

The Employee as a Key Stakeholder: a Contested Position

Authors

Dr. Suzanne Young¹

Graduate School of Management
La Trobe University
Melbourne
Victoria 3086
PH: 61 3 94793140
M: 0408501040
Fax: 61 3 94793144

Dr. Vijaya Thyil

Accounting Economics Finance and Law Group
Swinburne University of Technology
Melbourne
Victoria 3122
PH: 61 3 9214 8081
M: 0433118676
Fax: 61 3 98192117

Contact address: Dr Suzanne Young, Associate Professor, Graduate School of Management, La Trobe University, Melbourne, VIC 3086, Australia. [email: s.h.young@latrobe.edu.au]

ABSTRACT

Corporate governance has had an increasing focus over the last decade as corporate collapses and fraudulent activity have occurred. Legislation has been tightened but even so, governance has failed. This paper argues that employees are key stakeholders in the corporate governance system of an organization and play a crucial role in organizational success, and as such the paper investigates the position of employees as a component of corporate governance. This research finds that despite all the rhetoric around employees being stakeholders, employees in Anglo systems continue to be viewed as 'outsiders' with governance primarily focused on shareholder concerns. Employees are primarily seen as constituents of legal and regulatory frameworks and employee codes of conduct. Australian corporate governance reforms in areas of disclosure and legal and regulatory enhancements over the last decade have not resulted in any significant advance in the recognition of employees' interests in governance and perceptions of governance. In the public domain the rhetoric has often moved from shareholders to stakeholders, however there is lack of clear enunciation of employees in this stakeholder terminology. And for those organizations that are attempting to include employees in consultation, and as stakeholders, they need to do so consistently and across all organizational dimensions including governance, so that employees and other external parties are not confused as to the legitimacy and role of employees.

Keywords: employees, stakeholders, corporate governance, Australia, empirical

INTRODUCTION

Corporate collapses over the last decade have affected all stakeholders through a loss of public confidence, loss of jobs and loss of shareholders' funds. We have seen poor business decisions, extravagant business acquisitions, lack of attention to detail, exorbitant directors fees, lack of board scrutiny, and inadequate disclosures to stakeholders, which often resulted in foreclosures, bankruptcies and amalgamations in cases such as Enron, WorldCom, HIH, the Australian Wheat Board and more recently banks and financial institutions worldwide. Improved corporate governance has increasingly been seen as the answer to these problems as it seems that in these cases *'every one of the mechanisms set up to provide checks and balances failed at the same time'* (Monks & Minow, 2004:1). As a response, legislative control has been strengthened with the Sarbanes-Oxley Act 2002 (USA), Companies Act 2006 (Australia) and the Corporations Act 2006 (UK) alongside voluntary guidelines such as the Australian Stock Exchange (ASX) Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendation (Australia), in an endeavour to reduce risk to stakeholders such as shareholders, employees, communities, government, suppliers and customers. But even so with the international financial crisis (GFC) we are seeing increasing calls for still more governance improvements across many dimensions such as stakeholder management, disclosure, regulation, remuneration, and behaviours (Young, 2009; Solomon, 2009; Capezio & Shields, 2009). And in particular as Van Buren III and Greenwood (2011:15) citing stakeholder theorists (Clarkson, 1995; Freeman and Evan, 1990) observed, *'stakeholders co-create value in and for corporations; when corporations fail to create value for particular stakeholder groups (for example, employees, consumers, and suppliers), then the corporation does not succeed financially in the long run'*. Faleye and Trahan (2011:4) emphasized that *'employees are perhaps the most important value relevant stakeholders, since they are the ones who must execute the firm's strategies for creating value'* and observed that more theoretical and empirical work is needed in this area. Indeed, extending governance from a purely structural and compliance-based approach to incorporate behavioural considerations, and consequentially implications of and on employees, have been highlighted as important by many researchers (Cutting & Kouzmin, 2000; Thornbury, 2003; Westphal & Milton, 2000; Young & Thyil, 2007), especially in the context of the failure of compliance-based approaches to regulate behaviour in the GFC. As Muthusamy, Bobinski and Jawahar (2011:128) observed *'questions such as what role the employees — as insiders — are supposed to play in corporate governance and what responsibilities they need to assume for firm performance and shareholders' interests are becoming of paramount interest to modern management and economics'*. In this vein this paper will argue that as Anglo governance principles in countries such as Australia, UK and South Africa have moved to include statements in regard to stakeholders as well as shareholders, the inclusion of employees in governance rhetoric and practice would be an important addition to improve employee engagement, and organisational performance.

Stakeholder theory (Freeman, 1984) argues that organizations should meet the needs of a broad array of stakeholders which individually can threaten the organization's survival and who rely on the organization to fulfil their needs. Even organizations found in the Anglo-world that operate predominantly from the shareholder primacy approach where organizational purpose is based on fulfilling the needs of owners - achieved through maximising financial returns (Friedman, 1970) - are increasingly making statements about stakeholder engagement and highlighting this in the work they do in the Corporate Social responsibility field (Young & Thyil, 2007). However, there is minimal research that

examines empirically the position of employees as key stakeholders (Bartkus & Glassman, 2008) or investigates employees as an important component of governance (Young & Thyl, 2007). As Lewis et al. (2004) argue, despite the rhetoric of organizations in claiming employees as a key asset employee issues remain marginal in governance.

Research for this paper was conducted through exploratory interviews with executives, which in focusing on governance and its drivers was coded to investigate whether and how employees were included. Part one of this paper will discuss the literature surrounding employees as stakeholders, part two will describe the methodology, and part three will discuss the findings of the study. The discussion and analysis occurs before conclusions and limitations are provided. In investigating the role of employees in governance we are not looking at major employee shareholders, such as Rupert Murdoch and News Ltd, but rather focussing on a different scale - employees in their position as wage earners.

EMPLOYEES AS KEY STAKEHOLDERS

The importance of employees as stakeholders has been the subject of researchers operating from a variety of different paradigms.

Researchers such as Lewis et al. (2004) and Simmons (2003) discuss organizations' responsibilities to stakeholders including community, environment and employees on moral dimensions arguing that organizations should take up these responsibilities to re-balance the unequal power relationship between the corporation and those who are affected by its actions. Those operating in the industrial relations field contend that employee entitlements are involuntary lent capital and that employees should be granted enhanced voice or industrial democracy rights through democratic means such as occupational health and safety committees, quality circles, works councils and joint consultative committees, which could even extend to elected representation at board level (Burgess et al. 2006; Alexander & Lewer, 2004; Bray et al. 2001). Gospel and Pendleton (2003) contend that firms that are focused on shareholder value place shareholder interests above the interests of employees, and inevitably damage employees through workforce reduction, lower expenditure on human resource development and training, lack of job security and long-term career progressions, use of outsourcing, whilst securing commitment through profit sharing and implementing pay systems based on business unit performance. Williamson (2003) similarly argues that the shareholder primacy view contributes to short-termism in decision-making, and a low investment/high dividend regime, short-term employment relationships, insecure tenure and lack of training.

Even though it is accepted that Anglo firms operate from the shareholder perspective, many have argued normatively that over the long-term (beginning with Freeman, 1984; Prahalad and Hamel, 1990; Reich, 1998; Galbreath, 2006), focusing on the needs of other stakeholders such as employees, community, customers etc, ensures that necessary resources are obtained and optimally used and public image is enhanced, which in turn ensures long-term profit maximisation. As Jensen (2001, p. 15) argued: "We cannot maximise the long-term market value of an organization if we ignore or mistreat any important constituency". Such propositions are based on resource dependency (Barney, 1991) and stakeholder theory (Freeman, 1984) which similarly propose that firms will maximise profitability and hence shareholder returns by managing their strategic relationships with stakeholders.

In this vein, Pendleton (2008) contends that managers display strategic choice in relation to their employment practices and are often more favourable to employees than is usually claimed under the Varieties of Capitalism literature. He argues that there is increasing interest within employee relations in how governance affects employee management as the

generalisations around the determinism of markets on the management of employees are rather simplistic. Even so he cautions that well-developed financial systems have facilitated the growth of new forms of governance that can be harmful to labour and thus cast a long-term shadow over human resource and labour management.

Other perspectives of employees position in governance emerge from the behavioural literature which stresses the importance of motivation and leadership in developing and maintaining governance structures and processes, in employees role in developing and being a participant in an ethical and transparent culture, and in developing and using codes of conduct and proper compensation packages (Beatty, Ewing & Tharp, 2003; Dailey & Brookmire, 2005). Mele (2003) mentions 'organizational humanizing cultures' such as through the recognition of dignity, rights and personal growth, that inspire management for the common good rather than particular interests, and adds that such a culture might be capable of generating social capital for organizations.

Carroll (1991) argues that two criteria are important for decision-makers when sorting out priorities and importance of stakeholder claims: stakeholder power and legitimacy. It is argued employees should be able to exercise power over decision-making in return for their loyalty and contribution of their investment. Whilst legitimacy varies according to the situation, Carroll (1991) explains that employees have legitimate claims compared to other stakeholders especially at times of plant closures, whilst Armour, Deakin and Konzelmann (2003) argue that in insolvency, employment law and corporate restructuring, employees have greater legitimacy to be consulted with. Similar to Carroll (1991) Williamson (2003) argues that employees bear a higher risk than shareholders where in times of company failure a loss of employment brings a loss of income, skills, confidence and health, sometimes permanently. *'Employees level of risk is not matched by their level of influence, or by a right for their interests to be protected. This is both unjust and inefficient' ... a company is far more than its shareholders...If any group can be said to embody a company, it is its employees- they are the ones who make its products, deliver its services, create its profits and represent it to the external world'* (Williamson, 2003:514).

Australia operates within common law traditions which Crossland, (2007) argues puts legal constraints on pursuing a particular end, namely maximising shareholder value. Even so they are given almost free rein in terms of the means of achieving this end with built-in flexibility so that the governance practices can be adapted depending on size, activities and culture (Sarens and Christopher, 2010). In this vein an Australian Government Report (2006) found that the Corporations Act does permit directors to take into account the interests of stakeholders other than shareholders. Anglo systems generally operate with low employment protection although Australia's system with its arbitration and conciliation system and compulsory nature of award setting has been viewed historically as quite centralised with higher protection than what you would otherwise expect (Marshall et al., 2009). More recently changes to employment law have lessened protective mechanisms (Marshall et al. 2009). The scope of bargaining has been constrained and employees not well integrated into governance structures. Marshall et al. (2009) refer to this as a hybrid system of corporate and labor market systems. Similar to the UK, Australia operates from a principles-based approach to governance as opposed to the rules-based approach of the US. This is based on a comply-or-explain system where firms listed on the ASX must comply with the governance principles or explain why they have differed. In this vein the ASX principles state that *"in making ethical and responsible decisions, companies should not only comply with their legal obligations, but should also consider the reasonable expectations of their stakeholders*

including shareholders, employees, customers, suppliers, creditors, consumers and the broader community in which they operate” (2007:21).

For Australian companies and employees, there have been times when partnerships approaches between management and labour have been evident such as during the Accord years. However over the past decade this has been problematic as Australia has witnessed the introduction of the Australian Workplace Relations Act 1996, and the incorporation of Australian Workplace Agreements (AWAs) into the employment relations landscape and subsequently the Workchoices reforms of 2006. This unitarist framework has decreased collective decision-making by privileging individual contracts, increased management prerogative and weakened unions, reduced minimum standards and rights and often has been associated with reduced pay and poorer working conditions (Bray & Waring, 2006; Peetz, 2002).

In integrating these approaches and setting it within this industrial relations context, this paper will examine the position of employees in corporate governance to investigate the extent to which employees are perceived as key stakeholders. We argue that it is only by including employees as stakeholders, and reflected in governance, will employees and other external parties believe that they are explicitly recognised. If there is a gap between policies, statements and practices, not only will employee trust be reduced but governance and in turn organisational performance, will also fail to be optimised. After all, as observed by Faleye and Trahan (2011:27), ‘*what is good for the employees is good for the shareholders*’ too. By creating high trust cultures ethical stewardship honours a broad range of duties owed by the organization to stakeholders (Caldwell, Truong, Linh & Tuan, 2011:173). Treating employees as ‘owners and partners’ (Block, 1993:25) creates an inclusive governance system that contributes to long-run wealth creation.

METHODOLOGY

Qualitative methodology is applicable for this research as the study is exploratory in nature; as Patton (1990:424) has argued: ‘*The emphasis is on illumination, understanding, and extrapolation rather than causal determination, prediction, and generalization*’. This study uses interviews and organizational statements to provide this understanding of organizational viewpoints and priorities in regard to the inclusion of employees in governance.

It focused on gaining an understanding of executive’s perceptions of the meaning of governance, the drivers of governance and the characteristics of both effective and ineffective governance. Interviews were conducted in 2007 with seven executives and managers in six Australian organizations in public, private and government enterprises, operating in the brewing, mining, accounting and superannuation industries. The choice of the companies was based on purposive expert sampling. The accounting firm was used to provide external commentary on corporate governance due to their expertise as a consultant to companies. The superannuation firm was used to provide expertise from the institutional investor segment. Table 1 shows the details of these organizations and people interviewed.

Insert Table 1 here

Senior key executives in these organizations were interviewed using a semi-structured interview schedule. Interviewees were first phoned to explain the research, and a plain language statement and consent form, as approved by the Ethics Committee, were forwarded to them. The questions were exploratory in nature and questioning was used to uncover deeper meanings and underlying reasons and interpretations from multiple sources. Each interview lasted for approximately one hour and was audio-taped. The transcriptions were

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sent to the interviewees for verification of accuracy. The verification fulfilled the need for credibility checks and ensured that the information was reflective of the participants' meanings and the interviewer did not introduce bias.

As the information produced by qualitative methods is voluminous, content analysis (Patton, 1990) was used to identify, code and categorize its primary patterns. The data was coded by three researchers – two involved in the research and one independent- according to the major themes and secondary classification occurred on the basis of statements that included employees in these themes.

FINDINGS AND DISCUSSION

Interviewees only referred to employees in three themes: namely components of governance, the factors driving the evolution of corporate governance in Australia, and the major concerns among the public regarding governance issues.

Governance components

In relation to components of governance, apart from Codes of Behaviour which all respondents spoke of, there were minimal references to employees. One government organization spoke of the importance of the human resource department where *the responsibility of health and safety issues lies (Australian government enterprise)*. Similarly the mining company through their company secretary spoke of their emphasis on safety:

We have a massive, massive emphasis in this company on safety. Unfortunately people die working for this company. It is kind of one of those things where you live and you breathe it, ... (Mining co)

The public sector organization also spoke of ethical behaviour being of increasing concern.

We have an ethics committee internally and we have ethics programs that are being developed for every level within the organization. But there was also within that committee there was concern that we weren't doing enough in the area of application of the code of ethics at the more senior levels in order to... for historical reasons and cultural reasons. Because it incorporated elements of a code of conduct it was something that applied to the award based staff as opposed to the executive staff, even though the principles were the same (Mining co).

Along the same lines the superannuation fund spoke of their governance including employees through codes and adherence to values:

But I think more broadly the code of ethics as part of the staff agreement, it is very clear in the staff agreement, the expectations in regard to ethical behaviour. In respect to the values of your organization and the mission that certainly is communicated to all staff. So it follows through, and I think that also might be in the employer agreement (Superannuation fund).

Another spoke of the importance of risk management within governance and when prodded expanded saying it included non-market risks *that relate to community, government, non-government organizations, and employees (Brewing co)*.

Drivers of governance

In regard to key drivers of governance these were spoken of as changes to legislation such as the Companies Act in increasing board liability and improving governance focus. The second referred to was the move to the stakeholder perspective which was discussed as being derived from the social license to operate and risk management (rather than from a moral or ethical

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perspective). In neither of these two drivers were employees referred to specifically. For instance:

This issue isn't actually driven by any moral or ethical type guidelines, but it is because the landscape has actually changed in that companies can no longer act solely for their shareholders with complete disregard for other stakeholders because of what we now term the social license (Accounting & consulting firm).

Although one respondent, the public sector organization when speaking of their emphasis on stakeholders did specifically include employees as stakeholders.

Improved accountability was the third driver spoken of which is linked to reputational risk, sustainability & employer of choice initiatives. These concepts are important in relation to human resource practices and the ability to obtain employees at times of skills shortages.

The young people today want to work with companies who actually are doing what they say and are contributing more broadly to society, in fact contributing to society's transformation to sustainable development (Mining co).

I think one thing is that we are an Australian icon therefore you know that makes a big difference. We are very conscious of the fact that we are watched and that we are to lead, and that people will follow or criticize (Mining co).

Being able to attract good people is challenge - into the industry at this time, into remote areas that we work in, in many different countries around the world. And to do that you need to be more than a company that offers good pay. You need to actually be the company of choice for young people entering the workforce now. And increasingly these people want more than money. It is not just sustainable development either. They certainly do want to work for a company who believes in something (Mining co).

The fourth driver referred to was the evolution of society and corporations' life cycle. This evolution could be interpreted in Australia in one way as a movement away from collectivity towards individualisation even though this was not explicitly referred to (see Cooper & Ellem, 2008).

Public concerns

Public pressure was referred to in relation to investors demanding higher standards of behaviour, accountability and transparency. Social responsibility was included in this theme with many interviewees speaking of this pressure but no respondents speaking of any responsibility to employees. Another key sub-theme emerging in this area was in relation to executive remuneration where all respondents spoke of public and media interest in excessive pay and rewards. A typical statement:

Certainly executive pay is a hot topic. And people want to make sure that, especially if a company is struggling, that failure is not rewarded (Brewery co).

CONCLUSION

Some significant conclusions emerge from this study that investigated the extent to which employees are included in the governance frameworks of organizations.

Firstly, despite all the rhetoric of employee participation, there is still progress to be made in fully incorporating employees in governance. The dominant paradigm of corporate governance is one that adopts an approach which is restricted to the relationship between corporate managers and shareholders (Hill, 2003). This is consistent with the shareholder

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view of the firm where employees are not necessarily regarded as stakeholders but as beneficiaries of good business practice.

The major focus on employee codes of conduct, and legal and regulatory frameworks in areas of equal employment opportunity and occupational health and safety reveal that organizations principally view employees' role in governance from a control and legalistic position, where the firm sets rules for the employees to follow, and do not integrate employees as a crucial partner in the firm's operations. Although, it is evident in this study that safety is a high priority of mining companies and resource-based firms with these companies seeming to use safety program as a method of engagement.

In interpreting ethical behaviour through codes of conduct the focus was on employee behaviour rather than company behaviour and its effect on employees. Hence the use of ethics codes and codes of conduct to bring about ethical behaviour can also be seen through a prism of exerting more control over employee behaviour.

Secondly the data in particular demonstrates a resource dependency approach in arguing that a stakeholder focus of governance provides access to resources such as land and water, and employees. As has been pointed out in this research and in others, large companies and large investors are viewing reputational issues as increasingly important (Du, Bhattacharya and Sen, 2010; Pendleton, 2009) especially in areas of 'employer branding' with it being used to attract and retain good quality employees (Martin, 2009).

The use of share ownership schemes (ESOP) is contended as a way of retaining talent and motivating employees. Pendleton et al. (2002 as cited in Gospel & Pendleton, 2005) argued that the use of company stock has provided an alternative instrument for securing commitment of employees. In an Australian study (Lenne et al., 2006) of 513 2001 annual reports of ASX companies, reporting of ESOP's overwhelmingly emphasized their use in 'aligning' employer/employee interests but concluded that work re-organization and increased employee participation was an important co-variable in improving corporate performance and generating feelings of ownership. Similarly, a study (Pendleton 2010) of 2600 employees in three large UK companies found that participation rates in ESOP's were negatively related to employee attitudes and that equity did not provide employees with any meaningful control or influence. Hence ESOPs could be regarded as another form of control. In this vein we argue that it is not enough to simply incorporate employees into ownership but it is necessary to give them a voice through incorporation into decision-making and explicit governance structures.

Thus we conclude that Australian corporate governance reforms in areas of disclosure and legal and regulatory enhancements in the last decade have not resulted in any significant advance in the recognition of employees' interests in governance and perceptions of governance (also see Forsyth et al, 2006). In general organizations are operating from a shareholder governance approach, abiding by legal regulation and voluntary guidelines such as CLERP 9 and ASX Best Practice Guidelines, and with their governance practices being driven by changes in these regulations and codes, which it could be argued is to be expected in an Anglo-governance system. Institutional theory (Oliver 1991) can be used as an important framework to understand why the position of employees as *core* stakeholders is not strongly developed. The governance system of firms in Australia is based on principles which can be viewed as a construction of standards by institutional actors such as the ASX, whilst reforms are focused based on two main tendencies: the growing concern for transparency and risk management; and the growing concern for ethics and CSR. There is a lack of institutional pressure for wholesale governance reform in the area of employee interests or inclusion of

employees in decision-making. There is little evidence of attempts to move to what we would call an enlightened approach underpinned by moral obligations. However it is worth noting that the sustainability and employment drivers spoken of in this paper, alongside the financial crisis and increasing public calls (and government responses) for limits to executive remuneration, may all have an impact on this in the future. The impact of the environment cannot be ignored as a driver for change as Aguilera et al. (2006: 148) states: ‘*Recognising that firms are situated within a given society and political tradition, which will influence the decisions of individuals within the firm, one can conceptualise corporate governance as relationships within the firm and between the firm and its environment*’.

In the public domain the rhetoric has often moved from shareholders to stakeholders, however there is lack of clear enunciation of employees in this stakeholder terminology (also see Coopey, 2004). Organizations need to make the process of engaging employees more realistic and integrative, and institutionalise it into core business processes (also see Schouten & Remme, 2006) to move from seeing employees through a control prism to one that incorporates employees into their stakeholder lens. In doing so organisational benefits will result in areas of employee engagement, increased loyalty and improved attraction and retention of employees. And for those organizations that are attempting to include employees in consultation, and as stakeholders, they need to do so consistently and across all organizational dimensions including governance, so that employees and other external parties are not confused as to the legitimacy and role of employees.

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Table 1: Characteristics of interviewees and organizations

Name of the firm	Category of Organization	Respondent	Selected Details
Mining Company 1	Mining Company	Principle Advisor on Environment	<ul style="list-style-type: none"> • Revenues of US\$58,065 million. • 20,346 employees in Australia and New Zealand (2008)
Mining Company 2	Mining Company	Company Secretary	<ul style="list-style-type: none"> • Revenues of US\$51,918 million • 41,000 employees (2008)
Superannuation Fund A	Superannuation Fund	Executive Manager – Investments and Governance	<ul style="list-style-type: none"> • National industry superannuation fund. • Manages over AUD 13 billion (2008) • Over 650,000 members and 60,000 employers (2008)
Australian Government Enterprise	Australian Government Enterprise	Corporate Secretary	<ul style="list-style-type: none"> • Revenues of AUD 4,959.2 million. • 25, 042 employees (2008)
Brewery	Brewery	Director of Communications	<ul style="list-style-type: none"> • Revenues of AUD 4372.7 million. • 7000 employees (2008)
Brewery		Company Secretary	
Consultancy 1	Accounting and Consulting Firm	Executive Director AABS –RCIP	<ul style="list-style-type: none"> • Global consulting company. Offers services in Assurance, Tax, Transactions and Advisory services. • Revenues of US\$24.5 billion (2008) • 135,730 employees (2008)

