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**"The responsibilities of the board and the role of stakeholders"**

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***Roustem Davletguldeev, consultant to the Trade Union Advisory Committee to the OECD***

## **THE ROLE OF EMPLOYEES AS STAKEHOLDERS IN CORPORATE GOVERNANCE: THE EUROPEAN VIEW**

(A working paper for the Third Roundtable on Corporate Governance in South-Eastern Europe,  
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**Roustem Davletguldeev, representative of the TUAC to the OECD**

### **Introduction.**

It is a great honour and pleasure for me to be present here today at this important forum on Corporate Governance and I would like to express my gratitude to the hosts of this Roundtable: the OECD, the World Bank Group and the Zagreb Stock Exchange.

The Roundtables on Corporate Governance have considerable positive impact to creation of the favourable climate for investments in concerning countries and it's necessary to give the wider look on Corporate Governance problems.

It's very important for the development of Corporate Governance's culture in South-Eastern European countries to give attention to the stakeholders and in particular to the role of employees in corporate decision-making process. According to Preamble to the OECD Principles of Corporate Governance (1999): "Employees and other stakeholders play an important role in contributing to the long-term success and performance of the corporation, while governments establish the overall institutional and legal framework for corporate governance". I hope that my intervention can produce a comprehension on the necessity of taking into account the employees' interests in CG.

In this paper I reflected on the following points: what is the difference between insider and outsider models of the Corporate Governance in application to the European needs; the importance of the Corporate Social Responsibility's concept for the present situation in Europe; which are the essential forms of the employees' participation in EU Member States and in candidate countries; what are the actual state and leading perspective of the employees' participation in Corporate Governance for South-Eastern Europe.

### **Insider and outsider models of the CG in Western Europe.**

The analysts of corporate governance often make distinction between two principal models of the corporate governance, "insider" and "outsider".

'outsider' systems are those in which the owners of firms tend to have a transitory interest in the firm and do not have close relationships with those in senior managerial positions within the company. Rather, these systems are characterised by relationships between management and shareholders being fluid and arms-length. Outsider systems are also characterised by the existence of an active 'market for corporate control' - takeovers, particularly hostile ones, are seen as both a remedy for managerial failure and a disciplinary mechanism on managers, ensuring that they act in the best interests of shareholders. Indeed, a further feature of this system is the primacy of shareholder rights over those of other organisational groups (particularly employees). This system is said to be characteristic of 'Anglo-Saxon' countries; and

by contrast, in 'insider' systems the owners of firms tend to have an enduring interest in the company and often hold positions on the board of directors or other senior managerial

positions. These systems are characterised by stable and close relationships between management and shareholders. This stability of ownership, often coupled with legal or institutional barriers to takeovers, means that there is little by way of a market for corporate control. Moreover, insider systems are characterised by the existence of formal rights for employees to influence key managerial decisions, often through supervisory boards or works council-type bodies. The insider system is said to be found in varying forms in continental Europe.

The analyse of abovementioned characteristics in 16 European countries, including 15 EU members and Norway<sup>1</sup> showed that only two countries in Western Europe: UK and Ireland fit into the outsider category and other 14 have some common elements, and can all be categorised as insider systems.

The principal difference of all these systems from outsider one until recently has been characterised by more concentrated ownership than the UK and Ireland, and a market for corporate control has not been well developed. The important actors concentrating corporate ownership in European counties can be different depending on economic traditions or other reasons, for example investment banks are influential in Austria, where relatively few firms are quoted on the stock market, and in Germany, where corporate ownership remains highly concentrated. Despite processes of privatisation, the state is a key player in Norway, Greece and Portugal, and remains important in Finland, France and Spain, though much less so than in the past. Family ownership and control is an important feature of the Danish and Italian systems, and the Dutch system too, though here the increase in foreign ownership is notable. Investment foundations are central to the Swedish system, while 'collective investment funds' are a distinguishing aspect of Luxembourg. In Belgium, networks of inter-firm groups based on cross-shareholdings have created the so-called 'pyramid' or 'cascade' structure of corporate ownership.

The actual tendency of globalisation evolves many of these insider forms of ownership. As large firms internationalise they often weaken their roots in their domestic corporate governance system, while equity markets have become more open to foreign financial institutions. Change is also partly caused by privatisation, a policy that has been pursued by most governments in Europe. Many European governments are moving to adopt elements of the shareholders model under the pressure of international economic slowdown. For example, it's the case of Netherlands where the legislative proposals issued in 2001 and 2002 aim to strengthen the position of the general meeting of shareholders in Dutch companies in relation to company management and, in some cases, even the supervisory board. At the same time, the powers of employee representatives will remain largely unchanged. These changes may bring about a shift in the balance of power within large companies in favour of shareholders<sup>2</sup>.

### **The globalisation's challenge: Corporate social responsibility.**

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<sup>1</sup> Tony Edwards, Corporate governance systems and the nature of industrial restructuring // European industrial relations observatory on-line:

<http://www.eiro.eurofound.eu.int/2002/09/Study/TN0209101S.html>

<sup>2</sup> Robbert van het Kaar, Company law changes have implications for employee representatives // European industrial relations observatory on-line -

<http://www.eiro.eurofound.eu.int/2002/04/feature/NL0204102F.html>

From the other side globalisation produces the phenomenon of social responsible conduct that is promoted by formal and informal institutions and increasingly recognised by companies. Recently under the pressure from trade unions and environmental groups and now with a considerable support from intergovernmental organizations as OECD, European Community, Council of Europe the best performing companies, for the most part multinationals, are introducing corporate codes of conduct or codes of best practice which cover core labour standards such as proclaimed by the 1998 ILO Declaration on Fundamental Principles and Rights at Work, environmental, consumer standards. The OECD itself makes efforts to elaborate the culture of corporate social responsibility with revised Guidelines for Multinational Enterprises – international non-binding recommendations addressed to multinational enterprises.

The role of employees in corporate governance has an important place in widespread corporate governance guidelines and codes of conduct as, for example, in OECD Corporate Governance Principles, Corporate Governance Forum Principles (1998), Bosh Report, General Motors Board Guidelines, Dey Report and others<sup>3</sup>. As said in Corporate Governance Forum Principles: "...Without stable cooperation between employees and management, shareholders' value will never be maximised..."

In 2001 the European Commission was launch a debate about the concept of corporate social responsibility by presenting a Green Paper "*Promoting a European Framework for Corporate Social Responsibility*"<sup>4</sup>. The Green paper defined CSR as "*a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis*". After one year in July 2002 was adopted a Communication of Commission "*Concerning Corporate Social Responsibility: A business contribution to Sustainable Development*"<sup>5</sup> which presents the EU strategy to promote CSR in EU countries and in candidate countries. As indicated in Communication "*Within a business CSR relates to quality employment, lifelong learning, information, consultation and participation of workers, equal opportunities, integration of people with disabilities anticipation of industrial change and restructuring. Social dialogue is seen as a powerful instrument to address employment-related issues*"<sup>6</sup>. The important point is that the CSR have to be integrated into all European Union's policies

### **The essential forms of employees' participation in CG for the EU Member States and candidate countries.**

The employees' participation in corporate governance realises through different forms as information and consultation procedure, corporate bodies' representation, distribution of share profit among employees. The last form is until now popular in the USA, the UK and Japan - countries traditionally having the outsider systems. For example, the realisation of the program ESOP in the USA showed that employment grows faster after ESOP adoption especially where firms have a greater degree of employee participation in decision-making<sup>7</sup>.

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<sup>3</sup> See: Holly J. Gregory, International comparison of board "Best practices" in developed markets, 1999 // [www.blackwellpublishers.co.uk](http://www.blackwellpublishers.co.uk)

<sup>4</sup> COM (2001) 366

<sup>5</sup> COM(2002) 347

<sup>6</sup> COM(2002) 347

<sup>7</sup> See: M. Wright, I. Filatotchev, T. Buck, K. Bishop, Stakeholders and corporate governance in Russia // The Roundtable on Corporate Governance in Russia, 2001 – <http://www.oecd.org>

For the insider system in continental Europe is more natural the existence of a widespread system of indirect or representational employee participation at company or workplace level through elected 'works councils' or similar bodies. Statutory works councils systems based on legislation or widely applicable collective agreements exist in Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Luxembourg, the Netherlands, Portugal and Spain. In these countries, works councils elected by employees (sometimes from trade union lists) have a range of information and consultation rights – and even co-determination rights on some topics in some countries (e.g. Germany) – on a variety of matters relating to the company's financial, economic and employment situation, and/or personnel management and employment conditions issues. In Sweden, legislation provides similar rights to trade unions in companies. Only in Ireland and the UK is there no general, permanent system of works council-type bodies. Here, workplace participation currently rests largely on trade union recognition or the voluntary establishment of representative structures (by agreement or management initiative), except in specific circumstances dictated by EU Directives.

In addition, in a majority of EU countries, there is a statutory system for some form of employee representation on the board of directors or supervisory boards of some types of company. Such participation is relatively widespread in Austria, Denmark, Finland, France, Germany, Luxembourg, the Netherlands and Sweden, and restricted to some public sector organisations in Greece and Ireland.

At EU level, legislation has introduced a range of worker involvement requirements in the Member States, and created new representative bodies. Notably:

- the European Works Councils (EWCs) Directive (94/45/EC) has introduced pan-European structures for the information and consultation of employees and their representatives on a range of business and employment issues in multinational companies over a certain size operating in the EU;
- the recent Directive (2002/14/EC) establishing a general framework for informing and consulting employees will require all undertakings with at least 50 employees (or establishments with at least 20 employees) to provide employee representatives with information and/or consultation on a range of business, employment and work organisation issues. The implementation of the Directive may result in some form of statutory works councils in EU Member States which currently have none (essentially Ireland and the UK);
- Directive (2001/86/EC), adopted in October 2001, provides for employee involvement (through both information and consultation structures or procedures and board-level participation) in 'European Companies' (Sociétés Européennes) – the new optional form of Europe-wide company set up under the European Company Statute; and
- various Directives have guaranteed information and/or consultation on specific issues, notably collective redundancies , business transfers and health and safety<sup>8</sup>.

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<sup>8</sup> Directive (80/987/EEC) on the protection of employees in the event of their employer's insolvency, the collective redundancies Directive (98/59/EC) or the transfer of undertakings Directive (now consolidated in 2001/23/EC) - or health and safety - both in the framework health and safety Directive (89/391/EEC) and in several specific Directives (such as those on the protection of workers from the risks related to exposure at work to carcinogens [90/394/EEC] and asbestos [83/477/EEC]).

The current situation in the candidate countries with regard to representational employee participation is diverse, though works council-type structures generally seem less common and, where they exist, they are often only now being introduced. Among the 10 countries considered here, works council-type bodies of any type exist only in the Czech Republic, Hungary, Poland, Slovakia and Slovenia. Only in Hungary and Slovenia are these structures fully comparable with a 'typical' western continental European works council – ie widespread elected statutory bodies with an information and consultation role, which generally co-exist with representation and collective bargaining through trade unions.

'Worker councils' in Poland exist only in the country's rapidly disappearing state-owned companies. The recently introduced works councils in the Czech Republic and Slovakia can be established only in enterprises where no trade unions operate. Should a trade union emerge in the enterprise, the works council must be dismantled. Furthermore, the only role of these works councils is to be the conduit for workers' rights to information and consultation as set out in the "acquis communautaire" in areas such as transfers of undertakings or collective redundancies. While they have no works council structures, Estonia and Latvia have 'workers' trustees' – i.e. employees elected to represent the workforce – alongside trade union representatives, with a number of information and collective bargaining-related rights.

In the other candidate countries, the sole channel for employee representation at workplace/enterprise level is through trade unions, which in CEE candidate countries have information and consultation rights (perhaps somewhat analogous to the Swedish situation). Given the frequently low levels of union membership (see above), this will often mean that many workers have no representation at all. However, there would appear so far to have been considerable opposition in some countries (such as Poland) from both trade unions and employers to the introduction of works councils.

The requirement to implement the "acquis communautaire" which provide for information and consultation rights in the candidate countries has contributed to a major rethink of current worker involvement provisions. For example, it was the transposition of the acquis in this area that recently prompted the Czech Republic and Slovakia to introduce works councils. A debate on the issue has also been occurring in the Baltic candidate countries. The future implementation of the recent EU Directive on general national information and consultation rights for employees is arguably likely to accelerate the process of bringing the candidate countries more into line with current situation in most of the Member States (a similar process may occur in existing Member States such as Ireland and the UK).

Board-level employee representation does not appear to be a very common practice in the candidate countries, although information on this point is limited. However, it exists in Hungary, Malta, Poland (former state enterprises) and Slovenia.

Finally, representation on EWCs, of which there are currently around 700 in operation, is obligatory at present only for employees in the present 15 EU Member States (plus the three other countries of the European Economic Area). However, a number of EWCs in multinational companies with operations in the candidate countries provide, on a voluntary basis, for the representation of the workforces in these countries, as either full members or observers. This, though, is very much a minority practice. According to European Trade Union Institute (ETUI) figures, under one-fifth of EWCs in multinationals that operate in CEE candidate countries

(including Bulgaria and Romania) include workers' representatives from these countries. An examination of EWC agreements by the European Foundation for the Improvement of Living and Working Conditions has found that workforces in the Czech Republic, Hungary and Poland are each represented on under 8% of all EWCs, with the figures considerably lower for countries further east and south.

However, as candidate countries join the EU and come within the scope of the EWCs Directive, workers in these countries will gain entitlement to representation on EWCs and the special negotiating bodies that conclude new EWC agreements. Furthermore, the employees in the candidate countries will be counted towards the Directive's workforce-size thresholds (the Directive affects multinationals with 1,000 employees in total in all the countries covered by it, plus 150 employees in each of at least two of these countries), thus bringing more companies within the Directive's scope. The candidate countries have started to transpose the Directive – for example, Hungary, Poland, Slovakia and Slovenia have done so over the past year or so<sup>9</sup>.

### **The state and perspective of the employees' participation in the South-Eastern Europe.**

The employees' participation in the SEE countries can be characterised as being in reform. In all these countries continues the revision of labour legislation remained from ancient regimes. The establishment of free market economy values leads to practical disappearance of workers' participation in corporate governance. This syndrome is typical for the majority of post-socialistic countries, including the Russian Federation.

The present labour legislation of the SEE countries contains some provisions on employees' (workers') participation. In Bosnia and Herzegovina<sup>10</sup>, Croatia the legislation provides the existence of the works councils. In Romania the draft Labour Code will create the works councils, but only in enterprises or groups of enterprises which have a Community dimension in order that employees should be represented within a European Works Council. Very weak possibility for workers' participation under Law on Trade Companies (1996) and Law on Transformation of Enterprises with Social Capital (1993) exists in Macedonia<sup>11</sup>. Bulgarian Labour Code as amended in 2001 give to employees very limited right to participate in the management of enterprises through their representatives<sup>12</sup>.

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<sup>9</sup> This material is used from the paper:

Mark Carley, Industrial relations in the EU Member States and candidate countries // **European industrial relations observatory on-line:**  
<http://www.eiro.eurofound.eu.int/2002/07/Feature/TN0207104F.html>

<sup>10</sup> Labour Code and Act N.649 of 7 June 2001 on workers' councils.

<sup>11</sup> See: Ljubomir Drakulevski, Workers' participation: case of the Republic Macedonia // 11th CONFERENCE OF THE INTERNATIONAL ASSOCIATION FOR THE ECONOMICS OF PARTICIPATION (IAFEP) 'PARTICIPATION WORLD-WIDE', Katholieke Universiteit Brussel – K.U.B. (Catholic University of Brussels), Brussels, 4-6 July 2002.

<sup>12</sup> Labour Code of Bulgaria. Promulgated State Gazette, Nos.26 & 27/1986 Amended SG Nos. 6/1988; 21, 30, & 94/1990; 27, 32, & 104/1991; 23, 26, 88, & 100/1992; 69 & 87/1995; 2, 12 & 28/1996; 124/1997; 22, 56, 83, 108 & 133/1998; 51, 67 & 110/1999, 25/2001 // [http://www.mlsp.government.bg/English/MLSP\\_en\\_1.htm](http://www.mlsp.government.bg/English/MLSP_en_1.htm)

The most elaborated law in SEE countries is a Croatian Labour Act adopted in 1995 (N 758/95)<sup>13</sup> which Part XVIII. "Employee participation in decision making" (Art. 132-158) provides the creation of employees' council as a form of realisation of the employee right to participate in decision-making in companies with at least 20 employees. The employer has the duties to inform employees' council and to consult with him before passing decision; some management decisions for dismissal, appointment or others are subjects to co-decision making. In practice some trade union confederations have opposed the institution of works councils. Nevertheless it can be concluded that, as a rule, the councils are strong and influential bodies in which there are quality trade union activities and where works councils and health and safety stewards, in relation to their rights and obligations (six hours paid leave per member), represent additional tools for trade union work and influence<sup>14</sup>.

This brief overview shows a big disproportion in legal treatment of employees' participation in SEE countries. Adoption in recent time of the new legislative act on works' councils in Bosnia and Herzegovina, the drafting work on Labour Code in Romania demonstrate the strengthening of the insider systems in the region. An example of the Corporate Social Responsibility in the SEE countries can be given. It's a Corporate Governance Code for Romania (CGC), adopted by Business Association during the workshop conducted by the Strategic Alliance of Business Association, in Bucharest on March 24, 2000. As said in Chapter 1 of CGC "...this Code provides a set of rules and standards to guide the management of a company with respect to its strategic planning and decision making, in order to promote the interests of shareholders and associates, creditors, customers, employers and employees".

Regarding employees as internal constituencies and stakeholders the CGC gives some rights to the employees and their representatives. Upon certain conditions, including invitation, a representative of the trade unions or of the employees may attend the board meetings. Under the notions of dialogue and social partnership CGC proposes to establish the information and consultation procedure: "With the support of trade unions or employees' representatives, the Board and the executive officers shall introduce systems to secure the achievement of the following goals: i.Improvement of the information flow within the company, so that the employees may better understand the company they are working for and its objectives; ii.Periodical consultations between the employees and the chief executive officer or the members of the Board of Directors, before making decisions which directly impact the employees; iii.Early and efficient identification and solution of labour conflicts".

The perspectives for the development of the employees' participation in Corporate Governance in South-Eastern Europe are strongly connected with the economic and political processes in each concerned country as well in European Union in view of his future and inevitable enlargement. From the point of view of SEE Trade Unions the political and economic influence of the EU on the course of the development of industrial relations is felt in the majority of SEE countries thanks to the direct foreign investments, to the donations and loan extended by the EU. European companies give the investments into the economies of the SEE countries have brought with certain labour and industrial standards developed by the EU. Besides, the social partners, either at the level of the EU or at that of certain EU countries, with their co-operation

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<sup>13</sup> Labour Act of Croatia N 758/95 // <http://natlex.ilo.org/>

<sup>14</sup> Dušanka MarinkovićDrača, Labour legislation in Croatia // South-Eastern Europe Review, 2002, N 3 s, p. 11.

and bilateral and multilateral activities, have influenced a change in the positions and the policy of the social partners in countries in the SEE region. One should not neglect those governments in the region, due to the need to co-operate with the EU, more precisely because of expected EU support, have sought to present them as democratic and co-operative. Thus, often contrary to their will, they have introduced certain standards and institutions in the area of industrial relations and social dialogue as a constituent part of an overall façade to the democratic environment<sup>15</sup>.

We hope that this situation will be maintained by the economic growth, political stability and high level of corporative culture in the countries of South-Eastern Europe where the effective corporate governance with the active co-operation between corporations and employees in creating wealth, jobs, and the sustainability of financially sound enterprises.

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<sup>15</sup> See: Dragan Djuric, Social dialogue in south-east European countries // South-East Europe Review, 2002, N 3, p. 29-30.