Democracy at work: A European framework for employees' participation rights and the revision of the European Works Council Directive

CONSTITUENT PARTIES AND THE EUROPEAN MODEL OF PLURALISTIC CORPORATE GOVERNANCE

European Parliament

Committee on Employment and Social Affairs

July 1st, 2021

Christophe Clerc

STARTING POINT

The draft report highlights three important items:

A) The big picture: the failure of the short-term “shareholder value” principle and the need for sustainable corporate governance (Whereas F)

B) The European specificity:

The rich and interlocking network of workers’ participation at workplaces across the entire Union (Par. 1)

Board-level worker participation in 18 EU Member States and Norway (Par. 2)

Benefits of worker participation (productivity, innovation, work organization, gender equality, decision-making and alternatives to crisis-induced employment reduction) (Whereas H)

C) The conceptual basis:

Employees are not mere ‘stakeholders’ of companies, but ‘constituting parties’ alongside shareholders and managers

Worker participation in companies is a key component of a pluralistic model of corporate governance based on democratic principles, fairness and efficiency (Whereas I)

STARTING POINT

Consequently, the draft report:

A) Notes a missed opportunity: the 2019 Company Law Package failed to adequately define a high EU standard for information, consultation and workers' board-level representation in cases where companies restructure across borders (Par. 6)

B) Makes a proposal: ensuring that employees are represented on boards in European. scale companies (Par. 14)

FOCUS

1) Employees are not mere ‘stakeholders’ of companies, but ‘constituting parties’ alongside shareholders and managers

2) Worker participation in companies is a key component of a pluralistic model of corporate governance based on democratic principles, fairness and efficiency

I – EMPLOYEES AS CONSTITUTING PARTIES

A) THE "STAKEHOLDER THEORY": A POWERFUL BUT MISGUIDED CONCEPT

R. Edward Freeman
(1951 -)
Philosopher

Stakeholder theory (1980's)

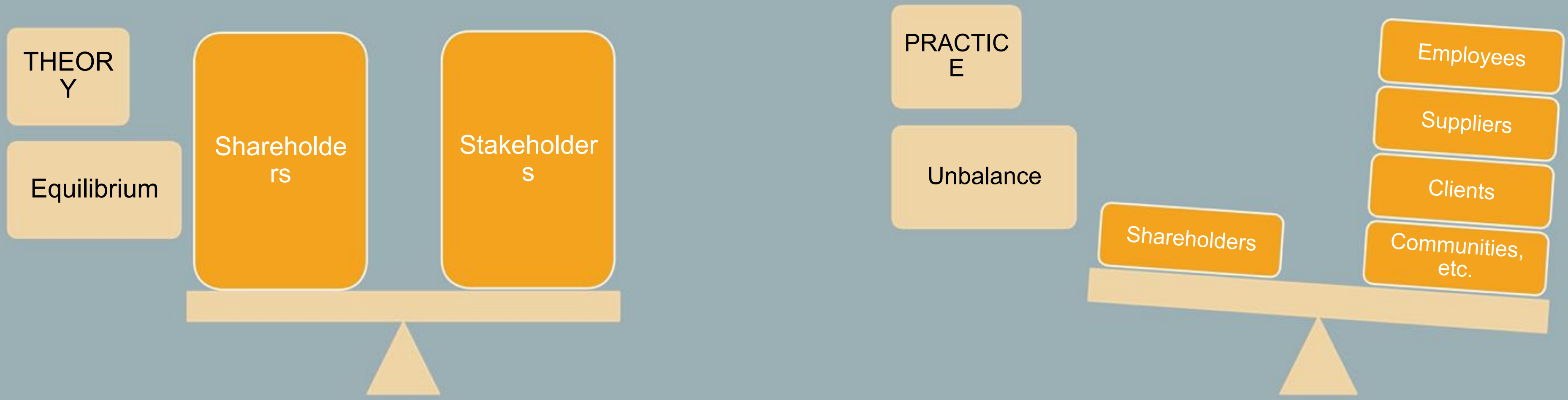
A stakeholder is *'any group or individual who can affect or is affected by the achievement of the organization's objectives*'.

A firm should create value for all stakeholders, not just shareholders.

Ethically useful concept.

I – EMPLOYEES AS CONSTITUTING PARTIES

However:



I – EMPLOYEES AS CONSTITUTING PARTIES

- The “SHAREHOLDERS vs STAKEHOLDERS” distinction is INEFFICIENT to address corporate governance issues.

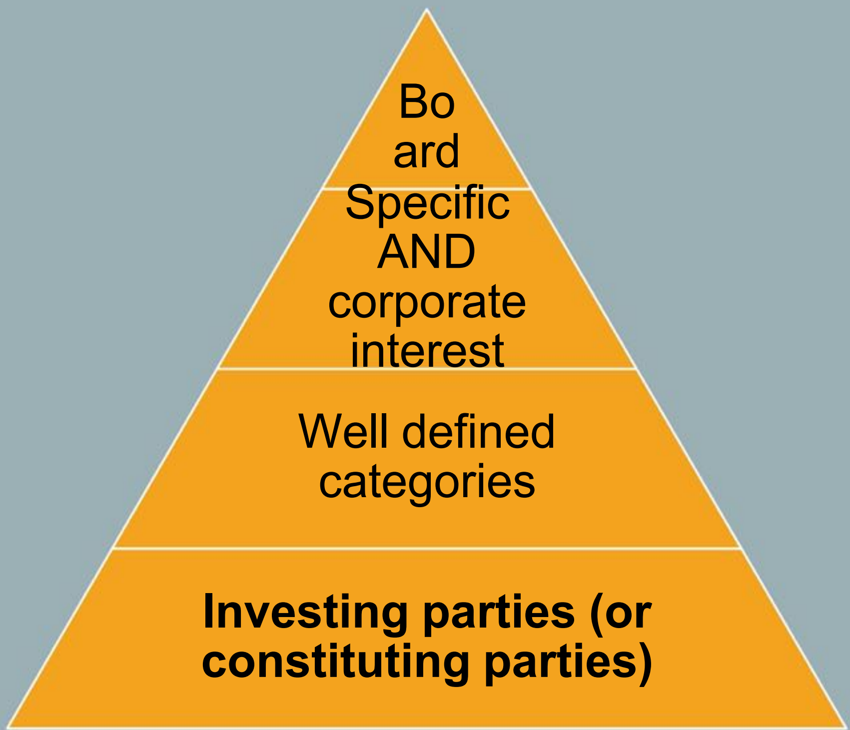
- Practical issue:
  - Question: Which stakeholders should be allowed to seat at the board?
    Examples: an environmental organization, a representative of clients or suppliers, etc.
  - Problems: Definition? Selection? Integration of company’s interest?
  - Answer: No solution, no action

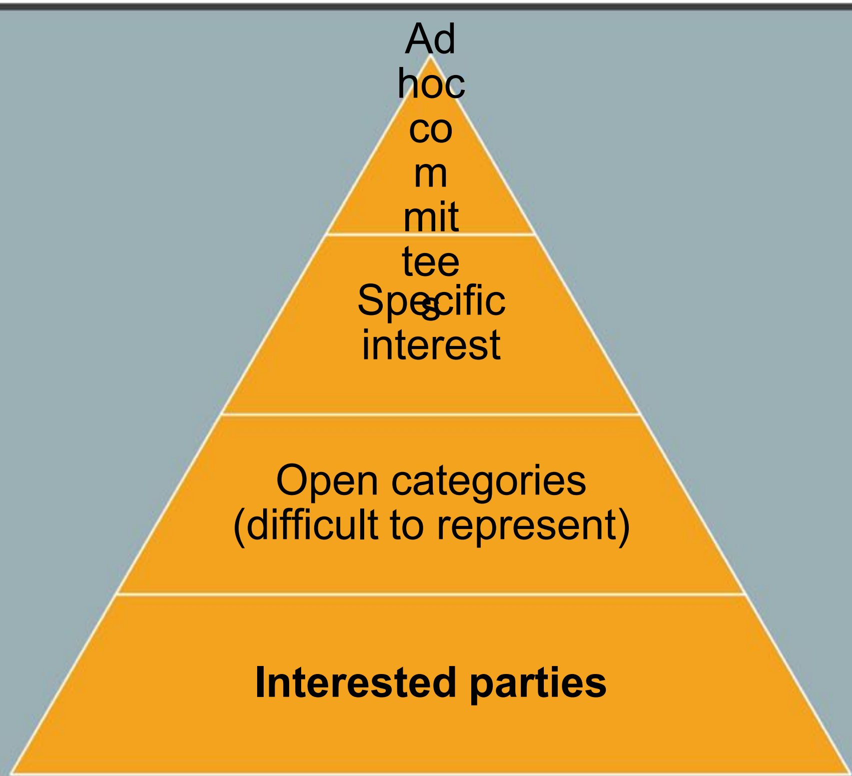
I – EMPLOYEES AS CONSTITUTING PARTIES

B) DISTINGUISHING BETWEEN “INTERESTED PARTIES” AND “INVESTING PARTIES”

- INTERESTED PARTIES:
  - Definition: All parties that are at risk because of the activity of the company
  - Examples: Shareholders, managers, employees, banks, suppliers, clients, subcontractors, communities, environment
- INVESTING PARTIES:
  - Definition: All parties that are structurally investing in the company
  - List: Shareholders: invest money
    Managers and employees: invest time (life) and competences

I – EMPLOYEES AS CONSTITUTING PARTIES





FOCUS ON THE “INVESTING PARTIES”*

STRUCTURAL INVESTMENTS: A structural contribution, a potential upside or downside on the value of the contribution and a return

- CONTRIBUTION :
  (1) Money or asset (material or immaterial)
  (2) Capacities and competences, span of limited lifetime

- POTENTIAL UPSIDE OR DOWNSIDE:
  (1) Value of assets
  (2) Increase or decrease in capacities and competences (including potential natural decrease through ageing and increase through on-the-job training); loss of time

- RETURN OVER THE LIFETIME OF THE INVESTMENTS:
  (1) Dividends
  (2) Wages

** Slide not verbally presented – for information*

FOCUS : COMPARING THE RISK OF TWO "INVESTING PARTIES" – WHY SHAREHOLDERS AND EMPLOYEES BEAR COMPARABLE LEVELS OF RISKS*

Comparing the risk of shareholders and employees		
	Shareholders	Employees
Nature of the risk	*<u>Risks to contributed assets</u>:* *Loss of capital* (money) *Opportunity loss* of better investments *No physical risk* (no work accident)	*<u>Risks to contributed assets</u>:* *Risk on skills*: reduction or stagnation trough non-use; loss through lack of formation *Risk on specific investments*: in the event of change of work *Risk on proper use of unique lifespan time*: ageing effect *Opportunity loss* of better work investment *Physical risk*: work accidents

** Slides not verbally presented – for information*

FOCUS : COMPARING THE RISK OF TWO "INVESTING PARTIES" – WHY SHAREHOLDERS AND EMPLOYEES BEAR COMPARABLE LEVELS OF RISKS*

Timing of the risk	*Risk when choosing the company (investment phase):* *Enlightened choice:* normalized accounting information; contract-based guarantees or public supervision (SEC, AMF, etc.) on information quality *Free choice:* significant number of different targets (there are always targets or listed shares for sale); simultaneous review; no strict time constraint	*Risk when choosing the company (hiring phase):* *Enlightened choice:* no normalized nor verifier information *Free choice:* small number of different targets (job market constraint, location constraints); simultaneous review almost impossible; strict time constraint -linked to budgetary constraints)
	Risk when exiting the company (selling phase): Quick sales; quick reinvestments (including through wait-and-see investments); reversibility; no limit in the number of buy/sell transactions.	*Risk when exiting the company (moving ou phase):* Long process (notice period); risk linked tc the process (trial period); reputational risk in the event of frequent changes.
Possibility to control the risk	*Economic control: risk division*	*Economic control: no risk division*
	Legal control: decision rights (designation and removal, mergers, dividends, etc.)	*Legal control: no decision rights*

II – A EUROPEAN MODEL OF PLURALISTIC CORPORATE GOVERNANCE

A) THREE CONSTITUTING PARTIES, THREE MONISTIC MODELS OF CORPORATE GOVERNANCE

- Principle: Each monistic model is based on a single value

- **EMPLOYEE - CENTRIC MODEL**
  - Base: Employees create the company wealth.
    Involving employees in governance improves efficiency.
    Democracy should not stop at the company front door.
  - Example: Mondragon cooperative (Basque country) - 80,000 employees

II – A EUROPEAN MODEL OF PLURALISTIC CORPORATE GOVERNANCE

- **MANAGEMENT - CENTRIC MODEL**

  - Base: Managers need enough autonomy to manage properly
    Center of the creative process that defines companies (see MinesParisTech)
    Role as "mediating hierarchs" (see Blair & Stout)
    Liable for their negligence (unlike shareholders whose liability is limited)

  - Model: USA – especially throughout the XXth century

- **SHAREHOLDER - CENTRIC MODEL ("Shareholder primacy")**

  - Base: Maximization of shareholder value
  - Model: United Kingdom

II – A EUROPEAN MODEL OF PLURALISTIC CORPORATE GOVERNANCE

B) The European model of pluralistic governance

- KEY CONCEPT: CHECKS AND BALANCES
  - In companies, power matters
  - “Power tends to corrupt, and absolute power corrupts absolutely” (John Dalberg-Acton)

- FOUR GOVERNANCE CRITERIA
  - Company interest: The law doesn’t mandate that companies be run first in shareholders’ interest

    Best when the law refers to “firm”, “company” or “constituent” interests
  - Shareholder rights: Must be sufficient to ensure a fair return on investment can be secured
  - Management rights: Sufficient autonomy must be secured (powers legally defined and protected, dismissal rules)
  - Employee rights: Board-level representation, as part of a wider system of efficient employee rights

II – A EUROPEAN MODEL OF PLURALISTIC CORPORATE GOVERNANCE

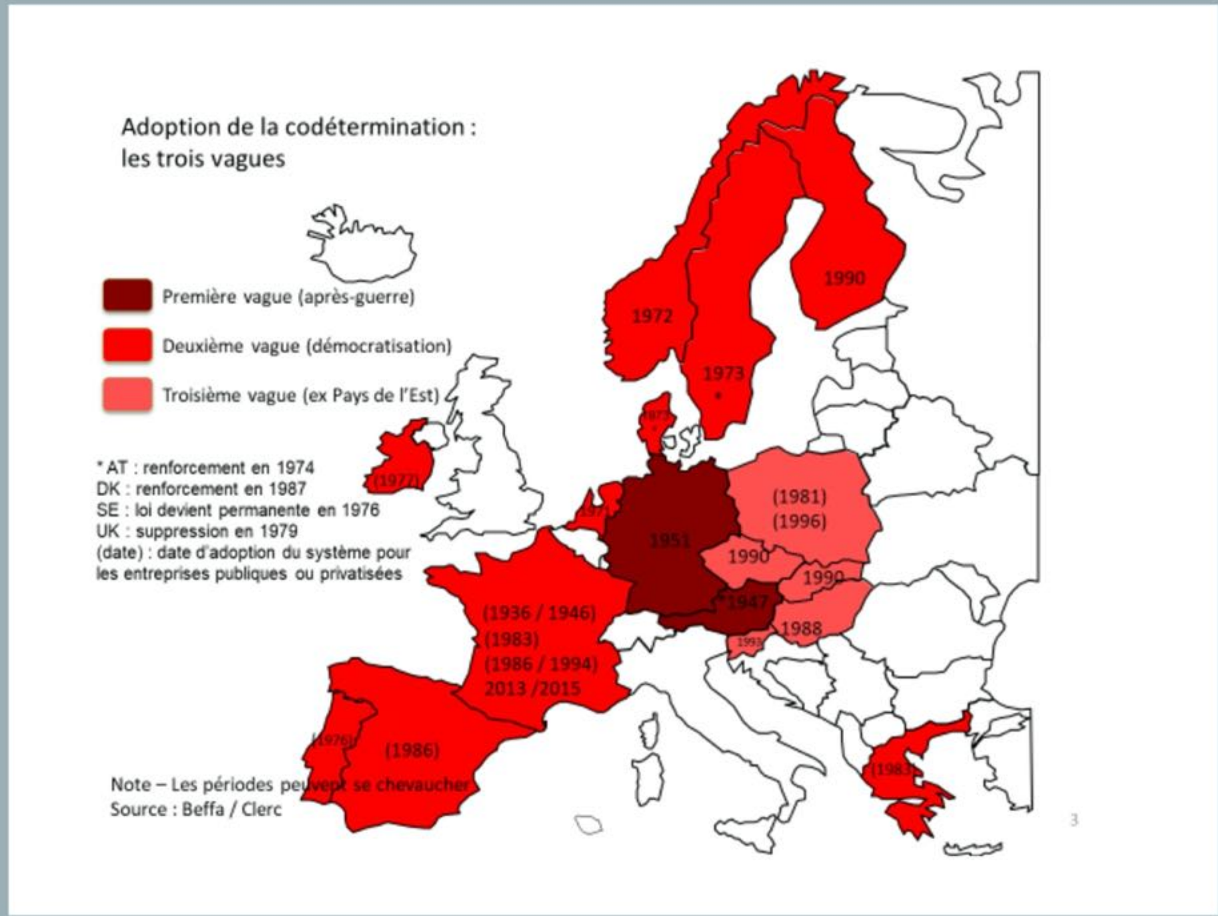
- FOCUS ON BOARD-LEVEL EMPLOYEE REPRESENTATION

  - A European concept: Only in Europe. Invented in Germany (all companies) and France (State-owned companies). Extended in Northern Europe and (after the fall of Berlin Wall) in Central Europe. Exists in most European countries.

  - Characteristics: Democracy, fairness and efficiency.

FOCUS ON CODETERMINATION

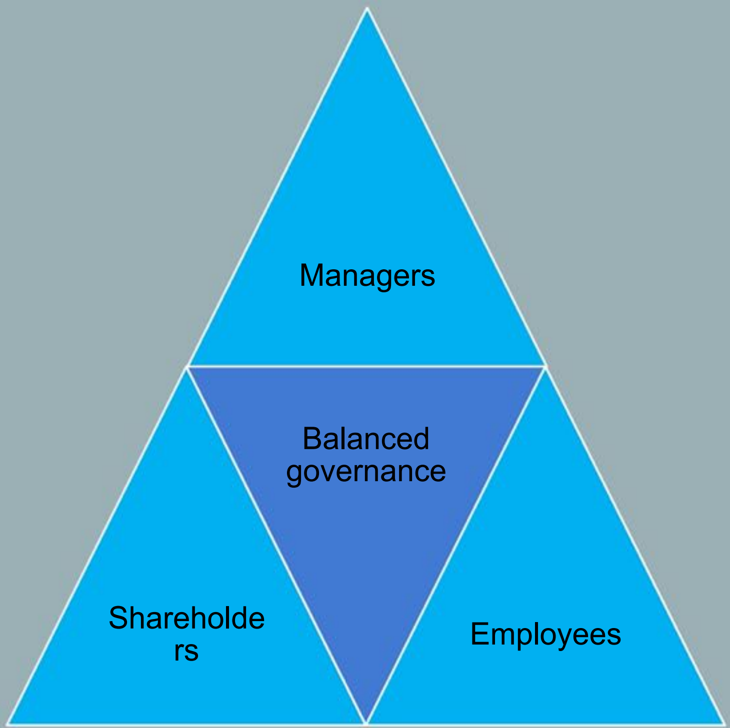
History of codetermination



II – A EUROPEAN MODEL OF PLURALISTIC CORPORATE GOVERNANCE

▪ SCANDINAVIAN COUNTRIES:	DENMARK, SWEDEN, NORWAY,FINLAND
▪ GERMAN SPEAKING COUNTRIES:	GERMANY, AUSTRIA
▪ OTHER COUNTRIES:	THE NETHERLANDS, FRANCE (since 2013)

CONCLUSION



The pluralistic model of governance proposed in the draft report is based on an acknowledgement of the importance of the three constituent parties of companies and expands on European values and models.

EXHIBIT:
THE HISTORIC RAISE OF SHAREHOLDER PRIMACY*

- Definition: "shareholder primacy" = monistic governance system where the ultimate power is granted to shareholders

  Examples: power of shareholders over management and its decisions ("short leash" theory); paramount role in takeover bids and preference for debt over capital (disciplinary theory).
- The rise of shareholder primacy:

1. UK in the 1960's (TOBs) and in the 1990's: Cadbury report; "corporate governance" codes; alignment of interest (stock-options)
2. US in the 1980's (proxy advisor: ISS), the 1990's (alignment of interest); the 2000's (shareholder activists)
3. International expansion: through **EU legislation** and OECD work

** Exhibit not verbally presented – for information*

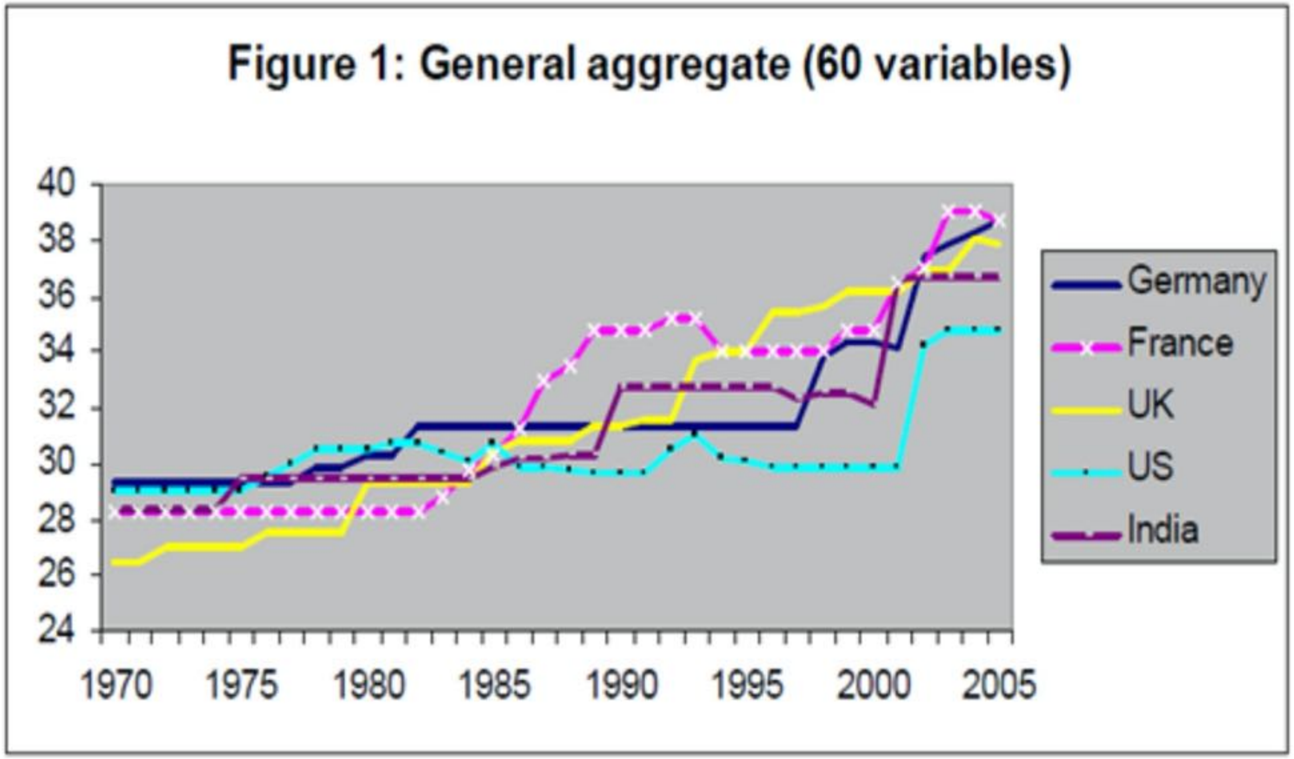
THE RAISE OF SHAREHOLDER PRIMACY (1970 – 2005):

THE EVIDENCE

(LELE & SIEMS, 2007)

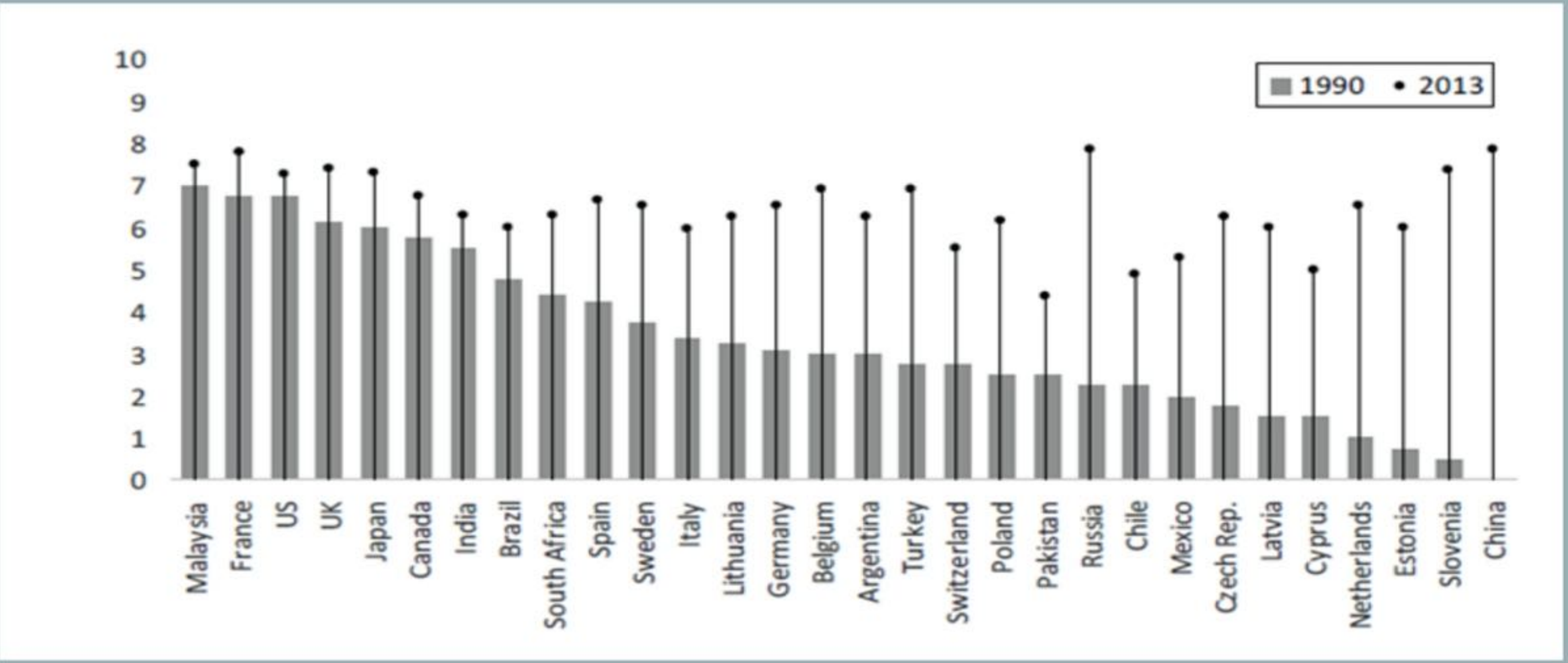
The 60 variables are a measure of shareholder power. They show the rise of shareholder primacy.

(NB – They are less relevant as a way to compare countries).



THE RAISE OF SHAREHOLDER PRIMACY (1990 – 2013):

DEAKINS ET AL., 2017



The variables used in this study are also a measure of shareholder power. They show the rise of shareholder primacy.

(NB – They are less relevant as a way to compare countries).

CONTACT

Christophe Clerc
Institut d'Études Politiques de Paris
Descartes Legal
c.clerc@descartes.law