Participative management

EMPLOYEE DIRECTORS and SUPERVISORY BOARDS

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I - INTRODUCTION

This memorandum has been prepared as a short and simple guide on two important and highly topical questions.

1. Should employees be represented on company boards ?
2. Is the two-tier system of boards, as found in Germany and the Netherlands, appropriate to the United Kingdom ?

Many other ways of engendering employee involvement, though not the subject of this memorandum, inevitably enter the discussion, and none can be treated in isolation. All arise from a growing pressure for employee participation which has its origin in the emergence of an increasingly affluent and educated working population, and is felt throughout society.

The Industrial Participation Association's concern is to help create a sense of common purpose at work, taking into account the interests of all parties, including the often neglected public interest.

The aim of this memorandum is to help the examination of these issues by setting out basic facts and clarifying the more important implications.

II - THE PRESENT FOCUS

Among the important factors that combine to focus on these issues are:

1. Britain's entry into Europe.
2. The European Commission Fifth Directive - being proposals to harmonise the organisation of companies throughout the EEC.

3. Publication of the report of CBI's Company Affairs Committee (Chairman Lord Watkinson): 'A new look at the responsibilities of the British Public Company'.
4. The TUC's interim comments to HM Government on schemes for worker participation within the EEC.
5. The enquiry by the Board of Inland Revenue into ways of encouraging share ownership among all employees, and the proposal in the budget designed to stimulate wider employee share ownership.
6. The review of Company Law in UK which is now in train for legislation in 1974.

III - EEC PROPOSALS

These are embodied in two documents: the Fifth Directive, presented by the Commission to the Council in September 1972, and the Draft Statute for a European Company, first tabled in 1970. It will be some time before either becomes law. There are likely to be significant changes yet, and either or both proposals may be rejected this time round. So far as employee directors and supervisory boards are concerned, the proposals reflect trends that are already widely found in Europe.

The Fifth Directive

The present draft of the directive includes the following provisions relating to supervisory boards (a full translation of the more important sections is given, as the directive has not so far been published in English):

1. It would apply to 'Sociétés anonymes' in Belgium, France and Luxembourg, to 'Aktiengesellschaften' in Germany, and equivalent company structures in the other EEC countries. The directive was drafted before Britain's entry, so the British equivalent is not stipulated. It would appear, however, to be 'limited companies'. Co-operative societies are specifically excluded.

2. "The structure of the company shall be arranged.... so that it shall have at least three distinct organs:
   a) the board of management responsible for administration and performance;

b) the supervisory board responsible for control of the board of management;
c) the general meeting of shareholders."

3. a) "The members of the board of management are elected by the supervisory board."
b) "When there are several members of the board of management, the supervisory board shall designate the member of the management board responsible for personnel and labour relations" (without however preventing him from having other responsibilities).
c) There is provision for local legislation to ensure that a member of the board of management may not be appointed or removed against the votes of the majority of the workers' representatives on the supervisory board.

4. a) "The legislation of member states shall provide, at least for companies with 500 or more employees, that the appointment of the members of the supervisory board shall be made according to the provisions of either paragraph b) or c) below:"
b) Elected by the general meeting, provided that: "at least one third of the members of the supervisory board are elected by the workers or their representatives, or on the proposition of the workers or their representatives." (This is broadly the German model.) Member states may also provide for some supervisory board members to be elected by other parties, to allow the representation of other interests, e. g. the public interest.
c) Elected (co-opted) by the members of the supervisory board itself. "Nevertheless the general assembly or the workers' representatives may object to the appointment of a proposed candidate, on grounds of his incapacity to fulfil his functions, or because by his appointment the composition of the supervisory board would lack balance between the interests of the company, the shareholders or the workers. In such case the appointment may not be made unless an independent public body has ruled that the objection is unfounded". (This is broadly the Dutch system. The limitation on objection procedures is to prevent the possibility of every appointment being blocked.)

d) "In companies employing a smaller number of workers than is stipulated (i. e. less than 500, or such lower number as local legislation may determine), the members of the supervisory board are elected by the general meeting."

e) "The original members of both management and supervisory boards may be nominated in the company's articles or constitution."

5. "No one may at the same time be a member of the board of management and the supervisory board. Members of both boards must be elected for a limited period not exceeding six years. They are eligible for re-election. Neither the board of management nor the supervisory board may determine the remuneration of their own members. Members of the board of management may not take any part in another enterprise, whether salaried or not, either on their own account or for the account of others, without the authorisation of the supervisory board, and the general meeting shall be informed of such authorisations. No one may be a member of the supervisory boards of more than ten companies."

6. "At least quarterly, the board of management shall provide the supervisory board with a report on the progress of the company.... The supervisory board may at any time ask the board of management for a special report on the company's business or on particular aspects of its business. The supervisory board or a third of its members has the right to obtain from the management board all documents and accounts and to make all necessary verifications."

7. "The authorisation of the supervisory board shall be necessary for decisions of the board of management concerning:

a) the closure or removal of the enterprise or of important parts of it.

b) important restrictions or extensions of the activity of the enterprise.

c) important modifications in the organisation of the enterprise.

d) the establishment of a lasting cooperation with other enterprises, or the termination of such cooperation."

e) such other operations as either the law or the company's articles may make subject to authorisation by the supervisory board.

8. "The members of the board of management may be removed by the

supervisory board. The members of the supervisory board may be removed at any time by the same organs or the same persons who elected them, and according to the same procedures." Nevertheless with the co-opted supervisory board (the Dutch model) a member cannot be removed except by judicial decision, on the request of the supervisory board, the general meeting, or the workers' representatives.

9. "The general meeting shall be convened at least once a year. It may be convened at any time by the board of management." A general meeting must also be held at the request of holders of a stipulated minimum amount of the capital. Shareholders with the same minimum qualifications may add items to the agenda of a general meeting already convened.

10. "Member states shall, within eighteen months of the notification of the directive, make such modifications in their legislative arrangements, rules or administrative procedures as may be necessary to conform to the provisions of the directive." They may arrange for the provisions not to apply to already existing companies, for a period of up to a further eighteen months.

In the long explanatory notes accompanying the Fifth Directive, the Commission enlarges on its reasons for some of the recommendations: "... The decision of the general meeting is necessary only for certain matters very important to the company.... The generally more restrained circle of the supervisory board is usually better suited than the general meeting to choose the people on whom to confer responsibility for the administration and performance of the enterprise..."

"The directive shares the idea that the constitution of the supervisory board cannot be made without the agreement of the general meeting. This (general meeting) alone is exclusively competent in companies where the workers do not participate in the appointment of the members of the supervisory board. The directive does not make such participation obligatory except for companies employing 500 or more workers. No other distinction is admitted, for example, the amount of paid up capital or the relationship between the shareholders (e. g. sociétés de famille - private

companies). The stipulated number of workers is however a minimum. Member states may fix a lower ceiling for workers' participation in the supervisory board.... The form of this participation need not necessarily be the same throughout the Community."

Statute for a European Company

The terms of the proposed Statute will only apply to those companies which voluntarily opt for European Status. Initially these will be few in number.

1. The proposals for employee directors and supervisory boards are virtually the same as those in the Fifth Directive.

2. In addition the Commission proposes that each European Company which has establishments in more than one EEC country should establish a European works council. Decisions by the board of management on seven key subjects would be subject to the agreement of the European works council. The subjects are: recruitment, promotion and dismissal; vocational; terms of remuneration; safety and health; social facilities; hours; and holidays.

IV - BRITISH BACKGROUND

British opinion has paid relatively little regard to the idea of employee directors and supervisory boards.

When, in 1970, the Labour Government asked industry for its views on worker directors the Industrial Participation Association polled its membership, a representative group of forward looking companies. There was a near unanimous rejection of the idea, both on grounds of principle and practicality. However, this enquiry provoked a substantial body of comment on the need to amend the Companies Act to bring the legal definition of directors' responsibilities more closely into line with best practice.

The CBI and the Institute of Directors obtained similar results from their enquiries at the time.

In their evidence to the Royal Commission on Trade Unions and Employers' Associations the TUC proposed there should be legislation to allow companies, if they wished, to make provision for trade union representation on boards of directors. But the TUC wished progress to be on a voluntary basis and until their recent memorandum (see Page 10) have been generally reserved about the benefits of employee directors. Often unions felt that representation on boards would lead to conflict of loyalty and handicap them in their bargaining role on behalf of members.

The Royal Commission Report (1968) was in fact opposed to the inclusion of workers' representatives in managerial bodies below board level, and a majority opposed the appointment of employee directors. Nevertheless, five out of the twelve Commission members believed that the present position in which shareholders have the exclusive right to elect directors was inappropriate, and the view was expressed by several members that experiments of various kinds, including worker director experiments, should be encouraged.

The Conservative Party view is that while Government must obviously have an interest and concern in these questions, they are primarily matters for the two sides of industry jointly to decide. The comments in the Labour Party's report on Industrial Democracy (1967) still broadly reflect the Party's views on employee directors (an opposition Green Paper on Industrial Democracy is in preparation). The Party stresses the need for a single channel of representation, for both bargaining and consultation. The report sees the extension and transformation of collective bargaining as the primary objective, particularly in the private sector, and states: "It is from the further development of bargaining and joint regulation that there may emerge new developments in worker representation in company decision making bodies. We consider it would be dangerous to abstract the question of worker representation on company boards of directors etc. from this more fundamental question of the strengthening and co-ordination of collective bargaining within the company".

However in the public sector the Labour Party report sees considerable room for experiment including placing representatives of workers directly concerned on particular boards, rather than the appointment of ex-officials, or union officers from other industries.

The Liberal Party, with its traditional emphasis on co-ownership and co-partnership does not however proselytise for employees on boards, but focuses on the development of consultative structures such as works councils through which negotiation with boards could take place when necessary. The Liberals would strengthen employee participation by amending the Companies Act so that the functions of the AGM, including of course the election of directors, would be exercised by an Annual Representative Meeting, comprising 50% of representatives elected by shareholders and 50% by employees.

The present Government has not yet formulated its policy on the EEC Fifth Directive, but is taking soundings from the CBI and the TUC.

It is against this background that the current interest and debate gains significance. It is never easy to measure gradual shifts in emphasis if not opinion. But the press has been full of articles and comment on different aspects of worker participation in recent months. A year ago the possible development of a two-tier board system and employee directors would have been given only superficial study. Today it is the subject of widespread and serious consideration, along with other ways of achieving wider employee involvement.

CBI - "A New Look at the Responsibilities of the British Public Company"

The CBI's recent report (January 1973) is intended to stimulate responsible discussion. It emphasises that "views ... in this interim report are provisional and not in every detail unanimous". A number of comments relate to the subject matter of this memorandum:

1. "We are convinced that the sense of collective responsibility for the conduct of business is best preserved where all the directors meet in a single board. For this reason we are firmly opposed to the introduction

of any form of mandatory two-tier board structure, unless further enquiry as to the results of such a system in other countries discloses advantages of which we are not at present aware".

2. On the question of employee directors, the report says that board membership should be open to all in the company, on the basis of merit. However employee representation at board level can in no way substitute for adequate arrangements for communication, consultation and negotiation at all levels within the company.

3. "We believe that each factory or undertaking in a large group should have its own joint council on which workers and management serve. At joint councils all matters must be freely discussed and in our view it is an advantage at the time when the company publishes annual or periodic accounts for these to be explained by a member of the board or by senior management. As part of this operation, we therefore support full disclosure of information to employees, subject to the important proviso that information of interest to shareholders must be given to them no later than it is given to the employees."

4. "Shareholders proprietorial rights imply corresponding duties". The board has ethical, social and practical responsibilities to all affected by company operations, though legally bound in specific conflicts of interest to give priority to shareholder interests. In respect of fiduciary responsibilities directors are trustees. Apart from nominee representation, each member of the board has a duty at all times to pay full regard to all interests - shareholders, employees, customers, creditors and the public. The Committee dislikes the idea of mandated board representation.

5. The Committee would welcome a code of conduct to guide boards on matters with an ethical or social aspect. Companies could adopt the code and bind themselves to it by writing it into their memoranda of association.

6. The report looks to increasingly responsible shareholder activity as a sanction against irresponsibility. It also calls for increased use of non-executive directors for the independent view they bring to boardroom discussion.

TUC - Interim Comments

These were made to HM Government in a memorandum dated 30th January 1973 in response to a request for trade union views on EEC proposals for worker participation. The comments are of an interim nature since the General Council are currently reviewing the whole field of industrial democracy and have yet to report.

Although the issues covered by collective bargaining vary across industry, matters dealt with by works councils in Europe are usually handled in Britain by collective bargaining. That being said, the TUC acknowledge that unions in Britain have little influence or control over many of the questions that the EEC Fifth Directive would make subject to supervisory board approval. They accept that these questions are of strategic importance to most trade unionists.

The TUC interim attitude to the European experiments can be summarised as follows - the comments apply to proposals both under the Fifth Directive and the Statute for a European Company.

1. The system of two-tier boards is probably desirable.

2. All employee appointments to supervisory boards must be made through trade union machinery at company level.

3. The worker representatives would be responsible to trade union members employed in the firm rather than to the annual general assembly of shareholders.

4. Although the Dutch system has certain practical advantages direct representation is only assured on the German model.

5. The TUC would reduce the minimum size of company to which the Fifth Directive would apply from 500 to 200 employees.

6. Works councils on the German model are not appropriate to the UK.

7. The number of worker representatives should be 50% of the supervisory board, not one third.

8. Worker representatives should have the right of appointment or veto of certain members of the management board.

The Fifth Directive does not call for the establishment of statutory works councils, and the TUC assumes that there would be no obligation to set up such bodies in the UK.

The proposed European Company Statute will apply only to companies which opt for European status, which initially are likely to be few in number. The TUC would wish to look very carefully at the arrangements for European works councils proposed under the Statute. While their memorandum argues that trade union machinery at company level would be the appropriate mechanism for appointing UK representatives, the TUC considers that it might be appropriate to accept the works council idea on a statutory European basis for the European company.

Institute of Directors

A memorandum in draft for consideration by the Institute's Council comments on two-tier boards and employee participation as follows:

1. The two-tier board and methods of achieving employee participation are separate issues.

2. Doubts that such a board could serve a useful function in the UK.

3. Dislikes the idea that the executive board is answerable to the supervisory board.

4. Fears that this would lead to delay in key decisions.

5. Draws attention to the difficulty of finding persons of the right calibre for supervisory boards.

The memorandum suggests that desirable changes can be better achieved by:

6. Legislation giving legal power to boards to take considerations into account other than those of shareholders alone.

7. More use of non-executive directors.

8. Establishment of a code of best boardroom practice.

The memorandum also argues against direct worker participation at board level, but would favour more appointments of persons with an employee background to the boards to ensure adequate representation of employee views and attitudes.

The memorandum holds that traditional methods of communication through collective bargaining and joint consultation are the most satisfactory. It does not oppose the mandatory introduction of works councils.

V - DISCUSSION

Would the introduction of employee directors into the present board structure, or into a new two-tier system strengthen the forces for co-operation in British industry without adversely affecting managerial efficiency and the decision taking process ? Would the two-tier board system help engender a sense of mutuality and common purpose between management and unions ? Did it achieve this in Germany, or was this attitude there to start with ? Would its introduction in the UK bring conflict into the board room, and make management still more difficult ?

These are crucial questions. But while it can be argued that consultation slows and complicates the planning and preparation stages of any programme, it can also accelerate the later stages of decision and implementation. It can also be argued that the stability and continuing effectiveness of a programme is made more certain by the involvement of a cooperating workforce, and that increasingly today management can only govern by consent.

* * *

There are some clear and obvious areas of agreement among the proponents of different views:

1. There is widespread agreement that employee directors cannot substitute for normal communication, consultation and negotiation within the enterprise. Useful involvement at board level can only grow out of an existing and effective industrial relations framework.

2. Most people are agreed that if the employee director is to represent a shop floor viewpoint adequately, and retain the confidence of his fellow workers, he must be able to keep in close touch with opinion on the shop floor. This can best be accomplished if he is also actively involved as a shop steward, convenor or works councillor in the negotiation/consultation processes in his plant or factory. Both European and British experience (British Steel Corporation) confirm this.

3. The employee director runs the danger of becoming "separated" from his "constituents". Whether this really happens, or whether his fellow workers just think it has happened, the result is the same. He loses their confidence and is unlikely to be re-elected.

4. On the other hand employee directors need time to become fully effective. Estimates vary from 18 months to 4 years, depending on the complexity of the business and the degree to which the company has been accustomed to disseminate information among employees.

5. Size of firm or unit is an important conditioning factor. The Fifth Directive does not propose employee representation on the supervisory boards of smaller firms. We would simply note here that other things being equal, there is less human conflict, and more natural opportunities for participation in small units than in large.

* * *

Major differences of opinion are to be found in the complex series of issues relating to the function of the board, the responsibilities and duties of directors, and how best to adjust the respective interests of shareholders and employees.

6. At present directors are legally responsible only to shareholders. The trade unions argue that elected employee directors must be answerable to and serve the interests of the employees rather than the share-

holders. Businessmen however, and in the past at least some union representatives, have pointed out that to allow 'mandated' directors would bring a new type of conflict into the boardroom. This would strike at the principle of collective responsibility for board decisions which cannot be fulfilled without an ultimate unity of purpose.

7. It is difficult to see how these two positions can be reconciled within the present framework of company law. One of the more important features of the two-tier system is that it would allow any conflicts of interest to be contained within the supervisory board, and not prejudice the effective functioning of the management board. Conflicts of interest are not of course inconsistent with the existence of a collective common purpose. It is worth noting that on the German pattern the supervisory board meets relatively infrequently and is concerned only with broad policy issues and not day to day management. Nevertheless it is just as subject, as any company board, to the ultimate pressures of the market.

8. A supervisory board would also allow other interests, for example consumer or the public interest, to be more easily represented. Such a board would come under the same moral and social pressures as existing executive boards.

* * *

A number of other issues are commonly raised as potential difficulties.

9. Managers not unnaturally stress that merit should be the sole criterion for board membership, and question where the many thousands of able and acceptable candidates for employee directors that might be required under the EEC legislation are to come from. Trade unions assert that their members have been accustomed through years of union representation to responsibility and decision making, and that given the opportunity would match the competence of many existing board members.

10. The question of who is to represent employees raises a number of important issues. The majority of British companies deal with more than one union. Who is to represent them in these circumstances ? This situation is further complicated by the growing unionisation among

technical, supervisory and managerial staffs, who may also insist on representation. The unions say that it is up to them to resolve these questions, but the difficulty remains and many managements fear the introduction of intra-union conflict into the boardroom. In Germany, where unionisation is by industry rather than by trade, the problem of multi-union representation does not arise.

11. Many people fear that giving veto rights to minority interests on supervisory boards, for example the right of employee directors to veto policy decisions in specifically defined areas, will make it impossible to take difficult and unpleasant decisions that may be in the long term interests of all. Union leaders reply that when they have been trusted with the whole truth they have shown themselves able to take painful decisions. They point out moreover that their views have to be taken into account, whether in the boardroom or outside it.

VI - OTHER ISSUES

We turn now to some other issues of employee involvement currently under discussion.

1. First the anomolous legal position of employees: they are de facto members of the company but have no legal membership rights. If a company fails or has to reduce its operation employees are just as much affected as shareholders, and possibly more so. A significant body of opinion holds that a change in the status of employees could lead to a fundamental change of attitude by employee to his company and management to employee. Proposals to establish 'the principle of membership and membership rights' in a practical and legally simple way have been submitted recently to the Department of Trade and Industry by a group which includes Sir Bernard Miller, who summarises their memorandum in the Spring 1973 issue of 'Industrial Participation'.

2. Related to the question of employee status is that of participation in ownership and capital formation. Many consider that the ultimate pattern for British industry could develop along these lines and be a way

of satisfying the legitimate interests of employees to have a stake as well as a say in the enterprise for which they work.

3. Meanwhile any changes in company structure must take into account the importance of safeguarding proprietorial rights, to enable trustee funds to invest in risk equity capital, not to mention the interests of the small saver.

* * *

The discussion about employee directors and two-tier boards is a discussion about power and decision making. It must not be forgotten that 'decisions' have always to be taken in a context which is largely dictated by the market, whether it be the product market or the labour market, or a mixture of both. Likewise in the last two decades the power of public opinion has become an economic force to be reckoned with.

There are many among management and trade unions who will resist change and seek to perpetuate the status quo. But power and influence are already more widely spread than is recognised, and in the last resort there can be no management without consent.