



Book Review

Hedging around the question of the relationship between corporate governance and labour regulation

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Corporate Governance and Labour Management: An International Comparison edited by Howard Gospel and Andrew Pendleton, Oxford University Press, Oxford, 2004, ISBN 0-19-926367-1, 400 pp.

The 1998 docks dispute was a watershed moment for the union movement in Australia, if only for the broad public support that was demonstrated for the workers' industrial action. The dispute arose when significant corporate restructuring resulted in a lack of working capital for the Patrick Stevedores group of companies that employed waterside workers represented by the Maritime Union of Australia (MUA).¹ On the evening of 7 April 1998, the entire workforce of these companies was effectively sacked. The action polarised the Australian community, and waterfront workers were joined at the picket line by a broad cross-section of the community including public servants, students and politicians.

At the same time as unlikely fellows were linking arms down on the docks, two similarly unlikely fellows — corporations law and workplace relations law — were being brought together in the legal arguments being made in court, as the High Court was asked to consider the legality of the Patricks corporate restructure under the Workplace Relations Act 1996 (Cth) (WR Act).² In its decision, the Full Bench considered whether the remedies under s 298U of the WR Act had to be subject to the Corporations Law. The majority found that:

The answer depends on the true construction of the two laws and the fields of their operation. When one law — the Corporations Law — deals with the constitution, administration and assets of a corporation and another law — the Workplace Relations Act — deals with relationships between employers and employees or

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1 For a description of the dispute and its significance, see R Morris, 'A Watershed on the Australian Waterfront? The 1998 Stevedoring Dispute' (2000) 27 *Maritime Policy and Management* 107.

2 The application was made under WR Act s 298. For a thorough case note, see J Tham, 'The MUA Case' (1999) 25 *Monash L Rev* 181 and also G Orr, 'Conspiracy on the Waterfront' (1998) 11 *AJLL* 159.

conduct in which persons engage qua employer or employee, there is not likely to be any general inconsistency between them. Corporations, like natural persons, can be subject to laws governing relationships and conduct. A law of the Commonwealth which governs the relationship of employer and employee does not purport to alter, and would not be construed as intending to alter, a State law prescribing a general regime for the administration of the assets of insolvent companies or the assets of companies which are, or are likely to become, insolvent.³

While the MUA decision demonstrates judicial resistance to considering the overlap or conflict between the regulation of corporations and the regulation of labour, in practice each of the two areas constrain and shape the operation of the other. Different fields of scholarship and inquiry have generated varying approaches to the question of the impact of the governance of capital markets on employment relations. The judicial treatment represented by the MUA decision is the most myopic, bounded by the rigidities of constitutional interpretation and the structure of statutes.

A new book edited by Howard Gospel and Andrew Pendleton illustrates the diverse and emerging literature on the interaction between corporate governance and labour management, and 'how this interaction has shaped distinctive national patterns of political economy'.⁴ Unhampered by legal scholarship's rigid distinctions, the contributors are able to take a broad view of this interaction. Yet, even working outside law's disciplinary boundaries, there appears no easy way to conceptualise the nature of the interaction. This book makes an important foray (possibly the most important foray to date) into considering the relationship between the two areas, and the contrasting application of various analytical methods from different fields to this question is of considerable interest. However, the book never quite resolves how to advantageously combine them.

National Typologies

Most of the chapters of the book are concerned with characterising national typologies and the extent to which those typologies are threatened or altered by current economic pressures. The first body of literature to be employed is the Financial Economics literature. Here a useful distinction has been made between 'market/outsider' and 'relational/insider' national systems:

Market forms of governance are ones where emphasis is placed on finance via public equities and market-based debt. In these systems, equity markets are extensive and there is usually a high turnover of shares and corporate bonds. Investors have diversified portfolios and may easily sell their investments. Under such arrangements, there exists an outsider form of governance based on relatively strong legal rights for investors and on an active market in capital control (mergers and

³ *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* (1998) 195 CLR 1; 153 ALR 643 at [42]. Despite this insistence that the laws were unrelated or did not affect each other, the orders suggest that the Workplace Relations Act is subject to the Corporations Law. North J's original Federal Court orders were rectified by the insertion of an appropriate qualification so that the administrators' discretion under the Corporations Law s 437A was not taken away.

⁴ H Gospel and A Pendleton, 'Corporate Governance and Labour Management: An International Comparison' in H Gospel and A Pendleton (Eds), *Corporate Governance and Labour Management*, Oxford University Press, Oxford, 2004, p 1.

acquisitions, especially hostile takeovers). This contrasts with relational forms of finance where more reliance is placed on bank and other loans, where securities markets are weak, and where investors are more likely to be long term. This is said to create a form of insider governance, where large owners have a more stable and direct relationship with the management of the firm, but where smaller investors and the market for corporate control exerts less discipline.⁵

The United States and the United Kingdom are said to have market/outsider systems, Germany and Japan to have relational/insider systems. Gospel and Pendleton find this distinction useful but criticise it for being too broad a bipolar typology and for assuming that labour has no role in corporate governance. Furthermore, the Financial Economics literature hasn't much to say about the consequences of different typologies for labour management.

Gospel and Pendleton also employ a Political Economy approach. As in the Finance Economics literature, this 'varieties of capitalism' or 'business systems' literature has placed considerable emphasis on forms of finance and corporate governance as key elements of national economic systems and important determinants of corporate behaviour. Again, two broad national typologies have been identified: the 'liberal market' economies of the United States and the United Kingdom, and the 'coordinated market' or 'stakeholder economies', of which Germany and Japan are typical. Gospel and Pendleton suggest that the varieties of capitalism approach has the advantage over other approaches because labour market institutions and outcomes are central to the thesis:

Thus, in liberal market economies, dispersed ownership and financial constraints are said to exert strong pressures on employment systems and job tenure. By contrast, in coordinated market economies, different governance arrangements, including the involvement of labour, mean that financial pressures are more likely to be absorbed by shareholders and less likely to impact negatively on labour. Other institutional complementarities are also seen to follow in areas such as training, wage systems, and forms of employee representation.⁶

Yet Gospel and Pendleton are, once again, critical of this body of literature for its limited national ideal types. More interestingly, they are critical of the notion of complementarity, 'defined as the interaction of two institutions in a way which raises returns from each'.⁷ For Gospel and Pendleton this 'implies that complementarity takes an almost evolutionary or Darwinian form: that is, "deviant" institutions will eventually be forced out by the combined weight of complementary institutions',⁸ leading to the creation of stable systems composed of mutually reinforcing elements. The problem they identify with the varieties of capitalism approach arises from this emphasis on systematic cohesion, instead of a consideration either of which institutions have the most powerful effects, or of the possibility that there is simply a coincidence of effects rather than a complementarity. In my view this is the most important point raised by Gospel and Pendleton, and one that is quite difficult to apply analytically since the impulse is to assume a causal relationship between

⁵ Ibid, p 7.

⁶ Ibid, p 8.

⁷ Ibid, p 9.

⁸ Ibid, p 9.

capital markets and labour management practices.

The United States

The various contributors come at the question of national typologies from a range of different angles. Sanford Jacoby provides a useful historical overview of corporate governance in the United States. He reminds us that shareholder primacy is the result of a shift in power over the past 20 years. It is this inclusion of power in Jacoby's analysis that makes it stand out from other contributions. To demonstrate the significant change in managerial philosophy that has occurred, he quotes from a classic 1950s study, *The American Business Creed* by Sutton et al:

Corporation managers generally claim that they have four broad responsibilities: to consumers, to employees, to stockholders, and to the general public . . . each group is on an equal footing; the function of management is to secure justice for all and unconditional maxima for none. Stockholders have no special priority; they are entitled to a fair return on their investment, but profits above a 'fair' level are an economic sin.⁹

Jacoby claims the idea of managerial prerogative traditionally meant that there was a looser coupling of management and shareholders than is currently the case, not merely a loose coupling between management and labour. Managerial prerogative gave managers the right to plough surplus cash back into the enterprise rather than pay it to shareholders. It also gave managers the ability to treat workers as stakeholders in the company, although not necessarily on par with shareholders.

Jacoby shies away from attributing a causal relationship between changes in corporate governance and changes in management attitudes towards employees and unions. Whether the shift away from a stakeholder view of employees and greater hostility towards unions were due to a shift in corporate governance is, according to Jacoby, difficult to assess because there were other coincidental events. The intensification of domestic and global competition and a rise in the union wage premium were two such events. Nevertheless, says Jacoby:

the increasing dominance of a credo that privileged shareholders over other stakeholders made it easier for companies to justify anti-union policies. Thus, changes in corporate governance promoted a growing resistance to union legitimacy.¹⁰

The capacity of shareholders to displace incumbent managers through hostile takeovers, using new financial instruments such as junk bonds, also contributed to a shift of power away from managers and other employees towards shareholders. Jacoby argues that the rise of institutional investors who lack insider information and who base investment decisions on short-term movements in stock price, as well as innovations that have induced individual investors to enter the market, have reduced the average amount of time a share is held and the turnover rate of individual portfolios. The result is greater

⁹ S Jacoby, 'Corporate Governance and Employees in the United States in Comparison' in Gospel and Pendleton, above n 4, p 38.

¹⁰ Ibid, p 39.

pressure on management to produce short-term results. As power shifted in the 1980s, managers found themselves exposed to greater risk and were forced to produce higher returns to satisfy investors and avoid takeovers.

At the same time as pointing to institutional complementarities in the shifts in corporate governance and industrial relations in the United States towards shareholder primacy, Jacoby shows that systems are porous. He cites numerous examples of management strategies which have been borrowed from 'relational/insider' systems. The 'resourced-based' approach currently taken by many US firms, which sees firms shifting the emphasis from a financial approach to one based on competing on the basis of their internal strengths, has been transplanted from Japan. This business strategy eschews unrelated diversification based purely on financial considerations in favour of diversification guided by core competency and potential synergies. The intense borrowing, from the 1980s onwards, of Japanese quality-oriented production techniques is a further example of porousness, which has led to the adoption of various 'high performance work practices' such as self-directed work teams, job rotation, peer review of employee performance and total quality management techniques in a significant proportion of US establishments.

While Jacoby contributes an important point by insisting that systems are malleable, it is a shame that he does not continue to apply a power analysis in this section. He acknowledges that:

because governance institutions are complex, path-dependent, and embedded in complex social systems, haphazard borrowing does not guarantee an improvement in the borrower's economic performance.¹¹

However, he fails to ask what happens to an institution or a practice when it is transplanted from one system into another.¹² Does an institution or practice perform differently or perform a different function when transplanted into a different system? Jacoby observes that 'high performance work practices' have not been combined with mechanisms to improve employee voice, particularly at the strategic level. When 'high performance work practices' are taken from a context in which workers have relatively secure employment and where strategic planning horizons are longer, what effect do they have on work systems and conditions in their new context? Evidence from Australia suggests that they can contribute to work intensification and downwards pressure on working conditions.¹³

Germany

Similar criticisms can be made of Jackson, Höpner and Kurdelbusch's discussion of the German system. Jackson et al analyse the extent to which new pressures on the German economy are placing the German 'stakeholder' model of corporate governance under strain. Germany's corporate system is

¹¹ Ibid, p 45.

¹² There is a growing literature on this question within legal discourse. See, for example, Gunther Teubner's seminal work, 'Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences' (1998) 61 *Modern L Rev* 11.

¹³ R Kelly, 'Total Quality Management: Industrial Democracy or Another Form of Managerial Control?' (1995) 6 *Labour and Industry* 132.

characterised by banks providing substantial long-term external corporate finance, acting as stable shareholders, and protecting companies against hostile takeovers. These features support long-term capital investment and curtail managerial 'short-termism'. Germany also has the most far-reaching system of codetermination among OECD countries. Workers enjoy extensive participation rights, both through works councils and representation in the corporate boardroom. These institutions have traditionally supported employment security and high-skill patterns of work organisation. The German system differs from the Japanese in that German firms are subject to stringent legal regulation of their internal governance structures. Outside the firm, governance is interwoven with industry-wide collective bargaining, membership in employer associations and chambers of commerce and industry, and obligations to train according to the public standards of the apprenticeship system.

Jackson et al observe that Germany proved to have a stable 'model' of corporate governance during much of the post-war period. However, considerable pressures for change developed from the early 1990s onwards:

Economic pressures of internationalisation and political pressures for liberalisation promoted a growing role for capital markets. New capital market actors, such as foreign and institutional investors, brought different investment strategies and an increased focus on financial returns. 'Shareholder value' became widely discussed as a new paradigm of management with greater focus on stock price, core competence, transparency, and investor relations activities.¹⁴

The authors ask how trends towards shareholder or market-oriented corporate governance will impact on labour management and employee representation. The existing literature posits tight complementarities between capital market institutions and labour institutions. Jackson et al test the existence of continuing tight complementarities through an empirical analysis of the way changes in capital market pressures are impacting on German labour management and industrial relations. They find that a more marketised role for capital has led to a shift towards a more marketised employment relations system. Stable employment is available to a shrinking number of employees and variable pay is making wage setting more decentralised and contingent on the market position of the firm or business subunit. However, Jackson et al find that the diffusion of shareholder value has not undermined the core institutions of German industrial relations, namely codetermination and collective bargaining. Importantly, though, they find that the economic functions of these institutions are changing in light of new pressures and managerial strategies:

Collective bargaining is struggling to maintain its past role in setting egalitarian and solidaristic wages. Unions are thus less able to exert a productivity whip on firms through high and uniform wages which were a 'beneficial constraint' on German work organization in the past. Now collective agreements are more defensive and

¹⁴ G Jackson, M Höpner, and A Kudelbusch, 'Corporate Governance and Employees in Germany: Changing Linkages, Complementarities, and Tensions' in Gospel and Pendleton, above n 4, p 99.

steer the process of decentralization. Likewise, codetermination has an increasingly insider-focus on the interests of core employees.¹⁵

It is Jackson et al's view that this shift is transforming codetermination from a politically guaranteed institution to a more private and contractual arrangement.

Despite these changes, Jackson et al are convinced that these institutions have short-term resilience. (They leave the long-term stability of the arrangements open to question.) The authors make a significant contribution in arguing that institutional linkages are not established once and for all, but are in constant negotiation. They posit that shareholder pressures have not only placed pressure on labour management, but also that Germany may be adopting a shareholder value model in ways that differ from countries where institutionalised employee representation is weaker. However, if the functions of these institutions change markedly, are they really the same institutions other than in name only? If works councils are performing the function of promoting greater managerial accountability and protecting insider employee interests, then what happens to the functions that they used to play? At what point will conflict between insider/core employees and outsider/peripheral employees place too significant a pressure on the existing institutions which have performed the function of avoiding class conflicts and the negative-sum solutions associated with the US or UK model?

Japan

One of the main problems with the varieties of capitalism approach on which this book draws is, as Gospel and Pemberton identify, the level of generality at which it operates. One of the major shortcomings of almost all the chapters in the book is that data mainly concern the governance and ownership structures of public companies, and thus generally large firms. The governance of smaller firms (the equivalent of proprietary limited companies or partnerships) is therefore not considered. For example, while the discussion of Japanese governance by Takashi Araki is distinctive because he at least makes reference to 'larger companies',¹⁶ that does not stop him from referring simply to the 'Japanese system' throughout his contribution. When small and medium enterprises employ the majority of people in an economy, is it accurate to draw conclusions about employment systems and corporate governance based on large firms?¹⁷ The 'ideal-type' account of the Japanese system has been criticised by authors such as Kumazawa and Yamada and Gottfried and Hayashi-Kato.¹⁸ These authors point out that the 'three pillars' of the Japanese employment system — lifelong employment, enterprise

15 Ibid, p 118.

16 T Araki, 'Corporate Governance, Labour, and Employment Relations in Japan: The Future of the Stakeholder Model?', in Gospel and Pendleton, above n 4, p 255.

17 Seventy to eighty per cent of all Japanese workers are employed by SMEs: H Sato, 'Labour-Management Relations in Small and Medium-Sized Enterprises: Collective Voice Mechanisms for Workers in Non-union Companies', in M Sako and H Sato (Eds), *Japanese Labour and Management in Transition: Diversity, Flexibility and Participation*, Routledge, New York, 1997, p 317.

18 M Kumazawa and J Yamada, 'Jobs and Skills under the Lifelong *Nenko* Employment Practice' in S Wood (Ed), *The Transformation of Work?: Skill, Flexibility and the Labour*

unionism, and 'nenko' (the seniority-plus-merit principle in pay and promotion) — which Araki refers to in his contribution, have only ever been assured for core, male workers in large enterprises.¹⁹ Japan's workforce is characterised by industrial dualism, that is, the interdependent co-existence of capital-intensive larger firms achieving high productivity, and labour intensive smaller firms lagging behind in productivity.²⁰ The conditions of core workers have traditionally been maintained by passing pressures on to suppliers.

When trying to draw broad characteristics, some level of detail will always have to be sacrificed. However, even a discussion of the corporate governance and labour management strategies of large companies would be incomplete without mention of the interdependence of small and large firms within strongly integrated vertical supply chains. Surely a characterisation of 'national typologies' requires an analysis of the practices of firms that employ the majority of workers.

Conclusion

Gospel and Pendleton's book adds to the existing literature on this topic by trying to extend and break down 'national typologies'. It also includes analyses of countries that defy the bipolar typology of 'market/outsider' and 'relational/insider' or 'liberal market' and 'coordinated market' economies, such as the Netherlands as well as Latin or Southern European countries. Sadly, no non-OECD countries are considered.

How should Australia be characterised in terms of these national typologies? It is generally assumed that Australia fits within the 'market/outsider', 'liberal market' category, but there are many features of the Australian finance and regulatory system that make it look different from the United Kingdom or United States. Surprisingly little work has been carried out which attempts to characterise Australia's institutions in these terms. Recent work by Brian Cheffins,²¹ drawing on empirical studies by Geof Stapledon,²² suggests Australia's pattern of corporate ownership might not fit the 'market/outsider' characterisation as easily as either the United States or Britain. For example, the re-concentration of shareholding in the hands of institutions in Australia remains offset by considerable non-institutional blockholding in publicly listed companies. This is one reason why, despite the importance given by finance economics to the market for corporate control in disciplining managers, and recent regulatory changes in Australia that restrict managerial discretion in takeover contexts, the scope and incidence of hostile

Process, Unwin Hyman, London, 1989; H Gottfried and N Hayashi-Kato, 'Gendering Work: Deconstructing the Narrative of the Japanese Economic Miracle' (1989) 12 *Work, Employment and Society* 25.

19 For example, while Araki, above n 16, p 274, states that 'enterprise unionism is a hallmark of Japanese industrial relations', it is estimated that firms that employ less than 30 employees have a unionisation rate of 0.8% and only a third of SMEs are unionised: Sato, above n 17, p 318.

20 Kumazawa and Yamada, above n 18, p 105.

21 B Cheffins, 'Corporate Governance Convergence: Lessons from Australia' (2002) 16 *Transnational Lawyer* 13.

22 See, eg, G Stapledon, 'Australian Sharemarket Ownership' in G Walker et al (Eds), *Securities Regulation in Australia and New Zealand*, 2nd ed, LBC Information Services, Sydney, 1998.

takeover activity in Australia may be less than in comparable governance systems.²³ On the labour management side, Australia's traditionally robust, but now very much eroded, industrial relations system, involving arbitration and trade union bargaining, may have had a constraining effect on the operation of managerial rights. O'Donnell et al suggest the formalisation of consultation procedures around redundancy and the growing jurisprudence around the transmission of businesses, while placing constraints on the corporate restructuring process and arguably protecting employees' proprietorial interest in their jobs and income, have not offset changes in the underlying structure of bargaining power between management and labour so as to prevent the reassertion of managerial fiat.²⁴ These are only initial thoughts, however, based on a survey of the existing literature. O'Donnell et al are of the view that given the possible diversity of outcomes made possible at the firm level by enterprise agreements and the diverse approaches taken by trade unions, further research should best proceed on a case-by-case basis.

It may be possible for the High Court to declare that corporations law and workplace relations law are separate regulatory areas and thus any apparent contradictions need not be reconciled. However, in many other forums further consideration of the regulatory interaction between corporations law and labour law is beginning to prove a fruitful area of scholarship.

²³ See the discussion in A O'Donnell, R Mitchell and I Ramsay, 'Shareholder Value, Corporations Law and Labour Law: Aspects of the Australian Experience', Paper for Australian Labour Law Association Second National Conference, Sydney, 24–25 September 2004.

²⁴ Ibid.