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# Introduction

**Sigurt Vitols and Norbert Kluge**

The hegemonic conceptual paradigm for corporate governance – the ‘shareholder value’ model of the firm – is in crisis. This paradigm, which claims that the stock market is the best yardstick for company value and that share-based remuneration is the most efficient way to reward top management, has dominated reform of company and securities law for the last two decades in Europe and much of the rest of the world. However, since the onset of the current financial and economic crisis, faith in this model has been shaken. Many researchers and policymakers believe that the shareholder value model was one of the major causes of the crisis and are raising the question of whether the basic assumptions of the model are flawed.

Although calls for fundamental reform of our corporate governance system are widespread, it is not obvious what the alternative would look like. Many policy proposals can be characterized as ‘tinkering with the model’, i.e. a set of piecemeal measures for incremental changes in the system. Stronger critics appeal to the concept of the ‘stakeholder’ firm, which refers back to the merits of traditional continental European systems. However, a return to these older systems is unlikely given major changes in the institutions that supported them, such as a decline in controlling shareholdings by families and banks. Furthermore, new problems have arisen which challenge older stakeholder systems. For example, dealing with the issue of sustainability requires a much higher level of transparency than existed in traditional models. It is therefore instructive to learn from but not sufficient to draw on stakeholder models from the past.

Over the past few years, a group of researchers and trade unionists concerned with corporate governance has been working on a fundamental alternative to the shareholder value model. This group was motivated by the European Commission’s efforts to establish a European framework for corporate governance. In 2003 this intention was detailed

in the plan on *Modernising Company Law and Enhancing Corporate Governance in the European Union* (European Commission 2003). In order to enlist expertise to help implement this plan the Commission established the European Corporate Governance Forum at the end of 2004.

From the beginning the Commission's proposals were observed critically by the trade unions. The European Trade Union Confederation (ETUC) was sceptical of an approach to corporate governance which prioritized transparency for shareholders and the so-called independent control of executives through financial market players (ETUC 2004). In this conception obligatory employee boardroom participation would play a marginal role, even though it is a widespread part of national corporate governance systems in at least 12 EU member states and exists in many European Companies (SEs) established according to European company law.

One indicator of the marginal importance of the stakeholder approach to corporate governance in the Commission's initiative is the composition of the 15 members of the European Corporate Governance Forum. Although the financial services industry and companies are well represented in the Forum, only one member could be considered to represent stakeholders other than shareholders. Initially this was Emilio Gabaglio, former General Secretary of the ETUC, and since 2008 Niklas Bruun, a law professor at the Hanken School of Economics and well recognized international legal expert with close ties to trade unions.

The European trade unions and their academic allies recognized the need for an expert group with a broader approach to corporate governance, and in 2005 the GOODCORP expert group was established by the European Trade Union Institute (ETUI). This group included academics from a range of fields (law, economics, industrial relations and sociology) and trade unionists concerned with corporate governance issues. The first effort by this group was to advise the ETUC on an inclusive approach to corporate governance which includes employees as key stakeholders. With the help of this advice, in a 2006 resolution the ETUC made a link in corporate governance between worker interests, company governance and provisions for worker participation. The resolution pointed out that worker involvement is a strong element in European thinking on corporate governance. The resolution described the reasons why workers have an interest in the 'good governance' of companies: 'Workers are not

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only parties to an employment contract, but at the same time are investors and citizens. Workers should be seen as participants in the company, just like shareholders, in the sense that they sustain risks arising from the company's choices' (ETUC 2006). The ETUC Congress in Seville in 2007 took up this perception in its political program *On the Offensive* by linking explicitly the struggle against 'casino capitalism' and the short-termism of financial markets through better taxation and regulation and stronger worker participation.

At the same time another expert group organised by the ETUC under the title 'Paths to Progress' worked out arguments from different academic disciplines which pointed in the same direction: Corporate governance cannot be reduced to the problem of how shareholders (the 'principals') can control managers (their 'agents'). Workers strongly claim the right to be fully involved in the strategic choices of companies in which they are employed. Of course, there may be different ways to move forward; these are influenced by the very different cultural roots and legal systems in EU member states and by the different experiences of trade unions. However, there is strong evidence supporting legal initiatives at EU level to strengthen worker voice and put workers in a better position vis-à-vis companies and investors. The work of this academic exercise, which was compiled and coordinated by the late Brian Bercusson, culminated in a publication with the Social Development Agency (SDA) (SDA 2006). After publication and public presentation, experts in the Paths to Progress group joined their efforts with the ETUI's GOODCORP group. Since 2007 this group has met regularly. Frequently these meetings have been organized in conjunction with EU Council Presidency conferences on corporate governance.

Some of current debates at European level have been influenced by this expert group. For example, in 2008 the European Economic and Social Committee (EESC) started a debate on 'what makes a good company' by adopting an initial opinion agreed by its social committee (EESC 2008). This document stresses the deep historical roots of worker participation in EU politics by showing its significant role up to now. Political consensus on employee participation was established in Europe after World War II, starting with the European Coal and Steel Community (ECSC Treaty of 1952). This stated that legally supported employee participation was an expression of socially responsible management. Afterwards, after three decades of debates on the issue, the so-called Davignon Working Group cut the knot in 1997 and paved the way for the

European Company Statute (SE). Here, the productive role of employee participation at all levels was emphasized: ‘The type of labour needed by European companies – skilled, mobile, committed, responsible, and capable of using technical innovations and of identifying with the objective of increasing competitiveness and quality – cannot be expected simply to obey the employers’ instructions. Workers must be closely and permanently involved in decision-making at all levels of the company’ (Davignon Group 1997: 5). It should also be noted that the European Works Council (EWC) has become an aspect of good management practice. Today more than twelve thousand EWC members invigorate the democratic infrastructure of European civil society.

Members of the GOODCORP group have also contributed to an awareness of the interlinkage between the economic, social and democratic functioning of obligatory employee involvement in company decision making: If European companies want to have long-term prospects they must organise a permanent innovation process together with employees and their representatives. For this companies need the commitment and knowledge of their workers. Functioning employee participation, especially at transnational level, can – in conjunction with increasingly transnationally organised personnel management – be a firm anchor for the necessary social integration in the company.

The fruitful years of collaboration of the GOODCORP group have enriched academic discussions and influenced political debates at EU level. In recent years these efforts have been guided by the need for new thinking about the future of the firm and its role in the economy, society and environment. Under the heading of the ‘Sustainable Company’ this group has been working on the concept of a company that would be economically successful, that would care for social interests inside and outside of the company, that would respect worker rights and that would be environmentally friendly.<sup>1</sup> GOODCORP has now reached the point where it is possible to present this book, which outlines key elements of the Sustainable Company and the legal and institutional framework that would be needed to support its diffusion.

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1. The term ‘Sustainable Company’ was used by Chris Laszlo in 2003 in a book outlining his concept of a company in which social, environmental and economic performance is aligned (Laszlo 2003). However, as will be shown in chapter 1 and elsewhere in this volume, our concept of the Sustainable Company differs significantly in that we stress the need for formal mechanisms of worker involvement and a binding legal framework for sustainability.

To briefly summarize, the first couple of chapters in this book deal with the overall thematic of shareholder value and its alternatives. In Chapter 1 Sigurt Vitols discusses the main flaws in the shareholder value model and outlines the key features of the Sustainable Company and the framework that would be needed to support it. The participation of stakeholders – and in particular workers – is needed to include ‘voice’ for long-term interests in company decision making and to counterbalance the short-term interests of many shareholders. In order to do this a comprehensive set of changes are needed in the way our companies are regulated in the areas of company and financial market law. In the second chapter Laura Horn provides an historical account of how shareholder value was implemented politically in the European Union. The shareholder value model of the firm did not evolve naturally, but rather was the result of an active process of regulatory change at the European level. In the past decade an important shift has occurred in European company law away from a harmonization project designed to protect worker interests to a competitive process in which worker voice has been marginalized.

The second set of chapters deal with the issue of worker involvement in the company. In Chapter 3 Howard Gospel lays out the arguments for why employee representation is so important to the Sustainable Company. Both theory and empirical evidence back up the idea that worker involvement can help create a ‘win-win’ situation in which workers enjoy strong rights and the company operates efficiently and in a sustainable manner. In the fourth chapter Jan Cremers provides more evidence on the role workers and their representatives can play in supporting sustainable companies. Management by itself – even when it is willing to participate in cooperative industrial relations and social dialogue – in most cases lacks the skills and knowledge needed to implement ‘best practice’ human resource policies. Here the involvement of empowered workers and their representatives is needed. In Chapter 5 Aline Conchon and Jeremy Waddington draw on the first results of a large-scale survey of board level employee representatives (BLEReps) in Europe and dispense with some common myths of shareholder value advocates regarding employee representation. Firstly, board level employee representation (BLER) is not a marginal phenomenon in Europe, but rather is part of the company law and industrial relations traditions of the majority of EU Member States. Secondly, BLEReps do not only pursue the particular interests of workers. They also assign a high priority to the overall long-term economic interests of the company

and actively seek solutions which simultaneously satisfy both sets of interests.

The next two contributions deal with the role of shareholding by employees and incentive schemes for managers. Andrew Pendleton in Chapter 6 discusses varying experiences with employee shareholding in Europe and argues that it could play a positive role in the Sustainable Company. When properly designed, employee shareholding schemes can increase the size of the stable shareholder base and strengthen employee voice within the company. At the same time, care must be taken so that employee welfare is not overly dependent upon shareholding. In the seventh chapter Rainald Thannisch discusses the lessons that can be drawn from Germany, where recent legislation on executive remuneration has mandated sustainability considerations and strengthened the influence of BLEReps. German trade unions successfully influenced the final form of this legislation. They also give active guidance to BLEReps to reduce the role of stock and stock options in executive remuneration. Instead, both fixed pay and elements of variable pay tied to sustainability objectives (such as employee and customer satisfaction and environmental performance) should have a greater weight in remuneration.

The next three chapters deal with the question of the potential for trade unions to support company sustainability in the context of globalization, both through agreements with multinational enterprises (MNEs) and through coalitions with new actors such as NGOs. Ulrich Mückenberger discusses the chances for different trade union strategies in the field of corporate social responsibility (CSR) in Chapter 8. European trade unions can no longer rely on the nation-state to enforce labour and environmental standards given the globalization of companies and their supply chains and weaknesses in enforcement in developing countries. Therefore, trade unions should increase their efforts to support transnational norm building, which requires the construction of new coalitions with NGOs and the media. In Chapter 9 Isabelle Schömann and Peter Wilke discuss the experiences to date with international framework agreements (IFAs), which are agreements on labour, environmental and/or other standards between multinational companies and trade unions covering more than one country. IFAs are a relatively recent phenomenon, are for the most part based in European companies and are mainly limited to direct labour concerns. However, evolving practice shows an increasing inclusion of environmental standards and

dispute-resolution mechanisms, which raises the potential of a greater role of IFAs in promoting the Sustainable Company. Katrin Vitols in the tenth chapter explores the potential for improving cooperation between trade unions and NGOs. Even though the relationship between these two actors is to some extent competitive and concrete examples of working together are relatively rare, there is nevertheless a significant and growing overlap in interests in sustainability issues between the two groups. A number of examples of successful cooperation exist which could be extended to increase support for the Sustainable Company.

The final set of contributions focus on improving framework conditions for the Sustainable Company by changing the ways that product and financial markets work through better regulation. In Chapter 11 Gregory Jackson and Anastasia Petraki show how companies, investors and other key actors in corporate governance have become caught in a trap of mutually-reinforcing short-term expectations. The Sustainable Company however requires an environment in which these actors would all share long-term, sustainability-oriented expectations. Regulatory and behavioural changes thus need to cover a variety of regulatory fields and affect all key actors rather than being piecemeal in nature. In the twelfth chapter Andreas Botsch outlines a far-reaching and comprehensive (but at the same time concrete) ten point program that should help financial markets to support a sustainable economy and society. Financial reforms since the financial crisis have however only partially implemented this program. Probably the most difficult point, and the one on which little progress has been made, is the democratization of the financial system. Andrew Watt in Chapter 13 outlines the problem of market prices not adequately reflecting the social costs of carbon emission by companies and discusses different methods for dealing with this. The most effective alternative for supporting the Sustainable Company would be the introduction of a carbon tax and the strengthening of the emissions trading system (ETS) in conjunction with other measures. At the same time this could serve as a model for dealing with other problems of externalities (i.e. cases where market prices do not accurately reflect the social costs of certain practices).

This book by no means presents a finished blueprint for the reform of corporate governance. The contributions here have for the most part focused on an identification of problems and a discussion of solutions that could be implemented in support of the Sustainable Company. Other potentially important elements, such as reforming merger policy in

Europe and reorienting investment strategies of pension funds, are not discussed in detail. Nevertheless, we believe that this book can make an important contribution to the current discussion on the problems with the shareholder value model and the characteristics of an alternative to it. In the interests of the long-term sustainability of our economy, society and the planet we hope that this book will help advance this debate.

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