on sensitive issues.

41. Having a voice in the corporate decision-making process is, however, no guarantee that it will be exercised effectively. Success depends on there being regular meetings and discussions, provision of adequate time off for workers' representatives, provision of adequate information to them, and the threat of real sanctions on those employers who fail to meet their responsibilities. Responsibilities exist too on the other side of the equation. For example, employee representatives themselves must invest the necessary time and effort to do the job, they must keep colleagues informed of the deliberations, and they must respect the fiduciary duty that often arises from membership of the board. Trade unions have a key role to play here, especially in providing logistical support and training.

Works councils and board-level employee representation in the OECD countries

<table>
<tr><th></th><th>Works council</th><th colspan="2">Board-level representation</th></tr>
<tr><th>Country</th><th></th><th>State-owned enterprises</th><th>Publicly listed corporations</th></tr>
<tr><td>Austria</td><td>Yes*</td><td colspan="2">One third of board members</td></tr>
<tr><td>Belgium</td><td>Yes</td><td colspan="2">No</td></tr>
<tr><td>Czech Rep.</td><td>Yes*</td><td colspan="2">One third of board members</td></tr>
<tr><td>Denmark</td><td>Yes</td><td colspan="2">From two members to one third of board members</td></tr>
<tr><td>Finland</td><td>Yes</td><td colspan="2">Determined by collective agreement</td></tr>
<tr><td rowspan="2">France</td><td rowspan="2">Yes</td><td colspan="2">2 works council representatives (no voting rights) and</td></tr>
<tr><td>from three members to one third of board</td><td>2 or 3 members for privatised corp.; up to one third of board for other corp. on a voluntary basis</td></tr>
<tr><td rowspan="2">Germany</td><td rowspan="2">Yes*</td><td colspan="2">One third to half of board members, chairman elected by shareholders</td></tr>
<tr><td></td><td>Iron, coal and steel industry: appointment of the personnel director of the management board</td></tr>
<tr><td>Greece</td><td>Yes</td><td>2 or 3 board members</td><td>No</td></tr>
<tr><td>Hungary</td><td>Yes*</td><td colspan="2">One third of board members</td></tr>
<tr><td>Ireland</td><td>No</td><td>Yes</td><td>No</td></tr>
<tr><td>Italy</td><td>Yes</td><td colspan="2">No (Constitutional law not implemented)</td></tr>
<tr><td>Japan</td><td>Yes (voluntary)</td><td colspan="2">No</td></tr>
<tr><td>Luxembourg</td><td>Yes</td><td colspan="2">Up to one third to half of board members</td></tr>
<tr><td>Korea</td><td>Yes</td><td colspan="2">No</td></tr>
<tr><td>Netherlands</td><td>Yes</td><td colspan="2">Works council binding recommendation of board nominate(s) to AGM</td></tr>
<tr><td>Norway</td><td>Yes*</td><td colspan="2">Yes</td></tr>
<tr><td>Poland</td><td>Yes*</td><td>From 2 members to two fifths of board</td><td>1 member of the management board for privatised companies</td></tr>
<tr><td>Portugal</td><td>Yes</td><td>No (Constitutional law not implemented)</td><td>Best practice of 1 member of the council of auditors</td></tr>
<tr><td>Slovakia</td><td>Yes</td><td>Half of board members</td><td>One third of board members</td></tr>
<tr><td>Spain</td><td>Yes</td><td>2 board members</td><td>No</td></tr>
<tr><td>Sweden</td><td>Yes*</td><td colspan="2">2 or 3 board members</td></tr>
<tr><td>Switzerland</td><td>Yes</td><td>No</td><td>No</td></tr>
<tr><td colspan="4">Jurisdictions in Australia, Canada, Mexico, New Zealand, Turkey, UK and USA have no regulatory provisions for works councils or for board-level employee representation.</td></tr>
</table>

*includes co-determination rights
Sources: HBS & ETUC 2004; EIRO 2001 and 2002.

3. Encouraging responsible shareholders

42. Rights of shareholders are a means to an end, not an end itself. Shareholders provide liquidity for investors who have in the past provided equity finance and bear a residual risk in the company. In return, shareholders receive dividends and expect appreciation of their investment over time. This occurs either through stock market share appreciation – if the corporation is listed – and/or when another investor, a group of investors or the market propose to buy the investment with a substantial premium – case of takeover, initial public offering, de-listing, etc. However, shareholders optimise return on their investment if, and only if, the long term interest of the corporation is fulfilled.

43. Such broader perspective on shareholders' rights is in fact not optional, otherwise the debate is relatively straightforward. From a shareholder-centred point of view, their rights

should include active participation to the AGM and approval of changes in the capital structure. For example, shareholders should be able to make proposals on the company's proxy statements, to vote on resolutions affecting conflict sensitive issues such as remuneration, nomination and board organisation, to consult and discuss all relevant issues among themselves, subject to safeguards for minority shareholders and rules on transparency and disclosure. Granting those rights however does not necessarily mean that they will use them 'wisely' to the benefit of the corporation. Shareholders have indeed the ultimate right to "remain silent" – with the notable exception of institutional investors in fiduciary capacity. They can also adopt short term strategies, speculate on the share value, and use various means to deliberately undermine the long term interest of the corporation and its workers. Thus any meaningful discussion on the role of shareholders must have as a purpose not simply expanding their rights *ad vitam eternam*, but to ensure an enabling regulatory environment that facilitates alignment of shareholders' financial interests with the objective of building robust and successful corporations that benefit all constituencies of the corporations and society as a whole.

3.1 An enabling regulatory framework for shareholders' responsibilities

44. It is the task of public policy to regulate in a way that achieves responsible shareholder activity, rather than relying on shareholders on their own to change their behaviour. The role of shareholders must be contemplated on the long term. Long term perspective should not prevent shareholders from divestment or modifying the structure of their portfolio investment in order to take advantage of new market opportunities, spread the risks. Liquidity in the marketplace is needed for efficient and adaptive allocation of capital. However, liquidity does not mean volatility and stock market should at all times reflect the fundamental long-term value of listed corporations. The portfolio investment policy of responsible shareholders must be regulated to ensure that it does not contribute to volatility of capital markets which undermines a corporation's capacity to access capital and/or to develop a long term strategy.

45. Responsible shareownership requires a robust corporate and financial market regulatory environment for shareholder investment policy to be designed in accordance with (i) the public purpose of the invested corporation and (ii) the imperative requirement of market stability and integrity that is needed for the corporation to access capital at affordable cost. Responsible shareholders acknowledge that they alone do not have exclusive control rights over the corporation and that the valuation of their stake in the company is dependent on those of other core constituencies, workers in particular. Shareholders can be said to own their shares, but not the corporations whose shares they own (which as an institution bearing legal personality, cannot be owned) or the assets of the corporation (which are owned by the corporation, not its shareholders). What is important is to implement strong incentives for shareholders to integrate those imperative requirements in their investment policy (ie. in which company to invest?) and from there, in their corporate governance policy (shareholder voting policy, dialogue with the management and other corporate constituencies, consultation with other shareholders). At the investment level, one way, but not an exclusive way, is to condition asset allocation to social responsible investment criteria (SRI). SRI and "best in class" investment (i.e. investing only in corporations with good social records) is an

appropriate policy to promote responsible corporations, but it is not the only way. It is equally important for responsible shareholders to have a voice in corporations with bad corporate governance and social or environmental responsibility records, this precisely to influence their boards and management.

3.2 Mobilising workers' pension capital for corporate governance reform

46. Empowering long-term responsible shareholders has a particular resonance in the case of institutional investors in fiduciary capacity such as pension funds. Institutional investors should adopt the highest level of transparency and accountability to their members. Shareholders who remain short-run in their outlook and indifferent to the long-term interest of the companies in which they invest "trade liquidity for control"[20], should not be granted special authority in corporate governance. Workers' pension funds, however, because of their particular liabilities and size cannot trade liquidity for control and must be granted effective control rights, including access to the companies' proxies. In countries with funded pension systems, trade unions are promoting their members' rights as shareholders to have a voice in corporate decision-making and, more broadly, to bring about good corporate governance regimes in those companies where their pension funds hold equity. Such campaigns aim to secure high levels of retirement income, while ensuring that the deferred income is invested in sustainable corporations. In the USA, Canada and the UK for example, the AFL-CIO, the CLC, the TUC respectively have committed substantial resources to mobilise what is in effect "workers' capital" behind corporate governance reforms, and are increasingly influencing the pension fund industry, especially through their trustee networks.

Pension fund asset management in selected OECD countries

Year 2001 Figures in billion US$	Financial assets of institutional investors	of which pension funds	Pension fund assets as % of total assets of institutional investors	Pension fund assets as % of GDP
Australia	458	238	52	68
Canada	794	331	42	48
France	1 701	n/a	n/a	n/a
Germany	1 478	61	4	3
Italy	1 007	47	5	4
Japan	3 645	711	20	19
Netherlands	722	398	55	105
UK	2 743	954	35	66
USA	19 258	6 351	33	63

Source: OECD 2003a

47. Mobilising workers' capital is both a bottom-up approach, of educating union and other worker trustees of such funds to use their leverage to change the behaviour of pension fund managers, and a top-down approach, where the union leadership engages the investment managers of these funds while seeking regulatory changes to empower the trustees and the relevant funds. There have been a number of successes, notably concerning the remuneration

[20] AGLIETTA & REBERIOUX 2004

policy of the board of directors, the separation of the CEO and Chair of the board, the promotion of non-executive directors who are "independent" from management, and respect for workers' rights. The AFL-CIO and its affiliates are now the leading US organisations filing proxy resolutions at AGM meetings.

3.3 Governance of pension funds and other forms of workers' capital

48. Shareholder empowerment can only come about through public policy to create a level playing field with clear rules of the game. Reforms are needed to the governance of institutional investor industry itself. As noted in Part one[21], there are numerous conflicts of interest within the internal and external governance structure of pension funds, which mean that they will not reform themselves. It has to be done through public policy. But those reforms alone will not work unless pension fund members and trustees are also empowered to ensure that investment managers act in their best interests. Member-nominated trustees must have pension fund board-level representation sufficient to give them an effective voice in decision-making. Regulatory reform should also address conflicts of interest.

49. Pension fund trustees also have rights and responsibilities. They should help ensure that investment policies are implemented, including that proxies are exercised and that voting is determined according to the long-term interests of the members of the pension plan. That duty is most often defined by law, as in the US Employee Retirement Income Security Act (ERISA), or by the pension plan's investment policy statement. Trustees should be responsible for developing and supervising implementation of the investment guidelines. Those guidelines should define the criteria used to determine how to vote on issues. They should be benchmarked according to relevant national and international standards in the field of corporate governance, social rights and environmental practices. Specific corporate governance issues are key requirements. All of that will require further resources and training; the most effective and efficient way of doing this would be to create an academy for trustee training, education and networking.

50. Workers' capital can take other forms, for example Employee collective saving schemes and employee share-ownership plans (ESOPs). Regarding the latter, the difference with workers' pension funds is that ESOPs are invested in the company that employs them. There is therefore an inherent risk of exposing workers to corporate risks twice, through their job and through their savings. For this reason, ESOPs should not be the foundation of workers' retirement plans. The story of Enron's 401K schemes is all too well known. What is important from a trade union perspective is that ESOP arrangements result in effective, active and independent collective ownership of the company share capital by employees. Where ESOPs are established, the corporate governance framework should facilitate the collective organisation of employee shareowners – in the form of employee shareowner associations – in a way that ensures independence from executive management. Such collective ownership, once a certain amount of capital has been reached, should result in independent representation on the board of directors. Workers' capital can also be found in labour-owned or labour-

[21] paragraph 16

oriented financial institutions that are specialised in financial assistance to unionised workers and their unions (such as life and non-life insurance, retail banking, asset management and housing loans), in cooperatives and more recently in new forms of worker friendly venture capital investment and holding companies.

4. Strengthening the accountability of the board of directors

51. The present report has outlined the most efficient and effective ways in which workers and shareholders may exercise rights to accountability. Both approaches should target a common objective: to strengthen, or rather to re-habilitate, the fundamental role of boards of directors, whether in one- or two-tier systems. Binding regulations should make sure that boards – not the management – are in a position to discuss, approve and supervise the implementation of the corporation's operational policies that taken together constitute its long-term strategy. Companies must be accountable for these policies to all internal stakeholders that engage in firm-specific investment. Boards should ensure continuous dialogue with worker representatives and responsible shareholders as an essential condition to strengthen the competitiveness of companies, to increase their capacity to prevent corporate failure and to manage change. Corporate governance matters, and specific mechanisms for worker participation should therefore be mainstreamed by trade unions in collective bargaining.

52. Binding regulation must touch upon the composition and the organisation of boards in a way that ensures diversity of profiles, capacity to understand and take account of all the corporate constituencies' interests, as well as the market forces that drive the corporations' activities. Such an approach would certainly include imperative requirements of independence of the board from the management, as well as strong rules to prevent conflicts of interests.

4.1 Organisation and responsibilities of the board

53. The composition and organisation of boards themselves is key to their operation and accountability. There must be a balance between directors whose primary function is to implement the strategy (the executive directors) and those supervising them –(the non-executive directors) with clear channels of accountability. Their respective roles and functions must be articulated through public policy, including clear definitions of "independence" and "objectivity", and set out in the company's articles of association. In one-tier systems, a majority of the board must consist of non-executive directors. Beyond that, the Chair of the board must be fully independent from the executive directors. That is the case by definition in two-tier systems (the CEO chairs the management boards, all members of the supervisory board are non-executive directors), in single-tier systems, the positions of Chair of the board and CEO must be separated.

54. Board meetings must also reflect the collegiality of the institution and its primary function as a "forum" where corporate strategy is discussed in an open and unrestricted way, and where different views over that strategy are resolved. Diversity can help in this regard,

not least in the gender balance, which should be a matter of public policy. Directors should also understand the interests of company stakeholders, its economic, social and environmental constraints, as well as the market forces that drive the business. The board should thus ensure a satisfactory dialogue with shareholders, employees and, where appropriate, other stakeholders, to discuss their concerns and interests in the formulation and implementation of company strategy. That dialogue should take place in a transparent manner. Furthermore, audit committees should take responsibility for ethical reporting and disclosure or they should alternatively work closely with a separate ethic committee. Both audit and/or ethic committees should have the power to launch internal reviews of the corporation independent of management. The following table proposes a framework for directors' responsibilities and those that are specific to executive and non-executive directors.

The responsibilities of directors

General responsibilities	Setting the long-term strategy of the corporation and its implementation	Ensure the accountability of the corporation	Prevent governance failure and oversee performance and risk mitigation (including hiring, overseeing and firing, when necessary the CEO).
Specific responsibilities of the Chair, other non-executive directors or members of the supervisory board	Advise and constructively challenge the executive directors. Supervise implementation.	Ensure the representation of interests of all stakeholders.	Manage conflicts of interest on sensitive issues, including: evaluation, nomination and remuneration of directors. Monitor the performance of the external auditor and internal auditing and ethical reporting.
Specific responsibilities of the CEO, other executive directors, executive officers and/or members of the management board	Formulate, propose and implement the long-term strategy.	Ensure compliance with national and international standards & regulations. Disclose the financial and non-financial performance and impact of the company's activities.	Implement internal risk reporting, Ensure socially and environmentally acceptable outcomes in cases of extraordinary events that substantially alter the structure of the corporation.

4.2 Nomination, qualifications and remuneration of directors

55. The modalities for qualification, nomination and evaluation of directors must reflect the responsibility of the corporation to all its stakeholders. Non-executive directors should be independent of management, competent, and demographically diverse. Directors' abilities and experience should also be diverse, and boards should balance directors drawn from commercial sectors with those drawn from the non-commercial sectors, so as to ensure that the board collectively has the required knowledge and expertise to fulfil its responsibilities. They should also be able to "think objectively" and not be influenced in their judgment by short-term market expectations of financial performance. Multiple directorships should be

barred, not only to avoid conflicts of interest but to ensure that directors can dedicate sufficient time to fulfilling their duties.

56. The process of nominating and electing company directors is of crucial importance to foster more diversified and accountable boards focused on the long-term success of companies. The process should be designed to empower core constituents who make firm-specific investments and have a demonstrated interest in the long-term success of the company. There is no single formula for nominating and electing board members, given the diversity of national jurisdictions, of shareholder structures and capital market regulations. In the U.S., the AFL-CIO is supporting an SEC rule change that would permit qualified shareholders to nominate board candidates on companies' proxies. In the UK, the TUC is campaigning for boards to recognise the importance of experience and skills gained in the non-commercial sector for a well-balanced board, and to target those with experience in fields such as the public sector, trade unions and NGOs when appointing non-executive directors. It has called for a pool of potential non-executive directors from which boards could recruit to be established by seeking nominations from stakeholder groups, including trade unions, and for selection procedures for non-executive director appointments to be open and transparent, with positions publicly advertised, and appointments made on the basis of an agreed job description and person specification.

57. A halt must be called to excessive director remuneration. While leadership and expertise, independence and risk exposure should be adequately compensated, remuneration should be defined solely by a company's own long-term interests. Under no circumstances should individual remuneration be fixed according to the so-called "industry median" or other extraneous indicators. Companies should publish a clear and detailed policy statement covering all aspects of their remuneration policy regarding the fulfilment of a director's responsibilities (base salary, bonuses, pension entitlements, civil liability insurance, training programmes, and associated costs). It must be consistent with the remuneration policy for its employees, including departure and pension arrangements. The granting of stock options should be banned, unless they are part of the same programme as Employee Share Ownership Plans (ESOPs) covering all workers. A stand-alone committee composed exclusively of non-executive directors, or the supervisory board in two-tier systems, should be given the authority to decide this.

5. Ensuring compliance through an enforceable regulatory framework

58. The post-Enron situation demanded something more, and there was an initial response, which began in the USA. The Sarbanes-Oxley Act was a welcome regulatory effort at the US federal level to restrain the powers of corporate executives, tighten requirements for the auditing profession. However, many commentators, including trade unions, have criticised the limited scope of the Act; key reforms were omitted that could have injected greater responsibility into corporate behaviour.

59. The European Commission added a regional dimension with its May 2003 Action Plan on "Modernising Company Law and Enhancing Corporate Governance in the European

Union", and in 2004 launched a European Corporate Governance Forum. To date, however, EU policy is oriented away from creation of a pan-European binding regulatory regime, as in the USA, and towards a series of "good practice" recommendations. The emerging focus on market transparency and disclosure is welcome - but core issues relating to board responsibility are left to soft-law.

60. At international level, the OECD has reviewed its Principles of Corporate Governance, with the adoption by Ministers at their spring 2004 Council meeting of a revised set of Principles.[22] At that time, the TUAC welcomed several improvements, including those to the Stakeholder chapter. The revised Principles recognise workers' rights within corporate governance systems that go beyond those established by law, to include those set through collective agreements and other "mutual agreements". Furthermore, works councils, board-level employee representation and employee share ownership schemes are encouraged. The revised Principles also set out requirements for institutional investors to disclose their voting policy, for the protection of minority shareholders and for enhanced duties of external auditors. However, welcome as these changes are, the Global Unions see the Principles as work in progress. Much more needs to be done, for example, to limit executive pay and to secure better boardroom accountability, including the separation of CEO and Chair.[23]

5.1 The role of corporate gatekeepers in ensuring accountability

61. The majority of recent corporate scandals have involved gross failures of internal accounting systems and external auditing practices. One major failing in the US is that corporate executives are not liable for the veracity of the accounts as presented by the external auditors. Accounting practices, usually developed by the profession itself, along with executives' inexperience and financial illiteracy, have undermined internal oversight. The desire by audit firms to win non-auditing business from corporate clients, along with the knowledge that self-regulatory systems governing their actions are, except at the limit, largely ineffectual, have undermined external oversight.

62. Overcoming the internal and external auditing deficits requires first and foremost a sanctions- based regulatory system of checks and balances. Auditing firms themselves must be liable for the audit provided. They should not be allowed to compete for other business services to audit clients where there is a conflict of interest that could undermine the integrity

[22] The Principles comprise six chapters: Ensuring the basis for an effective corporate governance framework (implementation and enforcement); The rights of shareholders and key ownership functions; The equitable treatment of shareholders; The role of stakeholders in corporate governance; Disclosure and transparency, and; The responsibilities of the board. The Spring 2004 meeting of the OECD Council of Ministers adopted the newly revised Principles following 12 months of negotiations by the OECD Steering Group on Corporate Governance. The TUAC and its affiliates participated in the review on an *ad hoc* basis. A more thorough evaluation of the review may be obtained from the TUAC Secretariat. In parallel, and touching upon capital market reforms, the OECD Working Party on Private Pensions is looking at ways of enhancing the regulation and governance of defined benefit plans, including pension fund asset management; and protecting the rights of members and beneficiaries.

[23] Other multilateral fora on social responsibility of businesses have, or will have, an impact on corporate governance debates. The Global Reporting Initiative Sustainability Guidelines are currently under revision, the International Standard Organisation (ISO) has launched a process for agreement on a new ISO standard on CSR. The United Nations has its 'Norms of the Responsibilities of Transnational Corporations and Other Business Enterprises with Regard to Human Rights', and the UNEP-Finance Initiative is working on new 'Principles for Responsible Investment'.

of the audit. The contracting-out by the Big Four (PricewaterhouseCoopers, Ernst & Young, KPMG, and Deloitte Touche) of their services and brand name to local accounting firms, a practice common in developing and transition countries, should be allowed only when the parent company assumes liability for the services supplied. The rotation of auditing firms on a regular basis should be encouraged as a complement but not a substitute for these measures.

5.2 Regulations for market transparency, stability and integrity

63. Public policy needs to set a framework for these activities and for reform of institutional investors' own internal governance structures. That framework must include a requirement for institutional investors to put in place investment policies that clearly set out their shareholders functions, including proxy voting and engagement guidelines. The proxy voting positions on all issues must be publicly disclosed. The public policy framework should require that institutional investors which are not strictly bound by fiduciary responsibilities – such as insurance companies – should adopt similar mechanisms. Full disclosure of the investments of institutional investors should be required by all jurisdictions. In the US large institutional investors are required to fully disclose their investment holdings on a quarterly basis and to inform their shareholders[24]. Institutional investors in most European countries fall far short of this requirement, e.g. only disclosing their top five holdings, less frequently than on a quarterly basis. Small investors, including workers and their families, should have the right to know where their money is invested.

64. Building an effective regulatory framework would secure, via binding requirements an enabling environment for active and responsible shareholders. Governments should in particular reform laws and regulations affecting the fiduciary duties of trustees, for the latter to have sufficient confidence in integrating non-financial criteria in their investment policies. Beyond the governance of institutional investors as outlined above, regulatory reform should also include incentives for corporations to formulate and communicate to shareholders in a way that is designed to attract long-term investment strategies. More broadly, a series of measures can be taken to reduce volatility in trading of shares and build stable and long term shareholding structure. In recent high profile cases in Germany, voting rights have been be diverted from their original long term purpose to serve predatory practices seeking short-term financial gains. This type of situation must be strongly discouraged, and long-term commitment by shareholders to companies should be rewarded using regulation[25]. What is at stake is to build a regulatory environment that does not only permit long term responsible shareholders to develop but also encourages, and indeed forces short-term "traders" to become long-term shareholders.

[24] the Securities Exchange Commission "13F form"

[25] for example, by increasing voting rights for long term shareholders to the detriment of short term shareholders, distribution of dividends in proportion of the shareholding record.

Conclusion

65. The diverse nature of national systems of corporate governance, including their contents, coverage, and means of implementation and enforcement, ensures that there can be no single blueprint for reform. Instead, we have focused more on key principles for public policy, including some elements more normally seen as related to capital markets. The point needs to be made that corporate governance and accountability, if they are to have any meaning, must be put in the context of a re-thought vision of the role and functioning of capital markets. That vision, not least concerning corporate governance, will only come about through an activist government stance leading to public policy reforms at the national, regional and international levels. This report has shown that the global systemic crisis of corporate governance is broader and deeper than envisaged by any government reform effort to date. With the question not when but where the next catastrophe will occur, governments must now rekindle the regulatory process.

66. The report has highlighted four areas where reforms are urgently required. They are: reinforcing worker representation; promoting responsible shareholder activism; strengthening the accountability of the board; and ensuring compliance through an enforceable regulatory framework. The Report of the ILO Commission on the Social Dimension of Globalisation contains a number of sound recommendations on the promotion and protection of workers' rights as well as on coherence among the multilateral institutions that together have the potential to harness globalisation for all[26]. Such international coherence is certainly required for corporate governance reform, and the OECD, notably its Steering Group on Corporate Governance, Public Governance and Insurance Committees, could provide much-needed leadership to take this forward.

67. As regards the international labour movement, the ICFTU, WCL, TUAC, the GUFs, and the ETUC, with their respective affiliates, are separately and together campaigning for a new global order for corporate governance. That campaign is taking two forms: capacity building in pursuit of these aims across and within the labour movement; and engaging public policymakers at the various levels, and market players where the labour movement has leverage. The international vehicle is the Joint ICFTU/GUF/TUAC Committee for International Cooperation on Workers' Capital and its four working groups, which cover pension fund trustee education, corporate governance and financial market regulation, cross-border shareholder campaigns, and ethically targeted investment. This report is intended to inform and help shape further national, regional and international trade union work through that joint labour committee. But we would hope that others involved in the debate, including public policymakers, will pick up on our recommendations and join us to put in place an effective and enforceable global system of corporate governance.

[26] ILO 2004

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ICFTU, International Confederation of Free Trade Unions – www.icftu.org

ETUC, European Trade Union Confederation – www.etuc.org

GUFs, Global Union Federations:

- Education International - www.ei-ie.org
- International Federation of Building and Wood Workers - www.ifbww.org
- International Federation of Chemical, Energy, Mine and General Workers' Union - www.icem.org
- International Federation of Journalists - www.ifj.org
- International Metalworkers' Federation - www.imfmetal.org
- International Textile, Garment and Leather Workers' Federation - www.itglwf.org
- International Transport Workers' Federation - www.itfglobal.org
- International Union of Food, Agricultural, Hotel, Restaurant, Catering, Tobacco and Allied Workers' Association - www.iuf.org
- Public Services International - www.world-psi.org
- Union Network International - www.union-network.org

TUAC, Trade Union Advisory Committee to the OECD – www.tuac.org

WCL, World Confederation of Labour – www.cmt-wcl.org

Global Unions are the ICFTU, the GUFs and the TUAC – www.global-unions.org

GURN, Global Unions Research Network – www.gurn.info

ICFTU/GUF/TUAC Committee for International Cooperation on Workers' Capital (CWC) – www.workerscapital.org