TRADE UNION RESPONSES TO GLOBALIZATION

A review by the Global Union Research Network

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INTERNATIONAL LABOUR OFFICE • GENEVA

GLOBAL UNION RESEARCH NETWORK

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First published 2007

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V. Schmidt (ed.)
Trade union responses to globalization: A review by the Global Union Research Network
Geneva, International Labour Office, 2007

Globalization, multinational enterprise, workers rights, trade union rights, trade union role, international trade union, developed countries, developing countries
03.02.3

ISBN 978-92-2-119860-4

ILO Cataloguing in Publication Data

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Typeset by Magheross Graphics, France & Ireland *www.magheross.com*
Printed in *(country)*

5 CORPORATE GOVERNANCE REFORMS AS A MEANS OF PROTECTING AND PROMOTING WORKER INTERESTS: SHAPING THE CORPORATION OF TOMORROW

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Introduction

There is a continuing crisis which centres on the corporation, its ownership and governance, and its wider economic and social responsibilities. This is not a new problem. It is, however, one that has been brought into sharp relief as a result of the major corporate scandals in the United States, Europe and elsewhere. Enron and WorldCom in the United States, Parmalat in Italy, Ahold in the Netherlands and Marconi in the United Kingdom are some of the best known examples, in a much longer list, where the abuse of corporate power has had devastating consequences for working people. Many of these problems in turn flow from the arrangements in place in respect of corporate governance.

There is a pressing and important need for trade unions to influence, in a practical and commercially realistic manner, the case for change. This can best be sustained by a programme of coordinated research aimed at promoting a clear understanding about what needs to be done to address these problems and how best to proceed. This paper explores more fully the nature of the problem and identifies the high ground of a response.

The nature of the problem

The process of corporate governance is controlled and directed at the highest reaches within the corporation – by the board of directors. In British and American jurisdictions there is no distinction in law between the corporation as an entity and the board which is there to protect shareholder interests and the interests of other stakeholders. This is a constitutional anomaly. This issue is addressed in German law through the existence of the supervisory

board.[1] The supervisory board represents the interests of the company, employees and other stakeholders. Other detailed aspects of governance arrangements in Anglo-American jurisdictions are also inadequately defined in law. Those concerning directors' fiduciary duties[2] are neither clearly nor objectively[3] defined. Some important requirements are currently left to the discretion of directors to interpret under comply or explain arrangements.[4]

Overall this is an unsatisfactory state of affairs. It undermines the credibility of corporate governance. There are no easy or obvious remedies. Reform has to be driven by strong, empirically sound, commercially realistic arguments. Global trade unions need to support practical research aimed at shaping these reforms.

The framework of governance in Anglo-American jurisdictions and elsewhere points to serious systemic weakness. The self-regulating disciplinary functions of the market have broken down. The passing of the Sarbanes Oxley Act by the United States Congress in 2002, in the wake of the Enron scandal, is a welcome step aimed at improving the framework of control and tightening the enforcement of relevant laws. Parallel moves have been taken in the United Kingdom and other European countries. They all aim to strengthen corporate governance and accountability. But this make-do-and-mend approach is only a start. More fundamental and forward-looking reforms are needed in shaping tomorrow's corporation.

The linchpin of corporate accountability is the publication of audited accounts. Accounts focus, however, on past activities. Whilst accurate company accounts and other financial disclosures are crucial ingredients of effective governance, shareholders and stakeholders need to have a full understanding of the direction and content of business development intentions. The report of the British Company Law Reform Steering Group (CLSRG) has, to its credit, recommended that larger publicly quoted corporations should in future prepare and present an OFR (Operating and

[1] See the German Co-determination Act 1976. See also the German Corporate Governance Code 2005 http://www.corporate.governance-code.de/index-e.html

[2] Directors' fiduciary duties in Anglo-American jurisdictions and their interpretation by the courts have evolved from ancient trust law and the law of equity, alongside common law. A common complaint is that directors in the contemporary setting are "protected" by equity in those jurisdictions and that the full force of common law does not therefore apply. See Penner, J.E., 2002, *The law of trusts*, Butterworths for a treatment of these issues. See also Parkinson, J., 1995, *Corporate power and responsibility*, Clarendon Press, (Chapter 4), for a discussion of managerial efficiency.

[3] Although the extension of statute law in the United Kingdom and the United States has resulted in greater objectivity of standards. Examples of this would include section 214(4) of the British Insolvency Act 1986 and its application in Norman v. Theodore Goddard (1991). In this landmark judgment, objective standards by which negligent behaviour by directors can be measured in terms of what might be expected from a reasonably diligent person were set out. The passing of the Sarbanes Oxley Act by the United States Congress in 2002 has had a similar impact. But in a number of other aspects directors' duties remain exempt from these higher standards.

[4] See the [British] Companies Act 2006, Chapter 2: General Duties of Directors, section 170 onwards.

Financial Review).[5] This will require the directors of the board to declare any material changes it sees in the prospective business activities of the corporation and any environmental or other liabilities that it foresees impacting upon the business. Being informed after the event can no longer be accepted as normal in effective and progressive corporate governance. Corporations need to engage before the event, with shareholders and other stakeholders – especially trade unions – in the articulation of commercial strategy.

Resistance to change

Existing habits and practices in Anglo-American jurisdictions discourage this sort of thinking. Corporations operating in Germany (and Austria, Belgium, France, Luxembourg and the Netherlands) often behave differently. The supervisory board oversees the executive board. Its role is to debate and agree matters of strategy and commercial policy with the executive board. In Anglo-American unitary board jurisdictions there is little appetite for this sort of dialogue. There is a widespread abhorrence in Anglo-American jurisdictions of supervisory boards, which are regarded as a distraction from reaching sound and effective business decisions. There is also little effective leadership from shareholders, as beneficial owners of the corporation, to promote fundamental change. There are complex reasons which explain shareholder inertia on the key issue of board involvement. Inertia arises from the fact that in reality shareholders in Anglo-American jurisdictions are largely institutional investors managing very large portfolios in a large number of different publicly quoted corporations.[6] As risk arbitrageurs they would be conflicted if required to nominate board directors from within their own ranks. The stark reality is that these risk arbitrageurs are not shareholders in the normal sense of the term and have no appetite for any day-to-day involvement in the affairs of the corporation. They are happy to sell if they are not satisfied rather than press for improvement where management is seen to be failing. There are no straightforward answers. But solutions can be found if there is a will to do so. The role of trade unions and workers' capital will continue to play an important strategic role in this area. Workers' pension funds are a major source of investment in industry. Trade unions must ensure that pension fund trustees play an effective role in forcing through progressive changes in corporate governance.

[5] This provision, approved by Parliament in March 2005, was repealed on 12 January 2006 because of an existing obligation on companies to provide a Business Review, a requirement of the European Accounts Modernization Directive 2003/51/EC of the European Parliament and the Council of 18 June 2003 amending Directives 78/660/EEC, 83/349/EEC and 91/647/EEC.

[6] This pattern of behaviour is, however, being fundamentally transformed by the activities of hedge funds and private equity whose strategy is to secure a small but significant shareholding and then insist upon and secure strategic changes from the incumbent management. The route often preferred is to de-list the target company, thus weakening further governance and accountability.

Resolving the paradox of shareholder ownership in Anglo-American jurisdictions is central to arriving at sensible, commercially viable reforms. How best to bring this about needs to be carefully explored and evaluated. It must result in shareholders and other stakeholders, including trade unions, being fully consulted. The constitutionality of corporate governance and the law that underpins this must uphold this commitment at every level in the corporation. Anything less will not do.

Promoting effective corporate governance

The global challenge facing citizens in general and trade unions in particular centres on fostering the development of a credible, transparent and participative system of corporate governance. The reason for this is that under existing arrangements corporations are not adequately accountable to shareholders or other stakeholders, including trade unions. The existing framework of governance allows these defects to remain unchecked. This needs, urgently, to be understood and addressed on the basis of practical and commercially realistic remedies.

In moving the debate forward the language of governance has first of all to be opened up and demystified. If, as it is argued, shareholders are the beneficial owners of the corporation then two questions at least have to be asked and answered. First, how do shareholders exercise their ownership rights and responsibilities? If they are the owners of the corporation then what is expected of them as owners in ensuring the full and proper accountability of the managers and directors who run the corporation on their behalf? A closely allied second question inevitably centres on the role directors play in ensuring the full and proper accountability of the corporation to shareholders and other stakeholders.

Seeking proper answers to these key questions reveals a raft of queries which cannot be adequately or credibly explained. On close inspection the language of governance is rhetorical, tautological and self-serving. A few examples will illustrate the difficulty that questioners have. The notion of shareholder ownership is inherently ambiguous. The term “ownership” on which great store is often placed is, in practice, defined as meaning just about anything other than what ownership is normally understood to mean. An honest reading of the language leaves the questioner sensing that there is something odd if not specious about the way in which the term ownership is used and understood. Ownership by shareholders must also entail duties and responsibilities if shareholders are to avoid being classified as absentee landlords caring little about governance issues and only interested in dividends and capital growth.

Demystifying the corporation

There is a concealed reason for this ambiguity. The ambiguity and ambivalence is a linguistic device to prevent the viewer from distinguishing between rhetoric and reality in respect of the underlying issue of ownership. A fair conclusion is that in reality publicly quoted corporations in Anglo-American jurisdictions are not owned, in any meaningful sense, by the shareholders. Lawyers in their search for a means to circumvent this difficulty have successfully argued that the corporation is not owned by anyone but is in reality a nexus of contracts with shareholders who enjoy rights to participate in dividends in proportion to their ownership of equity. Whilst this is an ingenious solution it is also one which is intuitively unsound. It is a device which masks the reality that directors control the corporation as if they were owners, which in law they are not. This appears to give them the best of both worlds: effective, if concealed ownership, without responsibility. Because shareholder ownership cannot be defined as having any operational meaning the ownership of the corporation is itself tainted with ambiguity. This inevitably undermines legitimacy and public confidence.

Corporations, as we are all aware, are fictional personifications in law. In law they may be sued, as legal persons, for acting unlawfully even though their existence is fictional. Yet corporations are not capable of actions or thoughts. The directors are the parties who speak for and act for the corporation. In practice the directors, or certain directors to be precise, are the controlling mind of the corporation. This confers massive undisclosed power on those directors whose actions are in turn governed, in law, by their fiduciary duties to shareholders and stakeholders. A close inspection of their fiduciary duties reveals, however, a pervasive vagueness of definition. The repeated theme throughout is that the director's first duty to is to act in the best interest of the company and the members. This, in turn, is defined as seeking to maximize shareholder value. At no stage, however, is this objective specifically or meaningfully defined.[7]

Though there are other important, complementary questions, the issues that have been identified call for proper, detailed scrutiny. Trade unions must, with patience and determination, resist arguments advanced by parties who have an interest in discouraging wider discussion and debate of these issues. Sadly, the OECD in its current review of the Principles of Corporate

[7] There is, for example, no reference to the forward time frame. This invites the criticism that directors of companies in Anglo-American jurisdictions systematically pursue short-term profit-maximizing strategies which may compromise longer-term sustainability.

Governance[8] has not grasped the unique opportunity the review presents to examine honestly and openly these issues. This arises because of resistance from certain governments and the business enterprise sector to any debate which might lead to change. There are powerful interests that want permanent closure of debate in this area.

Moving our understanding forward

Corporations are vitally important social and economic institutions. On their prosperity rests the prosperity of society at large. What trade unions and other citizen interest groups need to ensure is that the corporation operates within a clear ownership structure where elected directors have a constitutional independence from the corporation and can be seen to act in the best interests of the corporation, the shareholders in ownership and other stakeholders, in maximizing long-term shareholder value. In doing so it is important that any recommendations for change address the practical reality that corporations have to prosper if they are to survive. They can only survive if they can operate effectively in competitive markets. It is only if corporations are effective and profitable that investment can be sustained and employment protected and enlarged. Any changes must therefore recognize the importance of ensuring that the fairytale goose that lays the golden egg is not unreasonably hampered by the framework of corporate governance. The old-style negative response to capitalism does not offer a viable way forward. There is a soundly based consensus that private corporations of all shapes and sizes, offering the widest possible range of goods and services in competitive markets, are the best safeguard against tyranny. But there has to be a proper and credible response to the huge accretion of corporate power that has occurred, especially in the largest publicly quoted corporations, if fully competitive yet fair and responsible markets are to be created and maintained.

There are some important principles that should guide us in this process, each of which needs to be fully researched.

Principle 1

We need to know and understand how some European corporations fare that share, explain and react constructively to debate and discussion with share-

[8] This review is being managed by the OECD Secretariat. Debate of the important issues raised by TUAC in a number of written submissions has been prevented by the actions of certain OECD member governments and the Business and Investment Advisory Committee (BIAC) to the OECD. OECD civil servants for their part failed to ensure that the debate was full, frank and inclusive. The progress of these discussions can be followed on TUAC's website <www.tuac.org> Attention is drawn, in particular, to the "TUAC Evaluation of the 2004 Review of the OECD Principles of corporate governance".

holders and stakeholders about future commercial aims and objectives, when compared with Anglo-American corporations that don't.

Principle 2
Corporations and their boards need to consult with their shareholders and stakeholders if valuable business opportunities are to be spotted and acted upon. Corporate Social Responsibility is seen by the best and most effective corporations as a serious strategic business development commitment, not some PR-motivated bolt-on.

Principle 3
The maximization of shareholder value, as a prime objective of corporate endeavour, has to be "unpacked" in terms of what it means and how it should be interpreted and implemented. The underlying objective must be the long-term growth and prosperity of the corporation, its shareholders and stakeholders.

Principle 4
There is a need to clarify the fiduciary duties of board directors in ways that will encourage them and empower them to look widely and think deeply about their responsibilities in maximizing shareholder value as foreseen by Principle 3.

Principle 5
It is important that institutional investors play their part in improving both the quality and relevance of governance and the underlying constitutionality of the corporation and the board of directors. The socially responsible investment initiative is a good and worthwhile example of how institutional investors can reward progressive management and penalize those which are not prepared to embrace change.

Principle 6
The gatekeepers – the auditors, legal advisers, investment banks and commercial banks – have a key role to play in promoting better, higher and more relevant standards of governance. This is because of their close link to capital markets and the critical influence they have on those markets.

The importance of trade-union-driven research

The corporation has been subjected for the best part of half a century to the most detailed scrutiny by scholars, researchers and instructors in business schools and other academic institutions, mostly in OECD countries and most

particularly in the United States. One cannot but marvel at the sheer scale of research output. This needs to be qualified. Most of this research has been focused on the activities of American corporations operating within American-style capital markets. The scale of Nobel Prize-winning contributions from American researchers bears testimony to the domination of American research in this area and the vast knowledge and understanding of American markets and American practices and predilections to which this bears witness. In contrast, much less is known about the operation of capital markets and the performance of the corporation within those markets in other jurisdictions, notably in Germany and Japan.

It is important that the global trade union movement takes proper and effective ownership of its own programme of research in this field. The research needs to be focused, policy-oriented and above all commercially realistic. It also needs to achieve some level of critical mass and for its results to be widely disseminated and debated in the media. There can be no doubting that the time is right for an honest, open debate between the social and economic partners whose collaborative efforts have the potential and the capacity to build effective and prosperous businesses. We need to act now.

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