Institute of Advanced Legal Studies
School of Advanced Study
University of London

Martha Okigbo

The role of employees as stakeholders in corporate governance

LLM 2011-2012

International Corporate Governance, Financial Regulation and Economic Law (ICGFREL)

INSTITUTE OF ADVANCED LEGAL STUDIES, UNIVERSITY OF LONDON

The role of employees as stakeholders in corporate governance

Dissertation entry for LLM International Corporate Governance, Financial Regulation and Economic Law 2011-2012

Candidate Number: F1015

Contents

Chapter 1: Introduction

Recent discourse on corporate governance undermines the assertion that corporations ought to function purely in the interests of all stakeholders, rather than for the sake of controlling shareholders. But if the terms of stakeholders are taken to include all participants engaging in large firm-specific investments, then we can trace the real essence of governance as an appropriate basis for reform. Far from erasing the idea that firms should operate and be controlled by stakeholder categories, this should not only be for the interests of institutional investors, employees, suppliers and customers. New systems need to be devised that assign rights, responsibilities, and rewards to stakeholders who provide specialized inputs to the firm. Emphases on the contribution of employees in foreseeing a sustainable period of productivity is key if the most appropriate form of corporate governance is to be recognised. Yet, the crucial question remains as to the key qualities discernible from near-perfect models of corporate governance. Governance mechanisms and contractual arrangements remain to be intermittently formed, allotting functions to stakeholder participants. It would be apt for scholars to provide rationales for their arguments in favour of wholly owned employee corporations and cooperatives; however such cases seldom exist.

Obsolete arguments pertaining to the sole purpose of corporate governance in facilitating shareholder wealth maximization are impractical here. Its acceptance merits further consideration for other players, each of whom play a significant role in realising and fulfilling strategic objectives. Further, if theory establishes convincingly that employee ownership is an inefficient organizational form, then the reasons for other forms of organization must be explored more fully. A growing practice allows employees to cement their presence in the workplace as stockholders, thereby awarding concessions for equity stakes in firms. This interpretation caters for the need to demonstrate employee influence through defined benefit and stock ownership plans. Employees who gain ownership positions through other forms of compensation have typically been unable to secure equal access to the boardroom.

As groups become majority owners, the actual governance of the corporation may depend, in part, on how employees assume this position in the first place. Some transferences of equity-for-wages, notably seen in the airline, steel and trucking industries, pose concerns for employee representation in unions and governing boards. Employees do not only have unequal board representation when compared to their equity stake, they also cannot control the votes held in their interests, nor facilitate tenders surrounding takeover bids. Alternative mechanisms for voting stockholding shares, such as plans for “mirror voting” will in these cases be deployed. On the other hand, existing concepts of firm-specific investments are an insufficient means of justifying property rights. Some corporations will not function in the same manner as others, and may be less able to endorse firm-specific options. Stockholding groups that have an exemplary knowledge of day-to-day operations of the business will have a close involvement in ascertaining the most appropriate means of governance.

Companies owned by employees exemplify governance structures that delegate power to employees. However, some schools of thought argue that employee practices highlighted in multifunctional firms are inefficient, due to the reason that employees, as internal stakeholders, are unable to effectively maintain physical capital, for example through sole proprietorship. If employees are assigned majority ownership and control of the firm, the question posed should concern their place within the modern corporation.

The opposition of unions to employee ownership arises, in part, from their legitimate concerns on the negative risks imposed on workers. Inherent in the ownership debate lies the problem of excessive risk posed by pension plans. For example, the value of employee savings is increasingly linked to the future performance of the operating company; as opposed to proportional measures of their individual performance contribution. Worker autonomy has been seen as a means through which collective bargaining is undermined, and the evolving institution levelled by industrial unions has posed as a significant forum for discussion. The organizational barriers between trade institutions can also be seen as problematic.

Employee participation is also under threat as a complementary feature to management strategic positioning practices. Here, participation refers to initiatives employed by the state, highlighting the collective rights of employees seeking involvement in key decision-making, as well as efforts to reach full representation, deriding employer resistance. The examination of employee involvement in this discussion refers to the practices emanating from senior management and promoters of free market activity. Proponents claim this as providing employees with significant opportunities to interact and voice their dissatisfaction with the status quo. Vital for a keeping of employee voice and control, structures need to be firm, allowing regular exchanges of information through greater transparency and consultation. Measures of transparency and accountability forwarded by employees will need to deliver a strong outcome for the corporation.

Distinctions need to be made between arguments and models that seek to define the employee as separate from upper management and directors, as well as models seeking to accord control to those in a more dynamic fashion. A noted example of the preliminary model moves away from a purely contractual interpretation of the employment relationship, one that can be clearly discerned through freedoms of contract, to a more defined relationship allowing employees to gain, inter alia, a degree of job security that is enshrined by common law. In a market that is uncharacterised by perfect elasticity, employees have specialized skills to bring to the boardroom, which can be rewarded through pure corporate governance structures. Yet employees are expected to be continually instructed by management and be competent in promoting the company's mission, once put into practice. Where employees form means to a justified end, participation in decisions is key. Such corporate governance policies will lead to productive relationships between company and worker. Suppliers, as key stakeholders, are essential to the operations of the firm, as the raw materials supplied inevitably determine the outcome of the finished product. A similarity discerned occurs when they are valued as a reputable participant within the stakeholder network, as opposed to functional controller. Responding when the firm is at risk, the interaction of stakeholders and the board is crucial in reducing exposure.

Until recently, this approach did little to restrict corporate activity. However, subsequent crises altered legal precedent once the global ownership of stockholder interests was assumed. These changes arose at the expense of other claimants of the firm operating within the corporate governance framework. This, in effect, mandated that the claims of stakeholders be taken into full consideration and no longer be subordinated to stockholders.

Although stockholder rights are not regarded by the board of directors as the defining feature of corporate governance, they have the added advantage of protecting employee shareholding groups from managerial opportunism once formal agreements have been reached. An example in question is the claim that productivity concessions enhance the economic viability of the firm. The possibility might also arise where a manager attempts to extract further concessions. Such participation rights in governance help to address employee concerns that management enters into transactions for the sake of opportunism, rather than for the collective good of the firm. The regime of employment rights is emerging in academic discourse, particularly that on the importance of collective bargaining. Concerns were formerly voiced on the “old” system of collective bargaining, where workplace rules could be tailored to the specificity of each category of employers, and latterly changed in negotiations as a form of dissent within the corporate environment. The “new” employment system involves employment rights that are applied throughout organizations that can only be adjusted through lengthy bureaucratic and legal processes. Political demand, of course, has a major influence on managerial procedures. Managing an environment subject to cross-border regulations calls for a considered response within academic circles.

Modern interpretations of corporate governance place less emphasis on questions relating to the structure and functioning of the board and lesser participants. Rather, emphasis is given to the rights and prerogatives of stakeholders whose interests may not be represented as much. In this discussion, we adopt a broader view of corporate practices to refer to a holistic view of legal, institutional and cultural arrangements, particularly in determining the control of publicly traded corporations. The allocation of risks and returns amongst stakeholders stem largely from the activities they undertake. This debate has been extended, to include demands for participatory rights and whether employees, as stakeholders, ought to be embraced to a fuller extent. Including investors other than shareholders in the modern corporation, the stakeholders form a central part of the place in which they are assigned to function. The onus placed on shareholders, as an esteemed stakeholding group that creates successful corporate governance practice, must be framed around discussions on the importance of individual behaviour. Neither the stakeholder models nor those underlying the modern private system have been fully developed. We seek to consolidate prevailing perspectives on the role of stakeholders in the corporation, with intrinsic focus placed on employees as functional participants. If the view emerges that employees should play an integral role in the mechanism of corporate governance practices, then it is from the model of stakeholder involvement that solid arguments must proceed. References to managerial employees also remain relevant here. Despite the prevalence of power struggles amongst stakeholders, allegations that international law supports this, is justifiable, if not controversial. The corporation is subsequently viewed as a “nexus of contracts”, of which each assumes to satisfy the legitimate concerns of engaging parties.[1] The system can be understood as having assigned the same level of rights to stakeholders as the members of the governing board. The leveraging of power over workers is identifiable amongst managerial employees, in altering the performance of the firm, and at times conflicts with stakeholder integration. In Anglo-American models, this is underpinned by shared identity problems, raising concerns in the international field.

Fiduciary duties forwarded by legal scholars present a sound justification for the equitable rights of employees. However, a limitation emerges where justifications of fiduciary ties bestowed to employees, are articulated but not subsequently enforced. The assumption that shareholders vote accurately on the performance of management, can be applied to a unionized workforce, one that is aided by collective organization and prevents reprisal from management.

[1] Bratton Jr., W. W., 1990. The “Nexus of Contracts” Corporatoin: A Critical Appraisal. *Cornell Law Review* , 74(19), pp. 407-440.

This study will provide an alternative reading of modern mechanisms of corporate governance and ethics as one that needs to more fully integrate employees as key stakeholders. Through an enhanced understanding of corporate governance research, corporate law and international regulation, these disciplines serve to complement our positioning of corporate governance within a business environment that is becoming increasingly fractious. The methodology will be supplemented by extensive searches of published material, consisting of peer-reviewed journals, reports, theories, case law, statutes and legislation. The claims of corporate governance professionals are cross-checked against measures taken by regulators for their effectiveness. Publicly available sources of information have been referenced throughout with an emphasis on research studies carried out prior to writing. All sources were corroborated and referenced for their authenticity in supporting the arguments presented in this discussion. Data previously gathered from interviews will be placed alongside qualitative studies. Insight will be heavily focused on current trends, nature and approaches.

To a large extent, this qualitative analysis will be based on theory, with theoretical observations tested against real business practice for their validity. Consideration of employees as stakeholders could be presented here as a solution to the agency problem. Owing to the dispersed ownership structure of companies, directors may not necessarily take care of the interest of the shareholders. Arguments in favour of employees as stockholders are likely to balance and reconcile theories on economic efficiency and social justice.

Chapter 2: Employee Functioning in the Corporation

Extant scholarship on corporate governance tends to focus on the relationships between shareholders and directors or managers. Often neglected in the vast body of dialogue and discussion is the functional role of employees in modern corporations. Corporate structures across boards will be examined for their consistency in aiding the strength of the employee voice, with the practice of codetermination a plausible solution allowing for greater presence in the workplace. As stockholders, employees are able to have a material connection with the corporate entity, with equity ownership more common than is often realized in debates on corporate governance. Typically embodied in the employee, human capital is a crucial source of value for organizations, with employees having a formal but relatively un-acclaimed role, both as representatives on the board of directors, and as entry-level workers. The findings point to a far more plausible solution for workplace imbalances. Alleviated by more advanced information flows and greater communication throughout the corporation, organizational performance is likely to be enhanced.

I. Board Participation

Employee participation in corporate governance structures is effectively realized through board membership. Boards in local jurisdictions are structured to allow employees to voice their concerns and welcome improvements to firm performance. Distributing signals to the wider corporation employee interests will inevitably feature of primary importance during boardroom deliberations. More decisive weight, however, needs to be attached to potential conflict with shareholder interests in the private and publicly traded entity.[2] Where employee directors are appointed to committees, discussion is likely to focus on their rights within the

[2] Perotin, V. R., 2004. *Employee Participation: Firm Performance and Survival.* 1st ed. London: Emerald, p.87

organization, as representatives of workers. Employee representatives are likely to assess managerial competence, subsequent to ensuring that resources are usefully deployed. In countries favouring the establishment of committees as opposed to the traditional board structure, employees may be better represented in compensation committees.[3] Considering the interests of employees has been legally advanced through the passage of the Companies Act 2006. The basic requirement that their concerns are highlighted during the internal deliberations of the board is a feature of the seminal Act. [4] As Lord Wedderburn posited in the final report published in the Company Law Review, directors must identify the material interests of stakeholders in order to promote the company as a success for its members.[5] Note, however, that the report did not mention the safeguarding of employee interests per se, rather that this should be distinct from the legal relationship of directors to employees. The duties by which general directors should be bound are clearly listed. Critiques of §309(2) of the preceding Companies Act 1985 advance in favour of employees' concerns being prioritised.[6] In reality, §309(2) of the Companies Act 1985 was perceived as being of no practical use to employees, with negligible benefits granted.[7] The subsequent 2006 Act, however, compensated for this shortcoming, giving legally binding guidelines to directors on the means of fulfilling company duties, and reflecting the prescribed interests of stakeholders.[8] These guidelines explicitly cater for greater employee recognition, however, the existing law declines interference in substantive business decisions. The requirement that employees should be fully incorporated into the firm is considered as largely procedural. The

[3] *Ibid*., p. 219
[4] *Companies Act 2006* c. 46
[5]Wedderburn, L. A., 2002. Employees, Partnerships and Company Law. *International Law Journal,* 99(31), pp. 113-170
[6] § 309(2) , *Companies Act 200*
[7] *Ibid*.
[8] Holt, W. B., 1950. Alteration of a Company's Objects and the Ultra Vires Doctrine. *Law Quarterly Review,* 66(4), pp. 493-516

lack of remedies available for employee exclusion removes the ability to pursue cases when they do arise, with the company as the only legal person able to bring forward the claim.[9]

A further topic on the corporate governance debate relates the distribution of power to employee directors. Where boards function by consensus as opposed to the divided vote, the allocation of board positions will often determine the consensus decision. Due to concerns surrounding financial intermediaries and public shareholders, employees are rarely elected on majority, even though they may hold substantial bargaining power as majority shareholder.

By placing elected representatives on boards of company directors, employees are also shielded from obligations to place equity investments in the firm. Dow effectively concludes his research by referring to this system, most akin to democratic models of governance. By opening his arguments with a clear overview in favour of codetermination policies, Dow at the same time highlights the few controversies spawned by this model.[10] Whilst the concept of codetermination is used most broadly to endorse collective bargaining and work councils at the ground level, Dow and Svejner limit its scope to mandatory employee representation, a feature in Denmark, Sweden, Austria, Norway and Luxembourg dating back to the 1970s.[11] Whilst these countries initiated the practice in the workplace, Germany revived these efforts most vigorously. Utilising the theories of Berelli, Lys and Loderer, issues other than the gaining of wealth through the system have been widely explored.[12]

---

[9] Perotin, *op. cit*., p. 237

[10] Dow, G., 2002. *Governing the Firm: Workers' Control in Theory and Practice.* 4th ed. Cambridge: Cambridge University Press, p. 32

[11] *Ibid*., p. 193

[12] Bennelli, G., Loderer, C. & T. Lys, 1987. Labour Participation in Corporate Policy. *Journal of Business*, 60(9), pp. 87-109.

II. Stock Ownership

Employee-owned companies empower employees to enhance the productivity of a firm. Theorists have argued that this mode of governance is inefficient. There is admittedly a lack of incentive amongst employees to maintain physical capital in the form of property.[13] The argument that a more prominent role within corporate governance leads to an inefficient use of physical capital stems from a rather restrictive assumption, stating that an employee's stake in the firm is unmarketable and cannot be promoted favourably with ease. If employees are able to signal majority ownership in the form of shares and decide to sell whilst still salaried, for example, the market price of the shares would relate to the loss in value of the physical capital neglected. In the case of shares that are marketable, employees enjoy the same incentive to see the property efficiently maintained. The literature follows that employees prefer to accumulate net revenues amongst each worker as opposed to purely through profit. This preference would result in inefficient use of company resources leading to unequal levels of production. The issues at work here, however, need to be analyzed separately before an overall judgement can be summarily expressed. Critics including Mark J. Roe, in his assertions, do not ascertain prior whether the firm should primarily be classed and organized as a corporation, and if so, whether employees ought to control the firm.[14] These critiques do not accurately apply to the firm if it is presented as a corporate body. In these cases, workers hold a significant or wholly owned portion of share capital, with the employee-owners at liberty to sell their representation within the company. Stock ownership equips employees with voting rights, particularly in matters dealt with through shareholder

[13] Copeman, G. H., 1975. *Employee Share Ownership and Industrial Stability.* 3rd ed. London: Institute of Personnel Management., p. 58

[14] Roe et. al, *op.cit*., p. 241

votes. Whilst assigning the right to vote is not typically viewed as the most important feature of corporate governance, the employee shareholder group is essentially protected from bouts of managerial opportunism once agreements have been reached.[15] Workers may be concerned, for example, that where wage and productivity adjustments enhance the ability of the firm to conduct mergers, there will inevitably be cases where further concessions are sought. From the employee's perspective, it will be commonplace for stock ownership transactions to be stated in a format that gives employees rights of veto over the deal, even though the employees will not have majority ownership of the entity. In order for an effective solution to be posed, further insight into governance participation is needed amongst scholars, in helping to address employee grievances. Management will, in most cases, sideline employees when assuming dominance over transactions.

Equity ownership is more common than is realized in corporate governance debates. In studies undertaken by Douglas L. Kruse, and Joseph R. Blasi, approximately 1,000 publicly traded companies were identified where employees held at least 4% of stock.[16] Representing an average of 12% of voting shares this was compared against the rate at which ownership of equity ascended. Brian Finch predicted in a separate study that ¼ of operating entities would be 15% or more owned by employees.[17] According to critics, employee ownership will be increasingly prevalent over the next two decades, spreading throughout the economy and not focused solely on the steel and airline sectors, where equity-for-wage concessionary agreements have been well documented. To focus our inquiry, a potent example of stock transactions amongst employee participants will be examined. Majority equity acquired in United Air Lines, enabled the engaging parties to discern employee ownership as a future

---

[15] Copeman, *op. cit.*, p. 68
[16] Blasi, J. R. & Douglas L. Kruse, 2010. *Shared Capitalism at Work: Employee Ownership, Profit and Gain Sharing, and Broad-Based Stock Options.* 3rd ed. Chicago: University of Chicago Press, p. 192
[17] Finch, Brian *Insolvency and Financial Distress: How To Avoid It And Survive It* (New York: A&C Black, 2012), p. 126

trend rather than allowing for change in corporate governance techniques.[18] The structuring of the deal allowed employees to acquire stock through a recognized *Employee Stock Ownership Plan.* Distributing strong rights in employee governance, a central objective of the transaction, the restructuring of UAL's operations to include a low-cost carrier, increased efficiency, and changes in compensation packages required a greater level of employee cooperation.[19]

The evidence highlights the capability of the airlines industry in the US as highly profitable. The high expectations in corporate governance standards, however, are potentially mismatched with the industry's attitude towards employees. The case of United Air Lines also indicates that fluctuations in wealth can raise problems to a similar magnitude than its apparent advantages. Transactions in employee stock ownership do not address the imbalance between institutional shareholders and salaried employees. Ordinarily, employees have no basis to concede or begin negotiations on equity-for-concessions swaps. Stakeholder gaining proprietary positions through *Employee Stock Ownership Plans*, on the other hand, have not accessed the boardroom commensurate with directors. Less than half a percent of all companies studied had any form of employee representation drawn from non-senior management.[20] Out of the minority of firms where employees are taken as majority shareholder, substantive representation was a rarity.

III. Codetermination

On the other hand, employee participation in governance structures, whilst aided by the board of directors, entails more than simply a balancing function before individuals of notable

[18] Monks, R. A. G. & Nell Minnow, 2011. *Corporate Governance.* 1st ed. Stanford: Wiley, p. 45
[19] *Ibid*., p. 132
[20] Copeman, *op.cit*, p. 117

authority. The traditional conception of the board can be structured so that information is disseminated more widely.[21] This lends credibility and value to proceedings whilst facilitating the negotiation phase. Employee presence highlights the value of dialogue, in raising awareness of ordinary workers, in the hope that their interests will be adequately voiced and decisive weight accorded to apparent conflicts of interest. Employees are at an advantageous position to mediate the collective authority exercised by management, and the motivation of the board to safeguard the influence of public and private shareholders.[22] Once secure in this position, employees will assume a position of control, evidenced by a more collaborative working culture. A central governance question posited by readers in corporate governance follows the nature of authority wielded by employees participating in boardroom negotiations. The German system of codetermination provides adequate opportunities, assigning control rights to workers that are otherwise obsolete in the West.[23] Established by the *Codetermination Act*, this allowed the coal and steel industries in the region to profit the most favourably.[24] Referred to as the Montan sector, firms amongst the least affected class were required to have a supervisory board of eleven members, five of whom were chosen by employees, with the remaining six chosen by shareholders.[25] Amongst employee board members, blue- and white-collar workers are represented with separate procedures endorsed by board members. The Act effectively extended critics' version of "near parity" amongst the supervisory firm, extending the practice to all limited liability firms falling outside of the Montan sector. The initial system, on the other hand, was seen to be endorsing one of "full parity" between employees and board members.[26]

---

[21] *Ibid*., p. 675
[22] Wedderburn, *op. cit*., p. 120
[23] Fauver, *op. cit*., p.679
[24] Group, C. L. R. S., 2001. *Modern Company Law for a Competitive Economy: Final Report*, London: Routledge, p. 216
[25] Blair, M. & Roe, M. J., 1999. *Employees and Corporate Governance*. 2nd ed. Washington D.C.: The Brookings Institution, p. 180
[26] *Ibid*.

Corporate governance systems in Germany are heavily focused on maintaining employee representation on supervisory boards. Where this commonly occurs, such arrangements are legally mandated. Employees not only have extensive knowledge of operations at their disposal, but their existence on boards lends advanced operational insight to decision-making in boards The greater need for cooperation is matched with greater improvements in governance. The policy stipulating the rights of employees in contributing to decisions made by the board, referred to as the *Mitbestimmungsrecht*, also known as the Right of Codetermination.[27] Initially applied to German workers in the coal, steel, and mining industries where they assumed 50% representation on company boards, this requirement was extended to conglomerates in excess of 2,000 employees.[28] Stock corporations, on the other hand, with 500 to 2000 employees were required to have 33% representation on their boards. The supervisory board chosen by stockholders to promote interests through corporate governance, as well its role in the supervision and onboarding of executive directors, typically has employee members based on numbers, statutory capital, and the relevant codetermination statute. Studies undertaken in this field are usually based on board size ranges from eight to thirteen, however our sample generates an average board size of seven. Studies investigating the financial benefits of labour representation on corporate boards, however, are few to date. The nature of inquiry usually revolves around the enactment of legislation defining codetermining rights. Other studies advanced by Gorton and Schmid are concerned with the non-economic indicators of performance, for example, a firm's ability to execute decisions and develop employee foresight.[29] Tüngler notes a shift from the isolated supervisory boards documented by Fischer and Edwards to those concerned with actively monitoring firm and management performance.[30] Closely matched to the *Code of Best*

[27] Bennelli et. al, *op.cit.*, p. 45
[28] *Ibid.*
[29] Köke,J. *Corporate Governance in Germany: An Empirical Investigation*. Munich: Springer, 2002, p. 76
[30] *Ibid.*, p. 189

Practice published in the UK by the Cadbury Committee, the Deutscher *Corporate Governance Kodex*, was promulgated in 2002 as the *German Corporate Governance Code*.[31] Raising corporate governance standards, this Code specified corporate obligations for the supervisory and management boards. We note the adoption of the *German Corporate Governance Code* as optional, however analyses of annual reports dating from 2002 suggest the near universal desire to comply.[32] Authors more sceptical as to the widespread effects of codes of governance including McConnell, Dahya, and Travlos discover a marked increase in firm turnover, directed by management and employees, following the adoption by UK firms.[33] Likewise, there is an increasingly dominant role of supervisory boards and published statements of compliance with the regulations.

An additional yet highly significant type of labour representation appearing in corporate governance, is the right of codetermination in work councils. In keeping with these laws, councils must be elected by employees, whilst aggregate councils predominate in firms with multiple plants. Corporate entities holding over 100 employees on a permanent basis should establish a separate business and finance committee, which may also function as a reporting mechanism.[34] The literature surveyed suggests a strong consensus in favour of codetermination, where management and supervisory boards comprising of a concentrated employee base should prevail. However, there is an emerging school of thought forwarding a more diluted presence of codetermination across Europe. Michael E. Fuerst for example, argues that "excessive codetermination" may eventually "force the diminution of supervisory

[31] *German Corporate Governance Code*. Government Commission, May 26, 2010, p. 118
[32] Roe et al., *op. cit.*, p. 221
[33] Dahya, J., McConnell, J. J. & Travlos, N. G., 2002. The Cadbury Committee, Corporate Performance and Top Management Turnover. *Journal of Finance*, 25 (3), pp. 281-334.
[34] *Codetermination Act* 1976

board power".[35] His assertions counterbalance the findings of progressive scholars. They posit that as strong boards tend to attract strong influence from workers to board decisions, many firms continue to be family controlled. Thus the family-controlled firms avoid compliance with codetermination laws due to exemption, whilst the value of labour is summarily reduced. Taking into account the major strands of corporate governance, the nature of the supervisory board, concentrated ownership and product competition, a note of caution is attached. Whist scholars believe in the merits of the German system of corporate governance, others are more prudent, believing that concentrated ownership is effective in isolated circumstances only.

IV. Employees as "Human Capital"

The burden of risk associated with poor investments can potentially lie with employees, especially where they play a lesser role in transactions. Bearing some of the negative risk that is linked to investments made by managers, employee output has been intermittently referred to as "human capital".[36] Noted by Margaret Blair, this follows that employees, together with shareholders are most likely to be "residual claimants", harbouring some of the liability from those who internalise excessive corporate risk.[37] As these are made in highly specialized forms of employee ability, the role is essential to the longevity of the firm. The role of employees in corporate governance as a credible source of human capital is likely to be found across industry. Particular focus, however, can be placed on the service-oriented and technology reliant enterprises. Here, the intrinsic value of employees as prized labour emanates from the ability to innovate, provide specialize services, and customize on a mass

[35] Fauver, L. & Fuerst, M. E., 2006. Does Good Corporate Governance Include Employee Representation. *Journal of Financial Economics*, 82(1), pp. 673-716

[36] Blair et al., *op. cit.*, p. 92
[37] *Ibid*.

scale. Where employees function as core participants in the stake-holding enterprise, the resources inputted will inevitably amass the negative risk associated with the company. By its very nature, the role of employees in this cycle awards them a "stake" in the enterprise, just as the risk is distributed and aligned amongst shareholders.[38] Where highly specialized skillsets are sought, employees are more likely to ensure that company resources are efficiently deployed. "Human capital" viewed as being firm-specific is undoubtedly seen as necessary for wealth creation. Alluding to three kinds of evidence, we can show that workers are able to accumulate skills, indicative of the performance of the entire corporation given the right environment. This is aided by extended lengths of service, resulting in higher wages. Directly correlated with job tenure, worker development is expected to rise with increased experience. Higher wages may be construed as evidence that a worker's role in corporate governance is enhanced by the increased time value associated with their employment. Turnover rates will typically fall, leaving workers secure in their role. The "human capital" will be as attractive to the firm as to workers engrossed within.

The contract held between employee and employer is inherently at odds with employee rights to access the products of their labour. Seen as a contract through which to hire voluntarily, once a person is legally employed via an employment contract, they effectively are devoid from legal responsibility for the consequences of their actions, whether yielding positive or negative results. That obligation is typically assigned to the employer. The renting of capital on the other hand results in financial leverage; with the equivalent of securities trading the renting of capital multiplies the availability of equity capital. Similarly, the hiring of capital creates human leverage. Here, the multiple effects are on the employer, as if to state that the

[38] Lazonick, W. & Mary O' Sullivan, 2000. Maximizing Shareholder value: a new ideology for corporate governance. *Economy & Society,* 29(7), pp. 301-349.

results gained by an expanded workforce are the sole product of the employer. The apparent conflict between core responsibility and the employment process is an established legal norm. Through the employment contract, the corporation as a by-product of capitalism is transformed into an organization that is dominated by governance. The same organization, however, is not yet viewed as democratic despite the implicit “consent of the governed” evident in the employment contract.[39] Employees, in other words, are not able to distribute governance rights to the employer as their sole representative. Employing the social and political theories of Hobbes in this instance, we see the workers as alienated from their labour, with the right to govern their own activities threatened at the mercy of the employer. A reduced version of the contracting tradition, the argument in favour of applying democratic principles to the workplace is one which gains in plausibility. Once the democratic principle of equitable representation is realised in the ordinary workplace, so the employment contract gains more acceptance by the employed. It implies declaring the employment contract as void so long as the democratic right held by employees is alienated. Once the democratic principle is applied universally, workers become members of the company in which they work and not just treated as an ordinary worker. In effect, the employment relation is taken over by the new status as owner.[40]

Equally, they will have a tendency to leverage *de facto* control, drawing on their “inside knowledge” of the enterprise as well as the awareness of their own stake in its success.[41] Critics argue that workers are better placed to exercise judgement over the day-to-day operations of a firm than absentee shareholders. Monitoring management performance is also called into question here, highlighting a tension between worker autonomy and the acclaimed

[39] Ellerman, D. P., 1986. The Employment Contract and Liberal Thought. *Review of Social Economy*, 44(5), p.163
[40] Ellerman, *op. cit.*, p.221
[41] *Ibid*., p. 342

foresight held by management. The implications here are that internal stakeholders have preferred rights of ownership, perhaps to a greater extent than do their external counterparts. This, however, does not exclusively suggest that major stakeholders be given majority voting rights ahead of shareholders, nor should they be disenfranchised from a firm. What is called into question by these findings, however, surrounds our shared understanding of ownership and what it means to contracting parties. Closer examination is needed into the types of investment at risk in corporations where control is distributed unevenly across categories of stakeholder.

Recognition amongst employees of the importance of information flows, and their existence at all levels of governance is vital to the success of an organization. The implications are that it is often inefficient for key decisions to be made only by management. Models of Japanese companies discussed in Aoki's work captures this debate well.[42] Highlighting that structured systems at work turn out favourably when there is either prevalent or negligible levels of uncertainty, Aoki shows that this is a common occurrence in the workplace. At intermediate levels, however, efficient information flows gives workers the role to make some decisions as inefficient as possible.[43] Whilst this hypothesis may appear as an unconventional interpretation of organizational governance, Gregory Jackson's interjections provide some support.[44] Using information to appear inefficient by some stakeholder groups does, however, make others appear more reactive to unusual circumstances or shocks specific to the workplace. The problem of negating employee efficiency has also been modelled. Increases in information flows from management to entry-level employees could result in concessions during crisis, steering troubled enterprises away from bankruptcy. Increasing flows outside

---

[42] Masahiko, A., 2010. *Corporations in Evolving Diversity: Cognition, Governance, and Institutions.* 3rd ed. Tokyo: Oxford University Press, p. 303
[43] *Ibid*., p.32
[44] Jackson, G., 2007*Corporate Governance in Japan: Institutional Change and Organizational Diversity. 1st ed.* Oxford: Oxford University Press, 2007, p. 211

the traditional corporate hierarchy, establishing open forums for negotiation, and motivating employees to longer-term loyalty to the firm have been presented as possible solutions.[45] Aside from hypothetical conjecture, these plausible solutions have worked in practice. Collective voice in the corporation has been maintained, allowing the enterprise to function during economic grievances. A definitive goal of the *National Labor Relations Act*, employers of large corporations were to give their subordinates more than the statutory requirements.[46] Relations between the board, senior management and the labour force altered significantly after the passage of the Act, creating a more cooperative decision-making process.

Financial reporting, together with the voluntary or mandatory disclosure of information, is an aspect of governance that has the ability to make a difference to the ordinary citizen. Disclosure of information is identified as a means of holding the company responsible for failures in accountability. Internal information on the reputation of a company and how the governance model adopted will secure a good position for stakeholders. Making information available in the public domain helps to create a system more responsive to the plight affecting the corporation, employees and stakeholders. It will allow the enterprise to arrive at a clearer understanding of stakeholder's expectations. Corporate entities will be more capable to make astute decisions, once equipped with better information. In a review of corporate social and environment reporting practices, authors including Robert Gray discover a trend towards enhanced social reporting requirements.[47] With the USA spearheading the move towards greater accountability to stakeholders, reporting on socially responsible issues grew more

[45] *Ibid*., p. 123
[46] *National Labour Relations Act*, also known as the *Wagner Act* (1935) 29 U.S.C. § 151–169
[47] Gray, R., Owen, D. & Adams, C., 1996. *Accounting and Accountability: Changes and Challenges in Social and Environmental Reporting.* 2nd ed. London: Prentice Hall, p. 267

widespread from the 1970s. Voluntary reporting, however, is likely to be more limited in scope and will inevitably be biased to information portraying companies more favourably.

This discussion, then, calls for greater investigation to be undertaken in relation to board structures accommodating employees. It remains a recurrent feature that collective employee interest is largely unrepresented on boards. Neither a legal requirement applied universally nor a precondition of corporate governance, the emerging trend calls for greater inclusion. Through the practice of codetermination in parts of Western Europe, there is less reluctance enshrined by law to exclude employees from boards, with the supervisory and management committees providing oversight to the operations of the labour force. Shareownership is a material option for employees to assume a greater role within the corporation. However, statistics show that the levels of representation differ widely in jurisdictions. A more reliable indicator of involvement stems from the perception of employees as human capital, where the value is closely related to performance. Finally, as carriers of information, employees take on a largely transferable role, navigating through the corporate hierarchy with the aim of delivering operational and strategic solutions.

Chapter 3: Stakeholder Relations with a Focus on Employees' Role

Discourse on stakeholder relations questions the role of corporate governance in smoothing relations between the controlling participants, namely the employees, managers, investors, customers and suppliers of a firm. This chapter considers the views of stakeholders as a party asserting their interest in the enterprise, multiple self-interests that may not always be aligned. Rather these may be conflicting. Unlike investors in large companies, for examples, employees may be keen to assert their role as owners. This goal may be fulfilled as a result of long-term cooperation with colleagues and other internal stakeholders. Deconstructing ownership values gives way to an unbundling of rights that are separate from each other and may be dispersed amongst the remaining stakeholders. With a focus on the separate ownership of rights, we suggest that employees do have the option of assuming a role as property owners, with this distancing them from the privileges accorded to other stakeholder groups. Developments in relation to stockholding employees, however, do not lead to an automatic rejection of the shareholder primacy model. It merely suggests that the nature of employee relations requires further investigation. Managers also contend their acclaimed role as legitimate stakeholders. Their stake at the alleged centre of the corporate governance system is to be explored through their association as stakeholders. They may try to control participants by supporting and limiting interactions in the organization. As salaried employees, they should be held accountable and closely scrutinized for actions on behalf of the firm. Finally, stakeholder theory will be explored for its contributions, with the overlap into the discipline of stakeholder management deemed as an important contribution to existing literature on stakeholder relations. Legislation in the form of 'stakeholder statutes' will be seen as credible measures helping to shorten the distance between constituents, significantly aided through dialogue and active communication within and outside the boardroom.

I. Employee and Managerial Power

In opposition to the demands made by controlling shareholders in the largest corporations, employees seem to fulfil requests for ownership through commitment and extended participation. Whilst stakeholders appear to be motivated by differing interests, fragmented stakes in the corporation do not necessarily lead to a rejection of the shareholder primacy model. Supported by Lucian A. Bebchuk, this argument indicates that the limitations of stakeholder importance require further research, especially into the position of employees within.[48] Rights to existing employment, and compensation for losses in job tenure may seem to be of worthy consideration as vehicles for the bundle of rights associated with employee protection. However, the narrow focus on stakeholder rights to participation, as maintained by corporate governance scholars, is clearly distinct and separate from those distributed amongst customers, suppliers and creditors. There is some irony in alleging that the stakeholder model could be justified on the grounds of property holding, where ownership is equated with stakeholder legitimacy. The suggestion that property rights complements the shareholder primacy argument, contrasts markedly with more current trends arguing that the property ownership should be directed to stakeholders at the lower end of the hierarchy. This trend, ever present in the works of Honore, Coase and more recently by Munzer counters the arguments that private property rights cater solely for existing owners.[49] Bargaining for the remainder of stakeholders who are not owners does not account for the position of employees.

The key characteristics underpinning the central theories of distribution also bear relevance to corporate stakeholder. Referred to extensively, the notion of stakeholder as participant in distributive rights is well conceived.[50] Where the "stake" of employees adheres to those maintaining successful operations in the long run, this "stake" is essentially founded on effort. Upon comparisons to other stakeholders, we see that the community, for example, is motivated more by needs for a sound external environment. Reduced levels of pollution or requests for strong civic infrastructures will take precedence over the acquisition of capital

[48] Bebchuk, L.A., 2007. The Myth of the Shareholder Franchise *Virginia Law Review* 675 (93), p. 433
[49] Friedman, A. L. & Miles, S., 2003. Developing Stakeholder Theory. *Journal of Management Studies*, 39(1), p.21
[50] Nader, R., Green, M. & Joel Seligman, 1977. *Taming the Giant Corporation: How the Largest Corporations Control Our Lives.* 9th ed. Stanford: W.W. Norton, p. 410

through hostile takeover bids, for example. On a similar note, the stakes held by customers could be based on offers of enhanced protection rights in the market offering. Others making a more radical assertion would state that stakes "extending to the wider society" are not far removed from formal property rights, in line with critiques of corporate governance arrangements.[51] If this is correct, a factor that would be needed to show this as an accurate development would recognize stake-holding groups as having a plural interest in the affairs of the corporation.

Evidence shows that corporate governance appears to be an evolving, rather than static system, with managers at the centre. Whilst managers can be seen as controlling stakeholders, others are deemed as guiding and supporting interactions within the workplace.[52] Managerial power will continue to be exercised through the forming of entry and exit barriers, using enforcement measures to oversee corporate structures, or even by initiating acquisitions and takeovers. As salaried employees, managers inform suppliers by developing additional streams of supply, for example through purchasing and price monopoly agreements. As key stakeholders falling under the category of employees, managers influence the external community by manipulating information available to the public. This may extend to the state through lobbying and campaigning exercises. Commentators including Michael Jensen go as far as to state that management influence of stakeholders is the dominant approach.[53] The strategies employed by managers in order to manipulate stakeholders may appear as value in the short run; however this asymmetry of power disperses amongst other stakeholder groups in the long run. In response to this, some constituents may develop their own counterstrategies in an attempt to repel the influence of managers. For example, they make

[51] *Ibid*., p. 26
[52]Gunay, *op.cit,*. p. 89
[53] Jensen, M. C.,2002. Value Maximization, Stakeholder Theory, and the Corporate Objective Function. *Business Ethics Quarterly,* 12(1), p. 235

use of the same former enforcement schemes, but through institutional structures such as labour and consumer unions, and advisory associations. [54]

External stakeholders outside the corporation also try to change the behaviour of managers. With regards to financial institutions, these may attempt to exert influence on managerial action by threatening proxy fights. Events that occur when stockholders oppose one or many aspects of corporate governance, these will inevitably focus on managerial and directorial positions. Corporate activists could also attempt to influence shareowners through proxy votes.[55] These could be executed in the hope of replacing management for a more responsive workforce. Once management is engaged in a proxy fight, however, the balance of power lies with them over the groups attempting to enforce corporate change. As a result, the mechanism of displacing the stakeholder group is unchanged. External stakeholders outside the corporate may also try to change the behaviour of managers. With regards to financial institutions, these may attempt to exert influence on managerial action by threatening proxy fights.[56] Events that occur when stockholders oppose one or many aspects of corporate governance, these will inevitably focus on managerial and directorial positions. Corporate activists could attempt to influence shareowners through proxy votes. This could be executed in the hope of replacing management for a more responsive workforce. Stakeholder theory can be seen as managerial in a broad sense. The term does not only summarize existing conflicts between employees, of which managers are categorized. Rather, it explains and forwards structures, practices, and attitudes that can be seen to form the bulk of stakeholder management. The requirement is applicable for all persons responsible for effecting corporate policy, which includes the government, shareowners as well as managers. The theory does

[54] Jacoby, S. M., 2000. *The Embedded Corporation: Corporate Governance and Employment Relations in Japan and the United States.* 4th ed. Princeton: Princeton University Press, p. 142
[55] Bainbridge, S. M., Klein, W. A. & Ramseyer, J. M., 2008. *Business Associations: Cases and Materials on Agency, Partnerships, and Corporations.* 1st ed. Stanford: West Group, p.19
[56] *United Auto Workers v. LaSalle Mach. Tool*, 696 S. 452 (6th Circuit 1982)

not instantly presume that managers are the apex of corporate governance and control. The lack of attention drawn to stakeholder interests does not fully resolve the problem of evaluating their stake in the firm. Nor does the theory imply that stakeholder groups should be involved equally in workplace decisions and processes.

Opinions surrounding stakeholder theory have been presented in literature as a key distinction from stakeholder management. In contrast to this, a central tenet of stakeholder theory identifies the legitimate groups or persons participating in firm activity. [57] Each group contributes for the sake of their own interests; the legitimacy of the alternate interest does not become self-evident. Firstly identifying the stakeholders of a corporation, the theory attempts to give priority to the expedient group. The difference between this theory and those pertaining to others in the firm, or what is known as the "going concern" according to Archie B. Carroll, is that the former on stakeholders intends to guide and explain the organizational structure of a company, one in which numerous players achieve multiple purposes, which are not always congruent.[58] The stakeholder theory tends to be broad, with less emphasis on the particular. This is not to say, however, that the stakeholder concept is vacuous, rather it reaches further than the descriptive observations of an organization, and the role of stakeholders within.[59] However, the questions raised in relation to our discussion are distinct from each other, and are based on different types of evidence and forms of appraisal. A central thesis argues that stakeholder theory and its account for corporate governance is purely descriptive. The descriptive model of stakeholders provides an overall structure, or framework, for examining empirical claims, where insights into the stakeholder concept are

[57] Maani, K. C. R. Y., 2000. *Systems Thinking and Modelling: Understanding Change and Complexity.* 1st ed. London: Pearson., p. 201
[58] Buchholtz, A. & Carroll, A. B., 2011. *Business and Society: Ethics, Sustainability, and Stakeholder Management.* 3rd ed. New York: Cengage Learning, p. 630
[59] Friedman, A. L. & Miles, S., 2003. Developing Stakeholder Theory. *Journal of Management Studies,* 39(1), p. 19

laid down clearly, but assumptions relating to standards, approaches, or norms are not explicitly tested. The purely descriptive approach to testing the role of stakeholder participant, however, does not benefit from the same recognition as the "instrumental" theory.[60] This form realises an approach for forming connections between stakeholder management practices and achieving corporate goals in terms of performance, for example through profitability, growth, stability and productivity within the firm. Whilst both the descriptive and normative approaches involve the key acceptance of the intrinsic and legitimate interests, the instrumental component leans more towards a normative argument. Each stakeholder group merits consideration not only for furthering the interests of shareholders, but for their value as a key input to the firm.

As a damage limitation exercise, the adapting of techniques from existing stakeholder management practices is well received by participants and critics alike. Bringing the intrinsic uses into the corporation has often been described as an enlightened form of self-interest. [61] From the perspective of stakeholder management, as a discipline, the corporation can be presented as a joint effort of diverse and multiple interests and constituencies. The stakeholder view blends together employee relationships with a firm's resources, industry counterparts and social environment into a unified analytical framework. From this, the wealth of an organization can be enhanced, through relationships with actors other than employees.[62] Stakeholder connections with customers and suppliers, resource providers, and the local community are key to effective stakeholder management.[63] In other words, the managing of relations between stakeholders, for the sake of mutual benefit, is central to

[60] Gunay, S. G., 2008. *Corporate Governance: A Comparative Analysis of Stockholder and Stakeholder Governance Models.* 1st ed. New York: iUniverse., p. 238
[61] Maani, *Systems Thinking and Modelling*, p. 209.
[62] *The Model Business Corporation Act 2002*
[63] Freeman, R. E., Parmar, B. & Wicks, A. C., 2004. Stakeholder Theory and The Corporate Objective Revisited. *Organization Science,* 15 (9), pp. 364-369.

corporate success. Corporate leaders advocating an era of progressive stakeholder management, list the value of responding intelligently to the concerns of employees, as well as that of the general public. Allowing directors to sense and take advantage of new opportunities and anticipating problems before they arise. Since communication is an essential component of a successful corporation, stimulating change within the corporate hierarchy and equipping employees with the tools to further corporate objectives, dialogue needs to continue with all stakeholders not only to restore confidence, but also to relieve pressure on the company, shareholders and employees. Whilst directors need to function in the collective interests of shareowners, they should also account for the interests of other stakeholders. Accountability and transparency, whilst invaluable for effective leadership, should be balanced with the acceptance of all stakeholders, with equal recognition distributed amongst employees according to seniority. Balancing this entails a bargaining process involving participants, which should ideally be completed well in advance of completion. With a positive outcome, trust is enhanced between the firm and internal stakeholders. From a stakeholder perspective, corporate governance provides a mechanism for sustaining this balance.

II. The Rise of Stakeholder Statutes with Reference to Employees' Place

Over time, the law has progressively made allowances for corporate decision making, beginning an enduring process that accounts for corporate decision making. Nearly all jurisdictions have enacted laws dictating executive directors to consider the interests of stakeholders without breach of their fiduciary obligations. According to Kathleen Hale, protecting shareholders through statutes alone cannot enhance stakeholder consideration seen in the corporation.[64] With influence increasing over stakeholder groups, the law has enshrined the practice of declaring the stakeholder as legitimate constituents holding the balance of power.[65] A secondary purpose of the statutes is to prevent employees, including managers, to act against shareholders' interests. The aim of enacting legislation, moving apace in the 1980s, has been disputed. Whilst Kathleen Hale maintains the former argument, Testy states that the developments were made for the sake of managers.[66] As employees, they needed a reason to prevent hostile takeovers that were more beneficial to shareholders. As the controllers began to use a discourse relevant to their group of stakeholders, supervisors could justify a repudiation of a "premium bid and thereby remain in control of their enterprise (and their jobs)."[67] Conceding that there had to be a reason why executives rapidly welcomed its passage, the statutes were likely to be used for the sake of self-interest rather than an intentional duty of care.[68] With the sole exception of Connecticut, no state in the 1980s obliged leaders to consider stakeholders with much worth, and certainly did not expect administrators to act on their behalf.[69] Whilst traditional arguments convey stakeholder statutes as enactments that disrupt shareholder wealth maximization, others declare that such statutes are a clear violation of the *Fifth Amendment*, which forbids takings "on an unfair basis."[70] This precondition does not appear constitutionally sound, as the manner of takings presently is often misconstrued by relevant parties; however this clause does suggest the early reaction to shareholdings acquired. If the shareholder primacy norm was to be relaxed, further constraints such as the need to generate a surplus of capital, together with market

[64] Hale, K., 2003. Corporate Law and Stakeholders: Moving Beyond Stakeholder Statutes. *Arizona Law Review,* 45 (14), p.823
[65] Harner, M. M., 2010. Corporate Control and the Need for Meaningful Board Accountability. *Minnesota Law Review*, 44(5), p. 541
[66]Testy, K. Y., 2002. Linking Progressive Corporate Law with Progressive Social Movements. *Tulane Law Review* 76(1), p. 2210
[67] Hale, K., 2003. Corporate Law and Stakeholders: Moving Beyond Stakeholder Statutes. *Arizona Law Review,* 45 (14), pp. 823-889.
[68] Amendment V, *Constitution of the United States*
[69] *Connecticut General Statutes* S.33-756 (b)
[70] Cummings, L. & Patel,C., 1979. *Managerial Attitudes Towards a Stakeholder Prominence: Within a Southeast Asia Context.* 4th ed. Queensland: Emerald Group Publishing.

pressures would mean a retuning back to the norm. Unlike the majority of stockholders in large companies, employees appear to express ownership in the corporation through extent of commitment and long-term participation.[71] Where federal government has a constitutional right to seize ownership, expressed in the form of property for public use, the *Just Compensation Clause of the Fifth Amendment* requires the payment of fair compensation, equal to current market value, to the proprietor.[72] The wider group of persons with a controlling interest in the enterprise may have differing interests; however, the breakup of ownership in the modern corporation is not likely to lead to an instant rejection of shareholder primacy. Rather, it suggests that the emerging trend requires greater consideration.

A further variation evident in stakeholder statutes is the extent to which they extend permission to consider salaried employees outside of the board of directors. The issue as to whether workers at the grassroots level should be granted equal consideration remains undecided. Wyoming's current statute, for example, notes plainly that a director "may also consider...the interests of the corporation's suppliers, creditors and customers."[73] This piece of legislation omits the classification of officers as corporate stakeholder. Illinois extends this further by reporting that directors and officers ought to account for the input of stakeholder groups.[74] But if the intention of the statute is to allow consideration by directors and officers, then both sets should be included, with the role of officers more clearly stated. The absence of employees from statutory language, whilst still relevant, does not facilitate the decision-making process as easily as may have been in favour of stakeholders. In contrast, stakeholder

[71] Mitchell, L. E., 1992. "A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes," *Texas Law Review* 70 (26), p. 575
[72] Amendment V, *Constitution of the United States*
[73] *Wyoming Stautes* S. 17-16-829 (e)
[74] *National Labour Relations Board v. Wooster Division of Borg-Werner*, 356 U.S. 342 (1958)

consideration is allowed only during takeover or situations where change of control takes place. Held in nineteen states, this requirement is less inclusive of employee recognition.

Given that stakeholder statutes, admittedly, have done little to close the gap between salaried directors, managerial employees, and ordinary workers, the successive passage of legislation should not be dispelled for its failure to adequately account for all employees. Rather, they ought to be seen as a foundation upon which further revisions can be made to the laws encompassing stakeholder rights. Hale argues that a development that could be furthered, in addition to successive legislation, is seen in statutes pertaining to meetings.[75] Stakeholder meeting requirements, Hale states, would enforce corporate leaders with an obligation to hold periodic meetings with internal and external stakeholder groups.[76] The express purpose of these would be to limit the distance and, in effect, create a more earnest consideration of stakeholders during boardroom deliberations. Individual states could dictate how often the meetings should be held. Using further evidence, we can see the strengths of dialogue and discussion amongst stakeholder participants and their superiors at all stages of the decision-making process.[77] This would ensure a greater inclusivity in the workplace. Issues brought to the regular meetings would range from compliance with accounting practices to the issuing of employee bonuses. Other topics such as introducing new health and safety standards highlight a need to move away from purely discussing contractual changes in ownership, with more reliance instead upon the resizing of corporate objectives. On the other hand, by limiting meetings to changes in control, leaders within the corporation will expose the absence of stakeholder consideration. That employees and other groups should be fully

[75] Hale, *op. cit*., p. 846
[76] *Ibid*.,
[77] Eric W. Orts. Beyond Shareholders: Interpreting Corporate Constituency Statues. 61 *Washington Law Review*, p.23

accounted for and granted, once agreed upon in the boardroom, should be practiced throughout.[78]

We witness, then, a realignment of interests between employees and stakeholder counterparts. Employees continue to have a controlling interest in firm output; however the extent of their efforts is strongly contested by their supervisors. Alleged to be manipulating their rights as managers, it has been argued that they should equally be considered as stakeholder. Corporate governance scholars maintain that stakeholder participation rights have narrowed in focus. They focus less on the roles of key stakeholders in contractual arrangement with the firm and more on their exclusive relations with stakeholders within the firm. This network of relationships is built on by a series of implicit agreements where each group attempts to secure the most favourable results. The stakeholder view of corporate governance uses a system where a balance of interest is maintained. This may involve a complex bargaining process which needs to be ongoing. Once this continuum is achieved, trust can be secured throughout the firm and external stakeholders, of which the community plays a key role. Initially introduced by the passage of stakeholder statutes, communication is also clearly favoured. Dialogue between participants enables the corporation to reduce tension and relieve constituents from obligations imposed by superiors at the top of the corporate hierarchy.

Chapter 4: Regulatory Responses to the Stakeholders Governance Gap

Empirical evidence points towards the self-regulation of corporate entities as an ineffective means of governance. Stakeholders, it is suggested, are unable to receive a fair and equitable treatment from employers who dictate their own mechanisms of governance. Unless entities are explicitly connected to corporate culture, and employee commitment is actively sought,

[78] Stone, K. V. W., 1991. Employees as Stakeholders under State Nonshareholder Constituency Statutes. *Stetson Law Review*, 22(6), p. 45.

companies will yield insignificant results as a result of poor governance. One means through which employee commitment is encouraged by law is through the creation and maintenance of the employment contract. Workers can either be satisfied through this written agreement, as enshrined by law, or they can view the contract as a tool for alienation. Utilising social contract theory helps us to identify the line between regulators, lawmakers, and the governed, whom in this case would be the employee. Further, the regulatory tool of compliance management has been received ambiguously. Some quarters write that the technique is successful in securing a preferred mode of governance only once a favourable environment is maintained. This excerpt focuses on the regulatory and social conditions amongst which corporations exist and the challenges they face in achieving self-regulation. The issue of responsibility is also examined for its relevance to internal and external stakeholders, with perceptions of the term applied in different contexts. Finally, disclosure as a means of social reporting will be discussed in order to arrive at a clearer understanding of the company's role towards its stakeholders, from the regulatory point of view.

I. The "Open Corporation" and Compliance Programmes

Modes of corporate regulation that are most commonly accepted by scholars and practitioners involve the placing of stakeholders into an influential position, where they are able to input their views to corporate management. Christine Parker states that this development also implies the nature of regulatory enforcement, facilitated by law, as one that ought to allow the movement of companies into three distinct phases.[79] Prescriptive regulation aimed at corporations has reached a crisis. Involving entities that are unable to facilitate changes to working culture via restructuring, Parker suggests that the most viable means of securing

[79] Parker, C., 2002. *The Open Corporation: Effective Self-Regulation and Democracy.* 2nd ed. Melbourne: Cambridge University Press, p. 24.

transformation is through adopting self-governance practices. Prompting issues of responsibility through self-governing modes of regulation, this is aimed at the second phase, where companies report on the changes they have introduced. Enabling regulatory authorities and stakeholders to check that self-regulation is necessary, it is the responsibility of stakeholders to constantly evaluate changes to corporate structures, together with their outcomes and effects. With the empirical findings largely a result of qualitative fieldwork carried out by practitioners in Australia, Europe, and the USA, we are shown the variations of regulatory systems and their impact on governance. In certain instances, these have occurred with modest success.[80] Selznick takes a more ‘pragmatic’ approach, by relying on empirical evidence to show the nature of corporate systems.[81] Regulatory reform resulting in innovation and redesign to the ways in which employees are accounted for also calls into question the acceptance of responsibility by the corporation. Management of these responsibilities have been scrutinized in recent years for their impact on stakeholders. As part of the “open corporation”, a description of governance elaborated on by Christine Parker, the management of corporate responsibility shows an underlying commitment to respond to government initiatives via self-regulation.[82] This includes a realization of purpose by the organization and its approach to stakeholders, together with the on-boarding of the requisite skills and knowledge. Here, professionals take on a central role in facilitating engagement between upper management and stakeholders to form the “open corporation”, where interaction between stakeholders, the firm, and regulators, is encouraged.[83] These phases will follow in succession so as to avoid conflict and create a more robust system. For this arrangement to work however, it needs to be included as an integral part of corporate responsibility, as recognised by outside bodies. Whilst external regulatory pressure is key, studies point

[80] Selznick, P., 1969. *Law Society and Industrial Justice.* 12th ed. New York: Russell Sage Foundation Press, p. 309
[81] *Ibid*.
[82] Parker, *op.cit*, p. 49
[83] *Ibid*., p. 68.

towards the equal significance of internal compliance. In evaluating the US handling of the *Cooperative Compliance Programme* taking place between 1981 and 2004, we find that professionalism in the field of safety management was crucial for effective compliance with regulatory goals.[84] Labour-management forums were set up on six sites to tackle the goals of reform. The approach of the Programme mainly succeeded due to the strengthening of safety initiatives in ways that traditional strategies had failed. The style of launching voluntary safety programs by those recently promoted in the organization led to better implementation and oversight by senior management.

II. Approaches of the Financial Services Authority and Implications

As a means of avoiding the limits of industry self-regulation, greater agreement needs to be reached amongst beneficiaries. Including regulators, the corporate entity itself and stakeholder, of which we will continue to focus on employees, the success of self-regulation depends on the willingness of each group to comply.[85] A desire to comply with the new system of regulation must not avoid a complete rejection of the traditional mode; rather the inefficiencies of the existing framework will be focused on and expelled. If individuals and entities are to comply with regulations, the rules to be enforced fairly must be prior established. Trust in demands placed on employees to comply, and concerns in violating this is a central issue for regulators. This has led some scholars questioning the need for a more collaborative approach to regulation, with beneficiaries given access to participation and greater inclusion.[86] This approach to compliance management, however, does not wholly engage with the opinions and concerns voiced by employees. Prescriptive rules stipulated by

[84] Rees, J., 2010. *Reforming the Workplace.* 4th ed. Philadelphia: University of Philadelphia Press, p. 67
[85] Clarkson, M. B., 1995. A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance. *The Academy of Management Review,* 26(1), p. 108.
[86] *Ibid*., pp. 98

the Financial Services Authority (FSA) in the UK on *Senior Management, Arrangements, Systems and Control,* all approve delivery by persons in controlled functions. This is relevant for all employees assuming titles under the *Approved Persons Regime*.[87] This technique of "command and control" thus highlights the impossibility for regulators to be solely responsible for the mismanagement of corporate issues. It is simply not achievable for authorities to avoid every dispute between personnel. Neither would a common standard force businesses to be more accountable for their actions. Their scrutiny of compliance as an effective tool for integration may result in prolonged disagreement. Negative experience will dissuade employees from accepting the rules enforced on them, just as executives question the effectiveness of reforms imposed on the enterprise by regulators.[88] There is no bond convincing either party that compliance with all reforms to stakeholder governance is worthwhile. Rather, employees and other groups will be concerned with self-regulation and the entity's ability to connect with the individual bearing that legitimate interest, the effectiveness of corporate self-regulation ultimately depends on the strength of connection with stakeholders, internal and external to the organization. Viewed as both a "top-down" and a "bottom-up" approach to governance, broader association with organizational ethics poses further limits. [89] As with existing forms of social regulation, the "command and control" technique, this has been expressed by Anthony Ogus as one "in which standards, backed by criminal sanctions are imposed on suppliers".[90] This definition does not, however extend liability to those acts that may be committed "not in good faith".[91] The activity of individual actors within organizations is largely determined by their environment. As employees are

[87] Clarkson, *op. cit*, p. 150
[88] Haines, F., 1997. *Corporate Regulation: Beyond Punish or Persuade.* 4th ed. London: Oxford University Press, p. 239
[89] Stone, C., 1975. *Where the Law Ends: The Social Control of Corporate Behaviour.* 5th ed. New York : Harper & Row, p. 89
[90] Ogus, A., 1994. *Regulation.* 3rd ed. Oxford: Oxford University Press, p. 5
[91] *Ibid.*

hired to fulfil employer's requests, they are also at liberty to use their resources in order to pursue their own corporate interests.

In sum, we see a move towards greater inclusion of stakeholders. Through self-regulation, companies are able to determine how a corporation should be run and in whose interest. The evidence suggests that there are multiple factors at play, with existing tensions between regulators and corporate governance participants. What remains constant, however, is the desire of stakeholders to access rights to the corporation on a near equivalent basis with their employers. Views of the company as a wholly social enterprise do not hold. Disclosure of information and social reporting has not been evidenced by corporations throughout the world. Rather, it points to a recognised need for more socially responsible behaviour. Issues affecting the organization, similarly, do not focus exclusively on the financial markets in which they operate. The effect of corporate output has been called into question by the move towards a corporate democracy, with the main impact seen on workers.

Chapter 5: Conclusion

Our discussion on the role of employees in corporate governance has presented us with interesting issues that need to be more fully explored. Where Chapter 1 begins our discussion by introducing the topic and themes to be analysed in greater depth, Chapter 2 began with the rights of employee representation on boards of directors. We have shown that workers can and do participate upon election to the board, where they are in a position to influence senior management on their grievances and make sure that resources are deployed in their favour. Greater employee participation improves dialogue in the corporation, avoiding conflicts of interest and safeguarding those of shareholders. Board representation calls into question the concept of ownership, where employees are able to have a material presence on boards as shareholders. Companies owned by employees are a more effective way to dictate structures of corporate governance. However, this presence has been argued as a rarity, with findings pointing towards this framework as inefficient. Despite equity ownership becoming more common a feature in the workplace, equity owned by employees is heavily biased towards the service sectors. As competent and technically efficient individuals at the ground level, it is expected that workers could lend their operational insight in boardroom discussions, basing this on genuine experience and productivity. The issue of codetermination has been explored, with favourable models of corporate governance found in Germany. Employee representation is legally mandated, with the requirement for greater cooperation matched by strategic improvements in governance. Through works councils, employee ownership is concentrated upon as an effective form of pressure against traditional modes of governance. As a potent source of "human capital", employees will have an ability to control operations, drawing upon their specialist knowledge and questioning management techniques. Information flows are facilitated by a reliance on employees as carriers of information. Upon efficient exchanges of this information, transfers between stakeholder groups will make internal and external participants more reactive to unusual activity.

A complementary view on property as a sound basis for the stakeholder model of governance has also been shown. Holding a "stake" in the enterprise is compared to employee status as proprietor, both in terms of their physical and psychological presence in the workplace and their material ownership of the company's stock. As both parties compete for hegemony, the debate on stakeholder versus shareholder interests poses a distinct dilemma for the enterprise. Whilst employees and shareholders are bestowed with different types of power, these must be utilised for the common good of the company, with neither party gaining excessive proprietorship at the expense of the other. Thus, there is a further conflict of interest between the stakeholding group and the controlling shareholders, leading to an undeveloped solution to the shareholder primacy model. Granted, the traditional position of shareholder, as a legal person who assumes overall control and direction through stockownership, exists in company governance. This trend transcends jurisdiction, providing a core infrastructure and guide as to whom production should continue on behalf of. Whilst conflicts could be reprised through greater realisation of fiduciary obligations to the firm, the stakeholder debate still calls into question the extent of involvement. Issues, for example, as to whether employee and shareholder interests should be viewed purely as a matter of consideration, rather than a basis for substantive reform.

Extant research also highlights managers as having a controlling stake, once supervisory oversight is exercised. Stakeholder groups including customers, suppliers and workers may make use of enforcement schemes through consumer and labour unions, as well as trade associations. External stakeholders of the corporation may also try to alter management techniques. Here, we argue that managers should be considered as employees; their treatment as stakeholders is thereby justified. Managerial interests, for example, may meet those of other stakeholder groups to vote out the board, in the event of a hostile takeover. With job security threatened, employees and managers may be more closely aligned and will seek to join up. Relying on stakeholder theory in support of our findings, we see that managers should not by themselves be seen at the centre of corporate control. The suggestion made in support of our discussion follows that stakeholders, regardless of their internality or externality to the corporation, ought to be treated equally during day-to-day activity and decision-making. One way in which the law allows for decisions to be made is through the passage of stakeholder statutes. Successive statutes stipulating the rights of stakeholders include those of employees, maintain that their interests should be maintained without breach of their fiduciary ties. A second function of stakeholder statutes is to block the ability of employees to act against the interests of shareholders. Whilst this has considerable advantages for the unity of the corporation, the purpose of these statutes may not always work in the favour of employees. This suggests that they are at odds with a system of corporate governance, one that is run solely on behalf of shareholders. The legislative passage in the United States has done little to close the gap between the board of directors and workers.

We also turn to the regulatory framework facilitating corporate governance, and particularly the position of employees within. With empirical evidence suggesting that self-regulation is an inadequate form of stakeholder protection, the results have a sound basis for justification. Corporate self-regulation suggests that the responsibility to evaluate changes within corporate structures is left to internal participants. More evaluation of the response by regulators to imbalances in stakeholder protection is needed. The idea of the “open corporation”, where stakeholders can initiate change, is more than valid for its encouragement of greater transparency, accountability and disclosure of information. Obligations to comply with the new framework depend on a rejection of existing modes of governance, focusing instead on the ability of the corporation to connect to stakeholders. Once an effective dialogue is established, information flows are likely to become more efficient, resulting in a flat organization. Future research is likely to show in more depth the virtues of alternative models of governance. Whilst promoting employee input through a decentralization of decision-making process assigns more responsibility, traditional barriers will be eroded. No longer will the traditional hierarchy follow a “top-down” approach. Governance structures are likely to vary, with a preference for a more streamlined organization where employees, as stakeholders, steer the organization towards greater inclusivity.

In response to the questions posed at the start of this discussion, we have found that the role of employees within the corporation is multifold. With increased presence in the boardroom, aided by legislative reform, employees have retained their corporate voice. Board structures vary globally, with certain economies more advanced in terms of inclusion than others. As a potent source of knowledge, their ability to transmit information is key to overall productivity. Their collaborative approach with other members of the corporation bodes well in classifying employees. This study has attempted to connect these diverse approaches, and has brought into focus the need to accept workers as legitimate stakeholders into the corporation. Not only do they feature as skilled participant; employees are beginning to emerge as leaders of a distinctly modern corporate governance movement.

Bibliography

Cases

AMP Inc. v. Allied Signal Inc., 1998 U.S. Dist. 15617

Basswood Partners v. NSS Bancorp, 1998 Conn. Super. 317

Burton v. Atomic Workers Federal Credit Union 1990, 119 Idaho 17, 803

Kavanaugh v. Ford Motor Co. 1965 353 F. 2d 710

National Labour Relations Board v. Wooster Division of Borg-Werner, 1958 356 U.S. 342

Pague v. Western &Atlantic 1884 81 Tenn. 507, 519

Salomon v. Salomon & Co Ltd 1897 AC 22

Secretary of State for Employment v. ASLEF 1972 I.C.R.9

Toussaint v. Blue Cross & Blue Shield 1990 292 Michigan 880

United Auto Workers v. LaSalle Mach. Tool, 696 U.S. 452

Statutes

Codetermination Act 1976

Companies Act 1985

Companies Act 2006

Connecticut General Statutes

Dodd-Frank Wall Street Reform and Consumer Protection Act 2010

Financial Services Act 2010

Financial Services and Markets Act 2000

German Corporate Governance Code 2010

Model Business Corporation Act 2002

Sarbanes-Oxley Act 2002

The Equality Act 2010

Books/Articles

Bainbridge, S. M., Klein, W. A. & Ramseyer, J. M., 2008. *Business Associations: Cases and Materials on Agency, Partnerships, and Corporations.* 1st ed. Stanford: West Group.

Bennelli, G., Loderer, C. & T. Lys, 1987. Labour Participation in Corporate Policy. *Journal of Business,* 60(9), pp. 87-109.

Blair, M. & Roe, M. J., 1999. *Employees and Corporate Governance.* 2nd ed. Washington D.C.: The Brookings Institution.

Blasi, J. R., 1988. *Employee Ownership: Revolution or Rip-off?.* 2nd ed. Cambridge: Ballinger.

Blasi, J. R. & Douglas L. Kruse, 2010. *Shared Capitalism at Work: Employee Ownership, Profit and Gain Sharing, and Broad-Based Stock Options.* 3rd ed. Chicago: University of Chicago Press.

Bratton Jr., W. W., 1990. The "Nexus of Contracts" Corporatoin: A Critical Appraisal. *Cornell Law Review* , 74(19), pp. 407-440.

Brian Finch, 2012. *Insolvency and Financial Distress: How to avoid it and survive it.* 1st ed. New York: A&C Black.

Buchholtz, A. & Carroll, A. B., 2011. *Business and Society: Ethics, Sustainability, and Stakeholder Management.* 3rd ed. New York: Cengage Learning.

Clarkson, M. B., 1995. A Stakeholder Framework for Analyzing and Evaluating Corporate Social Performance. *The Academy of Management Review,* 26(1), pp. 92-117.

Copeman, G. H., 1975. *Employee Share Ownership and Industrial Stability.* 3rd ed. London: Institute of Personnel Management.

Cummings, L. & Chris Patel, 1979. *Managerial Attitudes Towards a Stakeholder Prominence: Within a Southeast Asia Context.* 4th ed. Queensland: Emerald Group Publishing.

Dahya, J., McConnell, J. J. & Travlos, N. G., 2002. The Cadbury Committee, Corporate Performance and Top Management Turnover. *Journal of Finance,* 25 (3), pp. 281-334.

Dow, G., 2002. *Governing the Firm: Workers' Control in Theory and Practice.* 4th ed. Cambridge: Cambridge University Press.

Ellerman, D. P., 1986. The Employment Contract and Liberal Thought. *Review of Social Economy,* 44(5), pp. 163-209.

Ellerman, D. P., 1986. The Employment Contract and Liberal Thought,. *Review of Social Economy,* 44(1), pp. 165-230.

Fauver, L. & Fuerst, M. E., 2006. Does Good Corporate Governance Include Employee Representation. *Journal of Financial Economics,* 82(1), pp. 673-716.

Freeman, R. E., Parmar, B. & Wicks, A. C., 2004. Stakeholder Theory and The Corporate Objective Revisited. *Organization Science,* 15 (9), pp. 364-369.

Friedman, A. L. & Miles, S., 2003. Developing Stakeholder Theory. *Journal of Management Studies,* 39(1), pp. 1-21.

Friedman, A. L. & Miles, S., 2006. *Stakeholders: Theory and Practice.* 5th ed. New York: Oxford University Press.

Gray, R., Owen, D. & Adams, C., 1996. *Accounting and Accountability: Changes and Challenges in Social and Environmental Reporting.* 2nd ed. London: Prentice Hall.

Group, C. L. R. S., 2001. *Modern Company Law for a Competitive Economy: Final Report,* London: Routledge.

Gunay, S. G., 2008. *Corporate Governance: A Comparative Analysis of Stockholder and Stakeholder Governance Models.* 1st ed. New York: iUniverse.

Haines, 1997. *Corporate Regulation: Beyond Punish or Persuade.* 4th ed. London: Oxford University Press.

Hale, K., 2003. Corporate Law and Stakeholders: Moving Beyond Stakeholder Statutes. *Arizona Law Review,* 45 (14), pp. 823-889.

Harner, M. M., 2010. Corporate Control and the Need for Meaningful Board Accountability. *Minnesota Law Review,* 44(5), pp. 541-602.

Holt, W. B., 1950. Alteration of a Company's Objects and the Ultra Vires Doctrine. *Law Quarterly Review,* 66(4), pp. 493-516.

Jacoby, S. M., 2000. *The Embedded Corporation: Corporate Governance and Employment Relations in Japan and the United States.* 4th ed. Princeton: Princeton University Press.

Jens Köke, 2002. *Corporate Governance in Germany: An Empirical Investigation.* 4th ed. Munich: Springer.

Kelley Y. Testy, 2002. Linking Progressive Corporate Law with Progressive Social Movements. *Tulane Law Review,* 31(5), pp. 1227-1420.

Klein, W., Rameseyer, J. & Bainbridge, S., 2008. *Business Associations: Cases and Materials on Agency, Partnerships and Corporations.* 2nd ed. Stanford, C.A.: West Group.

Lazonick, W. & Mary O' Sullivan, 2000. Maximizing Shareholder value: a new ideology for corporate governance. *Economy & Society,* 29(7), pp. 301-349.

Maani, K. C. R. Y., 2000. *Systems Thinking and Modelling: Understanding Change and Complexity.* 1st ed. London: Pearson.

Maani, K. E. & Robert Y. Cavana, 2000. *Systems Thinking and Modelling: Understanding Change and Complexity.* 1st ed. London: Pearson.

Masahiko, A., 2010. *Corporations in Evolving Diversity: Cognition, Governance, and Institutions.* 3rd ed. Oxford: Oxford University Press.

Michael C. Jensen, 2002. Value Maximization, Stakeholder Theory, and the Corporate Objective Function. *Business Ethics Quarterly,* 12(1), pp. 235-256.

Millon, D., 1991. Redefining Corporate Law. *Indiana Law Review,* 56(8), pp. 550-589.

Monks, R. A. G. & Nell Minnow, 2011. *Corporate Governance.* 1st ed. Stanford: Wiley.

Nader, R., Green, M. & Joel Seligman, 1977. *Taming the Giant Corporation: How the Largest Corporations Control Our Lives.* 9th ed. Stanford: W.W. Norton.

Ogus, A., 1994. *Regulation.* 3rd ed. Oxford: Oxford University Press.

Orts, E. W., 2002. Beyond Shareholders: Interpreting Corporate Constituency Statutes. *Washington Law Review,* 14(2), pp. 602-669.

Parker, C., 2002. *The Open Corporation: Effective Self-Regulation and Democracy.* 2nd ed. Melbourne: Cambridge University Press.

Perotin, V. R., 2004. *Employee Participation: Firm Performance and Survival.* 1st ed. London: Emerald.

Punfer, J., 1997. *Corporate Regulation: Beyond Punish or Persuade.* 5th ed. London: Oxford University Press.

Rees, J., 2010. *Reforming the Workplace.* 4th ed. Philadelphia: University of Philadelphia Press.

Selznick, P., 1969. *Law Society and Industrial Justice.* 12th ed. New York: Russell Sage Foundation Press.

Stone, C., 1975. *Where the Law Ends: The Social Control of Corporate Behaviour.* 5th ed. New York : Harper & Row.

Stone, K. V. W., 1991. Employees as Stakeholders under State Nonshareholder Constituency Statutes. *Stetson Law Review,* 22(6), pp. 45-62.

Wedderburn, L. A., 2002. Employees, Partnerships and Company Law. *International Law Journal,* 99(31), pp. 113-170.