MACFARLANES

EMPLOYEES ON THE BOARD: THERESA MAY'S NEXT BIG IDEA?

Reviewing corporate governance appears high on the new Government's agenda. Along with executive remuneration and a greater role for shareholders in the nomination and appointment of directors, there are signs of a greater role for employees too.

In one of her first speeches after having secured the Conservative nomination, Theresa May said this:

"I want to see changes in the way that big business is governed. The people who run big businesses are supposed to be accountable to outsiders, to non-executive directors, who are supposed to ask the difficult questions, think about the long-term and defend the interests of shareholders. In practice, they are drawn from the same, narrow social and professional circles as the executive team and - as we have seen time and time again - the scrutiny they provide is just not good enough. So if I'm Prime Minister, we're going to change that system - and we're going to have not just consumers represented on company boards, but workers as well."

Introducing a requirement to have employees on company boards would represent a major structural change in the UK corporate governance regime, moving it closer to the German model where collaborative decision-making has been the norm for several decades. Mrs May has not yet brought forward any detailed plans to assist firms in understanding precisely what she intends to introduce. This note summarises the position in Germany, so that clients can begin to consider how employee participation might affect their businesses.

THE GERMAN MODEL

Before looking at the regime in detail, it is important to appreciate the fundamentally different structure of German companies. UK firms usually have one board, with a number of sub-committees handling, for instance, remuneration or human resources. The structure of a typical German company is very different: it will have a management board running the company day-to-day, and a supervisory board overseeing management. Perhaps the best way to think of the difference from a UK perspective is to imagine all the non-executive directors of a UK company sitting on the supervisory board, overseeing the executives on the management board.

Employee representatives sit on the supervisory board only, with the impact depending on the size of the company. Smaller companies will have one third of the board nominated by employees, while larger firms will have half the supervisory board appointed by employees, the other half by shareholders.

EFFECT OF EMPLOYEE REPRESENTATIVES IN PRACTICE

The German model has its roots in ideas of social democracy, integration, collaboration, and worker protection. It has never explicitly been seen as a tool for more robust corporate governance. Indeed, having a supervisory board with employee representatives did not stop Volkswagen falsifying its diesel emission tests. Academic commentators in Germany and a 2006 Government commission have found no evidence that employees on the board has had a negative impact on the performance of German companies, but criticisms remain. The former CEO of Deutsche Bank has claimed the system gives German companies a competitive disadvantage in international deals, and could scare off potential investors. Whether or not that is accurate, there are other potential drawbacks:

- **Conflict**: Although employee representatives have a statutory duty to act in the company's best interests, their position as workers is commonly seen by critics as generating an inherent conflict of interests.
- **Skill**: Some have criticised the knowledge and skill of employee representatives. That appears a somewhat dubious line of attack, however, as in most sectors workers on the shop floor will have at least as good an understanding of the business on a micro level as management.
- **Structural issues**: In some circumstances, particularly in sectors with less harmonious relations between management and unions, the management board might be slow in bringing an issue to the supervisory board, being fearful of a negative reaction from the employee representatives.
- **Backscratching**: In some companies, employee representatives can remain in post for considerable periods, leading to the allegation that they have "gone native" and have ceased to provide meaningful oversight. Volkswagen again provides a good example - in 2005 employee representatives were reported as having accepted luxury travel and visits to brothels in order to keep them onside.
- **Unwieldy size**: There can be up to 20 people on a supervisory board, which can make effective oversight problematic in practice.

A GOOD SYSTEM FOR THE UK?

Whether or not Mrs May's Government proceeds with any move to introduce mandatory employee participation on boards remains to be seen. Even if it does, it seems unlikely that worker representation will reach the scale and power it has in German corporations. The UK's single company board model, and the fact that boards might range from the very small to the very large makes it harder to devise sensible numerical limits that would fit all UK companies. The very strict statutory duties imposed on UK directors might also prove a difficult hurdle - will worker representatives be directors? If not, will they simply be second-class citizens on the board?

CONTACT DETAILS

If you would like further information or specific advice please contact:

HAYLEY ROBINSON
PARTNER
EMPLOYMENT
DD +44 (0)20 7849 2969
hayley.robinson@macfarlanes.com

MARA SCHMIDT-KLIE
SECONDEE, GLEISS LUTZ
EMPLOYMENT
DD +44 (0)20 7849 2378
mara.schmidt-klie@macfarlanes.com

SEPTEMBER 2016