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RESEARCH POLICY BRIEF No. 7

**Potential Role in  
Corporate Governance  
by Employees of  
Asian Enterprises**

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*Publisher:* Grant B. Stillman  
[publications@adbi.org](mailto:publications@adbi.org)

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GOVERNANCE

# **Potential Role in Corporate Governance by Employees of Asian Enterprises**

Sang-Woo Nam

Based on ADB Institute Research Paper 52, *Employees in Asian  
Enterprises: Their Potential Role in Corporate Governance*

(Sang-Woo Nam, April 2003)

[www.adbi.org/PDF/wp/rp52.pdf](http://www.adbi.org/PDF/wp/rp52.pdf)

## **Family-controlled Companies**

Large publicly-held corporations or business groups in developing Asian economies are typically controlled (and managed) by families, and tend to suffer from poor corporate governance. Even though serious reform efforts are underway in the crisis-hit Asian countries along the Anglo-American model, it would likely take time for the model to take root in these economies. Any newly transplanted system needs local adaptation and setting complementary institutions in place for its proper functioning. If the abuse of power by controlling owners cannot be adequately checked by minority shareholders through the internal governance mechanisms or the market for corporate control, strong alternatives include two other important stakeholders: employees and creditor banks. This study evaluates the potential role of employees in corporate governance in developing Asian economies.

Improving corporate governance is one of the most important components of the reform package in the crisis-hit Asian economies. The corporate governance reform, undertaken largely along the Anglo-American model, pays little attention to the potential role of employees. However, employees are expected to play an increasing role in corporate governance due to not only employees' demand but also the needs of employers. Many employees feel that they have been major victims of the crisis, for which the poor governance in family-controlled firms is largely responsible. In return for large-scale layoffs and concessions in wages, they demand a role in corporate governance claiming that they can effectively check irrational management decision-making.

## **Valuing Human Capital**

Employees with valuable firm-specific human capital are becoming the most important asset for post-Fordist enterprises. Corporate success depends very much on their multi-ranged skills, knowledge, creativity, initiative, and self-managing teamwork. How to motivate them to make their best contribution to the company is a great challenge for corporate governance. It means that a single-minded pursuit of shareholder interests may be not only unfair but also grossly inefficient. Actually, corporate managers in advanced countries are observed to look after the interests of other stakeholders as well. The traditional distinction between owners and workers is also being blurred by making the latter the owners of their firms.

## **Challenges of New Environment of ICT**

Furthermore, due considerations have to be paid to the challenges the different models face in the new environment characterized by rapid progress in ICT, flexible production and work organization, and large-scale industrial restructuring. The European model of formalized worker participation in corporate governance may not be responsive enough to make the best use of employee information and knowledge. The Japanese model of the internal labor market is also under stress. With lifetime employment no longer taken for granted, workers' loyalty and cooperative spirit seem to be weakening as well as their enthusiasm for participatory practices. The American model may not be in any better position. In spite of its seeming flexibility, it is insensitive to worker protection and inadequate in motivating them to be more committed and make more firm-specific investment.

## **Labor Influence in Workplace**

In most Asian countries, labor is relatively weak and employees are not much empowered to give full play to their potential. This situation, however, is likely to change in the coming decades. Labor will become stronger with progress in democratization and continued industrialization. Intensified global competition and the emergence of the "new economy" will force many industrialized Asian countries to shift from a labor-squeezing to an employee-motivating strategy. Weakening family-control of businesses in the wake of the Asian crisis also gives a larger room to play for employees. In large Japanese enterprises, employees have practically been the controlling group in the presence of friendly and closely-knit corporate shareholders.

Industrial relations and labor unions provide a critical environment for a potential governance role for employees, as they affect the mode, agenda, and the effectiveness of various employee participation practices. While union density is generally low and declining, works councils are the most commonly utilized form of representative worker participation. They allow better flow and utilization of information and provide employees with the opportunities to express their interests leading to improved labor-management relations.

Worker participation on the board of directors is rare except in some European countries where such representation is legally mandated. Given that the board function is limited even in Anglo-American enterprises, any

substantive role is hardly expected in Asia. Finally, successful worker-owned cooperatives that best materialize industrial democracy are very few, clearly showing their weaknesses in governance and financing.

Worker ownership of their firms and participation in autonomous shop-floor practices constitute important complements to their role in corporate governance. Increased employee stock ownership, however, seems to have led to only a moderate rise in their corporate governance role. Active participation in employee involvement programs on the shop-floor allows them to share the corporate governance function as well, since the decision-making at the two levels is inevitably interconnected and management tends to be less resistant to employee demand for participation in higher-level decision-making.

### **Sharing Strategic Decision-making**

Employers in more industrialized economies in the region will also find it no longer feasible to survive global competition with their traditional approach of cost-cutting on the basis of standard mass production technologies. It becomes increasingly essential to motivate employees to build up necessary skills and give full play to their initiative and creativity in utilizing their knowledge and information on the shop floor.

Without sharing strategic decision-making power with the employees, however, shop floor participatory practices are unlikely to be very effective. As East Asian countries see further progress in democratization and strengthening of organized labor, prolonged confrontation between management and labor will result in huge socio-economic costs. A challenging task is how to come up with a compromise in industrial relations and workers' role in corporate governance that ensures both economic efficiency and employee satisfaction.

### **Current Weak Political Power in East Asia**

Currently, employees in East Asian developing countries seem to play very little role in corporate governance reflecting their weak political power as well as industrialization strategy that tended to repress workers' rights and made it not essential to rely on broad-based employee involvement in shop-floor decision-making. This is in sharp contrast with major industrialized countries with different models of corporate governance. In Europe where

workers have relatively strong political power, their role in corporate governance is legally guaranteed.

In the Anglo-American model that is based on shareholder sovereignty, there is no legally mandated role of workers in corporate governance. In recent decades, however, a clear trend is observed that American and British enterprises are increasingly interested in motivating their workers to be more committed to participatory practices in ownership, shop-floor work organization, and even the formal governance mechanisms.

Japanese enterprises are similar to Anglo-American firms in that no corporate governance role of workers is guaranteed by law. However, in the Japanese model, employees have traditionally been considered as the most important stakeholder and given a substantial influence on corporate decision-making. The political and economic realities of many East Asian economies in the coming decades will inevitably push their enterprises toward an increasing workers' role in corporate governance.

## **Toward an East Asian Model for Workers in Corporate Governance**

Given this, what, then, will be the East Asian model of involving workers in corporate governance? Although there would not be any single model that fits all the countries in the region, we may think of its common characteristics on the basis of the political, socio-cultural realities in workplaces.

In many of these economies, the status difference between management/capitalist class and labor workers may not be as large as it is in the United States. And the Confucian tradition (that apparently emphasizes respect for authorities and harmony) also affects organizational culture in a substantial way. It suggests that a system based on worker participation and cooperation might function better in the region than the Anglo-American model that is rather confrontational between management and labor.

However, it is not clear to what extent the developing East Asian countries share the Japanese tradition of treating employees as key stakeholders or business partners in spite of some common cultural roots. The European corporatist model would not be an option, either, at least for some time. Workers and labor unions would have to go a long way before they could gain political power strong enough to institute their corporate governance role and impose other regulations on workers' interests.

The model of employee role in corporate governance for East Asian enterprises is likely to be different from the existing models. Works councils are most promising as the channel of participation, and it makes sense to legally mandate the councils and provide guidelines on the mode of handling each of the major agenda. Priorities may also be given to improving industrial relations and promoting complementary practices. Strong incentives are desired to facilitate employees' stock purchases and encourage them to be stable and long-term shareholders. Efforts should also be made to remove institutional impediments or corporate practices that discourage employee involvement on the shop floor and to promote such complements as conducive work organization and human resource management.

### **Guidance on Specific Forms of Successful Corporate Governance**

If East Asian developing economies are to shape their own model, what guidance may be given on specific forms of corporate governance and other related policy issues on the basis of the experiences in more advanced countries as well as the realities and challenges these economies face?

As a formal governance mechanism, the board of directors is not likely to become a forum for sharing the decision-making functions between management and labor. Given the mandate of the board and the boardroom culture, labor director(s) are likely to be outsiders without substantial impact, though they may serve as a source of access to information or top management, as well as give some formality to the board and encourage more transparent management.

Legally mandating worker participation on the board may be premature since it will likely face strong resistance from management without much gain on the part of employees. Labor and management of individual enterprises may agree on worker participation on the board either as full member(s) or observer(s) on a voluntary basis depending on the cooperativeness of their industrial relations and the bargaining power of workers.

### **Useful Example of Works Councils**

A more promising channel of worker governance may be works councils, such as Japanese JLMC or Korean LMC. They provide a forum for serious

communication between management and labor. They potentially cover much wider-ranging issues in a less confrontational format compared with collective bargaining. Furthermore, given the low and declining trend of labor union density, this is practically the only representative form of worker participation in corporate governance.

As is already the case for many countries, it may be a good idea to legally mandate all enterprises to institute the council. Guidelines may also be given concerning the modes of handling major agendas of the council. For instance, enterprises may be strongly urged to allow employee representatives to participate in serious deliberation or joint decision-making on issues directly affecting work-life on the shop floor as well as other basic working conditions or workers' welfare. The mode and degree of worker participation on more strategic or general management issues may better be left to individual enterprises to suit their situation.

### **Complementarity among Various Worker Participation Practices**

Empirical evidence suggests strong complementarity among different forms of worker participation—strategic decision-making, equity ownership and other forms of financial participation, and decision-making on the shop floor together with conducive work organization and human resource management practices. In order to effectively motivate workers to make their best efforts, it might be necessary to have many of these complements in place.

Management, on their part, would be more willing to accept employee participation in corporate governance when workers are actively involved in shop-floor decision-making for the benefit of the company. Many Korean firms have introduced various forms of employee involvement practices to increase work efficiency. However, they have not been willing to share management prerogatives with workers or other complements have been lacking, failing to strongly motivate employees or to gain workers' trust. As a result, the practices have not been very sustainable or often remained perfunctory. In the United States where existing institutions are predominantly shareholder-oriented, the prevalence of employee involvement practices is still low. Policy efforts need to be directed toward removing institutional impediments that discourage the adoption of employee involvement and other complementary practices.

## **Employee Stock Ownership Programs**

As a strategic complement, employee stock ownership programs may be seriously considered. Since ownership is the prime source of governance, worker-ownership provides a natural channel for workers to participate in corporate governance. It also blurs the traditional distinction between capitalists and workers and reduces potential conflicts of interests between them, making the management task relatively easy.

Employee participation in ownership (as well as corporate governance) may also be a viable option of corporate restructuring for financially stressed enterprises. As was the case in the United States, strong tax incentives may be given to financial contributions of corporations or borrowings from financial institutions to facilitate employee purchase of shares. Essential for designing such programs is how to make them less susceptible to stock market fluctuations and encourage employees to be stable and long-term shareholders.

## **Building Trust between Labor and Management**

Finally, most essential in all these worker participatory practices is building “trust” between labor and management. The state-employer coalition at the national level and management unilateralism at the enterprise level that characterize industrial relations in many East Asian economies have to give way to more autonomous bargaining relations between management and labor.

This process will of course be helped by progress in democratization and industrial development. It may be desirable to have industrial or national level dialogues and bargaining on key issues of the labor market and worker welfare. This would relieve the workplace bargaining table of issues that might lead to serious confrontation, helping to promote more cooperative labor relations.

The governments should resist the temptation to co-opt a national-level labor organization as the dialogue partner, since such an organization lacks legitimacy and support of its constituency. Another way to foster the trust of workers is to improve transparency in corporate management as a part of corporate governance reform.

However, trust between labor and management seems to have been weakened in the crisis-affected Asian countries as enterprises in financial distress have become more sensitive to the interests of shareholders often at the expense of their employees.

## RESEARCH POLICY BRIEFS INDEX

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(Khee-Giap Tan, T. Karigane & M. Yoshitomi, December 2001)  
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- **RESEARCH POLICY BRIEF No. 4**  
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Based on ADB Institute Research Paper 49, *Track Record of Financial Institutions in Assisting the Poor in Asia*  
(Richard L. Meyer, December 2002)  
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- **RESEARCH POLICY BRIEF No. 5**  
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A Survey of Key Issues**  
Based on proceedings from ADB Institute Research Conference,  
*Infrastructure Investment and Poverty Reduction*  
(Att: John Weiss, 12-13 June 2003, Tokyo)  
[www.adbi.org/cfinfra03/contents.htm](http://www.adbi.org/cfinfra03/contents.htm)
- **RESEARCH POLICY BRIEF No. 6**  
**Future Role of Foreign Banks in Asia**  
Based on ADB Institute Research Paper 51, *The Role of Foreign Banks in Post-Crisis Asia*  
(Heather Montgomery, January 2003)  
[www.adbi.org/PDF/wp/rp51.pdf](http://www.adbi.org/PDF/wp/rp51.pdf)