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ANGLO-AMERICAN CORPORATE GOVERNANCE AND THE EMPLOYMENT RELATIONSHIP: A CASE TO ANSWER?

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Abstract
The corporate governance environment in the UK and US is generally thought to be hostile to the emergence of cooperative employment relations of the kind exemplified by labour-management partnerships. We discuss case study evidence from the UK which suggests that, contrary to this widespread perception, enduring and proactive partnerships may develop, in conditions where management can convince shareholders of the long-term gains from this approach, and where other regulatory factors operate to extend the time-horizon for financial returns. We conclude that there is more scope than is commonly allowed for measures which could reconcile liquidity in capital markets with cooperation in labour relations.

Keywords: corporate governance, labour-management partnerships, stakeholding

JEL Classification: G34, J53, K22, K23

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1. Introduction

Innovative forms of labour-management relations emerged in the US and the UK during the mid-1990s as ways of capturing the benefits of cooperation between corporate stakeholders. The background to this was rapid technological change and intensifying competition in product markets, brought about by globalisation and, particularly in the case of the UK, privatisation. Customers learned to exercise their choice more aggressively and shareholders became increasingly impatient for a quick and profitable return on their investments. In response to these pressures, firms were forced to re-examine their organisational systems and structures in an effort to improve performance (Burchell, Ladipo and Wilkinson, 2002). Although downsizing and business process re-engineering were part of the response, labour-management 'partnerships' were also initiated, often in the very same companies which had undergone substantial restructuring. These arrangements led to innovations in the employment relationship, including a significant degree of self-management and autonomy for employees.

The 1990s was also a period when corporate governance came to the fore as an issue both for public policy and management practice. The idea that managers should act as the agents of shareholders gained ground, particularly in the American and British systems. This was manifested in various ways, including the proliferation of corporate governance codes, the widespread adoption of executive share option schemes and similar forms of managerial remuneration, and the increasing degree to which whole industries and sectors were restructured through the operation of the market for corporate control (Holmstrom and Kaplan, 2001). In the process, long established mechanisms for the exercise of stakeholder voice – above all, employee representation in its various forms – were marginalized. Thus corporate governance, while on the one hand leading management to favour close cooperation with labour as a means of enhancing the firm's competitiveness, also intensified the pressure to prioritise short-term shareholder interests, thereby threatening to undermine these very same forms of labour-management cooperation.

This paper considers how far corporate governance has come to operate as a constraint on the emergence and stabilization of innovative employment forms and cooperative strategies in the British and American economies. The next section outlines the relationship between corporate governance regulations and the predominant norm of 'shareholder value' in the Anglo-Americans systems. Empirical evidence is then presented in the form of a report of case studies which have been tracking the impact of corporate governance on labour-management partnerships in a number of UK-based firms since the late 1990s.

2. What is 'corporate governance' and what is its relevance to employment and competitiveness?

Corporate governance is concerned, in essence, with issues of ownership and control of the enterprise (Berle and Means, 1932). 'Ownership' refers in this context to the legal allocation of property rights among the principal stakeholders or corporate constituencies (shareholders, creditors and employees), and 'control' to the way in which legal rules and social norms interact to determine the balance of power among these groups. A legal perspective is important here because of the pivotal role which legal rules play in constituting the corporate form and in framing the options available to the various parties with an interest in or affected by the enterprise. It is clear that legal rules do not operate in a vacuum, and that the same rules may have very different effects depending on the context in which they apply. For example, many of the rules of Japanese corporate law are borrowed from an American model which was imported after 1945, and, on the face of it, they provide powerful legal rights to shareholders to call corporate managers to account. In practice, however, shareholders have a marginal voice in Japanese corporate governance by comparison to the predominant role accorded, traditionally at least, to employees (Araki, 2004). This is an example of a case where the formal law appears to be less important than norms and practices which lie beyond the law. The point, from a methodological perspective, is not that legal rules can be ignored, but rather that it is necessary to understand how, in a given context, they interact with social norms to shape, over time, the expectations and strategies of the various parties.

Corporate governance has far-reaching implications for industrial relations and the employment relationship. The most important of these is that management and labour do not simply have to deal with each other. Both are subject to the wider interests of the dominant financial stakeholders who make up the 'residual claimants' or 'holders of the beneficial interest' (Hansmann and Kraakman, 2000) in the enterprise. In the case of large, private sector companies in Britain and America, these are normally the shareholders, although banks, in their capacity as lenders, and other creditors also play an important role, particularly when the firm is threatened with insolvency or has to operate in the shadow of insolvency law (Armour and Deakin, 2001, 2003). Crucial strategic choices for management in the field of labour relations, such as whether to resist, welcome or acquiesce in union involvement in the firm, may turn, to some degree, on the pressures being exercised by financial interests. The implications for the employment relationship may also be considerable, in terms of the degree of job security which the firm can offer, and the nature of employee involvement in the design and implementation of work systems.

This is not to suggest that there is necessarily a linear relationship of cause and effect between the framework of corporate governance which applies to a given organisation, on the one hand, and the type of employment practices which it pursues, on the other. Causal influences may run in both directions (see Gospel and Pendleton, 2005, for discussion). The rules of industrial relations and employment law, and a given firm's approach to labour relations, which may be of long standing and resistant to change, can frame management's options and thereby influence, in turn, the ownership structure of the firm. Thus it is possible, for example, that rules mandating a high level of employee participation in certain aspects of organizational decision making, a common feature of the labour laws of continental Europe, may have helped to entrench a 'blockholder' model, based on concentrated share ownership, in those systems. They may also have prevented the emergence of dispersed ownership of the kind observed in Britain and America, where employee consultation laws are weaker. The relative weight, in this respect, of corporate law and corporate governance, on the one hand, and labour law and industrial relations, on the other, cannot be deduced from a study of the legal texts alone. However, the legal nature of the relevant interests and claims, and the degree to which the legal-institutional system accords priority to the claims of certain stakeholders over others, should be taken into account in empirical studies of the relationship between corporate governance and organizational change.

In this respect it is vital to note that different corporate forms are associated with different patterns of ownership (Hansmann, 1996). A number of alternative forms for the enterprise can be observed within market systems, including publicly-owned state corporations, to organizations based upon customer ownership ('mutuals'), and entities owned by employees (a category which includes worker or producer 'cooperatives' as well as professional partnerships of lawyers and accountants). In the case of companies limited by shares, external providers of risk capital – the shareholders – are said to be the 'residual claimants,' in the sense that they are entitled by law to what is left from the income stream after the contractual claims of employees, commercial creditors and others have been met.[1] Because they are the last to receive anything in the event of insolvency, they implicitly assume the risk of failure. Conversely, shareholders gain in proportion to the organisation's success. Although, in law, they are not *entitled* to receive a dividend, in practice, the linking of dividends to corporate performance aligns shareholder returns directly to the success or failure of the enterprise. They also benefit through the increase in the value of their shares.

It is often claimed, in particular by institutional investors, that shareholders are the 'owners' of the company, but this does not accurately reflect their legal position in either the UK or the US. Shareholders do not own the company, nor do they own

its assets (Parkinson, 2003). Nevertheless, by virtue of the rules of company law and corporate governance practice, the ownership of common voting stock does give them certain other property rights which have important implications for incentives and hence for efficiency. In particular, shareholders of *listed* companies – that is, in essence, companies whose shares are traded on a stock exchange – can dispose of their shares in an open market, providing a way by which control of the corporation can be transferred. The orthodox view in the Anglo-American system is that market liquidity – the ability of shareholders to exit at low cost – enhances the organisational efficiency of the enterprise. Shareholders have a particularly strong incentive to monitor management, derived from the close link between shareholder wealth and the success or failure of the firm; the sale of stock is the mechanism by which this power is exercised. Managerial failure is punished by a fall in investor confidence and a declining share price. In effect, the stock market, once it attains a certain degree of liquidity, becomes a market for corporate control, in which rival management teams bid to persuade shareholders to sell them controlling interests by offering them a premium over current share prices.

It can be argued that employees and other long-term stakeholders have just as valid an argument as shareholders for being considered the residual claimants. This is because they are equally likely to make relation-specific investments (in human capital, for example) which will be at risk if the enterprise fails (Blair, 1995; Kelly and Parkinson, 1998; Blair and Kochan, 2000). The response of mainstream corporate governance theorists is that while it may be the case that many groups have a stake in the firm, only the shareholders have sufficient homogeneity of interests as a group to hold managers to account in an effective way (Hansmann, 1996). From this perspective, compromises in the pre-eminent rights of shareholders embodied in, for example, codetermination laws and laws requiring employee consultation, are inherently inefficient, and survive only because the costs of unraveling politically-motivated compromises are too high (Hansmann and Kraakman, 2001).

A large proportion of US and UK productive capacity, in relative terms, is held in the form of listed companies. In both systems, stock market capitalization has substantially exceeded national GDP since the mid-1980s (although the degree to which this is the case has fallen considerably following the end of the bull market in 2000 and subsequent stock market decline) (Gospel and Pendleton, 2005). US and UK listed companies, as we noted above, are mostly characterised by *dispersed-share ownership*; that is to say, the company's share capital is scattered among a large number of individual holdings, with no dominant or controlling interest. This is the model described by Berle and Means (1932) in their seminal study. However, to a large extent in the UK, and

to a lesser degree in the US, the principal shareholders are no longer households or individuals, but instead financial *institutions*, that is to say, insurance companies and pension funds, who act on behalf of their policy-holders and beneficiaries. The day-to-day control and management of their shareholdings is normally given over to specialised fund managers. Typically, the share structure of a UK-listed company will consist of several blocks (normally of around 5%, and rarely more than 10%) that are controlled by fund managers on behalf of a number of institutional clients. The *dominant block-holding* model, in which one shareholder holds a majority or near-majority stake, is rare in UK listed companies. Methods for securing dominant blocks through corporate cross-shareholdings (which until recently represented the norm in France: see Goyer and Hancké, 2005) and bank-led governance of the kind that has operated (in various different ways) in Germany and Japan (see Berglöf, 1997; Franks and Mayer, 1998), are not often observed in the US and the UK.

In principle, as we have just seen, dispersed share ownership strongly privileges exit over voice as the mechanism by which shareholders can exercise control over management. The disadvantage of dispersed ownership comes in the form of the high costs of voice: effectively coordinating the direct involvement of shareholders in the conduct of corporate affairs is difficult in practice. To some extent, this problem may be overcome through the actions of institutional shareholders (or, in many cases, the fund managers who represent them). Where a few institutions between them hold a majority or near-majority stake, they can often exercise a powerful if informal influence behind the scenes in the management of companies (see Armour, Deakin and Konzelmann, 2003).

But even exit carries with it potentially high coordination costs. The hostile takeover can be thought of as a mechanism for overcoming some of these costs in the context of share dispersion. A hostile takeover is, in effect, an appeal to the shareholders of a listed company to sell a controlling interest to the bidder. The shareholders are induced to exit by the offer of a premium above the current market value of their shares, the cost of which the new owner will aim to recover by restructuring the company (which can be interpreted as either running it more efficiently, or extracting rents from employees and other stakeholders: see Shleifer and Summers, 1988). In principle, the possibility of hostile bid being mounted should act as a powerful deterrent against under-performance by managers. However, the collective action costs of voting in response to a 'tender offer' of this kind are considerable, since shareholders have strong incentives to 'hold out' in the expectation of being able to extract a higher price near the point at which the bidder gains a controlling stake. Thus regulation is essential. Securities regulation – the body of law governing the issuing and trading of shares and other financial instruments – offers various

sets of solutions to this problem (see Deakin and Slinger, 1997). In the US these take the form of federal-level securities legislation dating from the late 1960s (the 'Williams Act') and relevant case law of the state of Delaware, in which most large companies are incorporated. In the UK, the relevant rules derive from case law, certain provisions of the Companies Acts and, above all, the City Code on Takeovers and Mergers (Takeover Panel, 2005a). The Code, like the Williams Act, dates from the late 1960s, but unlike the US Act, it is not embodied in statutory form, and the Panel has no direct legal powers of enforcement. However, its provisions tend to be strictly observed, since UK-based financial and legal professionals who are found to have breached the Panel's rulings may be penalised.[2]

Under the City Code, minority shareholders receive strong protection against expropriation by majorities during a bid. The use of two-tier offers, partial bids and other techniques that seek to lever a bid by offering differential terms to particular shareholders is highly restricted by the rules of the Code and by Panel practice (see Deakin and Slinger, 1997 for details). Other rules of UK securities law and practice make it nearly impossible for the managers of a listed company to put in place advance protections against hostile bids such as the issuing of non-voting stock or the implementation of various 'poison pill' defenses that are much more regularly observed in the USA. In these respects, the City Code reflects the strong influence of institutional shareholder interests within the UK financial sector, and their capacity for lobbying to maintain a regulatory regime which operates in their favour (Deakin and Slinger, 1997; Deakin, Hobbs, Nash and Slinger, 2003).

The effect of minority shareholder protection rules such as those contained in the City Code and, to a lesser degree, in US securities law and practice, appears to be to encourage further dispersion of ownership. Large cross-shareholdings are rare in part because under the City Code (rule 9) they would trigger an obligation to launch a 'mandatory' bid for control. Shareholders are encouraged to take what are relatively small stakes by continental European or Japanese standards, knowing that they are in general safe from the predatory actions of major shareholders. Thus the City Code is both consequence and cause of the emergence over time of the current pattern of share ownership in the UK, and of the high level of liquidity which characterizes the UK capital market.

The overall effect of these legal rules and extra-legal norms is to entrench *shareholder value* as the dominant objective of corporate management. The source for the so-called 'shareholder value' or 'shareholder primacy' norm is only partially located in company law. Indeed, despite the association made by some influential analyses between the common law of the US and UK and high

levels of investor protection (La Porta et al. 1997, 1999, 2000), close inspection reveals that the law provides little or no support for the notion that companies are run *for* their shareholders as 'owners' of the enterprise. Since the late nineteenth century, UK company law, in particular, has largely aimed to protect the autonomy of boards from day-to-day shareholder pressures (see Davies, 1997: 183-187). The legal notion that directors must act in good faith in the interests of the *company*, rather than the shareholders, means that boards have considerable leeway in taking a long-term view of what is in the best interest of stakeholders as a whole. In the UK this is reinforced by legislation requiring boards to consider the interests of employees alongside those of shareholders when exercising fiduciary duties (section 309 of the Companies Act 1985) and by case-law recognising that creditors, too, have claims as residual owners when the company approaches insolvency (see Deakin and Slinger, 1997).

In the UK, the government's recent review of company law has confirmed that boards are permitted to take a view based on 'enlightened shareholder value' – which seeks to strike a balance between the competing interests of the different stakeholders – if their objective is to benefit the shareholders in the long run (Company Law Review, 1999, 2000, 2001). For example, in most cases, it would be legally open to the directors to pursue a policy of minimum redundancies (to gain the cooperation of the workforce) or a preferred supplier policy (to enhance the quality of supplier relations), if the ultimate objective of these policies were to advance the long-term interests of shareholders. In the United States, in a similar vein, numerous states have enacted so-called constituency or stakeholder statutes which give boards leeway to balance shareholder concerns with the need to take into account stakeholder interests with a view to maintaining the long-run viability of the enterprise.

However, when the impact of company law is considered *together with* the operation of securities law, the picture becomes quite different. The leeway given to boards of listed companies is now much more limited. During a bid, the rules of the Takeover Code require boards of target companies to assume a neutral stance and offer disinterested advice to shareholders on the financial merits of the bid (Takeover Code, rules 3.1 and 25.1, respectively). Although the Code requires bidders to state their intentions with regard to the future treatment of employees (rule 24.1), this results in little more than the insertion of standard-form legal 'boilerplate' in offer documents issued by bidders (see Deakin, Hobbs, Nash and Slinger, 2003: 317). Employees, as such, have no standing to challenge a particular decision or commercial transaction in the courts on the grounds that there has been a breach of fiduciary duty by the board, nor do employees have any standing before the City Panel on Takeovers and Mergers.[3] There is no obligation on the part of either the target board or the

board of the bidder to consult employee representatives during a bid; this only occurs at the point when large-scale redundancies are about to take place. There is has even been some doubt as to how far either board may go in providing information to employee representatives without contravening the provisions of the Code and the listing rules on the disclosure of price-sensitive information, although the current view of the Panel is that this objection can be overcome if the employee representatives give undertakings of confidentiality (see Deakin and Morris, 2001: 808). The overall effect of these various rules is, in principle, to create strong incentives for boards to prioritise short-term shareholder interests over other concerns when faced with a hostile bid (Deakin and Slinger, 1997), and empirical research, based on case studies of takeovers from the mid-1990s and interviews with bid participants, suggests that this incentive structure is reflected in the way boards respond to bids in practice (Deakin, Hobbs, Nash and Slinger, 2003).

By international standards, there is a high level of hostile takeover activity in the UK and US. Even so, the numbers of hostile bids in a given year will be in the tens rather than the hundreds, whereas the number of listed companies in each country runs into the thousands (see Deakin and Slinger, 1997). More significant, in the UK, is the long shadow cast over corporate governance by the Code. Virtually no listed company is immune from the possibility of a hostile bid. To varying degrees, companies can insulate themselves against short-term fluctuations in their share price relative to the market by cultivating a culture of long-term investment. But this is not an option open to all; and there is question as to whether it is continuously available to any. In practice, the takeover mechanism has been the principal catalyst for corporate restructuring in both the US and the UK during the last two decades of the twentieth century, and virtually no industrial or services sector has escaped the changes induced by takeover activity. In this way, it would seem that corporate governance rules have indeed had a major effect on the industrial structure of the British and American economies.

The specific issue to which this analysis gives rise is whether dispersed shareholder ownership constrains the development of a ‘partnership’ approach in employment relations of the kind needed to promote competitiveness. With dispersion, shareholders benefit from the possibility of low-cost exit. The resulting liquidity in capital markets enables them to take advantage of alternative investment opportunities, and in principle permits more efficient resource allocation. The disadvantage is that other stakeholders, such as employees, suppliers and customers contributing firm-specific inputs, knowing that the shareholders may switch their investments at short notice, may be

dissuaded from making long-term investments of their own in the firm (Franks and Mayer, 1998: 728).

One of the very few studies to make the impact of corporate governance on labour-management partnerships is Kochan and Rubinstein's study of Saturn, the US vehicle manufacturer which was set up as an experiment in partnership between General Motors and the United Auto Workers union (Kochan and Rubinstein, 2000). Despite early success, the Saturn experiment proved to be far from trouble-free. On the one hand, critics taking a shareholder perspective argued that the considerable investments made by the company in the Saturn plant had failed to produce an adequate return (see Monks and Minow, 2004: 361-2). On the other, elements within the union claimed that the abandonment of seniority-based payment and job security systems was an excessive price to pay for greater employee involvement in the design of working practices (Rubinstein and Kochan, 2001) Thus the message to emerge from the Saturn case is that the tension between the priority granted to shareholder interests by the US corporate governance system, and efforts to build labour-management partnerships which will endure over time, remains, at best, unresolved.

3. The impact of corporate governance on employment relations: case-study evidence from the UK

Since the mid-1990s we have been studying a sample of UK-based firms with different patterns of ownership in order better to understand the relationship between corporate governance structures and labour-management partnerships.[4] The sample consists of companies which have all claimed, at various times, to be following a partnership model in relations with employee representatives. At the same time they have all been actively engaged in the market for corporate control, resulting in periodic restructurings following mergers and takeovers. Successive waves of interviews were conducted with senior managers and trade union officials in order to track, over time, changing perceptions regarding partnership between labour and management. The sample was put together with the aim of seeing how contrasting patterns of ownership (dispersed share ownership; concentrated ownership; UK control; overseas control) and different forms of market regulation (ranging from relatively unregulated product markets exposed to intense international competition, to utilities markets which are subject to intensive price and quality regulation) affected the emergence and stabilization of partnership relations. The study, therefore, was not designed to be representative, but the close focus on the development, over time, of a small number of organizations of different types was intended to make it possible to draw out the role of external pressures, including regulatory and governance factors, in explaining the variation in managerial responses to organizational uncertainty.

On the basis of the interviews which formed the basis for the study, a distinction emerged between partnerships which, on the one hand, were 'proactive' and 'mature', and those on the other which were 'reactive', 'weak' and 'disintegrating' (Deakin, Hobbs, Konzelmann and Wilkinson, 2003, 2005). These characterizations were drawn from the interviewees' own reported perceptions of the partnership arrangements in which they had been involved. *Proactive* partnerships were those in which the union's role was broadly conceived in terms of the promotion of a high-trust culture based on functional flexibility, with management, in turn, providing the conditions for employees to make the necessary investments in human capital. In *reactive* partnerships, by comparison, the union's role tended to be confined to dealing with the immediate consequences of restructurings in terms of large-scale redundancies, while management made a minimal commitment to employment security. *Mature* and *enduring* partnerships were those which survived moments of crisis caused by external pressures, in which both sides were willing to make relation-specific investments which would be put at risk if the company faced the prospect of competitive failure. By contrast, *weak* and *disintegrating* partnerships were those in which the parties were more concerned with taking steps to minimize their exposure in the event of corporate failure than with engaging in a strategy of aiming for mutual gains from cooperation. In this case, significant external shocks tended to lead to the breakdown of partnership.

The case studies provide evidence that dispersed share ownership puts pressure on partnership in labour relations. One of the case study companies, *Tenswell*, was a heavy-industry manufacturer producing for highly competitive, international markets.[5] In 1998, its chairman said: '[o]ur business is about profits and shareholder value. If it's jobs before shareholder interests, the answer is no…it simply prolongs the agony.' In 1999, the company merged with a continental European competitor. The new company listed its shares listed on the London and New York stock exchanges. Within a few months, as deteriorating trading conditions led to a fall in profits, the company's senior executive managers resigned and the former chairman took over as CEO with the stated aim of restoring shareholder value. In February 2001, the company announced a major restructuring programme with the loss of 6,000 jobs. There was no prior consultation with employee representatives. On the day of the restructuring announcement, the company's share price increased by 11%. Trade union officials were critical of US institutional investors who, they argued, had put pressure on the company to take a short-term view of shareholder value, and who were distant from the implications for workers and communities of large-scale closures. Despite a long tradition and active recent history of close management-union cooperation within the UK company, the unions perceived the radical downsizing as a breach of trust, revealing the

partnership to be merely ‘reactive’ and, beyond a certain point in time, more or less non-existent.

A contrasting case is that of *Cleanwell UK*, a wholly owned subsidiary of a continental European company (*Cleanwell International*). Prior to 2000, approximately half of the voting shares in this company were controlled by five main holdings, two of which were continental European public sector pension funds, and one a continental European bank. Cleanwell International shares were primarily listed on a continental European stock exchange, with a secondary listing on the London Stock Exchange. The trade union which represented employees at the UK subsidiary told us that the continental European model was an ‘important influence’ on the company’s approach to human resources and to union relations. But even under this model, the corporate group’s focus was on the creation of shareholder value, and its business objective was to double turnover, operating profit and earnings per share by 2005. The group’s partnership approach was, however, one of the bases on which it was able to commit to increasing the size of its business over the longer-term. The group’s 2000 annual report stressed the company’s belief that management, employees and shareholders shared common long-term interests. In 2000 the group’s CEO said that ‘we do not believe in “management by quarter”, with big dividends, and fragmentation of the business with a view to short term profit’. The company refused to pay a dividend at this point, arguing that it preferred to fund further investment from growth. According to the UK subsidiary’s finance director, interviewed in 2001, the pressure exercised by shareholders and banks was to demonstrate ‘credibility of management,’ by delivering what was promised over the longer term.

In 2000, the company’s corporate governance environment changed significantly as the group’s parent company increased its issued share capital by 5.1% to fund a number of acquisitions. The ‘voting’ and ‘capital’ shares were merged into a single, voting class. As a result, its shareholder base became much more dispersed, with only one pension scheme holding more than 5% of the total share capital. The geographical distribution of shares also shifted, with only 30% of the shares now held in continental European hands, and 56% in British or American ownership. However, the change did not dilute the company’s commitment to partnership with its employees. In 2000, the group launched a new human resource strategy as ‘a core element’ of its overall business strategy, and set up a new corporate human resources function ‘to strengthen its employee development efforts.’ According to the UK finance director, the changing structure of share ownership would not become a negative factor for partnership because investors ‘know what they are buying into’.

Other cases in the study also suggest that mature, 'proactive' partnership can be developed and maintained within the UK corporate governance environment. This is indicated by the experience of two utility companies, *Warmwell* and *Hearwell*. Warmwell's personnel director told us, 'we have excellent relations with our trade unions. We sit at the table with them at the national and the local level. We ... recognise the value of a legitimate role for the trade unions. Why fight? Why go back to the seventies? If there is a problem, we share the problem and the solution.' At Hearwell, too, the union described a mature partnership, explaining that evidence could be found in the fact that over a two-year period, the company and union had negotiated a complete overhaul of the system of grading structures, pay and conditions. In the opinion of the union official we interviewed, the result was a win-win situation: the company achieved greater flexibility and employees achieved better pay and a reduced working week. Hearwell's personnel director commented in 1999: 'I hesitate to call it a partnership, although to some extent that's what it has become.'

Yet both companies had highly dispersed share ownership at this point, and continually stressed the importance of delivering value to shareholders. During the period of the study (the late 1990s and early 2000s), both companies also pursued strategies designed to pay high dividends relative to earnings. In 2000 Warmwell stated that its aim was to increase its dividend by 5% in nominal terms over the next three financial years. At Hearwell, executive bonuses depended on maintaining the company's position in the top thirty UK companies, based on delivering total shareholder returns (that is, share price growth plus dividend flow) over a five year period. According to Hearwell's director of strategy, shareholders were the company's 'most important' stakeholder group.

Nevertheless, both companies emphasised long-term shareholder value and devoted considerable effort to managing shareholder expectations. Warmwell's 1999 annual report described a strategy of concentrating on shareholder value over the long term. Warmwell's personnel director told us that 'we spend a lot of time trying to educate the stock market on what we're about…the institutions are seeing us in a better light…All of our strategies are about building businesses. We believe that you can't do that in the short term…In every pound that we use to acquire or to grow organically, we're looking for a long term return.' In 1999, Hearwell told us that 'we have a different shareholder base to our competitors. We have a lot of pension funds and so on who are interested in long-running, continuing cash flows rather than sparky value appreciation and decline … I think the other thing is that we are quite explicit that we are a medium term stock.'

When Hearwell's share price fell in response to mounting debts following a series of acquisitions and the failure of certain investments to produce expected returns, the response of the union was significant. The union was careful to avoid arguing that financial pressures were having a negative effect on labour-management relations, because, in its view, the need to satisfy financial market concerns could 'distract' management from developing long-term strategies. The union argued that when share prices fell, management was prone to making 'knee jerk reactions' and attacking costs simply to demonstrate to financial analysts that some action was being taken. As a result, the union declined to join in public criticism of the company. Instead, it urged management to be less defensive in putting its message across to the financial markets, and to be more aggressive in publicising the company's long-term achievements.

The case studies also demonstrate complexity of the relationship between partnership in employment relations and the operation of the market for corporate control. In the case of Warmwell, partnership had, paradoxically, been employed as a mechanism to assist the company in the takeover process. According to Warmwell's personnel director, the company's acquisition of another UK utility was made possible by Warmwell's labour management strategy: '[we] use our trade unions … to talk with the local unions and say "we know you don't like the idea of being taken over. We don't like the idea of you being taken over. But if you're going to be taken over, it's better that it's these guys because they know what they're going to do and they'll treat you firmly but very fairly"'. A hostile takeover was used in this case to import the partnership philosophy into a company which had previously been opposed to the concept: after the acquisition was completed, the company reintroduced union recognition arrangements which the previous management had removed in the wake of privatisation.

The takeover battle was bitterly fought. Warmwell initiated the bid by making an offer to purchase shares in the target company at a premium of almost 40% over the then market price. The essence of its bid was that the target was at that point a 'high cost, high tariff' utility, which could be run more effectively in the future by means of Warmwell's superior 'expertise in best practice and cost control programmes'. The target responded in a manner typical of companies faced with an unwelcome bid, by attempting to demonstrate to its shareholders that it could return sufficient value to them in the short term to retain their loyalty. In effect, this was an effort to counter the bidder's offer of short-term gain (in the form of the premium over the pre-bid market price of the target's shares) with one of its own. Here, it took the form of a promise to return cash to the shareholders which would be generated in large part by a redundancy exercise aimed at cutting costs. Thus halfway through the bid process, the target

announced that it would be cutting 17% of its workforce in the then financial year, a figure equivalent to over 500 jobs, 200 or so more than had previously been announced. In the event it went even further, dismissing nearly 1,000 workers while the bid was in progress, including 500 in one day. However, this did not prevent the vast majority of its shareholders from accepting the offer tabled by Warmwell, which duly took control.

In this case, a hostile takeover led to a union-unfriendly employer being replaced by one which was considerably more receptive to union involvement. Whether the bidder would have made redundancies on the same scale as the target, had they not been made prior to the bid going through, cannot be known. However, the case study suggests, contrary to a widely received view, that hostile takeovers may select for stakeholder-friendly firms. This particular aspect of the UK corporate governance system may therefore work in favour of, and not against, a partnership agenda. However, it would seem that for partnership to emerge, corporate governance rules must work in conjunction with other regulatory influences to create a market environment favourable to labour-management partnership. This is because regulation can act in a way which is complementary to corporate governance through its influence on the relative position of stakeholder groups within the hierarchy of interests inside the enterprise.

An example of this effect can be found in the regulations governing the Private Finance Initiative (PFI), a procedure introduced in the UK in the late 1990s under which private capital was made available for large-scale public infrastructure projects. With the objective of ensuring a high quality standard of service, PFI regulations introduced for the National Health Service sector at this time required evaluation of the employment-relations records of firms who were bidding for contracts; they also entitled trade unions to interview and submit a report on short-listed bidders. According to the guidelines, the underlying logic of this approach was that companies with poor labour relations and inadequate investment in staff often delivered a low level of service. We found strong evidence of the supportive role of PFI regulation in the NHS in the case of Cleanwell UK, which had been highly successful in biding for this type of contract (see Deakin, Hobbs, Konzelmann and Wilkinson, 2002: 346).

Utility regulation provides another example. Although this form of regulation gives precedence to customers and the community's interest in the environment, rather than to employees, by setting quality standards it can underpin a partnership approach in labour-management relations. In particular, the imposition of guaranteed customer service standards by utility regulators serves as a significant support mechanism for partnership because it means that while

there are pressures to cut costs, there is a limit to how far these can be permitted to undermine standards of customer service. Thus Hearwell's trade union told us that high guaranteed standards of customer service provide an effective bargaining tool in negotiations over cost cutting: '[t]he vulnerable area is customer relationships and if those are disrupted, then there are various means through the regulator and other bodies that [the company] will be brought to account. So that's advantageous to us.'

Utility regulation can also extend time horizons by tempering the expectations of capital providers and extending operating parameters. By allowing for capital providers 'a return that is sufficient, but no more than sufficient' (in the words of a union interviewee), these regulations facilitate a longer-term view that is conducive to partnership. Regulators make assessments of the costs of debt and equity and of dividend yields in their price determinations. They also set operating parameters for periods of up to five years. At the same time, regulators' assessments of returns on capital are indicative and not prescriptive; regulators determine the level of prices but leave it to companies to manage their level of profits. As a result, this form of regulation still provides only a very weak support mechanism for partnership in itself; it is open to companies operating under this regime to decide whether or not to opt for a proactive approach to partnership.

The stress on customer service in utility regulation is nevertheless important in encouraging active partnership in conjunction with the operation of the takeover mechanism. Warmwell's bid for another UK utility company, considered above, was assisted by the publication by the regulator of information relating to levels of customer service and organisational costs in companies which had recently been privatised. On this basis, Warmwell was able to benchmark its own performance against industry standards and identify a suitable target for acquisition. As an interviewee put it to us:

> 'The skills that we built through benchmarking were just the same ones that we needed to evaluate potential acquisitions… We looked at [the target] and said we know what it can do: its costs per customer per kilometre of line, its fault rates and so on were all in the public domain from the regulatory process. We knew the international benchmarking levels possible from looking at … other leading companies. We could say - if that company was under our control, this is what it would be worth to us. We then looked at what we would have to pay for it.'

Here, the information generated by the regulatory process was used by the company to exploit what it considered to be its comparative advantage in being better able than the takeover target to meet high standards of service.

In Tenswell, by contrast, over 80% of the workforce was engaged in the production of a product where markets were highly volatile and price sensitive and there was, at that point, substantial global over-supply. Regulation had been aimed at increasing the intensity of national competition through the removal of barriers to trade, and the market was more or less unregulated in terms of price and quality standards. It was these conditions which imposed on the company the short-term time horizon under which its management felt it had little choice but to 'return value' to shareholders by way of plant closures.

Overall, the case studies suggest that corporate governance structures may play an important role in shaping partnership, *but only in conjunction with other regulatory factors*. Regulation of product and service quality, of the kind observed in most utility sectors and in certain others, favours the emergence of stable partnerships. This is because, in these markets, profitability is linked to the ability of companies to maintain a high and consistent quality of service for end users. As a result, companies are better able to convince shareholders to take the view that they will reap significant returns over the long term from a stakeholder approach.[6] In the absence of these stabilizing factors, however, goodwill between labour and management is not enough to sustain a partnership approach when it plainly conflicts with shareholder interests. In this case, the pressure to meet shareholder value over the short term tends to prevail.

4. Conclusion

The evidence which we have presented in this paper suggests that successful labour-management partnerships tend to be found in contexts where both sides can make credible commitments to cooperate over the medium to long term. The key role played by corporate governance and the regulatory framework is to extend the time period over which cooperative strategies can be played out. This can be done in a number of ways, most notably through product market regulations which encourage competition on the basis of quality rather than price, and through employment regulations which grant workers significant voice rights. Under these conditions, managers can develop corporate governance practices which encourage shareholders to take a long-term view of their investments. Where they are absent, partnership arrangements are highly vulnerable to shareholder pressure, no matter how much goodwill is invested by labour and management.

The evidence on which we rely comes from a small sample of firms in sectors which are not necessarily typical. However, longitudinal, micro-institutional case studies of the kind reported here provide a particular type of information, relating to the internal dynamics of relations between corporate stakeholders, which may not otherwise be available. It is interesting that the picture we get from this type of study does not necessarily fit the conventional understanding of the relationship between corporate governance and labour relations in the so-called Anglo-American systems. In Britain, just as in the US, innovative forms of labour-management partnership may come under pressure from forces in the corporate governance environment. But failure is not an inevitable outcome, and further research may cast light on institutional arrangements which make it possible to combine cooperation in labour relations with liquidity in capital markets.

Notes

[1] It is of course the case that the category of 'shareholders' includes those who have purchased the shares of the original providers of risk capital in the 'secondary market', and that, in the case of most large, listed companies in developed economies, the shareholders at any given time may well have made no direct contribution to the organisation's financing. For discussion of some implications of this phenomenon for contemporary corporate governance theory and practice, see Deakin, 2005.

[2] As a result of the adoption by the European Union of a directive on takeover bids (Directive 2004/25/EC of the European Parliament and the Council of 21 April 2004 on Takeover Bids, L 142 *Official Journal of the European Union* 30.4.2004), the Panel will, in the near future, acquire certain statutory powers. The expectation of the UK government and of the Panel is that this change will not have a major impact on the Panel's mode of operation. See DTI, 2005, and Takeover Panel, 2005b.

[3] This would continue to be the case under the draft legislation put forward by the UK government by way of implementation of the Takeover Bids Directive, but employee representatives would have new rights to receive information from both the bidder and target companies and to state their views on the merits of bids. In addition, the Takeover Panel would in future have as one of its members a person with experience of employee relations issues from the employees' perspective. However, the Panel's task would continue to be to ensure the fair treatment of *shareholders*. See DTI, 2005, and Takeover Panel, 2005b.

[4] For reasons of space it is only possible to report part of the findings here. For an explanation of the composition of the sample and the methodology used, and a more complete account of the study, see Deakin, Hobbs, Konzelmann and Wilkinson, 2002 and 2005, on which this part of the present paper draws.

[5] Tenswell, like the other names used to designate the case study companies, is a fictitious name.

[6] It may, conversely, be the case that shareholders are themselves increasingly receptive to this message, by virtue of the need for pension funds, in particular, to provide long-term financial stability for their beneficiaries, and that regulation can further encourage this development. A full analysis of this issue lies beyond the scope of the present paper; for discussion, see Armour, Deakin and Konzelmann, 2003.

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