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Lionel Fulton (ed.)

The forgotten Resource: Corporate Governance and Employee Board-Level Representation. The Situation in France, the Netherlands, Sweden and the UK

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EXECUTIVE SUMMARY

INTRODUCTION

The report looks at corporate governance and employee board level representation in four countries, France, the Netherlands, Sweden and the UK, based on four separate national reports from national experts. It shows the way national differences in the way companies operate have not been reflected in corporate governance codes, which are very similar. It also looks at how the role of employee representatives at board level has been largely ignored despite their positive impact. Other issues on corporate governance and employee representation at board level are dealt with in detail in the separate national executive summaries.

THE NATIONAL DIFFERENCES

There are substantial differences between the four countries in the way companies are managed and the framework in which they operate.

These differences start with the overall role of companies – in whose interests are they being run? While corporate governance documents in France and the Netherlands indicate that company's interests are not identical with those of their shareholders, this is not set out in the same way in Sweden. In the UK it is clear that companies should operate in the interests of their shareholders.

There are also major differences in current board structures for larger companies, with the Netherlands and the UK at the two ends of the spectrum. While in the Netherlands the dominant form is the two-tier system, with both a supervisory and a management board, the UK operates a single tier system with a single board, made up of both executive and non-executive directors. Sweden too has a single-tier board system but in contrast to the UK the board normally contains only one executive director. In France companies have a choice between a single and a two-tier structure, although around three-quarters of larger companies chose to have a single board.

Share ownership patterns also vary between the four countries, with shares in the UK having a more dispersed ownership than in the other three. For example, in Sweden most listed companies have a controlling owner. However, in France, the

previous pattern of substantial cross-shareholdings has largely broken down. In all four states the proportion of shares owned abroad is growing.

There are major differences in the extent to which employee representatives participate at board level, as well as the mechanisms by which they get there. In Sweden employees have a right to be represented at board level in all companies with more than 25 employees, although they cannot participate in issues connected with collective bargaining. They account for around one third of board members in most companies. They are chosen by the union in the company and are generally the key figures in a whole range of employer-union relations.

In France there are two ways in which employee representatives can be board members, either elected by all employees or as representatives of employees holding shares. Board members representing all employees are relatively rare in the private sector, largely found in recently privatised companies. And within these companies they make up between 10 % and 20 % of the board, where they have full rights. As individuals they are generally senior trade unionists, but are often at the end of their careers and, because they can hold no other office, they may be somewhat divorced from the day-to-day union concerns. Board-level representatives of employee shareholders, on the other hand, seem to be found in slightly more boards than other types of employee representatives, and this may be even more true in the future. However, they are normally present only in ones and twos and, as individuals, although they are often trade unionists, they are more likely to be executives than any other sort of employees.

In the Netherlands the legislation under which the works council nominates individuals to be members of the board has recently (2004) changed. Works councils now have a clearer right to nominate up to a third of supervisory board members, although they must be approved by the shareholders annual general meeting. It is still too early to see the impact of the 2004 changes. Under the old system smaller companies were unlikely to have a supervisory board member, nominated by the works council, but this was not the case for larger companies, particularly where the works council and supervisory board had reached agreement on the overall composition of the supervisory board. However, because the individuals nominated by the works council may not be employees or trade union officials dealing with the company, they are in no sense direct representatives of the workforce. Dutch law requires all supervisory board members to act in the interests of the company as a whole; individual supervisory board members may not represent specific interests, such as the workforce or a major shareholder.

In the UK employees have no right to participate at board level in any way, and in reality, except in a tiny handful of exceptional companies, they do not do so. Employee representatives are found as trustees of pension funds, which cover about one-fifth of employees in the private sector. However, this only gives them influence on company policy in a limited number of areas, and the legislative changes which have made this possible are very recent.

THE SIMILARITIES BETWEEN CORPORATE GOVERNANCE CODES

All four countries now have corporate governance codes, but they have not all been introduced at the same time. The UK was the first country to introduce a code following the Cadbury report in 1992. Later reports and codes followed resulting in the first Combined Code in 1998. A later Combined Code, which applies at present, was introduced in 2003. It gives greater weight to the role of non-executive directors following the Higgs report. Developments in France followed a broadly similar pattern with the first Vienot report in 1995 being followed by a second in 1999 and a third report by a committee chaired by Daniel Bouton in 2002. The current code, which draws from these three reports, was produced in 2003. In the Netherlands there have been two major reports/codes. These are the Peters recommendations of 1997 and, as these seemed to have only limited effect, the current corporate governance code, produced by a committee led by Morris Tabaksblat in 2003. Sweden was the last of the four to produce a similar corporate governance code. The code drawn up by a group of leading figures and chaired by a former finance minister Erik Åsbrink was published in 2004.

A number of reasons explain why the codes were introduced and why they are substantially similar. First they were drawn up in response to similar problems, financial scandals involving board members and concern over the high pay of some directors. Second, they were a response to the growing importance of international investors. Third, they were encouraged by international bodies, the OECD and particularly the European Union. And finally the committees drawing up the codes were very aware of developments in the area of corporate governance elsewhere, particularly in the UK.

As result the codes in all four countries take a broadly similar approach to what are seen as the key corporate governance issues. These are:

- the principle of comply or explain;

- the separation of roles between chair and chief executive (France is an exception);
- the need for a high proportion of independent directors;
- the existence of a nomination committee, largely made up of independent directors to choose new directors (Sweden is an exception); and
- similar arrangements for an audit committee and a committee on directors' remuneration.

There are some national differences but these are explained by the particular experiences of the countries involved. The Swedish code is the only one to refer to the aim of »gender balance« on boards.

There are also similarities in the way that corporate governance is monitored and the general picture which emerges is that the codes are largely being complied with and have resulted in an improvement of corporate governance practices. However, these assessments are based on published documents and the reality may be different.

The codes are also very similar in making only very limited reference to the role of employee representatives at board level. This is even the case in Sweden, where they are very widely present. Indeed some of the discussion around the codes, particularly in the Netherlands, seems hostile to the idea of employee influence on board membership.

THE REALITY OF EMPLOYEE REPRESENTATION AT BOARD LEVEL

There is evidence in both Sweden and France that employee involvement at board level brings benefits. Around two-thirds of company managers and chairs in Swedish companies are positive about having employee members on boards and this feeling is stronger in larger companies. Employee board-level representatives are seen as providing an effective channel of communications with employees, allowing employees to understand better why specific decisions have been taken. The position is similar in France, although the numbers involved are smaller. There it was also felt that employee representatives added greater knowledge to the debate.

In contrast, the disadvantages of employee board-level representation seem much less significant relating primarily to a fear that information may be leaked and that it becomes more difficult to have frank discussions. Concerns about irrelevant issues being taken up do not seem justified.

It is difficult to assess the specific impact of the representatives of the works councils on supervisory boards in the Netherlands, as they seem to differ little from other members.

CONCLUSION

Perhaps because of the strong influence of the UK, where there is no employee representation at board level, employees have been left with no effective role or voice in the corporate governance codes of France, the Netherlands or Sweden. This seems a shame because the evidence suggests that employees' participation brings clear benefits. In the world of corporate governance employee representatives at board level are a forgotten resource.

INTRODUCTION

This report looks at the relationship between corporate governance and employee representation at board level in four European states, France, the Netherlands, Sweden and the UK. It is drawn primarily from detailed reports on the situation in each of these countries prepared by four national experts.[1] It concentrates on the role and activities of board members, rather than looking at other aspects of corporate governance such as shareholder rights or the role of auditors.

The four countries are also the four EU states which score highest in the most recent biennial survey of corporate governance undertaken by the executive search company Heidrick & Struggles, which was published in 2005, just as they were in the previous study published two years earlier[2], although these results should be treated with some caution. As the 2005 Heidrick & Struggles survey itself points out »formal compliance [with a corporate governance code] does not necessarily guarantee a change in governance culture«.[3]

The report is set out in three main sections. First it examines the many national differences between the four countries in the way companies are managed and the framework in which they operate, including the role that employees play at board level. Second it contrasts this diversity with the substantial and growing similarity of the corporate governance codes that all four states have introduced and it examines the developments that have led to this. It points out that this similarity extends to the also most complete exclusion of the role of employees from national corporate governance codes. Finally it notes that the reason for this exclusion cannot be because the experience of employee participation at board level has been negative, because the evidence from Sweden and France, the two countries with such participation, points in the opposite direction.

1 The national experts are: Marc Lapôtre (France), Robbert van het Kaar (the Netherlands), Klas Levinson (Sweden) and Lionel Fulton (UK).

2 Corporate governance in Europe: what's the outlook? Heidrick & Struggles; 2005 (page 5) and Is your board fit for the global challenge? Corporate governance in Europe; Heidrick & Struggles; 2003 (page 5). In 2003 the top four rankings were: UK, at the top, followed by the Netherlands, France and Sweden; in 2005 the UK still topped the table but Switzerland, a non-EU state, came in front of the Netherlands, France and Sweden.

3 Corporate governance in Europe: what's the outlook? Heidrick & Struggles; 2005 (page 7).

For reasons of space this report is not able to cover the many other issues covered in the four national reports. These include:

- a detailed examination of how boards really work in France;
- details on the particular Dutch system of the right of inquiry into company affairs – the enquêterecht;
- the experience of Swedish trade unionists with board-level representation; and
- the extensive structures of shareholder engagement that have developed in the UK.

These issues are dealt with in greater detail in the executive summaries of the four national reports that are also included.

THE ROLE OF COMPANIES

Each of the four states has a differing view of the role of companies, in other words, in whose interest they operate – just their shareholders or in some way a wider community. Whereas in France and the Netherlands corporate governance codes make it clear that a company should operate in the interests of a wider group than simply the shareholders, this is less clearly articulated in Sweden. In the UK the law requires companies to operate in the interest of shareholders, as the owners of the company,

In France the view that a company has an identity and purpose which is broader than simply the interest of those who own it was expressed in the first report on corporate governance produced by Marc Vienot, on behalf of French business interests in 1995.

> »The interest of the company may be understood as the over-riding claim of the company considered as a separate economic agent, pursuing its own objectives which are distinct from those of shareholders, employees, creditors including the internal revenue authorities, suppliers and customers. It nonetheless represents the common interest of all of these persons, which is for the company to remain in business and prosper« .[4]

In the Netherlands too the latest corporate governance code, makes it clear that the company's interests are not identical with those of its shareholders.

> »A company is a long-term form of collaboration between the various parties involved. The stakeholders are the groups and individuals who directly or indirectly influence (or are influenced by) the achievement of the aims of the company. In other words employees, shareholders and other providers of capital, suppliers and customers, but also government and civil society. The management board and the supervisory board have overall responsibility for weighing up the interests, generally with a view to ensuring the continuity of the enterprise. In doing so, the company endeavours to create long-term shareholder value. The management board and supervisory board should take account of the interests

4 The Boards of Directors of Listed Companies in France, July 1995 (page 7).

> of the different stakeholders. The confidence of the stakeholders that their interests are represented is essential if they are to cooperate effectively within and with the company«.[5]

The Swedish corporate governance code does not spell out the role of the company in such detail. However, in the introduction to the code it does refer to stakeholders in relation to the role of the auditors, stating that as well as looking after the shareholders' need to control the board of directors,

> »Today the auditors are also considered to have the aim of protecting the interests of other stakeholders in the company, such as employees, creditors and capital market actors«.[6]

In the UK, on the other hand, companies are essentially seen as operating in the interests of shareholders. In current discussion on company law reform the Labour government has rejected the idea that a company should operate in the combined interests of different stakeholders, in favour of the »enlightened shareholder value« view. A White Paper in 2005 made it clear that the government agreed that:

> »the basic goal for directors should be the success of the company for the benefit of its members [shareholders] as a whole; but that to reach this goal the directors would need to take a properly balanced view of the implications of decisions over time and foster effective relationships with employees, customers and suppliers, and in the community more widely«.[7]

This position, the government argues, is in line with the current legal position, which, although complex, sees companies as operating in the interest of shareholders.

CURRENT BOARD STRUCTURES

Legislation and current practice has produced a different board structure for major companies in each of the four states. (This report concentrates on the position of companies listed on national stock markets, as these are normally the group to which corporate governance codes apply.) In simple terms they range from the two-tier board structure of the Netherlands, with both a supervisory and a management board, to a single-tier structure in the UK, where both executive and non-executive

5 The Dutch corporate governance code; Corporate Governance Committee; December 2003 (Preamble 3).
6 Swedish Code of Corporate Governance: report of the code group; Swedish Government Official Reports SOU 2004:130 (page 14 of Code).
7 Company Law Reform White Paper March 2005 (page 20).

directors sit together on a common board. However, the situation is, in fact, more complex and needs to be to be presented in some detail for each country, if the current debates on corporate governance and employee involvement are to be understood.

As in many ways the Netherlands and the UK provide the two ends of the spectrum, it is perhaps useful to look at them first.

The Netherlands

In the Netherlands two-tier boards are the dominant structure among listed companies with only a minority of single-tier boards. Under the so-called »structure regime« (*structuurregime*) large companies must set up a supervisory board. (Large companies are defined as those with issued capital of more than € 16 million, at least 100 employees and a works council, which is obligatory for companies with more than 50 employees.) The supervisory board appoints and dismisses the management board, and has a right of veto on important strategic decisions. Following changes introduced in 2004, the supervisory board itself is elected by the annual general meeting (AGM) of the shareholders, with nominations coming from the supervisory board. However, the works council has the right to nominate one-third of the members of the supervisory board. (For more details on how this system works and who can be nominated see section below).

This »structure regime« only applies to large companies which have a majority of employees in the Netherlands. International groups with the majority of employees outside the Netherlands are exempt from its requirements, although their holding companies for Dutch subsidiaries are covered by a less stringent version of the two-tier system. In this ›mitigated‹ version the supervisory board does not have the right to appoint and dismiss the management board; this is in the hands of the shareholders, in other words the international holding company, rather than the supervisory board. The supervisory board's veto on strategic decisions still applies, but only on decisions of its own management board, not those of the international group. However, it is still open to companies not legally covered by the structure regime to do so voluntarily and a number do so. Research undertaken in 1999 on 184 companies listed on the Amsterdam Stock Exchange AEX found that 102 were covered by the full structure regime. But another 30 applied the structure regime even though they were not legally obliged to do so.

However, more recently there have been some influential voices within the Dutch corporate establishment who have called for a move away from the two-tier sys-

tem. The committee which produced the most recent corporate governance code in the Netherlands, led by Morris Tabaksblat, stated that »the statutory two-tier laws that listed companies are obliged to apply actually impede the attainment of this objective [achieving more rigorous checks and balances within Dutch companies]. The committee suggests that the legislator consider scrapping the obligation to apply the statutory two-tier rules, particularly for listed companies«.[8] Some international groups, including Aegon, ING, and ABM AMRO, which previously applied the structure law on a voluntary basis at the highest level now only apply it to the holding companies for their operations in the Netherlands. However, their actions seem to have been motivated more by the relative powers of the supervisory board and shareholders, rather than the two-tier structure itself, and recent legislation has addressed many of these concerns (see pages 24 to 25).

The UK

The UK, in contrast, has a single-tier board system[9], with one board containing directors who are responsible for the day-to-day management of the company. However, in listed companies, as a result of a series of corporate governance codes, these executive directors have now been joined on the board by independent non-executive directors. Under the latest Combined Code of July 2003 half of all directors other than the chair should be independent non-executives in the largest 350 companies quoted on the stock exchange, the FTSE 350, and there should be at least two in smaller listed companies.

The Combined Code states that this is to ensure that »no individual or small group of individuals can dominate the board's decision taking.[10] But other elements in the code, such as the provision for the non-executive directors to meet separately, indicate that they are fulfilling some of the control functions of the supervisory board in a two tier system.

This aspect of the Combined Code is largely complied with. Figures from PIRC, an agency that monitors corporate governance, indicate that in 2005 on average non-executive directors made up 56 % of the boards of FTSE 100 companies, excluding the chair. The average figure for the remaining companies in the FTSE 350

8 The Dutch corporate governance code: account of the committee's work; December 2003 (point 3)
9 A single-tier structure is not specifically prescribed by British company legislation, which leaves most decisions on how companies should be structured to companies themselves in their Articles of Association. There are, however, no known examples of two-tier boards.
10 Combined Code on Corporate Governance: Financial Reporting Council; July 2003 (Main principle A3)

was 50 %, while the figure for listed companies outside the FTSE 350 was 42 %.[11] Directors, whether executive or non-executive, are appointed by the board, normally on the recommendation of the nominations committee, a sub-committee of the board. They should then be elected at the shareholders AGM. There are no representatives of the employees at board level.

Sweden

Sweden too has a single-tier board structure. But it differs from the position in the UK in two key areas.

First, there is normally only one executive director, the managing director, on the board. Other senior executives such as the chief finance officer or the chief operating officer, who would almost certainly be full board members in the UK, are not members of Swedish boards. Other than employee representatives (see next paragraph), the rest of the board is made up of non-executive directors.

Second, the board includes employee representatives. There must be two employee representatives and two deputies in all companies with at least 25 employees and this increases to three representatives and three deputies in companies with 1,000 or more employees, operating across several sectors. However, the number of employee directors may never exceed the number of other directors and their rights are restricted in some areas.

There are also differences in the role of the shareholders in choosing board members (see page 53).

France

France has since 1967 provided companies with a choice between either a single-tier board or a two-tier board, although the single tier-tier system is much more common. An analysis of the 40 companies in the CAC 40 in October 2005 shows that 11 companies (27 %) had both a supervisory board (*Conseil de surveillance*) and a management board (*Directoire*), while 29 (73 %) had a single-tier board of directors (*Conseil d'administration*).[12] A separate study for the AMF, the French financial markets authority, covering 2005, found that out of 108 companies examined, including all the CAC 40 companies, 77 % had a single tier board and 21 % had both

11 Corporate Governance Annual Review 2005; PIRC (page 12).
12 Company boards in the CAC 40 in October 2005: analysis by Marc Lapôtre.

a supervisory board and a management board (in other cases information was not provided in this way).[13]

In the past, while the chair of the supervisory board did not have executive functions, the chair of a single-tier board was also always the chief executive, the Président Directeur Général or PDG. However, legislation passed in May 2001 (loi sur les Nouvelles régulations économiques) permits the role of chairing the board to be separated from that of chief executive.

This led the Bouton committee, the most recent committee examining corporate governance in France, to comment in 2002:

> »French corporations thus have a choice between three possible models of management and control structures, a situation that is unique among comparable countries. This diversity of options should allow the shareholders and management of each listed company to work out the solution that best fits the nature of the company and its circumstances« .[14]

In practice it is the PDG in a single-tier board which is the most common model among French listed companies, with only three companies in the CAC 40 separating the functions of chair and chief executive.[15]

In both the single-tier and two-tier structures board members are elected at the shareholders' AGM on the basis of proposals from the board, often through a nominations committee. However, in addition to the shareholders' representatives it is possible for employee representatives to be board members in two separate situations. One is where the employees own more than 3 % of shares. The other is where the articles of the company provide for employee representatives. In practice in the private sector this second route has only been open where the company involved was formerly publicly owned and over time the number of companies with employee representatives at board level has declined. (For more detail on how employee representatives are chosen, see pages 26 to 34).

SHARE OWNERSHIP PATTERNS

The four countries also present significant variations in terms of the patterns of ownership of listed companies, although the differences between them are almost certainly less than in the past.

13 Rapport AMF2005 sur le gouvernement entreprise et le contrôle interne : January 2006 (page 11).
14 Promoting better corporate governance in listed companies: report of a working group chaired by Daniel Bouton; September 2002 (page 5).
15 Company boards in the CAC 40 in October 2005: analysis by Marc Lapôtre.

As in board structures, the UK is at one end of the spectrum, with the most dispersed pattern of share ownership, though recent changes make it less clear who is at the other end. A study which examined the extent to which shareholders in major non-financial companies are dispersed in Europe found that the median size of the largest block of shares held in major companies was much lower in the UK than in other European states, although it is important to note that the figures, on which this study is based, relate to the 1990s. Whereas in the UK the largest shareholder typically held 9.9 % of the shares, in the Netherlands the figure was 43.5 %, in Sweden 34.9 % and in France 20.0 %. (The figure for the USA on the New York Stock Exchange was 5.4 %). This led the authors to conclude that »voting power is much more concentrated on the Continent than in the UK or USA«.[16]

This point was also recognised by the group which drew up the Swedish Code of Corporate Governance. It noted:

> »Simply put, the large listed companies in the United States and the United Kingdom have for a long time had a more dispersed ownership, while the ownership structure in continental European countries is in many instances more concentrated in the sense that there are typically one or a few principal owners in the company«.[17]

The extent of the concentration of ownership varies between France, the Netherlands and Sweden, and has also changed over time. In Sweden, the group drawing up the report on corporate governance described the position in 2004 as follows: »the majority of companies have one owner or a group of owners whose shareholdings and number of votes in effect give them a controlling ownership position. Only a small number of Swedish listed companies lack a controlling owner.«[18]

In the Netherlands, a report which looked at annual general meetings held by the 54 largest Dutch listed companies over the period 1998 to 2002 found that »the ownership structure of the sample firms is relatively concentrated. The largest outside blockholder [defined as stakes over 5 % not held by directors] owns 14.3 % of the shares on average«.[19] And the Peters committee, which made proposals on corporate governance in 1997, pointed out that listed companies in the Netherlands

16 The Control of Corporate Europe; M. Becht and C. Mayer, in The Control of Corporate Europe edited by F Barca and M Becht; OUP 2001 (pages 19-20).
17 The Swedish Code of Corporate Governance: A proposal by the Code Group April 2004 (page 12).
18 The Swedish Code of Corporate Governance: A proposal by the Code Group April 2004 (page 14).
19 Shareholders' voting at general meetings: Evidence from the Netherlands; by Abe De Jong, Gerard Mertens and Peter Roosenboom, Erasmus Research Institute of management (pages 12-13).

included companies both with large blocks of shareholdings and with a single majority shareholder.[20]

In France the first Viénot report two years earlier referred to the extensive network of cross shareholdings that existed in France at that time. However, it also saw these as a weakness of the French capitalist structure, which it expected would change over time and one whose »elimination as quickly as possible would appear highly desirable«.[21] Since then there is evidence that the system of company cross shareholdings has broken down, with foreign institutional investors now holding a larger proportion of the stock of French companies.[22]

The increasing importance of foreign investors is a trend which is found in all four states. In the UK, non-domestic shareholders held 13.1 % of the shares in UK listed companies in 1992, compared with 32.6 % in 2004.[23] In the Netherlands, figures from Het Financieele Dagblat indicate that at the end of 2003 some 80 % of the shares in listed Dutch companies were in the hands of foreign investors. This is double the figure of 41.2 % calculated by the Peters committee for 1996.[24] In France the proportion of shares held by non-residents in the CAC 40, the top 40 companies listed on the French stock exchange increased from 33.4 % to 42.4 % between the end of 1997 and the end of 2002[25] and increased further to 46.4 % by the end of 2004[26]. In Sweden »foreign share ownership [of listed companies] went from 7 per cent in 1989, when foreign exchange controls were lifted, to 40 per cent ten years later«.[27] Although the proportion fell slightly at the start of the next decade, the overall share of foreign owners remained much above earlier levels.

This growing internationalisation of shareholdings has certainly played a part in encouraging the introduction of corporate governance codes (see below).

20 Corporate governance in the Netherlands – 40 recommendations; Committee on Corporate Governance June 1997 (page 10).
21 The board of directors of listed companies in France: CNPF (now MEDEF) AFEP; July 1995 (page 15).
22 A transformation in the French model of shareholding and management: Francois Morin, published in Economy and Society Volume 29, Number 1; 2000 (pages 36-53).
23 Share Ownership: a report on ownership of shares as at 31 December 2004; Office for National Statistics June 2006 (page 9).
24 Corporate governance in the Netherlands – 40 recommendations; Committee on Corporate Governance June 1997 (page 40).
25 La détention du capital des entreprises françaises du CAC 40 par les non-résidents de 1997 à 2002 : Bulletin de la Banque de France – N° 124 – April 2004 (page 33).
26 La détention du capital des sociétés françaises du CAC 40 par les non-résidents à fin 2005: Bulletin de la Banque de France • N° 149 • May 2006 (page 39).
27 The Swedish model of corporate ownership and control in transition; Magnus Henrekson and Ulf Jakobsson Working Paper No. 593, 2003 (page 26).

However, if increasing non-national shareholdings are a common feature across the four countries examined, the systems, as well as the actual practice, of employee representation at board level are an area of very great divergence.

In essence each of the four countries has different arrangements. These range from the universal presence of employee representatives at board level in medium and large-sized companies in Sweden, to the almost complete absence of anyone who could be said to represent employees in board levels in the UK. In the middle are France and the Netherlands. In France, employee representatives are present at board level, although only in a handful of cases. And in the Netherlands, the law provides employees with a role in choosing board members, although the mechanism for ensuring that their interests are represented is extremely indirect.

This section looks in detail at the situation in each of the countries in turn, examining:

- the background to the introduction of employee representation at board level and the legal basis for their presence;
- the way in which representatives are chosen;
- current practice;
- the powers of employee representatives at board level; and
- an indication of who the representatives actually are.

Sweden

In Sweden, the right of employee representatives to participate at board-level was introduced as a political response to the radical demands for the democratisation of working life in the 1970s made by the LO and TCO union confederations, representing respectively manual and non-manual workers. Two major pieces of legislation emerged as a result. One was the Board Representation Act of 1975, which provide for minority employee representation at board level. The other was the Employment (Co-determination in the Workplace) Act of 1976 – known as MBL – of 1976, which required that »before an employer takes any decision regarding significant changes in its activities, he shall, on his own initiative, enter into negotiations with the employees' organisation with which he is bound to negotiate pursuant to a collective bargaining agreement«.[28]

28 Employment (Co-determination in the Workplace) Act 1976: (Section 11).

Although the result of this process was legislation rather than collective agreements, which would have been more in line with the Swedish tradition of negotiated solutions, the idea of joint decision-making and mutual responsibility is very much in line with the spirit of co-operation that has been a Swedish hallmark since the Saltsjöbaden agreement in 1938. Both the MBL with its wide-ranging local divergence as well as the Board Representation Act, were based on the ideas of dialogue and of preserving basic power relations and were ´products´ of this co-operative tradition.[29]

The stated purpose of the Board Representation Act is »to afford employees information about and influence over the company's activities through representation on the board of directors«.[30] And under it, employees have the right to elect two representatives and the same number of deputies or alternates to the board in companies with more than 25 employees (three in companies with more than 1000 employees which operate in several industries, again with three deputies). Employee representatives can never form a majority on the board.

It is the local union that has the right to appoint representatives to the board, as the legislation states that »the employees' representatives shall be appointed by the local employees' organisations that are bound by collective bargaining agreements with the company«.[31] The choice is made either through local agreement between the unions in the company, provided they represent a majority of the employees, or, if agreement cannot be reached, a more formalised approach is adopted. This states that if one union has 80 % of the employees in the company, then it is entitled to both the employee seats on the board, otherwise each of the two unions with the largest membership in the company has a seat. In practice in most cases one of the employee representatives on the board come from the manual confederation and the other comes from one of the two non-manual confederations.

In practice there is no universal way for the local union to elect representatives to the board. The most common model of appointment in around one-third of cases is that representatives are elected at plant union meetings. In a fifth of the companies, the union board appoints members to the company board. In an eighth, a ref-

29 Edlund, S. Nystrom, B. Hellberg, I. & Melin T (1989) Views on Co-determination in Swedish Working Life. Lund.

30 Board Representation Act; 1975 (Section 1).

31 Board Representation Act; 1975 (Section 7).

erence group or a separate committee runs the elections, while member voting is the mechanism used in a sixth of cases.[32]

Recent trends have seen overall board sizes falling to an average of some five or six members; boards with ten or more members have become less common. As a result employee representatives make up one-third of board members in three-quarters of companies covered by the legislation. In addition, in most companies the employee representatives, who are full board members, are accompanied by their deputies either on all occasions (in 65 % of cases) or sometimes (in 15 %). They are almost all (95 %) employees.

In most areas of the board's work employee representatives have the same rights and responsibilities as other board members. This is in line with the legislation, which states that »Unless this Act provides to the contrary, the provisions of other acts or legislative instruments concerning members of the board of directors and alternate members of a company's board of directors shall apply to employee members and alternates for such members«.[33] The one area where the Act makes it clear that they should not have the same powers is where there might be a conflict of interest with the union, in particular in the area of collective bargaining. As the Act says, »Employees' representatives may not participate in dealing with issues that relate to the collective bargaining agreement or industrial action or other issues where a union organisation at the workplace has a material interest that may conflict with the interests of the company.«[34]

The view of the majority of managing directors and chairs of companies is in line with this legal position. Two-thirds of those questioned in the survey agreed with the view that employee representatives 'have the same legal responsibility as the elected board members', although a fifth of those questioned expressed the view that employee representatives had greater responsibility for employee development than other board members.

Employee representatives on boards are frequently the key union figures within the company. In the case of LO representatives, 60 % are the chairs of their workplace union and in the case of the PTK (the grouping bringing together non-manual unions in the private sector) the figure is 50 %. One-fifth of employee

32 These and other statistics on are based on data from an industry-wide survey from 1998 of managing directors, board chairs and employee representatives experiences of board representation and corporate governance. (Employee representatives on company boards in Sweden Klas Levinson; Industrial Relations Journal. No 3/2001) Data was also obtained in a follow-up survey of the 100 largest corporations in 2005.

33 Board Representation Act; 1975 (Section 11).

34 Board Representation Act; 1975 (Section 14).

representatives on boards are members of the executive board of the local union organisation (the club). These are the same people who are involved in other forms of negotiation with the company, in particular through the MBL. Employee representatives at board level have also been trained for the task. According to the 1998 survey 60 % of LO members and 44 % of PTK members had taken courses, which are run by the unions and financially supported by the government. There are special educational units for this both at LO and PTK.

The overall picture from Sweden is that employee representatives account for around one third of board members in most companies. They are chosen by the union and are generally the key figures in a whole range of employer-union relations.

France

France too has employee representatives on company boards. But the arrangements are very different. There are two ways in which employee representatives can be board members, either elected by all employees or as representatives of employees holding shares. In addition, in a third variant, they can also be present at board meetings as non-board members and only with the right to ask questions.

The right of employee representatives to be board members in their own right, that is not representing employee shareholders, goes back to legislation of July 1983, under which employees of state-owned companies had the right to elect either three, or one third of the members of the board. The arrangements varied in line with the number of employees. In 1986, when a number of these companies were privatised, an executive order (Ordonnance No 86-1135 of 21 October 1986) provided that these privatised companies could amend their statutes to include on their board members elected by the workforce. Under the terms of this order the number of employee representatives was limited to a maximum of four (five in the case of listed companies) and the number could also not exceed one third of the total of other board members. The order also provided that the position of an employee representative at board level could not be combined with any other elected position, such as a member of the works council or a trade union representative. This possibility is not just open to privatised companies. Any company can amend its statutes in this way if it wishes. The law is currently contained in Article L225-27 of the Commercial Code.

Further legislation in 1994 (Loi No 94-640 of 25 July 1994 relative à l'amélioration de la participation des salariés dans l'entreprise) following another wave of pri-

vatisations, obliged companies about to be privatised to provide for employee representation, through a resolution at an extraordinary general meeting of shareholders. Under the terms of this legislation employee members should have three seats (two elected by all employees and one elected by employee shareholders – see below) in companies where the board had fewer than 15 members, and four seats (three elected by all employees and one by employee shareholders) where the board had 15 or more members. However, it is important to note that there is no obligation on privatised companies to keep employee representatives at board level. The company can change its position through another resolution at a shareholders' meeting.

Employee representatives, other than those representing employee shareholders, are elected by all employees in France, although if there are two or more seats then one is reserved for a representative of senior staff (engineers and executives), with voting taking place in two electoral colleges, one for senior staff and one for the rest. Candidates must be nominated by one of the five union confederations that are seen as representative at national level, or they must have the support of 5 % of all employees, or, if there are more than 2,000, at least 100 employees. If there is a single place to be filled either overall or in each college, then there are up to two rounds of election, with a candidate being elected either with an absolute majority in the first round, or with the largest number of votes in the second. If there are two or more seats then they are elected on a list system.

In fact there are a minority of companies with employee representatives of this sort at board level. Only 11 of the CAC 40 companies have employee representatives on the board, other than as representatives of employee shareholders. These are AGF, Crédit Agricole, TF1, Thales, and Thomson – each with two; Arcelor (not a French company), BNP Paribas, France Telecom, Renault and Société Générale – each with three; and GDF (still 80 % owned with by the French state) with six. In total there are 31 employee representatives, other than representatives of employee shareholders, out of a total of 576 board members in the CAC 40 companies.[35]

A separate study, undertaken by the IFA (Institut Français des Administrateurs – French Institute of Board Members) in July to September 2005 and published in 2006, appears to provide a more positive picture with 51 % of 165 respondents to a survey of board members stating that they were on a board with employee representatives as members.[36] (This figure includes both those representing all em-

35 Figures as October 2005 from data compiled by Marc Lapôtre.

36 Les administrateurs salariés: un atout pour la gouvernance des entreprises françaises; IFA; February 2006 (page 7).

ployees and those representing employee shareholders.) However, the IFA survey also includes state-owned industries where employee board members are obligatory, and as the study itself points out, the respondents are those who already have an interest in the issue, and they are, therefore, not typical. This, plus the small number of responses received, means that the results should be treated with considerable caution. They are certainly not representative of French companies as a whole, although the figures give a picture of those companies which have employee representatives at board level. Overall, the survey indicates that 26 % of those with employee representatives at board level said that this was because they were state-owned, 21 % because they had been privatised, and another 18 % said that they had voluntarily changed their statutes to allow employee representatives to be present at board level.[37]

The IFA study found that where employee board members were present (excluding those representing employee shareholders) two was the most typical number. Overall 34 % of respondents with employee board members reported having two. But another 26 % said that there were three and the same percentage – 26 % – that there were four or more. Only 14 % reported that there was only one.

There is however, evidence that the overall numbers of employee representatives at board level are falling. A study in 2003 asked whether this group was »a species in the process of disappearance«[38] and further work by one of the authors, Marc Lapôtre – one of the national experts on whose work this report is based, confirmed that this seemed to be the case. He noted that the 26 employee representatives on 11 boards that he had studied in 2003 had fallen to 16 employee members in 2005. Four of them had gone when the company was taken-over by a foreign company; three as a result of a merger with a foreign company; and three had disappeared, even though there was no significant change in the company itself. The IFA study also concluded that there was »a reduction in the number of board members elected directly [by the employees], as a result of privatisations, mergers, a limit on the number of board members, and company internationalisation«.[39]

Where there are board members representing all employees– that is excluding those representing employee shareholders – they make up between 10 % and

37 Les administrateurs salariés: un atout pour la gouvernance des entreprises françaises (Etude); IFA; February 2006 (page 3).

38 Gouvernement d'entreprise: fonctionnement des organes de contrôle et rôle de représentants des salariés; Bénédicte Bertin-Mourot and Marc Lapôtre; CARIS Centre; November 2003 (page 96).

39 Les administrateurs salariés: un atout pour la gouvernance des entreprises françaises; IFA; February 2006 (page 6).

19 % of all board members in CAC 40 companies. The one exception is GDF, where they account for one-third.[40]

In terms of their rights and duties as board members, there is no difference between employee representatives on the board and board members chosen in any other way.

The fact that the position of an employee representative at board level is incompatible with any other representative position, such as works council member or trade union delegate – if they hold such a position they must give it up within eight days of being elected – clearly plays an important role in determining the type of individual who takes on this position. As Bénédicte Bertin-Mourot and Marc Lapôtre point out, in some cases the union, the normal nominating body, will prefer to keep a high-quality individual as a works council secretary or trade union delegate. In other cases they will be happy for that individual instead to take up the position representing employees at board level.[41] Different unions in the same company may also have different views on the relative importance of the posts. Finally the unions also have to take account of the need for the individual to win an election.

The result is that those who become employee representatives on company boards (again excluding those who represent employee shareholders) are frequently trade unionists who have had lengthy union experience, sometimes at national level, and are coming to the end of their working life. People in this situation have a number of advantages. They are generally well-known among their fellow employees; they probably know the company well; and finally, because they are closer to retirement, they are less subject to the pressures that otherwise can be brought to bear by senior management.[42]

The high proportion of employee representatives at board level who are at the end of their careers is also referred to by the IFA study[43], which points out that only 6 % of companies with employee board members have a specific arrangement to allow them to return to their former jobs without this having an impact on their ca-

40 Figures as October 2005 from data complied by Marc Lapôtre.

41 Gouvernement d'entreprise: fonctionnement des organes de contrôle et rôle de représentants des salariés; Bénédicte Bertin-Mourot and Marc Lapôtre; CARIS Centre; November 2003 (page 38).

42 Gouvernement d'entreprise: fonctionnement des organes de contrôle et rôle de représentants des salariés; Bénédicte Bertin-Mourot and Marc Lapôtre; CARIS Centre; November 2003 (pages 39-40).

43 »Until now the employee board members are chosen from among employees at the end of their careers.« Les administrateurs salariés: un atout pour la gouvernance des entreprises françaises; IFA; February 2006 (page 12).

reer prospects. The same study also shows that 35 % of employee board members received training for the post.[44]

The overall picture that emerges of employee board members in France, other than those representing employee shareholders, is that they are relatively rare in the private sector, largely found in recently privatised companies. And within these companies they make up between 10 % and 20 % of the board. As individuals they are generally senior trade unionists, but are often at the end of the careers and, because they can hold no other office, they may be somewhat divorced from the day-to-day union concerns.

However, being elected by all employees is not the only way that employee representatives can be board members. They can also be there representing employee shareholders.

Action to encourage employees to hold shares in the companies they work for in the private sector goes back at least to legislation on the provision of stock options to employees in 1970. In 1994 the legislation[45] which provided for employee representation on the boards of privatised companies, including one representing employee shareholders, (see above) also referred to employee shareholdings in other companies. It provided that, when these had reached 5 % of total share capital, an extraordinary general meeting of shareholders should be held to decide whether or not to have one or two board members representing these employee shareholders. These companies, unlike those being privatised (see above), were not obliged to provide board seats for representatives of employee shareholders. However, if the shareholders meetings did not agree to have employee shareholders on the board, they were obliged to reconsider the issue five years later.[46]

Later legislation, in February 2001, whose primary was encouraging employee saving, reduced the threshold from 5 % to 3 % and allowed more than two members to be appointed.[47] A year later, under the introduction of at least one member representing employee shareholders was set to become mandatory[48], where employee shareholders had at least 3 % of the shares. However, the necessary decree,

44 Les administrateurs salariés: un atout pour la gouvernance des entreprises françaises (Etude); IFA; February 2006 (page 8).

45 Loi No 94-640 of 25 July 1994 relative à l'amélioration de la participation des salariés dans l'entreprise.

46 Loi No 94-640 of 25 July 1994 relative à l'amélioration de la participation des salariés dans l'entreprise (Article 129-2).

47 Loi No 2001-152 of 19 February 2001 sur l'épargne salariale (Articles 24).

48 Loi No 2002-73 of 17 January 2002 de modernisation sociale (Article 217).

setting the conditions under which this should occur, had still not been introduced by mid-2006.[49]

Board members representing employee shareholders can be chosen in two ways: either by the employee shareholders themselves, or by the supervisory board of the of the company investment trust holding shares in the company (FCPE – fond commun de placement d'entreprise). Normally the number of candidates proposed in this way is twice the number of places and the shareholders' meeting chooses between them, although in some cases they are chosen by the PDG.

As with board level members representing all employees, there are relatively few board level members representing employee shareholders. In the CAC 40 companies, there are only 18 individuals, compared with 31 board members representing all employees.[50] However, they are found in a slightly larger number of companies, 13 in total, as compared to 11 with board members representing all employees. Nine companies – AGF, France Telecom, Renault, Saint Gobain, Schneider Electric, Suez, Thales, Total and Vinci – have one board member representing employee shareholders, three – Alacatel, Bouygues and Thomson – have two, and Essilor has three. These generally lower numbers per board are in line with the figures reported from the IFA study. It found that in 59 % of cases there was a single individual representing employee shareholders, in 29 % there were two, in 7 % three and only in 5 % of cases more than three.[51]

There are eight CAC 40 companies where the representatives of employee shareholders are the only employee representatives at board level – Alcatel, Bouygues, Essilor, Saint Gobain, Schneider Electric, Suez, Total and Vinci; six CAC 40 companies where representatives of all employees are the only employee representatives at board level – Arcelor, BNP Paribas, Crédit Agricole, GDF, Société Générale and TF1; and five which have representatives of both all employees and employee shareholders on the board – AGF, France Telecom, Renault, Thales and Thomson.

The IFA study does not breakdown its analysis of employee representatives at board level between those representing all employees and those representing employee shareholders. However, it notes that only 12 % of respondents stated that

49 Employee financial participation, including board-level representation for employee shareholders, is still be actively discussed in France, with the French government presenting new proposals in June 2006.

50 Figures as October 2005 from data complied by Marc Lapôtre.

51 Les administrateurs salariés: un atout pour la gouvernance des entreprises françaises (Etude); IFA; February 2006 (page 8).

they had introduced representatives of employee shareholders, because the 3 % threshold had been crossed.[52]

In contrast to those representing all employees, board members representing employee share holders are likely to become more common in the future. This is the view of Bertin-Mourot and Lapôtre, who commented that the legislation requiring the presence when the employee shareholders increased beyond 3 % »cannot but go in the direction of a significant increase of this type of board members«.[53] The IFA study, which found »an increase in the number of board members representing employee shareholders, as a result of the development of employee shareholding, savings for retirement or of the wish of companies to give a value to their human capital and to interest employees in capital«.[54]

However, for the moment at least the proportion of this type of board member within the board remains low – between 14 % and 6 % among CAC 40, most frequently 7 % (one of out 15) – with the single exception of Essilor, where it is 25 %.

As with representatives of all employees, the individuals representing employee shareholders have the same rights and duties as other board members. The practice may sometimes be different.

The board members representing employee shareholders are, in the view of Bertin-Mourot and Lapôtre, very different to those representing all employees. In the study they carried out in 2001, they found that they were »always executives, sometimes senior executives«.[55] The explanation is that as the executives hold more shares than other employees and so they have the greatest weight in the bodies representing employee shareholders. Where unions put forward candidates for election by employee shareholders, they are also normally executives, and the majority of the board-level representatives of employee shareholdings encountered by Bertin-Mourot and Lapôtre were trade union members, often coming from the union representing senior staff, the CFE-CGC. They were also, like other employee representatives, normally approaching the end of their professional life.

Overall board-level representatives of employee shareholders seem to be found in slightly more boards than other types of employee representatives, and this may

52 Les administrateurs salariés: un atout pour la gouvernance des entreprises françaises (Etude); IFA; February 2006 (page 8). Again it is worth pointing out that this does not mean that 12 % of all French companies have representatives of employee shareholders on the board.

53 Gouvernement d'entreprise: fonctionnement des organes de contrôle et rôle de représentants des salariés; Bénédicte Bertin-Mourot and Marc Lapôtre; CARIS Centre; November 2003 (page 97).

54 Les administrateurs salariés: un atout pour la gouvernance des entreprises françaises (Etude); IFA; February 2006 (page 6).

55 Gouvernement d'entreprise: fonctionnement des organes de contrôle et rôle de représentants des salariés; Bénédicte Bertin-Mourot and Marc Lapôtre; CARIS Centre; November 2003 (page 42).

be even more true in the future. However, they are normally present only in ones and twos and, as individuals, although they are often trade unionists, they are more likely to be executives than any other sort of employees.

The final way that employee representatives may be present at board meetings in France is as representatives of the works council. However, it is very important to stress that in contrast to the two groups already examined, these are not full board members. Instead they have very limited consultative rights.

The current right of the works council to appoint two members to be present goes back to the Loi Auroux of 1982, which strengthened the powers of works councils, particularly in the area of the employer's economic and financial position. For example, the law allowed the works council to make use of a financial expert, paid by the company with wide-ranging powers.

The legislation, currently found in Article 432-6 of the Labour Code, provides that normally two members of the works council, one representing employees on lower grades, and the other representing employees such as technicians and supervisors, will be chosen for this task by the works council. In larger companies, essentially those with more than 500 employees, this can increase to four.

Unlike the arrangements providing for full board membership for other types of employee representatives, the law on the presence of works council members applies to all companies. However, there is no information on how widespread their presence is in practice.

As already stated, these employee representatives have only a limited consultative role. They should receive the same documents as other board members. They can also make proposals to the board and the board is legally required to provide a reasoned response to them. But they do not take part in decision making.

In practice Bertin-Mourot and Lapôtre found that sometimes the works council sending representatives to the board in this way only represented the head office not the group as a whole. This means that the individuals present may have no knowledge of the group as a whole, and in some cases may come from senior executives in the company. As their report points out, »You find all sorts: experienced trade unionists, leading executives, non-manual workers with no connection with trade unions, etc.«[56]

Overall, despite their apparent potential across all types of companies, there seems no evidence that this type of employee representation, where employees are

56 Gouvernement d'entreprise: fonctionnement des organes de contrôle et rôle de représentants des salariés; Bénédicte Bertin-Mourot and Marc Lapôtre; CARIS Centre; November 2003 (page 44).

present at board meetings but not part of the board, is widespread or that the individuals involved come from a clearly defined group.

The Netherlands

There are individuals on supervisory boards in the Netherlands, who are chosen by the works council, but in contrast to both Sweden and France, they are not company employees. Indeed their links with the works council, the body representing employees, are often limited.

The legislation providing for employee representation in supervisory bodies was introduced in 1971 following long years of argument for workers' participation.[57] The so-called structure regime, which the legislation set up, provided for the co-option of candidates recommended by the works council onto the supervisory boards of larger companies, those with a set level of capital – this has increased over time and is currently € 16 million, a works council and with at least 100 employees in the Netherlands. There was no limit on the number of candidates which could be proposed by the works council, although equally there was no obligation on the supervisory board to co-opt the candidates the works council put forward. In practice supervisory boards in companies covered by the structure regime often drew up a profile of the desired composition of the board, in terms of background and experience and this profile was sometimes agreed with the works council. An important element of the system was that the individuals nominated by the works council could neither be employed by the company or the group, nor could they be employed by a union involved in collective bargaining with the company.

However, the structure regime, as introduced in 1971, did not just provide for the co-option of candidates from the works council but of all candidates. In other words neither the general meeting of shareholders nor the works council could choose the members of the supervisory board. They could both only make recommendations, with the final decision being taken by the supervisory board, although both the shareholders and the works council were able to object to appointments on the grounds that the individuals were unsuitable or that the appointment would unbalance the board. Other than this, the only body able to break the power of the supervisory board to continue to appoint as it saw fit was the Enterprise Chamber of Amsterdam Court, which could dismiss one or more members of supervisory

57 See paper written by Joan Bloemarts in Workers' participation at board level in the EU-15 countries Reports on the national systems and practices Hans Böckler Foundation / European Trade Union Institute (ed.) Brussels, 2004 (page 85).

board at the request of the board itself, the shareholders or the works council, for dereliction of duty, other serious grounds, or in the case of a drastic change of circumstances.[58]

This system of co-option was opposed by the unions, who urged that both the works council and the general meeting of shareholders should each appoint one-third of the members of the supervisory board. And in the 1990s increasing shareholder activism led to the system being seen as less and less appropriate among shareholders as well.[59] In 2001 the SER a social and economic advisory body made up of representatives of employers, unions and independent experts produced a report recommending significant changes.[60]

In essence the report proposed that the members of the supervisory board should be appointed by the general meeting of shareholders, rather than co-opted by existing members. However, it stated that the works council should be given special nominating rights for one third of the seats of the supervisory board. These nomination rights were special in the sense that they would be accepted, unless there were good grounds for not doing so, such as that the person was unfit or that the appointment would unbalance the board.

The SER report remained committed to the involvement of employees in determining the composition of the supervisory board. It stated, »The involvement of employees in this matter is a social right that should not be surrendered«.[61]

This report led in turn to new legislation which was passed in July 2004 and came into force on 1 October 2004. Under this, the supervisory board nominates candidates to the supervisory board in line with a desired profile of the composition of the board, but it is the general meeting of shareholders that finally appoints the members. The desired profile of the supervisory board should be drawn up within six months of the legislation coming into force and should be discussed with the works council and in the shareholders' meeting but there is no obligation for agree-

58 The case of Corus BV in March 2003, where the supervisory board refused to approve the sale of its aluminium operations, despite the fact that it had been agreed by the parent company Corus PLC (in this case the shareholder of Corus BV) and the Enterprise Chamber of the Amsterdam Court refused a request of Corus PLC to dismiss the supervisory board, indicates that it was not straightforward to get the Court to act against a supervisory board.

59 See paper written by Joan Bloemarts in Workers' participation at board level in the EU-15 countries Reports on the national systems and practices Hans Böckler Foundation / European Trade Union Institute (ed.) Brussels, 2004 (page 86).

60 Advies over het functioneren en de toekomst van de structuurregeling (The functioning and the future of the structure regime); SER; 19 January 2001.

61 The functioning and the future of the structure regime (English language abstract of the Dutch report; SER; June 2001.

ment to be reached. The general meeting can reject the supervisory board's nominations on the basis of a simply majority, either in one meeting, if this majority represents at least one third of the issued capital, or in a second meeting if less than one third of the issued capital is voted at the first meeting. The general meeting cannot nominate candidates itself. If the supervisory board's nominations are rejected it must nominate new candidate(s).

The works council also makes its nominations to the supervisory board, and as before they may not be employees of the company or of a union involved in collective bargaining with it. It has special nomination rights – in other words the nomination should normally be accepted – for one third of the seats of the supervisory board, although it can nominate more. If the supervisory board has objections to members proposed using the works council's special nomination rights – and there must be good grounds for objecting – the two bodies should attempt to reach an agreement. If no agreement can be reached, the issue goes to the Enterprise Chamber of the Amsterdam Court. However, even for candidates nominated by the works council, the final decision is still taken by the general meeting of shareholders. It can reject the nominations from the supervisory board that originally came from the works council in the same way and using the same procedure (a simple majority in single meeting if two-thirds of the capital is represented; a second meeting is needed if less than one third of the issued share capital is voted at the first meeting) as for any other nominees. The whole procedure then starts again.

In order to get to one third of the members of the supervisory board coming from the works council, the works council has the right to nominate for every other vacancy, until the one-third proportion is reached.

Another important change under the 2004 legislation is that a general meeting of shareholders has the right to dismiss the entire board by a majority vote, provided this vote represents at least at least one third of the issued share capital. The meeting must hear the views of the works council before taking a decision. If the entire supervisory board is dismissed, the Enterprise Chamber of the Amsterdam Court appoints an interim supervisory board with the task of nominating new candidates. As before, the Enterprise Chamber of Amsterdam Court can dismiss one or more members of the supervisory board at the request of the board itself, the shareholders or the works council, for dereliction of duty, other serious grounds, or in the case of a drastic change of circumstances.

Finally, the legislation also permits the supervisory board, general meeting of shareholders and the works council to agree other arrangements if they wish, although the right of the shareholders to reject a nomination cannot be removed.

In practice it appears that under the previous system not all works councils made use of their right to nominate members of the supervisory board. Research in 1995 found that only a minority of works councils did so, although some larger companies had reached agreements with their works councils to reserve a seat for a member proposed by the works council.[62] More recent research by Rienk Gooddijk indicates that this may have changed, but only slightly. Based on responses from 83 works council chairs (out of a total of 250 approached) It found that only 51 % of works councils had used their nomination rights: 28 % had done so once, 12 % twice and 11 % three times or more.[63] The research also found that size was the only significant factor, in terms of the characteristics of the companies involved, in determining whether the works council nominated a supervisory board member or not. While only one third (33 %) of works councils in companies with between 100 and 500 employees had used their right to nominate a supervisory board member, this figure rose to almost a half (47 %) in companies with between 500 and 2,000 employees and more than two-thirds (71 %) in companies with more than 2,000 employees. Other factors, such as whether shares are widely dispersed or concentrated in a few hands, or whether the company is Dutch or foreign-owned, appeared to play no role in whether the works council makes nominations.

One issue which does seem to make a difference is whether there is an agreement between management, the works council and the supervisory board on the practicalities of making nominations and the composition of the supervisory board. Goodijk's research shows that 65 % of the works councils that had such an agreement had made nominations. This is well above the overall figure of 51 %. The study notes that, »Especially the works councils' involvement in drawing up a profile for the supervisory board, seems to be stimulating to proposing a qualified and eligible candidate«.[64]

Indeed overall the research makes clear that the attitude of management and particularly the chair of the supervisory board plays a key role in whether or not the works council makes a nomination. More than half the works councils making nominations said that the chair of the supervisory board had stimulated them into making use of their right to do so.

62 Ondernemingsraad en vertrouwenscommissaris; R.H. van het Kaar; 1995.

63 Works Council's right to nominate Supervisory Board members; Rienk Goodijk; 2006 (pages 18 to 21).

64 Works Council's right to nominate Supervisory Board members; Rienk Goodijk; 2006 (page 19).

The reasons works council chairs gave for making nominations were:

- to create a better relationship with the supervisory board;
- to improve the composition of the supervisory board by making it more balanced; and
- because the supervisory board had taken the initiative.

The reasons they gave for not making nominations were:

- because they were involved too late;
- having no qualified candidates;
- the perception that the supervisory board would not accept the candidate;
- lack of close contact with the supervisory board; and
- too great a focus on operational concerns.

Where nominations are made by the works council, they are normally accepted by the supervisory board. The figures from the research show that these nominations are accepted in more than 80 % of cases.

This research was conducted in 2003 to 2004, before the current legislation came into force. It remains to be seen whether the October 2004 changes, which require the supervisory board to discuss its profile with the works council and which guarantee it one-third of the seats, will change the situation.

Once on the supervisory board, individuals nominated by the works council have exactly the same rights as other supervisory board members.

The fact that works council cannot, under either the old or the new system, nominate company employees or officials from unions involved in collective bargaining has a major impact on the type of individuals who are nominated. It means that they are probably more distant from the day-to-day concerns of the workforce than is the case of similarly nominated board members in Sweden or France. They are typically academics, perhaps with a broad sympathy for trade unions positions, individuals with a human resources background, people from the non-profit sector, and in some cases former senior trade unionists.

In summary, it is still too early to see the impact of the 2004 changes in the way works councils can nominate supervisory board members. Under the old system smaller companies were unlikely to have a supervisory board member, nominated by the works council, but this was not the case for larger companies, particularly where the works council and supervisory board had reached agreement on the overall composition of the supervisory board. However, the individuals nominated by the works council are in no sense direct representatives of the workforce.

The UK

In the UK there is no general right for any employee representatives to participate at board level. Proposals in the 1960s and 1970s to provide such a right[65] got a far as a White Paper *Industrial Democracy* in 1978. However, the election of a Conservative government in May 1979 meant that these proposals were abandoned. The handful of experiments with employee representatives at board level in state-owned companies were also stopped shortly afterwards. Since then there have been a very few examples where employee representatives have been present at board level, generally in companies which were either employee-owned[66] or publicly-owned[67], but these are very much the exception.

Employee representatives are, however, frequently trustees of occupational pension schemes for private sector companies. Overall, in 2005 there were some 4.7 million employees in private sector pension schemes.[68] This is about one-fifth of all employees in the private sector. The Pensions Act 1995 allowed for member-nominated trustees to make up one-third third of all trustees in schemes with more than 100 employees, and to provide at least one trustee in smaller schemes, although, following consultation with pension fund members, it was possible for employers to opt-out of this requirement. These rights were further improved by the Pensions Act 2004. This removed the possibility of employers opting out of the requirement that one-third of the trustees should be member-nominated. The regulations implementing the regulation started to apply from April 2006 and it is likely to be late 2007 before the new arrangements are fully in place. The 2004 Act also included the provision that the proportion of member-nominated trustees be increased from one-third to one half. However, the UK government is currently consulting on how this should be introduced and it unlikely to come in before 2009.

65 In particular the »Committee of Enquiry into Industrial Democracy« chaired by a distinguished academic Lord Bullock. The committee reported in January 1977 proposing an equal number of representatives of both shareholder and employee representatives on the governing board of companies employing more than 2,000 with these two groups appointing a third group of independent directors.

66 A number of companies were privatised in the 1980s by giving shares to the employees under Employee Share Ownership Plans (ESOPs). They often had employee directors, and most of these companies have subsequently disappeared. See Worker Directors in the UK: the Limits of Policy Transfer, 1972-2004; Michael Gold 2006.

67 A report by the Labour Research Department in 2002 for the TUC found that employee involvement at board level continued to exist in at least two publicly-owned bus companies. These were Nottingham City Transport, where 82 % of shares were owned by Nottingham City Council and Lothian Buses, which is wholly owned by the local authorities (91 % Edinburgh 9 % the adjacent councils).

68 Occupational Pension Schemes 2005: The thirteenth survey by the Government Actuary (page 26).

The 1995 Act, set out statutory rules for choosing member-nominated trustees. These were that members could only be nominated by active members – in effect employees, not pensioners – that if there were more nominations than vacancies than there should be a ballot of active members within 14 days of the close of nominations. Trustees could also propose other arrangements, but these needed to be approved by a ballot of the membership. The 2004 Act required that the nomination and selection process should be opened up to pensioner members as well as active members of schemes.

Research conducted for the government in late 2003 to early 2004 found that on average there were five trustees (5.07) per scheme, although large schemes (over 1,000 members) and very large schemes (over 5,000) members had more – 6.64 and 7.97 respectively.[69] Three-quarters of all schemes (72 %) had employee-nominated members, and larger schemes were more likely to have them (80 % for large schemes and 89 % for very large schemes). However, the survey provided no details on the proportion of member-nominated trustees.

However, the powers and range of issues covered by pension trustees are by no means the same as those of a company board, or supervisory board. Pension trustees are essentially concerned to ensure that funds are available to meet the pension funds commitments and that pensions are paid out fairly.

The need to ensure that there are sufficient funds means that pension fund trustees are concerned with the investment policy of their funds and for some time the TUC has encouraged member nominated trustees to take up issues in this area. This has certainly had an influence on broader corporate governance (see below). However, it is important to emphasise that this activity affects how a fund invests in other companies, not how the company itself acts.

However, a combination of new regulations under the 2004 Pensions Act and the fact that most company pension schemes are now in deficit[70], has strengthened the potential influence of pension fund trustees to influence the behaviour of their own companies.

The Pensions Regulator, the new organisation set up to police the operation of pension funds points out that trustees now have the »ability to exert leverage over the company, particularly because of trustees' ability to whistleblow to the regula-

69 The Myners Principles and occupational pension schemes: Findings from quantitative research; Sarah Horack, John Leston and Margaret Watmough; 2004 (pages 25 to 29).

70 Figures from Mercer Human Resources Consulting, which regularly monitors pension fund finances, indicate that, at the end of 2005, 97 % of the FTSE 350 had deficits in their pension funding under the FRS 17 accounting standard.

tor, with the regulator's powers to issue contribution notices or financial support directions«.[71] (Contribution notices are where the Pensions Regulator can require the pension deficit to be met in full and financial support regulations make a group of companies liable for the pensions deficit of a single company).

The Pensions Regulator therefore advises that, »In order to negotiate, and to protect scheme members' interests, trustees need to understand the sponsoring employer's financial position and the strength of its commitment to the funding of the scheme. They should monitor corporate activity and seek the employer's agreement to be given information at an early stage subject to the usual restrictions such as those on handling price-sensitive information«.[72]

The types of issue where the Pensions Regulator would expect trustees to have been consulted are giving increased security to other creditors, such as banks, return of capital to shareholders, through enhanced dividends or share buy-backs and changes of ownership, through takeovers.

Clearly these are some of the issues, which would also be discussed in a board or supervisory board, and in this sense member-nominated trustees are gaining an influence that parallels that of employee representatives at board level. However, it is important not to overstate this and to recall that it is a very recent development – the Pensions Regulator was only set up in 2005, that the range of issues covered is still fairly narrow, and that trustees can really only exercise pressure where funds are in deficit.

There are no statistics on who member-nominated trustees are, or how they are chosen. In practice, in companies with strong union organisation the member-nominated trustees are often chosen by the unions. Elsewhere the mechanism for choosing them may be much more opaque. In unionised companies the trustees will typically be made up of a mixture of leading lay representatives, retired union members and, sometimes, full-time officials.

To summarise, employees in the UK have no right to participate at board level in any way and in reality, except in a tiny handful of exceptional companies, they do not do so. Employee representatives are found as trustees of pension funds, which cover about one-fifth of employees in the private sector. However, this only gives them influence on company policy in a limited number of areas, and the legislative changes which have made this possible are very recent.

71 Clearance Statements; Guidance from the Pensions Regulator: April 2005 (page 23).
72 Clearance Statements; Guidance from the Pensions Regulator: April 2005 (page 24).

While each of the four states examined shows clear differences in terms of board structures, share ownership patterns and employee representation at board level, all four now have corporate governance codes, which in many ways are very similar. This section of the report looks at how these codes have developed, at the common features that they have and the way that their application is monitored.

THE RECENT HISTORY OF CORPORATE GOVERNANCE CODES

France, the Netherlands, Sweden and the UK all now have corporate governance codes, but they were not all introduced at the same time and the way that they have developed has varied.[73] However, although the detail has been different, the broad picture has been the same in each of the four countries. This has been of a series of official and semi-official reports produced by committees on corporate governance and chaired by leading business figures. These have led not to binding rules of behaviour but to a series of codes of good practice, which companies are not required to follow but which impose an obligation to explain if they do not.

The pattern was set by the UK, first of the four to introduce a corporate governance code. This code was introduced following the Cadbury report, named after the man who chaired the committee which produced it, Sir Adrian (later Lord) Cadbury, former chair of the confectionery and drinks company Cadbury Schweppes. Set up in May 1991 by the Financial Reporting Council, the London Stock Exchange and the accountancy profession, its remit was to »address the financial aspect of corporate governance«.[74]

It reported in December 1992 and recommended that all listed companies should comply with a code of best practice and that listed companies should make a statement about their compliance with the code.[75] These recommendations and the

73 This section does not examine corporate governance and similar codes which have been produced by bodies of investors such as the AFG in France, the SCGOP in the Netherlands, the Swedish Shareholders Association, or the Institutional Shareholders' Committee in the UK. Although these have certainly been influential, they do not have the same status as the codes examined here.

74 Report on the Committee on Financial Aspect of Corporate Governance (Cadbury Report): December 1992 (Para 2.1).

code of best practice were accepted by London Stock Exchange, which made them part of the 'Listing Rules' and therefore obligatory, on the basis that companies should either 'comply or explain' why they had not done so.

Two further reports followed: the Greenbury report on directors' remuneration, which was published in 1995[76] and also led to a code, and the Hampel report, published in 1998[77], which looked at the implementation of the two codes. The Hampel report did not make any major changes to the existing Cadbury and Greenbury codes. It also continued to argue strongly that the codes should not be prescriptive and that companies should be able to depart from the codes, where they judged this was appropriate. It also suggested that there should be »a set of principles and code of good corporate governance practice, which will embrace Cadbury and Greenbury and our own work«.[78] The suggestion was taken up by the London Stock Exchange and the result was the first version of the »Combined Code« in June 1998.

Further reports on internal controls[79] and auditing[80] followed. But the most important changes to the 1998 Combined Code, at least in the area of board membership came with the Higgs report on the role of non-executive directors.[81] This time the report was commissioned by the government and written by a single individual, Derek Higgs, Chairman of Partnerships UK and a non-executive director of a number of companies. The Higgs report made a number of recommendations to amend the existing Combined Code and strengthen the position of non-executive directors, in particular their independence and professionalism.[82]

75 Cadbury Report Summary of Recommendations.

76 Directors' remuneration – Report of a Study Group Chaired by Sir Richard Greenbury July 1995.

77 Committee on Corporate Governance: Final Report January 1998.

78 Hampel Report (page 57).

79 In 1999 there was detailed guidance on the implementation of internal control, which was produced for the Institute of Chartered Accountants of England and Wales, by a committee chaired by Nigel Turnbull, a director of the Rank Group . This met a promise made when the original code was published in 1998 that companies would be given guidance on how to implement the requirements in the Code relating to internal control. This set out how companies should manage risks. The initial guidance was reviewed in 2004 and new guidance was published in October 2005.

80 In July 2002 the government asked the Financial Reporting Council to set up a group to examine and develop the existing audit provisions of the Combined Code in the light of the dramatic collapses in early 2002 of US companies, like Enron and WorldCom (collapses which in the US led to the Sarbanes Oxley Act). The group chaired by Sir Robert Smith, chairman of the Weir Group, was appointed in September 2002 and its report was published in January 2003. It produced detailed guidance for audit committees, as well as additional provisions for the Combined Code. In particular it emphasised the independent role that the audit committee, should play. Its recommendations were incorporated into a new version of the Combined Code published in July 2003.

81 Review of the role and effectiveness of non-executive directors: Derek Higgs (Higgs report): January 2003.

82 Higgs report (pages 80-85).

The Higgs' recommendations were largely included in the new version of the Combined Code published in July 2003. And although some of the proposals were made less onerous and some of the Higgs' provisions (rules) were changes into supporting principles, the overall impact of the report was to produce a significant tightening of the Combined Code.

It is the 2003 version of the Combined Code which is still a requirement for all UK incorporated companies listed on the main London Stock Exchange.

France was the next country to make moves in this area. A report, dealing with the operation of boards of directors was produced in July 1995 by a working group set up by the CNPF – the French employers association, which later became known as MEDEF – and the AFEP – the body bringing together private businesses, and chaired by Marc Vienot, the PDG of the banking group Société Générale.[83] This report, which became known as Vienot I, included a series of recommendations, and the committee expressed the hope that »all boards will examine their own practice to see how far it is in keeping with the principles embodied in these recommendations«.[84]

The 1995 report also expressed the view that the issues should be re-examined in three years time and this resulted in a second committee, also chaired by Marc Vienot, whose report was published in July 1998 and became known, unsurprisingly, as Vienot II.[85]

Vienot II contained a series of recommendations, some of which were addressed to the government – in particular the proposal that a separation of functions between the chair and chief executive should be possible in a company with a single-tier management board.[86] The report also called on listed companies to state clearly in their annual reports how they had followed the recommendations of both the 1995 and 1999 reports, and, where they had not done so, to state »the reasons for which they had not implemented certain of them«.[87]

In April 2002 the two business bodies, MEDEF and the AFEP (which had become the AFEP-AGREF), again called on the head of Société Générale, who by this time was Daniel Bouton, to report on the state of corporate governance in France. The

83 The Boards of Directors of Listed Companies in France, July 1995.
84 Vienot I (page 6).
85 Report of the Committee on Corporate Governance chaired by Mr Marc Vienot; July 1999.
86 Later taken up in New Economic Regulations law of May 2001.
87 Vienot II (page 23).

Bouton report was presented in September 2002[88] and it argued that promoting good practice was the best way forward:

> »The working group is convinced that the surest way to improve corporate governance is through the evolution of individual and collective behaviour following "best practices" based on fundamental principles consistently applied to all economic players: personal responsibility, transparency and integrity«.[89]

This report in turn was followed by a set of »principles for corporate governance« based on the two Vienot reports and the Bouton report, published in October 2003.[90] It is these principles which currently apply in France, although overall they have a less binding character than similar codes in the three other countries studied.[91]

The Netherlands followed slightly later, setting up a committee to examine corporate governance in 1996. It was chaired by Jaap Peters, a former chief executive of the insurance group Aegon and reported in June 1997, making 40 recommendations.[92]

However, there continued to be problems in ensuring the recommendations were observed and when the Dutch Corporate Governance Foundation reviewed compliance with the 40 recommendations in 2002 it found that, »progress had been made in the field of corporate governance in the Netherlands in the last five years, but that further improvement was still possible and desirable«.[93]

As a result a new committee chaired by Morris Tabaksblat, former chair of the executive committee of Unilever and chair of the supervisory board of Aegon, was set up. It produced its first draft conclusions in July 2003 and a final Corporate Governance Code in December 2003.[94] The »principles of good corporate governance and best practices provisions«, set out in the code, are those which currently apply to listed companies whose registered office is in the Netherlands. The requirement for these companies to include a section in their annual report on their compliance

88 Promoting Better Corporate Governance in Listed Companies; September 2002.

89 Bouton Report (page 4).

90 The Corporate Governance of Listed Corporations; AFEP and MEDEF; October 2003.

91 The French securities authority, Authorité des marchés financiers, recommends that companies should refer to the MEDEF-AFEP recommendations in producing their annual reports (see Revue Mensuelle d'AMF; March 2004 page 17), and it comments on how far they have complied with them in its annual report on corporate governance (see Rapport AMF 2005 sur le gouvernement entreprise et le contrôle interne; January 2006 pages 11 to 13). But the recommendations are not part of the stock exchange listing requirements, as is the case in Sweden and the UK, or included in full in legislation, as is the case in the Netherlands (Decree of the Ministry of Justice 23 December 2004).

92 Recommendations on Corporate Governance in the Netherlands; June 1995.

93 Terms of reference for the Tabaksblat committee; March 2003.

94 The Dutch corporate governance code; Corporate Governance Committee; December 2003.

with the code was made legally binding by a resolution of the Ministry of Justice in December 2004.[95]

Sweden was the last of the four to produce national material on corporate governance. The background was the appointment by the government in September 2002 of a commission to look at measures which needed to be taken to strengthen confidence in the Swedish business community, which became known as the Commission on Business Confidence. As part of its work in October 2003 this Commission set up a special working party known as the Code Group, with the task of drafting a code of corporate governance for Sweden. This Code Group, composed of members of the Commission on Business Confidence and other business figures but with a majority from business, produced a draft code in April 2004. In September 2004 the Swedish government appointed another committee to examine the draft code and the comments that had been made on it. This committee was chaired by Erik Åsbrink, a former social democratic finance minister, who had chaired both the earlier Code Group and the Commission on Business Confidence. It reported in December 2004[96] and the code of corporate governance it contains currently applies to Swedish listed companies. It became a requirement for listing on the Swedish stock exchange on 1 July 2005 and it was to be fully implemented by 2006.

THE REASONS FOR THE SIMILARITY BETWEEN THE CODES

The similarity in the way that the codes have emerged is certainly not coincidental. They have been drawn up in response to similar issues and pressures.

One of these pressures has been evidence that the existing system has not been working well. In the Netherlands, for example, in 2003 the committee which drew up what became known as the Tabaksblat code pointed out that:

> »The bankruptcies of several large corporations, a series of high-profile accounting scandals and significant increases in the remuneration packages of some management board members have created widespread public doubts concerning the accountability and supervision of corporate policy-makers«.[97]

And these concerns could have applied to any of the four countries at the times when their codes or revisions of their codes were being introduced. The Dutch faced

95 Staatsblad 2004, 747. The itself was published in the official Staatscourant No 250 of 27 December 2004.

96 Swedish Code of Corporate Governance: report of the code group; Swedish Government Official Reports SOU 2004:130.

97 The Dutch corporate governance code: account of the committee's work (point 1).

a scandal at the retail company Ahold in 2003 after the earnings of its US operations were found to be massively overstated. The Cadbury committee in the UK was set up after a series of financial scandals at Polly Peck, Maxwell, Guinness and BCCI. French industry was rocked by the problems of Jean-Marie Messier at Vivendi Universal, leading finally to his resignation in July 2002. And in Sweden business confidence was damaged when executives at the leading insurance company Skandia, were accused of misusing corporate assets in March 2004.

In addition the scandals at the US companies Enron and WorldCom in 2001 and 2002 had a worldwide impact and led countries to look again at their corporate governance arrangements.[98]

Another pressure leading to the introduction of corporate governance codes, particularly early in the process, has been the growth in importance of non-national investors. This was referred to in the first Vienot report in 1995, which noted that: »privatisation and the growing presence of non-resident investors on the Paris stock market has led to the rapid emergence of a new type of shareholder with little knowledge of the rules and practices applied by the boards of directors of listed companies in France«.[99] And it was also given as a reason for action in the Peters report in the Netherlands in 1997, which referred to »increasing interest from institutional investors on the international stock markets, the Netherlands included«.[100]

More recently pressures to introduce and develop codes of corporate governance have come from international bodies like the OECD, which produced its first principles of corporate governance in 1999 and revised principles in 2004, and probably more importantly the EU. A High Level Group of Company Law Experts, chaired by Jaap Winter, recommended to the European Commission in 2002 that, while there should not be a single EU corporate governance code, individual member states should introduce them and they should then be co-ordinated. As the report noted:

> »We believe it is important that Member States designate one particular code of corporate governance as the code with which companies subject to their jurisdiction have to comply, or by reference to which they have to explain how

98 The Bouton Report, for example, referred to »Recent events, particularly revelations of questionable accounting practices, have impacted global companies, ruined shareholders and employees, and led to the disappearance of one of the leading audit firms. This has caused a severe breakdown of trust in the very essence of a market economy, namely the quality of corporate governance and the reliability of financial statements.« (page 2).

99 Vienot I (page 3).

100 Peters Report (page 9).

and why their practices are different. This would also facilitate the co-ordination of the efforts of Member States«.[101]

This approach was accepted by the European Commission which in a Communication in 2003 recommended that:

»Each Member State should progress towards designating a code of corporate governance, designated for use at national level, as the code with which listed companies subject to their jurisdiction are to comply or in relation to which they are to explain deviations«.[102]

The same Communication also promised that the Commission would produce specific recommendations on both directors' remuneration and on the role of non-executive members and supervisory board members in the short term and both of these have now been published.[103] The Code Group which produced the Swedish corporate governance code made specific reference to both recommendations, which at that time were in draft form, in the account of its deliberations and conclusions.[104]

A final pressure leading to individual states adopting corporate governance codes and also to making the codes themselves similar is provided by developments on codes elsewhere, particularly in the UK. For example the report introducing the Tabaksblat code makes specific reference to the Combined Code adopted in July 2003, pointing out that there are more best-practice provisions in the code for the Netherlands but »in terms of substance, there is little difference between the two codes«.[105] Similarly, the group drawing up the Swedish code was well aware of the provisions of other codes elsewhere, for example in the area of board composition[106], even if here it chose to take a slightly different path. In France too the com-

101 Report of the High Level Group of Company Law Experts on a modern regulatory framework for company law; November 2002 (page 73).

102 Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward; Communication from the European Commission; May 2003 (page 17).

103 Commission Recommendation of 14 December 2004 fostering an appropriate regime for the remuneration of directors of listed companies and Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board.

104 Swedish Code of Corporate Governance: report of the code group; Swedish Government Official Reports SOU 2004:130 (page 51).

105 The Dutch corporate governance code: account of the committee's work (point 15).

106 Swedish Code of Corporate Governance: report of the code group; Swedish Government Official Reports SOU 2004:130 (page 39).

mittee which produced the Bouton Report was well aware of developments elsewhere.[107]

THE CURRENT CODES

The result of these various pressures is that the corporate governance codes of each of the four countries examined are remarkably similar, despite the differing national contexts from which they emerge.

In most key areas the codes take broadly the same approach. These are:

- the principle of comply or explain – that the codes are not a strict set of rules which much be observed, but rather a set of guidelines which companies should either follow, or if they do not, explain the reasons for doing so. (The Dutch code uses the slightly different language of »apply or explain« arguing that »explanation constitutes compliance after approval by the general meeting of shareholders«);[108]
- the separation of roles between the chair and the chief executive – that the same person should not hold the same position, although here the French code is an exception;
- the requirement that a high proportion of board members should not be executives of the company – in most cases it is at least half;
- limits on the number of board positions that an individual should hold;
- the existence of a nomination committee, with a majority of independent board members, who nominate future board members, although here Sweden is an exception;
- the existence of an audit committee, made up entirely, or to a large extent, of independent board members; and
- the remuneration for senior executives, who in the UK will be board members, should be set by a remuneration/compensation committee, made up entirely, or to a large extent, of independent board members.

The Annex I sets out in more detail the way that the current codes of corporate governance in the four countries deal with these areas.

107 One example is in the remuneration of directors. Here the report states: »The working group reviewed practices in other countries and the majority of its members felt that it was not advisable to alter the French rules under which the board of directors sets the compensation of the chairman, the chief executive officer and chief operating officers.« Bouton Report; 2002 (page 14).

108 The Dutch corporate governance code: account of the committee's work (point 20).

The fact that the codes are so similar is in line with an earlier study for the European Commission carried out by an international lawyers' partnership, Weil Gotshal & Manges. It looked at the situation in the 15 states which were then members of the EU and concluded that:

> »The corporate governance codes analysed for this Study emanate from nations with diverse cultures, financing traditions, ownership structures and legal origins. Given their distinct origins, the codes are remarkable in their similarities, especially in terms of the attitudes they express about the key roles and responsibilities of the supervisory body and the recommendations they make concerning its composition and practices.«[109]

This report was published in January 2002, before the most recent versions of the codes in all four countries had been published. And since then the similarities have increased rather than decreased. For example, in the Netherlands, while under earlier 1997 Peters recommendations the supervisory board simply »considers whether to appoint from its midst a selection and nomination committee, an audit committee and a remuneration committee«[110], the 2003 Tabaksblat code is much more prescriptive. It states that »if the supervisory board consists of more than four members it shall appoint from among its members an audit committee, a remuneration committee and a selection and appointment committee«.[111] The Dutch code is now much closer to the UK Combined Code which insists on the existence of these three committees (subject, of course, to the »comply or explain« provisions of the Code.)

DIFFERENCES BETWEEN THE CODES

This is not to say that there are no differences between the codes in the four countries. Some of the key differences that remain are set out below (see Annex for further details and the source for the statements on each of the countries in this section).

In France it is still possible for an individual to combine the posts of chief executive and chair, in the classic role of PDG (Président Directeur Général). This is not

109 Comparative Study of Corporate Governance Codes relevant to the European Union and its Member States on behalf of the European Commission, Internal Market Directorate General, Weil Gotshal & Manges; January 2002 (page 74).
110 Peters Report (page15).
111 The Dutch corporate governance code: III.5.

possible under the corporate codes of any of the other three.[112] The Bouton Report considered the arguments both in favour and against the separation of the two roles but chose not to come down on either side.[113] However, in many ways what is surprising about the situation in France is not that the possibility of combining the two still exists, but the distance that France has travelled. Until the law on New Economic Regulations in 2001, it was not possible to separate the two roles in a single-tier board.

Although all four codes call for at least half of the board members (other than employee representatives at board level where these exist) to be non-executives, that is not employed by the company[114], there are differences in the attitude towards board members who represent major shareholders. In the UK, in larger companies at least half the board members must be both non-executives and independent of major shareholders. In the Netherlands too, in a single tier structure a majority of the directors should be both non-executive and independent, while in a two-tier structure no more than one member of the supervisory board may not be independent. But in Sweden it is only required that two board members are independent of major shareholders.[115] And in France there are different rules depending on the ownership structure – where there are no controlling shareholders at least half the board should be independent, but this falls to only one third where there are controlling shareholders.[116]

The UK has tighter rules on the length of time independent board members can serve than the other three. In the UK a board member's independence is questioned after 9 years. In France, the Netherlands and Sweden, they can serve for 12.[117]

112 See Annex page 72.

113 It noted: »One view is that the separation of functions within the board of directors or in the structure of the supervisory board and management board greatly facilitates control over the workings of the company and appraisal of the pre-eminent corporate officer (chief executive officer or chairman of the management board, as the case may be). An alternative view is that the same result can be achieved in a company led by a chairman and CEO thanks to effective specialized committees (audit committee, compensation committee, etc.)«, Bouton Report (page 5).

114 See Annex pages 73. In the UK these requirements apply to FTSE 350 companies. Smaller companies must have at least two »independent non-executive directors« (see Combined Code A.3.3).

115 The report of the group which drew up the code explained why it made this decision: »The rationale for this is the ownership structure commonly found in Swedish stock market companies, a structure with one or several principal owners along with a wider circle of smaller shareholders. This is combined with a generally positive view not only of the principal owners' active exercise of the ownership role but also the special responsibility that they take for the company, including, in many instances, making up the majority on the board of directors.« Swedish Code of Corporate Governance: report of the code group; Swedish Government Official Reports SOU 2004:130 (page 39).

116 See Annex page 73.

117 See Annex page 73.

The Swedish code is the only one to refer to gender balance, which is »to be the aim« in Sweden, if not elsewhere. [118]

And Sweden takes a different approach to the nomination of new board members. In France, the Netherlands and the UK they are nominated by a committee which either entirely (in the case of a single-tier board in the Netherlands) or largely (all other cases) consists of independent, non-executive directors.[119] But in Sweden it is a committee representing the company's shareholders which makes the nominations. This in the words of the group which drew up the Swedish code reflects: the important role played by the Swedish annual general meeting, a positive approach to owners' rights to exercise their ownership role in an active and responsible way, and the different ownership structure found in most Swedish listed companies compared with the case in the United Kingdom, for example«. Overall, the group concludes »The nomination of directors by a committee of the board of directors is foreign to Swedish corporate governance tradition«.[120]

There are, of course, other differences, but, as already stated, it is the similarities which are more striking.

MONITORING OF THE CODES

There are also clear similarities in the way that the codes have been monitored in three of the countries, France, the Netherlands and the UK. In Sweden the code is too new – 2006 is the first full year in which it has applied – for extensive monitoring to have taken place.

Looking only at the monitoring of the most recent version of these three countries' codes, all three produced official reports on progress either at the end of 2005 or the beginning of 2006, although there was a difference between the reports in France and the Netherlands, which looked at how far companies were complying with their obligations and the report in the UK, which looked rather at how the code was working.

The French report »Rapport AMF2005 sur le gouvernement entreprise et le contrôle interne« published in January 2006 was the second report produced by the French financial markets authority on corporate governance, as a result of legisla-

118 See Annex page 74.
119 See Annex page 74.
120 Swedish Code of Corporate Governance: report of the code group; Swedish Government Official Reports SOU 2004:130 (page 30).

tion passed in August 2003.[121] This required companies to provide details of their board practice to the annual general meeting of shareholders. The first AMF report under this legislation covered the year 2004. The report covering 2005 was based on an analysis of 108 companies including all of the CAC 40, the 40 largest companies listed on the French stock exchange.

The Dutch Report, available in English as »Corporate Governance Code Monitoring Committee: report on compliance with the Dutch corporate governance code«, was published in December 2005. It is the first report on the Tabaksblat code. It covers 150 companies with a particular focus on 14 AEX companies with the largest capitalisation on the Amsterdam Stock Exchange.

The UK report »Review of the 2003 Combined Code: findings of the Review« was published by the Financial Reporting Council (FRC), the body which produced the code, in January 2006. It was based on a consultation exercise with 59 responses being received from listed companies, investors and others. In addition the FRC analysed reports monitoring the implementation of the code in 2005, and commissioned an external agency to look at smaller companies (outside the FTSE 350) which are less frequently examined.

In each case the review found that the codes were substantially being complied with and had made an impact in terms of improved corporate governance.

The French report found that »compared with a fairly formal process in the previous year, which was the first year in which the LSF (the new legislation) applied, the reports analysed this year bear witness to important progress in certain areas. Among the examples, one can particularly note the progress made … in providing information on the limitations imposed on the powers of the chief executive, the description of the duties of the board, the evaluation of the work of the board and the efforts which have allowed the production of a report on internal control«.[122] In detail the AMF report found that 76 % of companies said that their boards included one or more independent directors, although in more than a fifth of the cases the definition of independent was not the same as that used in the AFEP/MEDEF corporate governance code; it found that 67 % of reports defined the duties of the board – up from 40 % in the previous year; that 68 % had an audit committee; and that among the 76 % of companies with specialist committees, 67 % had a remuneration committee , in other words just over half the total.[123]

121 La loi de sécurité financière (LSF) passed on 1 August 2003.

122 Rapport AMF 2005 sur le gouvernement entreprise et le contrôle interne; January 2006 (page 20).

123 Rapport AMF 2005 sur le gouvernement entreprise et le contrôle interne; January 2006 (pages 11 to 13).

The Dutch report is significantly more positive. It found that »Although the code is still in its infancy, it is clear that almost everyone is doing everything possible to make a success of corporate governance. The rate of compliance with and application of the code is high«.[124] In detail it found that on average 88 % of the code provisions were complied with, although the Dutch code takes explanation as being compliance. It found that the average rate of application, that is following the code provision, was 81 % and the average rate of explanation was 8 %.[125] On the issue of having only one non-independent board member, the report found that 56 % of companies applied this provision, 18 % explained why they did not apply it, generally because of the need to have key shareholders on the board, and 25 % neither applied it nor explained why they did not.[126]

The report from the Financial Reporting Council in the UK found that »it was the overwhelming view of respondents to the consultation that there has been an improvement in the quality of corporate governance among listed companies since the revised Combined Code came into force« and that »among FTSE 350 companies the percentage of companies choosing to follow the provisions of the Code has increased for the majority of provisions for which comparative data is available«.[127]

This view is broadly confirmed by the analysis of individual companies undertaken by other UK corporate governance monitoring bodies. For example, PIRC, the research body which advises pension funds and other institutional investors on corporate governance issues and other topics and has been critical of some aspects company behaviour states that it does not dispute the FRC's view that the Code is »having a positive impact«, although it does identify a number of areas where there are difficulties. Its 2005 review of corporate governance in 443 companies notes that although full compliance has dropped to 25 % on the new version of the Code compared with 47 % the year before (largely in relation to the 1998 version of the Code) this is not a cause for alarm as »full compliance with the 1998 Code rose year on year, so we would expect to see improvements over a similar timescale [and] 46 % of the FTSE 350 sample comply with the key provisions of the Code. These being

124 Corporate Governance Code Monitoring Committee: report on compliance with the Dutch corporate governance code; December 2005 (page 59).
125 Corporate Governance Code Monitoring Committee: report on compliance with the Dutch corporate governance code; December 2005 (page 15).
126 Corporate Governance Code Monitoring Committee: report on compliance with the Dutch corporate governance code; December 2005 (page 21).
127 Review of the 2003 Combined Code: Findings of the Review; Financial Reporting Council; 2006 (page 5).

separation of roles, composition of committees, three-year election periods and one-year contractual notice periods.«[128]

The broad progress that the reports from France, the Netherlands and the UK identify is largely based on an analysis of written documents – companies' annual reports and other statements. The reality may be very different.

This was certainly the conclusion reached by Bénédicte Bertin-Mourot and Marc Lapôtre when they looked at board practices in France based on interviews with those involved.[129] This concluded that only in a small minority of cases was it possible to see the sort of collegiate control of the company, which good corporate governance would imply. Much more frequent was the »one-man show« where the PDG took all the decisions (about half the cases) or boards where key decisions were not taken at the board itself, but outside by groups of directors, who either represented key shareholders, or, for some other reason, effectively controlled the company.[130]

This study was based on the position before the latest corporate government code was published but Lapôtre is still sceptical of improvements and the role that corporate governance codes can play. He points out that the boards which in practice were more collegiate, were those which did not score very highly on compliance with corporate governance codes and concludes that, »box ticking does not guarantee good corporate governance. Quality of work and debates are more important than formal conformity to corporate governance codes«.[131]

THE ROLE OF EMPLOYEES IN CORPORATE GOVERNANCE CODES

One final common point on corporate governance in all four states, is the fact that references to the role of employees are both infrequent and limited.

128 Corporate Governance Annual Review 2005; PIRC (page 2).

129 The study published as : Gouvernement d'entreprise: fonctionnement des organes de contrôle et rôle de représentants des salariés; Bénédicte Bertin-Mourot and Marc Lapôtre; CARIS Centre; November 2003, was based on interviews with 45 board members, of whom 27 represented the employees, either as shareholders (five) or as a whole (22), and 18 were »classical« board members, as well as interviews with five works council members, with an observer role on the board, and another 15 individuals from consultancies and other bodies involved in corporate governance.

130 Gouvernement d'entreprise: fonctionnement des organes de contrôle et rôle de représentants des salariés (pages 69 to 73).

131 Corporate governance discussions and employees representation at board level in France; Marc Lapôtre; May 2006 (page 37).

This is absolutely to be expected in the UK, where employees have no role at board level. But it is much more surprising in the other three states. It is perhaps in part a result of the fact that the development of corporate governance codes has been strongly influenced by the UK example and the fact that representatives of trade unions have not been involved in drawing up the corporate governance codes.

Whatever the reason, the final outcome is clear: employees have been largely written out of the script.

In France the main reference to the role of employees in corporate governance in the latest code is a single paragraph which simply sets out the current legal position:

> »French legislation has a double specific feature of involving representatives of the works council in proceedings of the board in an advisory capacity, and providing for appointment of one or more directors from among employee shareholders if the employee shareholdings exceed 3 % of the corporate capital, or the possibility of full participation of employee representatives in the board.«[132]

The code makes no references as to the role that these employee representatives could play in corporate governance, although it does suggest that board members representing employees are not seen as independent:

> »An 'independent director' is to be understood not only as a »non-executive director«, i.e., one not performing management duties in the corporation or its group, but also one devoid of any particular bonds of interest (significant shareholder, employee, other) with them.«[133]

This is in contrast to the European Commission recommendation on non-executive or supervisory directors which specifically states that employee directors should be seen as independent »when the non-executive or supervisory director does not belong to senior management and has been elected to the (supervisory) board in the context of a system of workers' representation recognised by law and providing for adequate protection against abusive dismissal and other forms of unfair treatment«.[134]

The corporate governance code in the Netherlands makes no specific reference to board members who have been nominated by the works council. (Dutch legislation does not permit employees of the company to be nominated in this way.) It states only that the supervisory board should include in the regulations governing

132 The Corporate Governance of Listed Corporations; AFEP and MEDEF; October 2003 (page 9).

133 The Corporate Governance of Listed Corporations; AFEP and MEDEF; October 2003 (page 9).

134 Commission Recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board (Annex II).

its operations and duties »a paragraph dealing with its relations with the management board, the general meeting of shareholders and the works council, where relevant« and that the chair of the supervisory board is responsible for ensuring that »the supervisory board has proper contact with the management board and the works council (or central works council)«.[135]

In fact the committee which drew up the code, although it accepted that the lack of trade union involvement meant that it was unsuited to making recommendations on the issue, nevertheless went on to be highly critical of the Dutch two-tier system, which, it noted, was in part there to provide a voice for the works council in the composition of the supervisory board. It stated:

> »It would have been extremely presumptuous of the committee to use the code for proposing amendments to the renewed appointment and dismissal system for supervisory board members of companies with statutory two-tier rules. Having said this, the committee does take the view that the renewed two-tier rules remain complicated, hamper the committee's objective to strengthen the »checks and balances« within listed companies, are difficult to explain to the international community, have a mandatory character that fits ill with the trend towards flexibilisation of company law, constitutes a risk for the important principle in the code that the supervisory board and its members must be able to operate critically and independently, and merely assigns »pseudo-rights of participation« to the works council.«[136]

The reference to the »renewed two-tier rules« indicates that the committee did not consider that the 2004 changes, which were implemented after the code (see pages 35 to 37), but widely discussed beforehand, had changed the situation.

In Sweden, as in France, the corporate governance code limits itself to setting out the current legal position:

> »Employees have the right to representation on the board of Swedish companies. In a few words, in companies with at least 25 employees, employees have the right to appoint two representatives to the board of directors and two deputy members, while in companies with activities in several lines of business and a minimum of 1,000 employees, they have the right to appoint three representatives and three deputies. However, employee representatives may never constitute a majority on the board.«[137]

135 The Dutch corporate governance code; Corporate Governance Committee; December 2003 (III.1.1 and III.4.1).
136 The Dutch corporate governance code: account of the committee's work; December 2003 (point 55).
137 Swedish Code of Corporate Governance: report of the code group (Introduction page 15).

The Swedish code makes no reference to any specific role that these employee directors could play.

In terms of the board's overall work employee representatives are neither defined as independent or dependent in the terms of the Swedish code, as the requirement for a majority of directors to be independent relates only to those »elected by the shareholders' meeting«[138] and therefore does not relate to employee directors, who are not elected in this way. However, the section of the code dealing with the remuneration committee states that it should consist of the chair and other members who »are to be independent of the company and senior management«.[139] This could exclude employee directors, despite the fact that the legislation on employee representation at board level specifically provides for them to be present in board sub-committees.[140]

A further weakening of the position of employee representatives at board level was also proposed by the Commission on Business Confidence, the body which proposed that a corporate governance code should be drawn up. In the report »Industry and Confidence« which it presented in March 2004 it suggested that »the law on board representation for private sector employees is changed, so that the right of deputies of employee representatives to be present at board meetings is limited to that of replacing ordinary members in their absence«.[141] Current legislation provides for deputies to be present at the same time as the full members.[142]

Taken together with the provisions of the code, the labour law experts Niklas Bruun and Magnus Lundberg have written of a »silent reform programme« directed at reducing employee rights at board level[143].

138 Swedish Code of Corporate Governance: report of the code group (3.2.4).
139 Swedish Code of Corporate Governance: report of the code group (4.2.1).
140 The legislation states: »One of the employees' representatives may be present and participate in deliberations when a matter, which is later to be dealt with by the board of directors, is prepared by members of the board of directors or officers of the company specifically appointed for that purpose.« Board Representation Act; 1975 (Section 13).
141 Industry and Confidence: Report from the Commission on Business Confidence; March 2004; SOU 2004:47.
142 The legislation states »An alternate for an employee member of the board of directors is entitled to be present and express her or his view at meetings of the board of directors and at the company's general meetings, notwithstanding that the members are present.« Board Representation Act; 1975 (Section 12).
143 Lundberg, M & Bruun, N (2005) Board representation neglected. Arbetsmarknad & Arbetsliv, no 4/2005.

THE REALITY OF EMPLOYEE REPRESENTATION AT BOARD LEVEL

THE BENEFITS

The failure to pay greater attention to employee involvement at board level in the corporate governance codes of the two countries that have it – Sweden and France – is surprising given the evidence of the benefits that employee involvement brings. (The situation is less clear in the Netherlands, where employee involvement is much more indirect.)

These benefits are most evident in Sweden, where employee involvement is most extensive (employees can elect board members in all companies with more than 25 employees – see pages 23 to 26).

Here studies undertaken by Klas Levinson[144] show that a clear majority of managing directors and chairs in the Swedish private sector companies see employee presence at board level, as a resource that contributes to company vitality and competitiveness.

More than 60 % of managing directors and 70 % of chairs, when asked, »What are your experiences of employee board representation and its advantages or disadvantages for the company?«, respond that they were »very positive« or »rather positive« (see table). Around one quarter (26 %) of chairs and under one third of managing directors are neutral on the issue, reporting that employee board representation is ´equally positive and negative´ for the company. And less than one-tenth have negative experiences. Not a single chair thinks that this form of employee participation is ´very negative´ and only 5 of 411 directors take this view.

The most positive experiences are found in large companies (having over 500 employees), where 70 % of the directors have positive experiences. The age of the director matters (in a significant way); the youngest directors have the least positive assessments.

144 The data comes from an industry-wide survey from 1998 of managing directors, board chairs and employee representatives' experiences of board representation and corporate governance. (Employee representatives on company boards in Sweden Klas Levinson; Industrial Relations Journal. No 3/2001). Data was also obtained in a follow-up survey of the 100 largest corporations in 2005.

Managing directors' and chairs' overall experience of employee board-level representation (n = 411, 326)

	Managing director	Chair
Very positive	19 %	23 %
Rather positive	42 %	46 %
Equally positive and negative	30 %	26 %
Rather negative	8 %	5 %
Very negative	1 %	0 %
Total	100 %	100 %

The 1998 survey also examined why senior company figures took this positive view. It found that nearly two-thirds of both managing directors (64 %) and chairs (61 %) considered that board representation contributed positively to a co-operative climate (see table). The proportion of directors holding this view was highest in the large companies and had increased further by the time of the 2005 survey.[145] Two-thirds of chairs (65 %) and almost as many managing directors (59 %) considered in 1998 that employee board participation made board's decisions better rooted among the employees, and about half of both groups (55 % of chairs and 47 % of managing directors) believed that it was easier to implement tough decisions knowing that employees were on the board. The 2005 survey indicated a slight increase from the 1998 position in the positive appreciation by managing directors and chairs of employee on the boards.

145 The matter of cooperative relations is of great importance in the Swedish model with its emphasis on dialogue and negotiation. The 1998 survey included a question on co-operative relations on the board. The response to »How would you describe the relationship in general on the company board as a whole?« showed that it was »very« or »rather«´ co-operative in 80 % of the companies examined. The existence of a cooperative climate between the parties is by no means limited to the board but permeates the entire company. Another question from the survey shows that the relations between managers and trade unions are »very« or »rather« co-operative in nine out of ten companies. Only four out of 411 managing directors believed that collaboration between management and employee representatives was »rather conflictual« while only one director saw it as »very conflictual«.

Managing directors' and chairs' experience of employee board-level representation in potentially positive areas (n = 411, 326)

	Managing director	Chair
They contribute to a co-operative climate	64 %	61 %
Board decisions are better rooted with the employees	59 %	65 %
Implementation of difficult decisions becomes easier	47 %	55 %

The survey also looked at the activity of employee representatives and it found that that they acted somewhat cautiously and were generally rather passive during board meetings. In half the companies, the representatives »support the suggestions without thorough discussions«. In 40 %, they »consider the suggestions after thorough discussions«. In only 3 %, do employee representatives »demand which issues that should be investigated and proposed«. This rather passive role did not apply where questions concerning personnel matters, reorganisation, production and work environment issues were being discussed. In these areas they were »rather« or »very« active.

Employee involvement at board level is much less extensive in France than in Sweden. But here too the experiences seem positive as indicated by the survey by the IFA (Institut Français des Administrateurs – French Institute of Board Members). Although it was on a much smaller scale than the Swedish survey and therefore its findings need to be treated with greater caution, the IFA survey, which examined both types of employee board members in France – as representatives of all employees and as representatives of employee shareholders – produced similar conclusions.

Looking at the view of the directors who were not employees – both executives and non-executives – it found that the main benefit they saw in having employee representatives at board level was that employees were better informed about the strategic choices facing the company. (Just over one third of executive directors considered that this was the case). Other benefits of their presence were that it worked as a mechanism for presenting to employees the realities of managing the business (just under one third of executives) as well as giving the board of directors a clearer understanding of realities of the company. However, one fifth of the executive di-

rectors did not see any advantage in the presence of employee representatives on the board.[146]

The French survey also looked at the issues on which employee representatives primarily intervened at board level and found that while human resources strategy was a key concern, the second on the list, it was not the only topic they took up at board level (see table).

Issues on which employee representatives primarily intervene at board level

Issues	Percentage
General strategy	45%
Human resources strategy	40 %
Development and investment policy	30 %
Societal interests of company	29 %
Financial issues	19 %
Pay	14 %
Commercial policy	13 %
Prevention of industrial risks	8 %
Sustainable development	6 %
Communications	3 %
Other issues	3 %
Do not intervene	17%

Source: Les administrateurs salariés: un atout pour la gouvernance des entreprises françaises (Etude); IFA; February 2006 (page 5). The figures are based on 71 responses, including 31 from employee representatives.

Overall, the IFA argues that, in order to examine the required diverse range of issues it is necessary to go beyond the classical network of elite managers and create »a bundle of competencies – sectoral, financial, in accountancy, in taxation, and in so-

146 Les administrateurs salariés: un atout pour la gouvernance des entreprises françaises (Etude); IFA; February 2006 (pages 6 to 7). The figures are based on 32 responses – 16 executive and 16 non-executive directors.

cial and societal questions … The more this diversity becomes necessary, the more the presence of competent employee directors is a trump card«.[147]

The idea that employee representatives at board level add something to the debates is also found in the study by Bertin-Mourot and Lapôtre. While it noted that their presence was often a cultural shock, it quoted one PDG who stated that »the employees are the directors who are the best informed of what is happening in the company, the most competent. If they have no ulterior motives, they can be the best directors«. A former board member coming from outside the company also saw their value as a source of expertise: »They bring more than the others to the meetings, more than the management, information about what the work involves, about the technology, about the customers. They bring this industrial approach from being in touch with the business«. Overall, as another independent director observed, »the employees present are less under the heel of management than the others, they have things to defend. They can say things without the PDG becoming resentful. They don't owe their seat to the PDG. The only criticisms come from the employee directors.«[148]

It is much more difficult to identify the specific benefits of the presence of the supervisory board members nominated by the works councils in the Netherlands. This is largely because it is much more difficult to identify how they differ from other members. In contrast to both the Sweden and France, the individuals involved may not be employees of the company. Their links with the works council, once they have been nominated also vary greatly and are often fairly limited. As a result they neither bring direct knowledge of the business to the board, potentially improving its decision-making, nor are they a route back into the workforce, making it easier for employees to understand and support management decisions. However, a series of interviews undertaken by Rienk Goodijk with 20 supervisory board members in large companies found that in general they were »rather satisfied with works councils' involvement in the board selection process to date«.[149]

Although sometimes the supervisory board members nominated by the works council may be more likely to raise employee related issues this is not generally the case and they are more likely to have the same concerns as other members. This was confirmed in a recent study by Dirk Jansen, who is a supervisory board mem-

147 Les administrateurs salariés: un atout pour la gouvernance des entreprises françaises; IFA; February 2006 (pages 8 to 9).

148 Gouvernement d'entreprise: fonctionnement des organes de contrôle et rôle de représentants des salariés; Bénédicte Bertin-Mourot and Marc Lapôtre; CARIS Centre; November 2003 (page 80 to 82).

149 Works Council's right to nominate Supervisory Board members; Rienk Goodijk; 2006 (page 23).

ber at CSM Nederland and Innovam, and Win van Logtestijn. Based on interviews with 15 works council-nominated supervisory board members its overall conclusion was that there was no difference between them and other supervisory board members. It is not clear if this situation will change as result of changes to the nomination arrangements introduced in 2004 (see pages 35 to 37).

THE DISADVANTAGES

It is sometimes suggested that employee representation at board level brings major disadvantages. However, the experiences of both Sweden and France suggest that these fears are largely unjustified.

The 1998 Swedish survey of chairs and managing directors explored the potential negative aspects of employee board-level representation but found little support for most of the alleged negative effects. Only around one-sixth (17 %) of both managing directors and chairs believed that »too many irrelevant issues are taken up« by employees on the board. And only around one in eight (13 % of chairs and 12 % of managing directors) considered that employee participation made decision-making more unwieldy. The fear that employee participation might result in increased risk of conflict among the board members was not borne out by the data – only around one in 15 respondents thought that this risk existed. However, one negative area was revealed by the survey – the increased risk that information might leak. Although still a minority, 40 % of managing directors and 37 % of chairs considered that the presence of employee directors increased the risk of information leaking. In practice, it is rare that this risk actually leads to a leakage of information.

Managing directors' and chairs' experience of employee board-level representation in potentially negative areas (n = 411, 326)

	Managing director	Chair
Increased risk of information leakage	40 %	37 %
Too many irrelevant issues are taken up	17 %	17 %
Decision-making becomes more unwieldy	12 %	13 %
Risk of antagonism on the board	7 %	6 %

The 1998 survey also looked at the length of time employee representatives spent on board issues and found that for half of the companies it was less than 40 hours a year, for one third it was between 40 and 80 hours and only a few spent more than 80 hours a year on board work. This indicates that employee board-level representation is not particularly costly for Swedish companies.

The French IFA survey also looked at potential problems. And one issue clearly topped the list. This was the potential limits placed on a frank exchange of views by the presence of employee representatives. More than half of the executive directors saw this as a problem and it was also viewed as the major problem by other non-employee directors. The second-most important problem identified by executive directors was the potential loss of confidentiality in board discussions, reported by almost half the respondents. Finally around a quarter of all non-employee directors, both executive and non-executive raised the issue of a change in the quality of discussions on strategy adversely affecting the performance of the company.

These concerns are also reflected in the study by Bertin-Mourot and Lapôtre. On the issue of frankness, they quote one PDG who said »In some extreme cases you end up by saying nothing, because you can't say everything in front of them. It is not that there is necessarily a formalised pre-meeting, but certain subjects are not debated«. And on confidentiality, they refer to another who commented »the violation of the secrecy of debates makes it impossible to run the board normally«.[150]

The worries about confidentiality and the quality of strategic discussions, found among French directors, match those of their Swedish counterparts. The concerns about a lack of frankness in board meetings, on the other hand do not seem to be present in Sweden. However, the Swedish study also looked at the experiences of employee board members and just under one third of them (31 % of manual and 28 % of non-manual union members) reported that »decisions were not made at the board but elsewhere«, which may mean that Swedish non-employee board members have got round the problem by having separate discussions, without employee representatives being present.

In the Netherlands, as with the benefits, it is very difficult to identify the negative aspects of the fact that works councils are able to nominate board members – the members they nominate are too similar to the others. The Goodijk interviews with 20 supervisory board members found some fears about how the situation might change, given works councils' new nomination rights (see pages 35 to 37).

150 Gouvernement d'entreprise: fonctionnement des organes de contrôle et rôle de représentants des salariés; Bénédicte Bertin-Mourot and Marc Lapôtre; CARIS Centre; November 2003 (pages 81 to 82).

Some thought the changes might affect boards' independence and lead to »German affairs«, although others considered it would help to extend the circle from which board members were recruited and »break through the old boys' network«.[151] However, these are fears and hopes for the future rather than being based on current or past experience. They therefore need to be treated with caution.

151 Works Council's right to nominate Supervisory Board members; Rienk Goodijk; 2006 (page 23).

CONCLUSION

The overall picture which emerges from this brief examination of corporate governance and employee involvement at board level in the four states is in practice fairly consistent.

France, the Netherlands, Sweden and the UK each have very different experience and legislative structures in terms of:

- their view of the role of companies – just for shareholders or for stakeholders as well,
- their board structure – single tier or two-tier,
- their share ownership patterns – widely dispersed or largely in the hands of controlling owners; and
- the way in which employees are represented at board level – from not at all to a substantial, although always minority presence, in all but the smallest companies.

Despite these differences each of the four has introduced codes of corporate governance, which, as version has followed version, have become more similar. The UK was the first, with the Cadbury report published in 1992, but the others all followed suit and particularly as new elements were introduced to the UK code, they were reflected in the new versions of codes elsewhere.

The reasons for this growing similarity were that each of the codes was dealing with similar problems, in particular financial scandals and in some cases company collapses, as well as concern over the high level of directors' pay. In addition there was a perceived need to respond to the growing shareholdings of non-national investors in all four countries, as well as to the messages coming from the European Union. The codes in many ways were also similar because they were written in full knowledge of developments elsewhere, particularly in the UK.

The result is that despite some variations, as a result of specific national circumstances, the current versions of the codes in the four states, all produced in 2003 or 2004, have a broadly similar approach to the key issues:

- the comply or explain principle;
- the separation of the roles of chief executive and chair (although France is an exception);
- the need for a high proportion of board members to be independent of the company; and

- the existence of nomination, audit and remuneration committees with a high proportion of independent members (Sweden is an exception in the area of nomination committees).

There are also similarities in the way that the codes have been monitored and the broad picture that emerges, at least from an examination of formal practice, is that the corporate governance codes have been largely complied with.

However, what is also striking is the way that the codes have in no sense incorporated individual countries' experience of employee involvement at board level. The codes themselves are essentially silent on the issue, and where views are expressed they tend to be hostile.

This cannot be because the experience of employee board-level representation has been negative. Research in both Sweden and France, the two countries where employees themselves are present at board level indicates clear benefits. They provide an effective channel of communications with employees, allowing employees to understand better why specific decisions have been taken and contributing to improved co-operation and knowledge on both sides. The disadvantages seem much less significant relating primarily to a fear that information may be leaked and that it becomes more difficult to have frank discussions. The evidence for the Netherlands, where employee representation is indirect, is less clear, largely because the differences between supervisory board members nominated by the works council and those nominated in some other way are much less obvious.

These positive experiences of employee representation at board level in Sweden and France are in no sense reflected in the corporate governance codes of the two countries. This may be because of the composition of the groups which drew them up –coming from the corporate world rather than broader society. It may also be because the model which seems to have influenced them most strongly – that of the UK – itself has no employee representation at board level.

Whatever the reason, employees are left with no effective role or voice in these corporate governance codes. This seems a shame because the evidence suggests that employees' participation brings clear benefits. In the world of corporate governance employee representatives at board level are a forgotten resource.

ANNEX: A COMPARISON OF CORPORATE GOVERNANCE CODES

	France	Netherlands	Sweden	UK
Date of most recent version of code	October 2003	December 2003	December 2004	July 2003
Comply or explain principle	Listed corporations should report with particulars, in their reference documents or in their annual reports, on implementation of these recommendations and, if applicable, explain the reasons why any of them may not have been implemented (19).	Unconditional freedom to decide whether or not to apply the code is not desirable … the flexibility is limited by the obligation of listed companies to explain in their annual report whether, and if so why and to what extent, they do not apply the best practice provisions of the corporate governance code (known as the ›comply or explain‹ principle) (Preamble 6).	The Code is intended to form part of self-regulation in the Swedish business sector. It is based on the principle »comply or explain«, which the majority of foreign codes follow. Under this principle a company following the Code may depart from individual rules; however, in that event, it must provide an explanation stating the reasons for each departure reported. (1.3).	While it is expected that listed companies will comply with the Code's provisions most of the time, it is recognised that departure from the provisions of the Code may be justified in particular circumstances. Every company must review each provision carefully and give a considered explanation if it departs from the Code provisions (Preamble).
Separation between chief executive and chair	Can choose either separation of chief executive and chair or combining the two posts in one individual in a single-tier board. It is also possible to have a two-tier board structure (3.1).	In a two-tier structure the chair of the supervisory board is not a member of the management board. In a single-tier structure, the chair of the management board shall not also be an executive director (III.8.1).	Chair cannot have tasks which are part of of the managing director's responsibilities in the day-to-day management of the company. (3.4.3).	Same person should not be chief executive and chair (A.2.1).
Chief executive can go on to be chair	No barrier	In a two-tier structure the chair of the supervisory board should not be a former member of the management board (III.4.2). In a single-tier structure the chair of the management board shall not also have been an executive director (III.8.2).	Nominating committee must give »special cause« for its proposals if it suggests that the outgoing managing director should become the chair (3.4.2).	Should not normally happen. If board decides that »exceptionally« it wishes to do this, it should consult major shareholders in advance (A.2.2).

	France	Netherlands	Sweden	UK
Date of most recent version of code	October 2003	December 2003	December 2004	July 2003
Non-executive directors on board	By law no more than one third of the board can be employed by the company. (This does not include employee representatives or representatives of employee shareholders.) (Code de commerce L225-22).	In a two-tier structure no more than one member of the supervisory board may not be independent (III.2.2). In a single tier structure, the majority of the directors shall be both non-executive directors and independent (III.8.4).	No more than one person from senior management – normally the managing director – may be a member of the board (3.2.3).	At least half the board (in larger companies) excluding the chair should be made up of independent **non-executive** directors. In smaller companies (outside the FTSE 350) at least two directors should be independent **non-executives** (A.3.2).
Independent directors on board	In companies without controlling shareholders, independent directors should account for half the members of the board. In other cases they should be at least one third. (8.2)	In a two-tier structure no more than one member of the supervisory board may not be independent (III.2.2). In a single tier structure, the majority of the directors shall be both non-executive directors and independent (III.8.4).	A majority of the board elected at the shareholders meeting (that is excluding employee representatives) should be independent of the company and its management (3.2.4) and at least two of these should also be independent of major shareholders (3.2.5)	At least half the board (in larger companies) excluding the chair should be made up of **independent** non-executive directors. In smaller companies (outside the FTSE 350) at least two directors should be **independent** non-executives (A.3.2).
Definition of independence in relation to major shareholders	Considered independent provided they do not take part in control of the corporation. Their independence should be reviewed if the shareholder controls more than 10% of the shares or votes (8.5).	Not considered independent if they or the company they represent control at least 10% of the shares of the company. This does not apply if the two companies are part of the same group (III.2.2.e and III.2.2.f).	Not considered independent if represent or are employed by a major shareholder, defined as a company controlling 10% or more of the shares or votes (3.2.5).	Not independent if represent »a significant shareholder« (A.3.1).
Length of time can serve on board	Not independent if have served on board for more than 12 years (8.4).	Supervisory board members may not serve more than three four-year terms (12 years in total) (III.3.5).	Not independent if have served on board for more than 12 years (3.2.4).	Independence likely to be doubted if served more than nine years (A.3.1).

	France	Netherlands	Sweden	UK
Date of most recent version of code	October 2003	December 2003	December 2004	July 2003
Number of positions that can be held	No more than four other directorships in listed corporations not affiliated to group (17).	Supervisory board members cannot serve on more than five boards (holding the chair counts double) (III.3.4).	Should not have »so many other duties that he or she is unable to devote the necessary time and care to the company's work« (3.3.1).	No individual should chair two FTSE 100 companies (A.4.3) and no executive director should have more than one non-executive post in another FTSE 100 company (A.4.5).
Gender balance	Not referred to.	Not referred to.	»An equal gender distribution on the board is to be an aim« (3.2.1)	Not referred to.
Appointment of directors	Nominations made by a nominations committee which may be the same as the compensation committee (16). But if it is a separate committee, it should have a majority of independent directors and should not contain any senior executives. In contrast to the compensation committee, the chair should be involved (16.1). The nominations committee is responsible both for the nomination of directors (16.2.1) and a plan for the replacement of senior executives, although here the chair should not chair the committee (16.2.2).	If supervisory board has more than four members it should set up a selection and appointment committee (III.5 Principle). It should not contain more than one non-independent supervisory board member (III.5.1). This committee should make proposals to the supervisory board for appointments and reappointments of supervisory board and management board members (III.5.13). In the case of a single-tier board the appointments committee should consist only of non-executive directors (III.8.3).	Nominations made by a nominations committee representing company's shareholders (2.1.1 and 2.2.1). It should have at least three members and a majority should not be board members (2.1.2). The managing director and other senior executives are excluded and if a member of the nominations committee represents a particular shareholder, this should be stated. (2.1.3).	Nominations made by a nominations committee consisting of existing board members with a majority of independent non-executive directors (A.4.1).
Period of office	Should not exceed four years (12).	Management board members: maximum of four years (II.1.1). Supervisory board members: four years (III.3.5).	One year at a time (3.2.6).	Re-elected every three years (A.7.1) but period of notice should not exceed one year (B.1.6).

	France	Netherlands	Sweden	UK
Date of most recent version of code	October 2003	December 2003	December 2004	July 2003
Audit committee	At least two third of the members of the audit committee should be independent board members and it should not include any senior executive (14.1).	If supervisory board has more than four members it should set up an audit committee (III.5 Principle). It should not contain more than one non-independent supervisory board member (III.5.1). In the case of a single-tier board the audit committee should consist only of non-executive directors (III.8.3).	Audit committee of three directors, none of whom should be senior executives. A majority of the committee should be independent of company and its management and at least one should be independent of major shareholders. An audit committee may not be necessary in smaller companies provided director from senior management does not take part (3.8.2).	Audit committee of three directors (two in smaller companies) who should all be independent non-executive directors and at least one of whom should have »recent and relevant financial experience« (C.3.1).
Senior executive remuneration	Law provides that board of directors set the pay of chair (Code de commerce L225-47), chief executive and senior executives (Code de commerce L225-53). Compensation committee should have a majority of independent directors and should not include any senior executives (15.1).	If supervisory board has more than four members it should set up a remuneration committee (III.5 Principle), to make recommendations to supervisory board on executive pay. It should not contain more than one non-independent supervisory board member (III.5.1) The remuneration committee should not be chaired by the chair of the supervisory board or by a supervisory board member who is a member of a management board at another listed company (III.5.11). It should not contain more than one member who is a manager at another listed company (III.5.12). In the case of a single-tier board the remuneration committee should consist only of non-executive directors (III.8.3).	Proposals made by a remuneration committee of board members who are »independent of the company and senior management«. A remuneration committee may not be necessary in smaller companies provided director from senior management does not take part (4.2.1).	Decided by remuneration committee of three directors (two in smaller companies), who should all be non-executive directors (B.2.1 and B.2.2).

	France	Netherlands	Sweden	UK
Date of most recent version of code	October 2003	December 2003	December 2004	July 2003
Presentation of remuneration to annual general meeting	Annual report should include section on remuneration but there is no requirement in the Code for it to be voted on separately at AGM (15.3.1). However, the law was changed in July 2005 to require a vote on unusual elements in the pay of executives, including payments on leaving office, (Code de commerce L 225-42-1).	Remuneration policy for future years should be submitted to AGM for adoption and supervisory board should determine remuneration of members of the management board on the basis of a proposal from the remuneration committee within the scope of this policy (II.2 Determination and disclosures of remuneration principle).	Company policy on remuneration is presented to AGM for its approval (4.2.2).	Law requires companies to present an annual report on directors' remuneration to be presented to AGM for an advisory vote (Directors' Remuneration Regulations 2002).

The codes covered are:

France: The Corporate Governance of Listed Corporations (Le gouvernement d'entreprise des sociétés cotées), which consolidated recommendations of the Viénot reports of July 1995 and July 1999 and the Bouton Report of September 2002): AFEB/MEDEF October 2003.

Netherlands: The Dutch corporate governance code (De Nederlandse corporate governance code): Corporate Governance Committee; December 2003.

Sweden: Swedish Code of Corporate Governance (Svensk kod för bolagsstyrning) SOU 2004:130: produced by the Code group; December 2004.

UK: The Combined Code on Corporate Governance: Financial Reporting Council July 2003.

CORPORATE GOVERNANCE AND EMPLOYEE BOARD-LEVEL REPRESENTATION IN SWEDEN: EXECUTIVE SUMMARY

Klas Levinson

A SYSTEM WHICH WORKS WELL

The current debate on corporate governance in Sweden and the reforms that have resulted from it have paid little attention to the issue of employee representation at board level. This is in glaring contrast to the heated discussions that took place in the 1970s when employee representatives gained the legal right to participate in company governance and management, as a result of the Board Representation Act.

One plausible explanation of the low profile of this issue in the current debate on corporate governance is that the system of employee board-level representation is functioning well and is able to deliver advantages that are appreciated both by managers and shareholders, and by employees and trade union representatives. The picture that emerges from this report's review of the empirical evidence would certainly support this. The Swedish system which places employee representatives on the company boards on the whole works well. An industry wide survey from 1998, with a follow-up in 2005, of 660 companies reveals that the majority of managing directors and chairmen of the boards have a positive experience of employee representation on company boards. They see employee board-level representation as a resource that contributes to positive relations, makes board decisions better rooted among employees, and facilitates the implementation of difficult decisions. Many of the fears of an increase in bureaucracy and leakage of information that were heatedly debated when the Board Representation Act came into force, have been shown to be greatly exaggerated.

Managers and board chairs are not the only winners. As the data reveals, employees and local unions benefit from taking part in the governance of companies. In the majority of local trade unions in Swedish industry, board-level representation helps union activities. Together with participation in management of day to day issues provided by another piece of legislation, the Employment (Co-determination

in the Workplace) Act – known by its Swedish initials as the MBL, board-level representation has led to a broadening and deepening of the activities of local unions.

These mutually positive effects mean that employee board-level representation can be seen on the whole as an example of what social scientists sometimes describe as a »win-win« situation.

RECENT DEBATE AND REFORMS OF SWEDISH CORPORATE GOVERNANCE

There have been a number of changes in corporate governance in Sweden in the past few years. These include a corporate governance code, based on the principle of »comply or explain« (the Swedish Code of Corporate Governance), a government suggestion for new legislation regulating directors' remuneration and a recent government initiative on possible measures to increase the proportion of women on the boards of listed corporations. Although the focus of these changes is not on employee board-level representation, they include elements that could be negative for employee representatives´ position on the board.

THE VIEW OF DIRECTORS

A clear majority of the managing directors and chairs in the Swedish industrial and commercial sector see employee presence at board level as a resource that contributes to board and corporate effectiveness. More than 60% of managing directors and 70% of chairs, when asked, »What are your experiences of employee board representation and its advantages or disadvantages for the company?«, respond that they were »very positive« or »rather positive«. The most positive experiences are in large companies with more than 500 employees. Around one quarter (26%) of chairs and under one third of managing directors are neutral on the issue, reporting that employee board representation is ´equally positive and negative´ for the company. And less than one- tenth have negative experiences. Not a single chair thinks that this form of employee participation is ´very negative´ and only 5 of 411 directors take this view. Statistical analysis reveals that directors' age matters; the youngest directors have the least positive assessments.

Nearly two thirds of company managing directors and chairs consider that employee board-level representation contributes positively to co-operative relations

between employees and management. They also believe that it makes board decisions better rooted among employees. Most find it is easier to make tough decisions knowing that employees are represented on the board and they believe that difficult restructuring processes are made easier by the fact that employees are present when these decisions are made at board level.

The survey also looked at a number of negative statements on employee board-level representation such as »It interferes with effective decision-making« or »It is too costly«. The results provide very little support for the fears that board-level representation risks slowing down the work of the board or increasing conflicts within it. Only around one-sixth of company managing directors and chairs believe that it leads to »too many irrelevant issues being taken up«. And only one in eight thinks that employee board-level representation makes decision-making »more unwieldy«.

EFFECTS OF BOARD REPRESENTATION ON EMPLOYEES AND LOCAL UNIONS

Employee board representation, together with the co-determination arrangements of the MBL, provides local unions with mechanisms for influencing the governance and management of companies in a way that has extensively broadened and deepened their activity at company level. Most union leaders in Swedish industry find board-level representation useful for union activity. Two-thirds of manual union representatives (LO members) and a somewhat lower percentage of non-manual (PTK) representatives believe that work on the board has been either »of great use« or »of some use« for union activities. Only a small proportion (6% of LO and 11% of PTK representatives) consider that it has been of very little use.

An open-ended question in the 1998 survey helps to indicate some areas where board-level representation has proven beneficial for local union work.

»We learn about future scenarios and prospective hot-spots at board meetings rather than at local MBL negotiations«

»We get an increased understanding of the conditions for company business and competitiveness«

»At internal union discussions we can readily understand how the company will react to our proposals«

»If we have problems with management we can take up these issues at the board«

»We have a voice when it comes to appointing new managing directors«

»Really half-baked proposals are never taken up since the company does not want anything to be accepted with inner reservations«

EMPLOYEE REPRESENTATIVES' BEHAVIOUR ON THE BOARD

The survey from 1998 reveals that employee representatives act somewhat cautiously and are generally rather passive during board meetings. In half the companies, the representatives »support the suggestions without thorough discussions«. In 40%, they »consider the suggestions after thorough discussions«. In only 3%, do employee representatives »demand which issues should be investigated and proposed«. This rather passive role does not apply where questions concerning personnel matters, reorganisation, production and work environment issues are being discussed. In these areas they are »rather« or »very« active.

Employee representatives are very rarely involved in the crucial activities of setting agendas, formulating problems and solutions. One explanation for the cautious behaviour of employee representatives in many matters discussed by the board is that they choose to concentrate on issues that directly affect the workforce, such as, production and environmental matters. Another element is that they might find it less meaningful to act in a forceful way since they know that managers and the representatives of the shareholders have the freedom to formulate problems and make decisions.

CORPORATE GOVERNANCE AND EMPLOYEE BOARD-LEVEL REPRESENTATION IN THE NETHERLANDS: EXECUTIVE SUMMARY

Robbert van het Kaar

INTRODUCTION

In recent years, there have been major changes in the Dutch system of corporate governance, and more changes are to come. This report contains an analysis of (changes in) the system of corporate governance in the Netherlands, with particular reference to their consequences for employee participation.

THE DUTCH TWO-TIER BOARD SYSTEM

Traditionally, boards in the Netherlands have a two tier structure: an executive board and a separate supervisory board. Most medium and large companies have installed a supervisory board and are obliged to do so if their issued capital and reserves pass the threshold of € 16 million and they employ at least 100 employees. These companies are so-called structure law companies. The supervisory board has a veto-right on all major decisions taken by the executive board, and appoints and dismisses the members of the executive board. However, when the majority of the employees of a group of companies covered by structure law works outside the Netherlands, the members of the executive board are appointed by the Annual General Meeting (AGM) of shareholders.

By law, members of the supervisory board are not allowed to represent partial interests, be it of shareholders, employees, banks or others. This is a core feature of the Dutch system, and sets it apart from systems such as in Germany, Austria and Sweden. In this sense, there is no real employee participation at board level in the Netherlands.

The rules governing the composition of the supervisory board were introduced in 1971 and modified in 2004. In the present system, the shareholders' AGM appoints

the supervisory board and has the right to dismiss the supervisory board (only the board as a whole, not individual members). Prospective supervisory board-members are nominated to the AGM by the supervisory board itself. Works councils have the right to propose candidates to the supervisory board and the supervisory board should accept these candidates up to a maximum of one third of the total of the supervisory board membership (the so-called enhanced right of proposal). The AGM can reject the candidates nominated by the supervisory board, but then the whole procedure starts again, including the possibility of the works council proposing candidates.

In principle, listed companies with the majority of their employees working outside the Netherlands, do not have to apply structure law at the highest level of the group, but are allowed to do so at a lower level, usually the holding company of the subsidiaries in the Netherlands. In the past, Dutch listed international companies voluntarily applied structure law at the highest level, but many recently have ceased to do so.

EMPLOYEE BOARD LEVEL PARTICIPATION IN PRACTICE

In the past, only a minority of works councils has actively used their rights to propose supervisory board members. At present, still only about half of the works councils in structure companies use their right of proposal. There appears to be a connection between use of the right and other parties' attitudes towards works council involvement in supervisory board nominations. The works councils' involvement in drawing up a profile for the supervisory board seems to be of particular importance in determining whether the works council makes use of its rights or not. Works councils in companies with a Dutch parent seem to be more actively involved in the board member (s)election process than works councils in a subsidiary or division of a foreign parent company. Where ownership is dispersed between many shareholders works councils have used their right of proposal more frequently. It seems likely that concentrated ownership provides a strong position for major shareholders to influence the selection and election process.

The frequency and intensity of contacts between supervisory board members nominated by the works council and the works council itself varies substantially: from virtually non-existent to remarkably close, especially in times of crises. On average, there is quite some distance between the works council and supervisory

board-members. On the whole, supervisory board members nominated by the works council do not differ significantly from other supervisory board members.

INDEPENDENCE OF THE SUPERVISORY BOARD AS A KEY FEATURE OF THE DUTCH SYSTEM

As stated above, an essential feature of the Dutch system is that members of the supervisory board are expected to be independent, in several senses. This is true for all members of all types of supervisory boards, not only the boards of companies subject to the structure law.

Firstly, members of the supervisory board are not allowed to be an employee of the company, or one of its subsidiaries. The reason for this is that employees are in a dependent position towards management, and this cannot be reconciled with the function of supervision of management by the supervisory board. Union officials who are involved in collective bargaining in the business are also banned from being a member of the supervisory board of that company.

Secondly, members of the supervisory board are required to operate in the interest of the company as a whole, including the undertakingand the business linked to it. In other words: they are not allowed to represent any interest group participating in the company and the undertaking, be it shareholders, employees or outside interests, such as a bank.

Both statements above are in need of some qualification however. With regard to the ban on employees being a member of the supervisory board it should be stressed that it is not forbidden for employees higher up in a group of companies to be a member of the supervisory board of a subsidiary company. This is in fact more the rule than the exception in all those companies where the supervisory board is established at the level of the Dutch sub-holding, while the parent company is outside the Netherlands. It is also true for those multinational companies with their HQ in the Netherlands with the majority of their employees outside the Netherlands (like Philips, AkzoNobel, ING, ABNAmro etc – in fact all major Dutch multinational companies). In those companies the supervisory board is established at the level of the sub-holding covering the Dutch activities of the group. It is not unusual that at least some of the seats on the supervisory board are occupied by employees (executives) from higher up in the group.

On the issue of acting in the interest of the company and the undertaking as a whole (and not in any partial interest), it should first be stressed that this is the legal

requirement in Dutch company law, and the extent to which this norm is abided by is not very clear. This is partly due to the norm itself: What is the meaning of 'the interest of the company and the undertaking linked to it'? In the case of the Netherlands, it is clear that the interest of the company and the undertaking can not simply be reduced to 'the interest of the shareholders'. The interest of the company and the undertaking is more than that, and is also comprised of the interest of other stakeholders, amongst them, the employees. But this does not say anything about the relative weight to be given to these different interests which now and then (but do not necessarily always) collide.

TENDENCY: MORE INFLUENCE FOR SHAREHOLDERS

Traditionally, most Dutch listed companies are well protected against hostile takeovers. Since the beginning of the 1990s, the defensive measures used by companies have come under attack. The pressure has come from shareholder activism, and from both Dutch and EU legislation. Recent legal changes include:

- the introduction of a veto right for the general meeting of shareholders with regard to major strategic decisions that affect the identity of the company (e.g. major investments or divestments, mergers or de-mergers etc.).
- introduction of a limited right of instruction. This gives the general meeting of shareholders greater powers to influence or restrict the room for manoeuvre of the management board.
- the right of holders of certificates of shares to vote. There are however a few important restrictions on the right to vote by proxy. In case of a hostile takeover bid, and also when the owner(s) of certificates of shares own 25% or more of the outstanding capital, or when the shareholder (i.e. the foundation owning the shares) is of the opinion that proxy voting is not in the interest of the company, the proxy voting right may be restricted or cancelled.

More changes are pending, for example a further restriction of the use of defensive measures through the implementation of the 13th EU-directive on public takeover bids.

The main effect of these measures is (or will be) that the position of shareholders and the AGM is strengthened in relation to the board. Arguably, this weakens the relative position of works councils, because their rights are linked to decisions taken by the board.

PRIVATE EQUITY ACTIVISM

A recent development in the Netherlands is a more activist stand by private equity investors, hedge funds, and other (institutional) investors. These funds have in recent years built up sizable holdings in Dutch listed companies. At the end of 2003 some 80% of the shares in Dutch listed companies were owned by foreign investors, and this figure has probably increased since then. Around half of the Dutch shares are owned by European investors and around 25% by investors from the US.

These funds have started to criticise the policy of the board of several listed companies and in several cases have succeeded in reaching their aims (blocking proposals, changing the corporate structure etc.). This shareholder activism also puts pressure on the traditional Dutch two-tier board structure. The main reason is that members of the supervisory board feel obliged to get involved more intensely with the management board, with the consequence that –in the more extreme cases- the chairman of the supervisory board gets to resemble the chairman of the board in a (Anglo-Saxon) one-tier structure.

THE DUTCH CORPORATE GOVERNANCE CODE

On 9 December 2003 the Tabaksblat-committee published the Dutch corporate Governance Code, consisting of a list of principles and (more detailed) recommendations. The code is meant in the first place for listed companies, but most of the principles are also considered good (or best) practice for non listed companies in the private sector.

At the heart of the code is the so-called 'apply-or-explain' principle: companies are supposed to apply the code's principles and if not, explain why they chose not to apply. This principle has become part of Dutch company law: the extent to which the principles of the code are applied has to be explained in the annual accounts.

Criticism came from different directions, and was of varying content. Shareholder representatives have generally welcomed the code, although some expressed the view that the code did not go far enough. The employee-side has pointed out that, although in the introduction to the code the Tabaksblat committee pledges allegiance to the stakeholder view on companies, employees and employee representatives only figure marginally in the code itself. There were also no employee representatives on the various committees involved. Representatives of boards of directors and supervisory boards have criticised the recommendations on remu-

neration and on the restriction in the number of terms on the board allowed. A more general point of criticism was the rather detailed character of the code.

The Tabaksblat committee has furthermore made several wider statements on corporate governance issues. In one such statement, the committee shows itself as an opponent to structure law. In retrospect, statements made by the committee (partly in interviews with the press) have helped to change the corporate governance climate in the Netherlands in a shareholder-friendly direction.

THE RIGHT OF INQUIRY (ENQUÊTERECHT)

Another unique element of the Dutch system is the right of inquiry. This arrangement was established in 1971, the same year that the arrangement for employee participation in the supervisory board of large companies (the structure law, structuurregeling) was created. As with the structure law, the creators of the arrangement were aiming to put capital and labour on an equal footing. In this case however, labour was not to be represented by works councils, but by the unions. Through the arrangement, both shareholders and unions acquired the right to request the court to start an investigation into a company when there were serious doubts about the soundness of its policy. Over the years, the arrangement has gained in importance, and has also entered the domain of corporate governance.

One thing that is striking is that in the vast majority of the several hundred court cases/requests for an inquiry, the request was made by shareholders. Only in some twenty cases has the request been made by the unions. As far as the employee-side is concerned, the most recent phenomenon is that the right of inquiry in two cases (both in 2005) has been granted to the works council, by the management board of the company.

CONCLUSION

The three main players in the corporate governance area are the shareholders, the board (executive and supervisory board) and, arguably, the employees and their representatives. The main development of the past ten to fifteen years in the Netherlands is the strengthening of the position of the shareholders, due partly to shareholder activism and partly to legislation. As such the position of employee representatives in the company has not been weakened. But indirectly, it has. The main

reason is that the room for manoeuvre of the board has been restricted relative to the shareholders. And because the decisions of the board are the anchor point for co-determination in its different forms, the room for manoeuvre of employee representatives has been restricted as well.

With regard to employee participation at board level, the main feature of the Dutch system is that in fact such participation does not exist, because the key feature of the system is the independence of the supervisory board. There is only a very weak link between employees and the supervisory board. What should be stressed however is, that unlike in Germany, worker influence on strategic issues takes place through the works council, and not so much through the supervisory board. This influence can be qualified as strong, at least in a formal sense, and is at present on the whole undisputed.

CORPORATE GOVERNANCE AND EMPLOYEE BOARD-LEVEL REPRESENTATION IN THE UK: EXECUTIVE SUMMARY

Lionel Fulton

THE STRUCTURAL AND LEGISLATIVE FRAMEWORK OF UK COMPANIES

The private sector dominates the UK economy, employing almost 80% of the total workforce. Most of these people work in companies, and most of them – 57% – work in large companies, those with more than 250 employees.

There is little difference in UK company law between different types of company, although significantly different requirements apply to the 1,300 or so companies listed on the London Stock Exchange.

UK company law is based on a complex series of statutes going back to 1844 and in 1998 the then recently elected Labour government promised a modern framework for company law. Despite the hopes of some, including the TUC the union confederation, that this process of company law reform would allow wider concerns to be taken into account in considering in whose interests companies operated, it soon became clear that the government did not plan a radical change in this area. Instead the government has opted for the »enlightened shareholder value« view of the duties of directors, which states that they must act in the interests of shareholders, even if it sometimes may make sense to take other interests into account. The government has even backed down on a proposal to require listed companies to provide additional information to shareholders.

CORPORATE GOVERNANCE CODES

While there has been little progress in terms of legislation, concern both about specific financial scandals and the high level of directors' pay has led to a number of reports on corporate governance being produced by leading business figures. Beginning with the Cadbury report in 1992, these reports have in turn resulted in a series of codes on corporate governance for listed companies, culminating first in

the Combined Code of 1998 and then in a revised version in 2003. The major difference between the first and second versions of the Combined Code is a much greater emphasis on the role of non-executive directors, following the Higgs report in 2003.

At the same time the pressure on directors' pay has been such that legislation was introduced in 2002, allowing shareholders to vote on the issue, although the vote itself is non-binding.

The current version of the Combined Code sets out a series of main principles and supporting principles. Like all its predecessors it is not a strict set of rules but is based on the concept of »comply or explain«. Companies must either comply with the code, or explain why they have chosen not to. It is up to shareholders to decide whether they accept the explanations.

The main elements of the current Combined Code are that:

- there should be a separation of roles between the chair of the company and the chief executive – the same individual should not hold both positions;
- at least half the board, excluding the chair, in larger and medium-sized companies, should be made up of independent non-executive directors, and directors are likely to cease to be independent, if they have close links with the company, including being shareholders, or have been on the board for more than 9 years;
- directors should be chosen by a nomination committee with a majority of independent directors;
- directors' performance should be evaluated;
- executive directors' pay should be set by a remuneration committee of independent non-executive directors and a substantial proportion of that pay should be linked to performance;
- the board should have an audit committee of independent non-executive directors;
- the chair should have regular discussions with major shareholders; and
- the company should arrange for the votes at Annual General Meetings of shareholders to be recorded.

The general view is that the code has led to an improvement in company behaviour. The official Financial Reporting Council reported in 2006 that »it was the overwhelming view of respondents to the consultation that there has been an improvement in the quality of corporate governance among listed companies since the revised Combined Code came into force«. And this view is supported by other independent observers, although significant problems remain in the area of directors' pay.

THE ROLE OF SHAREHOLDERS IN CORPORATE GOVERNANCE

The UK system of corporate governance is based on the concept of there being a significant number of shareholders who invest on a long-term basis in companies and engage regularly with company management. And there are a number of codes and statements of principle in the UK which encourage this approach. These include part of the Combined Code itself, addressed to institutional investors, a statement of principles produced by the ISC, the body representing major institutional investors, such as pension funds and insurance companies, and a set of principles for pension funds, known as the Myners principles, after the man who produced the report which drew them up. They all include measures to encourage institutional investors to become involved with companies to improve their performance, in some cases setting out a series of steps to be taken to enable this to occur.

It has become easier to judge progress in the corporate governance area because of the emergence of a number of independent monitoring bodies who provide information on company compliance with the Combined Code. Among the most important are RREV (initially a joint venture between the National Association of Pension Funds and a US corporate governance monitoring company Institutional Shareholder Services, now wholly owned by Institutional Shareholder Services), PIRC (a monitoring body initially set up by local authorities) and a third group Manifest.

The available evidence suggests that these codes have had some impact both on the extent to which institutional investors have taken up the issue of corporate governance and on the behaviour of companies themselves.

For example the Investment Management Association, the body which represents major fund managers, found that in 2005 its members were devoting increased resources to corporate governance issues, and those choosing fund managers were paying greater attention to them. On the other hand, an earlier survey of pension funds in 2003 found that only 15% of funds had decided to take a more activist approach to their investments. However, these funds were the larger funds, representing 51% of all pension scheme membership. There is also evidence of increased levels of voting at shareholder AGMs, with the average proportion of shares voted rising from 50% in 2000 to 59% in 2006.

In terms of the impact on companies' behaviour, it is possible to identify some companies where shareholder intervention has produced changes, often in the level or structure of directors' remuneration. However, public intervention in terms of dissenting votes at AGMs continues to be very much the exception, although there may be more happening behind the scenes.

It is also difficult to measure whether adherence to high corporate governance standards has a positive effect on companies' performance, although some research by Deutsche Bank and other shows some evidence of a positive relationship between corporate governance and profitability.

One interesting development is that the proportion of shares in listed UK companies owned by the main domestic institutional investors has fallen – from 60% in 1992 to 38% in 2004. This has been offset by the growth of overseas holdings – up from 13% to 33% in the same period – and in the growth of holdings of other financial institutions – up from close to zero to 11%. This in part reflects the growing internationalisation of institutional shareholdings, with UK pension funds holding more non-UK assets and foreign funds holding more UK shares, for example. But it may also be the result of the growth in holdings of other types of shareholder such as hedge funds, who may be less concerned with long-term shareholder engagement.

EMPLOYEE PARTICIPATION AT BOARD LEVEL

There is no legal basis for employee participation at board level in the UK. Although pressure for »industrial democracy« resulted in a White Paper in 1978, which in time could have led to employee participation at board level, the proposals were abandoned by the Conservative government elected in 1979. Since then there have been a very few examples where employee representatives have been present at board level, generally in companies which were either employee-owned or publicly-owned, but these have been very much the exception.

The TUC hoped to use the debate on company law reform to re-open the issue but the government rapidly made it clear that it was unwilling to move in this direction. The TUC has called on trade unionists to be considered for non-executive directorships, and has spoken positively of the Dutch arrangements as a possible way forward. However, there is no evidence, apart from a tiny handful of former senior trade union figures, that this call has been heeded.

EMPLOYEE PARTICIPATION AS PENSION FUND TRUSTEES

Member-nominated trustees have the right to make up one third of trustees in pension schemes, and these are generally chosen by employees and often by their

unions. From 2009 the proportion is set to increase to 50 %. The TUC has set up a network of member-nominated trustees and hopes to use the pressure they can bring to bear as investors to improve corporate governance and take up other issues.

However, a combination of new regulations under the 2004 Pensions Act and the fact that most company pension schemes are now in deficit, has also strengthened the potential influence of pension fund trustees to influence the behaviour of their own companies. The Pensions Regulator, the new monitoring body, would expect trustees to have been consulted on issues such as giving increased security to other creditors, like banks, returning of capital to shareholders, through enhanced dividends or share buy-backs and changes of ownership, through takeovers.

However, it important not to overstate this development, to recall that the range of issues covered is still fairly narrow, with trustees only able to exercise pressure where funds are in deficit.

CORPORATE GOVERNANCE AND EMPLOYEE BOARD-LEVEL REPRESENTATION IN FRANCE: EXECUTIVE SUMMARY

Marc Lapôtre

THE KEY QUESTIONS

Two questions were central to this study: how corporate governance works in practice in France and how employees' representatives take part in decision-making at board level?

These two questions are not independent: if boards do not do the job they should, that is, if they are not a place where strategy is defined and management control is exercised, then employee representatives are not able to take part in decision-making.

THE PROBLEMS OF CORPORATE GOVERNANCE IN FRANCE

Debates on corporate governance tend to focus on whether boards conform to corporate governance recommendations. But in the recent past it has clearly been shown that this conformity does not provide protection against dysfunctional boards. Vivendi Universal's board conformed to these codes but it did not perform its role of monitoring management.

A study of French boards by Marc Lapôtre and Bénédicte Bertin-Mourot shows that even though more information is now given to shareholders and the public in annual reports, especially on corporate governance, boards themselves still perform unsatisfactorily. Too many boards are still little more than a rubber stamp. French company chiefs, the PDGs, tend to give preference to ensuring that codes are complied with formally – »box ticking« – rather than improving the way the board actually functions.

Directors' liability is proving to be the most important mechanism in improving the work of boards in France. More and more directors are becoming conscious of

their responsibility and of the risks they take, if they fail properly to exercise their role of monitoring the company's activities.

A number of points explain why French boards do not do the job they should.

Autocracy

In half of the boards studied, there was no director strong enough to question the PDG. These boards were all rubber stamps. There was no-one exercising control over the most senior manager.

The duration of meetings

The length of meetings (3 or 4 hours) is insufficient to allow boards to debate for as long as they should, to take strategic decisions and to monitor how they are implemented. This point is more a symptom of autocracy than a problem in itself. Specialised committees may help to shorten board meetings but tend to prevent all directors participating in the debates that they should.

Homogeneity

The study of board composition shows that most of the directors of any board belong to the same social networks as the PDG. For example, if he is a member of one Grand Corps, many of the directors will also be members the same Grand Corps.

A high proportion of board members are themselves PDGs or former PDGs. Cross shareholdings and reciprocal directorships (where two companies »exchange« directors) were common in the past, although they are now found less frequently.

Independent directors

To fight homogeneity, the French code of corporate governance recommends the appointment of »independent« directors. But, there is no legal definition of independence. As a result, most of these »independent« directors are independent of the company and have no interest in it, but they are not independent of senior management.

It is not an advantage for a director to have no interest in the company. The boards that work best are those where many different interests are represented, not

those where directors have no interest in the business. Having a diversity of interests represented promotes an effective debate.

In many boards, some directors are clients or suppliers of the company. Questioning the PDG can damage their own businesses.

Directors' nomination

The way directors are chosen is certainly the most important point in terms of the quality of the board. Currently, it is the PDG who controls the composition of the board. Even where an appointments committee exists, no director is proposed to the Annual General Meeting (AGM) of shareholders without the agreement of the PDG – even if, in some cases, this is informal. It is not shocking to choose someone who will help the PDG to elaborate his strategy, but it is unacceptable when this same person has to monitor the senior manager. Being the friend of the person whose activities are being monitored can hardly be seen as a proof of objectivity.

Pension funds have large shareholdings in many French companies, but, despite this, they rarely interfere in directors' nominations. They use other mechanisms to influence the strategy of the company and do not need to intervene in the composition of the board. They have direct contact with the PDG and can indicate what they want without a seat on the board. There are no directors representing pension funds in any of the forty boards of the CAC 40.

France is unusual in one respect: shareholders not present at the AGM normally give »proxy voting rights« to the PDG. In some cases, the PDG holds more than 50% of voting rights and generally the majority of the voting rights of those represented at the meeting.

The result is that this senior manager often chooses the directors who are responsible for monitoring him, and, as a result the level of oversight is rarely rigorous.

EMPLOYEES' REPRESENTATIVES AT BOARD LEVEL

Two types of employee representatives are present with full rights on some boards in France. These are the employee directors who represent all employees, and the employee directors who represent only employees who are also shareholders. There are major differences between these two, both in the way they are appointed and the way they act during board meetings.

Employee directors representing all employees

Many non-employees directors question the legitimacy of this kind of representatives. The study by Lapôtre and Bertin-Mourot noted that they were an »endangered species«, and this is even truer today. Since the study (in 2003) many of the seats held by these directors have disappeared or, sometimes, have been replaced by directors representing employee shareholders.

The interest of employee representatives is not in doubt: they provide a lot of information on the business and, in some companies – if the PDG permits it, they can make proposals on a range of different economic and social issues.

At present France has developed no alternative channel to influence decisions before they are taken. Work councils are consulted – in practice informed – by management, but after the board has made its decision. Classically union action tends to result in a decision being modified or reversed but unions do not participate in making it.

The presence of employee directors representing all employees has an impact on the board's work. The interests they defend at board level force the debate and this clash of interests is the only way that debate is initiated.

Their extensive knowledge of the company and its employees make them an important resource for the board. They can anticipate the effects of decisions on the industrial relations climate within the company, and they are a good source of information on company developments for external directors.

Employee directors representing employee shareholders

Senior management is well disposed to employee shareholdings because they provide stability. They are a good defence against take-over bids. But PDGs often dislike the presence of employees at board level, as they are an uncontrolled source of information on the business.

Most employee directors representing employee shareholders are more directors representing shareholders than directors representing employees. They act like shareholders. It is not at all certain that they will represent employees' interests.

The view of the unions

Most French unions are favourable to employee representations at board level. Only the CGT-FO is sceptical, although other organisations do not accord the issue great importance.

The fact that most organisations do not co-ordinate employee representatives at board level makes it difficult for an overall approach to the issue to emerge.

Nevertheless, the government is preparing a law on employee shareholding and the question of employee representation at board level, both representing all employees and employee shareholders, may become more important in the coming months.

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