Employee participation in corporate governance: an ethical analysis

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Introduction

This article outlines the ethical case put forward by Catholic Social Thought ("CST") for giving employees a role in corporate governance and some type of ownership interest in the corporations that they work for. The first section provides some definitions of corporate governance and considers the ethical significance of a corporate governance system and the impact on employees of the theory of the firm (and accompanying approach to corporate governance) that is adopted. The following section offers a definition of employee participation and explains its ethical and economic advantages. It outlines the German system and explains that codetermination has never taken root in the United Kingdom. This section concludes with a brief explanation of some alternatives to codetermination as ways of building employee interests into corporate governance. The third section looks at the question of employee ownership. Again, it notes the ethical and the economic arguments in favour of employee ownership. ESOPs are one possible way forward and they can have a significant impact on employees and on corporate governance. Badly designed forms of employee ownership could harm both the firm and its employees. The article gives some indications as to why this is so. It assumes, nevertheless, that these problems can be surmounted or avoided. The governance structure of the John Lewis Partnership plc is explained in some detail and is offered as a possible model for employee-owned businesses. Finally, the article will look at the case for the introduction of mandatory codetermination systems.
Corporate governance

One of the best-known definitions of corporate governance is to be found in the Report of the Committee on the Financial Aspects of Corporate Governance:

Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders’ role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company’s strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board’s actions are subject to laws, regulations and the shareholders in general meeting.¹

“Corporate governance”, then, as it is usually explained and understood now, refers to the system for setting policy at the highest level, establishing and monitoring management processes and establishing systems of risk control.

The corporation, as is true of any human community of any size, needs a system of governance. “Corporate governance” describes the system answering the need for a “political” authority in the corporate community. It identifies the corporation’s decision-

¹ The Report of the Committee on the Financial Aspects of Corporate Governance, (‘the Cadbury report’) para. 2.5.
making bodies and how they interact with each other. It allows the members of the corporation to act collectively. Corporate governance includes arrangements for deciding on the composition of the board, the groups or persons to whom it is accountable and the criteria to be applied when assessing the board’s performance.

The Cadbury report definition of corporate governance suggests that it is a system dominated by the board and shareholders: the board administers the corporate governance system and accounts to shareholders for its stewardship of that system (implicitly because the system is managed on behalf of shareholders). It seems from this definition that employees have no role to play in corporate governance and that they have a subordinate claim (or no claim at all) on the board’s attention. This is in line with the current orthodoxy that sees the shareholders as being, in practical terms though not in legal terms, the owners of the corporation.

There are other explanations as to the nature of corporate governance. Gospel and Pendleton suggest that corporate governance essentially deals with the relationship between capital, management and labour. They say that ‘corporate governance is concerned with who controls the firm, in whose interest the firm is governed and the various ways whereby control is exercised.’ Kay and Silberston suggest a “trusteeship” model of corporate governance that emphasises “the evolutionary development of the

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corporation around its core skills and activities. Corporate governance, on this view, aims to “build up” the corporation so that it is better able to carry out its core activities. To a large extent, their theory of the firm suggests, this will involve refining the structures, routines and organisational structures that are at the heart of the corporation. They also argue that governance involves preserving and enhancing the value of corporate assets and balancing fairly the various claims on the returns generated by those assets. There is much good sense in this explanation of the firm. It emphasises the dynamic aspects of the life of the corporation but also that it has an inner core that should not be lightly gambled away and that decisions affecting it are not exclusively to be considered in terms of the impact on shareholders.

Corporate governance is about finance, about the relationship between employees, shareholders and management and about the evolutionary development of the core skills and activities of the corporation. It is also about ensuring that the corporation plays its part as a responsible citizen. In other words, corporate governance has to deal with all of the aspects of the life of the corporation even though, in some contexts, it may be appropriate to highlight one or other of these aspects (such as shareholder relations).

A natural law approach to thinking about the corporation can help to integrate partial insights into the nature of the firm. It also emphasizes that corporate governance, like any

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5 Kay and Silberston, 'Corporate governance', p. 61.
other social reality, should be appraised in terms of human flourishing. A natural law approach to the firm reminds us that the principal question is whether corporate governance makes it easier for the corporation to meet the genuine human needs of clients or customers and, in doing so, makes it easier for employees, shareholders and management to fulfill themselves as human persons. It also asks whether the corporation plays the part it should as an element of the broader fabric of economic and social communities.

CST sees the firm as a community of persons. At its heart is a relationship between the firm’s participants (its employees and shareholders). The firm allows them to combine to produce goods or services in ways that would not have been available to each participant as an individual acting alone. Thus, the firm allows its employees to meet a range of needs. It provides a salary and an opportunity to use and develop skills. Many people probably find that their work offers them their greatest opportunity to contribute to the development of society. Shareholders find in the firm an opportunity to put their capital to productive use and to get a return on it. A community’s governance is intended to help it achieve its goals; in the end, the community’s collective goal is oriented towards helping its members to meet the needs that brought them to the community. The profound link between the good of the firm and the flourishing of its participants is what brings corporate governance into the ethical or moral sphere.

It is obvious that human communities, other than the very smallest, need some formal mechanism to co-ordinate the activities of their participants and to focus them effectively
on whatever it is that the community seeks to achieve. Those in charge of governance have a responsibility to work to build up the community’s common good. Drawing on the initiative and resources of the “governed”, they have to develop the infrastructure that will allow the community to achieve its goals more easily and fully. The corporation shares this need. Some person or body has to take responsibility for this task. Otherwise, the firm cannot perform its essential function of enabling its participants to do much more by working together than they could achieve alone. The firm seeks to add value to human work and effective governance is indispensable if this goal is to be achieved. Those in charge of governance have to decide on the projects to be pursued, organize employees and secure the necessary financial and other resources. They have to develop the productive capacity of the corporation and its ability to meet the needs of its customers or clients. Governance arrangements will need to establish who is to take decisions within the firm and who has the authority (and in which circumstances) to act in the name of the firm as a whole. “Corporate governance” describes the system answering the need for a “political” authority in the corporate community. It identifies the corporation’s decision-making bodies and how they interact with each other. It allows the members of the corporation to act collectively.

From this view of the nature of the firm it follows fairly naturally that employee welfare should be a paramount concern of corporate governance. Greenfield puts it like this:

Shareholders believe that buying shares is better than putting money in savings accounts, for example, because shareholders believe that managers can utilize the productive
capacity of the firm to make a better, or safer, return than other possible investments. Workers show up to work because they believe that the managers can organize their labour and other resources so that they can be more productive than the sum of their productiveness as individuals, and that they will share in the gain. Like shareholders, workers depend on the care, skill and good faith of the management.\(^6\)

It is clear that CST’s approach (founded on Christian anthropology and its own principles and values) is markedly different from that of much contemporary corporate governance scholarship (what one may call “the mainstream”). The latter often looks at economic activity from a materialistic perspective. It tends not to think in terms of human flourishing and of the significance of membership of the firm for its participants; it often has a utilitarian underpinning that consciously rejects any emphasis on goods that are fulfilling for human persons. Implicitly, at least, the mainstream view sees human work (and the worker) as inputs or raw material. Work and the worker rank alongside financial and material resources in terms of importance with special respect being accorded to financial returns. Employee welfare is relevant to corporate governance in the sense that it is a means to an end, in the same way that keeping hens happy might be thought of as leading to more and bigger eggs. Employee welfare, according to this view, is a legitimate concern of corporate governance only to the extent that it enhances profitability. That labour is at the service of capital seems self-evident and this “axiom” creates a very high burden of proof for those who would want to see employee welfare as a central theme of corporate governance. The concept of shareholder value is an

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expression of the belief that the corporation is principally a tool to meet the needs of shareholders. CST would suggest that employee value is an equally important concept to develop.

CST sees the economistic mindset (the view that labour is an immaterial commodity) as the ultimate source of practices that degrade the worker\(^7\). CST comes into its own when it engages with this world-view. Indeed, the idea that the firm exists only to make a profit has not only an ethical but also a religious dimension. Usually implicitly, it suggests a mechanistic conception of the world and a belief that the market is self-governing. The idea of the invisible hand is highly suggestive of a deistic conception of God as a watchmaker who sets the wheels in motion and then withdraws.

The work of the board of directors, and any discussion of corporate governance, is shaped partly by the theory of the firm that is adopted. A natural law approach to social ethics emphasises that the corporation has a reality of its own, that it is part of social, economic and political communities that have a more wide-ranging commitment to human flourishing and that it is at the service of its customers or clients as well as of its employees and shareholders. Corporate governance has to help the corporation to meet these objectives and cannot be understood by focusing on just one of these objectives or a sub-set of them.

\(^7\) John Paul II, *Laborem exercens*, paras. 7 and 11-14
Contemporary corporate governance has become very preoccupied with the agency problem: agency theory highlights the danger that the directors will abuse their power over the corporation and divert corporate assets to themselves (directly or indirectly). In particular, directors are described as the agents of shareholders (rather than of the corporation). Agency theory emphasises the need for company law and corporate governance to provide shareholders with adequate protection against the risk of expropriation by directors\textsuperscript{8}. British company law and corporate governance have developed a range of tools to try to counter this concern.

There is no doubt that the danger is real. The question is whether dealing with it has been allowed to skew corporate governance and to focus excessive attention on one aspect of one relationship within the corporation (the shareholder – director relationship). Some suggest plausibly that the danger is over-stated because directors are motivated by factors such as a desire to do a good job, to be respected and by a sense of professionalism\textsuperscript{9}. Others go further and suggest that building corporate governance around agency theory will amount to a self-fulfilling prophecy and create a low-trust environment in which opportunistic behaviour will become the norm\textsuperscript{10}. Gospel and Pendleton criticize the


\textsuperscript{9} See, for example, the critique in L. Donaldson, ‘The ethereal hand: Organizational economics and management theory’, \textit{The Academy of Management Review} 15 (1990), pp. 369 - 381.

agency model for its reductionist exclusion of actors other than managers and shareholders.\(^{11}\)

Concern over the agency problem has spilled over into thinking about employee participation. It has been argued that shareholders are vulnerable to exploitation by directors. This is clearly also true of employees but it is further argued that employees can protect themselves through carefully drawn contracts while shareholders cannot.\(^{12}\) Some point to the German codetermination system to show that management is able to play shareholder and employee representatives on the supervisory board off against each other. As a result, it is argued, they loosen the system of monitoring and accountability that minority shareholders depend on.\(^{13}\)

On the other hand, it can be argued that employees cannot usually protect themselves contractually against loss of their “human capital” investment in the firm and so they are as vulnerable as shareholders; experience and common sense tend to confirm this view. Agency theorists see monitoring of executives as an important role of non-executives yet, as Jacoby points out, outsiders may not be well-placed to make an effective contribution to governance.\(^{15}\) In principle, employees are likely to be more expert and more keenly

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interested monitors of senior management. If one accepts that this is true, the challenge is to design governance systems that will, at the same time, allow employees and shareholders to contribute appropriately to governance, allow for strong and decisive management of the corporation and make management accountable to both employees and shareholders.

Gospel and Pendleton suggest that corporate governance deals with the relationship between capital, management and labour.\(^{16}\) This is a realistic way of thinking about corporate governance: it is impossible to understand the central purpose of the firm, and about how it adds value, without bringing employees into the picture. Clearly, employee interests cannot be well-served if corporate governance is reduced to a conversation between management and capital. As Jacoby has shown, employee participation in corporate governance can make a radical difference to how employees are treated by the firm.\(^{17}\)

Jacoby’s comparative study of the role and importance of HR directors in Japan and the US shows how the Japanese conception of the firm as a community has practical implications for board composition (the inclusion of the HR director on the main board of Japanese listed companies) and for employees (greater commitment to security of tenure

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\(^{16}\) Gospel and Pendleton, ‘Corporate governance and labour management: an international comparison’, pp. 4 - 5.

\(^{17}\) Jacoby, The embedded corporation. Corporate governance and employment relations in Japan and the United States.
and to the use of internal labor markets). Edwards’ study of the impact of national
corporate governance and industrial relations styles on how employees are treated in
corporate restructurings also provides evidence of a positive link between corporate
governance and the way that employees are treated by the firm. More broadly, it is hard
to believe that anyone can benefit in the long term from a skewed vision of the firm and
of the goals that corporate governance ought to serve.

Lord Wedderburn of Charlton explored the link between the British view of the
corporation and the difficulty in finding a place for employee participation in British
corporate governance:

[T]he interests of the employee find little solace in our company law as it has been
developed since the repeal of the Bubble Act in 1825. The status of the shareholder and
the nature of the share were anchored by the common law firmly into an individualist
ideology of proprietorship which ran with the grain of society and especially with the
capital market of the day. The shareholder's property in his share and the "interests of the
company" as the shareholders interests alone, became pillars of the modern law with no
plurality of other interests acknowledged (such as those of the employees) … In England,
the company law developments did nothing to assuage, and something to sharpen,
hierarchic structures of authority. Modern company legislation in Britain has barely

18 Jacoby, The embedded corporation. Corporate governance and employment relations in Japan and the United States..

addressed these social dimensions of the law, and the next Companies Bill is likely to concentrate on deregulating private companies, not making a contribution to consensus.\(^{20}\)

Elsewhere, Lord Wedderburn has pointed out that the deeply-entrenched shareholder value approach made it difficult for measures that might have promoted employee interests to gain any ground in the recent reform of UK Company Law\(^ {21}\).

Rock and Wachter suggest that two governance systems exist side-by-side within the firm: there is employee governance and corporate governance. Corporate governance topics include (1) entering new markets, closing plants and investing in new technology; (2) issues concerning payments to shareholders; and (3) relations between the board and executive officers. Employee governance is concerned with the relationship between the firm and its employees and especially with the pattern of remuneration over the course of the employment relationship. Rock and Wachter acknowledge that these two strands of governance need to be integrated into the overall governance structure of the firm\(^ {22}\). The idea that employees and shareholders have distinctive concerns, areas of expertise, concerns and modes of contribution to the overall governance of the firm is plausible. It must be remembered, however, that there is no clinical divide between what Rock and Wachter term corporate governance and the legitimate interests of employees; plant


closures offer an obvious example of a “corporate governance” topic as to which employees could reasonable expect to be kept informed and to have their interests taken into account.

Parkinson highlights the link between the prevailing conception of the corporation and the way that employee interests fit into the corporate governance structure. He argues that the firm should be seen as a complex social institution. It is not simply the property of its shareholders nor a mere nexus of contracts; these conceptions of the firm are to some degree impoverished. Rather, he suggests that the firm should be considered as a complex social institution that has a reality of its own and that is not simply the property of its shareholders. This way of thinking about the firm would bring employees (and he believes other “stakeholders”) into the centre of corporate governance. The challenge is then to find legal mechanisms to give content and meaning to the firm-as-social-institution approach

Blair proposes a view of governance that would give control of corporate assets to those who bear the risks associated with ownership. She argues that employees should be given some control rights to encourage them to make firm-specific investments. Firms that rely on such investments should, she suggests, make use of employee share ownership schemes

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Blair and Stout\textsuperscript{25} see the firm’s central role as being the organisation of team production. The firm’s governance structure can help to overcome the shirking and rent-seeking problems that might plague team production. Corporate assets are controlled by an internal hierarchy under the overall control of the board. The hierarchy’s role is to coordinate the activities of team members, allocate the resulting production and mediate disputes among team members over that allocation. The board’s principal task is to encourage firm-specific investments essential to certain forms of production. The hierarchy’s control over corporate assets enables it to play the co-ordinating role that the successful team requires.

Corporate governance should include some criterion or criteria to guide decision-making by the board. What has been said already suggests some principles that should guide a CST-inspired approach to corporate governance. First, governance will ensure that customer or client needs and expectations are as fully satisfied as is possible. Second, governance is at the service of the firm’s participants; it exists to facilitate their pursuit of the goals that (reasonably) brought them to the firm. Third, those in charge of governance have some responsibility for deciding on how the firm is to contribute to the common good of the societies in which the firm is integrated. Much of this can be summed up by saying that those in charge of governance are responsible for developing the firm so that it is better able to make its specialized contribution to the well-being of its participants and the common good of society at large.

Can profitability provide the necessary criterion to guide corporate decision-makers? To some extent, of course, it must be taken as a criterion of central importance. Profit provides the return that investors need and it is needed to pay salaries. It can be a source of the funds that the business needs to sustain itself, grow and contribute to the communities of which it forms part. Profitability also provides a means of assessing whether the corporation’s assets have been put to effective use. There is a moral case for choosing the most efficient (or least wasteful) means to achieve given ends and measuring profitability provides a way of checking whether or not the correct choices have been made in this regard. So, profitability is undoubtedly a good measure of the corporation’s vitality. At an ethical level, however, it can never be the sole determinant for decision-making. To take obvious examples, a drugs cartel or a protection racket might be extremely profitable but they are not consistent with a will to self-realisation. They will harm the common good and destroy rather than build up lives and communities. As a practical matter, it seems implausible to suggest that directors could routinely take the pursuit of profit as their sole decision-making criterion. It is more likely that in practice they have to juggle a range of concerns that include the development of the products and services offered by the firm, meeting the needs of shareholders (especially those with significant shareholdings), employee concerns and external pressures (such as those imposed by government or by lenders and suppliers). It is doubtful whether telling directors that they have to make a profit (or to maximise shareholder value) provides

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26 John Paul II, Centesimus annus, paras. 35 - 36.
directors with any guidance at all beyond that which is glaringly obvious to them in any event. As Davies and Lord Wedderburn of Charlton put it:

[T]here seems to be no mechanism which will guarantee continuous profit-maximising behaviour on the part of controllers of large companies. Neither shareholder control (whether by institutional or private shareholders), the forces of market competition, the market in corporate control via takeovers, nor the threat of liquidation seem .. to be sufficient to impose upon corporate managements the discipline of profit maximization.27

The task of those in charge of corporate governance is sophisticated and demanding; they are responsible for building up the business and its common good and this task cannot be adequately explained by saying that the ultimate goal is the pursuit of profit.

Employee participation in governance

“Employee participation” can refer to the range of ways in which employees can participate in the major decision-making fora that affect their working lives and environments. Employee participation can refer to participation at levels of governance higher than the corporation, including employee participation in governance at the level of the economy as a whole or of specific sectors within the economy. Employee participation can also refer to decision-making at levels below the board such as the workplace or within the employee’s immediate “team”. This participation might be direct,

with each individual employee participating in the decision-making process. More usually, however, it will be indirect in that employees participate in governance through representatives.

The principal focus of this paper is on employee participation in corporate governance. The corporation has an impact that is both extensive and direct on the working life of the employee and, as argued above, the corporation exists to enhance the productive capacity of the individual employee. Codetermination is the best-known form of employee participation in corporate governance. This system reserves seats on the board of directors for employee representatives. It is not, however, the only form of employee participation in governance. In Japan, the human resources director often acts as an advocate for employee interests; he does so within a corporate governance culture that gives a high priority to employee welfare in any event.

From an ethical perspective, there are at least two good reasons for seeking to promote employee participation in corporate governance. The first reason is related to CST’s principle of participation. CST is anxious to promote the idea of the subject character of society. We are not simply objects to be governed but rather we are to do what we can to build up the communities to which we belong. A society’s common good is built up through the intelligence, commitment and effort of its members. Communities should be

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“personal” in that they serve some range of personal values so that they play their part in enhancing the personality of their members. They should also be personal in the sense that they reflect the personality of their members. Each community, each corporation in our case, will have its own style of governance because it will reflect the unique style of its participants and the way in which the corporation, over time, has managed to harness the energies of its members. One of the cardinal rules for the design of governance structures should, therefore, be that they facilitate the active participation of as many as possible in ways that are compatible with effective collective action. The corporation’s governance structure should not be a bureaucratic machine but, rather, should ensure the intelligent and appropriate participation of management, employees and shareholders.

Codetermination allows employees to participate indirectly, through representatives, in the life of the corporation. It would, of course, need a supporting structure of mechanisms to allow the individual employee to engage with governance. Otherwise, codetermination might do little to make a reality of the corporation as a community of persons.

Employee participation can also help employees to protect themselves from unjust treatment when the corporation is going through hard times or in the event of a major restructuring. In *Economic Justice for All*, the US Bishops said:

As a minimum, workers have a right to be informed in advance when such decisions are under consideration, a right to negotiate with management about possible alterations, and a right to fair compensation and assistance with retraining and relocation expenses should these be necessary. Since even these minimal rights are jeopardized without collective
negotiation, industrial co-operation requires a strong role for labor unions in our changing economy.\textsuperscript{30}

Employee participation is a theme that emerged gradually in CST. \textit{Rerum novarum} does not explicitly mention employee participation. Its emphasis on the dignity of the worker, however, could be said to imply that this is a theme that would be developed later. Some Catholics argued that employee participation was a natural right that should be enshrined in law\textsuperscript{31}. Pius XI rejected this view of employee participation as an entitlement in \textit{Quadragesimo anno} but stressed the desirability of a partnership approach to relations within the firm\textsuperscript{32}. This idea was developed in various ways in \textit{Mater et magistra} which spoke of employee participation in decision-making both within the firm and at the level of the economy in general. Since employees were affected by policies developed at levels higher than the firm, they ought also to be allowed to participate in developing those policies. \textit{Mater et magistra} also called for employees to be allowed to share in the profits of the businesses that they work for.

CST’s stance on employee participation was summed up in this passage of \textit{Gaudium et spes}:

\begin{footnotesize}
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\item Pius XI, \textit{Quadragesimo Anno}, paras. 64 - 65.
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In economic enterprises it is persons who are joined together, that is, free and independent human beings created to the image of God. Therefore, with attention to the functions of each - owners or employers, management or labor - and without doing harm to the necessary unity of management, the active sharing of all in the administration and profits of these enterprises in ways to be properly determined is to be promoted. Since more often, however, decisions concerning economic and social conditions, on which the future lot of the workers and of their children depends, are made not within the business itself but by institutions on a higher level, the workers themselves should have a share also in determining these conditions-in person or through freely elected delegates.  

CST claims no competence when it comes to devising technical solutions for the implementation of employee participation in its various forms. There is obviously a range of acceptable solutions and each firm and each economy will have to work out approaches that suit it best. *Laborem exercens* points the way. The goal to be achieved is that ‘on the basis of his work each person is fully entitled to consider himself a part-owner of the great workbench at which he is working with every one else.’ The passage continues:

A way towards that goal could be found by associating labour with the ownership of capital, as far as possible, and by producing a wide range of intermediate bodies with economic, social and cultural purposes; they would be bodies enjoying real autonomy

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33 Second Vatican Council, *Gaudium et spes*, para. 68.

with regard to the public powers, pursuing their specific aims in honest collaboration with each other and in subordination to the demands of the common good.\textsuperscript{35}

It is for the direct employer (the firm) and the indirect employer (anyone with a say in the terms of employment such as the state) to reach workable and just solutions.

\textit{Rerum novarum} was inspired by concern over the material poverty of the working classes in the industrialized nations at the end of the nineteenth century. It was also a response to an economic system and a way of looking at things that saw work as a mere commodity so that no respect was accorded to the subjective dimension of work. CST has emphasized the importance of allowing employees to exercise their initiative and to play a part in the governance of the firm and of the economy but it has not committed itself to any specific model of employee participation since a range of ethically acceptable approaches exists.

CST is, of course, not alone in making the ethical case for employee participation in corporate governance. Axworthy makes the moral case for employee participation in these terms:

Employees are denied any meaningful degree of control over their working lives. This stems from their lack of power in their corporations. If control over one's life is seen as being important, it would seem that some power should be conferred on employees. The

solution should be to ensure mechanisms which permit employees to be the effective
decision-makers in their places of work. Only then can meaningful strides be taken
towards participatory democracy at the workplace.36

Klare calls for a recasting of corporate governance and labor law to promote workplace
democracy. He argues that the main goal of labor law should be to expand and enhance
democracy at every level of the experience and organization of work. This is a demand
both of a respect for self-realization and of the practical needs of the firm operating in a
modern economy. Employees increasingly look to their work as a source of self-
realization in a deep sense (as presenting opportunities for learning and expression,
challenging work and an improvement in their technical skills and personal capacities)37.

McCall argues that employee participation rights should operate at every level. He
considers that rationality, fairness, self-respect, health and democracy are all promoted
by employee participation rights. Rationality and freedom are core aspects of human
identity and they are incompatible with the idea that employees should be the passive
objects of "management"; this is especially important because work is a central aspect of
our lives. "Fairness" rests on the conviction that human beings all enjoy equal dignity.
The nature of work relationships can have a profound impact on an individual's sense of

36 C. Axworthy, ‘Corporation law as if some people mattered’, University of Toronto Law Journal 36 (1981),
p. 423.

37 K. Klare, ‘Workplace democracy and market reconstruction: an agenda for legal reform’, Catholic
self-respect. Finally, he suggests that corporate democracy can lead to greater participation in the political process\(^{38}\).

There is also an economic case to be made for employee participation. Indeed, there is no shortage of commentators who point out the economic benefits of making credible commitments to employees that their interests will be given reasonable consideration in times of crisis. Armour \textit{et al} make the point that takeovers may have the effect of expropriating employees by reneging on implicit promises made to them. The takeover threat would then make it very difficult for management to make credible commitments to employees\(^{39}\). Howse and Trebilcock consider the risk of employee dislocations in the event of major restructurings\(^{40}\). They point out that workers invest human capital in their employers and that there is a need for mechanisms to protect these stakes in the firm. Howse and Trebilcock note that it is difficult to craft ex ante contractual commitments that adequately protect employees. Earnings are often set below an employee's contribution to productivity in the early years but rise with seniority. Shareholders can engage in rent-shifting by reneging on the implicit agreement about employee entitlements. They ask how participation could function to protect the employment


bargain. Employee representation on the board could be useful, even if the employee representatives were in a minority, because of the information that the representatives would gain about the economic condition and strategy of the firm. The employee representatives could also act as whistle-blowers and raise an early warning about management proposals that have the potential to harm employee interests. Employee representatives would also be able to add a new dimension to boardroom discussions by pointing out difficulties or strategies that management had simply not considered. Howse and Trebilcock make the point that it is possible to design arrangements for useful employee participation at board level that would not involve employees in the governance structure for worker-management relations. The alternative might be an obligatory, ongoing consultation process about events or proposals that threaten job security. Even if major restructuring and job losses are inevitable, such an arrangement might allow an orderly and humane transition.

Co-determination is the most obvious example of a system of employee participation in corporate governance. A codetermination system gives one or more employee representatives a formal place at the boardroom table. Germany is an example of a jurisdiction with mandatory codetermination rules. Its system of company law specifies the size of the supervisory board of any Aktiengesellschaft (“AG”) and of a Gesellschaft mit beschraenkter Haftung (“GmbH”) with more than 2,000 employees. An AG established after 1994 with fewer than 500 employees is exempt from the co-determination rules.\footnote{Gesetz fur Kleine Aktiengesellschaften und zur Derelegierung des Aktienrechts (“Law for Small Stock Companies and to Deregulate Stock Law”).} Above these thresholds, German law requires minimum levels of
employee representation on the supervisory board\textsuperscript{42} although, ultimately, shareholder representatives have a majority of the voting rights. In addition, Germany has a system of national Works Councils and these may apply even to quite small businesses\textsuperscript{43}.

The German approach to co-determination has been summarized by Jackson, Hopner and Kurdelbusch thus:

Employee voice is institutionalized through the legal institution of codetermination at the level of the supervisory board and works councils … Employee representatives on the supervisory board provide a counterweight to shareholders in the appointment of management, as well as involving employees in monitoring of strategic business decisions. In certain companies, the appointment of a labour director to the management board by the employees reinforces the consensus nature of decision-making within the board.\textsuperscript{44}

Hopt points out the need for ways of monitoring board performance (through audit mechanisms, for example or the use of market-based mechanisms such as the market for

\textsuperscript{42} \textit{Bertriebsverfassungsgesetz} (“Industrial Constitution Act”).


corporate control). Labour representation at board level could be seen as a further tool for monitoring board performance and can be seen as similar to the use of outside directors. He argues that co-determination has not been economically inefficient (despite the fact that it slows down decision-making). Indeed, he suggests that co-determination has positive economic effects because it reduces strategic behaviour and improves the flow of information to the board. He acknowledges that having employee representatives on the board poses challenges in terms of the need to ensure that they respect their duties of confidentiality and loyalty to the corporation; he believes, however, that these challenges can be met.

Dinh argues that codetermination, works councils and collective bargaining are part of a package that allow management and labour to carry on a continuous negotiation process. Having several channels allows for issues to be divided up between those that are best dealt with at firm level and those that can be dealt with at industry level. The codetermination aspect of the package has come in for criticism but it is more likely that Germany will continue with a reformed version of codetermination than that it will abandon it altogether. Goodijk argues that Germany’s model can help to build a participative company where there is worker involvement in the implementation of policy, the design of the workplace and the improvement of work processes. Direct

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participation by employees in some levels of decision-making could, he suggests, be complemented by indirect or representative participation at corporate level. He recommends improving the links between works councils and the board and between works councils and trade unions.\footnote{R. Goodijk, ‘Corporate governance and workers’ participation’, \textit{Corporate Governance} 8 (2000), pp. 303 - 310.}

Jackson \textit{et al} note that Germany is becoming more open to shareholder value management practices and consider what this is likely to mean for codetermination. Despite the pessimistic claims of some, codetermination has proven able to justify itself in terms of shareholder value. It has not resulted in a loss of managerial accountability; quite the reverse is true. Codetermination and a shareholder value approach to governance, in combination, lead to a partnership approach being taken to industrial relations; this works well for employees with stable positions within the firm. They observe a trend towards firm-by-firm negotiation of the details of codetermination; it is becoming less politically guaranteed and more contractually negotiated.\footnote{Jackson, Hopner and Kurdelbusch, ‘Corporate governance and employees in Germany: changing linkages, complementarities and tensions’, pp. 115 – 118.}

The United Kingdom flirted with the idea of codetermination in the late 1970s. The Bullock Report\footnote{Command Paper (Cmnd.) 6706, London, HMSO.} proposed that there should be a system of employee participation on the boards of companies with more than 2,000 employees. There were to be equal numbers of shareholder and employee representatives and a third group selected by the first two
groups. The third group would both provide expertise and act as a tie-breaker in the event of deadlock. The system would only apply to businesses once employees had voted in favour of its introduction. Bullock recommended that certain functions (appointment of senior management, changes in capital structure and major disposals) would be reserved to the board regardless of the wishes of shareholders. The report recommended that there should be a statutory statement of directors' duties and that one of these should require directors to take employee interests into account. The principal proposals of the Bullock Report were never implemented.

There is no guarantee that co-determination would turn an enterprise into the sort of participatory community that CST calls for:

Only if there is parity of employees on the board of directors, only if they have support staff answerable to them to advise them, and then only if the employee directors do not become co-opted can the scheme have any chance of being effective. Merely permitting employee representatives to sit on the board of directors will do little to ensure that appropriate attention is paid to employee interests.  

At the very least, co-determination has symbolic value in that it gives employees a constitutionally recognised place in corporate governance. Employee representatives can act as advocates for employee interests and help to improve the flow of information between the board and employees.

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It has been argued that some forms of codetermination are harmful in that they allow managers to play employee and shareholder representatives off against each other. As a result, management may be able to free itself from effective scrutiny\(^{52}\). The indirect result of this would, presumably, be to raise the company’s cost of capital (assuming that minority shareholders felt that there was a significant agency risk).

An alternative (or complementary) strategy to co-determination would be the reformulation of the directors’ duty of loyalty so that it includes a duty to promote employee welfare. O’Connor is among those calling for this approach to be taken. She laments the fact that the shareholder-value approach fails to acknowledge the importance of human capital. But she suggests that this failure will be corrected as economic systems are forced to acknowledge the importance of human capital. She argues for the imposition of a fiduciary duty on directors to keep employee representatives informed about the business and to have regard to any representations that they may make\(^{53}\).

Even without a co-determination system, indeed even without structural reform of corporate governance, it would be possible to bring employees into the corporate governance system. Jacoby has argued that a human resources director in the boardroom

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could do much to ensure that directors have regard to employee welfare\(^5^4\) (though this would rely on the human resources director understanding that his role was, in part, to act as an advocate for employees). Gospel and Pendleton argue that even in shareholder-centred systems like the UK, managers can secure a very considerable degree of discretion to handle matters as they see fit\(^5^5\). Deakin \textit{et al} also contend that it is important not to get too carried away with the idea that there is a single approach to corporate governance common to all UK listed companies. UK company law and corporate governance are, it is true, strongly attuned to the needs of shareholders. At the same time, there is empirical evidence to show that unions can play a significant role, even in UK listed companies. Goodwill is not enough, however. Management will only be able to persuade key investors of the benefits of a partnership with employee representatives where there is a clear link between financial returns to shareholders and product or service quality. The human factor also has a part to play: effective management-employee partnerships depend on the quality and vision of management at all levels as well as of union representatives. Finally, it is important that there is an effective human resources director playing a part in board-level decisions; this person can argue the case for investment in human capital\(^5^6\).


\(^5^5\) Gospel and Pendleton, ‘Finance, corporate governance and the management of labour: a conceptual and comparative analysis’.

Employee share ownership

CST’s interest in employee share ownership (or some functional equivalent) is principally based on its reflection on the relationship between the human person and material creation. The Church’s thought on this matter is rooted in reflection upon the account of creation given in the opening chapters of the Book of Genesis. God made His initial gift of the created world to the entire human race. The human person, each individual, has, in the Christian view of things, a unique vocation to play a part in cultivating the earth’s resources so that it is enhanced and so that it meets human needs. *Laborem exercens* puts it this way:

When we read in the first chapter of the Bible that man is to subdue the earth, we know that these words refer to all the resources contained in the visible world and placed at man’s disposal. However, these resources can serve man only through work. From the beginning there is also linked with work the question of ownership, for the only means that man has for causing the resources hidden in nature to serve himself and others is through his work. And to be able through his work to make these resources bear fruit, man takes over ownership of small parts of the various riches of nature: those beneath the ground, those in the sea, on land or in space. He takes all these things over by making them his workbench. He takes them over through work and for work.\(^57\)

The following passage occurs a little later:

\(^{57}\) *John Paul II, Laborem Exercens*, para. 12.
it is clear that recognition of the proper position of labour in the production process demands various adaptations in the sphere of ownership of the means of production.\textsuperscript{58}

The institution of private property, that is, plays an indispensable part in establishing an appropriate, properly human link between the worker and the part of creation worked upon. The worker achieves the stable form of possession that sustained work (with its enormous significance for the self-realisation of the worker at a range of levels) demands and the profit he makes by his work provides him with an incentive to put the property to good use\textsuperscript{59}.

\textit{Centesimus annus} did not deal directly with employee rights, nor with the question of employee participation. The need to give employees some stake in their work, to make an appeal to a legitimate form of self-interest is, however, reinforced by this extract from \textit{Centesimus Annus}:

Man tends towards good, but he is also capable of evil. He can transcend his immediate interest and still remain bound to it. The social order will be all the more stable the more it takes this fact into account and does not place in opposition personal interest and the interests of society as a whole, but rather seeks ways to bring them into fruitful harmony.

\textsuperscript{58} John Paul II, \textit{Laborem Exercens}, para. 14.

In fact, where self-interest is violently suppressed, it is replaced by a burdensome system of bureaucratic control which dries up the wellsprings of initiative and creativity. 60

The idea of an alignment between self-interest and the well-being of one’s communities is obviously relevant to the theme of employee participation. This provides another, very pragmatic, reason for giving employees some kind of financial participation in their own firm: this participation (if well-designed) can reinforce their commitment to the common good of the firm.

CST urges those involved in corporate governance to look for specific and effective ways of strengthening the concept of the mutual complementarity of capital and labour. One could say that CST calls for a more work-oriented vision of the corporation to complement and correct the finance-driven view of the corporation that currently prevails. Employee share ownership is the most obvious way of aligning the interests of shareholder and employees. Properly structured, it could give employees a way of participating in governance as well as the other benefits of ownership (financial and psychological).

Gates 61 points out that the capitalist system as currently constructed has set in train a dynamic that tends to concentrate wealth in the hands of a few people. This process

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60 John Paul II, Centessimus Annus, para. 25.

results in more and more wealth becoming concentrated in the hands of an elite. He calls for a financially-engineered response that would enable more people to acquire significant capital. ESOPS, for example, could be encouraged through the right tax incentives.

Turning employees into owners would benefit the organisation, he argues, since it would enhance feedback mechanisms and give employees a way of having their voices heard. There would be obvious financial benefits to employees but Gates hopes that there would be wider benefits too:

Fundamentally, we need organizational structures enlivened with *spiritus* (“life-breath”). That requires commercial relationships that foster a sense of belonging while providing avenues for exercising personal responsibility according to a self-perceived sense of place, commitment and community. That new context will, in turn, awaken people to their opportunities to serve (both inside and outside the firm) and provide them (through ownership) an institutionally empowered means for taking up those opportunities. My hope and expectation is that a renaissance in service would evoke in its turn a renaissance in commitment to the democratic process, as those who have gratitude for the opportunities accorded them will be eager to extend those opportunities to others.62

Employee ownership is capable of conferring economic benefits on the firm. Employee participation and ownership can align the interests of owners with those of employees and, properly structured, can provide employees with additional incentives to work well.

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Employee participation engenders loyalty and commitment and so reduces the need for supervision costs. Incentives for individual effort do not reward contributions to a team effort. Employee commitment to the firm is especially important in sectors that rely on innovation.

Njoya has shown that the idea that employees have a proprietary interest in their jobs has had judicial approval in the UK and the US. The question, though, is how the concept can be given practical meaning: clearly, economic reality means that no-one has a guaranteed job for life. Njoya, for good reasons, focuses on protecting employees when the firm is restructuring or approaching insolvency. The promotion of employee share ownership is another avenue that could be explored; it is another possible way of operationalising the job-as-property concept.

Shareholders do not own the corporation as such. Davies comments:

The old argument that the shareholders have [control rights] because they are the owners of the corporation now carries little sway, because its premise is false: shareholders own their shares, not the company.

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Shareholders are, however, almost invariably granted extensive rights of control over the corporation’s management, constitution and economic surplus. It could be argued that in practical terms, those control rights amount to ownership of the corporation.

The vast majority of corporations in the United Kingdom are, at least in principle, run for the benefit of their shareholders. Gospel and Pendleton highlight the ways in which the corporation’s financing arrangements have an impact on management policies. Finance and governance, they suggest, affect the interests pursued by managers, the time horizons that they adopt in their decision-making processes and the strategies that they pursue (whether the focus tends to be on profit or on incremental product improvement). It also has an impact on whether the firm tends to rely on market-based incentives to secure employee commitment.

The influence of finance and governance specifically on labor management occurs at system level. It has an impact on job security and internal labor markets. Further, a shareholder value system of corporate governance forces firms to break implicit contracts with employees. Then there is an effect in terms of employees' willingness to acquire firm-specific skills. Finance and governance may have an impact on the nature of firms' demand for skills. It may be difficult to promote flexible forms of work and teamwork in the UK / US.


There are some well-founded objections to employee ownership. Some suggest that investor-owned firms are the norm because they enjoy significant efficiencies that employee-owned firms cannot replicate. It has been argued that shareholders can play the governance function more efficiently. Unless the employee-owned firm’s governance and management structure are well-designed and unless they can find ways of financing the business, employee owned and managed firms will fail. Dow and Putterman suggest that capital usually hires labour because: the owners of capital have better incentives to monitor the use of physical assets; workers could not finance the firm; workers are risk averse and need to diversify some of their wealth away from their employer; labour-managed firms cannot cope with highly specialised physical assets and because labour-managed firms find it difficult to reach collective decisions because of the diversity among employees in terms of appetite for risk, personal situations and attitudes. No doubt there is substance in many of these objections. They are not, however, lethal to the arguments put forward here. Rather, they show the need for careful attention to detail when trying to design participatory workplaces.

Employee share ownership plans (ESOPs) are one possible way of meeting CST’s aims of giving employees some financial participation and a real sense of ownership. The distinctive feature of an ESOP (Employee Share Ownership Plan) is that a trust is used to acquire and hold equity and to distribute it to employees. Pendleton argues that ESOPs have their most profound effect, in participation terms, where setting up the ESOP has

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been accompanied by innovative governance structures with well-developed systems for representative participation and close links between the system for participation in management and that for participation in governance. Examples of innovative governance structures include providing for worker-directors and the establishment of employee-shareholder committees. In these cases, employee ownership was found to have a significant intrinsic impact on employees’ psychological commitment.  

It seems that the new governance institutions in employee-owned firms do make a difference; there are greater flows of information from management to representatives, especially on financial matters, worker-directors are involved in all types of board-level decisions and do seem to have some influence. They do not lead to worker-control though. The new governance structures can be thought of as being akin to German-style co-determination:

Property rights give workers and their representatives legitimate access to information and decision-making that is rare in the UK. Whilst formal veto powers are given to worker directors in the Articles of many of these companies, these are rarely exercised. Instead, the primary importance of board or trust membership is that it provides a mechanism for the expression of employee interests at the highest level of management, and for the transmission of company information to employee representatives. These institutions create the potential for top managers to incorporate employee and employee-owner interests and concerns into top-level decisions but they do not lead to top managers

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making decisions at the behest of employees and their representatives. Boards of directors in these companies are best seen as coalitions of interests rather than as vehicles for translating employee-owner interests into corporate policy.\textsuperscript{69}

Blasi et al contrast the US and EU experience of employee share ownership. They point out that employee shares and options should be distributed in addition to, not as a partial replacement for, the employee’s salary. Otherwise, employees would be poorly diversified, having both their human and financial capital in the same boat. Second, they report that in the US (where employee ownership is more widespread) the availability of a large established market for corporate shares creates an infrastructure for corporations seeking to promote employee share ownership. Thus, contrary to what one might have thought, active stock markets favour employee ownership (at least to some extent). Finally, they note that advocates of employee share ownership are subjected to an unreasonably high burden of proof; their opponents insist on evidence that employee ownership leads to superior performance. Amongst other deficiencies, this approach ignores the fact that there are grounds other than performance on which to base the call for measures to promote employee ownership\textsuperscript{70}.

Michie and Oughton argue that employee participation can be a way of ensuring that employee interests are reflected in corporate decision-making. They suggest that

\textsuperscript{69} Pendleton, \textit{Employee ownership, participation and governance – a study of ESOPs in the UK}, pp. 187 – 188.

employee participation and ownership can align the interests of owners with those of employees and that institutional shareholders lose value by not actively engaging with employees. Ownership matters, they contend, because it is associated with control rights and financial incentives.

The problem for corporations and for employees is that "financial" shareholders may have shorter time horizons than employees and management. In addition, corporate governance needs to address the conflict of interests between owners and employees and between managers and non-managerial employees. Change is needed to overcome short-termism. Employee participation can engender loyalty and commitment and so reduce the need for supervision costs. Incentives for individual effort do not reward contributions to a team effort but employee commitment to the firm is especially important in sectors that rely on innovation. Michie and Oughton advocate an integrated approach to corporate governance that includes ownership, employee participation and high performance work systems and shareholder activism. When it comes to devising governance structures that might facilitate employee voice, Michie and Oughton point out that employee ownership both allows employees to benefit from the success of the company and (because of the resulting employee voice) can help to ensure the prevalence of participatory HR management practices.

To maximise shareholder voice, it makes sense for employees to find ways of pooling their voting rights; Trade Unions could play an important part in helping to ensure that the voice of employee / shareholders is heard. The problem with current board structures
lies in the importance given to the views of the Finance Director and of others with a focus on "the bottom line"; their perspective might discourage the adoption of progressive Human Resource practices. Michie and Oughton argue that reform of corporate governance / company law is needed so that the importance of stakeholders other than shareholders can be recognised. There should be experimentation with new corporate forms and employee share trusts should play a more active role in corporate governance\textsuperscript{71}. 

It would clearly be undesirable if employee share ownership became a source of division within the company. The aim to be achieved is for share ownership to become a means of fostering a partnership approach within the company. This is achievable given management skill and the right investors. It is a mistake to believe that financiers are a homogeneous group even within a system. Different investors have their own preferences concerning time frames, respect for other stakeholders and so on; it would be mistaken to see them all as being driven by a simple desire for profit\textsuperscript{72}.

Deakin \textit{et al} point out that it is important not to get too carried away with the idea that there is a single approach to corporate governance common to all UK listed companies. UK company law and corporate governance are strongly attuned to the needs of shareholders. At the same time, there is empirical evidence to show that unions can play a


significant role, even in UK listed companies. Goodwill is not enough, however. Management will only be able to persuade key investors of the benefits of a partnership with employee representatives where there is a clear link between financial returns to shareholders and product or service quality. The human factor also has a part to play: effective management-employee partnerships depend on the quality and vision of management at all levels as well as of union representatives. Finally, it is important that there is an effective human resources director playing a part in board-level decisions; this person can argue the case for investment in human capital.\footnote{S. Deakin, R. Hobbs, S. Konzelmann and F. Wilkinson, ‘Partnership, ownership and control. The impact of corporate governance on employee relations.’ Employee Relations 24 (2002) 335 - 352.}

Shareholders should be responsible citizens of the corporate community by contributing to governance. This is especially true of institutional investors given that they have greater power in individual companies and in the economy as a whole and that they have the resources to play an informed role in corporate governance.\footnote{J. Hawley and A. Williams, Fiduciary capitalism. How institutional investors can make corporate America more democratic, (Philadelphia, University of Pennsylvania Press, 2000).} Corporate governance policy should aim to encourage individual shareholders, especially institutional shareholders, to accept the responsibility that comes with their extensive control rights. This responsibility obviously includes a responsibility to assess whether or not the corporation’s assets are being put to productive and profitable use. It goes wider than this, however. Part of this responsibility is that shareholders should seek to cultivate a spirit of partnership with employees. Shareholders should give life to the idea that property ownership is at the service of human needs and human work. Share ownership has ethical
and cultural dimensions that need to be emphasised to a far greater extent than has been true in the past.

The John Lewis Partnership

The John Lewis Partnership (owning the John Lewis and Waitrose chains) is an employee-owned business that competes successfully with aggressive businesses with more conventional governance structures. Commercially, it is no push-over and yet its central philosophy is that it exists for the sake of the all-round well-being of its employees. The commercial success of the John Lewis Partnership gives the lie to those who argue that firms that put employees at the heart of their ownership and governance are doomed to failure.

Its Constitution is a remarkably sophisticated document and it deserves careful attention as a possible working model for a business that aspires to be run in accordance with CST’s insights. It declares that the Partnership’s ultimate purpose is the happiness of all its members through their worthwhile and satisfying employment in a successful business. It aims to make sufficient profit to sustain its commercial vitality, to finance

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76 The John Lewis Constitution, Principle 1.
its continued development, to distribute a share of profits to members and to enable it to undertake other activities consistent with its ultimate purpose\textsuperscript{77}.

The Constitution creates three governing authorities, the Partnership Council, the Partnership Board and the Chairman\textsuperscript{78}. The Chairman appoints a Management Committee comprising the top layer of management but this is not a governing authority. The power of the governing authorities depends on the consent of the Partners ("employees")\textsuperscript{79}. The shared aim of the governing authorities is to safeguard the partnership’s future and to enhance its prosperity. They should encourage creativity and an entrepreneurial spirit without risking any loss of financial independence\textsuperscript{80}.

The Partnership Council is predominantly composed of employee representatives as they are to outnumber any of the Chairman’s appointees by at least four to one\textsuperscript{81}. Its role is to hold principal management to account by discussing, asking questions about and making recommendations on any subject it wishes. The Partnership Council is intended to act as a channel of communication between management and employees ("Partners"). The Partnership Council can ask the Partnership Board (the board of directors of John Lewis Partnership plc) and the Chairman any question it wishes and they must answer unless

\textsuperscript{77} The John Lewis Constitution, Principle 3.

\textsuperscript{78} The John Lewis Constitution, Principle 2.

\textsuperscript{79} The John Lewis Constitution, rule 2.

\textsuperscript{80} The John Lewis Constitution, rule 4.

\textsuperscript{81} The John Lewis Constitution, rule 12.
doing so would, in their opinion, damage the Partnership’s interests. The Chairman has to appear half yearly before the Partnership Council to review the Partnership’s trading position and general progress and to answer questions. If the Council judges that the Chairman has failed to fulfil his responsibilities or is no longer a suitable person to do so than it may pass a resolution to dismiss him. Thus, the most powerful figure in the whole system is ultimately answerable to employee representatives. The Partnership Council has counterparts at Division and Local levels with broadly the same responsibilities as those of the Partnership Council in respect of their Division, branch or unit (as the case may be). The Chairman can make appointments to the Partnership Council, principally to ensure that its work benefits from the full participation of senior management and has immediate access to specialist knowledge.

The Partnership Board is the board of directors of John Lewis Partnership plc and it exercises the traditional corporate governance functions. The Partnership Council elects five Partners to the Partnership Board (there are currently twelve members of the Board). So there is strong employee representation in corporate governance. There is

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82 The John Lewis Constitution, rule 7.

83 The John Lewis Constitution, rule 9.

84 The John Lewis Constitution, rule 10.


86 The John Lewis Constitution, rule 12.

87 The John Lewis Constitution, rules 38 – 40.

88 The John Lewis Constitution, rule 18(iii).

also a Chairman’s Management Committee the members of which are appointed by the Chairman. The Management Committee coordinates executive responsibility in the Partnership and the views of principal management.\footnote{The John Lewis Constitution, rule 42.}

The Chairman is absolutely central to the working of the Constitution. As already seen, he can make appointments to the Partnership Council and appoints the Chairman’s Management Committee. He is the senior executive in the Partnership.\footnote{The John Lewis Constitution, rule 42.} He has the duty to ensure that the Partnership retains its distinctive character and its democratic vitality.\footnote{The John Lewis Constitution, rule 41.} On taking office, he makes a written undertaking that, among other things, he will uphold the Constitution and work to the utmost of his energy and ability for the fulfilment of the Partnership’s Principles.\footnote{The John Lewis Constitution, rule 43(i).} The Partnership Council, as we have seen, can hold the Chairman to account and even resolve to dismiss him.\footnote{The John Lewis Constitution, rules 9 and 10.}

A commitment to subsidiarity is one of the most striking features of the John Lewis Partnership Constitution. It emphasises that every Partner has a responsibility to promote the well-being of the business. It encourages the exercise of initiative and tries to devolve decision-making power to as local a level as possible. It seeks to create as many opportunities as possible for Partners to voice their opinion on Partnership matters. The Introduction to the Constitution states that the Partnership is the general body of Partners,
working together for the success of the business\textsuperscript{95}. The Partners “share the responsibility for ownership as well as its rewards – profit, knowledge and power”\textsuperscript{96}. The Partnership operates on democratic principles and seeks as much sharing of power among its members as is consistent with efficiency\textsuperscript{97}. The Partnership’s management should devolve as much power to its representative bodies as is commercially prudent\textsuperscript{98}. In carrying out his duties, the Chairman is actively to seek to share power with his subordinates, delegating as much responsibility and encouraging as much initiative as possible\textsuperscript{99}. The Partnership encourages Partners to fulfil their potential and increase their career satisfaction in a number of ways\textsuperscript{100}. The Chairman is to maintain open communication with Partners at all levels and Partners have a duty to inform the Chairman of anything he reasonably should know\textsuperscript{101}. The Partnership’s in-house journals rely upon intelligent cooperation from Partners and a determination on the part of management to share as much information with Partners as possible\textsuperscript{102}. All of this comes on top of the ability to participate in governance that has already been discussed.

\textsuperscript{95} The John Lewis Constitution, Introduction, para. 4).

\textsuperscript{96} The John Lewis Constitution, Principle 1.

\textsuperscript{97} The John Lewis Constitution, rule 1.

\textsuperscript{98} The John Lewis Constitution, rule 4.

\textsuperscript{99} The John Lewis Constitution, rule 45(i).

\textsuperscript{100} The John Lewis Constitution, rule 56.

\textsuperscript{101} The John Lewis Constitution, rule 45(iii).

\textsuperscript{102} The John Lewis Constitution, rule 77.
The Constitution emphasises the duties and responsibilities of individual Partners; this clearly goes hand in hand with the benefits of membership. The Partnership aims to employ and retain as its members people of ability and integrity who are committed to working together and supporting its Principles 103. It seeks to recruit only those who share its values and will contribute to its success 104. The Partnership will not retain any Partner who cannot contribute satisfactorily 105 nor will it retain Partners in positions that are no longer required 106. The whole of Section 2 of the Constitution’s Rules section is devoted to the Partners’ rights and responsibilities.

As for job security, the Constitution’s rules contain a section dealing with security of employment. The Partnership aims to offer secure employment 107 though the commitment is not absolute since Partners can be dismissed if they cannot contribute satisfactorily 108 and Partners will not be retained in a position that is no longer required 109. The Partnership commits itself to give all the help it reasonably can to any Partner who has difficulties at work 110. Partners with more than five years’ membership are to be encouraged to develop their skills so that they can continue in the Partnership for the rest
of their working lives\textsuperscript{111}. When a position becomes redundant, the Partnership will seek to provide alternative employment if possible\textsuperscript{112}.

The Principles section of the John Lewis Partnership Constitution set out the Partnership’s aims and ultimate purpose. Three (out of seven) principles concern the Partnership’s relationships with principal stakeholders (although that term is not used by the Constitution; these set out the Partnership’s approach to dealing with customers\textsuperscript{113}, its business relationships\textsuperscript{114} and the community\textsuperscript{115}. These principles are elaborated upon in a section of the rules in the Constitution entitled “responsibilities to others”\textsuperscript{116}. The “others” in question are customers\textsuperscript{117}, suppliers\textsuperscript{118} and competitors\textsuperscript{119}. The rules also encourage the Partners to get involved in public service\textsuperscript{120} and require them to comply with all legal requirements\textsuperscript{121}. The Partnership commits itself to taking all reasonable

\begin{footnotes}
\item[111] The John Lewis Constitution, rule 68.
\item[112] The John Lewis Constitution, rule 68.
\item[113] The John Lewis Constitution, principle 5.
\item[114] The John Lewis Constitution, principle 6.
\item[115] The John Lewis Constitution, principle 7.
\item[116] The John Lewis Constitution, rules 92 – 108.
\item[117] The John Lewis Constitution, rules 92 – 94.
\item[118] The John Lewis Constitution, rules 95 – 103.
\item[119] The John Lewis Constitution, rule 104.
\item[120] The John Lewis Constitution, rule 105.
\item[121] The John Lewis Constitution, rule 106.
\end{footnotes}
steps to minimise any detrimental effect its operations may have on the environment and to promote good environmental practice\textsuperscript{122}.

The Constitution of the John Lewis Partnership has been described in some detail because it fits so admirably with CST principles. It makes employee well-being (defined in terms of financial returns and satisfying careers) the firm’s ultimate purpose. Its sophisticated governance structure allows for dialogue between employee representatives and management and generally encourages all employees to voice their opinion on matters related to the partnership. Crucially, it requires Partners to take responsibility for the business and encourages the delegation of power. All of this contributes to a general sense that the firm belongs to the Partners. The Partnership sets itself high standards in its dealings with stakeholders but makes it clear that they are “others”, not Partners in the firm. Clearly, the constitution is worthless without an effective commitment to put it into effect. The Partnership seeks to recruit only those who share its values and will contribute to its success\textsuperscript{123}.

Mandatory codetermination?

Should the state intervene and impose some form of employee participation as a matter of law? The principle of subsidiarity suggests that the state should be reluctant to intervene

\textsuperscript{122} The John Lewis Constitution, 108.

\textsuperscript{123} The John Lewis Constitution, rule 53.
in the internal affairs of its intermediate associations. Promoting research into the issue, discovering and disseminating best practice are better approaches.

Nevertheless, the state may sometimes legitimately feel that it has to intervene; indeed, Bellace suggests that it is crucially important for the state to devise mechanisms that will “serve as bulwarks for independent employee voice”\textsuperscript{124}. Legally mandated systems might be better able than systems relying on “soft” power to stand up to the spread of an aggressive shareholder value mentality and legal intervention might allow capital and labour to overcome mutual distrust to reach a solution that each group would find preferable and that enhances total firm value\textsuperscript{125}. Management and capital might systematically oppose any form of participation in ways that threaten to leave workers as permanent outsiders. Legislation might be needed to overcome this. The state might feel that important political values affecting the state as a whole are at stake and that this justifies intervention\textsuperscript{126}.

The fact that employees at a given time voiced opposition to a move to participation should be investigated and considered carefully. It may be that employees do not understand what the change might mean for them and fear that it is a ruse to impose extra work for the same or less pay. They may have concerns, perhaps well-grounded, that the

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\textsuperscript{125} D. Charny, ‘Workers and corporate governance: the role of political culture’, in Blair and Roe (eds.), \textit{Employees and corporate governance}.

\textsuperscript{126} M. Roe, \textit{Political determinants of corporate governance}, (New York, Oxford University Press, 2003),
\end{flushleft}
seemingly benign proposal will be abused by management. There could be genuine employee fears about management’s agenda or its willingness or ability to improve the content of employees’ jobs and the causes of those fears would need to be addressed. That aside, in the last analysis the fact that some employees express reluctance about a move to employee participation is not a reason in principle to abandon a commitment to a participatory workplace.\textsuperscript{127} The firm is a community with interests that are directed towards, but that are larger than, the fulfilment of the needs of a given individual or group of individuals (such as those of employees at a given moment in time). The firm has to be structured in such a way as to serve all employees, shareholders and customers over its lifespan. Further, the firm forms part of a broader social fabric and its ability to engage and develop its employees has broader social implications.

Johnston argues the case for legally-imposed or facilitated co-determination. There are a number of reasons why efficient codetermination would not be generated by purely market processes. There are problems of bounded rationality and opportunism to contend with and these may prevent parties from seeing the benefits of shared governance or, if they do, on being able to devise adequate structures. There could also be an adverse selection problem: if codetermination were not mandatory the least able employees would go to the codetermination firms where they are more secure. Further, managers may resist codetermination because they do not want to share power with employees or to

\textsuperscript{127} Despite the arguments of some in the law and economics camp that the expressed preferences of current employees should be taken at face value and should be determinative of the question as to whether employee participation should be introduced. See, for an example of this view, S. Bainbridge, ‘Corporate decision making and the moral rights of employees’, 43 (1998) \textit{Villanova Law Review}, pp. 769 – 771.
be monitored by them. He also points out that where co-determination is not the norm, sheer unfamiliarity with this governance structure is an obstacle to its emergence\textsuperscript{128}.

Singer argues that governmental intervention, in corporate governance and more generally, to promote fundamental employee rights (including rights to participate in the formulation of corporate policy) is both necessary and morally justifiable. He rejects the argument that this is an intervention in private contracting that would necessarily harm everyone by imposing higher terms than employers would be prepared to offer or employees would be prepared to accept (the unintended consequences type of argument). He argues that this logic does not apply when there is a radical inequality of bargaining power. More fundamentally, there are some things that are due as a matter of common decency. Consistently with a natural law approach, Singer’s starting point is to say that employment (by which he seems to mean stable and “well-paid” employment) is a prerequisite for participation in the economic system and is necessary for human flourishing. Thus, a just economic system will have to provide: access to well-paid employment (providing a wage that will support a family at least above subsistence level); some reasonable guarantees of job security; retraining and job placement when employees are “in transition”; and a right to participate in formulating corporate policy in a democratic manner. He suggests that this outcome is most likely to be achieved by some form of codetermination or by giving employees ownership of voting shares or by a

combination of the two. Worker participation is justified, he believes, by analogy with democracy in the political system\textsuperscript{129}.

Dundon \textit{et al} point out, however, that the state of legislation or regulation is only one factor in determining whether or not employees will be given a voice in the organisation. In the last analysis, it is the attitude of management that will be crucial in this regard. The outcome for any given firm will result from a dialectic between regulation and management choice\textsuperscript{130}.

Conclusion

Corporate governance is the system within the corporation for setting corporate strategy and ensuring effective use of corporate assets. It allocates power and responsibility, typically between senior management, shareholders and employees. The way that corporate governance is organised can have a very significant impact on employees.

CST has stressed and explained the ethical importance of employee participation in corporate governance and of giving employees some form of ownership of the firm that they work for and a share of its profits. As this article has shown, there are real and significant difficulties in the way of workable employee participation in governance and


share ownership. It is argued, however, that they can be overcome with skilful design and a resolve on the part of senior management.

British companies are almost always under the control of shareholders and senior management. The shareholder value system means that management is under a duty to promote the best interests of shareholders. Even then, management can do much to promote a partnership between shareholders and employees. This calls for skill on its part in choosing the right investors and in creating the space for a partnership approach to work. The human resources director has a very important role to play in this regard.

The most obvious way of achieving employee ownership and financial participation is for employees to buy or be given shares in the company that employs them. ESOPs are an established tool for achieving this. In the right circumstances, ESOPs can lead to innovative governance structures that give employees a greater say in corporate governance.

Codetermination can do much to improve corporate governance and to improve the flow of information between management and employees. There is, however, virtually no prospect of codetermination being introduced on a widespread scale in the United Kingdom. Even in Germany, where it is well-established, it has been subjected to criticism. It is also under pressure from the spread of the shareholder value system. Nevertheless, it seems certain to survive though possibly in a modified way that is more accommodating of shareholder value practices.
The principle of subsidiarity suggests that states should be very slow to impose governance structures on corporations. It is unlikely that market forces would lead to codetermination being introduced where it is not already present. This suggests to some that they are in efficient but it may also be that serious market failures play a part in obstructing the spread of codetermination. In any event, there are important moral and political issues at stake that markets are not capable of addressing.