

**The Europeanisation of Corporate Governance in  
Germany and the UK**

**Draft**

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### Introduction

The business organisation is central to the functioning of any productive economy. It produces goods and services for consumers and generates wealth in the form of wages, profits, interest payments and taxes. It also imposes costs in the form of investments of time, capital and skills and produces externalities such as pollution and urban congestion. It then distributes these costs and benefits among the range of constituent groups that are in some way connected to the activities of the company. These ‘stakeholders’ - managers, investors, creditors, employees, suppliers, customers, communities, the state and wider social and economic interests – are bound in a pattern of structured relationships, both with each other and the corporate entity itself. ‘Corporate governance’ is broadly defined as ‘the system by which companies are directed and controlled’ (Cadbury, 1992:para. 2.5). This ‘system’ is understood here to refer to the rules and other institutions that define stakeholder relationships at the strategic level of the business enterprise. It both shapes and reflects the socially determined purpose of corporate activity by allocating strategic decision-making power among stakeholders and establishing a framework of rules and incentives within which stakeholder relationships are formed and maintained.

Although capitalism has become the dominant mode of production across Europe, capitalist relationships generally, and their organisation within the corporation specifically, have evolved within distinct national jurisdictions (Zysman, 1983; Albert, 1993). In Germany, institutions have evolved that support a pluralist system of corporate governance, which balances the interests of stakeholders without necessarily favouring any single group. The UK system, by contrast, establishes the principle of shareholder sovereignty, whereby the fundamental aim of the company is to maximise shareholder returns. Section 1 will provide a brief outline of the two contrasting systems

The process of integrating the economies of Europe has produced a number of legislative initiatives that impinge upon national corporate governance regimes. These fall into the policy areas of company law, financial market regulation and employment and social policy. EU rules in the first two categories have increasingly come to reflect Anglo-Saxon preoccupations with capital market liquidity and the rights of minority shareholders, while those in the latter have supported the involvement of employees in corporate governance. The purpose here is to examine the impact of EU rules on the national systems of corporate governance in Germany and the UK. Section 2 will draw on the europeanisation literature to identify the mechanisms through which EU policy initiatives impact on the national level. Subsequent sections will then take the examples of EU proposals for a takeover directive and rules on employees' information and consultation rights to provide contrasting perspectives on the EU's impact on the corporate governance systems of Germany and the UK respectively. Commission proposals for takeover rules afford a primary role for shareholders in deciding the outcome of a bid. While these have little effect in the UK because of that country's extensive provision for shareholder rights during a takeover bid, they are at odds with Germany's pluralist system of corporate governance. Section 3 will examine how the German system has responded to this pressure. Section 4 will then examine the impact of EU rules that mandate information and consultation rights for workers on the UK's shareholder primacy system.

While Germany's system of works councils and co-determination make extensive provision for the involvement of employees, UK workers have traditionally been excluded from corporate decision-making. Thus, while the German system experiences pressure to adjust to the EU's Anglo-Saxon-oriented takeover directive, the UK is under pressure to adapt its corporate governance system to continental practices of worker involvement. This suggests EU pressure for convergence of diverse systems. The 'mechanisms of europeanisation' approach adopted here allows this issue to be addressed.

## 1. Corporate governance in Germany and the UK

## *Germany*

In Germany, corporate ownership is concentrated in the hands of a relatively small number of blockholders. These usually consist of family owners, other companies that are bound in networks of cross-shareholdings, and banks. Together they account for over two thirds of German share ownership (Lannoo, 1999:277). These blockholders exercise close control over their investee companies, usually through board representation<sup>1</sup> and the exercise of majority voting rights. The stock market is small and relatively illiquid and hostile takeovers are virtually unknown. Banks typically play a significant role in industrial finance and this is often matched by the influence they exercise through board representation and voting rights derived from their ownership of shares and also by acting as proxies for small shareholders. Pursuing profits for shareholders is not considered to be the overriding concern and legal and normative traditions emphasise the social role of corporate activity. Article 14(2) of the German Constitution, for example, establishes the principle that '(p)roperty imposes duties. Its use should also serve the public weal'.

The ownership structure of German companies and the financial, legal and normative environments in which they operate, encourage 'patient capital'. This is reflected in a strategic emphasis by corporate management on products and turnover, market share and the number of people on the payroll, rather than profits (Schneider-Lenne, 1994:285). Blockholders are incentivised to evolve strategies aimed at the long-term growth and development of the company by engaging in enduring, trust-based relationships with other stakeholders. While there is a danger of overemphasising the communitarian aspects of German corporations (Vitols, 1997), there is a clear emphasis on consensual decision-making and collaborative effort among stakeholders, who generally perceive their interests to be served best by the long-term growth of the company. Consequently, there is an inclusive approach to stakeholder relationships. The governance role of employees is shaped by the system of co-determination, which grants them up to 50 per cent of supervisory board seats, and extensive use of works councils through which employee interests are represented in negotiations with management.

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<sup>1</sup> German companies operate a two-tier board system, made up of a management (*Vorstand*) and supervisory board (*Aufsichtsrat*).

## UK

In the UK, share ownership is typically widely dispersed among a large number of (often institutional)<sup>2</sup>, investors, each of who owns only a small fraction of the total shares of any one company. Although coalitions of shareholders may control, on average, 30 per cent of a company's equity (Franks and Mayer, 2000:3), single investor shareholdings in a company usually amount to no more than a few per cent, often much less. Holdings of more than 10 per cent are rare and are generally accounted for by small family-controlled companies or those with a significant state interest (Vitols *et al*, 1997:9). The evolution in the UK of a banking sector that lacks integration with industrial strategy at either the macro or micro level (Hutton, 1996; Charkham, 1994:298), leads to a high level of dependence of UK companies on equity markets to finance expansion. But, as La Porta *et al* (2000) point out, minority investors who, due to collective action problems and easy exit opportunities are unable/unwilling to exercise direct control, will not be inclined to invest unless their interests are adequately protected from rent seeking managers. Consequently, UK financial market regulation, company law and self-regulatory measures of the corporate sector have developed to reconcile the principle-agency difficulties that arise with dispersed ownership. These focus on the maintenance of liquid capital markets, the prevention of expropriation by corporate management, and on aligning corporate decision-making with the interests of shareholders by improving transparency, disclosure, accountability and the introduction of performance/share-based executive pay.

This regime is necessarily underpinned by an ideology of shareholder sovereignty that upholds the property rights of shareholders. The early 'assimilation of corporate property with private individual property', begun in the Nineteenth Century, continued unchallenged throughout most of the Twentieth Century (Donnelly *et al*, 2000:25). Consequently, corporate legislation and case law in the UK are based on the underlying premise that a company's directors have a fiduciary responsibility to run the company in the best interests of its shareholders (Wedderburn, Parkinson). This necessarily denies

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<sup>2</sup> In the UK, institutional investors account for over two thirds of corporate ownership (Lanoo, 1999:227).

the possibility of any pluralist form of governance that accommodates a range of interests without giving any one overriding priority. But it does not deny the possibility that the best interests of shareholders (both current and future shareholders) may, in the longer term, be consistent with the cultivation of collaborative links with other stakeholders (Wedderburn, 1985; Parkinson, 2000; DTI, 2002). Nevertheless, UK law does not mandate this and managers, monitored by shareholders, decide how best to accommodate stakeholders' interests.

### Europeanisation

'Europeanisation' is usually envisaged as the impact of European integration on domestic policies, politics, polities and identities. This is seen to occur through a number of distinct mechanisms. Here, the concern is with the pressure experienced in Germany and the UK to comply with EU directives on takeovers and employee information and consultation rights respectively. It therefore adopts the familiar 'misfit – adjustment pressure – outcome' approach (Cowles *et al.*, 2001) that employs the equally familiar 'uploading' and 'downloading' metaphors. EU rules that do not fit well with domestic models generate adjustment costs. In order to minimise these, governments and other domestic policy elites seek to upload domestic policy models into the EU policy-making and block agreements that would oblige them to download alien rules and practices later.

It is the downloading phase that constitutes europeanisation proper. This focuses on the domestic impact of EU-level agreements. The domestic response to EU pressure depends on two sets of factors. The first is the size of misfit. Where EU rules are consistent with domestic rules then there is no misfit, domestic systems are under no pressure to adjust and there is no europeanisation. Europeanisation occurs where domestic rules are adjusted to comply with EU requirements; that is, there is some degree of misfit to begin with and an enforcement mechanism to ensure compliance. Where the difference between EU and domestic rules is great, then domestic policy elites may oppose their national implementation. In this case, the outcome may be either inertia (where the relevant requirement is simply ignored) or retrenchment (where domestic rules are reinforced to reaffirm the domestic policy model in the face of EU pressure). In this

understanding, europeanisation is expected to occur most freely when misfit and adjustment pressure are only moderate.

But, outcomes are mediated through a number of domestic factors. These are variously identified in the literature (Cowles *et al*, 2001; Schmidt, 2001) but commonly include: policy legacies and reform trajectories that may make it easier or more difficult to implement EU rules, the institutional distribution of policy-making power that enables or disables potential veto groups, and the existence or otherwise of a cooperative decision-making culture that encourages cost sharing. It is through such factors that domestic responses to the pressure to adjust to EU rules are shaped.

#### The Takeover Directive and europeanisation in Germany

In outsider systems, the threat of hostile takeover plays a key role in aligning managerial decision-making with the interests of minority shareholders. They are usually triggered when managerial performance is deemed to be less than optimal in terms of building shareholders value. This provides the opportunity for a bidder to acquire the company, install a more efficient management team and then profit from the resulting dividends and increase in share price. The threat of hostile takeover is deemed to discipline managerial decision-making according to the norms of shareholder value. Consequently, outsiders will be more willing to invest and incentives for insiders to maintain their dominant blockholdings will be diminished (La Porta, 2000).

#### *Proposals for a 13<sup>th</sup> Company Law Directive on Takeovers*

The Commission published its first proposal for a 13<sup>th</sup> *Directive on Company Law concerning takeover and other general bids* in 1989 (CEEC, 1989). Noting that the incidence of takeovers had increased over the previous 25 years and that their prevalence and the rules governing them vary enormously between Member States (*op.cit.*: *Explanatory Memorandum*, para 8), the aim of the proposal is to ‘afford shareholders and other interested parties equivalent standards of protection before the law in all Member States’ (*op.cit.*: para 2). Two provisions in the directive proved crucial for their subsequent impact on the German system. The first was the ‘mandatory bid’ provision of

Article 4. This required that once a bidder acquired 33% of the voting rights of the target company, an offer must be made for all remaining shares. The second was Article 8, which established the principle of ‘board neutrality’. This required that the target board refrain from taking any action to frustrate a bid without the prior approval of the General Meeting of its shareholders.

The 1989 and revised 1990 proposals failed to find agreement in the Council. A revised draft (CEC, 1996) followed the themes of the previous draft but replaced some of its detailed requirements (including those concerning the mandatory bid) with a framework of common principles together with a number of more general requirements. However, it proved impossible to obtain the necessary level of agreement on this or a subsequent draft (CEC, 1997). Negotiations continued for a further four years and acquired added impetus by inclusion of the directive in the *Financial Services Action Plan (FSAP - Lamfalussy, 2000)*. In June 2000, the Council unanimously adopted a Common Position on the draft, which was accepted by the Commission a month later. The European Parliament (EP) approved the draft, but only with 15 amendments. The most controversial item was the issue of ‘board neutrality’, opposed primarily by Germany. The Commission and EP eventually agreed a draft but this was then defeated by a German-led coalition in the EP.

#### *The Impact of Proposals for a Takeover Directive on Germany*

The acquisition of companies through public tender offers is not common practice in Germany, and hostile bids – those opposed by the target company’s board – are, with rare exceptions, unknown. The first successful hostile bid for a German company by a foreign bidder did not occur until 2000, with the *Vodafone-Mannesmann* takeover. The absence of takeover activity in Germany is explained by the structure of corporate governance that presents insiders with both the incentives and mechanisms to avoid exposure to unwanted offers.

Yet in 1995, Germany adopted its own voluntary Takeover Code and then six years later, following its successful opposition to EU proposals, introduced statutory takeover rules that many regarded as an *anti* takeover law. These developments in the German takeover



regime were influenced in substantial ways by the Commission's efforts to introduce a takeover directive. The europeanisation of German takeover regulations can be examined in two distinct phases. The first covers the period from the publication of the Commission's first proposal in 1989 to its third draft in 1996. This was a period of modest adjustment by the German system. The second phase covers the period from the 1997 draft to just after the 2001 EP vote rejecting the proposal. This resulted in German retrenchment.

*1989 to 1996: The Issue of the Mandatory Bid and the German Takeover Code*

Unsurprisingly, corporate insiders – family owners, banks and insurance companies, non-financial companies involved in cross-shareholdings in interlocking directorships, trade unions, and, in some cases, *Lander* Governments have expressed little interest in rules to facilitate takeovers. Exposure to takeover is seen as a threat to the persistence of major family shareholdings, the long-term strategic planning capacity of the company, the social and economic plans of regional governments, the stability of profitable industry-finance relationships and the jobs of employees. It is true that, prompted by concerns about Germany's image in international capital markets, the Ministry of Finance authorised the Stock Exchange Experts' Committee (SEEC) to publish 'Guiding Principles' for takeovers in 1979. But these merely consisted of a few non-binding principles that had no discernable impact on takeover activity (Thoma, 1997). Thus, from the point of view of the dominant German elites, the Commission's first proposals for a takeover directive in 1989 and 1990 were at best anomalous, but, at worst, had the potential to disrupt established insider relationships.

Yet, despite the failure of the proposals and despite also the lack of any demand from domestic elites for more comprehensive takeover rules, the German Ministry of Finance instructed the SEEC to review its 1979 Guidelines and make recommendations for reform. The result was the publication in 1995 of the German Takeover Code (*Übernahmekodex*). In all respects bar one, this demonstrates a high degree of

compliance with the failed directive.<sup>3</sup> The exception was the mandatory bid requirement of Article 4. The aim of this provision is to protect the financial rights of minority shareholders by preventing blockholders from negotiating a transfer of control among themselves at one price then offering minorities a reduced price (or no offer at all) once control is achieved. This is at odds with the German system of insider control, which permits control to change hands with the acquisition of only 20 or 30 per cent of the stock. The mandatory bid requirement of the German Code is therefore less stringent. Although it requires that a mandatory bid be made once a certain threshold is reached, it allows for circumstances in which this may be deferred for either 18 or 21 months. Importantly, it sets the threshold that would trigger a mandatory bid at 50%. Given the ownership and control structures of German companies, this would allow control to change hands before the threshold is reached, thereby avoiding the obligation to make a bid for the remaining shares.

Given the Commission's continued commitment to a takeover directive, despite the failure of the 1990 proposal, the German Code can be seen as a defensive response to those intentions, in particular the mandatory bid requirement. While many of the other requirements of the 1990 proposal did not present any difficulties of 'fit' with existing German rules and could be absorbed, the mandatory bid requirement could not. The introduction of a weaker mandatory bid requirement into the code seems to have served as a bargaining chip in negotiations with the Commission. By establishing a takeover code (albeit non-statutory) that complied with all other major provisions of the directive, German representatives would be in a better position to negotiate a compromise on the mandatory bid provision (Faylor, 1998:35).

The strategy seems to have had some effect. The German Code became effective on October 1 1994, four months before the publication of the EU's revised draft (CEC, 1996). This made two concessions to the German position on the mandatory bid. First, the new proposal allowed for alternative mechanisms to the mandatory bid (Art. 3).

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<sup>3</sup> Based on comparison of the directive with translation and commentary on German Code by Thoma, (1997, 1998); Faylor (1998).

German negotiators had argued that the detailed provisions of its Stock Corporation Act (*Aktiengesetz*) provided extensive protections for minorities (Faylor, 1998:35; Baums, 1996) and that these combined with Article 16 of the Code provided equivalent minority protections to the requirements of the proposed 13<sup>th</sup> Directive (Baums, 1996:4). Second, the 1996 proposal drops the requirement of the earlier proposal that a mandatory bid be triggered once a 33% threshold is reached. Instead, it devolves responsibility for determining the threshold to the supervisory authority of each Member State (CEC, 1996: Art. 3.2). Thus, as a result of successful uploading, the misfit created by earlier proposals was diminished. The 1996 draft was viewed favourably in Germany by both Parliament and industry associations (Baums, 1996:1) and opposition was dropped. The outcome of this was that Germany now had a voluntary Code governing takeovers that was fully consistent with the failed directive.

#### *1997 to 2001: Board Neutrality, New Misfit and German Retrenchment*

However, German support for the directive did not last. By the end of the decade, the board neutrality provision in the directive was becoming problematic for German elites. Article 8a (CEC, 1997) requires that Member States introduce rules that prevent boards from taking action to frustrate a bid unless they have the approval of the General Meeting of shareholders convened specifically for that purpose. This requirement is part of the array of rules designed to resolve principle-agent problems that arise in widely held systems. But in Germany where ownership is concentrated, dominant shareholders exercise close control over the board so the principle-agent issue does not arise. This makes a rule to ensure board neutrality during a bid superfluous as the board is rarely in a position to act independently of the interests of the dominant shareholders. Consequently, since the publication of the first draft in 1989, German negotiators had not opposed this provision. But, by the end of the 1990s, the board neutrality requirement was seen as a major problem for the German system. What had changed were the orientations of key policy actors as a result of domestic rule changes that were unwinding the more traditional German defence mechanisms.

By the mid 1990s, growing perceptions of economic underperformance and a number of high profile scandals and corporate failures prompted a German reform agenda aimed at improving supervisory structures and facilitating companies' access to capital by modernising securities markets. This took the form of the Control and Transparency Act (1997). Its aim was to improve the effectiveness of corporate governance in line with the needs of emerging capital markets but without fundamentally altering its structure (Cioffi, 2002). Importantly, it introduced reforms that, while aiming to stimulate developments of German securities markets, as well as diminish the governance role of banks, eroded traditional German takeover defences (*ibid.*). It removed the option for voting caps and established a 'one-share-one-vote' principle; it sought to encourage the banks to reduce their corporate equity stakes; and it prohibited the voting of cross-shareholding stakes above 25% for supervisory board elections (Seibert, 1999). These rule changes, together with the removal of the 50% capital gains tax on the sale of corporate shareholdings by the 2000 tax reform, led to expectations of extensive corporate restructuring as banks and non-financial companies sought to divest themselves of their unwanted holdings (*Business Week*, 10/01/2000; *Europe*, 10/2001).

Nevertheless, the reforms enjoyed fairly broad domestic support. The major German banks were increasingly concerned to cast off their *hausebank* role and compete in global investment banking markets (Gordon, 2003) and had been lobbying German governments for just such measures (*Business Week*, 10/01/2000). Similarly, the large, globally oriented manufacturers were seeking such reforms to facilitate their global restructuring ambitions (*ibid.*). The financial sector was also a beneficiary of the new policies. The tax reform was not only aimed at facilitating corporate restructuring. Its other purpose was to invigorate German securities markets by increasing the proportion of shares traded (Cioffi, 2002:34). On the day the reforms were announced, the DAX Index gained nearly 2% and the stock prices of Deutsche and Dresdner Banks rose between 3 and 6 percent (*Sunday Business Post*, 2001). Although, the reforms were essentially neo-liberal in origin (Cioffi, 2002:35), the political left was relatively quiescent and the union organisations pronounced them 'tolerable' (*Business Week*, 10/01/2000). They had been

won round by the Schroder government's presentation of the reforms as essential for growth and jobs (*The Times*, 14/07/2000).

Thus, despite the fact that the reforms significantly eroded the future capacity of German companies to protect themselves from takeover, a broad base of support was evident. The 2000 takeover of Mannesmann by Vodafone demonstrated the vulnerability of widely held companies (*Europe*, 10/2001: 22) but even here opposition to the bid, whilst highly vocal and public, did not lead to a backlash against the reform programme or lead to demand for rules to reconstitute German defences (Cioffi, 2002). Here, the EU's impending takeover directive appears to have played a significant role.

Concern among corporate elites was that the board neutrality requirement of the proposed directive would now make German companies asymmetrically vulnerable to takeover (Cioffi, 2002). The directive would prevent the board of the offeree company from taking frustrating action against a bidder unless it had the approval of shareholders. Domestic reforms were expected to accelerate the dispersal of corporate ownership of German companies and the Vodafone-Mannesmann takeover had amply demonstrated that the interests of dispersed (often foreign) shareholders do not necessarily coincide with the traditional concerns of *Deutschland AG*. Therefore, the provision to allow the board to attempt to frustrate the bid *with* the consent of shareholders did not allay fears. With the possible break-up of the controlling blocks of shares, it was perfectly feasible that minority shareholders would carry the vote against a board seeking to engage in defensive action.

The defensive actions a board might take include the 'poison pill', selling off key assets, reshaping the capital structure, 'tin parachute agreements' and the 'Pac Man' defence (Gordon, 2002 for detail). These have never been employed in Germany and their legality under German law is uncertain anyway (*ibid.*). Nevertheless, domestic reforms had removed the availability of more traditional measures and were beginning to unwind the system of cross-shareholdings that supported the insider system of control. And now the EU directive was threatening to remove remaining (albeit untested) defensive options.

Moreover, as German negotiators were to point out, the EU proposal did not prohibit defence mechanisms that German law had outlawed but were still used in other Member States, such as golden shares and multiple voting rights.

Despite this, the German government remained a supporter of the proposal and in June 2000 the Council unanimously agreed a Common Position on the draft. In the domestic sphere, a statutory replacement for the Takeover Code was being developed alongside negotiations in Europe in the expectation that agreement would soon be reached (Cioffi, 2002). The June 2000 draft of the domestic Act demonstrates a high degree of compliance with the EU proposal (Weber-Rey, 2000 for summary of 2000 draft). But, during the following nine months, the growing anxiety of corporate elites in the wake of the Vodafone-Mannesmann takeover and the potential consequences of domestic reform found clear focus on the 13<sup>th</sup> directive. There was a growing perception that the board neutrality requirement would constitute a significant threat to vested corporate interests and the consensual industrial model itself. While the unions saw a more liberal takeover regime as a shift in the balance of power from employees to shareholders and as a means of imposing restructuring costs onto the workforce, managers perceived threats to their position as incumbents and the future of corporate Germany generally (Cioffi, 2002: 38). This prompted the formation of an industrial coalition of management, unions and the government of Lower Saxony to press the German government and members of the European Parliament to oppose or substantially reform the directive (*FT*, 2/5/01; 6/7/01). Despite agreement being reached in a special conciliation committee in June 2001, the proposal was defeated by a tied vote in the European Parliament one month later.

Immediately following the failure of the EU directive, Chancellor Schroder announced his intention to finalise a takeover regulation that would permit boards to oppose a bid without shareholder approval (*FT*, 6/7/01). In November that year, an amended draft was passed by the German Parliament and the *Securities, Acquisitions and Takeover Act* (*Wertpapiererwerbs und Übernahmegesetz* – hereafter TOA) came into force on 1 January 2002. In all fundamental respects, bar one, it demonstrates a high degree of

compliance with the requirements of the failed directive<sup>4</sup> Following the European Parliament vote, a last minute change to the proposed TOA made it permissible for a board to take defensive action *without* the approval of shareholders – in stark contrast to both the failed directive *and* earlier drafts of the TOA and the TOC it was to replace (above). Section 33 of the TOA establishes board neutrality as the default position but then allows the board to engage in defensive action providing that it has the approval of the *supervisory board* (Lovells, 2002).

Thus, the misfit between the board neutrality provision of the proposed directive and the German system of corporate control prompted the mobilisation of domestic elites. The directive provided a focal point of opposition for traditional elements of corporate Germany whose anxieties about the apparent move towards shareholder capitalism had been growing for some time. This resulted in defeat of the directive and the enactment on Germany of draconian anti-takeover legislation.

#### The UK and EU Rules on Employee Information and Consultation Rights

The involvement of workers in decisions that affect their interests is an intrinsic feature of European models of corporate governance. ‘Involvement’ takes the form of information and consultation rights and sometimes also participation rights, usually through representation on the board. With the exception of the UK and Ireland, the national regulations of the remaining thirteen Member States make employee information and consultation a matter of legal right (CEC, 1998: Annex, Table1). Seven of them also make provision for employee participation through board representation (Davignon, 1997: para. 76).

In the UK’s shareholder primacy model, underpinned by a dominant property rights theory of the company, the extent to which the interests of other stakeholders can be accommodated is necessarily limited (Wedderburn, 1985; Parkinson, 2000). The relative absence of ‘committed capital’ and the short-term horizons of the stock market have encouraged the commoditisation of work: low wages, low skills and flexible labour

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<sup>4</sup> Based on comparisons with translation of German Act by Lovells (2002)

markets, leading in turn to polarised and adversarial industrial relations (Hutton, 1996). The result of this is that neither side of industry has ever seen much advantage in the development of inclusive corporate structures or collaborative industrial relations. Labour and Union leaderships in Britain have traditionally been distrustful of workplace cooperation (Beesley and Evans, 1978) and nationalisation rather than company law has been seen as the best means of advancing the interests of workers (see for example, Crosland, 1967; Donnelly *et al*, 2000).

Thus, E/EC directives aimed at establishing minimum standards of involvement across Europe have created implementation difficulties in the UK. Four pieces of legislation make up the EU regime for the corporate involvement of employees. The 1975 Directive on Collective Redundancies (CEEC, 1975)<sup>5</sup> requires an employer to begin consultations with employee representatives with a view to exploring other options, minimising the number of redundancies and developing procedures for redeploying or retraining workers affected. The directive on business transfers (CEEC, 1977)<sup>6</sup> aims to safeguard the rights of employees in the event of a transfer of ownership<sup>7</sup> by establishing information rights and ensuring that the employee obligations of the employer are transferred to the new employer. The European Works Council Directive (CEC, 1994) requires the establishment of European-level works councils to improve the information and consultation rights of employees in community scale undertakings.<sup>8</sup> Finally, the Information and Consultation Framework (ICF) Directive (CEC, 2002) seeks to establish minimum standards of employee involvement on an EU-wide basis. This applies to undertakings employing at least 50 and establishments employing at least 20 workers in any Member State. It requires employees to be given information concerning the economic situation of the company and probable developments, especially those that affect employment and changes to the organisation of work (Art. 4(2)(a-c)). Consultations should be timely and at the appropriate managerial level; management must be responsive to employee opinions and consultations must be conducted with a

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<sup>5</sup> Amended by 92/56/EEC and consolidated by 98/59/EC.

<sup>6</sup> Amended by 98/50/EC and consolidated by 2001/23/EC.

<sup>7</sup> It applies only to 'legal transfers of mergers'; that is, it does not apply to transfers of ownership that result from share acquisition (see Art. 1(1)).

<sup>8</sup> Those with at least 1,000 employees in the EU and 150 or more in at least two Member States (Art. 2(a)).



view to reaching agreement (Art 4(4)(a-e)). The directive, however, leaves national governments free to define the practical arrangements for ensuring the provision of information and consultation rights in accordance with national law and industrial relations practice.

### *Implementation in the UK*

E/EC information and consultation rules have created continual adjustment difficulties for UK policy makers. Although the two earliest directives only grant information and consultation rights in the specific instances of collective redundancies and business transfer, both were opposed by UK policy-makers. It was not until after a 1995 ECJ ruling (ECJ, 1994) against the UK government that domestic laws on collective redundancies were brought into line with the requirement of the directives, first introduced twenty years earlier (CEC, 1999). Similarly, in the case of the business transfer directive, a satisfactory level of implementation was only achieved in the UK following a formal notice of complaint from the Commission in 1989 and a 'Reasoned Opinion' in 1991 concerning the lack of implementation (CEC, 1992).

In 1992, the Conservative government, headed by John Major, negotiated an opt-out from the Social Chapter of the Maastricht Treaty. The Social Chapter was to provide the basis for measures to offset the potentially adverse social consequences of the single market and monetary union. But, for the Conservative government of the time, this was seen as a reversal of over a decade of reforms under Thatcher, aimed at promoting supply side policies and forcing businesses to take decisions to promote their profitability. The EWC Directive was based on the Social Chapter and therefore did not apply to the UK when it was adopted in 1994.

The opt-out, however, at least as far as the EWC directive is concerned, was of more symbolic than practical significance for the involvement of employees in UK companies. First, the directive would only have applied to those companies or groups that had a significant European dimension (around 300 in total). Second, many of these companies already had extensive experience of works councils through branches in countries whose

national rules made them mandatory. Third, many of the UK companies that were 'exempted' by the opt-out were nevertheless subject to the requirements of the directive by virtue of their branches or subsidiaries located in Member States that were implementing the directive. The opt-out simply meant that European scale companies were obliged, under the terms of the directive, to establish European-level works councils for their continental workers: their UK workers could be excluded from participation. Most affected companies decided to include their UK employees anyway (*The Times*, 23/9/96).

The opt-out, however, was of huge political significance and was widely acclaimed in the Conservative press. The notion of information and consultation rights for employees did not fit well with the dominant property rights model of companies. With the exception of the industrial democracy debate of the 1970s that led to the Bullock Committee, the manager-shareholder relationship was always the prime focus of concern (see, for example, Cohen, 1945; Jenkins, 1962; Cadbury, 1992). The idea of the company as an association, whose internal structures could be altered in order to pursue pragmatic compromises between capital and labour, was largely absent from the British debate (Donnelly, 2000:10). However, during the 1990s, the ideological and theoretical landscape began to shift and stakeholder issues entered mainstream debate.

The new decade saw the emergence of debates that reflected on the corporate excesses of the 1980s and the economic and social consequences of the endemic short-termism of British industrial finance. By the mid-90s, a number of influential reports had been published that associated the underperformance of UK companies (especially when compared to their German and Japanese counterparts) with a lack of long-term planning and neglect of stakeholder relationships (DTI, 1994; RSA, 1995; IPPR, 1997). A number of leading journalists (Hutton, 1996; Plender, 1997), academics (Kay, 1994; Milgrom and Roberts, 1992; Blair, 1995) and Labour activists (Mitchell and Sikka, 1996) were also sending the same message. The elections of John Monks and Tony Blair – both arch modernisers (Taylor, 2000) – as leaders of the TUC and Labour Party respectively, saw each of them engage with the stakeholder debate as a means of

realigning their respective organisations. Realising that even should Labour form a future government, the restoration of pre-Thatcher union rights was not going to occur<sup>9</sup>, the TUC based its future strategy of workplace modernisation on the European concept of industrial partnership (*ibid.*). For New Labour, the stakeholder idea dovetailed nicely with its electoral strategy of winning the middle ground without alienating its more traditional support. Its inclusive theme suggested a remedy for the divisiveness of the Thatcher legacy, while providing a dynamic alternative to the perceived drift of the Major Government (Plender, 1997:212). The stakeholder idea subsequently became the motif of 'New Labour's' 1997 election manifesto. The change of government in 1997 was decisive in shifting the ideological ground. The EWC was no longer unacceptable and one of the first tasks of the new government was to end the opt-out and sign up to the EWC directive (CEC, 1997a), which became effective in the UK in January 2000

Nevertheless, the EU's intention to introduce legislation that would oblige all companies with more than 50 employees to establish permanent information and consultation procedures was vigorously opposed by the Labour government. This requirement is not incompatible with the UK's corporate governance regime. In its *Final Report*, the Steering Committee of the CLR recommended a statutory codification of directors' duties that did not significantly alter the position established by case law (above). Accepting this, the government stated that subsequent legislation should be based on the principle that:

The basic goal for directors should be the success of the company in the collective best interests of shareholders, but that directors should also recognise, as the circumstances require, the company's need to foster relationships with its employees, customers and suppliers ... (DTI, 2002: 3.3).

But, while UK law does not prevent directors from accommodating the interests of employees, and even encourages this where it serves the best interests of the company and its shareholders, a fundamental principle is that it is directors, under a fiduciary obligation to shareholders, who are in the best position to decide the most appropriate

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<sup>9</sup> As shadow employment minister, Blair had used the provision of the EEC's *Charter of Fundamental Social Rights*, that established the principle of individual choice with respect to union membership, to deter TUC calls for a future Labour government to restore closed shop agreements (Taylor, 2000).

way of incorporating the interests of other stakeholders. Consequently, the directive's mandatory provision of information and consultation rights for employees presented a case of moderate misfit.

Under pressure to maintain its business friendly image and amid signs of a business backlash against government and EU regulation, especially in the area of employment law (*Economist*, 19/8/2000), the Labour Government vigorously opposed the directive. In a coalition with, among others, Germany, the Labour Government successfully blocked the directives' progress for over three years. When Germany withdrew from the blocking coalition, the UK negotiated transitional arrangements that would allow its implementation to be phased in over a number of years for smaller companies.

### Conclusion

National systems of corporate governance are based on deeply embedded institutions. In Germany, the company is perceived as a social institution that balances a range of stakeholder interests. Ownership is concentrated and stability of control is facilitated by cross-shareholdings and a system of co-determination that grants supervisory board representation to employee representatives. In the UK, the company is seen more as a vehicle for the pursuit of profits for shareholders. Shareholder primacy is supported by case law and statute, together with liquid capital markets and a liberal takeover regime. Both systems have faced EU rules that do not fit well with their respective systems of corporate governance. Proposed takeover rules would have shifted the balance of power to minority shareholders in the German system and undermined traditional systems of insider control. Conversely, in the UK, EU rules that mandate information and consultation rights for employees are at odds with a system that sees the pursuit of shareholder value as the overriding objective.

Germany's 1995 Takeover Code represents a case of modest adjustment to EU proposals. In most respects, the 1990 proposals created little misfit for the German system and could be absorbed comfortably. The mandatory bid requirement did not fit well and was only very partially absorbed. The introduction in Germany of the Takeover Code at this time

was significant. It allowed German negotiators bargain effectively and win important concessions on the mandatory bid requirement. Successful German uploading in this area resulted in a more watered down version of the EU's proposals that reduced domestic misfit and facilitated absorption.

During the second half of the 1990s, a domestic reform programme in Germany took development of the German corporate governance model in a direction that made the board neutrality provision of EU proposals increasingly problematic. Despite intense negotiations, revisions to the draft did not sufficiently reduce misfit. The board neutrality provision of the proposed directive had become a focal point of opposition and served to mobilise domestic industrial elites who were able to exert sufficient pressure to successfully oppose the directive. In the domestic sphere, this resulted in retrenchment through the enactment of legislation that sanctioned autonomous defensive actions by the boards of target companies.

In the UK, pressure to adjust to European information and consultation rules was met initially by inertia. It took twenty years for the UK to achieve an acceptable level of compliance with directives on collective redundancies and business transfers; then only following additional pressure from the Commission, which included an ECJ ruling. The EWC Directive was more important for its political symbolism than its actual impact on companies. Many of UK companies that fell within its scope despite the opt-out absorbed its requirements fairly comfortably. The political misfit was diminished by the election of a Labour government pursuing a reform agenda that engaged positively with the stakeholder debate. The Information and Consultation Framework Directive, however, applied to all companies employing more than 50 and was seen as out of step with the principle that it is for managers, monitored by and held accountable to shareholders, to judge how best to develop relationships with stakeholder groups, such as employees. Unlike the German case, UK negotiators were unable to block the directive and, although some concessions have been negotiated, its central provisions must now be transposed into UK law.

Thus, while adjustment pressure in Germany resulted in retrenchment, the UK is obliged to adjust to EU requirements. The explanation of these different outcomes lies in both the extent of misfit and mediating factors found in domestic arenas. The board neutrality provision of the takeover directive was substantially at odds with core institutions of the German model. Domestic reforms had gone some way towards eroding the ability of boards to defend against hostile takeovers. But these reforms were limited in their impact. They were designed to modernise the existing system, not transform it. In the context of these reforms, the board neutrality provision of the takeover directive had the potential to leave boards powerless against the wishes of outsider/minority investors. It was therefore conceivable that the collective impact of domestic reforms *and* the EU directive would substantially undermine the insider system of control upon which German corporate governance is founded.

In the case of the UK, the requirements of the ICF Directive establish a framework for the development of cooperative industrial relations based on partnership rather than conflict. This is significant and may ultimately lead to far reaching changes in industrial relations (Hutton). But it is not transformative with respect to corporate governance. Case law establishes that directors are entitled (perhaps even obliged) to take into account the interests of employees where this is consistent with the best interests of the company and its shareholders. This position is confirmed by the White Paper that resulted from the findings of the Company Law Review. Offering information and consultation rights to employees is consistent with this. Misfit does occur by making such rights mandatory. This is inconsistent with the principle that it is managers, held to account by shareholders, who should decide how best to accommodate the interests of employees. But this is hardly a core institution. The mandatory provision of information and consultation rights does not challenge the notion of shareholder primacy or the institutions of company law, case law, capital markets and the takeover regime that support it. Thus, while the board neutrality provision of the takeover directive was incompatible with the core institutions that underpinned the German system of insider control, the mandatory provision of information and consultation rights for employees in the UK does not challenge core institutions and therefore presents a more manageable degree of misfit.

While in both cases, EU rules were consistent with domestic reform trajectories, the interaction with domestic politics occurred differently. In Germany, there is a strong perception of a common industrial interest among company managers, key shareholders, union representatives and regional government who have a tradition of collaborative activity. This, together with a political structure that favours veto groups, enabled powerful and ultimately decisive opposition to emerge. In the UK, conversely, the Information and Consultation Directive was divisive. It was supported by the unions and opposed by business groups. The relative absence of a common industrial interest, together with a political structure that disadvantages veto groups, prevented more effective domestic opposition from emerging.

Thus, EU rules appear to be exerting pressure towards convergence. The proposed takeover directive sought to empower minority shareholders in the governance of companies by making them the ultimate arbiters of the success or otherwise of a takeover bid. Thus, a central Anglo-Saxon principle has been adopted at the EU level and, for a time at least, pressure exerted for its EU-wide adoption. The ICF Directive mandates information and consultation rights for employees. And this strand of the European social market model has been implanted in the Anglo-Saxon system of the UK. While the extent of misfit between the takeover proposals and the German systems exerted too much pressure and resulted in German retrenchment, the ICF Directive presented only moderate misfit for the UK and led to adjustment. In line with expectations, this suggests the capacity of EU rules to bring about convergence of deeply embedded national corporate governance systems through adjustment pressure is limited to incremental changes which do not challenge core institutions.

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