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GERMAN CORPORATE GOVERNANCE PROVISION FOR EMPLOYEES: LESSONS FOR AUSTRALIA?

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This paper analyses Germany's system of corporate governance for employees, and asks whether its distinctive model may provide a better set of solutions for Australian firms in dealing with the emerging social and economic realities of the 21st century? Germany's system of governance is predicated on employee involvement, whereas Australia's system, like its Anglo-US counterparts, focuses squarely on shareholders rights. Which model – Germany's stakeholder/communitarianism, or Australia's shareholder primary - will better fit the evolving needs of firms, and the challenging environments in which they will need to function and flourish?

I INTRODUCTION

This paper examines the situation of employees within the existing and emerging corporate governance arrangement in Germany. Despite Germany's recent economic woes, it remains the largest single economy in the European Union, and the third largest in the world after the USA and Japan. Germany is a paradigm case of providing clear and explicit provision for employees to have a place on company boards. Employees are therefore key stakeholders in the management of German firms and their representation is actually calibrated in relation to the size of the firm: the more employees, the more employee representatives on the board. Germany's 'stakeholder corporate governance' model represents a clear

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counterpoint to the Australian position, which is overwhelmingly predicated on shareholder primacy. As such, Australian firms provide no formal voice or representation for employees in terms of the management and governance of the company. Germany's governance arrangements regarding employees can, potentially at least, provide a source of innovation for the development of Australia's provision in this area.

Australia's corporate governance system represents something of a paradox. Its historical and philosophical roots are aligned with the Anglo-US model of shareholder primacy. As a result of the dominant position of shareholders within this construct, the provision made for employees in the Australian system is piecemeal and sporadic. However its geographic place is in Asia, and emerging Asian economies such as China and India look set to develop models more attuned to 'stakeholderism.' Japan is the prime example of a developed economy within the region adopting such a model.

Whilst Australia's system of governance is advanced in relation to shareholders, it is largely silent in relation to employees. As a result, employees do not enjoy formal legal rights – whether by statutory or at common law – to participate in the management of firms. Such provision, therefore, may occur only as a result of the enlightened behaviour and self-interest of firms, but not as a legally or cultural specific referent. Given the long-established climate of economic prosperity in Australia, there has been little reason to seek guidance and input from other than US-influenced models. This is especially the case when proponents of strong employee participation, such as Germany and Japan, have been in recession. However, with Australia suddenly experiencing economic uncertainty through rising interest rates and high fuel prices, there is an incipient feeling that the economic good times of the longest decade (1990 to 2005) may finally be coming to a close. This phenomenon is occurring at the same time as Australia is undergoing fundamental changes in the workplace, and the relationship between firms and their workers, in the guise of the federal WorkChoices legislation. The next few years, therefore, will be fascinating to observe in relation to the resilience, or otherwise, of Australia's model of governance in the wake of a new downward trend in the economic cycle. In this sense, Germany, as a prime example of stakeholder governance, provides

valuable information about the major competitive model dealing with employee governance.

II A BRIEF DESCRIPTION OF KEY GOVERNANCE FEATURES

A *Comparing tenets of German and Australian corporate governance*

Germany is regarded as possessing a 'closed' system of corporate governance. Together with Japan, it is the leading exponent of this type of system. Closed systems are characterised by reference to, and as oppositional of, open systems. The adjective 'closed' refers principally to the market for securities in corporations. It means that the shares are little traded and that shareholdings are stable and typically held for the long term. As Mark Roe notes by way of summary, Germany possesses a 'shareholder denigrating culture.'[1]

Alternative to the open and closed dichotomy, Colin Mayer categorises corporate governance systems into outsider-based and insider-based frameworks.[2] Anglo-American models, such as Australia's, are classic outsider systems with shareholdings in the firm being actively traded by both institutional and individual shareholders. Such systems rely 'on active external markets for corporate control through mergers and takeovers of listed companies.'[3] Australia squarely fits this model, along with the United States and United Kingdom, and the volatile takeover by Toll Holdings of Patrick Corporation is a good example of the market forces at work in such systems.

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1 Mark J Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (2003) 71.

2 Colin Mayer, 'Stock-markets, Financial Institutions and Corporate Performance' in N Dimsdale and M Prevezer (eds), *Capital Markets and Corporate Governance* (1994) 179.

3 On Kit Tam, *The Development of Corporate Governance in China* (1999) 25; Low Chee Keong (ed), *Corporate Governance: An Asia Pacific Critique* (2002) 4.

On the other hand, insider-based systems are found in Germany, Japan and continental Europe.[4] They do not possess 'an active market for corporate control, which is usually vested with large shareholders including banks.'[5] As Roe notes:

> Germany lacks good securities markets. Initial public offerings until recently have been infrequent, securities trading is still shallow, and even large public firms typically have big blockholders that make the large firms resemble semi-private companies.[6]

In depicting this model, there is a complex series of links between firms, institutional investors and banks. The Japanese *keiretsu* is a good example of these forces at play with its explicit and implicit links between a series of connected firms, banks and others.

Insider-based systems have evolved and 'developed in different social and commercial environments.'[7] They also proceed on the basis of different conceptions of the company as a Dodd-inspired vehicle, as opposed to a Berle derivation. This dichotomy is a reflection of the debate between the two US professors – A A Berle, Jr and E Merrick Dodd, Jr – in the 1930s, summarised in the three articles they produced as an evolving dialogue regarding the nature and purpose of firms.[8] Professor Berle advocated the view of the firm as a wealth building vehicle for shareholders/owners. His model provided impetus to the project of Anglo-US-Australian corporate and employee governance. Professor Dodd, on the other hand, believed the company to be a more complex, multi-dimensional entity, operating for the greater good of society, rather

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4 On Kit Tam, above n 3, 25.

5 Ibid.

6 Roe, above n 1, 71.

7 On Kit Tam, above n 3, 28.

8 The three articles are A Berle, 'Corporate Powers as Powers in Trust' (1931) 44 *Harvard Law Review* 1049; E Dodd, 'For whom are corporate managers trustees?' (1932) 45 *Harvard Law Review* 1145; A Berle, 'For whom corporate managers are trustees: a note' (1932) 45 *Harvard Law Review* 1365.

than a narrowly aligned band of owners/shareholders. Dodd's stakeholder model promoted employees, customers and others generally 'interested' in the company's work and the role in the society it serves. For Dodd, firms served society; for Berle they were beholden to shareholders, and hence the stakeholder and shareholder models were given voice, and continue to inform much of the debate concerning corporate governance around the globe.

As a consequence of their fundamentally different organisational premises, the Berle and Dodd theories of the firm helped to shape and define differing models of employee governance. Dodd's version of the firm can be argued to 'harmonize the interests of a wider range of stakeholders including the employees of the company.'[9] These models also transpose the ranking and importance of stakeholders. Instead of the Anglo-US-Australian domination of the shareholder as the pre-eminent corporate stakeholder, employees figure prominently: 'human capital, and the employees' investment in developing this firm-specific resource, are considered to be given their due importance in these models.'[10]

German governance has been said to take on an 'enclavist perspective.'[11] Dixon explains this stance as follows: 'Enclavists would see a blurred boundary between the corporate and the social spheres, which should be expanded if they conceal any unequal power relations in the corporate sphere' and they 'prefer a corporate governance mode where the corporate stakeholders and owners are jointly in the ascendancy.'[12]

This model has been referred to as 'the stakeholder (interactive or codeterminant) mode.'[13] The enclavist perspective is, in contrast to

9 On Kit Tam, above n 3, 28.

10 Ibid.

11 John E Dixon, *Responses to Governance: Governing Corporations, Societies and the World* (2003) 92.

12 Ibid.

13 J P Hawley and A T Williams, 'Corporate Governance in the United States: The Rise of Fiduciary Capitalism' (Working Paper, Los Angeles: Saint Mary's College of California, School of Economics and Business Administration, 1996) 21, as quoted by Dixon, above n 11, 92.

the individualist perspective,[14] favoured in the Australian corporate governance market.

Australia has an embedded shareholder culture. Directors are required by the law to keep watch for shareholders and their interests. This legal result is effectively codified in the various provisions of the *Corporations Act 2001* (Cth). These include:

- s 140 on the effect of the constitution and replaceable rules as operative contracts between the firm and a member and the members *inter se*. This provision gives members exclusive contractual rights and remedies.
- ss 232-4 oppressive conduct of affairs, gives members rights to take court action in the event of overbearing conduct.
- ss 236-7 proceedings on behalf of the company by members, again, gives shareholders rights ahead of other stakeholders to litigation in the firm's name.
- s 461 winding up by the court, including application by the members in terms of a special resolution (s 461(1)(a)) and due to oppressive conduct (s 461(1)(f)).

These provisions collectively position shareholders as pre-eminent within the firm. In a country such as Australia, with its strong common law tradition, it needs to be remembered that the emergent statutory provisions invariably began life as common law, judge made rulings. In this way, we can argue that the resulting shareholder primacy is a reflection of deeper and more basic cultural, economic, and social constructs.

B *The German model of the company*

Germany provides a fundamentally different corporate governance model that, in turn, underpins its elaborate approach to the

14 Dixon, above n 11, 83.

recognition and formulation of the rights and entitlements of employees.

The role of the German corporation is that of a legal entity cast with social responsibility. This precept is at the centre of the German firm and is found in the central piece of national legislation, the *German Federal Constitution*. Article 14(2) states that, 'property imposes duties. Its use should also serve the public wealth.' As Dixon notes, 'Article 14(2) of the Constitution expresses a *social market* philosophy.'[15] It both creates and expresses 'a social market'[16] philosophy. This has been referred to as supporting the 'social governance of markets'.[17] As we shall see in relation to the work of Katherina Pistor, the concept of social governance predates that of corporate governance in Germany.

The second driving force behind Germany's system of social governance is noted by Stefan Prigge.[18] Rather than relying on a statutory provision, it is associated with a legal gap in German law, as compared with Anglo-Saxon models. As he notes, German corporate law provides that there is 'no clear-cut legal obligation' requiring a board:

> to act solely in the interest of shareholders. … Instead, among legal scholars as well as among board members, there is no small support for a stakeholder approach i.e. one in which boards are obliged to consider the interests of a variety of constituencies.[19]

As a result, the German system of governance is the national system most closely aligned to Professor Dodd's complex, broad stakeholder model of the company in action engaging with the

15 Ibid 93.

16 Ibid.

17 S T Bruyn, *A Future for the American Economy: The Social Market* (1991), as quoted in Dixon, above n 11, 93.

18 Stefan Prigge, 'A Survey of German Corporate Governance' in Klaus J Hopt et al (eds), *Comparative Corporate Governance- The State of the Art and Emerging Research* (1998) 943.

19 Ibid 950-1.

community or communities in which it operates. (This model can be seen as the precursor to the more modern corporate social responsibility or CSR movement.) As such, German governance illustrates the strong links between the conception of the company and the resulting employee governance provisions.

C *Characterising the system of German employee governance*

In terms of David Charny's tripartite depiction of comparative employee governance models, Germany is an example of the 'hard system.' Germany's system of employee governance can be described as the paradigm hard regime. Charny uses the tri-partite division of hard, soft and no participation regimes.[20] Hard regimes are those 'that would support or make specific legal provision for institutional mechanisms or procedures by which employees would participate in governance.'[21] Formal mechanisms for employee involvement are embedded in the system and their genesis is the firm. German corporations provide a range of participatory mechanisms; they 'combine mandated social benefits, works councils and codetermination to this end.'[22] German 'securities markets have historically been weak.'[23] This phenomenon aligns itself to other features of the large German firm. For example, 'a shareholder-driven boardroom is impossible in the largest firms, because labor gets half of the German supervisory board.'[24] The structural dimensions of German governance therefore impact in a fundamental way on the dynamics of the firm.

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20 D Charny, 'Workers and Corporate Governance: The Role of Political Culture' in M M Blair and M J Roe (eds), *Employees and Corporate Governance* (1999) 91.

21 M M Blair and M J Roe, 'Introduction' in M M Blair and M J Roe (eds), *Employees and Corporate Governance* (1999) 1, 6.

22 Ibid.

23 Roe, above n 1, 71.

24 Ibid.

Germany has sought to achieve its 'corporate social objectives by the statutory imposition on corporations of corporate governance mechanisms that reflect the values of consensus, solidarity, community, and inclusiveness.'[25] As Roe notes, the German system of the firm 'formally manifests the underlying drive for institutions that would keep social peace and, historically, a middle way between harsh capitalism and strong socialism.'[26]

As John Dixon argues, 'societies have evidenced a willingness to exercise significant social control over all corporations.'[27] This is not to assume that the social obligations are a readily agreed set of principles. They go 'well beyond merely seeking to control industry entry, to combat fraud, or to regulate restrictive practices by embracing social regulation in order to protect particular social groups.'[28] They include 'occupational health, safety and welfare requirements, consumer protection, environmental protection and planning restrictions, technology assessment, and antitrust (antimonopoly) restrictions.'[29] They include, at the outer margins, holding firms to 'public account… for their support of good causes and for acting in the public interest.' These are fine sentiments but very difficult to define and therefore problematic. They reflect the post-modern dilemma; that individuals, depending on their perspectives, will have different views of these goals and their efficacy. As a matter of public policy

> their determination involves the state in a delicate balancing act between individual autonomy (the protection of the positive freedom of corporate owners, governors and managers) and collective control (constraining their positive freedom to promote the negative freedom of stakeholders).[30]

25 Dixon, above n 11, 82.

26 Roe, above n 1, 71.

27 Dixon, above n 11, 82.

28 Ibid.

29 Ibid.

30 Ibid.

As the exemplar of the hard system of employee governance, Germany displays an advanced degree in having resolved the 'competing social solidarities'[31] in the sense that individual and collective interests are in balance. In this accomplishment, it appears to have also resolved 'the knowability of the corporate interest, on the appropriate role of the corporate owners, stakeholders and managers in its identification, prioritization, and satisfaction; and on corporate governance capacity – and thus on corporate governability.'[32] This returns us to the precept at the centre of the German firm: 'that Article 14(2) of the Constitution expresses a *social market* philosophy.'[33]

Germany's arrangement is therefore formal, legally dominated and backed up by social behaviour. It is, for Australian observers, an advanced case of employees as corporate participants. As such, Germany is the leading corporate governance example of employee involvement. It is a prime example of seeking to find 'optimal governance balance'[34] to reflect a modern, post-Fordist economy. Along with Sweden, Germany has made room 'on the board for constituent groups (employees, consumers and minorities).'[35]

There are 'three pillars of German industrial relations.'[36] These are works councils, collective bargaining and 'employee and trade union representation on the supervisory boards of companies.'[37] The third element of the German model is one of 'co-determination' where employees have a formal and legally enforceable place in the corporate governance framework. Germany's model is a reflection of its economic and social history; it has developed a strong rights-

31 Ibid 83.

32 Ibid.

33 Ibid 93.

34 D A Bavly, *Corporate Governance and Accountability: What Role for the Regulator, Director, and Auditor?* (1999) 116.

35 Ibid.

36 Shelley Marshall, 'Works Councils and Bargaining with(in) Neo-Liberalism' [2003] *Australian Journal of Labour Law* 234, 236.

37 Ibid.

based movement that has been enshrined in many aspects of its law since World War II.

III RELEVANT CONTEXTUAL ISSUES

A *The influence of social governance*

The complex company model has long been a feature of German commerce; indeed 'German company law from the Weimar period (1919-33) recognized a broader range of stakeholders in the corporation'[38] than the United Kingdom and other common law countries. In particular, whilst corporate governance is a concept whose genesis occurred in the Berle and Dodd debate of the 1930s, the concept of codetermination predates it and originated in the 'social movements of late nineteenth-century Europe.'[39] It is from these sources that the legacy of employee involvement and participation in the company emerged. It was seen as a way of overcoming 'the contradiction between the classic liberal ideals of self-determination and the rights of the individual, on the one hand, and the reality of industrialization, on the other.'[40] The interplay between these types of diametrically-opposed forces has been in evidence, therefore, for more than a century.

The *German Federal Constitution* provides via article 14(2) that 'property imposes duties. Its uses should also serve the public good.' This formally recognises the corporation as a social institution. This is in accord with the sentiment that 'a corporation is the legal personification of a firm which is a social institution. This legal personification should not distort the underlying social reality.'[41] This grand narrative of the firm appears to be exemplified in German corporate theory and practice. The 'objectives of German

38 J H Farrar, 'Frankenstein Incorporated or a Fools' Parliament? Revisiting the Concept of a Corporation on Corporate Governance' (1998) 10 *Bond Law Review* 141, 154.

39 K Pistor, 'Co-determination: A Sociopolitical Model with Governance Externalities' in M M Blair and M J Roe (eds), *Employees and Corporate Governance* (1999) 163, 164.

40 Ibid.

41 Farrar, above n 38, 162.

companies do not stop at profit maximization, but recognize a broader concept of the interest of the company as a whole.'[42]

B *Political history: post war boom*

The period after the Second World War offered an opportunity for a new settlement between managers and workers. Whereas before the war there had been a struggle between the concept of managerial control – as 'the traditional means of increasing productivity'[43] – and an institutional means of consultation – via, for example, works councils, the post-war period essentially removed the choices. Employers 'had lost the capacity to support authoritarian alternatives to liberal democracy, just as communist and communist and syndicalist tendencies among labour movements were more or less effectively suppressed by the American presence.'[44] The post-war period marked a fundamental shift from the interwar period. In the new age,

> there was no doubt that industrial relations in reconstructed Europe would be both labour inclusive and moderate – with employers recognizing unions and unions by and large accepting the role of employers.[45]

In this environment economic imperatives set the tone for the emerging model of employee-employer relations. 'The pressing need for economic reconstruction, moreover, virtually forced unions and employers to work together in pursuit of economic improvement.'[46]

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42 Ibid 155.

43 Joel Rogers and Wolfgang Streeck, 'The Study of Works Councils: Concepts and Problems' in Joel Rogers and Wolfgang Streeck (eds), *Works Councils: Consultation, Representation, and Cooperation in Industrial Relations* (1995) 3, 16.

44 Ibid 17.

45 Ibid.

46 Ibid.

Whereas the chief victors in the Second World War – the United States and United Kingdom and by extension, loyal satellites such as Australia – oversaw an increasingly atomised and antagonistic relationship between managers and workers, continental Europe embraced a socially inclusive model of the workplace. Germany's post-war experience is a good example of Roe's hypothesis of 'peace as predicate': 'before a nation can produce, it must achieve social peace.'[47] This also translates to an individual firm level: 'before a nation can produce, it must have sufficient economic peace that the factory can function.'[48] The German narrative of workplace relations in the post-Second World War period illustrates this well. From a nation whose infrastructure had largely been destroyed, Germany rose in a few short decades to be the most powerful economy in Europe and the third most powerful in the world after the United States and Japan.

C *The EU project*

Germany and France have been the chief protagonists of European integration. As such their corporate and employee governance models have shared more in common than has either system with perennial European Union 'outsider', the United Kingdom. This has resulted in differing narratives: for Germany it has been a leader and the concept of engagement has followed. For the United Kingdom it has observed and 'opted out' of key social and governance developments. Whilst there is a European as opposed to Anglo-American style of governance, the German model of governance has regularly been 'portrayed as the most distinctive of the European types.'[49] The key challenge for the German economy and for its employee governance framework will be the newly expanded EU comprising some 25 nations. In particular is the fact that freedom of movement will mean that many workers, both skilled and unskilled,

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47 Roe, above n 1, 13.

48 Ibid vi.

49 Thomas Clarke and Richard Bostock, 'Governance in Germany: The Foundations of Corporate Structure?' in K Keasey, S Thompson and M Wright (eds), *Corporate Governance: Economic, Management, and Financial Issues* (1997) 233, 233.

from poorer nations within the union will be seeking work and re-settlement in Germany.

IV GERMAN EMPLOYEE GOVERNANCE IN DETAIL

A *Two-tier board structures*

The structure of German corporations is fundamentally different from the Anglo-US model favoured by the United Kingdom, the United States and Australia. Whereas a single board is the framework for firms in these countries, a two-tier board is the relevant frame for German firms. This is particularly the case for: 'the public limited company (Aktiengesellschaft, AG) [which] stands at the centre of the analyses, since in other legal forms of business organization, ownership and control are more closely aligned.'[50] As Prigge notes, 'the management board conducts the business of the *AG* and is supervised by the supervisory board.'[51] The upper, supervisory board is the *aufsichstrat* and the executive board or committee is the *vorstand.* There is a close working relationship between the two boards. The executive board presents proposals and plans to the supervisory board, which in turn performs a comment and approval role.[52] The supervisory board also 'reviews and assesses subsequent management performance.'[53] It has the power 'to appoint and remove executives from the executive committee.'[54] As noted earlier, there is no clear-cut legal obligation that requires both boards, or indeed either of them, to 'act solely in the interest of shareholders.'[55] This circumstance, together with a

50 Prigge, above n 18, 947.

51 Ibid 949.

52 R I Tricker, *Pocket Director: The Essentials of Corporate Governance from A to Z* (1996) 92.

53 Ibid.

54 Ibid.

55 Prigge, above n 18.

particular reading of Article 14 of the *German Federal Constitution*,[56] sets the basis for social governance.

The structure of German firms raises fundamental differences of approach in terms of both corporate and employee governance. The complexities of this symbiotic relationship between two independent board structures presents an alien conception to corporate models generated along single board lines. It raises seemingly insurmountable philosophical and operational obstacles. For Australian firms, for example, the key issues will be ones of independence in relation to board issues that are intrinsic to single board frameworks. For example, can the CEO also be the Chairperson? Another issue of independence is the role, number and function of the non-executive directors. A third issue is the role played by the auditors and, in particular, whether they are conducting non-audit work. The challenges raised by these issues are exacerbated by a single board structure. It becomes the locus of the major conflicts between stakeholders.

A two-tier board structure introduces both a level of complexity and a level of specialisation. This allows a mechanism for more arm's length dealings and for more stakeholders to be involved in the governance of the firm.

Particular structural issues have emerged from these tensions between individualism and industrialisation. First and most obviously, the German board structure is two-tiered with a supervisory board and an executive board, as opposed to the unitary board structure favoured in the United States, the United Kingdom and Australia. This more formal structure compartmentalises the company because 'the members of the supervisory board are totally separate from the top management team.'[57] Under German corporate law, the members of the supervisory board are elected by the shareholders.[58] The supervisory board has three broad functions: it is in charge of appointing and dismissing members of the executive board, of supervising the executive board and of providing the

56 Dixon, above n 11, 93.

57 Tricker, above n 52, 20.

58 Pistor, above n 39, 168.

management body with advice.[59] The supervisory board is precluded by German law from being involved in the day-to-day management of the company; instead, operational affairs are the exclusive province of the executive board.[60] Its role is therefore that of overseer or supervisor.[61]

The structural dynamics of the German firm, in turn, impact on the financial market in which firms operate. As Krainer notes:

> the structure and composition of these two boards are designed to minimize the conflict among the various stakeholders and other interested parties in the firm, and maintain it as an ongoing concern. One result of this form of corporate organization is that very few hostile takeovers occur in Germany.[62]

B *Codetermination*

Codetermination is a meta-value of German corporate life. It encompasses 'a close relationship between capital and labour',[63] especially in the larger firms. The term itself is broad and covers two basic tenors of German corporations. As Stefan Prigge notes, there are actually 'two kinds of co-determination in Germany: via supervisory boards and via works councils.'[64] In this section we examine some of the generic traits of, and background to, codetermination.

In terms of more recent historical developments, codetermination 'got its most recent formal push in 1976, after blockholding had been around in Germany for quite some time.'[65] The German practice of 'co-determination' is set out in the *Codetermination*

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59 Ibid.

60 Ibid.

61 C Zschocke, *The German Stock Corporation Act* (3rd ed, 2001) 45.

62 Robert E Krainer, *Corporate Finance, Governance, and Business Cycles: Theory and International Comparisons* (2003) 126.

63 Tricker, above n 52, 92.

64 Prigge, above n 18, 1004.

65 Roe, above n 1, 78.

Act 1976.[66] Employee representation on the supervisory board is guaranteed by law and is calibrated by reference to the number of employees in the particular organisation. In particular, 'under the Codetermination Act, the number of employees that work for a company determines the size of the supervisory board.'[67] Employee codetermination of management decisions is 'a specialty of the German stock corporation.'[68] The codetermination threshold is a company with five hundred employees and thereafter operates on a sliding scale:

- For businesses with more than 500 and less than 2 000 employees, one-third of the supervisory board must be employee representatives;
- For businesses with between 2 000 and 10 000 employees, there are six representatives on the supervisory board for both employees and shareholders;
- For businesses with between 10 000 and 20 000 employees, there are eight each;
- For businesses with more than 20 000 employees, there are 10 each.[69]

In these larger corporations or '*aufsichtsrat*', employees share an equal stage with shareholders, but 'labor loses if there's a tie vote.'[70] Traditionally the largest employers have been coal and steel firms.

As noted earlier, there is a complex interplay between codetermination, blockholding and key relationships such as those between the firm and its main bank. As Peter Mulbert notes, 'co-determination on the level of the supervisory board also plays a role in enhancing a bank's influence. To a high degree, management's

66 Zschocke, above n 61, 45.

67 Ibid.

68 Ibid 44.

69 Ibid 46.

70 Tricker, above n 52, 55.

interests coincide with those of a bank as business partner of the company.'[71] In this sense, German companies are more akin to the common law notion of partnership as two or more parties working on a common venture with a view to making a profit. Codetermination therefore marks the German model as vastly different to the Australian, UK and US models. It renders German employee governance more akin, as Bob Tricker opines, to 'a form of "partnership" between capital and labour.'[72] Its hybrid nature, crossing between company, partnership and joint venture, goes against the common law grain of fairly tightly delineated business forms.

The employee representatives 'on the supervisory board are directly elected by the employees by means of a complicated procedure.'[73] Deadlocks are avoided by virtue of the fact that the chairperson of the supervisory board has an additional casting vote.[74] Codetermination is 'an explicit manifestation of social democracy, one that well illustrates the effects on corporate organization of social democracy.'[75] Rather than the system being seen as the excessive exercise of employee power, the view is that the system works well and there is generally a cooperative alignment between shareholder and employee groups. As Stefan Prigge notes in this regard,

> [t]he employee representatives should not be regarded as a homogeneous group. The instructive contributions by internal employee representatives are appreciated by shareholder

71 P M Mulbert, 'Bank Equity Holdings in Non-Financial Firms and Corporate Governance: The Case of German Universal Banks' in Klaus J Hopt et al (eds), *Comparative Corporate Governance- The State of the Art and Emerging Research* (1998) 445.

72 Tricker, above n 52, 55.

73 Ibid 46.

74 Ibid.

75 Mark J Roe 'Political Foundations for Separating Ownership from Control' in Joseph A McCahery et al (eds), *Corporate Governance Regimes: Convergence and Diversity* (2002) 113, 116.

representatives as opposed to effects of external members coming from unions.[76]

The supervisory board's chief weapon in its exercise of control over the management board is 'the authority to grant or refuse consent' to interim decisions.[77] Other control mechanisms vested in the supervisory board include the right 'to comment on management board decisions, which corresponds to a right to information.'[78] The management board may disregard the supervisory board's opinion, but there is 'a resulting obligation of the management board to justify its action, in particular vis-à-vis the supervisory board members.'[79]

As noted above, codetermination is closely linked with blockholding. As has been noted, '*once the two were in place*, neither could change easily without changing the other. German blockholding called forth codetermination, and vice versa. Evolution was harder, and maybe still is because the two complementary institutions must move in unison.'[80]

Blockholding was first in time and meshed with codetermination. Just as many firms had a family bias with the blockholder being a family group, such a notion of community seems to have sat comfortably with the notion that the supervisory board should reflect the community of interests within the firm. There is a correlation between the interests of the blockholder and the interests of the key stakeholders, being the employees and the shareholders. This result strikes observers of the Anglo-US model as counter intuitive. There are strong 'social democratic pressures on the firm'[81] in Germany that do not appear to be replicated in the UK, the US and Australia.

76 Prigge, above n 18, 1009-10.

77 Tricker, above n 52, 45.

78 Ibid.

79 Ibid 46.

80 Roe, above n 1, 78.

81 Ibid 79.

The 'political economy effects on the German boardroom are as strong, or stronger, than the corporate law institutional effects.'[82] This analysis returns us to Pistor's notion of social governance and its hegemony within the German firm.[83]

Codetermination has flow-on effects for other aspects of the governance of firms. In a publicly-owned firm it should have the effect of raising managerial agency costs to shareholders, 'by pushing managers to choose strategies that they and employees, but not shareholders, prefer.'[84] This is based on another German firm assumption that 'managers have a well-known propensity to expand firms in ways that do not benefit shareholders, but rather favour themselves (and incumbent employees).'[85]

The supervisory board is the locus of power for employees in German firms. This board is made up of employee representatives and shareholder representatives in equal measure. One is not able to be a member of both the supervisory and executive board.[86] This ensures in theory at least that the boards are operating independently of one another.

They have an equal voice. Roe questions whether 'once both shareholder voice and labor voice were firmly heard, it was hard for reformers to lower one without the other as well?'[87]

One of the reasons that codetermination has not taken off in Anglo-Saxon countries is due to the difficulties of empirical checking and cross-checking. As Gerum and Wagner note:

> The attempt to check empirically the economic effects of co-determination for supervisory board has to struggle against a whole series of difficulties. In Germany, nearly all large companies are subject to co-determination for their supervisory

82 Ibid.

83 Pistor, above n 39.

84 Roe, above n 1, 72.

85 Ibid.

86 Tricker, above n 52, 92.

87 Roe, above n 1, 16.

> boards, so that there is almost no way of comparing large companies with co-determination with those without it. On the other hand, comparison with small companies is a problem because of the significant influence of company size on efficiency. International comparisons are not very helpful either. The objection that other factors of the economic and institutional context may have been more relevant – such as the high average qualifications of the workforce, the economic rationality of the unions, the longer planning horizon used by German managers, or perhaps even the exchange rate – can be raised against all findings on the alleged efficiency or inefficiency of co-determination.[88]

These translation effects have proved effective to further buttress the social, economic and political forces that have kept codetermination at bay in such other jurisdictions as the US, the UK, and Australia.

C *Blockholding*

The German corporate system is predicated on 'block', as opposed to diffuse, share ownership. Concentration of share ownership in firms is more pronounced in Germany than other western systems of governance. This facet of governance particularly involves the banks, such that many companies develop and maintain a 'main bank relationship'.[89] The blockholding phenomenon has proved persistent in Germany. So much so that, at the end of the 20th century, 'nearly every large firm still had a large blockholder, usually from a family, but for some firms from a bank, insurance company, or another corporation.'[90] Germany's concentration of ownership is in contrast to the US pattern of diffuse ownership. In

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88 Elmar Gerum and Helmut Wagner, 'Economics of Labour Co-Determination in View of Corporate Governance,' in Klaus J Hopt et al (eds), *Comparative Corporate Governance- The State of the Art and Emerging Research* (1998) 341, 348-9.

89 E Berglof and H Sjogren, 'Combining Arm's-Length and Control-Oriented Finance Evidence from Main Bank Relationships in Sweden,' in Klaus J Hopt et al (eds), *Comparative Corporate Governance- The State of the Art and Emerging Research* (1998) 787.

90 Roe, above n 1, 16.

the 'twenty firms in Germany that have just over $500 million in stock market capitalization… eighteen have blockholders owning 20 percent or more of the stock.'[91] In the US, only two of such firms exist. This pattern of blockholding is arguably generic in large firms in Germany. For example, 'financial institutions have fifty percent ownership blocks of 5 percent or more of the stock in the 100 largest German firms.' The American figure by contrast is 'about zero.'[92] The Australian market, whilst much smaller than these two behemoths, much more closely tracks US patterns. However, with the growth and importance of superannuation fund holdings, the pattern of block holding, as a variant on the German theme, is likely to emerge in Australia in the next decade.

Blockholding has been a persistent feature of the German corporate landscape. Whilst 'some of this is an artefact of the Post-Second World War family-founders of some large firms',[93] this is only a partial explanation of the phenomenon. It has proved a particularly durable national practice. As Roe notes:

> Ownership concentration has persisted longer than a generation, and thus far even when a family sells out, it typically sells to another, new blockholder, not to dispersed stockholders via, say, an initial public offering flowed by a relentless sell-off of the family's holding.[94]

Blockholding and codetermination are symbiotically linked. Blockholding was first in time.[95] Codetermination 'then came forth as a political and social reaction to blockholding.'[96] Blockholding is a critically important element of determining the balance of power

91 Ibid 17.

92 Ibid.

93 Ibid.

94 Ibid.

95 Ibid 78.

96 Ibid.

on the supervisory board.[97] This is because half the seats are mandated as going to employees. There is a certain prerogative to even up the scales by providing a counterbalance to the 50% block of employees. This fairly straightforward 50-50 split is much more difficult to achieve in other systems and 'diffusely-owned firms may be unable to create' such a weighting.

Banks play an active role in the German system of insider governance. They hold major shareholdings in firms and are active players in the multi player governance paradigm.[98] The role of German banks and other major shareholders is exacerbated by the blockholding device. As Boehmer notes, there is an inverse relationship between the number of voting blocks and the amount of market value controlled.[99] It provides a greater concentration of economic power both 'in absolute and percentage terms' especially given the extent of 'cross holdings among the largest shareholders.'[100] According to Boehmer:

> Banks, the government, and insurance companies command ninety-eight voting blocks, controlling DM 247 billion. In contrast, industrial companies and individuals own 319 voting blocks, but control only DM 142 billion in market value. Therefore, holdings of banks, the government, and insurance firms are far more concentrated and more strategically placed in that they command the assets having the largest value. This observation holds for all types of listed companies, although to a lesser extent for listed industrial firms and a larger extent for listed banks and insurance companies.[101]

In the final analysis, there is no consensus as to the value of blockholding. This accords with a post-modern reading of a modern

97 Ibid 71.

98 Tricker, above n 52, 92.

99 Ekkehart Boehmer, 'Who Controls German Corporations?' in Joseph A McCahery et al (eds), *Corporate Governance Regimes: Convergence and Diversity* (2002) 268, 272.

100 Ibid 273.

101 Ibid 272.

industrial society. There is not a single perspective approach. Instead, there are a myriad of competing views and opinions, depending on one's frame of reference. As Boehmer notes, 'several different studies have attempted to assess costs and benefits of large blocks held by different shareholders in Germany. Unfortunately, they disagree with respect to whether these blocks are beneficial or not.'[102] Whatever the case, blockholding is a key indicator of a closed or insider-based financial market and, at the same time, a 'hard' framework for the provision of employee governance. This is the paradox of blockholding. It provides for a concentration of a certain type of institutional shareholder power, whilst at the same time working in apparent harmony with a defined structure of employee participation. One of the keys to its success is that it keeps agency costs low, and therefore shareholders are relatively content. This reflects the thesis that 'large blockholding is considered to be one of the mechanisms for controlling the agency problems which arise whenever managers have incentives to pursue their own interests at the expense of the shareholders.'[103] This theory proceeds on the basis that such shareholders play an efficient 'monitoring role'[104] in the operation of the firm.

D *Works councils: worker involvement in decision-making*

As we have seen, Germany adopts a consultative, participatory model in relation to its two-tiered board system and the role of the supervisory board. The second institutional reflection of the 'broader conception of the company'[105] is the works council. The works council is a European Union innovation and is part of a European corporate governance approach, suited to its particular cultural and business traditions.

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102 Ibid.

103 Mara Faccio and M Ameziane Lasfer 'Institutional Shareholders and Corporate Governance: The case of UK Pension Funds' in Joseph A McCahery et al (eds), *Corporate Governance Regimes: Convergence and Diversity* (2002) 603, 603.

104 Ibid.

105 Farrar, above n 38, 155.

The works councils reflect the traditional robust advocacy of social and community values in terms of European Union developments. The balance between the need to make a profit and broader notions of fairness, akin to social responsibility theory, have been central in terms of EU thinking, as highlighted by treaties such as *Maastricht* in 1994. This picture of the German firm places it most firmly at the Dodd-inspired end of the spectrum. The company is a complex, stakeholder driven model in which employees are key stakeholders. In this sense, German corporate governance is a 'multiplayer game.'[106]

Whereas some large US firms, for example, briefly experimented with the works council concept in the 1920s and soon abandoned them,[107] Germany embraced the practice from about the same period.[108] This was largely in response to the turbulence created by the First World War and the Russian Revolution of 1917. In essence, the traditional trinity of management, unions and government relations was disrupted.

> Many European countries found themselves confronted by a revolutionary movement of 'workers' councils' which saw itself as the basis of a new social order; a 'producer democracy' based on direct worker self-government without employers, states and, not least, trade unions.[109]

This development illustrates the fact that political contexts give rise to radical new developments in employee governance terms. Distressed political circumstances may be a conduit for creative solutions. Political economic and social circumstances force change and reinvention. To the victors go the spoils, but in terms of governance, they produce little impetus for change. Whilst these 'syndicalist' councils were suppressed in most European countries

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106 Pistor, above n 39, 179.

107 Richard B Freeman and Edward P Lazear, 'An Economic Analysis of Works Councils' in Joel Rogers and Wolfgang Streeck (eds), *Works Councils: Consultation, Representation, and Cooperation in Industrial Relations* (1995) 27, 27.

108 Rogers and Streeck, above n 43, 14.

109 Ibid.

by 'mainstream unions and social democratic parties'[110] joining forces, this was not the case in Germany. A 'special development took place in Germany and was intensely watched elsewhere in Europe.'[111]

That development was that the syndicalist councils, even though defeated, were institutionalised 'as "works councils" (*Betriebstrate*) in the 1920 Weimar Constitution and *Betriebsrategesetz*, thereby laying the cornerstone for what later became the German

Works Constitution (*Arbeitsverfassung*).'[112] The hallmarks of the works councils under this arrangement were as follows:

- They were 'elected by all workers regardless of union membership.'[113]
- They were 'given legal rights and responsibilities with respect to both representation of workers at the workplace and consultation and cooperation with management.'[114]
- They were 'made legally responsible for supervising the implementation of industry wide collective agreements and public legislation applicable to their workplace.'[115]
- They 'were barred from calling strikes, with wage bargaining explicitly reserved for the unions and employers' associations.'[116]

From these early tensions associated with the advent of works councils, a situation has developed where they are now generally 'accepted among trade unions and the great majority of

110 Ibid.

111 Ibid.

112 Ibid.

113 Ibid.

114 Ibid.

115 Ibid.

116 Ibid.

employers.'[117] They are described as 'representative, encompassing, and mandatory in the private sector (manufacturing and services).'[118] The public sector provides for a variation of this form of staff representation 'with somewhat fewer powers than works councils.'[119]

The members of the works councils are 'elected by the whole workforce of establishments with five or more permanent employees.' Small firms are therefore bound by the democratic ties that bind larger firms. This whole-scale embrace of workplace practices is in contrast to the Australian position where small firms will seek dispensation from the rigors of work related regulation.[120] If a firm has several bases it will have a centralised works council, 'composed of delegates of the establishment-level works councils.'[121] For a company group, a central works council will be formed if 'requested by the works councils of subsidiaries employing at least 75% of the group's workforce.'[122]

Works councils therefore demonstrate a centralising, collectivist tendency. They support the rights and welfare of a particular cohort: employees. They do not represent employers and senior executives.[123] Works councils are ubiquitous in Germany. In 1990 there were 180 000 members from 33 000 establishments covering 70% of the eligible workforce.[124] The term of office of councillors is four years; before 1989 it was three years and before 1972 it was

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117 Walter Muller-Jentsch, 'Germany: From Collective Voice to Co-management' in Joel Rogers and Wolfgang Streeck (eds), *Works Councils: Consultation, Representation, and Cooperation in Industrial Relations* (1995) 53, 53.

118 Ibid 55.

119 Ibid.

120 For example, small businesses in Australia (those with less than 100 employees) have the ability to avoid unfair dismissal claims under the Federal Work Choices legislation: see Australian Government, *WorkChoices: A New Workplace Relations System* <https://www.workchoices.gov.au/> at 20 June 2006.

121 Muller-Jentsch, above n 117, 55.

122 Ibid.

123 Ibid 56.

124 Ibid.

two years.[125] There is an implicit stability with longer terms of office and the hegemony of the councils is demonstrated by the trend towards longer terms of office. As with employee numbers on the supervisory board, there is a gradation of works councillors corresponding to increasing employee numbers in the firm. For firms with less than 100 employees it is five councillors; for five hundred there are nine and for firms with 1 000 employees there are 15.[126] There is, therefore, a democratic principle at play that sees an increased works council to reflect a large and more disparate workforce.

The employer resources given up for the works councils to function are not inconsiderable. Firms with between 300 and 600 employees must provide for one of the nine works councillors to have full time work release so that they focus exclusively on their role as a councillor.[127] For 1 000 member firms three councillors are given work release and for 5 000 member firms it is seven.[128] These standards are seen as *de minimis* by some employers and they will, as a matter of practice, exceed them. For example, Volkswagen provides for the full-time release of all of its works council members.[129]

The role of works councils is determined by the *Works Constitution Act 1972* (the Act). This Act ensures that 'works councils are now the pivotal institution of the German industrial relations system.'[130] Section 2(1) of the Act provides that works councils are obliged to work with management 'in a spirit of mutual trust' and their aim is to act 'for the good of the employees and the management.' The Act ratifies the aim of contractual solemnity between the works councils and the firm. For example, s 74 requires the council to negotiate with management 'with a serious desire to reach agreement.'

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125 Ibid 57.

126 Ibid.

127 Ibid.

128 Ibid 58.

129 Ibid.

130 Ibid 55.

The 'participation rights'[131] conferred on works councils are as follows:

- Codetermination rights on social matters.
- Codetermination rights on personnel matters.
- Veto rights on individual staff movements.
- Information and consultation rights over personnel planning.
- Information rights on financial matters and alterations.

E *Union participation*

There are clear links between works councils and unions. Whilst works councils may be the pre-eminent institution of the German industrial relations system, their 'position vis-a-vis the union have been continually strengthened.'[132]

Works councils are legal institutions which are 'formally independent of unions and have their own constituency, being elected not by union members only but by the entire workforce of an establishment.'[133] This means that there may be potential conflict between the union and non-union sections of the electorate responsible for voting for the works council. However, in practice, 'most works council[l]ors are loyal union members with close ties to their unions.'[134] The working relationship is mutually supportive; for example, 'unions supply works councils with information and expertise through educational courses or furnish them direct advice through union officials.'[135] As a virtual quid pro quo, 'works councils, in turn, are pillars of "union security": union members are

131 Ibid 58.

132 Ibid 61.

133 Ibid.

134 Ibid.

135 Ibid.

usually recruited by works councillors who are, contrary to the legal provisions, often regarded as workplace union representatives.'[136]

Muller-Jentsch's thesis then is one of close ties and a cooperative alliance between unions and works councils. On the other hand, Rogers and Streeck assert that there is an 'ineradicable *ambivalence of unions towards works councils.*'[137] This is due to two main reasons. First, is the 'many twists and turns'[138] undergone by Germany's works councils since their origins in the modern era dating from the 1920s. Second is the fact that:

> councils may be all kind of things to unions: employer-sponsored union substitutes, as well as vehicles of union recognition and union access to the workplace; radical syndicalist opposition to unionism and collective bargaining, as well as easily controlled internal representatives of the external union; agents of particularistic collaboration with the employer, as well as of particularistic militancy; supports for centralized bargaining, as well as vehicles of decentralization.[139]

This complex set of binaries or correlatives,[140] has meant that unions 'have preferred or accepted a vast variety of configurations in the workplace.'[141]

Whatever the actuality of the dynamics vis-à-vis unions and works councils, it is emblematic of the enmeshed and complex nature of German governance. This symbiotic relationship between key components is an enduring characteristic of German employee governance. For example, as we have seen, codetermination and blockholding are closely entwined concepts in much the same way that works councils and unions intersect on a number of fronts.

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136 Ibid.

137 Rogers and Streeck, above n 43, 15.

138 Ibid.

139 Ibid.

140 Wesley Hohfeld, the American jurist, developed the concept of jural correlatives. See Roland Turner, *Thinkers of the Twentieth Century* (2nd ed, 1987).

141 Rogers and Streeck, above n 43, 15.

These elements of a complex form of governance – 'social governance' to use Pistor's terminology – are quite foreign to the Anglo-US model of shareholder governance with its positivist ethos, its non-recognition of employees and its simple linearity.

The level of complexity becomes more pronounced when the various elements of German employee governance are given an over-arching rubric. As Rogers and Streeck note: 'Under co-determination, works councils gradually turned into the local infrastructure of a flexible system of shared, quasi-public, centralized governance of the employment contract.'[142] This is the Dodd model of the corporation in action. It is diametrically opposed to the atomised, individual employee-to-employer model of workplace relations so keenly promoted in Anglo-US employee governance and likewise privileged under Australia's Workplace Agreements regime set out in the *Workplace Relations Act 1996* (Cth). The employee governance regimes of these countries reflect the point that

> one way in which employers have historically responded to the quandaries of representative collective representation is by trying to avoid it altogether and instead to base social relations at the workplace on non-representative, one-to-one communication with individual employees.[143]

V CRITIQUING GERMANY'S EMPLOYEE GOVERNANCE

Germany's system of 'codetermination offers *social governance*, whereas corporate governance provides firm-level governance'.[144] This statement reveals the depth of German governance and the fact that commentators on German governance have actively adapted new concepts to cover very broad emerging philosophies such as 'social governance.' Such concepts cover very broad arrangements.

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142 Ibid.

143 Ibid 19.

144 Pistor, above 39, 163 (emphasis added).

For example, co-determination is

> practiced on two levels: at the shop-floor level, through workers' councils, which give employees the right to obtain information and to participate in decisions that directly affect their workplace; and at the corporate level, through employee and union representation on supervisory boards.[145]

The German system is not, however, without its critics. Corporate decision-making under this arrangement is likely to be slower and more costly because more stakeholders are involved and they will have differing levels of knowledge, therefore requiring more lead-time to become fully informed about corporate decisions. Codetermination 'not only adds to costs of firm-level governance, but it also alters the dynamics in ways that will tend to reduce the company's control over management.'[146] This unexpected result arises because 'the traditional focus of the corporate governance debate on the dichotomy between owners and manager loses much of its explanatory power.'[147] With a multi-player governance system, and the resultant increase in agency costs, 'the public corporation should be viewed less as a series of bargains than as a series of coalitions.'[148]

An approach adopted by US critics is to compare the German boardroom with 'American observations about what makes for a good board.'[149] These features include 'small size, with specialized sub-committees, frequent meetings, intense information flow, and low conflicts of interest.'[150] These features have been largely parroted in Australia in the wake of our own corporate disasters, such as HIH Insurance Group and One.Tel. Many boardrooms in

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145 Ibid 165-6.

146 Ibid 179.

147 Ibid.

148 John C Coffee Jr, 'Unstable Coalitions: Corporate governance as a multi-player game' (1990) 78(5) *Georgetown Law Journal* 1495, 1496.

149 Roe, above n 1, 72.

150 Ibid.

Australian firms still display club-like atmospheres where directors are appointed in private and via secretive deals, and boards can be accused of operating in cosy alignments, rather than via the rigorous arm's length deployment of resources.[151] The critique has been levelled at the German boardroom that it (generically) 'seemed historically weak on all four traits.'[152] Germany's distinctive board machinations are a product of German 'social politics' and, in particular, a reaction to the practice of codetermination.[153]

Such a shareholder-centric view is bound to wonder at the economic and social success of the German firm. Germany's system involves a balancing act of group interests rather than an individualist's aim to excise others from positions of influence. This is most clearly seen in the US and Australian industry of hostile takeovers and mergers. Roe seems scathing of the fact that Germany has 'a weak securities market, tight family ownership, and bank influence.'[154] But, as the recent Toll-Patrick hostile bid in Australia illustrates, the attendant professional and advisory fees drained out of both the target company and the bidder are enormous. Perhaps, just as German social politics has seen these attributes solidify, in an age of comparative legal and social analysis, these traits have further been strengthened as a rejection of the Australian-US market with its virulently strong securities market and Darwinian takeover mentality. In any event, very large Australian and US firms invariably have a dominant shareholder or controlling presence.[155]

Roe concedes that the German arrangement does have its pitfalls.

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151 Prominent examples cited include the National Australia Bank boardroom infighting of recent times and the appointment this year to the BHP Billiton board of close associates of the Chair.

152 Roe, above n 1, 72.

153 Ibid 73.

154 Ibid 81.

155 Toll has Mr Little; Patrick, Mr Corrigan; NewsCorp has the Murdoch Family and PBL, James Packer. The list goes on; large firms and the cult of personality seemingly go 'hand in glove' in Australian corporations.

For example, it necessarily

> undermines the bottom line efficiency of the society. What is lost in shareholder value may be gained on the shop-floor in motivation. And what is not made up in motivation might be made up for in a greater sense of involvement, of a generalized increase in utility. Such value cannot be readily measured, but may still be there.[156]

Utility, in this sense, is a measure of the happiness and satisfaction of the firm's constituents. This type of approach has received recent support in terms of the relevant Australian literature.[157] It is a somewhat complex issue and difficult to measure, as Glenn Patmore notes, but is nonetheless, gaining support in a European context.[158] The German methodology proceeds on the basis that such utility analysis can, and should, be applied to an array of stakeholders. It assumes a broad approach and questions, and rejects, why the utility should be measured in relation to the shareholders alone.

This is the critical point of difference between the German and the Australian systems: identifying and measuring the so-called 'bottom-line' is a fundamentally different exercise in the two nations. In Australia, it is oriented toward maximising shareholder returns. This provides for a simple equation for measuring utility. It focuses on the equity owners as the pre-eminent stakeholders and assesses their increases in wealth due to the company's ability to deliver dividends and to increase share values. It has both an income and capital component, both of which lend themselves to exact measure, both for individual shareholders and for the shareholders collectively. Its simplicity reflects a strong positivist focus in US-Anglo corporate law.

The German approach, on the other hand, is more complex. It is more socially oriented, than scientifically demonstrable. It defies

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156 Roe, above n 1, 81-2.

157 Glenn Patmore, 'How can we be happy at work? Rethinking the role of law in the 21st century' in P Gollan and G Patmore (eds), *Partnership at Work: the challenge of employee democracy, Labor Essays 2003* (2003) 58.

158 Ibid.

ready measurement. As such, it invites scepticism from observers steeped in the shareholder model of the firm. For example, as Mark Roe notes, 'such value cannot be readily measured, but may still be there.'[159] This choice reflects the diffuse constituency of shareholders and the demands of the wider securities marketplace. In Germany, codetermination sets up equality between employees and shareholders and, as a result, introduces an element of complexity to the issue. The bottom-line becomes a more hybrid concern involving shareholders, employees and wider social concerns. These parties have mandated interests. The first two under Germany's codetermination legislation and the firm under the principles set out in the German *Constitution*. Germany has struck out on a very different route from the Anglo-US paradigm such that the value of comparative analysis can only take us so far. The differences are so fundamental as to provide diametrically opposed models.

The centralising, collectivist ethos is an ever-present feature of German employee governance. It is particularly the case in terms of the establishment and practices of works councils. Centralised collectivism is therefore a pervasive model. In this sense Germany adopts a model directly opposed to the atomised, individualism of the Anglo-US paradigm.

Of particular interest will be the way that international and global entities deal with national auditing standards. The German auditing practice has been subject to criticism. For example, Peter Schmidt notes that:

> There is a growing expectation that the auditor should not only confirm the reliability of the information disclosed by the company. It is expected that the auditor should give a comprehensive judgment on the state of the company's affairs and in particular on its future prospects. This expectation contrasts widely to the legal framework governing disclosure and auditing in Germany.[160]

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159 Roe, above n 1, 82.

160 P J Schmidt, 'Disclosure and Auditing: A German Auditor's Perspective' in Klaus J Hopt et al (eds), *Comparative Corporate Governance- The State of the Art and Emerging Research* (1998) 743, 752.

This debate has sharpened in light of the US *Sarbanes-Oxley Act 2002*, and will play a pivotal role in convergence issues in the next decade. Firms with any form of US presence are effectively caught in the new regulatory net provided by the *Sarbanes-Oxley Act 2002*. The Act sets rigorous new benchmarks for auditor independence that have already impacted on a major Australian listed entity, National Australia Bank. As a result, the notion of 'expectations' in this field, outlined by Schmidt and which are commonplace in the EU, the UK and Australia, have been replaced by mandatory requirements. Likewise, Australia keeps adding to its formal and informal corporate governance regulation. The federal government's Corporate Law Economic Reform Program 9 (CLERP 9) legislation and the ASX's Guidelines represent the latest instalments in this output.[161] How attractive will the complex corporate environment prove to foreign firms? Australia, like the US has constructed a high and onerous set of compliance hurdles.

VI EXAMINING LINKS BETWEEN GOVERNANCE FEATURES

In general terms we have seen that 'corporate governance and securities markets are linked.'[162] In particular, there is a strong cause and effect relationship in German governance linking features of the firm – including codetermination, works councils and blockholding – to a socially-informed version of employee governance.

As La Porta et al note,[163] the US legal system 'is relatively strong in protecting the contractual rights embedded in equities.'[164] And more

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161 For a good summary of the effect of the CLERP 9 legislation (formerly the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth)) see, for example: Deloitte Australia, *Remodelled CLREP 9 lifts the bar on corporate governance* <http://www.deloitte.com/dtt/article/0,1002,sid%253D10236%2526cid%253D54640,00.html> at 20 June 2006; see also, the ASX, *Principles of Good Corporate Governance and Best Practice Recommendations* <http://www.shareholder.com/visitors/dynamicdoc/document.cfm?documentid=364&companyid=ASX> at 20 June 2006.

162 Roe, above n 1, 76.

163 R La Porta et al, 'Law and Finance' (1998) 106 *Journal of Political Economy* 1113.

generally they found that, 'Anglo-Saxon legal systems were found to be more protective of investors' legal rights than the various Civil law systems.'[165] Australia's corporate governance reflects this affinity to contract: shareholders garner their rights via contract and employees are increasingly forced, in the wake of WorkChoices, to bargain on the premise of contractual equality with employers. This difference in orientation of the legal system means that 'it is therefore not surprising that the US [and Australian] financial system is more oriented around the stock market and is characterized by diffuse stock ownership'.[166] On the other hand the German system displays different characteristics. It is predicated on 'protecting the contractual rights embedded in debt.'[167] As a result, 'the German financial system is more oriented around banks and is characterized by concentrated stock ownership.'[168]

The complex issue from a comparative point of view is whether the institutional differences are fundamental or can many of the differences be explained away by the relative differences that markets face at a given time within the economic cycle?[169] The larger question is whether business cycles 'differ across countries?'[170] Traditionally macro economic analysis has been 'attracted to the idea that institutions are, for the most part, irrelevant.'[171] This is because economic theory has assumed that institutions are merely vehicles to 'help individuals match their opportunities to their preferences, and that basically all individuals across both time and countries are alike.'[172] In this theoretical world, all individuals seek to 'maximize expected intertemporal utility over

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164 Krainer, above n 62, xix.

165 Ibid.

166 Ibid (words added).

167 Ibid.

168 Ibid.

169 Ibid. This is the central thesis of Krainer's book.

170 Ibid xv.

171 Ibid.

172 Ibid.

consumption and leisure.'[173] Business cycles are caused when individuals collectively invest more or less then they usually do.[174]

The German-Australian comparison of employee governance provision illustrates the fundamental importance of institutions to financial markets and to the forces at work. Far from being irrelevant, they provide basic mechanisms for changes in the business cycle.

The operating paradigm of German employee governance demonstrates the complexities of the Dodd-styled model of the company. Once the company is operated beyond the simple linear relationship between the board and owners, the unfolding dynamics are both hard to predict and to control. This, in turn, raises fresh questions about the transparency of processes and of accountability issues in terms of the exercise of power. Each model of employee governance therefore carries within it potential causes for concern.

Roe's thesis is that Germany's strong promotion of employee governance is an integral part of the political order and the version of social democracy practiced in much of Europe. Such 'social democracies press firms and managers from many sides to favor employees with jobs in place.'[175] The hegemony of employees induces shareholders 'to reduce their internal conflicts and face employees more cohesively.'[176] Achieving 'social peace in the corporate context'[177] is a key element of German governance. The ways to produce this peace 'have the common effect of distancing shareholders from the day-to-day operation of the firm.'[178] This changes the fundamental driver of the firm. It makes firms socially

173 Ibid.

174 Ibid.

175 Roe, above n 1, 33.

176 Ibid.

177 Ibid 14.

178 Ibid.

oriented rather than 'market oriented',[179] as in the case of Anglo-US firms.

Roe and other commentators are sceptical about the success of German employee governance. He notes that understanding the institutions of German governance is difficult.[180] This scepticism is bound up in a perspective dominated by the market. For example, that German elements of governance 'could not withstand a *normal* efficiency critique.'[181] The word 'normal' here seems to equate to the 'US' or, interchangeably, 'Australia.' It illustrates the difficulties of comparative analysis by common law lawyers of civil law systems.

VII EMERGING ISSUES AND THE WAY FORWARD

The German scheme of 'collective governance'[182] therefore reflects a sophisticated approach to employee involvement and one quite distinct from UK, US and Australian conceptions. The UK is, however, inevitably influenced by EU policy, and, as the European project advances and the UK's involvement deepens, the question will be whether the *de minimis* UK provision made by its corporate system for employees will be able to influence the hegemony of Germany's formal and legally sanctioned provision?

The German system of employee governance is the pre-eminent 'hard' system of governance in the world and the leading driver of EU policy in this area. It is pitted against the US system as the leading example of 'no participation' for employees. Australia is firmly in the no participation camp, a point made more obvious in the wake of the Australia-United States Free Trade Agreement (AUSFTA), which entered into force on 1 January 2005. However, as the globalisation project intensifies with more pressure on international trade rules and the emergence of bilateralism in this

179 Ibid.

180 Ibid.

181 Ibid.

182 Pistor, above n 39, 178.

context, the traditional market for employee governance based on geographic proximity will be further tested by new measures. These include political, economic and social ties. For example, the UK is currently in the midst of a long policy debate about its degree of engagement within the European Union and the effect this has on its relationship with the US. The policy trend in the UK is to tread a delicate line between actively engaging in the EU debate, whilst at the same time trying to embrace the social policy of the US with its perceived success at job creation programs and its maintenance of low unemployment rates.

As Du Plessis argues, corporate governance 'should be viewed very specifically in the context of a country's own tradition, history, culture and own corporate law system.'[183] In this regard, the German model of employee governance will come under strain, especially as the EU debate intensifies and if other factors, such as downward economic activity, eventuate. It will be then that Germany's 'hard' employee governance regime will come under particular and close scrutiny. This is a phenomenon that has become familiar in Japan as it has grappled with its decade-long recession.

Germany does, however, start from a position of some advantage in terms of defending its employee governance framework from significant dismantling. (Japan, as a soft governance regime, enjoys the same sort of advantage, albeit to a lesser extent.) Germany possesses a coherent system and structure of employee governance. It provides a positivist framework for employees, rather than being merely a post-modern conceit where each firm is essentially free to follow its own course of action based on enlightened self-interest. Germany therefore has the advantage of knowing what exactly it is defending, and upholding, in terms of its employee provision. This affords Germany a clearer focus than other nations in defending what is uniquely referred to as its system of 'social governance.'

As Australia maps its 21st century economic progression, it is faced with a clear choice. Does it remain wedded to the historically relevant, Anglo-US informed version of the contractual domain of

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183 Jean Du Plessis, 'Reflections on Some Recent Corporate Governance Reforms in Germany: A Transformation of the German *Aktienrecht*?' (2003) 8 *Deakin Law Review* 381.

the firm as a shareholder-dominated entity? Alternatively, does it seek to invest the concept of 'the firm' with meaning beyond mere written law, by embracing stakeholders with vital interests concordant with those of the firm? It is this second option, informed regionally by Japan, and more distantly, but just as relevantly, by Germany in the midst of the EU, to which Australian firms, trading far and wide, can look and learn. This alternative model, built on stakeholder values, was, as we have seen, sketched out by Professor Dodd as long ago as the 1930s. And yet, it carries within it, the weight and expectation of a more enlightened coda for Australian firms doing business in the international environment that will surely characterise the 21st century.

The German example of clearly defined provision for employees gives Australian legislators another view of how firms can function. To adopt its key provisions would, however, inevitably mean scaling back the influence of shareholders within the firm. This would be to disregard strong legal, cultural and historical ties exerted by the Anglo-US model. Ultimately, as the German model shows, these are fundamental facets of a national corporate governance system and not easily removed.

We can draw the following conclusions:

- Australia has a strong version of shareholder-driven corporate governance. As a consequence, it makes little formal provision for employees.
- It adheres to the Anglo-US notion of the firm. Australia has entered a free trade agreement with the US which would pre-suppose a deepening of ties.
- Germany is a paradigm case of legal provision made for employees. It is a leading economy in the growing EU project. Japan provides a variant on the German scheme.
- In today's world, marked by greater convergence and the emergence of three pre-eminent trading blocs – the EU, the US, and Asia – it would seem inevitable that all three will exert influence on Australian firms: how they do business, their goals and rationales. This will, over time, influence corporate governance provision.

- However, the particular forces at play within a given nation are critically important. Australia's unique history, geography, location, culture and politics provide a particularised operating environment for firms.
- Tensions of several kinds – between nation states and international influences, between competing theories of the firm and between stakeholder interests within firms – will underwrite the development of the next phase of Australia's corporate governance project. These tensions will provide the framework of, and the scale for, the Australian firm in the new international environment. In the case of employee provision within the governance project, there is a clear choice between the formal German provision and the essentially organic or firm-driven approach that Australian firms adopt as a result of the lacuna in terms of legal provision.
- Ultimately, the embedded nature of shareholder primacy reflected in the *Corporations Act 2001* (Cth) would make it very difficult to change the focus of Australian governance arrangements from shareholders to any other stakeholder group, including employees. It would also require a complete legislative change of approach, and the tipping point for such a change simply does not exist in the midst of prolonged and robust economic conditions. The Australian model reflects a close alignment of common law and statute, and the deeper forces – cultural, social and economic – at play. In this sense, both Australian and German corporate governance reflect the importance of giving full account to nationally oriented influences.