

TUAC trade union advisory committee to the
OECD organisation for economic cooperation and development
■ CSC commission syndicale consultative auprès de
OCDE l'organisation de coopération et de développement économiques

Paris, 19 September 2003

TUAC Initial Statement on The Review of the OECD Principles of Corporate Governance

Background

TUAC and its affiliates actively participated in the development of the original 1999 OECD Principles of Corporate Governance. Though not meeting all of our expectations as to what constitutes a best practice international standard to guide corporate governance reforms, we nevertheless welcomed the instrument as a platform upon which to build. We also warned OECD governments against being complacent about their own systems – the official line being that the Principles were aimed at improving corporate governance in developing and transition countries. Since that time we have actively participated in the further work of the OECD on this matter, with the ICFTU have sought an effective input into the work of the World Bank – OECD Global Forum on Corporate Governance.

The recent swathe of corporate scandals in the major OECD countries have highlighted that the systemic crisis in corporate governance is in fact a global affair – no company and no country is immune. No shareholder or worker can have confidence that their investments, or job, pension, or healthcare is safe. What we are now witnessing is that the post-Enron environment of public mistrust of corporate management¹ is leading to a de-legitimisation of the corporation itself, as a vehicle, whose social mission is the creation and equitable distribution of sustainable wealth, accountable to its internal constituents and society as a whole.

The task now facing OECD governments, which are the home of the world's most powerful corporations, is to ensure that the Review of the Principles helps reverse that trend (that is why the TUAC and its affiliates have supported the Review). True, not every corporate failure is a failure of governance – businesses succeed and fail for many legitimate reasons in a market economy. Neither could the Principles cover every unforeseen governance failure. However, the recent past has indicated those failures of corporate governance that can be addressed by the Review. And that is how the labour movement and the wider public will judge the outcome of the exercise, and with it the credibility of the OECD – will the revised Principles pass the Enron test. That is the challenge facing the Steering Group.

To help the OECD meet that challenge, the TUAC initial statement on the Review proposes the following conceptual framework to guide the Steering Group discussions. A separate TUAC statement proposes textual amendments to the OECD Secretariat draft revised Principles that will be discussed by the Steering Group meeting in November.

¹ A recent UK public opinion poll found that 80% of people believe that directors of large companies cannot be trusted to tell the truth, while 78% either agreed or strongly agreed that directors are paid too much. Meanwhile two-thirds of those polled said that they do not believe companies can be trusted to honour their pension commitments. See: <http://www.mori.com/polls/2003/ft/030622-top.html>

1. There is a systemic crisis of the corporation itself, not just of corporate governance.

The post-2001 corporate collapses and scandals touched every sector of the economy and society. Trillions of dollars of investment finance was wiped out as corporate value was destroyed, and contagion affected broader equity and financial markets. But the real financial and human cost was borne by working families, in terms of lost jobs and pensions, and health care. At the same time the media spotlight shone on the new gilded age of corporate elites, laying bear their ability to enrich themselves, irrespective of corporate performance, at the expense of investors and workers alike. The implosion of Arthur Andersen exposed the rampant collusion and conflicts of interest between the self-regulated internal and external poachers and the gatekeepers of the corporate world, and other service providers. Irreparable damage was done to the public's faith and trust in the corporation itself, and the stewards of the market system.

A sense of urgency did prevail among many policy makers and some business leaders in the immediate aftermath of the scandals. Many OECD government and parliament leaders vowed to, and have or are enacting new measures in an attempt to inject confidence back into the system. Closer to home, the US government pushed for the Review of the Principles to be brought forward. These measures are welcome. But TUAC is concerned that they amount to little more than a peace meal approach, whereby the issue is simplified to the question of penalising a "few bad apples", or that wider problems can be dealt with through greater transparency or more self regulatory codes and standards. Furthermore, there is a sense that as time has past, complacency is setting in among governments and regulators, and with it a feeling that the global community is failing to tackle the systemic crisis of the corporation. The Review of the Principles is a window of opportunity for governments to restore momentum to, and to reaffirm the need for an effective global, coordinated approach to corporate accountability and governance.

- ✓ OECD Governments should consider the Review in the context of a systemic crisis of the legitimacy and accountability of the corporation itself, not just corporate governance.
- ✓ The outcome of the Review should send the right signal to global market institutions, to the developing world and to the millions of workers and household who have been affected directly or indirectly by corporate governance failure.

What this means for the review process of the Principles:

- ⇒ The Principles and the annotations should use clear-cut, uncompromising language. Wording arrangements that tend to soften the content, such as "seeking to ensure" (instead of "to ensure") or "a practice is" (instead of "a best practice is"), should be avoided as much as possible. The Principles should not seek to ensure, they must ensure. Some parties support weaker wording because they argue the Principles will become "too prescriptive". We disagree. Principles are *by definition* non-prescriptive; they are international benchmarks whose implementation is left to other legal and contractual frameworks. Therefore, any softening of the language would be counter-productive, as it would only weaken them by letting diverse interpretations takeover the true objectives of the Principles.
- ⇒ Recent corporate scandals have revealed the importance of the cross-cutting issue of preventing conflicts of interest. Principles related to the responsibilities of gate-keepers,

such as auditors, should be considerably strengthened. Auditors and other gatekeepers should not be seen as profit makers that take advantage of their key positions in the market information chain. They are here to serve the public concern of market integrity and transparency. The rules that apply to these professions should target that objective.

2. Corporate accountability is a prerequisite for corporate governance.

Corporate governance is often portrayed as a narrow set of policies governing the relationship between managers and owners, with the aim of increasing shareholder value. While these are unquestionable core issues of the agenda, we nevertheless believe that it is also about the accountability of the corporation to all internal constituents and wider society. This issue is as central and as relevant when discussing corporate governance. So too is the notion that the company is a “private entity owned by shareholders”. TUAC strongly challenges this view as it implicitly separates the corporation as such from its inherent contribution to the wealth of societies and its impact on workers, on people’s livelihood and on the environment. We believe in a pluralist approach to the governance of the corporation. We reject the claim that shareholders are the only bearers of residual risk and that other stakeholders (for example workers and creditors) are adequately protected through contractual or legal frameworks that are separate from the governance of the corporation. Workers in particular have a stake in the corporation (firm-specific risk) they work for as investors that goes far beyond or may not be guaranteed by contracted labour agreement². In fact the corporation cannot be set aside from the wider public interest as there are many areas where its actions overlap with other public policies and regulations. To ignore these linkages – and the direct and specific liabilities that go with it – often generate externality costs borne ultimately by society³. Similarly, institutional investors are not the ultimate owners. They are in reality stewards of workers capital, who they owe their fiduciary duty and loyalty of action to. Corporate accountability therefore is a major issue of corporate governance.

- ✓ OECD member states should adopt corporate accountability as a paramount objective and to take into consideration all implications, that such an understanding may have for the present Review.

² “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”, in “The Conceptual Foundations of the Company: a Pluralist Approach”, Gavin Kelly & John Parkinson, in “The Political Economy of the Company”, A. Gamble, G. Kelly & J. Parkinson (eds), Oxford Hart Publishing, 2000. By the end of 2003, the TUAC will publish a Global Union report on the governance and the accountability of the corporation that addresses this issue in depth.

³ For example, a corporation that externalizes to the community the cost that it generates such as sickness and disabilities due to poor health and safety at work conditions, environmental damage, public resource and fiscal diversion, etc.

What this means for the review process of the Principles:

- ⇒ To reflect the above, the Principles should include two new chapters on the role and the responsibilities of the CEO and senior management, and on the responsibilities of institutional investors.
- ⇒ The Principles should clearly state that the role of corporate governance is to ensure the accountability of the corporation to all relevant internal and external stakeholders and society at large.
- ⇒ We strongly urge a substantial review of the Stakeholder chapter, including an extension of their rights and responsibilities, so that this chapter becomes more consistent with the rest of the Principles. Indeed as it stands, the Principles within the Stakeholder chapter are confined to rights “as established by law”. This goes against the aim of the Principles, which is to identify high quality standards of corporate governance practices *assuming* that the law is respected anyway.
- ⇒ Active long term shareholders are central in assuring the accountability of the corporation. The Principles should ensure that shareholders have the necessary rights and responsibilities to deliver effective ownership of the corporation. Shareholder, institutional investors in particular, must be active informed owners.
- ⇒ The duties of directors are toward the company, not just the shareholders. The two are separate issues. The Principles should state explicitly that directors, along with the CEO and the executive management, bear the responsibility of the accountability of the company to all its constituents.
- ⇒ The legal and regulatory framework must include effective redress mechanisms for violation of stakeholders’ rights, including the minority shareholders, the employees and the creditors.

3. The Review of the Principles must be coherent with other internationally agreed commitments.

Some parties have expressed concern about “overstretching” the scope of the Review to the extent it risks losing relevance and impact. According to this opinion, all issues that are not directly linked to the principal/agent problem should be set aside, as they belong to other fora. But, as the Preamble of the original Principles states: “corporate governance is only part of the larger economic context in which firms operate, which includes, for example, macroeconomic policies and the degree of competition in product and factor markets.” The argument of keeping rigorous limits to the scope of corporate governance is therefore erroneous. That corporate governance is part of a wider landscape impacting the corporation’s environment requires that it be made coherent with other agendas. This means that the Review should be seen within the broader context of shaping a global governance framework as set out by the United Nations, notably Monterrey’s 2002 Financing For Development Summit and Johannesburg’s 2002 World Summit on Sustainable Development.

- ✓ OECD Governments should consider the Review in the broader context of their own commitments agreed in other international fora.

What this means for the review process of the Principles:

- ⇒ The Principles should include a new chapter on implementation and enforcement of the Principles with a particular focus on the priorities of the developing world. Though OECD-based, the Principles are global in reach.
- ⇒ The Principles should elaborate on how the governance of the corporation can contribute to the objective of sustainable development and should encompass the concept of corporate social responsibility (CSR).
- ⇒ Transparency and disclosure requirements should be substantially extended to cover intangible assets and social and environmental impact assessments of the corporation.
- ⇒ A new principle on disclosure of beneficial ownership is necessary to make the Principles coherent with *inter alia* the 40 recommendations of the Financial Action Task Force on Money Laundering, and associated work in other fora.
- ⇒ The chapter on the responsibilities of the Board should state explicitly that the Board takes decisions in compliance with internationally recognized standards of corporate social responsibility, including the ILO Declaration of 1998 and the OECD Guidelines for Multinational Enterprises.

4. The “no one size fits all” perspective should not be a pretext to adopt a minimalist approach.

OECD countries have different views on how companies should be governed, and accordingly have different corporate governance regimes. Diversity of national regimes applies to the substance (ie. one-tier versus two-tier systems) and its implementation (hard law versus soft law and self regulation). More fundamentally, differences in national corporate governance regimes reflect different societal choices of economic development. Some parties have argued that because there is no “one size fits all”, the Principles should remain general in approach. While clearly the Principles should be comprehensive and global, TUAC warns against fuelling a minimalist approach, leading to a lowest common denominator revision. On the contrary, the Review should define leading edge principles of what a “good” company is, that is accountable to all its constituents and to the society, within a comparative approach to national regimes.

- ✓ OECD Governments should assess the diversity of corporate governance regimes and be careful not to prioritise one model to the detriment of others.
- ✓ They should review the Principles with a view to target overall improvement of national regimes rather than to seek status quo and minimum common ground.

What this means for the review process of the Principles:

- ⇒ The best practices of different corporate governance regimes must be included. Simply because a best practice of corporate governance is not systematized across the OECD should not impede the Steering group from considering it as a Principle. A typical example would be to have AGM resolutions be binding on the management, even though not all national regimes reflect this. We believe that the Principles should target an “ideal corporation”, which all corporations should continuously target. Furthermore, in the past 12 months, many companies and institutional investors have taken proactive steps to strengthen their corporate governance frameworks. We welcome that, but in many cases, this has happened because of exceptional circumstances or because of the commitments of key personalities. The most recent and high profile case is ex-World Com / MCI’s new

corporate governance measures. We would deplore that corporate or market led initiatives take the lead in reforming corporate governance and that inter-governmental initiatives lag behind.

The necessity of new language that is responsive and proactive

The purpose of the Principles is to set a universal standard of reference on corporate governance which can “benchmark” national regimes both within and beyond the OECD. As outlined above, it should take full consideration of the broader nature of the corporate governance agenda and seek to reconcile governance and accountability of corporations. In doing so, it should avoid isolating corporate governance from other global issues and to ensure on global coherence. Finally, the Review should not lock itself into a minimalist approach, for fear of national diversity and should on the contrary lead the way to a leveling-up of existing national regimes.

OECD Governments should not step aside from a radical rethinking and redrafting of the Principles. They should act both in a responsive and a proactive manner:

- ✓ The outcome of the Review should send a clear signal to the global community on the way to respond to the on-going crisis of legitimacy of the corporation.
- ✓ It should be proactive in leading the way to an inclusive and global approach to the governance of corporations.

<p>As a general drafting matter, the labour movement urges the Steering Group to make all necessary textual changes in the Principles and the annotations that meet the above concerns.</p>
--

We will of course be making further proposals as the Review unfolds.