

SUPERVISORY BOARD AND WORKS COUNCIL
IN THE NETHERLANDS
*OPPORTUNITIES FOR THE WORKS
COUNCIL TO INFLUENCE THE
COMPOSITION OF THE BOARD:
CONTEXT, CONDITIONS AND EFFECTS*

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Abstract

In this paper, we present our first research findings on the opportunities for works councils and their practices to influence the supervisory board member(s) election under the 'old' co-option system. When and under which conditions works councils are really using their right to propose supervisory board candidates and what kind of effects could be expected from that? The conceptual framework for our research work is presented next, finally followed by a description of the first research findings. The research findings to date, reveal what sort of conditions and factors have a stimulating impact on the works councils' behaviour to use the formal right to propose supervisory board candidates, to influence the composition of the supervisory board and to build up a relationship with that board. The research also shows the perceived effects of proposing candidates. The findings confirm the expectation that the attitude of the parties involved is very dominant and that works councils which are really striving for a better strategic position at the corporate level, are more actively involved than other works councils.

Keywords: supervisory board, works council, the Netherlands, board composition

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1. Introduction

In the Netherlands, the corporate governance model is based on the two-tier principle. Large companies have two separate boards, the board of directors (the executives) and the board of supervisors (the independent non-executives) that meet with each other several times a year.

In the specifically Dutch system of labour relations with its strong focus on consensus, trust and the involvement of stakeholders, the supervisory board has traditionally had a rather exceptional position and responsibility, that of monitoring and advising the board of directors not only on behalf of the shareholders but on behalf of the company as a whole. The supervisory board has to control the board of directors in the best interests

of the company, operating independently from all the shareholders and stakeholders.

Under Dutch rules, the supervisory board very recently - until October 2004 - had the right to appoint its own members (the so-called co-option model), being independent of the management and the shareholders and stakeholders, striving for homogeneity and acting consensus oriented. Both the shareholders' meeting and the works council had the right to propose candidates and to object to the appointment of particular candidates.

In 2004, however, the Dutch Parliament decided - in line with the proposal of the government advisory body, the Social Economic Council SER (SER, 2001) - to change the co-option system by giving the shareholders the right to formally appoint the members who have been recommended by the board, and by giving the

works council the right to select and nominate – at most - a third of the board members. This change in legislation might lead to a substantial transformation of power towards shareholders. We are questioning whether the new one-third formula will really mean an improvement in favour of the employees' representatives: what kind of effects could be expected from that?

From the Faculty of Management and Organisation of the University of Groningen, the Netherlands, we have started an extensive research programme to investigate the way the works councils influenced the board member(s) election under the old corporate governance system and the possible implications of the new system in terms of the manner in which it could well impact on power relations or the influence of works councils relative to shareholders. Our research programme must provide a better insight into the opinions, the perceptions and the experiences of the parties involved: the works council, the supervisory board itself, the managing directors and the shareholders. Case studies and analyses of best practices should further deepen our insight and knowledge.

In this paper, we present our first research findings on the opportunities for works councils and their practices to influence the supervisory board member(s) election under the 'old' co-option system. When and under which conditions works councils are really using their right to propose supervisory board candidates and what kind of effects could be expected from that? The paper provides the highlights and recommendations based on research work in the last few years (Lemain & Goodijk, 2004).

Experiences and past behaviour might probably deepen our insight and show us what kind of factors are stimulating or restraining for a works council to using its right to propose or even to nominate board member candidates.

First of all, the article describes the complex Dutch corporate governance system and the functioning of the supervisory board and the works council under both the current and the new rules of the structure regime. It also provides an overview of the discussions on changing the co-option system from the stakeholder perspective up until now. The conceptual framework for our research work is presented next, finally followed by a description of the first research findings. The research findings to date, reveal what sort of conditions and factors have a stimulating impact on the works councils' behaviour to use the formal right to propose supervisory board candidates, to influence the composition of the supervisory board and to build up a relationship with that board. The research also shows the perceived effects of proposing candidates. The findings confirm the expectation that the attitude of the parties involved is very dominant and that works councils which are really

striving for a better strategic position at the corporate level, are more actively involved than other works councils.

2. Dutch Structure Regime and Works Councils' rights

In this paragraph, we will describe the development of the complex Dutch corporate governance system and especially the method of supervisory board member (s)election, based on – changes in – legislation and corporate governance codes.

Legislation

Since 1971, the board structure of large Dutch companies has been regulated by Book 2 of the Civil Code (the so-called Structure Act). The key issue is the structure regime for companies that meet certain criteria related to the number of employees (at least 100) and the amount of subscribed capital (16 million Euro at the moment). The structure regime provides a mandatory two-tier board structure with a board of directors (a management board) and a supervisory board composed entirely of supervisory directors. Under the rules of that structure regime it is not the shareholders' meeting but the supervisory board that has the legal right to appoint and dismiss the managing directors and to approve important decisions concerning mergers, acquisitions, investments or reorganizations. The shareholders' meeting is only meant as a forum for shareholders to be informed by the management board, to be given explanation of the company policy and to call the management to account: this forum has the legal right to finally declare the annual report, or to withdraw/revoke ones' confidence. The Civil Code also provides regimes for other and smaller companies. The 'mitigated' structure regime and the 'exempted' regime are mostly of importance to multinationals and local companies that are part of a foreign holding structure or to companies that have more than half of the employees working abroad. Under the rules of these regimes the supervisory board still has the right to ratify important management decisions, but the shareholders have the right to appoint or dismiss the managing directors. The 'common' regime is applicable to small and medium-sized companies, giving them the choice between a governance model with a board of managing directors only or the two-tier board model.

Until 2004, the shareholders' meeting did not even have the formal power to substantially influence the composition of the supervisory board. However, considering the relatively high ownership-concentration in the Netherlands (and the important role of large financial institutions such as pension funds, banks, insurance companies etcetera in corporate ownership, compare De Jong et al,

2001 and Poutsma & Braam, 2005), the shareholders did have some power to influence the strategic management board decisions, for instance by using their voice-option at the shareholders' meeting, by not approving the annual report, by using their right of inquiry into mismanagement or by the exit-option.

When vacancies arose, the supervisory board appointed its own directors through the system of controlled co-option. The co-option system has been a very specific characteristic of Dutch board member(s) election. As mentioned above, both the shareholders' meeting and the works council had the right to propose candidates and to object to the appointment of candidates nominated by the board.

The right to raise objections to the appointment of a supervisory board member could be based on three grounds (Book 2, art. 168/278, Dutch Civil Code):

The procedures have not been diligently adhered to by the parties involved: parties must have the opportunity to select and propose their own 'independent' candidates after being formally informed of upcoming vacancies at an early stage of the decision-making process.

The proposed candidate is found to be unqualified to fulfil the board position: parties can judge that the candidate is not sufficiently qualified considering his or her knowledge, skills or experience.

The appointment would not result in a balanced composition of the supervisory board: the board has to be made up of members with a broad range of knowledge, skills, network contacts and backgrounds.

If an objection were to be made, the supervisory board would require the permission of the Enterprise Chamber of the Court of Appeal in Amsterdam in order to get the candidate appointed nevertheless.

A few years ago however, the SER proposed to strengthen the legal position of shareholders in the decision-making process, to change the co-option model and to give shareholders the right to formally appoint the board members (SER, 2001). The works councils on the other hand, should be given the right to select and nominate – at most - a third of the board members.

In October 2004, the SER's proposals were accepted by the Dutch Parliament and the Structure Act of 1971 has been amended.

1971:

- The Supervisory Board has the right to appoint and dismiss the managing directors and to ratify important management board decisions.
- The Supervisory Board (re-)appoints its own members (co-option).
- Both shareholders' meeting and Works Council have the right to propose candidates and to object to the nomination of a particular candidate (controlled co-option).

2004:

- The Supervisory Board retains the right to appoint and dismiss the managing directors but the shareholders' meeting gets a stronger right to influence strategic management decisions (decisions with substantial impact on the company's identity).
- Both the shareholders' meeting and the Works Council retain the right to propose Supervisory Board candidates.
- The Supervisory Board nominates the candidates but the shareholders' meeting gets the right to formally appoint the members.
- The Works Council gets the right to a binding nomination of at most one third.

Figure 1. Changes in the Dutch structure regime

Codes of good corporate governance

The SER's proposal to strengthen the position of the shareholders has to be seen in the broader context of the corporate governance debate in the Netherlands. For several years now there has been growing criticism that the Dutch corporate governance system is limiting the power of the shareholders far too much.

In 1997, the Peters Corporate Governance Committee presented forty recommendations to especially improve the functioning of the supervisory board and to strengthen the role of the shareholders. Among these recommendations were:

- the Board should draw up a profile and adjust it from time to time,
- the Board should be composed in such a way as to enable its members to operate independently,

- the reappointment of Board members must always be carefully considered and should not be an automatism,
- the Board should evaluate its own functioning and performance at least once a year,
- more information and transparency should be provided to shareholders by improving the quality of annual reports and general meetings.

Although most shareholders did not fully agree with continuing the specifically Dutch structure regime, and the employee representatives were disappointed that there was a lack of attention paid to the role of works councils, there was a generally positive response from the various shareholders and stakeholders to the recommendations.

Since the committees' report was published, several companies have paid more attention to the functioning of their boards and best practices have also showed some changes in the attitude of supervisors, from a rather passive towards a more active and responsible one. However, the latest monitoring by the Peters Corporate Governance Monitoring Committee (in December 2002) showed that companies still provided insufficient information on how their boards were functioning and that, as yet, there was no real growth in the involvement of the shareholders.

In March 2003, the Tabaksblat Committee was established to formulate a renewed code of best corporate governance practice, based on the recommendations of the Peters Committee. At the end of that year the Tabaksblat Committee completed its final report after a period of consultation with several of the parties (shareholders and stakeholders) involved. The Committee made several recommendations, not for changing the co-option system as such but for strengthening the independence, the quality and the expertise of the supervisors within the co-option model. It also recommended a limitation on the number of board memberships for supervisors, the limitation on board memberships for executive directors and more frequent contacts between the supervisors and the external accountant.

Most of the recommendations – based on the so called comply-or-explain principle – have been warmly welcomed by both the shareholders and the other stakeholders, although each stakeholder group still has its own arguments and wishes for changes and adjustments to the code.

Basic principles of the Dutch structure regime

The Dutch corporate governance model as described above, notwithstanding the changes that have been proposed by the SER and implemented recently, fits into the context of the specific Dutch system of

labour relations and is based on the principles of co-operation, equivalence, confidence and consensus (compare e.g. SER, 2001):

The company is considered to be a co-operation of employer and employees with a longer term perspective and having open relationships with shareholders and stakeholders (the so-called institutional firm).

The company boards are responsible for balancing all the different shareholder and stakeholder interests and gaining their confidence.

Decision making is considered to be consensus-oriented.

Furthermore, the Supervisory Board has to meet the requirements of independence, quality and trust in order to monitor and control management decisions on behalf of the entire company.

Although there is a gradual change towards the Anglo-Saxon model, the Dutch labour relations are, in general, still dominated by the stakeholder approach.

These principles should be seriously considered and taken into account for explaining the functioning of the Dutch model, the changes needed and the possible position of the works council relative to shareholders. To analyse the real works councils' influence on the board member(s) election, the wider context of stakeholder positions should be described.

The stakeholder approach

Basic principle of the Dutch labour relations and starting point of our research on the Dutch system of corporate governance, traditionally is the stakeholder approach which assumes that the supervisory board has to monitor the management on behalf of the company as a whole and all the relevant stakeholders (and which should balance pluralistic claims, compare Gedajlovic 1993). This approach also assumes that serving the stakeholders' interests – and performing a 'balancing act' (see section 5) – also serves the interests of the shareholders and the management (compare the stewardship theory). We consider that the stakeholder approach can include the shareholders' interests too. From this standpoint, a good relationship between the board and the stakeholders (characterised by dialogue, transparency and accountability) is crucial for a well balanced policy-making process and for running the daily business effectively. Several Dutch companies have already developed their own stakeholder concepts – including shareholders' interests – for making the 'balancing act' (Goodijk, 2001), but more extensive research is needed on how to balance all the competing interests of the stakeholders in business practice.

The stakeholder approach has proved to be beneficial to a company in terms of trust, stability

and commitment, although this approach may also have disadvantages, such as the slowness of the decision-making processes if all competing claims of stakeholders have to be considered, or the lack of attention to the shareholder value.

3. Discussions on changing the co-option system from a stakeholder perspective

Ever since the introduction of the Structure Act in 1971 there has been discussion about the principles mentioned above and the system of controlled co-option.

In the 1970s and the early 1980s, a period characterized by a relatively large amount of attention paid to employee participation, the discussion focussed for the greater part on employee involvement in the composition of the board and the working of the Dutch co-option system relative to the direct election model of the Aufsichtsrat in Germany. From that perspective, an extensive comparative analysis of the advantages and disadvantages of both the Dutch and the German board systems has been made (see e.g. Gelauff and Den Broeder, 1996).

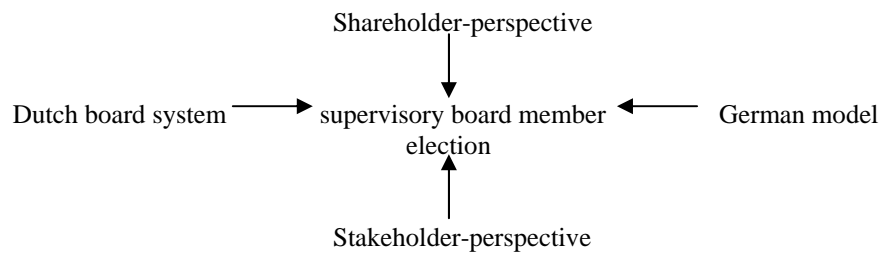


Figure 2. Contextual factors that have influenced the discussion on changing the co-option system

In the last fifteen years, much more attention has been paid to improving the functioning of the boards, the board of directors as well as the supervisory board, and to strengthening the position of the shareholders towards the supervisors with the argument that if the shareholders have more power to influence the appointment of supervisory board members, this definitively should lead to improved functioning and performance of the board.

The government advisory board, SER, concluded that the shareholders' position should also be strengthened in view of the international developments (especially the Anglo-Saxon trends) and the financial market requirements. However, in her point of view, the specific Dutch system of labour relations and the stakeholder-approach should require a well-balanced solution. If the position of the shareholders has to be strengthened, then employee involvement should also be improved. Furthermore, the interests of society as a whole should – as much as possible - be included in the monitoring function of the supervisory board.

As a consequence, the SER advised the government to change the system of supervisory board member (s)election by, on one hand, giving the shareholders a stronger position in the appointment of candidates and, on the other hand as a sort of compromise, providing the works councils the one-third nomination right. The debate shows that each shareholder and stakeholder group and/or party involved had its own specific arguments to become increasingly critical of the functioning of the supervisory board in particular.

Our previous research work, based on case studies and in-depth interviews in several Dutch companies and a great amount of relevant documents (Goodijk et al., 1998, 2001-2003), strongly confirmed that the main parties involved (the shareholders, the employees and the management of the company) were very dissatisfied with the recent state of affairs.

Now the co-option system has been changed, the criticism on the supervisory board has not stopped yet. Quite a lot of the shortcomings of the board as perceived by the parties, have not really been improved so far. The improvements longed for, seem to depend not only on structural changes but also – and probably mainly – on board behaviour, interaction between parties and dynamics. These findings and critiques need, of course, to be analysed in the broader context of the corporate governance debate. The debate on the functioning of boards and especially on that of the non-executives, is taking place not just in the Netherlands but worldwide.

Issues which have received a great deal of attention in that worldwide debate include (compare Stiles and Taylor, 2001; Van den Berghe, 2002; Colley et al., 2003) likewise the 'enlightened amateurism' of supervisors, their loyalty to the top management, the 'closeness' of the board and the slow integration of new members, the claim for enhanced shareholder control over poor management performance and the advantages and disadvantages of employee representation on the board, but also the relative lack of attention to group dynamics and personal behaviour within the board.

Shareholders:
<ul style="list-style-type: none"> · lack of shareholder influence · not enough attention paid to their financial interests within the board · better monitoring and control of the management needed
Employees:
<ul style="list-style-type: none"> · board is too much a continuation of the management · the boards are too passive towards company policy · the old boys' network
Management:
<ul style="list-style-type: none"> · have become increasingly convinced that good supervision is beneficial for the company · board members should have a better understanding of the business · the board should challenge the management more

Figure 3. Parties' main arguments for criticizing the co-option model

The US Senate Governmental Affairs Committee's Permanent Subcommittee on Investigations, for example, concluded that in the case of Enron the board had failed because of lax oversight, superficial reviews and a puzzling display of disinterest. Independence, expertise, time allocation and the auditing responsibility should be re-assessed. In the WorldCom case, the Bankruptcy Court Examiner judged that the board had not asked enough critical questions and was too much of a continuation of the management and the CEO. In the Netherlands, the same criticism has been made of the supervisory board of Ahold. It seems that the boards do not accept their full responsibility in accordance with their roles and obligations.

Worldwide there is also discussion on the pros and cons of the one- and the two-tier systems and the convergence tendency between the two systems (Van den Berghe, 2002). Despite there being differences in principles worldwide, there is an increasing understanding that:

- the roles of the CEO and the chairman in the one-tier model should be separated, although combining the roles of chairman and CEO seems to be very suited to the leadership philosophy in Anglo-Saxon countries)
- non-executives should be more independent of management
- audit committees should be composed only of non-executives
- board reviews can improve board functioning
- much depends on the personality and social behaviour of the chairman

- stakeholders (shareholders, employees, customers, society) should be recognised as 'critical governance watchers'.

There is as yet no evidence to prove that one of the models as such works better than the others. Improvements should be found in a better functioning of the board model itself (see e.g. Stiles et al., 2002). There would seem to be a learning process required: all the different board models can learn from each other without regarding differences in terms of competition. It is not simply a question of choosing between different board models and governance systems, but of selecting those key factors and conditions, especially social-cultural ones, needed to improve the system.

The starting point, the set of principles, however, can vary, focussing more or less on (short term) shareholder value alone, on longer-term value creation or on balancing all the relevant stakeholder interests. Most countries criticize the shortcomings and failures of their one-tier model and urge for improvements in the model (for example by splitting the roles of CEO and chair), while still preferring that model. In the Netherlands there still seems to be a little preference for the current two-tier model. Parties argue that in such a model the independence of supervisors can better be guaranteed, especially if the supervisory board has the task and responsibility to operate in the best interest of the company as a whole. And moreover: from the stakeholder perspective, the board has to monitor the 'balancing act' of the top management (Goodijk, 2001).

The SER advised the government not to change the mandatory two-tier system yet, although this system is not in line with the internationally more usual one-tier board. The Tabaksblat governance code argued that it should be possible for

internationally oriented Dutch companies to opt for the one tier model, but this code too has not especially focussed on changing the two-tier model. Common opinion in the Netherlands is that both the systems have their pros and cons. To date, most Dutch companies have the two-tier board system in conformance with legislation, but some internationalised companies such as Shell and Unilever, have already used the opportunity – or have the intention to do so – to opt for the one-tier system at the holding level. The motivation for this change is, as far as we know, highly based on perceived financial market requirements and shareholder pressures and the – worldwide – claim for enhanced shareholder control in cases of poor management performance. Employee representatives in particular argue that this change could ultimately exclude employees’ involvement in the boards’ composition and further unbalance the power positions. Furthermore, many internationally oriented Dutch companies have introduced a dual holding structure consisting of an international holding and a national subholding. This construction means that – only – the subholding has to be structured in line with the (mitigated) structure regime. Under such a structure regime, the supervisory board has to be structured and composed in conformance to the rules as mentioned above, but this board has got limited rights in comparison with the board under the rules of the so called complete structure regime. Under the mitigated regime not the supervisory board but the shareholders’ meeting has the right to appoint and dismiss the board of directors.

Our conclusion so far is, that solutions are still being discussed and looked after from the stakeholder perspective, striving for a certain balance in the power of capital and labour. But it is clear that the traditionally developed balance is under considerable pressure now. The strengthened position of shareholders, also in the Netherlands with its specific focus on equivalence, balance and

consensus, could really affect the position and influence of the works councils and could have impact on their involvement in the supervisory board member(s) election. On the other hand, given the greater shareholder influence, could it be the case that the works council will be galvanised into action by the threat that it could lose influence? There is no research yet to show the one or the other.

But first of all, we research the influence of the works council in the field of shareholders and stakeholders to the present (last year) and find out under what conditions a substantial influence on the composition of the board could be reached. Such a research could be the starting point for research into the new situation.

4. Conceptual framework for our research

Our research mainly focuses on the involvement of works councils in the process of supervisory board member(s) election under the ‘old’ rules of the Dutch structure regime. We seek to question which factors are stimulating or restraining for works councils in actually using their formal rights and possibilities and what kind of effects the works councils are striving for.

We consider that the position and the formal as well as the de facto influence of the works councils on the election process can not be studied isolated from the factors we discussed in par. 2-3:

- the legislation and codes/societal norms on corporate governance,
- the formal and the perceived – supervisory and managing - board roles,
- the formal influence, the interaction between as well as the actual behaviour of the works council itself and of the other parties involved such as the shareholders and the top management.

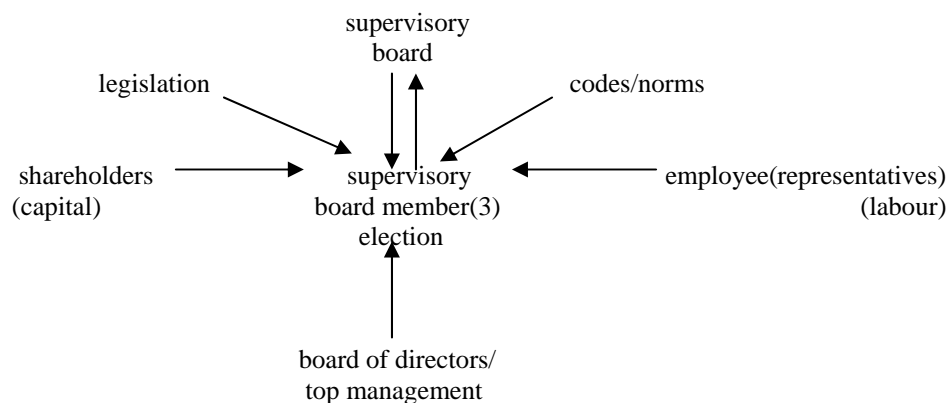


Figure 4. Conceptual framework to investigate the works councils’ influence on the election process of supervisory board members

Legislation, codes and board roles

The corporate governance legislation and the codes in the Netherlands have already been explained. These rules, principles en best practice regulations have their impact on the roles of the supervisory board and the board of directors.

In general, the supervisory board is charged with the functions of monitoring and controlling the managing board, of appointing and evaluating top management, of offering expert advice to management and voting on major decisions. While the board's role seems to ensure that shareholder and stakeholder interests will be considered, there are some potentially serious problems, such as a lack of board independence from the top management/the CEO, board members not having the time or expertise to fulfil their roles adequately and members not having a vested interest in the company.

Regarding board roles in general, there is a great diversity of roles and there are several differences in the functioning and the composition of boards. Anglo-Saxon countries have adopted several variants of the single-tier board model, for example, boards dominated by (a majority of) executives or non-executives, boards combining or separating the CEO and chair positions and boards with more or fewer committees. Countries such as the Netherlands and Germany, on the other hand, have adopted different forms of the two-tier model, separating the executive function from its monitoring function thus separating the 'decision management' and the 'decision control' roles (Fama and Jensen, 1983). Maassen (2000), for example, carried out extensive research on the differences of board roles in the two-tier system, comparing the outcomes with the functioning of one-tier boards. His research reveals that although managing directors and supervisory directors normally meet together, more emphasis is placed on separate supervisory board meetings. More emphasis is also put on independent supervisory board leadership and supervisory board composition (page 163). We assume that a separate supervisory board would offer better conditions for works councils to influence the board composition, especially if the board considers itself being responsible for and taking into account all the various stakeholder interests.

In the last ten years, pressure has been put on one-tier boards to improve the formal independence of the board (Demb and Neubauer, 1992; Charkham 1994, Tricker 1995). In particular, one-tier boards with a majority of executive directors have been put under pressure to increase the number of independent non-executives. The parties involved have also objected to having one group of directors supervising and controlling another group within the same board (see Sheridan and Kendall, 1992). There

is a worldwide tendency for one-tier boards to be pressurized into changing towards becoming more independent board types and taking into account the broader stakeholder interests.

Supervisors in the two-tier boards, on the other hand, are being challenged to become more independent of the management and – at the same time – to become more actively involved in policy making (the dilemma of having both distance and involvement). Overall, there seems to be a tendency towards convergence (Van den Berghe 2002).

The main purpose and role of the board is to monitor the management and provide resources such as: expertise, advice, legitimacy, links to important stakeholders, access to financial resources. Monitoring activities can vary from controlling the CEO, the strategy or the implementation, to planning CEO succession and evaluating and rewarding the CEO or top management of the company. In most countries, the board is expected to monitor the management on behalf of the shareholders, but in the Netherlands (and in Germany) the monitoring by the Supervisory Board (in Germany the Aufsichtsrat) is more focussed on protecting the interests of all the stakeholders (not just the shareholders but also the employees, the customers/clients, the society) and the interests of the entire company. In the one-tier model the boards' powers are derived from the shareholders they represent. While in the Dutch and German two-tier board system the management (the executive directors) is controlled by the Supervisory Board keeping the shareholders at a certain distance.

In our research, we seek to question whether and to what extent the works councils' involvement in the supervisory board member (s)election is depending on the boards' (in-)dependence of the top management and on its attitude towards stakeholder interests.

Shareholder or a wider stakeholder perspective

The shareholder approach primarily focuses on creating shareholder value, with board decision making generally being under high pressure of short term financial performance and profit making. A wider stakeholder perspective that – besides other interests - also takes into account the employees' interests, gives rise to differences in the definition of boards' roles.

The role of monitoring is a central aspect of the agency theory. In this theory, the primary function of the board is to monitor the actions of the agents (the managers) in order to protect the interests of the principals (the owners). Agency theory describes the potential for conflicts between the management and the shareholders, while the stakeholder theory urges to pay attention to various interests. Other governance theories that give rise to differences in

boards' roles, are the stewardship theory assuming that serving the shareholders' interests also serves the managers' own interest, and the resource dependence theory that defines companies as being open systems and boards that have to manage external dependence and reduce environmental uncertainty (Hillman, 2003). Agency theory, stakeholder or stewardship theory, resource dependence theory and also other theories such as institutional or social network theories, have all proved to be relevant in helping explain the functioning of boards, but in agreement with Lynall et al. (2003, p. 419-420) the predictive validity of these theories is contingent upon the life-cycle stage at formation and the relative power of important stakeholders.

According to both agency theory and stakeholder approach and because of the potential power relationship between the CEO (and other executive directors) and the board, board independence is also considered to be a key factor for improving the monitoring role of the board. More independent oversight and supervision (via outsider-dominated boards and board committees, separation of the CEO and chair roles, etc.) seems to work better, although there is no real evidence yet that board independence results in improved company performance. In this respect the Dutch and German two-tier board model, with separated responsibilities for executives and non-executives, might have some advantages concerning the independence of monitoring.

Good relationships and independence are both important (and probably necessary) for the board, although these aspects are somewhat contradictory. Quality, professionalism and personal behaviour are also recognised as being crucial factors for the monitoring role of the board and for creating a company that performs better and is increasingly responsible (compare Van Ees and Postma, ...).

The crucial factor for improving the boards' monitoring function is probably not the actual structure of the board and the choice between a one-tier or two-tier model, but the real functioning and the composition of the board. These specific board characteristics and the board members' attitudes might be dominant factors to explaining the actual works councils' influence on the board member(s) election process.

Works Councils' influence and actual behaviour

Our leading research question in this article is whether – and under which conditions – the Dutch Works Council of large structure corporations will really use its opportunities to influence the composition of the supervisory board. And what kind of results could be expected from this involvement? Past behaviour will not necessarily

reflect future behaviour, given that the context or regulatory environment has changed, but the research findings might deepen our insight on what parties can do to stimulate the works councils' involvement under the new structure regime rules.

Previous Dutch research in the 1990s (Van het Kaar, 1995 and Van den Tillaart, 1999) revealed that, under the old rules, many works councils did not make the most of their right to propose board candidates. The main reasons then appeared to be their own passivity and lack of attention and the fact that they did not know or could not find any qualified candidates. Other factors that seemed to influence the works councils' activity in this field, could be clustered in categories such as company characteristics and parties' behaviour. Remarkable finding was also that works councils that had succeeded in realising an agreement on the involvement procedure, seemed to have better conditions for influencing the board member(s) election process than other works councils. The successfully realising of such an agreement, however, might be highly dependent on the organizations' culture and the attitude of the parties involved.

Previous research also showed that works councils particularly expect effects in terms of a better relationship between works council and supervisory board and a more balanced composition of the board. Improvement of quality of the board was not a main goal the works councils strived after, by using their right to influence the composition.

Research model and testable hypotheses

Based on these research findings we developed our research model to investigate the works councils' influence on the composition of the supervisory board and the perceived effects in the last few years. Sub-questions of the research were the following:

- What is the influence of legislation, codes and specific company agreements on the practices?
- What are the main characteristics of the structure companies concerned, that influence the practices?
- What kind of effects could be expected from the attitude and behaviour of the parties involved (such as the supervisory board itself, the managing board, the shareholders) on the potential works councils' role?
- To what extent have works councils already put in practise their right to propose Supervisory Board candidates?
- What are the works councils' reasons for using or not using this legal right to date? Which factors have the most stimulating or restraining influence?
- Under which conditions could works councils – probably even better under the new legislation - effectively practise their right?

- And what are the effects, in terms of: relationships between works council and

supervisory board, balanced composition of the supervisory board and quality of the board?

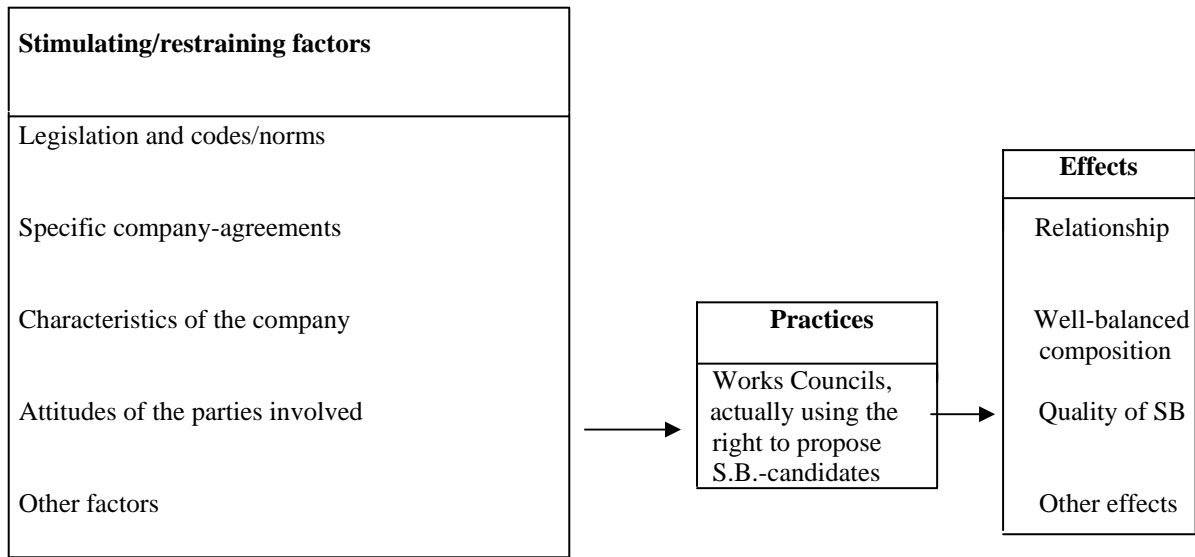


Figure 5. Research model: Potential stimulating/retraining factors, practices and effects.

We have tested the following hypotheses:

Although legislation provides them the opportunity, works councils do not make the most of their right to influence the supervisory boards' composition yet. The works councils' actually using of the right to propose supervisory board candidates mainly depends on the organizations' culture and especially the positive attitude of the management board towards the councils' involvement in the procedure. Building up better relationships with the supervisory board is perceived by the works council as being one of the most desirable effects of using the right to propose board candidates.

Up to date, our research has included:

A database research on the relevant legislation, corporate governance codes and company agreements, the structure corporations' characteristics: facts and figures, such as the structure regime, the ownership-structure, size of the boards, number of employees etcetera (documentation and additional survey research).

The opinions and perceptions of the (chairmen of the) works councils of the – about 250 - large structure corporations, concerning the works councils' activities and the perceived effects of using the legal right to propose supervisory board candidates (opinion-survey).

Some case studies and best practices (in-depth interviews)

Next few years we want to investigate the opinions and perceptions of the other parties involved, such

as the supervisory board members, the shareholders and the managing directors, taking into account the changes in legislation that took place last year.

5. Research findings

Our research is concentrated on getting a deeper insight into the potentially stimulating and restraining factors for works councils to use their formal right to propose – and in the future to nominate - supervisory board candidates and in the possible effects of using that right.

In the period 2003-2004, as a first step in this research programme, some explorative research work has been done to investigate and to analyse facts and figures of the structure corporations (the database research) and the works councils' opinions and perceptions (the opinion survey). General data (facts and figures) were gathered via the annual reports and the websites of the structure corporations as being registered by the Chamber of Commerce. A survey was developed to investigate the opinions/perceptions of the works councils' chairmen. In the opinion survey, 83 (central) works councils of the 250 companies concerned (that makes about a 30% response) responded to the survey.

Firstly, the research shows that only 51% of the works councils of these large Dutch companies have actually – more or less frequently – used their formal right to propose supervisory board candidates to date:

Not at all	48%
Only once	28%
Twice	12%
Three times or more	11%

Figure 6. Percentage of works councils, which have used the formal right to propose supervisory board candidates last three years.
Respondents: *Works Councils' chairmen*, $n = 83$

This finding confirms once more (compare the research of Van Het Kaar and others) our first hypothesis that only a small percentage of the works councils really use their right to influence the boards' composition up to date. The percentage hasn't substantially increased since the 19980s and 1990s.

The amount of using the formal right seems to depend on company characteristics as mentioned before, specific company agreements on the relationship between the works council and the supervisory board, some characteristics of the works council itself (such as the degree of maturity/professionalism) and especially the attitude of the other parties involved: for instance, their attitude towards the works councils' involvement in the board member(s) election.

Legislation, codes and company agreements

Although legislation on the works councils' involvement in the board member(s) election is important, legislation is not a sufficient foundation for really practising this right. Neither the legislation and structure regime rules nor the corporate governance codes seem to play an important role to activating the works councils until last year. Highly distinguishable however, is the presence of a written agreement on how to practice the legislation procedure and codes regulations in case of board member(s) election: an agreement between the parties concerned, the works council, the managing director(s) and the supervisory board. In these companies, there seems to be more openness and willingness amongst board members towards the works councils' involvement (see hypothesis 2). About 65% of the works councils that have succeeded in making such an agreement with their boards is actually using its formal right to propose candidates.

The existing agreements include subjects such as the procedure of the works councils' involvement in the composition of the board, the drawing up of a profile and the information exchange between works council and the supervisory board. Especially the works councils' involvement in drawing up a profile for the supervisory board, seems to be

stimulating to proposing a qualified and eligible candidate.

Company characteristics

Our desk-research and surveys have provided some general characteristics of the companies involved that seem to be relevant for our research, such as:

The type of the structure regime: about 40% of the companies operate under the rules of the complete structure regime and the other 60% have a so-called mitigated regime (see par. 2). Works councils are, in general, not quite highly aware of the differences between these two structure regime types.

The size and the number of employees: most of the companies (about 70%) have more than 500 employees.

Whether or not being listed at the stock exchange: 50% of the companies are listed companies.

The ownership-structure: the differentiation or concentration of ownership, having national or foreign holding-structures etcetera. One of the findings is that most companies only have one or a few important/dominant owners (a high ownership concentration). And about 25% of the companies concerned has a foreign mother company possessing all the shares.

The research shows that there is a positive correlation (Mann-Whitney, $p < 0.01$) between the size/number of employees of a company and the works council using the right to propose supervisory board candidates. This correlation has already been suggested by research done in the past (compare Van het Kaar, 1995).

The research has not proved a correlation between the structure regime's type and the works councils' activity to propose candidates.

Works councils of companies with a Dutch 'mother' seem to be more actively involved in the board member(s) election process in comparison with works councils of companies being a subholding or division of a foreign mother company. And in cases of differentiated ownership, works councils have more frequently used their right of proposal: probably, more concentrated ownership provides a - relative to the works

councils - stronger position for the big shareholders to influence the board member(s) election.

However, although works councils of companies with a Dutch mother or companies with differentiated ownership have more frequently used their right of proposal, our research doesn't prove significant (with $p < 0.01$) differences between companies with highly concentrated ownership and

companies that have many small shareholders, or between companies having a Dutch mother-company and companies with a foreign holding structure.

Many of the companies (34%) have a rather complex system of ownership-combinations. More detailed information on that, however, did not prove any significant differences between categories.

Size/number of employees	percentages	Percentage of WC's using their right to propose SB-candidates
100 – 500	32%	33%
500 – 2000	39%	47%
> 2000	29%	71% (significant, $p < 0.01$)
Ownership-structure		WC's using their right to propose SB-candidates
Highly concentrated ownership (only one or a few large shareholders)	24%	35%
Many small shareholders	5%	50% (not significant)

Dutch mother-company (the only shareholder)	9%	57%
Foreign holding-structure (foreign mother only sh)	24%	44% (not significant)

Foundation	5%	25%

Others (combinations)	34%	67%

Figure 7. Only one significant difference found (positive correlation, Mann-Whitney with $p < 0.01$) between company characteristics and WC's using their right to propose Supervisory Board candidates

Attitude of parties involved

Most significantly distinguishable seems to be the actual attitude of the parties involved, such as the works council itself, the supervisory board and the managing directors.

Works councils don't particularly mention the attitude of shareholders as being an obstacle for having influence on the supervisory board member(s) election. The opinion survey reveals that works councils' actually practising the formal right to proposing candidates, highly depends on the attitude of the managing director(s) and – especially the chairman of - the supervisory board. Much seems to be dependent on their attitudes towards the works councils' involvement: in general, they are

questioning whether this involvement would really contribute to a higher qualified and a more balanced composition of the board, to a better communication between works council and supervisory board, or – on the other hand – would negatively affect the independence of the board.

More than 50% of the works councils that have used their right to propose a candidate, responded that the chairman of the supervisory board had stimulated them to making actually use of that right. Another remarkable finding is that more than 80% of the works councils' recommendations have been followed by the supervisory board. For the present, we conclude that in case the works council plays an active role in proposing candidates, one or more of these candidates have finally been appointed by the

supervisory board. So, much also depends on the attitude and professionalism of the works council itself. This conclusion has been underlined by the respondents.

Stimulating and restraining factors

The research has particularly revealed the following stimulating factors for works councils to using the right to propose supervisory board candidates:

- A written agreement – given concrete form to the legal right - on the procedure of the works councils’ early and substantially involvement in the board member (s)election process and the exchange of information.

- Co-operation in drawing up a profile, as an instrument for selecting qualified and eligible candidates.
- The personal behaviour, attitude and willingness of the chair and/or CEO to involve the works council in the selection-process.
- And the organizational culture of having open and frequent relationships/contacts between the parties at the corporate level.

On the other hand, works councils that do not use their right of proposal, most often argue that the formal procedures have not diligently been adhered to by the supervisory board (vacancies have been reported much too late) and that the works council itself mostly has no qualified candidate.

Works Councils’ arguments	
to propose Supervisory Board candidates	not to propose Supervisory Board candidates
<ul style="list-style-type: none"> * to create a better relationship with the Supervisory Board * to improve the composition of the Supervisory Board (more balanced) * because the Supervisory Board itself took the initiative to involve the Works Council 	<ul style="list-style-type: none"> * being involved too late * having no qualified candidates * perception that the Supervisory Board will not accept the candidate * lack of contacts with the Supervisory Board to date (‘distance’) * Works Council overly focused on operational problems

Figure 8. Works Councils’ arguments (not) to propose Supervisory Board candidates

Perceived effects

Two thirds of the works councils have experienced that using the right of proposing candidates, improves the relationship and trust between works council and supervisory board. At the same time our research showed that an ‘open’ culture at the corporate level works positively out for using the right. So, there seems to be a positive interactive relationship between a culture of consensus and trust on one hand and making effectively use of the right of proposal on the other hand (see hypothesis 3).

Other effects mentioned in the survey, are:

- a better (‘broader’, more balanced) composition of the supervisory board: works councils have proposed candidates with somewhat other qualities, such as HR-expertises,
- a more active attitude and a higher sensitivity of the supervisory board towards works councils’ opinions and concerns,
- and a stronger strategic position of the works council in the decision making process at the corporate level, by having a better access to the supervisory board.

Better relationship/trust between Works Council and Supervisory Board
More balanced composition of the Supervisory Board
More active attitude/higher sensitivity of the Board towards the Works Council
Stronger Works Councils’ strategic position in the decision making process

Figure 9. Perceived effects of proposing Supervisory Board candidates

Conclusions

As described above, the Dutch corporate governance system based on the Structure Act is

rather complex. The supervisory board – being appointed by co-option until 2004 - has traditionally had the exceptional responsibility of monitoring the management not only on behalf of the shareholders

but on behalf of the company as a whole. This fits with the specific Dutch system of labour relations and the stakeholder approach: management and supervisors have to function on behalf of all the stakeholders (including the shareholders) and have to balance all the relevant stakeholder interests (the so-called balancing act). Basic principles are: co-operation, consensus and trust. And the responsibility of the supervisory board requires a high degree of independence of the board members.

In 2004, the co-option model was changed: shareholders have been given the legal right to formally appoint the board members and – from the stakeholder perspective - works councils received the right to a binding nomination of at most one third of the board.

In this article we considered that under the late rules, even in large structured companies, many works councils did not make the most of their legal right to influence the supervisory board member(s) election and to propose board candidates. We took to question which factors would really lead to a substantial improvement of the works councils' involvement in the composition of the board, and what effects could be expected from that. For, there is no evidence yet that works councils will use their right better as soon as new legislation provides them the opportunity to select and nominate a third of the board members.

Our research findings to date, have shown that active works councils could be successful, especially by making clear and practical agreements with the managing director and the supervisory board on the procedure of being really and timely involved. The attitude of the (chairman of the) supervisory board is considered as being very crucial. The works councils' involvement in the drawing up of a profile as an instrument for selecting and nominating supervisory board candidates, seems to be very stimulating. These research findings highly correspond with the results of previous research work (Van het Kaar, 1995, Van den Tillaart, 1999).

Much, however, depends on the corporate culture and the behaviour and willingness of parties and/or persons concerned. Like other corporate governance issues, culture and personal behaviour seem to be more important and decisive than structure and legal rules.

Using the right to propose candidates proves to be profitable for the works council: it can contribute to a better relationship with the supervisory board and can meet the works councils' requirements for contacting the supervisory board and exchanging information in case of important management decisions or urgent situations.

Based on these findings, we also assume that the strengthened role of the works council to influence the composition of the supervisory board, does not necessarily be at the expense of the

independence of the board. On the contrary, it probably might lead to a more active attitude, a better ('broader', more balanced) composition and an even higher degree of independence of the board, operating as a monitoring and controlling instrument on behalf of the company as a whole and regarding all the relevant shareholders and stakeholders. More explorative research work needs to be done to confirm or to deny this hypothesis.

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