
Employees in Asian Enterprises: Their Potential Role in Corporate Governance

Sang-Woo Nam

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Employees with valuable human capital are becoming the most essential asset in the era of global competition, and a great challenge for corporate governance is how to motivate them.

Employees will increasingly be induced to participate in shop-floor decisionmaking. This will gradually allow them to participate in corporate governance as well.

While works councils are likely to be the most promising channel for employee participation in corporate governance, also important are such complements as employee stock ownership and conducive work organization and human resource management.

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ABSTRACT

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 will likely to take time for the model to take root in these economies. Any newly transplanted system requires local adaptation and the establishment of complementary institutions to function properly. If abuses of power by controlling owners cannot be adequately checked by minority shareholders through internal governance mechanisms or the market for corporate control, strong alternatives can include two other important stakeholders: employees and creditor banks. This paper evaluates the potential role of employees in corporate governance in Asian developing economies.

Employees with valuable firm-specific human capital are becoming the most important assets 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 the single-minded pursuit of shareholder interests may not only be unfair but also grossly inefficient. Actually, corporate managers in advanced countries can be 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 owners of their firms.

In most Asian countries, labor is relatively weak and employees are not greatly empowered to give full play to their potential. This situation, however, is likely to change in the coming decades. With progress in democratization and continued industrialization, labor will become stronger. Intensified global competition and the emergence of the “new economy” will force many industrialized Asian countries to shift from labor-squeezing to employee-motivating strategies. The weakening of family control over businesses in the wake of the Asian crisis has also given a larger room to play for employees. In large Japanese enterprises, employees have practically become 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 effectiveness of various practices of employee participation. While union density is generally low and declining, works councils are the most commonly utilized form of representative worker participation. They allow a better flow and utilization of information and provide employees with the opportunity 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 function of boards is limited even in Anglo-American enterprises, a substantive role can hardly be 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 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 the corporate governance role of employees. Active participation in employee involvement programs on the shop-floor has allowed employees to share the corporate governance function as well, since 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.

The model role for employees in corporate governance for East Asian enterprises is likely to be different from existing models. Works councils are most promising as a channel of participation, and it makes sense to legally mandate such councils and provide guidelines on the mode of handling each of the major agenda items. Priorities may also be given to improving industrial relations and promoting complementary practices. Strong incentives should be provided 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.

TABLE OF CONTENTS

<i>About the Author</i>	II
<i>Abstract</i>	III
<i>Table of Contents</i>	V
1. Introduction	1
2. The Potential Governance Role of Employees in East Asia	7
2.1. Arguments for Employee Participation in Corporate Governance	7
2.1.1. Protection of Firm-specific Human Capital Investment	8
2.1.2. Emerging Governance Concerns in “New Enterprises”	9
2.1.3. Stakeholder Theory of the Corporation	10
2.1.4. Emergence of “Shared Capitalism”	11
2.2. The Changing Socio-Economic Environment	12
2.2.1. Democratization and Labor’s Voice	12
2.2.2. Weakening Family Control of Businesses	13
2.2.3. Emergence of the “Knowledge Economy”	15
2.3. The Japanese Challenge: Employee Sovereignty	16
3. Types of Employee Participation in Corporate Governance	26
3.1. Industrial Relations and Labor Unions	26
3.1.1. Workers and Corporate Governance: Brief International Comparisons	27
3.1.2. Labor in the Newly Industrialized East Asian Countries	28
3.2. Representation and Deliberation at Works Councils	31
3.2.1. Unions and Employers at Works Councils	33
3.2.2. Works Councils in Asia	34
3.3. Employee Representation on the Board of Directors	35
3.3.1. Board Representation, Unions, and Their Impact	36
3.3.2. Lessons for Asian Firms	38
3.4. Worker-Owned Cooperatives	39
3.4.1. Structural Weaknesses	39
3.4.2. Prevalence of Worker Cooperatives	41
3.4.3. Productivity of Worker Cooperatives	42
4. Complementary Forms of Employee Participation	43
4.1. Worker Participation in Ownership	43
4.1.1. Rising Prevalence and Its Background	43

4.1.2.	Effects of Employee Ownership	46
4.2.	Employee Involvement on the Shop-Floor	46
4.2.1.	EI, Labor Unions, and Corporate Governance	47
4.2.2.	Other Complementary Practices	48
4.2.3.	Effects of EI Practices and Their Complements	49
5.	Employee Participation in Korea	50
5.1.	Operation of LMCs	50
5.2.	Other Forms of Participation	54
5.3.	Evaluation of Worker Participation in Korean Enterprises	55
6.	Conclusions	61

Tables and Figures (in body of text)

Table 1.	Share of Executives from Outside for Listed Companies: Japan	20
Table 2.	Attributes of Representative Directors with or without Union Experience: Japan	21
Table 3.	Union Experience of Representative Directors: Japan	23
Table 4.	Korean Labor-Management Councils: The Most Important Agenda in 1999	51
Table 5.	Subcommittees of Labor-Management Councils	52
Table 6.	Korean Labor-Management Councils: Handling of Major Individual Agenda (1999)	53
Table 7.	Korean Labor-Management Councils: Other Characteristics (1999)	54
Table 8.	Worker Representation on the Board of Directors: Korea (2000)	56
Table 9.	Opinions on Degree of Worker Participation by Level of Participation: Korea (2000)	56
Table 10.	Worker Participation in Decision-Making Process on the Extent of Sharing Managerial Information: Korea (2000)	56
Table 11.	Worker-Participation in Corporate Decision-Making Process: Korea (1996)	57
Table 12.	Incidence of Representative Participation: Korea	58
Table 13.	Attitudes toward Union Participation in Management Decisions	58
Table 14.	Worker Participation in the Distribution of Corporate Performance: Korea (2000)	58
Table 15.	Worker Participation in the Distribution of Corporate Performance: Korea (1996)	59
Table 16.	Employee Stock Ownership Plans: Korea	59
Table 17.	Views on the Effect of Worker Participation on Corporate Organizational Efficiency: Korea (1996)	60

Table 18. Degree of Worker Participation and Evaluation of Its Performance: Korea and the U.S.	61
Appendix Table 1. Comparison of Characteristics of Sample Firms and Survey Methods	65
Figure 1. Perceptions of Directors on Importance of Stakeholders: Japan (1998)	18
Figure 2. Union Penetration Rate	29

Employees in Asian Enterprises: Their Potential Role in Corporate Governance

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1. Introduction

Concern over corporate governance arises typically in situations where there is a gap between the interests of management and those of owners. The ownership of most large modern corporations is widely diffused, and in practice, professional managers make critical operational decisions, usually without the consent of shareholders. Berle and Means (1932) first noted the separation of ownership from control, resulting in the agency problem of managers' pursuing their own interests, often at the expense of those of the owners. There have been several mechanisms, both within corporations and in the external markets, to induce managers to be more accountable to shareholders. Internal corporate mechanisms include shareholders' meetings, exercise of other shareholder rights, the board of directors, and providing equity-based compensation to managers. External mechanisms include markets for corporate control, managerial labor, and products or productive factors. However, these instruments were generally ineffective even in the United States particularly until the 1970s.

The shareholders' general meeting is a forum where the owners can exercise their rights by participating in the selection of the members of the board of directors and other major decision-making items. However, a minority shareholder is typically faced with a free-rider problem: he is not much interested in supervising and monitoring the management, as only a small fraction of the benefit from his effort will accrue to him. Management virtually controls the agenda of the shareholders' meeting and pushes their own proposals without much opposition. Although proxy voting has been designed to mitigate this problem, proxy fights have been relatively infrequent and rarely successful. Large institutional investors such as investment funds and other financial institutions can play a more critical role in corporate governance since they are much less subject to the free-rider problem. Nevertheless, they have also been constrained by the legal structure, conflicts of interest, and political pressures (Romano, 1995; Kroszner and Strahan, 1999).

In practice, the board of directors is considered to be a more important mechanism for overseeing the management and pursuing the best interests of the owners. However, the board has also been widely viewed as ineffective except in situations of takeover bids or changes in top management. Boardroom culture is characterized by the encouragement of politeness, consensus, and complacency, and directors usually do not have adequate access to relevant information. The board is

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often oversized, making it easily controlled by the CEO who usually serves as chairman of the board. Even the outside members have hardly been viewed as truly independent, as the management often has a substantial influence on the selection of outside directors. Board members have often not been sufficiently motivated to pursue the best interests of shareholders with only a very small equity stake in the firm, or have been constrained by legal liabilities that make them more concerned with minimizing risks rather than maximizing shareholder value (Jensen, 1993).

The 1980s, however, saw a surge in corporate governance activity in the United States with a takeover boom, which may be seen as a response to the failures of internal governance mechanisms. With leveraged buyouts (LBOs) and takeovers, management interests became better aligned with those of shareholders as managers were provided with substantial equity stakes. LBO sponsors or investors were generally very keen about monitoring the corporations through active representation on the boards of directors. A large increase in debt burden resulting from leveraged buyouts or takeovers also imposed strong financial discipline on corporate management (Holmstrom and Kaplan, 2001). In the 1990s, however, the takeover wave was substantially subdued by anti-takeover legislation and political pressures (in response to some negative perceptions about takeovers such as a costly and socially counterproductive nature involving rent-seeking, fraud, tax-saving, and wage cuts) as well as other unfavorable environmental factors including the collapse of the junk bond market that had financed most leveraged buyouts and takeovers. The much weaker takeover activity since the early 1990s is partly attributable to the stronger governance roles of other mechanisms: more extensive use of stock options given to CEOs, increased monitoring by institutional investors, stronger shareholder activism, and improved effectiveness of corporate boards.

In Asian countries, particularly newly industrializing economies, increasing attention needs to be given to the corporate governance problem arising from the separation of control from ownership. However, in many of these countries, the majority of large corporations are owned and controlled by families, and the nature of governance concerns is somewhat different from that described above. The major agency problem exists not between the management and owners in general, but between the management and minority (non-controlling or outside) owners. Since the management is typically controlled by a large shareholder (family), and the most important managerial positions are held by family members, the typical agency problem exists actually between the controlling family and outside shareholders. The existence of large shareholders itself may not be a matter of concern, and may actually be a blessing. Many empirical studies show that firms tend to perform better when they have large shareholders, who have a strong incentive to closely monitor their firms, and suffer less from the free-rider problem (Shleifer and Vishny, 1997).

However, the beneficial effect of large shareholders can be expected only when the management is separated from ownership, or when proper corporate governance mechanisms are in place and operating so that outside shareholders can effectively oversee corporate management. These conditions are generally not fulfilled in most Asian enterprises. The controlling owners are typically preoccupied with conducting the managerial function themselves, perhaps due to the perceived agency problem when management is separated (with limited transparency and disclosure, poor rule of law as

well as poor corporate governance) or to potential rents expected from the managerial function.¹ Where the managerial function is essentially conducted by the controlling owner, the agency problem between this owner and outside shareholders is potentially serious, particularly for large business groups with many subsidiaries. For the purpose of maintaining management control, they may try to minimize ownership dilution and resort to borrowing and cross-shareholding or ownership pyramiding as they work to expand their businesses.

This creates a large gap between ownership (cash flow) rights and control rights for the controlling owners, which may motivate them to maximize their personal or family wealth, often at the expense of outside shareholders. If the ownership share of a controlling family is just five percent, each dollar gain in firm value leads to just a five-cent increase in its family wealth, and there is a strong incentive for the family to make managerial decisions that may mostly benefit themselves rather than their firms or outside shareholders.² The consequent expropriation of outside shareholders is the major corporate governance problem in many Asian enterprises. What makes the problem serious is that the financing, investment, management and governance patterns of these groups are very distorted. Their behavioral characteristics include high debt dependence, excessive diversification and overinvestment, extensive cross-shareholding and cross-subsidization among group subsidiaries, highly centralized management without separation from ownership, and inadequate corporate governance mechanisms. These distortions and structural weaknesses have exposed the economies to higher risks and inefficiencies, and were largely responsible for the Asian financial crisis of 1997 (Nam, 2001a and 2001b).

It is not surprising that improving corporate governance structure has been one of the priority areas in the post-crisis reform efforts. Efforts directed toward enhancing managerial transparency through improved standards of accounting and audit and strengthened disclosure requirements would provide better infrastructure to allow stronger corporate governance in the crisis-affected economies. Reform measures have also included improving specific governance mechanisms both within corporations and in the external markets. The rights of small shareholders have been strengthened by making it easier for them to exercise their rights such as bringing derivative suits against board members and requesting the inspection of account books. A minimum quota for outside directors has been imposed. Also, mergers and acquisitions have been made much easier in order to foster the market for corporate control.

¹ The two reasons for the preoccupation of controlling families with conducting the managerial function may actually be part of the same problem. Unless the perceived agency problem is severe, expected rents from conducting management duties are small. If the controlling owners decide to stay away from the management, they will try to make sure that the agency problem is not serious. On the contrary, if they are preoccupied with the management function (due to the serious perceived agency problem and expected rents from management), they are likely to resist any reform conducive to reducing the agency problem (by interfering in the policymaking process). Of course, the motivation of family owners to participate in management can be much more diverse and complex: the firms are their creation, and are foundations for the family pride that they want to see preserved and flourish.

² Empirical evidence of the “tunneling” or expropriation of minority shareholders by controlling owners (with deviations of control rights from cash flow rights), and its effect on corporate value include: Claessens, Djankov, Fan, and Lang (1999, 2000), Bertrand, Mehta, and Mullainathan (2000), and Johnson, Boone, Breach, and Friedman (2000).

Though these reform efforts along the Anglo-American model will certainly lead to some improvements in corporate governance in the crisis-hit economies, there is no guarantee that this model will work best for these economies. The efficacy of the Anglo-American governance model is often questioned even in its own place of origin. For instance, the general shareholders' meeting has never been viewed as effective in overseeing management, and the board of directors is seen to perform a meaningful corporate governance function only in a management emergency. It is only in the last two decades or so that corporate governance concerns began to be seriously dealt with in the U.S. and U.K. The most notable developments have included a surge of takeover activity in the 1980s and an increased role for institutional investors in corporate governance in more recent years, as well as the more widespread use of equity-based compensation for corporate managers.

However, these mechanisms can hardly be expected to function properly in the developing Asian economies until the corporate ownership structure is substantially changed and the necessary institutions are in place. For instance, boards of directors, which are typically chaired by the controlling owner-manager and have a majority of insiders, are far from being forums where management proposals can be seriously challenged. This is particularly the case in Asian cultures that discourage overt opposition to authority. Hostile takeovers are seen as a costly way of disciplining poor management and aligning the interests of managers with those of owners. In the Asian context, hostile takeovers are unlikely to emerge as an important mechanism for disciplining poor management, given extensive cross-shareholding among the subsidiaries of family-based business groups. Since Asian enterprises are already heavily dependent on borrowings, they will find it practically impossible to increase their leverage further to finance takeovers. In some countries, the potentially strong opposition of labor unions for fear of drastic corporate restructuring would also discourage takeover attempts. No greater optimism can be given to the role of institutional investors in most developing countries in Asia. Private investment funds affiliated with major commercial interests are likely to be seriously constrained in overseeing and disciplining corporate managers because of their (or their affiliates') business relations with these corporations. Public investment funds without such conflicts of interest are not expected to play any significant role either, since the operation of these funds is usually controlled by the government or they are restricted in investing in the stock market. Stock options might also be costly, and their effectiveness often relies on a bullish stock market.

The shaping of a corporate governance system in each Asian country will certainly be affected by the trend of globalization and the path-dependent nature of institution building. Even though the dominant Asian model of owner family control will be modified substantially, the change is likely to be gradual and evolutionary, since the families continue to control a large share of capital in their economies. In the face of keener global competition, pressures to improve managerial transparency and increasing difficulty in pursuing family interests at the expense of firm value, the family owners are likely to gradually pull out of the management. This means that the role they play will be restricted to monitoring the management. This role for large shareholders should not be discouraged, though close attention needs to be given to preventing them from pressuring, or colluding with, management to pursue their family interests. At present, it is not clear, in the absence of a monitoring role by the families, who could efficiently fill the corporate governance vacuum. The capital market is not

yet able to take up this role, given the demanding institutional requirements for the effective regulation and efficient functioning of the market (Kanda, 2001).³ Outside of minority shareholders, then, the remaining candidates for checking the potential abuses of family owners are creditor banks and employees.

Creditor banks are in a position to play an important monitoring role in Asian developing countries, where capital markets are not well developed and dependence on banks is generally high. They are supposed to have natural advantages in monitoring corporate clients, as they tend to maintain long-term relationships and provide multiple services including loans and settlement accounts. This role, however, has been constrained by the banks' own weak governance due to extensive government intervention or ownership connections with major clients. When government-directed loans to particular firms and industries are prevalent (and bank managers are not very performance-conscious), banks tend to neglect monitoring, believing that the government will take care of their clients in the event of financial distress. As the result of the recapitalization in the wake of the Asian crisis, many banks are now in the hands of the government. It will take some time for the banking sector to build an autonomous and long-term relationship with its corporate clients and to gain the ability to perform monitoring functions properly.⁴

Aside from shareholders and creditor banks, long-term employees may be the most important group of corporate stakeholders. Their firm-specific human capital, which has been built up over many years, is not greatly valued if they have to leave their firms. This makes them intrinsically interested in participating in corporate governance. There are different models for them to play this role. In many European countries, employees are represented on the supervisory board of directors and participate in works councils. Since this model is, to a large extent, the product of political choice, it is not easily reproducible by countries in a different socio-political environment. Japanese firms are known to have a tradition of treating their employees as the most important stakeholders, and have utilized such arrangements as joint labor management committees and various shop-floor activities to allow them to participate in both work-related and strategic decision-making. Even in the Anglo-American enterprises, where employees are typically denied any governance role, there is a clear trend toward making workers shareholders of their firms, and simultaneously letting them be more involved in autonomous practices at workplaces.

³ It may be argued that the financial crisis of 1997 and the imposition of IMF-prescribed corporate governance reform might actually be a rare opportunity to impose a new (Anglo-American) model, as was the cases for the start of "worker codetermination" in Germany and the breakup of the *zaibatsu* in Japan after World War II. Depending on the seriousness of the governments in carrying out reform and further developing complementary institutions, reform efforts may actually turn out to be an important watershed in shaping a new system in these economies. Globalization, with the increasing ownership of enterprises by foreign investors and the inroads made by more transnational corporations, may also facilitate this process. However, there seems to be little evidence that the family-based system, though damaged, is undergoing fundamental changes.

⁴ Banks, as pure creditors, however, have a fundamental problem of conflict of interest in playing a corporate governance role. They prefer less risky projects with a lower chance of failure, while shareholders generally prefer higher risk projects that maximize firm value. Furthermore, banks, as senior creditors, have a conflict of interest, since as they exercise influence over management decisions they might favor themselves vis-à-vis other creditors (Kroszner and Strahan, 1999).

Interest in the corporate governance role of employees has been further prompted by the unmistakable trend of the “new economy” or “knowledge economy.” East Asian governments and enterprises are also under increasing pressure to transform their economies. For knowledge-intensive firms, the human capital of the “knowledge worker” is the most essential asset and their major source of value. A challenge for employers is that these knowledge workers can easily leave the firms unless they are properly treated. The most effective way to attract, keep and motivate such workers seems to be to allow them to participate in decision-making and to share the results of corporate performance. This has profound implications for corporate organizational, governance and ownership structure. Knowledge-intensive firms tend to have flatter organizational hierarchies, and they let their knowledge workers have a stronger voice in corporate management and become significant owners of their firms. Core employees increasingly participate in corporate governance and become “residual claimants” like other shareholders through ownership and other financial sharing.

Finally, poor industrial relations are a potentially serious obstacle to the restructuring and sustained growth of some Asian economies. During the process of industrialization, which was heavily dependent on exports of labor-intensive products, workers have long been denied their basic rights. Authoritarian regimes in some of these economies have given way to democracies, substantially relaxing the long-suppressed union activities. However, industrial relations are still characterized by antagonism and confrontation, and gaps remain in the perspectives and attitudes of labor and management. Those countries have yet to see major progress in democratization, and the deregulation of labor is likely to follow the same path. Improving industrial relations should be given top priority, not only for the smooth corporate restructuring that is essential for surviving in intensified global competition, but also for building stable democratic societies. Greater involvement of employees in decision-making at various levels of their workplaces would be a promising avenue towards this goal.

Our main interest lies in seeking a system of corporate governance that can survive in the increasingly competitive and globalized world. As such, in this paper, arguments for or against worker participation at various levels will mainly be made on the grounds of efficiency as opposed to social ones. This paper demonstrates that, in light of the experiences of the advanced industrialized countries as well as the socio-political realities and legacies of past development strategies in the Asian developing countries, it would be wrong to promote worker participation in formal corporate governance mechanisms such as corporate boards of directors. Worker-owned cooperatives, as business organizations wholly owned and controlled by workers, are also shown to have many limitations. Nevertheless, it is argued that worker participation in corporate ownership, employee involvement on the shop-floor, and other complementary practices will be essential for firms whose success depends increasingly on motivating key employees. This trend, however, means that some managerial decision-making functions must be shared with employees, particularly on issues directly related to workers’ work lives and welfare. Finally, it is suggested that the most promising avenue for employee representation and participation at the corporate level would be works councils, given the ineffectiveness of worker representation on boards of directors as well as the relative weakness of labor unions with their confrontational nature of collective bargaining.

Section 2 reviews the potential governance role of employees in East Asia, looking at general theoretical arguments and the changing socio-economic environments faced by these countries, as well as the traditional Japanese model under which employees have in practice controlled their firms. In Section 3, we discuss different types of employee participation in corporate governance, including collective bargaining in unionized firms, representation and deliberation at works councils, employee representation on boards of directors, and the operation of worker-owned cooperatives. Some other practices, such as worker participation in ownership and employee involvement programs on the shop-floor, also affect and are being affected by their role in corporate governance. These complementary practices are discussed in Section 4. The state of participation for Korean employees is presented briefly in Section 5, as Korea is a leading economy in East Asia in terms of the level of industrialization and power of labor. Finally, conclusions are given in Section 6.

2. The Potential Governance Role of Employees in East Asia

What is the rationale for employees playing a role in corporate governance? How effectively can employees play this role, which is traditionally the responsibility mainly of the suppliers of capital? Both shareholders and long-term employees make substantial match-specific investments into their firms. This makes both groups strongly interested, and qualified to be involved, in the governance of their firm. Employees working for many years for a firm receive formal and on-the-job training and accumulate firm-specific skills and knowledge, which lose much of their value if the employment relationship is terminated. In this Section, we review emerging arguments for an employees' role in corporate governance both in general and in the East Asian context. Also discussed are the traditional management and governance in Japanese enterprises, where employees held a unique position.

2.1. Arguments for Employee Participation in Corporate Governance

Employees are generally supposed to do a poor job in governing their firms (Rock and Wachter, 1999). First, they may be more risk averse than shareholders given that they are usually poorer and have a limited capability to diversify their capital or earnings. This leads them to prefer stable wages and to be less willing to be residual claimants, to whom the governance role is generally assigned. Second, they may have a comparative disadvantage in playing a governance role at the corporate level. Employers generally have better information about the product market, relevant technologies, and other issues of strategic decision-making, while employees have a comparative advantage in information about their work on the shop-floor. Third, the free-riding problem in a teamwork situation may best be dealt with by monitoring by residual claimants, to whom most of corporate performance accrues after the payment of all predetermined financial obligations. Moreover, the residual claimants should be capital suppliers, since a firm's physical assets could be abused if not monitored by their owners (Alchian and Demsetz, 1972). Finally, workers are more heterogeneous than investors in their interests and objectives in the firm. They have different preferences with regard to income stability, job security, safety, work efforts, etc., so that decision-making is likely to be difficult and time-consuming.

These disadvantages may explain why the role of employees is rather limited in traditional corporate governance in countries like the United States, where such participation is not required by law. Recent years, however, have seen the emergence of arguments emphasizing the importance of human capital, presumably reflecting the ongoing changes in the nature and operation of many enterprises in the rapidly growing sectors of advanced economies. These arguments all assume that the human capital of employees is probably the most valuable corporate asset and that employees ought to be treated as residual claimants as are shareholders. As such, they note that corporate governance systems should give adequate attention to employees if the firms are to survive in an increasingly competitive environment. They throw serious doubt on the relevance of shareholder value maximization as the sole corporate goal, since the pursuit of this objective is unlikely to encourage employees to do their best to add to corporate competitiveness and value.

2.1.1. Protection of Firm-specific Human Capital Investment

Employees of a firm have made firm-specific investments that are at risk and need to be recognized and protected, just like the financial investments of shareholders.⁵ These investments are the source of “rents” or real economic surplus generated by the firm, and need to be fostered for the maximization of societal wealth. As employees “co-specialize” in a given firm together with shareholders, they are entitled to share the rents according to their contribution. However, under the current corporate model, firms are supposed to maximize the returns to shareholders after paying out all operating costs, including the rewards for the firm-specific human capital. In other words, more often than not, shareholders’ returns are pursued at the expense of the employees with firm-specific skills. This distributional practice is not only unfair to employees but is also inefficient, as firm-specific human capital investments, the source of rents, are not properly encouraged.⁶

What are the implications of this argument for corporate governance, ownership, and worker compensation? To ensure the maximization of the total wealth-creating potential of corporations, the board of directors should be accountable to the shareholders, employees and other parties who have made firm-specific investments that are at risk. As shareholders and employees are the two most important firm-specific investors, it makes sense to let the returns to the firm-specific human capital be tied to corporate profits through some mechanism of profit-sharing, or to let them have equity ownership as well. This would enhance the effectiveness of the board, as the incentives of these two classes of firm-specific investors would be better aligned.

⁵ Here, the firm-specific human capital investment is defined as “skills or knowledge or networks of personal relationships that are specialized to a given enterprise and that are more valuable in that enterprise than they would be in alternative uses” (Blair, 1996, p.8). Employees with firm-specific skills, like shareholders, share in the residual risk of the firm, as their compensation is not truly fixed and they may be laid off under a typical employment agreement that is imperfectly enforced legally.

⁶ The maximization of firm (share) value is grossly distortive as a guide of corporate governance or performance standards. This standard may lead to the premature closure of firms with substantial firm-specific human capital when the business environment becomes unfavorable. It is incompatible with the goal of social wealth maximization.

2.1.2. Emerging Governance Concerns in “New Enterprises”

The nature of enterprises has changed substantially over the last few decades, particularly in the high-tech industries. The body of physical assets as the major source of corporate value in large vertically-integrated enterprises has given way to human capital.⁷ Today, corporate success depends very much on the contributions of human capital expected of highly skilled and cross-trained workers, worker initiative, local information and self-regulation, horizontal communication, cross-functional development teams, and continuous improvement (Milgrom and Roberts, 1995). In these “new enterprises,” the major concern of corporate governance is to secure and retain valuable corporate assets such as employees’ human capital and customer or supplier relationships as well as capital of shareholders, and to motivate them to best contribute to the creation of corporate value (Rajan and Zingales, 2000b). It is not at all clear whether management should be solely, or even mainly, responsible to shareholders.⁸

Given more outside opportunities, employees with valuable human capital can easily leave the firm. Even if they stay with the firm, moreover, they may not do their best to contribute to the creation of corporate surplus by way of making firm-specific investment. Then, how can a firm motivate parties that have valuable assets that are not easily appropriated? One promising way seems to lie in allowing them to participate in corporate decision-making and to share in the corporate surplus through flexible wages, shared ownership and other mechanisms. The challenge is how to prevent them from claiming an overly large share of the surplus at the expense of other contributors, so that every party is motivated to remain loyal and keep making relation-specific investments with the firm. Entrepreneurs try to accomplish this task by resorting to a combination of contracts and the design of corporate organization and governance.

In firms where human capital is the most valuable asset, the corporate organization tends to be characterized by a flat hierarchy. This is what we see in most law, accounting, consulting, and high-tech firms.⁹ It is also the prediction of a theoretical model (Rajan and Zingales, 2000a), that focuses on the high expropriability of assets in human capital intensive firms (ideas, strategies, client lists, etc.), and claims that these assets are better protected in a horizontal hierarchy.¹⁰ In such firms,

⁷ Several factors have contributed to this phenomenon. The development of intermediate or capital goods industries has stopped corporate physical assets from being unique to any particular firms and led to the diffusion of flexible manufacturing. Increased competition has also made vertical integration inefficient, as it became increasingly difficult to make stand-alone firms excel in all segments of the vertically diversified firms.

⁸ This complexity of corporate governance results basically from the increasing difficulty in writing complete contracts, specifying rights and duties in all possible contingencies, with other corporate asset holders such as employees. Even with the most comprehensive employment contract, it is practically impossible for a firm to own or exhaustibly appropriate employees, or impose residual control rights over their human capital.

⁹ It should not be overlooked (as commented by Ronald Dore), however, that multi-layered hierarchies often exist not for functional-authority reasons, but to give scope to continuous promotion, precisely with the intention of retaining valuable human capital.

¹⁰ In firms with a steep vertical hierarchy, experienced employees have a strong motivation to become managers and make more firm-specific investments, utilizing their positional advantages (control over other skilled employees) to expropriate their know-how. In a horizontal hierarchy, (potential) managers

experienced workers can only be induced to make firm-specific investment by giving them a share of the firm's surplus. In human capital-intensive firms, corporate governance concern certainly involves much more than supervising top management to better align their interests with those of shareholders.

2.1.3. Stakeholder Theory of the Corporation

This theory views corporations as organizations where various stakeholders with diverse interests of intrinsic value accomplish their objectives in cooperative and competitive ways.¹¹ Among the many categories of stakeholders, employees stand out, along with shareholders, in terms of the magnitude of the "stake." The theory is often presented in three different forms—descriptive, instrumental, and normative (Donaldson and Preston, 1995; and Freeman, 1999). Descriptive stakeholder theorists are concerned with the observed reality of corporate behavior. They find that most managers are sensitive to the diverse interests of stakeholders and regard it as unethical to serve the interests of shareholders only. It also notes that "stakeholder management" is widely supported by institutions around the world, including co-determination in Europe, well-established business practices in Japan, and legal opinions and statutory law in the United States (as evident in the interpretation of the "business judgment rule" and determining the reasonableness of defense against hostile takeovers for the interests of employees).

Instrumental stakeholder theory tries to identify the connections between "stakeholder management" and corporate performance. The central tenet is that firms that give due attention to the interests of key stakeholders through mutual trust and cooperation will achieve better corporate performance, thanks to the constructive contributions of the stakeholders. However, identifying the relationships is not an easy task, though casual observations abound that successful firms tend to be sensitive to the interests of diverse stakeholders.¹²

Finally, stakeholder theory is often presented as normative ethics. It maintains that firms should treat stakeholders as an "end" and view their interests as having intrinsic value, giving attention to the legitimate interests of all appropriate stakeholders in fair and mutually supportive ways. Though capitalism is basically supported by individuals acting in their own interests, healthy capitalism is seen to stand on a solid base of high-level morality. One concern of "stakeholder management" is the difficulty in disciplining managers, as they have large room for discretion in managerial decision-making, and can justify self-serving actions on the pretext of serving certain stakeholders. However, the ethical guidance for corporate management cannot be based

do not have such positional advantages or the motivation to make firm-specific, value-adding investments.

¹¹ Stakeholders are defined as "any group who places demands on the company and on whom the company has claims" (Rhenman, 1968), or "those groups with a direct interest in the survival of the corporation; without their support the corporation might cease to exist" (Alkhafaji, 1989).

¹² Existing empirical investigations show no strong relations between "stakeholder management" and conventional performance measures. This result may be little surprising, since "stakeholder management" no longer single-mindedly pursues the interests of shareholders. However, the inadequacy of empirical evidence remains even despite composite measures of corporate performance reflecting the diverse interests of all stakeholders.

on pure ideals: in order to serve the “stakes” of stakeholders, firms have to remain viable, and generate adequate profits.

2.1.4. Emergence of “Shared Capitalism”

A new emerging trend, that is most conspicuous in the United States and United Kingdom, is the blurring of the traditional distinction between capital and labor (and for that matter, the distinction between management and labor as well). Employees are sharing the risk and profits of their firms through the ownership of equity shares and profit-sharing or gain-sharing plans, and are increasingly becoming involved in decision-making at the firm or shop-floor level. Many employees hold shares through employee stock ownership plans (ESOPs), pension plans based on defined contributions, and stock options.¹³ The modes of their participation in decision-making include partnership arrangements with labor unions and employee-involved councils at the firm level as well as autonomous work teams and quality circles on the shop-floor. These modes of employee participation foster a sense of ownership or partnership and a corporate culture of sharing, and thus encourage co-monitoring and teamwork among employees and innovative ideas. Obviously, this trend is driven by the market rather than by ideology.¹⁴

A critical question is whether this trend of “shared capitalism” will continue in the future. Though there will be ups and downs, there are reasons to believe that the trend will continue (Freeman, 2000). First, the sharing of financial returns and decision-making is likely to be dominant in the knowledge-intensive and high-tech sectors, where innovative ideas are critical for business success. As these sectors continue to expand, other more traditional sectors of the economy will also be affected. Second, young educated workers are attracted by the potential for attaining wealth through risk-taking by equity ownership. Finally, with increasing deregulation and globalization, corporations face growing competition and risk, which calls for the cushions of flexible arrangements of worker compensation (with more stable employment). This option should also help corporations by encouraging their employees to make firm-specific human capital investments.

¹³ In 1996, the percentage of American employees holding shares in their companies in the FORTUNE 1000 reached 45%, representing a significant increase from 26% in 1987 (Science Interviews, 2001). Also observed is the tendency of these different modes of employee sharing programs to go hand-in-hand. It means that these programs are mutually complementary in empowering the workforce. Empirically, they have a modest positive effect on the productivity of employees in addition to making them more satisfied and loyal to their firms (see Section 4 for the empirical studies).

¹⁴ Freeman observes that “shared capitalism” as a model is based on the following empirical propositions. First, people care about fairness and the well-being of other members of an organization. Second, sharing with the employees enhances fairness and economic justice, and it also increases employment satisfaction as well as their productivity. Finally, capitalism permits a variety of institutional forms and distributive outcomes (Science Interviews, 2001).

2.2. The Changing Socio-Economic Environment

2.2.1. Democratization and Labor's Voice

There has been remarkable progress in democratization in East Asia in recent decades. To a varying degree, this has contributed to a greater voice for workers.¹⁵ These developments are largely the result of successful economic development that gave rise to the growth of educated middle classes as well as organized workers (Diamond and Plattner, 1998). Globalization, by increasing flows of information and economic interdependence across countries, also puts continuing pressure on governments to make more democratic reforms.

Korea and Taipei, China ended their authoritarian regimes in the latter half of the 1980s. They demonstrated that soft authoritarianism, aiming at both political stability and economic development, could be an alternative path to democracy, though the management of the transition was not necessarily smooth. In Taipei, China, significant progress toward democracy was made in 1986 when the formation of opposition parties was allowed; the first direct presidential election was held in 1996. In 2000, an opposition leader who had once been a human rights activist was elected president (Clark, 2000). Korea had a similar path with the Declaration of Democratic Reform in 1987, which led to the first direct presidential election in more than 15 years and the revision of labor laws as well as the symbolic jailing of two previous presidents for the illegal acceptance of political contributions following the election of a civilian president five years later.

The Philippines and Thailand were ahead of other countries in the region in instituting Western-style democratic institutions, though they did not have much success in promoting viable political parties and other institutional consolidation. However, the authoritarian rule in the Philippines beginning in the early 1970s ended in 1986, when Ferdinand Marcos was overthrown by the People's Revolution. In Thailand, the democracy movement of 1973 survived a non-democratic power alliance among the military and bureaucracy (and later big businesses) and many coups, to see the better functioning of political parties, emergence of NGOs and other institutions of civil society. In 1998, Indonesia ended an authoritarian regime that had been led by two charismatic leaders for over 30 years. In spite of the current instability, many improvements have been made toward lifting restrictions on the media, making the parliament better represent the people, making elections fairer, and limiting the potential abuse of power by the top leadership (Masters, 1999).

The leaderships of Singapore and Malaysia have posed an ideological challenge to the Western ideal of democracy on the basis of their economic progress. Government is often claimed to be a trustee of the people's welfare, empowered to make broad judgments for the long-run interests of the people. As long as this custodian role is performed well, and tested by regular elections, it was argued, some restrictions on the roles of the press, parliamentary opposition, open criticism, and

¹⁵ The postwar efforts toward democracy failed in most of the newly independent countries of this region due to unfavorable socio-economic conditions, weak political institutions, and nationalistic drives for economic development. However, popular sovereignty has increasingly called for the legitimization of the regimes, together with institutional reforms allowing fair elections, the growth of opposition groups and civil society, and reduced control over the media.

judiciary could be tolerated. In spite of these restrictions, changes will occur in these countries, reflecting the preferences of people who are increasingly wealthier, more educated, and probably more sensitive and open to global norms and perspectives (Means, 1996).

Labor workers and unions have not necessarily been successful in organizing and asserting their demands at the national or corporate levels. In the newly industrializing economies, government efforts to maintain labor peace and competitive wages have typically resulted in state-employer alliances against unions, or tripartite cooperation with co-opted unions, as seen in Singapore. Globalization has also resulted in a rise in state-employer bipartism, particularly in the less industrialized countries. Moreover, the Asian economic crisis of late 1997 has seriously weakened the bargaining power of labor. Nevertheless, the voices of workers will be strengthened in the long run with the progress of democratization, as seen dramatically in Korea and, to a lesser extent, Taipei, China. Also, beyond a certain level of industrialization, the strategy of containing wage increases and raising numerical flexibility in employment will be increasingly ineffective and self-defeating. Employers are likely to recognize the importance of strengthening employee commitment to greater work efforts and more firm-specific human capital investment, which will inevitably lead to a stronger voice for workers.¹⁶

2.2.2. Weakening Family Control of Businesses

The Asian crisis clearly exposed the structural weaknesses of family-controlled business groups in the region. In Korea, the bankruptcies of major business groups were largely responsible for the undermining of the confidence of international investors and creditors in the Korean corporate and banking sectors. These groups were characterized by overly ambitious investments, predominantly financed with debts in expectation of a government bail-out when things went wrong.¹⁷ Generally, the relative positions of these groups and the unchallenged position of families in the governance of these groups are likely to be substantially weakened in the wake of the crisis. First, many went bankrupt, while others are in the process of reorganization or disintegration into pieces. Secondly, the equity shares of controlling families in many of their subsidiaries have declined considerably as a result of new capital injections by foreign investors or the governments, as well as capital write-offs usually required before recapitalization, or debt-equity swaps by creditor banks as part of workout programs. In some cases, creditor banks forced the family owners to give up their managerial control.

¹⁶ In countries pursuing “market socialism,” such as China and Viet Nam, workers lack an autonomous voice or the right to strike. Though union organization is largely compulsory in China, unions usually work as a “transmission belt” for state/managerial decisions without exerting much influence either on national policy-making or firm-level decision-making. Foreign-investment corporations often get union-free deals from local governments, but may face “wildcat” strikes that ironically have prompted the state to encourage collective bargaining (Frenkel and Peetz, 1998).

¹⁷ This behavior might be explained by the symbiotic relationship between the government and large businesses together with efforts to maximize the interests of controlling families often at the expense of outside shareholders (Nam, 2001a and 2001b). However, bail-outs became increasingly burdensome due to financial deregulation and the sheer magnitude of the required rescue operations.

The ongoing reform of corporate governance, undertaken as an important component of post-crisis policy, very much constrains the pursuit of family interests at the sacrifice of outside shareholders. The board of directors has been revitalized, the rights of minority shareholders strengthened, and rules for accounting, auditing and disclosure improved. The governance role of large family-owners is clearly declining, in what is potentially a change for the better. However, this potential gain may not be realized unless the role is taken up more efficiently by other stakeholders. Surely, with corporate governance reform along the Anglo-American model, outside shareholders have gained more effective tools to protect their interests.¹⁸ Banks may also be able to play their monitoring and governance roles better, since they are less subject to government intervention in their operations and less burdened with non-performing loans. Banks now actually have a stronger motivation to monitor many of their corporate clients, since they have become shareholders of these firms as a result of debt-equity swaps.

Nevertheless, there is no assurance that these new institutional reforms will bring about any significant strengthening of corporate governance. It is well known that even in Anglo-American corporations, the board of directors with a majority of outsiders does not play any substantive role except in the selection of new CEOs. We are even less optimistic about the working of the model in the East Asian setting, where industrial concentration is high and familial and other informal ties are very strong, encouraging people to avoid open conflict in favor of harmonious personal relations and “face saving.” Furthermore, the Anglo-American model, which is based on shareholder sovereignty and market discipline, is premised on a well-developed capital market infrastructure. It will take some time for East Asian developing countries to meet this requirement of institution-building. The same may be true for creditor banks if they are to play a significant role in corporate governance. Many major banks are (back) in the hands of the government as a result of recapitalization with public funds. It may be difficult to establish autonomous and stable bank-business relationships, which are a prerequisite for an efficient governance role, before the health of banks is restored.

If we do not have full confidence in the governance role of minority shareholders and creditor banks, another possible candidate among the major stakeholders is employees. Employees still do not play any significant governance role in East Asian developing countries. The patriarchal character typical of the chairmen of family-controlled business groups has been an impediment to the promotion of a voice and participation in corporate decision-making for employees. In the wake of the crisis, however, the controlling families of large businesses have been heavily discredited for their mismanagement and preoccupation with family interests. Workers are particularly discontented, feeling that they are the major victims of the crisis. It is very likely that employees will ask for a larger role in corporate governance commensurate to the risk they bear (probably at some later time, when they regain their bargaining power that has been weakened after the crisis).

¹⁸ They include requiring outside directors on the board, introducing a cumulative voting system for the selection of directors, and relaxing the criteria for the exercise of shareholder rights such as derivative suits, petitions for dismissal of a director, and proposals of the agenda for shareholders’ meetings.

2.2.3. Emergence of the “Knowledge Economy”

The diffusion of computers and information/communication technology (ICT), together with progress in globalization, has accelerated the arrival of a “knowledge economy.” The advancement of ICT has accelerated innovation in various aspects of corporate activities, changing the ways corporations do their businesses and organize their work and structure. It is not yet clear how prevalent “new enterprises” will be in the East Asian economies. East Asian enterprises generally lag in this new trend, though some have demonstrated their capability in selected areas, and vigorous efforts are being made to reduce the gap.¹⁹ Most likely, the “new enterprises” may have a spill-over effect on “old enterprises” which will in any event have to deepen their knowledge intensity. Unlike the Silicon Valley model, the distinction between “old” and “new” enterprises may not be sharp in East Asia, as they often operate side by side within large business groups. In this case, new practices of corporate governance with significant employee involvement are not likely to be limited to a small segment of the economies.

Given East Asia’s past track record of flexibility and adaptability as well as its relatively high quality of human capital, such efforts are likely to pay off with the growth of many firms making the best use of technologies. Microsoft Chairman Bill Gates is optimistic in this regard.

“Microsoft considers Asia the world’s fastest growing region in term of adoption and consumption of new technology. By 2003 there will be 63 million Internet users in Asia (up from about 20 million today) generating more than US\$ 32 billion of e-commerce, mainly supplied through broadband services. Countries like Korea and Taipei, China have around 20% Internet penetration already, with Japan and Singapore growing rapidly. By the end of 2001, China will rank as the world’s third largest market for PCs and in this time the country’s Internet usage will double to 20 million. We are incredibly optimistic about the future of Asia, because its countries are rapidly increasing their investment in the technologies and infrastructure needed to connect businesses, governments and educational systems. The opportunities for Asia to become a driving force behind the digital economy on the global stage are tremendous.” (Microsoft Corporation, 2000)

With their accumulated experience and technical capability in duplicative imitation, many firms in the East Asian NICs in the 1980s and 1990s were increasingly involved in creative imitations such as design copies, creative adaptations/improvements, and the adaptation of new technologies to local markets or other industries (as were Japanese firms after World War II). This usually required successful learning through substantial R&D investment as well as benchmarking and strategic alliances. Growing out of this stage, some leading enterprises in the region have successfully demonstrated a capacity for innovation, introducing new products in such selective areas as semiconductors, other electronics, and biotechnology. The success of East Asia in

¹⁹ Korea, Singapore, Taipei, China, and Malaysia are the largest producers in the developing world of ICT goods including electronic data processing, consumer audio and video, and components. They are, however, substantially behind the world leaders in software and services. Singapore, Malaysia and Korea have invested heavily in relevant infrastructure. Malaysia’s well-publicized Multimedia Super Corridor aims to attract foreign companies for major advances in information technology and Internet systems. Similar efforts are being made by the Korean government, which is pushing a Media Valley project. In Singapore, investments are geared at promoting multimedia software and entertainment as well as quick-response manufacturing services. Also underway in most of the region is deregulation to lower the barriers to related industries (*Business Week*, 1999).

technology learning demonstrates the importance of an outward-oriented industrialization strategy, strong government leadership with vision and supporting policies, and the expansion of higher education (Kim, 1997).

These attributes will continue to play a significant role in the arrival of the “knowledge economy” in East Asia. It is argued that innovation is best encouraged where organizational integration and insider control are ensured (O’Sullivan, 2000; and Lazonick and O’Sullivan, 1997). The most important corporate investments are those in human resources willing to commit their skills and efforts to the collective learning and accumulation, with the expectation of sharing the gains from the innovation. In order to ensure that strategy and learning can intimately interact with each other for the best results, the power of strategic decision-making needs to be in the hands of core members of a corporation, who are integrated into the organizational learning process of innovation. This inside control is particularly important for industries whose competitiveness depends heavily on the integration of shop-floor workers in the organizational learning process. If East Asian enterprises are to accelerate the formation of their innovative capacity, they will have to pay more attention to the governance role of their essential employees.

2.3. The Japanese Challenge: Employee Sovereignty

The formal participation of employees in corporate governance was first led by their representation on boards of directors in Germany. However, more broad-based worker participation in Europe was experimented with in Norway and Sweden in the context of industrial democracy. In Norway, works councils, production councils, and worker-recommended representatives on the board of state-owned enterprises were instituted by the 1950s, as part of an experiment with the “socio-technical system” originally proposed by a British institute. The idea is that the highest efficiency in production cannot be obtained by the best technical system alone, but requires the joint optimization of technical and social systems, to adequately deal with such problems as the alienation of labor and worker resistance to repetitive, monotonous manual work. Worker participation in corporate governance at the top level, such as in the board of directors, was not perceived to be very effective without the support of the involvement of workers in decision-making on the shop-floor. As the result, great emphasis was placed on increased worker autonomy (industrial democracy from below), job redesign toward a more human touch, and on-the-job learning (Akaoka, 1989).

However, this experiment was better received and widely undertaken in Sweden beginning in the 1970s. There, managers were generally less concerned about their prerogatives being challenged by workers. In essence, the Scandinavian model of worker participation was pursued in the context of industrial democracy or a social compromise between managers/capitalists, who were concerned about worker productivity, and workers, who wanted to have a stronger voice and bargaining power. It contrasts with worker participation in Japan, which is deeply rooted in socio-cultural tradition, and possesses a set of complementary institutions and practices. The roles and positions of employees in Japanese enterprises have traditionally been very different from those in Western firms. It is often claimed that the reality in large Japanese firms is the *de facto* sovereign power of employees, in sharp contrast to the shareholder sovereignty of American companies.

“The firm belongs to the people who have committed themselves to it for long periods. They have the right to make the decisions of basic importance to the firm, and they have priority rights in the distribution of the economic products of the firm’s activities” (Itami, 1994).

Consequently, Japanese firms have distinct characteristics in terms of the patterns of sharing major corporate resources and power—information, value-added and decision-making authority. Information tends to be more widely shared by managers and workers alike, and differences in status and salaries between them are also relatively small. Under this bottom-up management style and *de facto* delegation, employees are very much encouraged to make autonomous decisions related to their work. They have a stronger influence on higher-level strategic decision-making, despite the fact that their representation in formal governance mechanisms may be as limited as in American firms.²⁰

The Evolution

In Japan, several historical trends seem to have contributed to the weakening of capitalists and the emergence of a managerial control relatively free from owners (Nishiyama, 1983). In the 1930s, in order to finance large investments for militarization, family-controlled business groups, the *zaibatsu*, started to offer their stocks to the public. After the war, the Allied Powers dissolved the *zaibatsu*, and banished their top manager-owners from the business world. A further diffusion of equity shares occurred with the large-scale mobilization of capital during the high-growth period of the 1950s and 1960s. While capitalists were alienated, labor power led by white-collar elite middle-managers emerged after the war, in the midst of threat of starvation. This was also helped by the initial encouragement of the Supreme Commander for the Allied Powers, and the popularity of Marxist ideas.

The formation of “corporatism” in Japan, is often argued to have its origins in the house masters and employees in Tokugawa (Edo) and early Meiji family businesses (Iwata, 1992).²¹ Merchant houses had their shops and households separated, and business matters were largely left to the managers (*bantō*) and salesmen (*tedai*), who could even force the master to retire from the business with the consent of other family members.²² Later, when Japanese firms underwent structural changes along the lines of

²⁰ American corporations, in contrast, typically have top-down, centralized management with information and decision-making power very much concentrated at the top and a clear distinction in status between managers and workers. Even the distribution of corporate value-added is fairly skewed toward a limited number of top managers, who have large salary differences with ordinary employees.

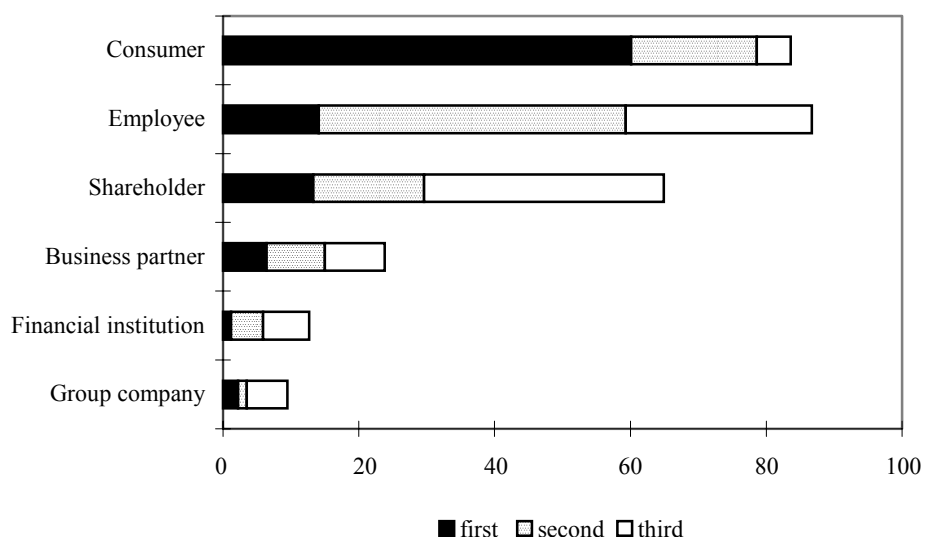
²¹ Murakami (1978 and 1987) traces the origin of Japanese-style management from the *ie* system of *bushi* society in the eastern part of Japan in the eleventh century. The main characteristics of the system include life-long membership, the succession of the *ie* on genealogy (as a symbol of unification), a functional hierarchy with emphasis on performance and flexibility in job allocation, and the autonomy of the *ie*. Dore (1973) argues that even though few of the features of Japanese system are direct institutional legacies from the feudal period, the conscious choice of institutional innovation has reflected the Confucian ideology prevailing in the late 19th century. This ideology is characterized by a belief in benevolence and trust in evoking loyalty and accountability, with importance attached to public reputation together with efficiency, profits and business expansion.

²² There were differences among the major *zaibatsu*. For example, the owners of those that emerged after the Meiji Restoration, such as Mitsubishi and Yasuda, tended to have direct and powerful control

the Western capitalist system, many distributed substantial ownership shares to employees. Some employees were promoted as directors (with stocks borrowed from controlling shareholders). The Japanese bonus system for all employees dates back to the Tokugawa era. These practices clearly indicate that employees were recognized as legitimate business partners, not easily replaceable productive factors.

How strong is the tradition of employee sovereignty in Japanese enterprises? According to a 1993 survey by the Japan Association of Corporate Executives (JACE, 1994), a large proportion of top managers in large Japanese corporations view the *improvement of employees' welfare* as the most important managerial goal (35.9%), a figure much larger than the share for *pursuance of capital gains for shareholders* (3.8%). Likewise, JACE (1999) from a 1998 survey reports that Japanese corporate directors see *employees* as a more important stakeholder (1.6 points) than *shareholders* (1.1 points), while *consumers* are considered to be most important (2.2 points).²³ This perception of Japanese managers, however, seems to have changed substantially in recent years (see Figure 1 and the following section on *signs of stress and lessons for other Asian economies*).

Figure 1. Perceptions of Directors on Importance of Stakeholders: Japan (1998)



Note: Respondents include 1,200 directors in corporations whose shares are traded in the Stock Exchange or the over-the-counter market, or in other member companies of Japan Association of Corporate Executives.

Source: Japan Association of Corporate Executives, *White Paper on Corporations*, 1999.

Main Characteristics

With the integration of employees into corporations, Japanese firms have been viewed as a “unified body of employees” (Matsumoto, 1983; Dore, 1992; Miwa, 1996). In these enterprises, the stake of employees is seen to be of paramount importance, making

over management, while ownership and control was more separated in the older *zaibatsu* like Mitsui and Sumitomo.

²³ The score for each stakeholder was calculated by giving a weight of 3, 2, or 1 for the share of respondents who said the stakeholder was most important, second most important, or third most important, respectively.

them the *de facto* controlling group of the firm.²⁴ This means that large Japanese corporations are relatively free from shareholder control, and are in practice a community of employees, making employees more willing to bear the risks and share the fruits of corporate activities. As employees join the management through the promotion ladder, a strong sense of unity and partnership is inspired for the body of employees, including themselves. The CEO and managers tend to listen more carefully to employees and their representative organizations, to which they themselves formerly belonged.²⁵ The followings behavioral characteristics are the consequences of this corporate culture.

- There are relatively small differences in status and treatment between managers and workers as well as between white-collar and blue-collar workers.
- Enterprise unions are the prevalent form of union, and they are generally cooperative with management being less resistant to wage restraints or corporate restructuring.
- A broad range of skills is effectively developed through job rotation under the seniority-plus-merit (*nenko*) principle in pay and promotion.²⁶
- Increases in market shares and business expansions, which raise job opportunities for employees, are more important than profits to shareholders as a corporate objective.²⁷
- Workers generally have a strong commitment, and programs for voluntary employee participation in corporate decision-making tend to be prevalent and effective.
- There is little separation between management and control (board authority). Long-term associations and shared experiences within the same firm among most of the directors make the board practically an extension of management (see Table 1).²⁸

²⁴ The “controlling group” may be defined as that “which has the power to set the terms of membership for all the participants and selects the basic value criteria that will be employed in making decisions and choices among alternatives” (Simon, 1976).

²⁵ In Japan, over three quarters of executives are recruited from employees who have been promoted inside the firm, while only 35% are promoted from outside, as in the case of American firms (Yashiro, 1995).

²⁶ In larger Japanese firms, worker productivity rises relatively quickly with tenure reflecting intensive and continuous on-the-job training. However, as substantial firm-specific human capital investments are made (and productivity rises fast) in the early years of employment, wages often do not rise fast enough to keep up with productivity gains. This is the result of sharing the cost of firm-specific human capital investment between the employer and employees, given the uncertainties for both side about continued employment of the worker as well as the performance result of the investment. Okazaki (1993) finds that the wage profile in large Japanese firms is flatter than the productivity profile until the age of around 45, but that after that age, wage continues to rise even though productivity decreases.

²⁷ Miwa (1996) finds that large Japanese firms usually do not increase dividend payments even when their profits increase substantially. Many firms also diversified in their heydays for the purpose of creating job opportunities for their employees. Naturally, they are not greatly interested in M&As, which would create few jobs for their employees.

²⁸ Almost 80% of all Japanese corporations have no outside board members, and another 15% have no more than two outside board members (Monks and Minow, 1995). A 1998 survey shows that among

Corporate Governance

As the major stakeholder, employees need to be given a governance role and a voice on issues such as job design, work organization, technology choices and compensation, some of which are usually regarded as managerial prerogatives. Otherwise, they would not be strongly motivated to involve themselves in efficiency-enhancing practices on the shop-floor. Japanese workers seem to have participated actively in decision-making at various levels on issues related to their work and employment: shop-floor activities, collective bargaining, and corporate governance (mainly through joint labor-management committees). Since these issues are interrelated, it natural that they participate at all the levels, even though the intensity of participation has varied (Koike, 1999; Nitta, 1988; and Ujihara, 1989). However, questions remain: how could the body of employees secure and defend their interests from other stakeholders, particularly shareholders; and what checked them from abusing their power and creating ‘soft-budget’ problems including excessive compensation, lower work efforts, resource waste and distorted investment decisions?²⁹

Table 1. Share of Executives from Outside for Listed Companies: Japan

Level of Executives	Total Number of Executives	Those from Outside				
		Total (%)	Banks	Government	Top Nine Trading Cos.	Others
Chairman	1,013	325 (32.1)	56	34	12	223
Vice Chairman	81	25 (30.9)	4	4	1	16
President	2,429	871 (35.9)	134	66	68	603
Vice President	1,191	333 (28.0)	102	58	22	151
Executive Director	2,991	772 (25.8)	206	94	37	435
Managing Director	6,990	1,701 (24.3)	415	238	95	953
Counselor & Director	258	104 (40.3)	13	12	2	77
Director	15,945	3,523 (22.1)	593	227	237	2,466
Auditor	9,033	3,540 (39.2)	836	328	177	2,199
Total	39,931	11,194 (28.0)	2,359	1,061	651	7,123

Note: Samples include all 2,432 Exchange-listed companies in 1998.

Source: Toyo Keizai Shinpo Sha, *Kigyo Keiretsu Soran*, 2000.

almost 40,000 executives serving 2,432 companies, 72.0% were promoted within the corporations (a slight decline from 75.6% in 1990), while those from creditor banks and other corporations and retired government officials, respectively, represented 5.9%, 19.5%, and 2.7% (Toyo Keizai Shinpo Sha, 2000).

²⁹ Aoki (1988) views Japanese firms as a coalition of two dominant stakeholders—shareholders and quasi-permanent employees. The main task of top management is mediation between these two groups in creating and distributing the organizational quasi-rent. Like shareholders, core employees are residual claimants, as their future income, promotion, and employment status depend on the health of their company. Labor unions are interested in participating in top-level strategic decision-making to ensure the fairness and efficiency of the distribution of organizational surplus among shareholders, employees and future investment.

Table 2. Attributes of Representative Directors with or without Union Experience: Japan

	Experience as Union Officials	
	Yes	No
Number of Managers (%)	31.9	68.1
• Average Age	60.6	60.4
• Position when Entered the Company (%)		
- Just Graduated	76.1	50.1
- Moved from Another Company (Non-Director)	9.8	23.2
- Joined as Director	14.1	26.7
• Length of Service (%)		
- Under 10 Years	12.6	25.5
- 10 to 30 Years	6.5	17.7
- More than 30 Years	80.9	56.8

Note: Based on a questionnaire survey conducted in January / February 1999 where 1,211 representative directors in 731 Exchange-listed companies (55.9 % of the total listed companies) responded. 637 firms (87.1% of the responding firms) had labor unions. The same survey asked their views toward companies. 85% of the respondents replied positively to the statement “managers need to seriously consider the interests of other stakeholders than shareholders,” while only 34% said yes to “the role of managers is to pursue profit maximization for shareholders.” 57% responded negatively to “companies belong to shareholders, and employees are just one of productive factors.” The views were not significantly different between directors with and without union experience.

Source: Fujikazu Suzuki, “Corporate Governance and Labor Union” (in Japanese), *Corporate Governance in Present Japan*, Takeshi Inagami (Edited), Toyo Keizai Shinpo, 2000.

Friendly shareholders or corporate alliances. In Japan, suppliers, banks, trading companies and dealers of a firm often form *friendly shareholders* (*antei-kabunushi*). They participate in the cross-holding of shares as a token of good will or commitment as business clients, and collectively hold large shares of equity (Miwa, 1996).³⁰ Similarly, the role of a limited number of allied firms, or *keiretsu*, with a close and stable long-term relationship is also emphasized (Itami, 1994). This long-term relationship can be efficient since it allows better communication and flows of information, discourages opportunistic behavior, promotes cooperation and a fair distribution of profits, and reduces business uncertainty.³¹ Friendly shareholders or affiliated companies usually form a stable group of owners and remain supportive of

³⁰ Blocks of equity shares held by friendly and stable shareholders, including business partners and financial institutions, represented 48% in 1990 before steadily declining to 38% in 1999. Of these friendly/stable shareholdings, cross-holdings represented 21% in 1990 and 11% in 1999 (Inoue, 2000).

³¹ Kato (1997) finds that the CEOs of keiretsu firms earn substantially less than those of independent firms with otherwise similar characteristics, and are rewarded for promoting capital investment and thus the growth of the firm (which benefits the main bank). This result is interpreted to support the “monitoring and control” view of corporate groups: the top managers of keiretsu firms are more effectively monitored than independent firms because the system of main bank monitoring tends to be more effective than the market for corporate control in Japan.

existing management, thus serving as an effective defense against hostile takeovers. They remain friendly partly because they are mutual hostages through cross-shareholding, and partly because the ownership stability (and associated relation-specific assets) helps their business (Miwa, 1996). As a result, this relationship holds the risk of being biased against necessary changes.

Monitoring by main banks. Japanese main banks are believed, through their efficient monitoring activity, to have played an important role in mitigating unique incentive problems (soft-budget discipline) resulting from insider control. Main banks, with the integration of monitoring by phases, a substantial equity stake, and often a representation on corporate boards, had good access to vital information about their client firms. The arrangements of loan syndicates and delegated monitoring among major banks, together with the implicit obligation of main banks to bear a disproportionate share of the costs of restructuring in cases of loan defaults, provided strong monitoring incentives to them. The possibility of a main bank being captured by the interests of insider-controlled borrowing firms should have been low, even in cases where the client firms were members of the same *keiretsu*. The contingent governance scheme (main banks' intervention in, or takeover of, management in the event of financial distress among borrowing firms) also provided a strong threat for the punishment of poorly performing firms (Aoki and Kim, 1995).³²

Disciplinary role of insiders (the internal labor market). Since they have a large stake in their firms and the expectation of lifetime employment, workers' loyalty and commitment is directed to the firms rather than personally to managers. This explains why any significant abuse of managerial power is likely to ignite a rebellion among subordinates (Iwata, 1992). Employees and their representative organizations are expected to exercise checks on management with a view to defending the long-term viability of the firm (Fujimura, 1997). CEOs usually feel overseen by their own employees and are under strong peer pressure to protect their well-being and lifetime employment (Yoshitomi, 1997). The bottom-up consensus method of decision-making prevalent among major Japanese firms may also be seen as a way of exercising this disciplining role (Nakamura, 1997).³³ On the other hand, discipline has been imposed on workers by the mechanism of "life-long" competition within firms. Through job rotation and on-the-job skill formation, employees undergo a long process of evaluation by many supervisors, which minimizes the problem of free-riding and shirking in their work. Depending on the results, they get speedy promotion to managerial positions, move to affiliate firms, or are forced to leave, and large earnings differences are apparent at the age of around 50 (Yoshitomi, 1997).

³² Empirical evidence on the effect of main banks on the performance of client firms is generally, though not overwhelmingly, positive, at least before the 1980s. They include Tomiyama et al. (2001), Small and Medium Size Enterprise Agency (2000), Lichtenberg and Pushner (1992), Kang and Shivdasani (1997), Kaplan and Minton (1994), and Kaplan (1994) for positive evidence, and Nitta (2000) and Randall, Nakamura, and Shivdasani (2000) for negative evidence.

³³ Even on such difficult issues as corporate restructuring, management usually succeeded in persuading the union to agree to the crucial elements of the plan, while unions could reflect their concerns in the specifics. As main banks' role in monitoring corporate management has weakened since the mid-1980s (due to reduced reliance on bank credit by major enterprises), an increased role is called for by employees and enterprise unions (Fujimura, 1997).

Table 3. Union Experience of Representative Directors: Japan

	Experience in Single or Head Unions		Experience in Branch Unions	Sub Total	No Union Experience
	Top 3 Officials	Executive Committee Member			
Characteristics of Representative Directors					
Career Type	Internally Promoted	5.7	6.9	12.5	25.1
	Joined as Director	1.8	1.0	1.3	4.1
Managerial Position	Total	7.4	4.5	12.5	24.4
	President	0.1	0.8	1.9	2.8
	Vice President	1.4	1.5	1.3	4.2
	Executive Director	3.2	1.9	3.5	8.6
	Managing Director	2.7	0.3	5.8	8.8
Characteristics of Sample Firms					
Number of Employees	Less than 3,000	6.9	6.0	7.9	20.8
	3,000 – 9,999	1.4	1.0	4.2	6.6
	Over 10,000	0.1	0.3	0.5	0.9
Management Characteristics or Group Affiliation	Managed by Owner	1.6	2.0	1.8	5.4
	Main Company of a Group	4.7	3.7	4.2	12.6
	Affiliated or Related Company	1.5	1.1	2.3	4.9
Businesses Undertaken	Manufacturing	3.0	4.0	8.0	15.0
	Commerce	0.7	0.6	0.5	1.8
	Finance, insurance	1.9	0.7	1.0	3.6
	Construction	1.2	1.4	1.7	4.3
	Others	1.4	0.5	1.3	3.2

Note: The sample of the survey is the same as that of the Table 2.

Source: Hiroyuki Fujimura [2000], “Career of Managers and the realities of their remuneration,” *Corporate Governance in Present Japan* (in Japanese), Takeshi Inagami (Edited), Toyo Keizai Shinpo.

Signs of Stress and Lessons for Other Asian Economies

The rationality of employee sovereignty is said to rest on both economic efficiency and social acceptability (Itami, 1994). It allows a better alignment of interests between the firm and employees, encouraging them to raise the work efforts, participate and cooperate, and take a long-term view. It also leads to informational efficiency as employees on the shop-floor are likely to have informational advantages in production-related matters. Furthermore, employee sovereignty is viewed as socially acceptable, bringing about enhanced workplace harmony. This is because the firm-specific human capital of employees is the most essential asset for continued innovation and business success for post-Fordist enterprises (as opposed to earlier industrial firms where mass-production and hierarchical work organizations were the dominant modes, making physical capital the most valuable asset). It also gives fair treatment to employees whose risk and stake in their firms are even higher than those of shareholders.

Though this rationale is convincing, it does not necessarily mean that this is the best and most feasible model for other Asian economies. We also observe that this traditional Japanese model is undergoing change. JACE (1999) reports that, when asked who will be the most important stakeholder in the future, only 7.3% of responding directors said it is *employees*, while the share was 25.8% for *shareholders* (and 59.8% for consumers). Kikuchi and Hirata (2000) also report that 41.4% of Japanese non-financial corporations whose stocks were traded on the first section of the Tokyo Stock Exchange responded that the most important stakeholder was *shareholders*, while only 7.3% said it was *employees*.³⁴ Clearly, a change is occurring toward an increased role for shareholders in general.

This suggests that the internal control role of employees, combined with the monitoring role of banks and friendly shareholders, is no longer working very efficiently.³⁵ It is likely that the expansion-biased employee sovereignty model and the stability-biased external governance by friendly shareholders do not accord well with the slow economic growth and intensified global competition. To survive, firms must have a sharper focus on profitability, and be able to make necessary adjustments in their business relations and internal organization in a timely manner. Slow growth also means a shortage of managerial positions and this, together with the aging workforce and increasing share of highly educated women, has raised tensions in the internal labor market of Japanese firms. At the same time, with rapid and discrete advances in information and other technologies, enterprises have experienced a substantial mismatch of manpower, forcing them to turn to the external labor market for more mobile, general professional skills (Iwata, 1992; Yoshitomi, 1997).³⁶ This mean that employees, and

³⁴ It is not clear, however, to what extent this change in consensual views is a permanent one reflecting new perceptions about the efficiency or superiority of Japanese practices and systems, as opposed to a rather transitory one resulting from the prolonged economic recession and consequent widespread corporate financial distress.

³⁵ Itami (2000) notes that both the internal and external monitoring of managers has been ineffective, suggesting that there should have been a more formal mechanism, like board representation, for employees to participate in corporate governance. He also notes the malfunctioning of the Japanese model, including exorbitant and irrational practices geared to serve the interests of employees at the expense of shareholders and the neglect of R&D investment.

³⁶ The rapid development of information technology has led to radical changes in modes of production, services, work organization, and corporate management, together with changes in the required mix of

even those who might be considered as “core,” cannot be confident of rising to a managerial position and a long tenure with their firms, weakening the disciplinary role of the internal labor market.

The main bank system has also been under stress since the 1980s. As many of the better client corporations rushed to the capital market for cheaper financing, banks could no longer closely monitor these firms. Instead, they turned increasingly to smaller, less creditworthy firms and increased property-related loans backed by real estate. With the collapse of the asset bubble at the end of the 1980s, Japanese banks were loaded with many non-performing loans: it was probably tough for them to accurately evaluate all the new clients and projects, or they simply neglected their monitoring as the value of loan collaterals kept rising. As the banks fell into trouble, firms with close relationships with them suffered greatly, as they found it difficult to turn to other sources of finance. The implicit “insurance function” of main banks also seems to be weakening as banks can no longer afford to organize financial rescue packages (bearing a disproportionate share of the burden themselves) given that many client firms are in financial distress simultaneously (Spigel and Yamori, 2001; Economic Planning Agency, 2000).

Nevertheless, it cannot be denied that the Japanese model worked efficiently in the post-war high-growth period. Enterprises in other Asian economies should also learn to motivate their employees to invest in firm-specific skill formation and to give them an appropriate governance role as well. The major question concerns the model’s replicability. The Japanese model is a product of its cultural tradition, historical turns and twists, deliberate institution building efforts, and natural evolution from existing institutions. Many of these factors, including the fate of the *zaibatsu*, establishment of labor peace with the promise of lifetime employment, and presence of friendly shareholders, are relatively unique to Japan. As is the case for any corporate governance system, the efficiency of the model will depend on whether or not complementary institutions are in place, such as the internal work organization, and the labor and financial market institutions (Aoki and Kim, 1995). Since a piecemeal introduction of the complementary institutions would bring about only limited results, it may be infeasible or too costly to transplant the system.

Still, many East Asian countries share Confucian culture with its emphasis on benevolence, trust, harmony, and learning, and this might provide a fertile ground for building institutions favorable for the enhanced roles of employees. Aoki (1990) notes that the distinguishing features of Japanese enterprises include horizontal coordination among operating units based on the sharing of on-site information. He argues that this mode has advantages (over hierarchical organization) in that, among other things, workers’ learning ability is high, individualistic values are less prevalent with workers being evaluated by their contributions to organizational goals, and communication among operating units is easier. Workers in most Asian countries surely score high in

skills. In periods of major discontinuity and uncertainty in the process of technology development and innovation, as is currently witnessed with the IT revolution, the relative value of existing firm-specific skills and knowledge is bound to decline (Yoshitomi, 1996). Once the process slows down, however, allowing only incremental innovation on the basis of the newly accumulated skills and knowledge in ways specific to firms, the relative importance of employees with these skills and knowledge is likely to be restored. Technical change (R&D intensity) in general is known to be skill-biased (Machin and Reenen, 1998), which might also help restore the relative position of these core employees.

all these aspects. The lesson seems to be that, in order to survive in intensified global competition, Asian enterprises—within their existing institutional constraints—should try to balance the roles of shareholders and employees in corporate decision-making according to their comparative advantages, potential contributions, and stakes.

3. Types of Employee Participation in Corporate Governance

Workers have several channels through which they can participate in corporate governance. Participation typically involves worker representatives becoming involved in formal corporate governance mechanisms. One form is membership on the corporate board of directors, and another is works councils. Collective bargaining between management and labor unions, which is not considered as a formal governance mechanism, also has a significant impact on corporate decision-making. Also discussed in this section is a particular form of enterprise, the worker cooperative, whose ownership and control are in the hands of employees.

3.1. Industrial Relations and Labor Unions

The main objective of labor unions is to use collective bargaining to press management to provide greater welfare for workers, and they potentially affect the work life of employees a great deal. American unions generally have an inherent reluctance to become involved in corporate decision-making, as this has the potential to bring about complicated internal conflicts among their members and, thus, weaken their bargaining position against management. By sharing in managerial decision-making, employee involvement challenges the basis of union power because it can undermine worker solidarity and may end up limiting their freedom to fight for workers' interests as a whole (Hansmann, 1990; and Levine, 1995).³⁷

Nevertheless, labor unions cannot be ignored in discussing the governance role of employees because of their effect on the power of workers relative to management and the consequent dynamics of workers' roles. Labor unions, to begin with, may have substantial influence over the modes and agenda of representative participation such as the board of directors and works councils. Depending on how labor unions are organized (at the national, regional, sectoral, or corporate level), and how important issues such as wages and benefits are bargained at higher levels, corporate-level bargaining agendas tend to be determined as a residual. Secondly, labor unions affect the incidence and effectiveness of various practices of employee participation at the corporate and shop-floor levels. Unions, for instance, may directly represent workers on the board of directors and works councils, or, in the absence of formal representation, may still influence the outcome. Employee involvement programs on

³⁷ Levine (1995) notes three sources of union power in the traditional American workplace: an ideology based on worker solidarity, united against management; a detailed contract that limits managerial favoritism; and the set of detailed work rules that may be utilized as a form of job protest. Employee involvement in managerial decisions at the shop-floor or higher levels undermines these bases of union power. However, the flipside of the confrontational posture of labor in the Anglo-American world is the ideology of managerial prerogative that discourages initiatives that might lead to increased labor involvement at the expense of managerial autonomy (Charny, 1999).

the shop-floor may also be affected by labor unions either directly or through their effect on the level of trust between management and labor.³⁸

3.1.1. *Workers and Corporate Governance: Brief International Comparisons*

After World War II, industrial relations in various countries took different paths as a result of differing political responses given their market structures and political situations (Hiwatari, 1999). In many European countries, and most strongly in Germany, worker participation in corporate governance is legally mandated. Employees in large companies are represented on corporate *supervisory boards* in equal number to shareholders. German workers exert their influence at two other levels. One is *industry-wide negotiations* at the regional and national levels over worker compensation and other labor market policies. The other is *works councils* at workplaces, which serve as a forum of information exchange, deliberation and consensus-building between management and labor. These participatory mechanisms are interconnected and largely complement each other. For example, since important bargaining issues are largely settled outside the firms through industry-wide negotiations, works councils have less tension and fewer issues to disagree on, and help to create a more cooperative atmosphere at the corporate level. Labor is generally strong, and this influence typically extends to the political arena. This, together with the legally mandated role of employees in corporate governance, makes managers sensitive to workers' interests and committed to worker participation (Charny, 1999).

In contrast, American labor is denied any guaranteed role in corporate governance, which is considered to be an exclusive right of shareholders. Employee representation on the board of directors is rather exceptional, and is witnessed only in cases of worker buyouts or in other firms with significant employee ownership. The role of works councils is also limited, as American labor is generally reluctant to become substantively involved in corporate decision-making in an effort to avoid any weakening of worker solidarity. Labor unions are rather sparsely organized and often fragmented by divisions according to occupational category, resulting in bargaining weaknesses at the firm level. Given the existence of a governance role played by the market through hostile takeovers and institutional investors, on top of other internal governance mechanisms for shareholders, there has been little need to turn to employees for this role until recent decades.³⁹

In Japan, as well, employees do not have any assured role in corporate governance and have traditionally been little involved in strategic corporate decision-making. Nevertheless, through collective bargaining, joint labor-management committees and more informal arrangements, Japanese employees are known to have significant influence on corporate governance. The board is typically dominated by inside members promoted through the corporate hierarchical ladder, making the board

³⁸ Empirical studies, however, generally find no significant productivity effect of labor unions or union membership (Black and Lynch, 2000; Batt, 1999; and Kleiner and Lee, 1997).

³⁹ In contrast to the European pattern, collective bargaining and corporate wage setting are typically carried out at the firm level in the United States. The consequent confrontation and crowding of issues at the bargaining table are not conducive to promoting a cooperative environment between management and labor (Rogers, 1995).

and management fairly sympathetic to worker interests. Corporate governance has typically been guided by the interests of broader stakeholders, with relatively weak pressure to accommodate the interests of shareholders. Union sovereignty is maintained at the enterprise level.⁴⁰ Unions, which organize all core employees with virtual guarantees of lifetime employment regardless of their occupational categories, tend to be cooperative with management.

3.1.2. Labor in the Newly Industrialized East Asian Countries

It is a well-known fact that the East Asian NICs, including Korea, Singapore and Taipei, China, long repressed organized labor activities in the process of their impressive economic development. Relying mainly on export-oriented industrialization, based on labor-intensive manufacturing, the regimes considered it imperative to keep wages stable and maintain labor peace. Union registration rules have effectively blocked unions or union federations other than those allowed by the authoritative governments in Singapore and (until recently) Korea. Some issues of substantial interest for employees such as work assignments, recruitment, retrenchments, and dismissals, have been excluded from collective bargaining in Singapore and Malaysia. Collective bargaining has frequently been limited by government intervention, and political activities have been either prohibited outright or carefully circumscribed.⁴¹

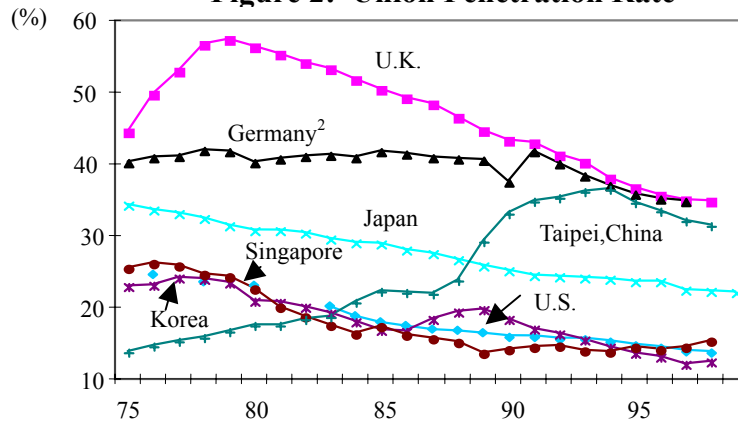
Industrial relations in these countries have been characterized as “authoritarian paternalism,” for Korea (Park, 1999) and “active patriarchalism” with the party-union (PAP-NTUC) symbiosis for Singapore (Woodiwiss, 1998; and Leggett, 1993), and the ruling elite has seen labor unions as “sources of political opposition” in Taipei, China (Frenkel, et. al., 1993). In return for the suppression of labor activities, the governments have directed major policy efforts to providing basic benefits such as medical insurance, housing, pension or severance pay, and enacting labor standards. Some also tried to engage represented labor in a national-level policy forum (but mainly to ensure the cooperation of labor in times of macroeconomic difficulty). The Singapore government has long had its co-opted union federation join the national-level tripartite council (the National Wages Council, NWC), though many doubt its legitimacy as representative of labor. In Korea also, the Tripartite Commission, made up of labor, management and the government, was launched in the early 1998 in the wake of a severe financial crisis (see Box 1).⁴²

⁴⁰ The dominance of enterprise unions in Japan was consolidated largely by the managerial offensive against revolutionary unionism after World War II, the institutionalization of the Spring Struggle (*Shuntō*) for industry-wide wage negotiations, and oligopolistic export industries that played a leading role in wage setting.

⁴¹ In China, unions are compulsory in the non-agricultural sectors but depend heavily on the political party both at the state and enterprise levels (Frenkel and Peetz, 1998). Further progress in democratization and industrialization/urbanization will be needed for China and other transforming economies in Asia to foster autonomous unions. In less developed Southeast Asian countries, including Malaysia, industrial relations are generally characterized by state-management bipartism at the national level and managerial unilateralism at workplaces, in a way that to a large extent is geared to attracting foreign direct investment. A strengthened role for unions in these economies will require further advances in democracy as well as upgraded industries that depend more heavily on innovative ideas and the commitment of workers rather than cheap wages.

⁴² The NWC of Singapore is responsible for recommendations on desired wage adjustments, labor dispute arbitration, and the deliberation of other social policies. The Council played a major role in

Figure 2: Union Penetration Rate¹



Notes : ¹ Union membership as percent of total employees. In the case of Korea, it is percent of employees eligible for union membership (defined as regular employees—civil servants—teachers). Daily workers also included from 1988.

² Germany represents West Germany only until 1990.

Sources: US, UK, Germany: Ministry of Labor, *White Paper on Labor Abroad*.

Japan: Japan Statistical Association, *Historical Statistics of Japan*; Management and Coordination Agency, *Japan Statistical Yearbook*.

Korea: Ministry of Labor, *Labor Statistics Yearbook*.

Taipei, China: Republic of China, *Statistical Yearbook of the Republic of China*; Frederic Deyo, *Beneath the Miracle: Labor Subordination in the New Asian Industrialism*, Berkeley: University of California Press, 1989.

Singapore: Department of Statistics, *Yearbook of Statistics*.

Before the Asian crisis, sustained economic growth and industrialization in East Asia had led to a fairly tight labor market and a substantial expansion of well-educated waged workers. Some of these countries had also experienced progress in political democratization since the second half of the 1980s. It is puzzling for many that labor unions in these economies remained relatively weak in spite of this favorable environment (see Figure 2 for the trend of union penetration).⁴³ Korea's union penetration rate declined to below 12% in 1999 after hitting a peak a decade earlier at almost 20%. In Singapore, the penetration rate dropped from around 26% in the mid-1970s to the 14-15% level since the late 1980s. In Taipei, China, the penetration ratio rose dramatically in the late 1980s and the early 1990, but had little to do with a real strengthening of labor.⁴⁴ Democratization and the emergence of opposition parties have

urging flexible wages and wage restraints following economic difficulties in the mid-1980s and the Asian crises in 1998 and 1999. The Korean Tripartite Commission was successful in working out a labor market reform program as an essential component of the post-crisis policy package, but has suffered from boycotts by labor representatives.

⁴³ The decline in union membership may be explained by the following three factors. First, globalization has undermined unions' influence on macroeconomic policy formulation and shrunken labor-intensive industries in advanced countries. Also, globalization in the Asian developing countries has either increased real wages substantially, or prompted the governments to restrict union activities with a view to attracting foreign investment. Second, lower economic growth and high unemployment have weakened the position of workers. Finally, changes in the labor market structure and increasing diversity in workers' interests have undermined worker solidarity. These changes have included: falling shares for manufacturing and blue-collar workers; increasing shares for young people with a more individualistic bent, women, highly skilled workers, and non-regular jobs; and disenchantment with politically motivated unions (International Labor Office, 1998).

⁴⁴ Multiple unions at the company level are to be allowed only after 2002. Unemployed or dismissed workers are not permitted to join labor unions, which is in contrast to most OECD countries, where the

led to an increased political interest in securing working-class support as well as competition in union elections in Taipei, China. Nevertheless, the capacity of unions to negotiate with employers and the government remains limited (Frenkel, et. al., 1993).

Box 1. Labor Unions in Korea in Recent Years

Launched with the mandate to come up with a social contract that would help overcome the economic crisis, the Tripartite Commission in Korea successfully reached agreements on such thorny issues as enhancing labor market flexibility, and moderate wage increases as well as a strengthening of the social safety net. Most importantly, in order to facilitate much needed corporate restructuring, redundancy layoffs were legalized with strengthened procedural restrictions, and temporary work agency (labor outsourcing) was formally introduced to induce lower labor costs and a flexible response to changing market demands.

In spite of the high visibility of frequent and violent disputes, Korean labor remains relatively weak with a dualistic structure. Unionized workers represent only 11.9% of total waged and salaried workers. They are mainly regular workers in large private and public enterprises. By contrast, most workers in small and medium-sized enterprises as well as temporary workers and day laborers are not unionized. The low union penetration, a dualistic structure in labor protection, and low job security characterize the Korean labor market. Corporate restructuring, labor market reform and changes in human resource management practices have resulted in extreme insecurity for Korean workers in recent years. Workers with a permanent contract represent less than 30% of the workforce, the lowest among OECD countries (OECD, 2001).

Union militancy in Korea seems to be the result of several factors. Often, the government has not been strong enough to have labor laws enforced and has intervened in illegal disputes only selectively. The result has been a low cost for illegal disputes and militant and hostile confrontation. Second, enterprises that suffered from the worst labor disputes have typically been those that enjoyed rents in monopolistic or oligopolistic markets or implicit protection from bankruptcies. They include public enterprises and large family-based business groups whose operation has been far from transparent and accountable to minority shareholders and employees. Third, while many Korean workers have lost their jobs since the outbreak of the crisis toward the end of 1997, they have been poorly protected by social safety nets. Finally, Korean labor regulations may still be in need of many improvements in order to meet international standards.⁴⁵

In spite of its militancy, Korean labor seems to remain pragmatic and is not ideologically oriented. Though its pragmatism may be yet to be tested, the ultimate character of labor cannot deviate much from the ideology of ordinary Korean people. Given the egalitarian nature of the society and the little evidence of class struggle, labor militancy is likely to be weakened with improvements in the conditions mentioned above. Casual observations are consistent with this view. In the wake of the political democratization in 1987, Korea saw a rapid increase in (mostly illegal) labor disputes. Soon, however, the growing middle-class showed its concern over militant and chaotic strikes, which often prompted the government to intervene. Other evidence for this view comes from the results of the last parliamentary election. Even though labor was granted its long-fought-for right to conduct political activities in 1996, the Democratic Labor Party created failed to get even a single candidate elected in the 1999 election.

membership qualification is usually determined by the unions themselves. In the public service, labor unions are denied such rights as bargaining and strikes, and only have the right to form consultative workplace associations. Finally, compulsory arbitration is required in rather broadly-defined "essential services" including those of banks, transportation, and oil supply (OECD, 2001).

⁴⁵ The union penetration rate rose sharply in Taipei, China from 26% in 1987 when martial law was lifted, to 37% in 1994, before sliding back to the 30% level by 2000. About 80% of union members belong to regional-based occupational unions, which mushroomed in the late 1980s after being acknowledged as the sole agents for government-subsidized labor insurance (Chu, 1996).

These economies have for the most part responded to increasing competitive pressure from market opening and globalization with cost-cutting measures such as relying more on temporary and contract labor, subcontracting, retrenchment, and threat of closures and relocation of production (Deyo, 1997; and Frenkel and Peetz, 1998). The resulting job losses and insecurity have greatly weakened unions' bargaining power and enabled the governments to enact or enforce tougher labor legislation. Several explanations might be given for this. First, traditional cultural values may be a fundamental impediment to the development of more advanced industrial relations. These values include the tendency toward authoritarian paternalism among older-generation entrepreneurs, respect for hierarchical authority, and avoidance of open conflicts (Frenkel and Peetz, 1998). Second, the legacy of past development strategies might still have a heavy influence. Labor unions, which were suppressed and co-opted throughout the earlier stage of industrialization, lack the political capacity to alter their position. Finally, these economies have mainly been engaged in the local adaptation of established technologies rather than innovation in the process of industrialization. This strategy does not depend critically on broad-based worker involvement at the expense of managerial control over the production process.

The situation of weak labor and a limited role in corporate governance will change slowly as these countries make further progress in democratization and come under increasing pressure to rely on the innovative ideas and dedicated efforts of employees for continued economic success. Short-sighted strategies are no longer appropriate, particularly for the Asian NICs, for it would delay their transition to higher value-added market niches and high-performance work organizations. New strategies should give priority to promoting employee participation and involvement as well as a more attentive human resource management and better labor standards and labor practices. Currently, employee involvement in decision-making remains relatively rare and autocratic in these countries, relying more on informal consultation and closely circumscribed deliberative forums rather than on open collective forms of participation (Deyo, 1997).

3.2. Representation and Deliberation at Works Councils

Works councils are "institutionalized bodies for representative communication between a single employer/manager and the employees of a workplace (single plant or enterprise)." The council represents all workers at a given workplace, irrespective of whether they are union members or not.⁴⁶ There seems to be increasing interest in works councils, given that traditional union-based representation is under pressure. Centralized industry-wide bargaining in Europe, where solutions are often reached as political compromises, has become increasingly irrelevant. The more decentralized system of collective bargaining in North America has also suffered from a continuing decline in unionization (12% of the private sector workforce). In this situation, the

⁴⁶ Work councils, however, may be organized to represent specific occupational groups such as blue-collar or white-collar workers, or may be functionally differentiated to deal with specific issues such as health and safety, training, and productivity. Moreover, as the councils may or may not include management as formal members, they lie outside the managerial line of authority.

councils have come to be viewed as more promising form of institutionalized representation at workplaces (Rogers and Streeck, 1995).

While works councils are legally mandated in some countries, they are also sometimes set up voluntarily by employers (*paternalistic councils*) often with a view to forestalling or undoing unionization, or are created by industrial agreement.⁴⁷ They can be differentiated according to how substantive their communications are. They may be *consultative councils*, where workers are involved in information exchange and consultation to enhance economic performance; or *representative councils*, where workers assert their interests and “industrial democracy” with some form of participation in managerial decision-making.

What benefits can be expected from works councils? Rogers (1995) proposes several potential gains: they can enhance work efficiency, promote workplace democracy, and improve regulatory performance. Higher efficiency can be attributed to increased information flows, the informational advantages of workers on the shop-floor, and changes in power relations. Increased information and communication between management and workers allows them better cope with problems faced at workplaces as well as those arising due to a changing business environment. Workers who have a better understanding of problems tend to be more devoted to tackling them, and to be more willing to make concessions when the firm is in difficulty. Worker contribution through decision-making on the basis of local knowledge is expected to be largest when the uncertainty at workplaces is neither very low nor very high (Aoki, 1990, 1988). Furthermore, as workers have greater control over the use of the shop-floor information they possess, they will be more willing to share it with management. At the same time, though management action is likely to be constrained or delayed by consultations in the council, this might be compensated for by a higher efficiency in making decisions.⁴⁸

Second, works councils provide workers with the opportunity to express their interests. For many firms without labor unions, the council is the only formalized option for the promotion of workplace democracy and collective representation. Workers, who gain a greater voice in shop-floor decisions, can check unilateral management decision-making leading to higher efficiency at workplaces. Finally, works councils can serve as a powerful mechanism for the better enforcement and higher efficiency of public regulation. Given the existence of numerous workplaces and employees in an economy, the enforcement cost of rules and regulations at workplaces can be enormous, often resulting in regulatory failures due to inadequate means of enforcement. Works councils, which are composed of parties that have the motivation and means of monitoring and enforcement, are in a position to perform this job. They can serve as “competent enforcement agents,” making regulation work in ways respectful of local variation,” and facilitate the achievement of public goals (Rogers, 1995, p. 389).

⁴⁷ In Norway, Spain, and Portugal, worker participation in management, including work councils, is constitutionally prescribed, while in many other European countries, including Germany, France, Austria, Belgium, and the Netherlands, works councils are prescribed in their laws. Works councils are also set up and operated according to labor-management agreements at the national level (Denmark and Sweden), or by agreement at the establishment level (Japan, the United States, the United Kingdom, Canada, Australia, and New Zealand).

⁴⁸ While Kato and Morishima (1995) find significant productivity-enhancing effects for Japanese joint labor-management committees and non-union employee associations, Kleiner and Lee (1997) find no such effect for either labor-management councils or labor unions in Korean manufacturing enterprises.

3.2.1. Unions and Employers at Works Councils

The division of labor between works councils and labor unions is diverse among countries. Political unionism in Europe traditionally has been suspicious of workplace organization and representation. As these organizations tend to be preoccupied with securing the particular interests of workers, the objective of mobilizing broad class-based solidarity across enterprises and occupations inevitably becomes weakened. Employers, on the other hand, have been keen about protecting their managerial prerogatives, though they have also desired to consult workers in order to improve productivity on the shop-floor. Works councils were introduced after World War II to supplement the existing centralized collective bargaining. They have been viewed as a compromise solution between political unionism and corporate employers, both who wish to keep the workplace safe from major negotiations and conflicts.

However, with the exception of Germany where councils had strong legal base with a representational character, consultative councils soon became almost dormant in Europe. While employers insisted on the right to set up consultative councils at their own discretion, unions basically saw the councils as management tools for promoting employee loyalty and weakening unions' positions. Since the 1970s, there has been a renaissance of works councils (Streeck, 1995). The competitive pressure of globalization, market volatility, and flexible production resulting from rapid technological change all contributed to bringing about fundamental changes in corporate decision-making patterns and work organizations. Production decisions had to be made more frequently and in a speedy fashion, which inevitably called for decentralization to workers as part of their routine assignments. Employers found it increasingly difficult to resist granting a representation function to the councils. Labor unions also became interested in involving themselves in cooperative consultations toward shop-floor efficiency, since such knowledge is crucial for the effective representation of worker interests. The consequence has been "shared control over managerial decisions" and "a new productivist covenant between capital and labor" (Rogers and Streeck, 1995, pp. 19-20).⁴⁹

In the Anglo-American world, the councils have typically been initiated by employers as a means of promoting workers' identification with their firms (rather than with their occupation or other workers as a class). As such, unions have regarded the councils as instruments of employers designed to undermine union power, and have preferred collective bargaining as the means for pursuing employee interests. In the United States, nonunion collective worker representation has never been mandated. Nevertheless, organizations of this nature grew in number in recognition of the potential benefits of worker involvement. Employers welcomed a voice from employees that could be gained while forestalling unionization and avoiding serious confrontations. The councils were actively utilized during the war periods in the 20th century with a view to reducing disruptions in production. These employer-initiated councils did not last very long, and survived only in some big firms.

⁴⁹ Capitalizing on this strong position, employees and unions may pursue their interests beyond a justifiable level at the expense of shareholders. This situation can be prevented if the firms are exposed to competitive markets and a tough competition policy is imposed (as argued for the German case by Streeck 1989). If there is little competitive pressure, performance is likely to be poor for government-owned/invested enterprises with strong unions and works councils.

However, interest in employee involvement, including works councils, has been revived in the U.S. since the 1970s as in Europe. In response to intensified international competition as well as the changing nature of production and work organizations toward higher flexibility, employers wanted to get their employees more involved and have them make positive contributions at their workplaces. Following the relatively short-lived interest in the quality of work life (QWL) programs in the early 1970s, there has been sustained interest in a wide range of worker involvement programs since the 1980s. These include QWL committees, quality circles, autonomous work teams (as well as participatory compensation schemes), which have usually been accompanied by worker representation in the form of works councils (Rogers, 1995).

3.2.2. *Works Councils in Asia*

In Asian countries, works councils are either prescribed in the constitution (India) or by law (Korea, Taipei, China, Thailand, and Pakistan), or set up by agreements between labor and management (Japan, Indonesia, Malaysia, Singapore, and the Philippines). In Japan, joint labor-management committees (JLMCs) have been set up at an increasing number of companies since the 1950s as a way of mitigating hostile labor-management relationship through information sharing and other cooperative efforts at the top corporate level. Many experts actually find in the JLMC the crucial secret of labor peace in Japanese enterprises (Shimada, 1992; and Inagami, 1988). As of the mid-1990s, a little below 60% of Japanese firms, or about 80% of listed companies, had JLMCs instituted.⁵⁰ However, the incidence was much lower for firms without labor unions, standing at a little over 30% (Kato and Morishima, 1999; and Kato, 2000). In Korea, labor-management councils (LMCs) have been required by law since 1963 for all firms beyond a certain size. As of the end of 1999, 96.5% of all firms with 30 employees and more had LMCs instituted (Huh, 2000).

Employees' Governance Role: The Japanese JLMC

Worker participation in strategic decision-making through JLMCs in large Japanese firms is very widespread despite the absence of a legal basis and often without explicit agreements with the union on the *modus operandi* of the committee. Two factors seem to be particularly important in explaining the significant governance role of employees through the JLMCs (Nakamura, 1997). One is the “white-collarization” of workers. The promotion of workers to supervisory positions through skill formation in the internal labor market of firms has nurtured workers with intellectual skills capable of contributing to management decisions. The other is the lifetime employment strategy. The expectation of life-long employment has promoted a strong desire among employees to participate in top managerial decisions, especially on items concerning employment status like dismissals, promotions and transfers. Kato (2000) maintains that labor unions in Japan effectively prevented JLMCs from becoming dormant by

⁵⁰ In spite of the stagnation of the Japanese economy in the 1990s, there was no significant fall in the proportion of establishments with JLMCs between 1988 and 1995, even though there was some decline in the frequency of JLMC meetings and number of special subcommittees operated (Kato, 2000). While such industries as electricity & gas, manufacturing, transportation & communication had an incidence rate of over 60%, the rate was below 50% for construction, services, and wholesale & retail trade.

maintaining the strong consultative role of the committees during the period of economic stagnation in the first half of the 1990s.

Field research on Japanese firms shows the ways in which employee opinions are reflected in the operation of JLMCs. Neither management nor unions seem to view the JLMC as a joint decision-making mechanism. Still, employees can see their inputs reflected substantially in strategic corporate decision-making, even without major confrontations at JLMC meetings (Kato, 2000). First, management and union representatives tend to engage in extensive informal pre-negotiations prior to the formal meetings. Thus, proposals submitted to the JLMC meetings by management usually already reflect the opinions of labor unions. Second, management tends to avoid “unreasonable” proposals for fear of destroying its good working relationship with the union. Here, the tradition of employee sovereignty or the perception of a firm as ‘a unified body of employees’ is likely to play a role.

Nonunion employee representation mechanisms in Japan, such as JLMCs and voice-oriented employee associations, are seen to strengthen employee voice and serve as effective substitutes for enterprise unions (Tsuru and Morishima, 1999). Employees seem to use their stronger voices for more active participation in strategic decision-making and better procedural justice in performance evaluation (rather than for better working conditions that to a large extent are determined outside the firm and by improved corporate profits or promotions). However, these representation mechanisms are not found to contribute to lowering employee separation rates or satisfaction levels.

3.3. Employee Representation on the Board of Directors

The board of directors is supposed to be the supreme internal organization of corporate governance. It is mandated to mainly represent the interests of shareholders in the Anglo-American world, while the broader interests of stakeholders seem to be represented in other parts of the world. In many European countries, including Germany, Sweden, Denmark, Norway, Austria, Luxembourg, and in a limited way the Netherlands, the corporate board of directors is required by law to have employees represented. In this section, we review the role of employee representation in corporate boards in Europe and the United States, and attempt to draw some lessons for Asian corporations.

In Europe, it is ironic that employee representation on the board was introduced by the British government in post-war Germany with a view to restricting capitalist control over armaments industries, including coal and steel. In 1951-52, a two-tier board system comprising supervisory and management boards was adopted, as well as parity representation by shareholders and employees on the supervisory board in the coal and steel industries (with 1/3 employee representation for larger companies in other industries). In 1976, parity representation was extended to all companies with 2,000 or more employees.⁵¹ Some other European countries followed suit after the 1952 German legislation, while others instituted employee representation with some time lag, in the 1970s.⁵²

⁵¹ Also introduced was the rule of allocating two seats to the board chair, and allowing the shareholder representatives to choose the chair in case the board cannot select one by a 2/3 majority. Another rule adopted later was allocating 1/3 of the employee seats to union officials.

⁵² Austria, Norway, and Luxembourg introduced 1/3 labor representation on the board following the German lead in 1952. In Sweden, 1976 legislation allocated 2 board seats to labor representatives after a

Employee directors are not a uniquely European phenomenon. In the United States, there were early cases such as the Milwaukee Journal and Providence and Worcester Railroad. In more recent decades, worker representation on the board emerged in some enterprises in financial distress due to accelerated competition, with labor unions making a major concession in wages and benefits. Some cases were Chrysler, Eastern Airlines, Pan American Airlines, and a number of trucking firms in the early 1980s. Board seats for employees also came about as the result of employees emerging as significant shareholders of their companies through ESOPs (employee stock ownership plans), stock bonuses, and direct stock ownership. At the same time, board representation by employees or labor unions in the United States, where such representation is not legally mandated, has raised potentially complex legal issues, which might partly explain why worker directors are relatively rare there.⁵³

In Japan, most board members are insiders who have risen to top management positions through internal promotions under the lifetime employment system. Since it is mainly composed of incumbent managers, the board of directors in Japanese firms is a *de facto* superstructure of management and is in a poor position to properly supervise management. Furthermore, about 30% of representative directors in Japanese firms are typically ex-union leaders (see Tables 2 and 3). This strongly suggests that core employees play a large role in corporate governance even though they are not formally represented on the board of directors. Often, creditor banks (mostly main banks) and affiliated companies are also represented on the board. They have informational and monitoring advantages through either repetitive transactions or other stable and close relations in the form of cross-shareholding, a common main bank and participation in the same presidents' club of a *keiretsu*.⁵⁴

3.3.1. Board Representation, Unions, and Their Impact

Though labor unions generally welcome employee access to the board of directors, they have concerns as well. The major one is its possible interference with the union's collective bargaining. It is highly plausible that employee representation in strategic

few years experiment. Denmark legislated 2 board seats to be given to labor representatives since 1974 if requested by the works councils except for small companies. In Netherlands, employee councils have the right to veto nominees to corporate supervisory boards since 1971. Board representation by employees was also experimented with in Britain, Ireland, and Australia, but was largely limited to public enterprises (Stern, 1998).

⁵³ Among other things, an industry-level union representing workers in competing companies could use the information to influence the actions of these companies, in a way that is a violation of antitrust regulations. Another issue is that of role conflicts for union officials represented on the board, who have a potentially conflicting "duty of loyalty" to the firm and a fiduciary responsibility to the union. In spite of these legal issues, the agreements reached between labor and management concerning board representation do not seem to have been seriously challenged.

⁵⁴ However, the appointment of outsiders is rather unusual. For the 119 largest publicly-held Japanese firms, outside board members from either banks or affiliated firms represented less than 13% of the firm-years from 1980 to 1988 (Kaplan and Minton, 1994). They find that appointments of outside directors from banks or affiliated companies increased with poor stock performance (or earnings losses in the case of directors from banks). They also find that the turnover of incumbent top executives increases substantially in the year of both types of outside appointments. They conclude that banks and corporate shareholders play an important monitoring and disciplinary role in Japan.

decision-making leads to the better reflection of workers' interests in management decisions. This would certainly promote a cooperative labor-management atmosphere that could undermine employee support of the labor union in its collective bargaining. Management also has its own concern that the sharing of sensitive information with employee representatives might weaken its bargaining position and result in the leakage of confidential data outside the company.

Notwithstanding these concerns, labor unions were involved in the process of selecting employee representatives on the board in most European countries where such representation is mandated. There seems to be convincing evidence that, both in Europe and the U.S., worker representation on the board (in firms with strong unions) brings about a meaningful contribution only when the union is deeply involved in the selection process and has close information exchanges and coordination with the representatives (Stern, 1998; and Hunter, 1998). This indicates that board representation and collective bargaining can be useful in both pursuing workers' interests and contributing to improved managerial decision-making. Recognizing this possibility, labor unions have often sponsored training programs for employee representatives on the board on procedural and legal matters related to the corporate board as well as on substantive issues normally discussed at board meetings.

What difference can employee representatives make to the board or managerial decision-making? This question may be rephrased into two separate questions: one on the effectiveness of the board in general and the other on the role of employee representatives on the board. On the first question, the board has often not been a forum of crucial corporate decision-making. At times, important decisions have already been made by management before being presented to the board, and serious discussions are discouraged. On the other hand, issues in which employees might have keen interest are often not presented to the board in order to avoid objections from worker directors. In either case, employee representation on the board has little impact on management decisions.

The role of worker directors is also limited as they struggle with role conflicts. As board members, they are required to act for the corporation as a whole rather than promoting the narrow group interests of employees, in spite of their obvious constituency. Given these conflicts, they often find themselves isolated from both other members of the board and from fellow workers. A lack of interaction with the worker constituency, which is partly attributable to the confidentiality restrictions, further constrains their effectiveness on the board. However, employee representation on the board is known to have made positive contributions in some areas. The board has increasingly been a forum for industrial relations and shop-floor issues, on which worker directors can give expert opinions, and made management more cautious about employee-sensitive issues such as layoffs and plant closures. Worker representation has also increased the flow of information among the board, unions, and employees, helping both management and labor better understand each other and reduce conflicts. Finally, with new employee representatives, the board becomes more formalized and professional, and members representing the owner families tend to be replaced by professional members.⁵⁵

⁵⁵ Empirical evidence on the effects of worker directors on corporate performance is scanty. The available studies for European firms show either a negative effect (FitzRoy and Kraft, 1993; and Svejnar, 1982), or a weak positive effect (Jones, 1987).

The experience of employee representation in the United States does not seem very different from those of European firms. The roles of worker directors have not been very effective, being mainly restricted to calling attention to the interests of employees and facilitating communication between the board/management and workers. Employee representation tends to be more effective in cases where the worker directors are directly elected by the workers and accepted as legitimate participants on the board. This is more likely to be the case where the board representation is motivated by the ideology of industrial democracy (shared by some corporate managers even in the U.S.) rather than financial difficulties (Stern, 1998; and Hunter, 1998).

Overall, how should worker representation on the board be evaluated? From a *management perspective*, employee representation on the board may be considered a success, since employees are more involved and the interests of both management and workers are better aligned for higher organizational efficiency. *Pluralist theorists with a collective bargaining perspective* evaluate the board representation as ineffective or as a half success at best. They welcome the legitimate access of employees to corporate decision-making processes, permitting them to compete for influence particularly on issues directly affecting employees' interests. Nevertheless, the outcome is not satisfactory because employees are not adequately represented in most cases and not truly accepted by other members of the board. Finally, *conflict theorists with an industrial democracy perspective* tend to regard the practice as a failure. They view board representation as just another way of dealing with worker resistance without making any substantive changes to the corporate policy-making process or the ultimate outcome of power/class relations. They see that management/shareholder control over corporate matters is strengthened rather than weakened as board decisions are legitimized through worker involvement (Stern, 1998).

3.3.2. Lessons for Asian Firms

For the purpose of drawing lessons for Asian firms, U.S. experience may be more relevant since the legal basis for board representation by employees and broad boardroom culture in Asia is more similar to that of the U.S. than Europe. Hunter (1998) argues that outside directors only rarely take a leading role in the governance of American firms, and that worker directors identify themselves as outsiders. Outside directors are seen to play a significant role only when decisions have to be made concerning takeovers or changes in top management. As board functioning relies much on consensus and collegiality among the members, participants tend to avoid overt constituency representation. Worker directors trying to strongly push the interests of employees are likely to end up being isolated from other members.⁵⁶

Based on interviews with 25 worker directors in 24 firms in 1989-90, Hunter concludes that a board with worker representation is not a vehicle for true joint governance, since its function is constrained by boardroom norms and a legal framework. Still, he sees more effective functioning of worker directors in situations where significant share ownership is held by the union members (and hence there is a greater overlap of interests between shareholders and employees), union support of the

⁵⁶ After extensive surveys and interviews of corporate board members, Lorsch and MacIver (1989) identify the following board norms that indicate a lack of directoral independence: (i) members do not criticize the CEO, especially in front of inside directors (ii) they do not seek information outside the communication channels provided by the CEO, and (iii) they do not discuss issues of accountability or the premises upon which the board operates.

worker representatives is stronger, multiple members represent the union or employees, and there is managerial commitment to employee participation is higher. It is also more effective in relatively smaller firms (higher chance of substantive contribution on the board).

Dallas (1997) focuses on social dynamics on the board to explain the limited role played by outside directors when they serve together with inside (managerial) members. He argues that high compliance (less independence) can usually be expected in any group where:

- Other members have a strong influence on determining one's rewards or penalties,
- Each member has strong attraction toward other group members,
- Tasks for the group are ambiguous and complex, and
- Member behavior is publicly observable by other members.

A corporate board with both outside and inside members has all these characteristics, constraining the independence of outside directors. For example, the chance of serving continuously on the board depends much on the opinion of other members (particularly those serving on the nomination committee). Furthermore, board members are typically motivated to serve on the board most strongly by the attractiveness of other members, rather than the firm's financial strength, or their potential contribution to the firm (Korn/Ferry Int'l, 1995).⁵⁷

3.4. Worker-Owned Cooperatives

John Stuart Mill (1848, 1936) conjectured that voluntarily formed producer cooperatives would dominate capitalist employment relationship once the working classes had achieved a sufficient level of education and political emancipation. No such signs are evident even though workers are now well educated and political democracy has become ingrained in Europe and North America. Typically, producer or worker cooperatives have the following features:

- Current workers own 100% of the company with no concentration of capital.
- Major corporate decisions are made on a one-person one-vote democratic basis.
- Work, wages and other forms of compensation are shared on a democratic basis.

Obviously, there is a socialist bent to these arrangements. They might be viewed as a "third way" between capitalism and socialism or, at the very least, as a promising first step toward socialism. Some claim that altruism is usually required to establish this kind of firm (Aldrich and Stern, 1983).

3.4.1. Structural Weaknesses

Many scholars have been interested in the reasons behind worker cooperatives not being very successful or sustainable (Dow and Putterman, 1999; and Bonin, et. al., 1993). Potential problems of employee governance, which were already mentioned above, include:

⁵⁷ On the basis of this analysis, and in recognition of the importance of an independent board for conflict monitoring as well as the importance of other relational roles requiring a mix of different kinds of directors, Dallas proposes a dual board structure, like that of Germany, in the United States.

- *Risk aversion.* Some workers may not want their wages to be fixed and would be more motivated by profit sharing and equity participation.
- *Disadvantage in the information required for strategic decision-making.* This disadvantage may be eased by hiring managers with necessary professional expertise from outside.
- *Monitoring difficulty in capital-intensive firms.* Mutual monitoring within a group of co-workers, however, may be made efficient, particularly with the help of the group bonuses or penalties.
- *Heterogeneity of employees in their interests and objectives.* The consequent difficulty in reaching managerial decisions may be mitigated by ensuring a certain level of homogeneity among the members or by sacrificing the objectives of enterprise democracy to some extent.

Worker cooperatives face other problems in addition to these problems of governance by employees. Most prominent are the difficulties in financing investments and making sustained growth as well as poor incentives for more productive workers and entrepreneurs.

Difficulties in financing investments and sustained growth. Workers typically do not have sufficient wealth to set up a company. Risk aversion or the desire for diversification also limits financial investments by workers in the cooperative where they work. Borrowing on human capital is difficult because of the inherent information asymmetry, moral hazard problem, and inalienability. Borrowing on firm-specific physical capital is difficult as well, due to its poor collateral value.⁵⁸ Investments may be financed with internal capital accumulation (forgone wages) or by recruiting new members. This is not easy owing to the “horizon problem”: workers may not benefit from the investment due to its long gestation period, during which they might leave the firm. Another impediment is the “common property problem”: due to equity dilution, existing members may be reluctant to recruit new members even though more capital is needed for investment.⁵⁹

Poor protection of productive workers or entrepreneurial talent. In situations where the wage schedule is determined democratically, the median cooperative member becomes the decisive voter. If he has less than average ability, he will vote for an egalitarian wage schedule that leads to weak work efforts. In usual companies, this perverse incentive problem is minimized as productive members can credibly threaten to leave the firm. However, in worker cooperatives, the threat is not credible because the severance usually prevents them from earning a return on their capital investment (Kremer, 1997). Also, in worker cooperatives, those with entrepreneurial talent and innovative ideas are forced to share the profits with other members, and this weakens their incentives. Attempts to finance new investments utilizing these ideas by recruiting additional members can also be frustrated by severe informational asymmetries or the risk of having the ideas stolen. This may explain why worker cooperatives are more common in industries with long-established production methods such as plywood, clothing, construction, reforestation, and restaurants.

⁵⁸ This constraint may be most significant at the initial stage of a firm, and may induce worker cooperatives to avoid industries with high capital-intensity and significant economies of scale. The problem is likely to be particularly severe in areas where workers’ human capital is not firm-specific (making the potential moral hazard problem worse). Thus, worker cooperatives are more likely to operate in situations where human capital is more specialized but physical assets are generic (Dow, 1993).

⁵⁹ These two problems may be solved *in the presence of an efficient market for membership rights*, which is not likely to emerge. First, information asymmetry about the firm’s future prospects and the abilities of the applicant may be serious problems. Second, if entrants pay a market-price membership fee, why should they risk financial capital in the same firm where they work (Moretto and Rossini, 1999)?

3.4.2. Prevalence of Worker Cooperatives

In spite of their inherent weaknesses, there are cases of success (see Box 2). The ICA (Industrial Cooperative Association) Group in Boston has tried to identify worker cooperatives in the U.S., and guesses that the number might be as high as 1,000 (Somayaji, 1998). In general, worker cooperatives seem to have a higher prevalence in such sectors as bookstores, building/renovation firms, retail food stores, bakeries, restaurants, and plywood cooperatives of the Pacific Northwest (U.S.), refuse collectors in San Francisco, and small-scale craft manufacturing (Europe).⁶⁰

Box 2. Worker Cooperatives around the World

Worker cooperatives have a long history in the United States, where Philadelphia's Journeyman Carpenters initiated the nation's first working-class cooperatives in 1791. Later, as part of the labor union movement, cooperatives were advocated as an alternative to the capitalist system of compensation and treating workers. Plywood cooperatives of the Northwest, for example, were successful enough to raise their market share to 25% at their peak in the 1950s (Dow and Putterman, 1999). Some of the cooperatives suffered from the problem of reduced effort by workers, hired waged labor rather than adding new members (which would have diluted their ownership), and were sold to conventional firms. With the introduction of non-democratic practices, they tended to "degenerate" over time (Krimerman, 1998). Still others failed due to financing difficulty or tensions in personal relations among the members.

Worker cooperatives have sometimes been imposed by authorities as a national policy. The Israeli kibbutzim and worker-managed Yugoslav cooperatives beginning in the mid-1970s are illustrations. In Yugoslavia, firms with more than five workers were required to be self-managed on a democratic basis with the board of directors largely represented by workers.

Probably the most interesting case is the "Mondragon" enterprises of the Basques Region in Spain. Mondragon is an association of worker-owned and controlled enterprises producing a wide range of high-tech and other products, including the nation's largest producers and exporters of consumer durables. They are known to have been more productive than their competitors, and have rapidly spun off new cooperatives while keeping them strategically aligned in diverse business activities. An internal system of welfare and human resource management has been developed including health insurance, retirement benefits, education and training. Their own bank has played an essential role in evaluating the economic feasibility of projects and providing other business assistance to member cooperatives. It is also observed that workers have made substantial capital investments through the reinvestment of their dividend income and savings out of their wages (Krimerman, 1998).

⁶⁰ Workers in many professional firms such as investment banks, law or accounting firms and advertising agencies collectively own a large majority of equity shares. However, these companies do not usually fall under the category of worker cooperatives, since they are not geared to realizing industrial democracy at workplaces. Rather, these organizational forms seem to have evolved because of their advantages in corporate governance. If specialized skills or the capacity to perform complicated tasks embodied in the human capital of workers are the major source of corporate value, and the productivity of these workers is very sensitive to managerial decisions, as is expected with most professionals, it may be more efficient to give the governance function to these workers, together with significant equity shares (Dow and Putterman, 1999).

Worker Cooperatives Operated by the National Union in Singapore

Worker cooperatives have also operated in Asian countries, although data are hard to come by. The best known are Singaporean cooperatives, which were established by the National Trade Union Congress (NTUC) under government support. The goals of the NTUC cooperatives are to provide low-priced goods and services to workers and to allow union leaders to gain management experience, in a way that is expected to contribute to better labor-management relations (NTUC, 2001). Currently there are ten cooperatives in the fields of supermarkets, food stalls, miscellaneous health care, insurance, finance, housing and mass media.⁶¹

Probably the best-known NTUC cooperative in earlier years was Comfort Taxi, which was established in the early 1970s to provide reliable and efficient taxi and minibus services while providing the vehicle operators with the chance to become owner-drivers. This model of worker cooperatives was replicated by the Indonesian Workers' Cooperative Alliance (INKOPKAR), which has a transportation cooperative, the Jakarta Taxi Drivers' Association (Campos and Root, 1996). However, the Comfort Group, which provided other related services as well, was incorporated in 1993 and soon gained a listing on the Exchange of Singapore. Its evolution seems to clearly illustrate the financing constraints that worker cooperatives generally face in the course of their growth. While Comfort Taxi was strictly a worker cooperative, most of the current NTUC cooperatives are closer to consumer cooperatives. NTUC members usually get preferential treatment as clients and the members of the cooperatives receive dividends out of profits.

3.4.3. Productivity of Worker Cooperatives

Efficiency is not necessarily the major objective for setting up a worker cooperative. However, worker cooperatives might choose to enter business in sectors where their disadvantages can be minimized. They can accommodate all forms of worker participation including decision-making, profit-sharing and ownership. Workers must have a strong attachment with the firm, which they usually cannot leave without large financial losses. Knowing that additional efforts will all accrue to themselves (collectively), they are expected to be more dedicated (and have a stronger work effort), more cooperative, and more willing to carry out self-monitoring at workplaces.

How do cooperatives and their various forms of participation compare with conventional firms in terms of worker productivity? A meta-analysis by Doucouliagos (1995) based on 43 studies finds favorable results for worker-managed firms.⁶² All forms of worker participation—shared decision-making, profit-sharing, and worker ownership—have a statistically significant positive effect on worker productivity in worker-managed firms. The effects of sharing decision-making and profit sharing are

⁶¹ The ten NTUC cooperatives include FairPrice (supermarket chain), Foodfair (franchise food stalls), Childcare, Eldercare, Denticare, Healthcare, Income (insurance), Choice Homes (housing), Media (publications and broadcasting), and Thrift (financial services).

⁶² Meta-analysis, which is widely used in psychology and sociology, is a technique of analysis for combining results across studies with comparable specifications and measurements of variables. It tries to derive conclusions about the overall association (without asserting causality) among variables through some quantitative assessment.

stronger than those found in conventional firms. This favorable result seems to arise from the fact that various complements of worker participation are largely in place in worker cooperatives. Another meta-analysis by Kruse and Blasi (1995), based on eight studies of worker cooperative, shows that better firm performance is strongly linked to such features as the share of employees who are members, workers' average capital stakes, and employee bonuses (profit sharing).

4. Complementary Forms of Employee Participation

In the Anglo-American model of corporate governance, the residual claimants are almost exclusively shareholders, and they are mainly responsible for managerial control and supervision. If the employees of a firm collectively own significant equity shares, they can naturally participate in corporate governance as shareholders. This leads to a system of "shared capitalism." Another avenue for employees to gain access to corporate governance is involvement in shop-floor decision-making. Knowledge-intensive enterprises, which depend heavily on the innovative ideas of employees, allow workers to make autonomous decisions at their jobs. If these practices of employee involvement (EI) give the workers stronger bargaining power, they are likely to demand participation in corporate governance. Effective EI practices may also require appropriate managerial policies in such areas as compensation, organizational structure, and human resource management.

4.1. Worker Participation in Ownership

Ownership is the prime source of corporate governance. Employees who also own equity shares of their firm can influence corporate decisions as do other shareholders. In addition to worker cooperatives, there are two types of employee ownership (Toscano, 1983). One is direct ownership, resulting from such management policies as all-employee stock options and worker buyouts of troubled firms. Share ownership is typically concentrated among managers and other higher-paid workers. The other is trust ownership under employee stock ownership plans (ESOPs), where the shares are held, and usually represented by, ESOP trustees (with voting rights denied to employees).

4.1.1. Rising Prevalence and Its Background

During the 1990s, employee stock ownership has increased in many countries, particularly the United States. Approximately 20% of US adults report owning stocks in their companies. One third of large American corporations, particularly in retail and high-tech sectors, offer broad-based stock option plans to all or most of their employees (Blair and Kruse, 1999).⁶³

⁶³ It is certain that employee stock ownership in the United States was boosted by the bullish stock market in the 1990s. With a downturn in the stock market, stock options and ESOPS might lose their appeal. In order to mitigate this problem, stock options are sometimes designed as exercisable in pieces over a period of years or are repriced, though these practices create their own problem of weakening the incentives for greater work efforts. Outside shareholders would protest the dilution effect of options on stock prices, if they are not sure about performance improvement.

Box 3. ESOPs in the U.S. and Korea

American ESOPs

Basic Nature

ESOPs are the dominant form of employee stock ownership in the United States, and are generally created to receive Federal tax breaks. Employees usually borrow from the seller—an outgoing large owner, the corporation, or a bank—to purchase the shares. Few, if any, labor unions see employment ownership as an ideological goal, but as a response to crisis to ensure job retention and protection.

Ownership

American employees owned 8-9% of the shares of their own firms in 1998, with about half owned through ESOPs. Companies are usually only partially owned by workers, although almost a quarter of roughly 11,000 firms with ESOPs are known to be majority-owned by employees (Kim and Noh, 2000).

Control and right exercise

Most ESOPs are not controlled by workers. They are typically retirement benefit plans, and workers own their companies through a trust fund. Worker-owners may or may not get full voting rights; however, if workers borrowed to buy the stock in the ESOP, the trustee (appointed by management) may vote for the shares that are not paid off yet. Even in companies where workers own a majority, they are usually not represented on the board. For workers to have a significant influence in corporate decision-making, they need to have at least 1/3 of the total shares.

Korean ESOPs

Basic Nature

Korean ESOPs were introduced in the late 1960s as a part of the promotion of the capital market or encouraging firms to go public. Employees purchase shares with their own funds (35% in 1999), corporate contributions (48%), or borrowings from financial institutions (16%), and become members of an ESOP cooperative. Their major attraction is a government regulation requiring a priority assignment of 20% of the shares to the cooperative when a firm goes public or raises equity capital in the market.

Ownership

As of 1998, employees held 2.1% of the equity shares of their own companies with ESOPs (Kim and Noh, 2000). There were over 1,600 ESOPs as of March 2001 including in 692 listed companies. Employees purchasing shares through the cooperative are not allowed to dispose of them for a certain period (now shortened to a year), and this has been a source of complaint among some worker-shareholders mainly interested in short-term capital gains.

Exercise of control and Rights

The ESOP cooperatives—which have a looser form than American trust funds—are not in a position to become legal partner of a contract. In a majority of the cooperatives, not only the chief representatives but other representatives as well are appointed by the company. Most commonly, the chief exercises voting right on behalf of the worker-shareholders. Still in many companies with an ESOP, employee voting rights are not exercised at all or are exercised individually (Choo, 1996).

More than 15% of the private sector workforce, or around 18 million workers, receive broad-based stock options or are involved in ESOPs in the U. S. (Burlingham, 2000). There seem to be several factors behind the rapid increase in employee stock ownership in the United States. Tax incentives seem to have played an important role (Blair and Kruse, 1999).⁶⁴ Firms, on their part, view employee ownership as a tool for defending managerial control, saving the company in times of financial distress, and motivating people to be more attached to the company and make additional efforts (Blair and Kruse, 1999; Kruse and Blasi, 1995).

- **Managerial defense against takeover:** Employees and ESOP trustees who hold shares of their own companies are likely to be more stable shareholders, and are unlikely to sell the shares to hostile bidders. The State of Delaware (where about half of large American corporations are incorporated) adopted a requirement in 1987 that bidders holding more than 15% of a company must wait three years to complete a takeover unless they acquire at least 85% of the target company's shares. This legislation made ESOPs more attractive as an effective means of takeover defense.
- **Worker buyouts:** Some companies facing financial difficulties due to increased competition have had to turn to their employees, asking them to make substantial wage or benefit concessions in exchange for equity shares. Employee buyouts have been most visible in the trucking, steel, and airline industries—Weirton Steel in 1984; Northwest Airlines, TWA, and United Airlines in 1993-94. Employees are sometimes represented on the board of directors, and in some cases like United Airlines, have majority equity shares.
- **The need to engage and motivate employees:** With the widespread downsizing of firms for survival, lifetime jobs with secure benefits and employee loyalty seem to have become increasingly difficult to find. Amid this trend, many firms are making greater efforts to keep core workers longer and encourage them to make more firm-specific investments in human capital. Stock options and other equity-based compensation schemes help align employees' interests with those of their firms by having them share both the rewards and risks of their own creative activities.⁶⁵

An Example of Worker Ownership: Naeil Shinmoon in Korea

Naeil Shinmoon is a successful experimentation integrating ownership, management, and labor in Korea. It was launched in 1993 as a weekly newspaper, as a part of

⁶⁴ Modest tax incentives were introduced under the 1973 Employee Retirement Income Security Act and subsequent legislation for (i) firms that set up ESOPs (ii) financial institutions that extend loans to firms to set up ESOPs, and (iii) entrepreneurs who sell their firms to their employees when they retire. Most of these incentives were later removed or weakened, but much stronger ones were newly introduced related to stock options. Taxes are deferred on compensation received in stock options until they are exercised, and, if the options satisfy certain requirements, the income (difference between the market value and the exercise price) may be subject to a lower capital gains tax rate.

⁶⁵ Kruse and Blasi (1995) see employee ownership as part of a much larger effort to change workplace culture toward encouraging employees to behave like owners with greater involvement and more flexible work rules and compensation. They also regard ownership as a natural tool for rewarding employees for the future intellectual capital they will create for the firm (firm-specific knowledge) as it ensures that they are the beneficiary of their own efforts.

minority shareholder movement by a couple who were former labor activists. It was transformed into a worker-owned corporation in 1997, and 54% of the shares are now held by about 100 employees. The remaining equity ownership is held by around 1,700 minority shareholders. *Naeil* has an affiliated advertisement company that is also a worker-owned firm. Its management principles include transparency, disclosure, and no-borrowing and non-compromise in its news service. *Naeil Shinmoon* became a daily newspaper in 2000, with its main emphasis on political and economic news for opinion leaders. Realizing profits beginning in the third business year, it paid out 20% and 30% in dividends in 1999 and 2000, respectively. While many other newspapers faced financial difficulties after the outbreak of financial crisis and had to go through painful restructuring, *Naeil Shinmoon* came through the distress without any layoffs (by soliciting about 1,300 life-time subscribers who made advance payments for a period of 20 years). Very much motivated by the ideology of worker governance, *Naeil* also has the characteristics of a worker cooperative.

4.1.2. Effects of Employee Ownership

Kruse and Blasi (1995) conducted a meta-analysis on the effect of employee ownership on productivity and profitability on the basis of nine studies comprising both cross-sectional and pre/post comparisons. Their analysis shows an overall positive effect of U.S. ESOPs. The average productivity difference between firms with and without ESOPs is estimated at 6.2%. The average estimated productivity gain accompanying the new adoption of an ESOP is estimated at 4.4%. The study also shows an overall weakly positive effect of employee ownership on worker attitudes and behavior. The meta-analysis by Doucouliagos (1995) based on 11 studies finds a positive, albeit small and statistically not highly significant, relationship between employee ownership and productivity. More recent studies generally find a positive productivity effect of ESOPs, stock options, or combined employee ownership (Kato and Morishima, 1995; Black and Lynch, 2000; Welbourn and Cyr, 1999; and Blasi, et. al., 1996).

4.2. Employee Involvement on the Shop-Floor

Employees generally have a comparative advantage in information and knowledge on the shop-floor. On the basis of this advantage, they often participate in decision-making on ways to improve work efficiency and job satisfaction. Firms in mature economies become increasingly knowledge-based, and the innovative ideas and firm-specific human capital embodied in core employees become the most valuable assets. The success of such enterprises depends critically on how effectively workers are encouraged to make their best efforts. Employee involvement (EI) programs on the shop-floor include quality circles, QWL programs, autonomous teams, and various job enrichment programs.⁶⁶ EI practices have increased steadily since the 1980s, at least in

⁶⁶ Quality circles meet regularly mainly to discuss ways to improve quality, raise productivity, and solve safety problems. QWL programs are geared to alleviating worker alienation particularly for assembly-line workers. Autonomous teams are groups of workers to whom wide discretion is given to organize their tasks with little supervision, and whose suggestions are implemented unless management specifically justifies a negative response. Finally, job enrichment programs usually include job enlargement to include a broader array of tasks. By the mid-1990s, 52% of American employees in firms (with more than 25 workers) reported some EI program at their workplace, and 31% said they were involved in a program (Freeman, Kleiner and Ostroff, 2000).

the United States. This trend is due partly to employees emerging as significant shareholders of their own companies through ESOPs, worker-controlled pension funds, and worker buyouts. As owner-workers, they have a larger stake in their firms and are more interested in EI.

4.2.1. EI, Labor Unions, and Corporate Governance

How do EI practices on the shop-floor relate to employees' participation in corporate governance? Many decisions made at the top have a profound impact on workers on the shop-floor. Issues at the top-level and those on the shop-floor are often closely linked.⁶⁷ Thus, employees who are actively involved in shop-floor decisions are likely to demand more information sharing with the management and ultimately participation in top-level decision-making. In the absence of a role in corporate governance (and the consequent support of labor organizations), EI practices are unlikely to be very successful. On the part of employers, sharing the governance function with employees becomes less objectionable, since workers can make an effective contribution on the basis of their enhanced capacity obtained from active participation in autonomous, self-managed shop-floor activities.

However, labor unions see EI with apprehension as they do works councils, since it challenges the basis of union power—worker solidarity. Actually, managers often push EI programs for the purpose of weakening the appeal of unions to their employees. There seems to be a clear link between EI programs and union decline, particularly in countries where labor participates actively in decision-making at the strategic and shop-floor levels (Maranto, 1994). EI programs are more common in non-unionized firms and where workers do not hold favorable views about unionization (Russel, 1988). Nevertheless, EI tends to be more sustainable and effective when it has union support and involvement. Union involvement brings a long-term perspective to EI programs. The best results are expected where unions participate as equal partners in designing and implementing them as well as sharing the gains. Labor unions tend to push the management to institute complementary practices to enhance the efficiency of EI programs. Thus, to promote the effectiveness of EI, firms are ill-advised to weaken union leadership, its solidarity and bargaining power.

Employers are often also reluctant to introduce EI programs if they believe workers already have too strong a bargaining power or that EI would lead to such a situation (Levine, 1995). They worry that the union might demand too much managerial power and too large a share of the gains from EI practices. Particularly in places where EI practices cover broader issues rather than a mere narrow focus, they are likely to result in substantial changes in information-sharing, access to top managers, and processes of collective bargaining and even strategic decision-making (Cutcher-Gershenfeld, et. al., 1991). For both management and unions, high-powered EI practices seem to be a double-edged sword. Understandably, before the development of mutual trust, they are hesitant toward EI programs for fear of seeing their power undermined.

⁶⁷ For example, issues such as the introduction of new technologies, worker retrenchment, revision of compensation structures and new work rules may be closely related to work organization and assignment, mode of supervision, job rotation, and worker morale.

4.2.2. Other Complementary Practices

Effective EI requires other conditions than participation in decision-making beyond the shop-floor. There is strong complementarity among employee roles in corporate governance, EI programs on the shop-floor, and other conducive practices including worker compensation, organizational innovation, and human resource management.⁶⁸

Financial participation: profit-sharing. Without the assurance that the positive results of their efforts will at least partly accrue to them, employees tend to remain rather passive. Profit-sharing represents a company-wide incentive scheme that links the compensation of employees to the performance of the company.⁶⁹ Higher performance can be expected through several routes (OECD, 1995). First, profit-sharing increases work efforts by motivating employees to work harder and smarter. However, the connection may not be significant due to the dilution effect: the benefit of each individual worker's additional efforts is shared with other members. Second, in a cooperative and participatory environment, the financial incentive encourages workers to monitor each other's efforts, and to share information leading to better performance. Finally, it gives workers a stronger sense of "ownership," and encourages them to stay with the company and to make more firm-specific investment and accumulate higher skills and knowledge.⁷⁰

Workplace organization. Certain corporate organizational features and forms of workplace culture provide a favorable environment for EI. The basic premise of the EI policy is none other than sharing managerial decision-making with workers on the shop-floor. As such, vertical hierarchies must be reduced to allow the decentralization of power, and closer horizontal interaction can be encouraged through looser compartmentalization and flexible forms of work organization. The promotion of group cohesiveness can also help. Large differentials in status, compensation, and other benefits among employees, particularly between managers and workers, discourage close cooperation among them. Finally, active participants in EI programs may end up being penalized in one form or another. This can happen in a corporate culture plagued by the lack of a grievance system and other due processes, poor rule of law, managerial discretion, and low trust. For EI practices to be effective, attention should be paid to improving this corporate culture.

⁶⁸ Kruse and Blasi (1995) maintain that high corporate performance calls for the creation of a corporate culture that emphasizes company spirit, group cooperation, and effective social sanctions for "free-riders." Such culture can be created by (i) encouraging EI in workplace decisions and information sharing (ii) ensuring that productivity increase does not lead to job insecurity (iii) flattening corporate hierarchies (iv) employee stock ownership and shared compensation schemes and (v) worker training.

⁶⁹ Profit-sharing is distinguished from gain-sharing, which links the compensation of a group of employees to improvements in specific measures of internal productivity, such as the ratio of labor cost to total sales or value-added productivity. The incidence of profit-sharing programs is not high even in advanced industrialized countries. Only in Canada, France, Germany, Italy, Japan, Mexico, the Netherlands, the U.K., and the U.S., are 5% or more of total employees covered by some profit-sharing programs (OECD, 1995).

⁷⁰ The tendency toward longer tenure may also come from employment stability over the business cycle. Thanks to the flexibility of compensation, under which the total corporate wage bill is cut through lower profit-sharing bonuses during recessions, companies are expected to refrain from laying off workers even though their profits drop.

Human resource management. The major worker capacity required for effective EI is local information and knowledge about work processes. This capacity can be augmented by experience at workplaces, formal training, and information sharing with management. To encourage firm-specific human capital investment by workers, incentives may be given for longer-term employment, though this introduces rigidity in a firm's manpower management. On-the-job training needs to emphasize cross-training and job rotation for both multi-skills and job enrichment. Paying for skill or knowledge makes more sense than paying for a particular job, given that job categories become blurred and workers are called on to perform multi-tasks at workplaces with increasingly flexible work organizations. The management practice of sharing information with workers often makes a big contribution to improving their productivity.

4.2.3. Effects of EI Practices and Their Complements

The interest in EI practices is largely attributable to the changed position of employees in post-Fordist enterprises in advanced industrialized countries. Today, efficiency considerations dictate that workers make many shop-floor decisions, rather than being ordered by managers. There are several sources for this efficiency. First, workers on the shop-floor are often found to have information that managers lack about ways to improve efficiency. Second, employees tend to exert stronger work efforts and to better implement decisions that they have made. Third, when employees are rule-makers at their workplaces, they are likely to better supervise themselves, reducing the need for costly formal monitoring, and to better monitor their own managers, preventing them from pursuing their interests at the expense of the corporation. Finally, EI programs are expected to improve labor-management relations through improved communication and cooperation.

However, EI has disadvantages as well. It means that the traditional management power of decision-making is shared with employees. Decisions may be delayed and valuable internal resources wasted in the process. EI also requires substantial supplementary investments including worker training, which pays off only with a considerable time lag. Moreover, extensive EI practices are likely to lead to stronger bargaining power for employees and may distort corporate decisions, resulting in a deterioration of corporate performance. Lastly, EI programs do not solve the associated free-riding problems (Smith, 1991; Freeman and Rogers, 1993; Maranto, 1994; Doucouliagos, 1995).⁷¹

A relatively large body of studies indicates that there is a positive relation between EI practices and productivity, though the degree of association is generally weak. A meta-analysis based on 15 quantitative studies shows that employee participation in decision-making has a weak positive effect on worker productivity

⁷¹ As a deterrent to more widespread EI practices, Levine (1995) points out critical imperfection in the capital market, making it biased against strengthening human capital (and high-performing organizational changes). Stock prices respond to short-run accounting measures that "record" worker training as reduced current earnings, not as an increase in human capital—a critical source of future corporate value. M&As, leveraged buyouts, and corporate restructuring often yield short-term gains at the expense of long-term performance due to the erosion of human capital and trust. Firms with EI practices often face higher capital costs, as some potential shareholders may be concerned about the sharing of control rights with workers.

(Doucouliagos, 1995). Firms with flexible organizational practices generally enjoy better financial performance and higher productivity (OECD, 2000). Evidence also shows that EI is an innovation whose economic gain accrues largely to workers, rather than to the firm and shareholders (Freeman and Kleiner, 2000; and Freeman, Kleiner, and Ostroff, 2000). Still, the majority of studies following the meta-analysis of Doucouliagos (1995) generally report positive effects of various EI practices on such corporate performance measures as labor productivity and return on assets (Black and Lynch, 2000; Huselid and Becker, 1996; and Kirkman and Rosen, 1999).

Empirical investigations generally confirm a complementarity among various practices of employee participation. They show evidence of a significant productivity gain for groups of participatory employment practices: among these are information sharing, both at the top and grassroots levels, and financial participation, and innovative human resources and work practices (Kato and Morishima, 1999; Berman, et. al., 1999; Michie and Sheehan, 1999; Ichniowski, et. al., 1997; and OECD, 2000). However, some find little or no productivity effect where these individual innovations are adopted in isolation. As more direct evidence of complementarity, studies find that firms with EI practices or flexible work organizations are also more likely to have shared compensation schemes, supportive human resource management practices, and higher requirements for skills/tasks and education (Freeman, Kleiner, and Ostroff, 2000; OECD, 2000 and 1995).

5. Employee Participation in Korea

The role of employees in corporate governance and other participatory or involvement practices in Korean enterprises are discussed in this section. Korea is an interesting case, since it is ahead of most other developing countries in the region in terms of industrial development and rights given to workers. Labor unions, though representing only about 12% of total eligible employees, are generally militant, sometimes leading to serious concerns about restructuring and restoring the vitality of the economy. Korean firms and labor face the challenge of developing cooperative industrial relations while lifting repressive labor regulations. The forms and degree of worker participation in Korean enterprises are likely to suggest the pace and directions for workers' roles in other countries in the region.

5.1. Operation of LMCs

In Korea, as is in Japan, works councils are composed of both labor and management.⁷² They seem to have contributed to strengthening the voice of workers in business matters and to promoting trust and cooperation between the two sides. Kleiner and Lee (1997)

⁷² In Korea, the labor-management council (LMC) was first stipulated in the revised Labor Union Act of 1963. However, firms started to set up LMCs after some particulars were established in 1973 (about the deliberation agendas) and 1975 (about the range of applicable firms). In 1980, the Labor Management Council Act was enacted separately, and in 1997 was replaced by the Law on Enhancing Employee Participation and Cooperation. The Law requires the setting up of a LMC at all establishments with 30 or more employees, and gives the rights to appoint employee members of the Council to the labor union representing the majority of the employees. The Law also introduced more agenda items for deliberation, newly specified agendas for resolution, and granted a right to request materials on "report agendas" to the employee members of the Council.

find that both effective LMCs and unions enhance the voice of the employees, as measured by their perceived influence over human resource matters as well as job satisfaction. Korean LMCs meet about four times a year, and discuss a wide range of issues.⁷³ However, their agendas are dominated by wages & working conditions and worker welfare, safety and health (see Table 4). Many LMCs have one or more subcommittees for in-depth discussions of specific issues. The most common subcommittees are on worker grievances, followed by worker welfare, wages and other working conditions, and work environment and health. It is noteworthy that, unlike at their Japanese counterparts, productivity enhancement is rarely given a priority in the agenda of Korean LMCs (see Table 5). Concrete agendas for LMCs are prescribed by law as either “report,” “deliberation,” or “resolution” items, even though the level of observance seems to remain low, with about 40% of these items not discussed at all at the LMC meetings (see Table 6).⁷⁴

**Table 4. Korean Labor-Management Councils:
The Most Important Agenda in 1999**

	(% of firms)		
	Total	Unionized Firms	Non-Unionized Firms
• Managerial Issues	6.9	7.5	6.7
• Issues Related to Production	5.0	1.1	6.7
• Personnel Issues	10.1	11.8	9.3
• Social Issues	16.7	24.7	13.3
• Wages and Working Conditions	57.9	51.6	60.4
• Others	3.5	3.2	3.6

Most Important Sub-Agenda (each firm choosing three agenda)

1. Wage level	64.5
2. Allowances, bonuses and severance pay	33.0
3. Worker welfare programs	27.7
4. Safety, health and improvement in working conditions	18.2
5. Working hours and breaks	15.1
6. Dealing with worker grievance	13.2
7. Payment methods, structure, etc. of wages	11.6
8. Personnel policy	11.0

Source: Huh (2000)

⁷³ In Japan, the average number of JLMC meetings fell substantially from 14 to 9 times a year between 1988 and 1995. However, this is still high compared with Korean LMCs, which had only 4.1 meetings on average in 1999 (Kato, 2000; and Huh, 2000).

⁷⁴ The agenda items required to be “reported” by the law include management and production plans, corporate financial condition, changes in organizational structure, personnel policy, and manpower management plans. Items required to be “deliberated” include the introduction of new machines and technologies; productivity enhancement; worker recruitment, redeployment and training; safety, health and working conditions; business hours and breaks; performance-based pay; and prevention of labor disputes. Finally, labor and management are required to reach a “resolution” on such items as workers’ welfare facilities, grievance procedures, and the establishment of various labor-management joint committees.

At firms with a labor union, worker representatives are elected by the labor union as in Japan (although a recent change in the Korean law has limited this privilege to unions representing the majority of employees). In other cases, worker representatives are typically elected by employees, though the management nominates them in more than one third of small or non-unionized firms. Korean LMCs are seen to be complements of labor unions rather than substitutes, as is the case for Japanese JLMCs (see Table 7). The survey by Huh (2000) for Korea also shows that LMC meetings are requested more often by workers than by management, particularly in unionized firms. Moreover, 48% of LMCs find their role to be complementary with collective bargaining, and often engage in preliminary discussions of collective bargaining issues or following up on bargaining agreement to decide on related details. In 19% of the firms, LMCs even tended to replace collective bargaining.

Table 5. Subcommittees of Labor-Management Councils

	Remarks (%)
• Prevalence: 37.8% (standing committees, 12.4%)	– 1 subcommittee (18.8), 2-3 subcommittees (11.2), 4 or more (7.9)
• Areas of activity	– Worker grievance (34.2), worker welfare (13.9), wages and other working conditions (10.6), work environment & health (7.9), human resource development (6.7), personnel policy (6.1), general management (3.9)
• Rights of subcommittees	– Resolution (2.4), deliberation (24.2), being reported (2.4), proposition (6.1)

Source: Huh (2000)

**Table 6. Korean Labor-Management Councils:
Handling of Major Individual Agenda (1999)**

(% of firms)

	Not Discussed	Report	Deliberation	Resolution
Report Agenda				
• Management Plan	42.4	31.9	21.7	4.0
• Corporate Financial Condition	34.9	45.4	16.5	3.2
• Changes in Organizational Structure	47.3	28.7	19.4	4.7
• Production Plan	44.9	25.2	23.5	6.4
• Personnel Policy	39.5	28.5	24.1	7.9
• Manpower Management Plan	31.8	29.4	28.4	7.0
• Others: business performance and prospect; business expansion, mergers or factory moving; business suspension and closing; production performance; enlisting and training				
Deliberation Agenda				
• Introduction of New Machines or Technologies	58.4	16.8	18.1	6.6
• Enhancing Productivity	42.6	17.7	34.6	5.1
• Recruitment and Worker Redeployment	40.3	29.0	24.6	6.1
• Worker Training	36.3	31.0	27.0	5.7
• Safety, Health, and Working Conditions	20.3	23.2	43.1	13.4
• Business Hours and Breaks	23.8	25.1	35.7	15.4
• Performance-Based Pay	43.3	19.7	28.2	8.8
• Prevention of Labor Disputes	59.6	7.0	25.9	7.4
• Others: change in work process; establishing/revising work rules; change in personnel/labor management system; general rules of employment adjustment including layoffs; worker welfare promotion; improvements in payment methods and structure of wages				
Resolution Agenda				
• Establishment/Management of Welfare Facilities	32.3	19.0	37.4	11.2
• Grievance Procedure	24.8	17.2	44.4	13.6
• Establishing Various Labor-Management Joint Committees	61.0	8.7	22.7	7.6
• Others: basic plan for worker training and capacity building; establishment of employee welfare fund				

Source: Huh (2000)

Table 7. Korean Labor-Management Councils: Other Characteristics (1999)

Selection of Worker Representatives		(% of firms)		
	Directly Elected	Indirectly Elected	Nominated by Firm	Nominated by Union
Total	38.1	16.8	28.3	16.8
Unionized Firms	25.8	6.7	7.9	59.6
Non-Unionized Firms	42.9	20.8	36.3	0.0
Small Firms	39.7	16.0	36.1	8.2
Medium-Sized Firms	36.1	19.6	16.5	27.8
Large Firms	33.3	12.5	12.5	41.7

Modes of Instituting the Agreement			
	Total	Unionized Firms	Non-Unionized Firms
• Written Accords	43.9	57.4	38.6
• Reflected in Collective Agreement	6.1	21.3	-
• Reflected in Work Rules	13.3	4.3	16.9
• Oral Agreement	27.6	10.6	34.3
• Others	9.1	6.4	10.2

Relationship between Agenda of L - M Council and Collective Bargaining				
	Total	By Firm Size		
		Small (100 ⁻)	Medium	Large (500 ⁺)
• Separated	23.4	21.9	23.9	25.0
• Complementary	47.9	37.5	52.2	56.3
• Council-Dominated	19.1	21.9	21.7	6.3
• Bargaining-Dominated	9.6	18.8	2.2	12.5

Note: Separated (the council not dealing with agenda for collective bargaining), complementary (the council often engaged in preliminary discussion of collective bargaining issues or deciding the details of bargaining agreements), council-dominated (the council often replacing collective bargaining process), and bargaining-dominated (collective bargaining often replacing the council discussion).

Source: Huh (2000)

5.2. Other Forms of Participation

Participation by employee representatives on the board is rather rare in Korea. Even when such participation does take place, the workers tend to join as observers rather than as full members. In some large enterprises, employees have secured the right to recommend outside director(s) who can represent their interests (see Table 8).

A survey on worker participation in management decision-making in Korea shows that both management and labor assess the degree of participation as being rather low. Particularly low is participation at strategic levels in production/management strategy or corporate governance. Participation in work-related shop-floor decisions is also low, while that in decisions on information sharing or worker welfare programs is relatively high. On the issue on the extent of information sharing, for instance, workers are briefed by management or participate in deliberations in most firms, and participate

in resolution in some of smaller firms (see Tables 9 and 10). Among the forms of participation, the labor-management council is most prevalent while participation in joint QWL committees or personnel/disciplinary committees is not uncommon. As for substantive participation, job enlargement or redesign is more prevalent than potentially more effective tools such as autonomous work teams or mini profit centers. Worker participation is also more active in non-unionized firms, with the exception of representative participation (see Table 11).

Within representative participation, labor-management councils are most prevalent, with participation on the board of directors being rather exceptional (see Tables 11 and 12). Worker participation in personnel or disciplinary committees is not uncommon. The managements of Korean firms are found to be very reluctant to share the decision-making function. Almost half of managements in survey firms demonstrate an allergic reaction to “management participation” by labor. On the contrary, labor unions are generally sympathetic to management participation, with only a quarter of surveyed labor representatives giving a negative response. Interestingly, managements in manufacturing industries and at small and medium-sized firms are less resistant to a participation in management, but labor in these sectors is less enthusiastic (see Table 13). Korean firms utilize various forms of worker participation in the distribution of corporate performance, and do this rather evenly, particularly for managerial and clerical workers. The measures include employee stock ownership programs, though stock options are not yet very common. As is the case for most non-representative EI programs, financial sharing schemes are more prevalent in non-unionized firms (see Tables 14 and 15). ESOPs in Korea are mostly controlled by the companies. The majority of ESOP representatives are appointed by the company, and about 80% of the chief representatives are company executives. For most ESOPs, voting rights are either not exercised or exercised by the chief representative (Table 16).

5.3. Evaluation of Worker Participation in Korean Enterprises

How is worker participation in Korean firms evaluated in that country? The evaluation seems to be strongly favorable for labor-management cooperation, information flow, procedures for organizational operation, quality of managerial decisions, and worker skill formation and safety and health. On the other hand, there seems to be almost no effect on the flattening of managerial hierarchy, decentralization, or participatory management style (see Table 17). Comparisons of the incidence and evaluation of various forms of worker participation between Korea and the U.S. firms reveal that the rate of favorable self-evaluation is significantly lower in Korea, in spite of the much higher incidence (see Table 18). This suggests that EI programs in Korea have failed to empower workers to make their best efforts. This result is not surprising given that Korean managers appear to be still reluctant to delegate work-related decisions to employees on the shop-floor and to make necessary changes in workplace organization.

Table 8. Worker Representation on the Board of Directors: Korea (2000)

(% of firms)

	Total	By Firm Size		
		Small (300 ⁻)	Medium	Large (1000 ⁺)
• No Channel	88.7	94.1	83.6	85.0
• Observation	6.8	3.7	10.6	6.7
• Recommendation of Outside Director	1.8	0.8	1.0	6.7
• Direct Representation	1.8	1.5	2.9	1.7
• Direct Representation, and Recommendation of Outside Director	0.8	0.0	1.9	0.0

Source: Hwang (2001)

Table 9. Opinions on Degree of Worker Participation by Level of Participation: Korea (2000)

Levels and Area of Participation	Degree of Participation ¹
Strategic Level	2.33
• Production & Management Strategy	2.06
• Corporate Governance	2.29
Functional Level	2.83
• Human Resource Development	2.42
• Deliberation on Information Sharing	2.98
• Worker Welfare Programs	3.09
Shop-Floor Level: Work & Work Environment	2.60

Note: ¹ Average of the following scores: 0 (no channel of participation), 1 (very low), 2 (low), 3 (high), and 4 (very high).

Source: Hwang (2001)

Table 10. Worker Participation in Decision-Making Process on the Extent of Sharing Managerial Information: Korea (2000)

(% of firms)

	Total	By Firm Size (Responses by management only)		
		Small (300 ⁻)	Medium	Large (1000 ⁺)
• No Channel	19.3	24.3	12.5	8.3
• Participation Excluded	12.7	11.0	10.6	16.7
• Explanation by Management	27.8	25.0	30.8	38.3
• Deliberation	22.0	16.9	27.0	26.7
• Resolution	16.5	20.6	16.3	8.3
• (Not Sure)	1.7	2.2	2.9	1.7

Source: Hwang (2001)

Table 11. Worker-Participation in Corporate Decision-Making Process: Korea (1996)

	Share of Employees Covered (% of firms)				Participation Ratio (%) ¹		
	None	1-20	21-60	61-99	100	Total	Unionized Non-Unionized
Representative Participation							
• Board of Directors	67.6	17.6	10.2	2.7	2.1	6.2	5.6 8.9
• Labor-Management Council	3.4	16.8	19.7	33.2	26.9	54.8	58.0 38.6
• Joint Committee for QWL	28.9	19.4	24.4	17.8	9.4	26.3	24.4 35.8
• Personnel/Disciplinary Committee	33.5	20.6	16.5	14.4	14.9	24.5	26.0 18.2
Substantive Participation							
• Mini Profit Centers	73.4	10.4	9.8	4.0	2.3	9.9	9.6 11.5
• Job Enlargement	9.5	25.3	44.7	18.5	2.1	29.3	27.7 36.5
• Job Redesign	16.7	32.8	37.7	10.5	2.2	22.6	20.7 31.6
• Autonomous Work Teams	56.5	19.4	14.7	8.8	0.6	11.0	9.5 18.2
Consultative Participation							
• Employee Survey	21.6	19.5	24.8	25.2	8.9	38.1	33.9 54.6
• Employee Suggestion	2.9	8.2	22.2	26.5	40.1	74.3	78.5 56.1
• Quality Circles	8.2	19.1	35.5	24.2	12.9	44.9	43.7 50.0
• Other Problem-Solving Teams	18.1	33.5	29.1	15.9	3.3	24.4	22.3 36.0

Note: ¹ Estimated share of employees covered by the scheme in all the surveyed firms.

Source: Lee and Yu (1997)

Table 12. Incidence of Representative Participation: Korea

Channels of Representation	Incidence (%)
Board of Directors	4.4
Production or Other Work-Related Committees	17.3
Personnel Committee	23.2
Disciplinary Committee	54.2
(Equally Participated by Labor and Management)	(23.1)

Source: Choo (1996)

Table 13. Attitudes toward Union Participation in Management Decisions

(%)

	Total	Manufacturing	Non-Manufacturing	Small & Medium-Sized	Large
Attitude of Management					
- Resistant	47.4	46.2	49.6	47.4	47.6
- Only Partly Favorable	38.7	37.7	40.7	36.0	42.8
- Largely Favorable	12.0	13.8	8.9	13.3	9.6
- Others	1.8	2.4	0.7	3.3	0.0
Attitude of Labor Union					
- Enthusiastic	43.8	39.4	51.9	38.9	50.3
- Selectively Positive	31.5	30.9	32.6	34.1	27.9
- Infeasible, No Interest	23.6	28.9	14.1	25.6	21.2
- Others	1.0	0.8	1.5	1.4	0.6

Source: Choo (1996)

Table 14. Worker Participation in the Distribution of Corporate Performance: Korea (2000)

(% of firms)

	Merit Pay	Team Incentives	Gain-Sharing	Profit-Sharing	ESOP	Stock Option
Incidence: Total	33.7	18.9	27.8	16.7	19.5	4.3
• Unionized	23.8	14.9	21.0	16.1	17.3	2.4
• Non-Unionized	44.1	23.1	34.9	17.2	21.8	6.3
Coverage by Occupation¹						
• Managerial	83.3	54.8	81.0	67.1	93.4	90.5
• R&D/Technical	45.5	46.4	50.4	49.4	68.4	47.6
• Clerical	59.6	51.2	84.3	71.2	93.4	71.4
• Service/Sales	37.8	60.7	56.2	58.9	60.5	57.1
• Production/Unskilled	11.5	9.6	24.0	28.8	14.5	0.0

Note: ¹ For firms that adopted the specified scheme of worker participation in the distribution of corporate performance.

Source: Park and Noh (2001)

Table 15. Worker Participation in the Distribution of Corporate Performance: Korea (1996)

	(% of firms)			
	Individual Incentives	Team Incentives	Profit-Sharing	Employee Stock Ownership
Share of Employees Covered				
None	35.7	45.7	42.2	47.6
• 1 – 20	23.1	22.0	17.6	10.5
• 21 – 60	27.7	21.0	9.5	13.6
• 61 – 99	7.5	5.4	12.5	12.6
• 100	6.0	5.9	18.1	15.7
Participation Ratio (%) ¹				
• Unionized	23.5	18.9	28.9	35.6
• Non-Unionized	19.9	14.1	24.9	35.6
	37.3	38.9	45.8	35.8

Note: ¹ Estimated share of employees covered by the scheme in all the surveyed firms.

Source: Lee and Yu (1997)

Table 16. Employee Stock Ownership Plans: Korea

		Prevalence (% of firms)
Presence of ESOP	- Instituted	29.6
Selection of ESOP Representatives	- Appointed by enterprise	51.9
	- Elected by employees	32.1
	- Others	16.0
Status of ESOP Chief Representative	- Company executive	80.7
	- Labor union official	5.5
	- Labor union member	6.4
	- Others	7.3
Exercise of Voting Right	- Not exercised	29.4
	- By the chief representative	41.3
	- By individually members	19.3
	- Others	10.1

Source: Choo (1996)

**Table 17. Views on the Effect of Worker Participation
on Corporate Organizational Efficiency: Korea (1996)**

(% of firms)

	Strongly Disagree	Largely Disagree	Neutral	Largely Agree	Strongly Agree
• Improved Labor-Management Cooperation	2.7	9.7	30.8	40.5	16.2
• Faster Information Flow	2.2	15.1	44.1	28.5	10.1
• Better Procedures for Organizational Operation	2.3	17.1	40.0	35.4	5.1
• Improved Managerial Decision-Making	6.8	15.9	35.8	35.8	5.7
• Performance-Based Compensation	6.9	19.4	41.7	22.3	9.7
• Managerial/Supervisory Hierarchy Reduced	8.7	13.3	56.6	19.1	2.3
• Change toward Participatory Management Style	4.6	21.3	42.0	22.4	9.8
• Decentralization of Decision-Making	7.3	16.8	46.9	21.8	7.3
• Introduction/Utilization of New Technologies	6.9	15.5	49.4	21.8	6.3
• Worker Skill Formation Aided	3.4	12.6	46.9	31.4	5.7
• Improved Worker Safety and Health	2.2	13.2	35.7	37.4	11.5

Source: Lee and Yu (1997)

**Table 18. Degree of Worker Participation and Evaluation of Its Performance:
Korea and the U.S.**

(% of firms)

	Participation Rate		Success Rate ³	
	Korea (1996)	U.S. (1990)	Korea (1996)	U.S. (1990)
Participation in Decision-Making (cases where at least 40% of employees are covered)				
• Employee Survey	45	32	24	70
• Quality Circles	58	13	42	52
• Other Problem-Solving Teams	32	22	33	73
• Mini Profit Centers	12	2	25	53
• Job Enlargement and Redesign ¹	36	9	21	56
• Autonomous Work Teams	15	1	26	60
• Labor-Management Joint Committee for QWL	37	3	30	50
Participation in Distribution of Corporate Performance (cases where at least 60% of employees are covered)				
• Individual Incentives	14	15	41	74
• Team Incentives	11	6	32	61
• Profit Sharing ²	31	19	40	63
• Employee Stock Ownership	28	46	44	72

Notes: ¹ For Korea, the average of the ratios for job enlargement and job redesign.

² Includes gain-sharing for Korea; and it is the average of ratios for gain-sharing and profit-sharing for the U.S.

³ Share of firms that evaluated their programs “successful” or “very successful.”

Source: Lee and Yu (1997)

6. Conclusions

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

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

information on the shop-floor. Unless strategic decision-making power is shared with employees, however, the effectiveness of shop-floor participatory practices will be unlikely to be very effective. As East Asian countries see further progress in democratization and the strengthening of organized labor, prolonged confrontations between management and labor will result in huge socio-economic costs. One challenge 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.

At present, employees in East Asian developing countries seem to play a very small role in corporate governance, reflecting their weak political power as well as an industrialization strategy that tended to repress workers' rights and make it unnecessary to rely on broad-based employee involvement in shop-floor decision-making. This stands 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, which is based on shareholder sovereignty, there is no legally mandated role for workers in corporate governance. In recent decades, however, a clear trend has been observed for American and British enterprises to try to motivate their workers to be more committed to participatory practices in ownership, shop-floor work organization, and even formal governance mechanisms. Japanese enterprises are similar to their Anglo-American counterparts in that no corporate governance role by workers is guaranteed by law. However, in the Japanese model, employees have traditionally been considered as the most important stakeholders 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 enterprises to give workers an increasing role in corporate governance.

What, then, will be the East Asian model for involving workers in corporate governance? Although there may not be any single model that fits all the countries in the region, we may think of common characteristics of different systems on the basis of the political, socio-cultural realities of workplaces. In many of these economies, the status difference between the management/capitalist class and laborers may not be as large as it is in the United States. Moreover, the Confucian tradition (which 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 is likely to function better in the region than the Anglo-American model, which assumes a rather confrontational role 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 will not be an option, either, at least for some time. Workers and labor unions have to go a long way to go before they can gain sufficient political power to institute a corporate governance role and impose other regulations on workers' interests.

Due consideration must also be paid to the challenges faced by the different models in a 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

sufficiently responsive to make optimum use of employee information and knowledge. The Japanese model of the internal labor market has also come under stress. With lifetime employment no longer taken for granted, the loyalty and cooperative spirit of workers seem to be weakening as well as their enthusiasm for participatory practices. The American model may not be in a 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 investments (Charny, 1999).

If East Asian developing economies are to shape their own model, what guidance can be given on specific forms of corporate governance and other related policy issues on the basis of the experiences of advanced countries as well as the realities and challenges these economies will face? As a formal governance mechanism, the board of directors does not seem likely to become a forum for sharing the decision-making function between management and labor. Given the mandate of the board and boardroom culture, labor directors is likely to be outsiders without substantial impact, though they may serve as a source of access to information or top management and may give some formality to the board and encourage more transparent management. Legally mandating worker participation on the board may be premature, as it will face strong resistance from management and does not offer much gain to employees. Labor and management of individual enterprises may agree on worker participation on the board either as full members or observers on a voluntary basis depending on their industrial relations and the bargaining power of workers.

A more promising channel for worker governance may be work councils, such as Japanese JLMCs or Korean LMCs. They provide a forum for serious communication between management and labor. They can cover wider-ranging issues in a less confrontational format than collective bargaining. Furthermore, given the low and declining trend of labor union density, this is in practice the only representative form for worker participation in corporate governance. As is already the case for many countries, it may be a good idea to legally mandate that all enterprises institute an council. Guidelines can also be drawn up concerning the ways to handle the major agenda items of the council. For instance, enterprises can be strongly urged to allow employee representatives to participate in serious deliberations or joint decision-making on issues directly affecting work life on the shop floor as well as other basic working conditions or worker 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 situations.

Empirical evidence suggests that there is 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 a conducive work organization and human resource management practices. In order to effectively motivate workers to make their best efforts, many of these complements must be in place. Management, for its part, is 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 prerogative with workers, and other complements have been lacking. As a result, they have failed to strongly motivate employees or to gain workers' trust. Consequently, the practices have

not been very sustainable or have 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 the institutional impediments that discourage the adoption of employee involvement and other complementary practices.

As a strategic complement, employee stock ownership programs should 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 task of management 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 the financial contributions of corporations or borrowings from financial institutions to facilitate employee share purchases. It is essential, in designing such programs, to consider how to make them less susceptible to stock market fluctuations and encourage employees to be stable and long-term shareholders.

Finally, the most essential issue 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, which characterize industrial relations in many East Asian economies, must 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 for industrial or national level dialogues and bargaining to be held on key issues of the labor market and worker welfare. This would relieve the workplace bargaining table of issues that might lead to serious confrontations, and help to promote more cooperative labor relations. Governments should resist the temptation to co-opt national-level labor organizations as the dialogue partner, since such organizations lack legitimacy and the support of their constituencies. 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 employees.

Appendix Table 1. Comparison of Characteristics of Sample Firms and Survey Methods

	Huh (2000)	Lee and Yu (1997)	Park and Noh (2001)	Hwang (2001)	Choo (1996)
Sample Firm Characteristics	Selected from firms with labor-management councils by standard stratification based on industry, size of firm, and existence/absence of labor union	Obtained from 1,200 largest firms in terms of sales in 1995 (listed in <i>Korea's Top 5000 Companies</i>)	Obtained from all firms listed on the Korea Stock Exchange (and a pool of non-listed companies)	Selected arbitrarily from firms with labor union in consideration of firm size: equal number for manufacturing and non-manufacturing	Selected from firms with labor union
Number of Sample Firms/Respondents	330 firms; 660 respondents (labor and management)	223 firms	486 firms	300 firms; 600 respondents (labor and management)	389 firms
% Unionized	28.5	67.7	51.0	100.0	100.0
% Non-unionized	71.5	32.3	49.0	-	-
% Small firms	80.6 (30 - 199)	19.7 (- 299)	-	45.3 (- 299)	40.5 (- 299)
% Medium-sized	16.4 (200 - 999)	46.2 (300 - 999)	-	34.7 (300 - 999)	35.0 (300 - 999)
% Large firms	3.0 (1,000 -)	34.1 (1,000 -)	-	20.0 (1,000 -)	24.5 (1,000 -)
Survey Method (Respondents)	Field interviews Member of labor-management councils representing management and employees	Questionnaires by mail Officers in charge of personnel or labor issues	Mail and telephone calls Officers in charge of personnel, planning and organizational matters	Interviews Those representing management and labor	Questionnaires by mail Labor union representatives
Survey Date	February - March, 2000	April - May, 1996	August - September, 2000	January, 2000	August - October, 1995

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