

BETWEEN CONTROLLED CO-OPTION AND DIRECT ELECTION

The current debate on the functioning
and composition of the Supervisory
Board in the Netherlands

*Rienk Goodijk**

Abstract

This paper first describes the complex Dutch corporate governance system and the functioning of the Supervisory Board under the rules of the structure regime and co-option model up to the present time. The critiques of the parties and stakeholders involved in this model are investigated next, followed by a description and explanation of the recent developments of the Dutch model and a discussion of the pros and cons of the alternatives with regard to the interests of the various stakeholders. Finally, some key factors for improving the boards' functioning in the – changing – Dutch corporate governance system are presented. The findings and recommendations are based on case-studies and interviews conducted in large Dutch companies over several years and on extensive analyses of documents and recent evolutions. This research method however, is only suitable for a process of exploration, clarification and development of hypotheses.

Keywords: board of directors, composition, stakeholders, Dutch companies

Professor of Labour Relations and Corporate Governance, University of Groningen
Senior Consultant GITP International, Van der Does de Willeboissingel 13, 5211 CC 's Hertogenbosch, The Netherlands
Tel. +31 73 6919110, E-mail: r.goodijk@gitp.nl or r.goodijk@bdk.rug.nl

1. Introduction

The renewed corporate governance debate in the Netherlands which has taken place in the last few years, has mainly focussed on the functioning and composition of the Supervisory Board (Raad van Commissarissen) in the two-tier board system. The professional monitoring functioning of these boards is increasingly considered to be of great importance for the quality and transparency of policy-making.

Most parties concerned, such as the shareholders and other stakeholders, the management and the supervisors themselves) criticize the functioning of the supervisory board and have put pressure on politicians to change the Dutch corporate governance system.

Research (Goodijk et al., 1998, 2001-2003), based on a large number of documents, several case-studies and in-depth interviews with key

persons (representatives of the stakeholders), shows that each group of stakeholders has its own arguments for criticizing the system.

The shareholders have been the most severe in their criticism of the functioning of the Supervisory Board, arguing that their financial interests are not being given enough attention. They therefore propose better monitoring and control of management by the board and more shareholder influence on the appointment of board members.

The employee representatives (union leaders, Works Councils), on the other hand, argue that the board is too much a continuation of the management, too passive towards company policy making and too much of an old boys' network.

And many supervisors themselves also recognise the inadequate functioning of the boards, which tend to have a 'wait-and-see' attitude, are not really actively involved in the policy making

process of the company and operate passively at a distance.

Since the 1990s, and after several well-publicized affairs of mismanagement and lack of supervision (see, for instance, the Ahold-case), this rather passive attitude on the part of the supervisors has become no longer acceptable to the stakeholders. Supervisors are increasingly being challenged to become more active players at the corporate level, to improve their performance and to accept full responsibility.

In the specific 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 responsibility and position, that of monitoring and advising the management not only on behalf of the shareholders but on behalf of the company as a whole. Under Dutch rules, until now, the board appoints its own members (the so-called co-option model), being independent of the management and the stakeholders, striving for homogeneity and acting consensus-oriented. The basic principle of the 'structure regime' is that the Supervisory Board requires the confidence of the shareholders as expressed at the shareholders' meeting, because of the transfer of formal rights from the shareholders' meeting to the Supervisory Board.

Most shareholders (mainly institutional investors, insurance companies, banks and private companies) however, begun to show decreasing confidence and criticize their lack of influence. Another serious problem regarding this model is the so-called old boys' network, a small circuit of directors appointing each other to the most prestigious boards.

For these reasons, the co-option system in the Netherlands has been now under serious discussion: it has been widely discussed and put on the agenda of the Government advisory board, the SER, and the Parliament. The system has been compared with other systems, such as the German system of direct election, and the pros and cons of these discussed. The Dutch Parliament has recently cut the Gordian knot and decided to change – from October 1st of 2004 - the co-option model into a model somewhere between co-option and direct election.

This paper first describes the complex Dutch corporate governance system and the functioning of the Supervisory Board under the rules of the structure regime and co-option model up to the present time. The critiques of the parties and stakeholders involved in this model are investigated next, followed by a description and explanation of the recent developments of the Dutch model and a discussion of the pros and cons of the alternatives with regard to the interests of the various stakeholders. Finally, some key factors

for improving the boards' functioning in the – changing – Dutch corporate governance system are presented. The findings and recommendations are based on case-studies and interviews conducted in large Dutch companies over several years and on extensive analyses of documents and recent evolutions. This research method however, is only suitable for a process of exploration, clarification and development of hypotheses. There is relatively little literature exploring the functioning and composition of the two-tier boards.

2. The Dutch corporate governance system

The Dutch corporate governance system is based on a two-tier board principle. Large companies have two separate boards - the board of directors (the executive management) and the board of supervisors (the non-executives) that meet with each other several times a year. The Supervisory Board consists only of 'independent' non-executives who have to serve the interests of the company as a whole.

Structure regime and co-option

Since 1971, the board structure of 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 large companies that meet certain criteria related to the number of employees and the amount of subscribed capital. These structure corporations have more than 100 employees, a legally established Works Council and equity of at least EUR 13 million. 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 companies that are part of a foreign holding structure. In these regimes the Supervisory Board generally has less rights and possibilities. The 'common regime' is applicable to small and medium-sized companies, giving them a choice between a governance model with a board of managing directors only and a two-tier board model.

While the shareholders' meeting has been granted extensive powers on policy-making in companies with a common regime, a substantial part of its power and control shifts to the mandatory Supervisory Board in structure corporations.

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 with a legal minimum of three directors. Under the rules of the structure regime it is not the shareholders' meeting but the Supervisory Board which has the

legal right to appoint and dismiss the managing directors. The Supervisory Board also has extensive powers to ratify certain management board decisions, such as the issuance and acquisition of shares in the company, the entry into or the termination of any ongoing co-operation by the company or a subsidiary of the company with another legal entity or partnership, the participation by the company in the capital of another company, the investment of a certain amount, a proposal to amend the articles of association, the termination of the employment of a substantial number of employees, a drastic change in the employment conditions, and so on. Under the rules of the mitigated structure regime the Supervisory Board does not have the formal rights to appoint and dismiss the members of the management board.

Up until October 1st of 2004 the shareholders' meeting in companies that operate under the rules of the complete or mitigated structure regime, has no formal power to influence the composition of the Supervisory Board. When vacancies arise the Supervisory Board appoints its directors through the system of co-option. Candidates are neither appointed by managing directors nor elected by shareholders or employee-representatives. The Dutch Supervisory Board has no capital or labour seats but appoints and reappoints its own members, in contradistinction to the German system of direct election. In Germany, supervisory board members are elected directly by shareholders and employees: the supervisory board (Aufsichtsrat) of large German companies is made up of equal numbers from each side.

In Dutch structure companies, both the shareholders' meeting and the Works Council (Ondernemingsraad) have the right to propose Supervisory Board candidates and to object to the appointment of certain candidates (the system of controlled co-option).

This system of controlled co-option means that each of the (re-)appointments should be checked by the shareholders and the employee-representatives and judged according its criteria such as qualification of the candidate and balanced composition of the board. The Supervisory Board must inform the shareholders' meeting and the Works Council at an early stage of the decision-making process about pending Supervisory Board vacancies and nominations. Before the board appoints a new board member, the shareholders' meeting, the Works Council and the management board have the right to propose other candidates for nomination. The shareholders' meeting and the Works Council also have equal rights to object to the appointment of candidates nominated by the board. This right to raise objections to the appointment of a supervi-

sory director is based on three grounds: the nomination and appointment procedures have not been diligently adhered to by the parties involved, the proposed candidate is found to be unqualified to fulfil the board position, and the appointment would not result in a balanced composition of the Supervisory Board.

If an objection is made, the Supervisory Board requires the permission of the Enterprise Chamber of the Court of Appeal in Amsterdam in order to get the candidate appointed.

Basic principles

The Dutch corporate governance model as described above, fits into the specific Dutch system of labour relations and is based on the basic principles of co-operation, equivalence, confidence and consensus.

The company is considered to be a co-operation with a longer-term perspective and having open relationships with the stakeholders, which include shareholders, employees, customers and society as a whole.

The board of management and the Supervisory Board are responsible for balancing all the different stakeholders' interests and gaining stakeholders' confidence. The shareholders' meeting is a forum for shareholders to be informed by the boards, to be given an explanation of company policy and to call the management to account.

The Works Council, as representative of the employees, has formal rights and informal possibilities for influencing the decision-making and the balancing act at the corporate level. The consultation process with the board of management is, however, highly based on interdependence, trust and consensus, and therefore very much situation determined, with big differences in the actual position and the functioning of the Works Councils.

The Supervisory Board's role and responsibility is to monitor and control management decisions on behalf of the entire company. That responsibility requires a high degree of independence on the part of the supervisors. In the Dutch corporate governance model this independence should be guaranteed by the system of co-option.

However, the co-option model has been subject to a great deal of criticism. From the stakeholders' point of view the Supervisory Board is far too much of an old boys' network. And the fact that members of the Supervisory Board are appointed by co-option and not selected at the shareholders' meeting, also limits the power of the shareholders. From that perspective, co-option can also be seen as a means of protecting the company from undesired shareholder activism.

3. Discussions on improving the performance of the board

Ever since the introduction of the Structure Act there has been discussion about the principles and the system of controlled co-option and the position of shareholders and employees in the nomination and the appointment of Supervisory Board members.

In the 1970s and 1980s, the discussion focussed for the greater part on employee involvement in the composition of the board. An extensive comparative analysis of the advantages and disadvantages of both board systems has been made between the Dutch and the German models (see e.g. Gelauff and Broeder, 1996).

In the last decade much more attention has been paid to strengthening the position of the shareholders, with the argument that if the share-

holders have more power in the appointment of Supervisory Board members, this should lead to improved functioning and performance of the boards.

As has been mentioned above, shareholders and stakeholders have become increasingly critical of the functioning of the Supervisory Board and of their lack of influence and involvement in the nomination and appointment of its members in the co-option model.

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), shows that the main parties involved (shareholders, employees and management) are very dissatisfied with the current situation:

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 more 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 1. Stakeholders' main arguments for criticizing the co-option model

These findings and critiques need to be analysed in the broader context of the corporate governance debate. It is not only in the Netherlands but worldwide that debate on the functioning of boards and especially on that of the non-executives is taking place. Issues which have received a great deal of attention in the debate include (compare Stiles and Taylor, 2001; Van den Berghe, 2002; Colley et al., 2003):

- the advantages/disadvantages of the one- and two-tier board systems
- the claim for enhanced shareholder control over poor management performance
- the advantages/disadvantages of employee representation on the board
- the 'enlightened amateurism' of supervisors
- the unequal workload between the chairman and other members
- the slow integration of new members
- the relative lack of attention to group dynamics and personal behaviour within the board.

The US Senate Governmental Affairs Committee's Permanent Subcommittee on Investigations, for example, concluded in the case of Enron that the board had failed because of lax oversight, superficial reviews and a puzzling display of disinterest.

Independence, expertise, time spending 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.

Board roles and governance theories

In general, the board is charged with the functions 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 CEO, board members who do not have the time or expertise to fulfil their roles adequately and members who do not have a vested interest in the company.

There is a great diversity of board roles and 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 shows, for example, that although managing directors and supervisory directors normally meet together, more emphasis is placed on separate supervisory board meetings. And more emphasis is also put on independent supervisory board leadership and supervisory board composition (page 163).

In the last decade, pressure has been put on one-tier boards to improve the formal independence of the board (Demb and Neubauer, 1992; Charkham 1994, Tricker 1994). 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 a more independent board type. 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 the policy making (the question of 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 (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 considered 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 whom they represent. But 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 distance.

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). The agency theory describes the potential for conflicts between the management and the shareholders, while, for example, the stewardship theory assumes that serving the shareholders' interests also serves the managers' own interests. In the so-called resource dependence theory, companies are open systems and boards have to manage external dependence and reduce environmental uncertainty (Hillman, 2003). Agency theory, resource dependence theory, but also other theories such as institutional or social network theories, have all proved to be relevant in helping to 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.

In the agency theory 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 that perspective the Dutch and German two-tier board model, with separated responsibilities for executives and non-executives, undoubtedly has some advantages concerning the independency of monitoring.

Stakeholder perspective

Shareholder and stakeholder perspectives give rise to differences in the definition of boards' roles. The starting point in this paper on the

Dutch system of corporate governance is the stakeholder perspective that assumes that the board has to monitor the management on behalf of all the relevant stakeholders (and should balance pluralistic claims, Gedajlovic 1993), and that serving the stakeholders' interests – and performing a 'balancing act' (see section 5) - also serves the interests of the shareholders and the management. In this point of view, a good relationship between the board and the stakeholders (characterised by dialogue, transparency and accountability) is crucial for a balanced policy-making process and for running the daily business. Several Dutch companies have already developed their own stakeholder concepts 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 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.

Good relationships and independence are both important (and probably necessary) for the board, although these aspects are somewhat in contradiction with each other. Quality, professionalism and personal behaviour are also recognised as crucial factors for the monitoring role of the board and for creating a company that performs better and is more responsible. The crucial factor for improving the boards' monitoring function is probably not the actual structure of the board and the choice between a one- or two-tier model, but the real functioning and the composition of the board.

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 the (short term) shareholder value only, on longer-term value creation or balancing all the relevant stakeholder interests.

The main question in this paper is how the Supervisory Board in the Netherlands can become a more effective monitor, changing from the co-option system towards a more direct election system, and what can be learned from a comparison of the Dutch system with the German model. What are the key factors for improving the boards' performance, especially in the context of Dutch labour relations?

4. Recent developments of the Dutch model

There has been a growing criticism that the Structure Act is limiting the power of the (general meeting of the) shareholders too much. There is also a change in the positive attitude towards protective measures. Almost all Dutch companies listed on the Stock Exchange are protected against too much shareholder influence and hostile take-overs by statutory measures such as the issuing of share certificates instead of shares (no voting rights attached), issuing priority shares to entrusted officials (shares with special influence on certain major decisions) or issuing preference shares to a friendly third party, usually a foundation. This section describes the recent discussions and developments of the Dutch model. First of all, the Peters Committee re-activated the discussion in the Netherlands within the broader context of the corporate governance debate basing this on Cadbury and other committees and codes.

Peters Committee

In 1997, a special Dutch Corporate Governance committee, the Peters Committee, made forty recommendations for improving the functioning and performance of the Supervisory Board and for strengthening the position of the shareholders. Among the recommendations were:

- the Board must 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 and critically
- the reappointment of supervisors must always be considered carefully and should not be an automatism
- the division of tasks and the working method of the board and its chairman should be formulated in a code
- 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 shareholders did not agree with continuing the specific Dutch structure regime, and the employee representatives were disappointed that there was still a lack of attention to workers' participation and to the role of the Works Councils, there was a generally positive response from the different stakeholders towards the recommendations made by the Peters Committee. Since the report of the committee was published, several companies have paid more attention to the functioning of their boards and in these cases there has been a gradual development from an old boys' network towards a more professional board.

Best practices already show some changes in the attitude of supervisors, from a passive and reserved attitude towards a more active and responsible one. Communication by the supervisors to the outside world is also becoming more open. Supervisors are gradually becoming more willing to answer to the shareholders. They have become more critical of the composition and performance of their own board and have enabled stakeholders (shareholders, employees) to exercise influence on these aspects. In spite of all these positive developments, however, the stakeholders (especially the shareholders) are still – and increasingly – criticizing the functioning of the board. The latest monitoring by the Peters Committee (in December 2002) showed that companies still provide insufficient information on how their boards function and that, as yet, there is no real growth in the involvement of the shareholders.

SER proposal

The question has also been placed on the agenda of the Dutch Social and Economic Council (SER, the Government advisory board).

During the last few years, the members of the SER (representatives of the employers and

employees and so-called crown members) discussed the pros and cons of the Dutch model and reached an agreement on how the Supervisory Board should be improved.

In line with existing Dutch principles and law on corporate governance, the starting point of the SER proposal remained the longer-term stakeholder approach and certain equilibrium between the influence of shareholders and employees on the composition of the Supervisory Board. The company was considered to be a co-operation and interrelationship between several actors, such as the management, the shareholders and the employees.

Other starting points and principles of the SER included:

- independence: the board should not be dominated by coalitions or interest groups
- trust: good functioning of the board requires adequate trust from the stakeholders
- quality: the board should have sufficient quality to be able to monitor
- broad composition, based on a wide range of expertises ('naar behoren samengesteld zijn') with representatives from different groups and types of expertise.

These principles did not really deviate from those formulated earlier in the Dutch law either.

The SER proposed (SER proposal, Jan. 2002) to give shareholders the right to formally appoint the board members who had been recommended by the board itself, and the Works Councils should be given the right to select and nominate a third of the board members at most.

The SER also recommended that:

- parties (the board together with shareholders and employee representatives) should draw up a profile
- the board of directors (the management) should improve its communication and information to the Supervisory Board,
- there should be better monitoring by the board and accountability towards shareholders.

This SER proposal thus suggested abolishing the controlled co-option system and giving more rights to shareholders, without attacking the above mentioned principles and the existing structure regime.

Tabaksblat Committee

In March 2003, a new Corporate Governance Committee (Tabaksblat Committee) was installed by the Dutch Finance Department to formulate a renewed code of best corporate practice, based on the recommendations of the Peters Committee. The first draft code – consisting of 23 principles

of good governance and 124 rather detailed recommendations - was presented last summer, including some drastic rules and limitations on board membership and (additional) management remuneration. The Tabaksblat Committee completed its final report at the end of 2003 after a period of consultation with several of the parties involved. The Committee made several recommendations for strengthening the independence, the quality and the expertise of the supervisors. It also recommended a limitation on the number of board memberships for supervisors, the limitation of board memberships for executive directors, more frequent contacts between the supervisors (especially the members of the audit committee) and the external accountant, recommendations on education and a special introduction programme for new members. Most of the recommendations – based on the so called comply-or-explain principle and in line with the recommendations of the European High Level Expert group – have been warmly welcomed by the stakeholders, although each stakeholder group still has its own arguments and wishes for changes and adjustments to the code. The shareholders still claim more influence for the General Meeting, the employers criticize the limitations on memberships and remuneration and that the rules are too detailed, and the employee representatives still claim more attention to workers participation in corporate governance.

Results

During all these years of discussions about good governance, stakeholders have made up their own minds. Several codes have been formulated and comments on these digested. There has also been a lot of political discussion about how to improve corporate governance, especially on improvements in the functioning and composition of the Supervisory Board. Politicians have even discussed a proposal (put forward by the left-green wing) to give both the shareholders and the employees the right to elect an equal number of the members, comparable to the German system. This proposal had no chance at all of succeeding

because it was not considered compatible with the specific Dutch labour relations.

The SER proposal – in a revised version but not fundamentally changed – has been on the agenda of the Parliament since the end of 2000. In the definite proposal (Tweede Kamer/Dutch Parliament, 2002) the recommendations made by the SER are underlined and in some aspects (for instance, the drawing up of a board profile) even strengthened. Although there seemed to be some resistance amongst politicians to adopting the proposal under discussion without taking any account of the further recommendations made by the Tabaksblat Committee and without discussing the complete structure regime, Parliament has definitively approved the revised version of the SER proposal.

The actual results and effects of this decision and of all the discussions mentioned above, will become evident in the next few years.

5. The balancing act

The Dutch co-option system has been criticized and discussed in the Netherlands for several years now with answers being sought to the questions of how to improve the functioning and monitoring of the Supervisory Board?, do the shareholders need more influence on the composition of the board?, should co-option be replaced by election? The government advisory board SER concluded that the shareholders' position should be strengthened in view of the international developments (especially the Anglo-Saxon trends) and financial market requirements, but the specific Dutch system of labour relations requires a well-balanced solution. If the position of the shareholders is to be strengthened, then employee participation should also be improved. And the interests of society as a whole should be included in the monitoring function of the Supervisory Board. The SER tried to find a balance between:

- a) the shareholder and the stakeholder approach
- b) the Dutch system of co-option and the German model of direct election.

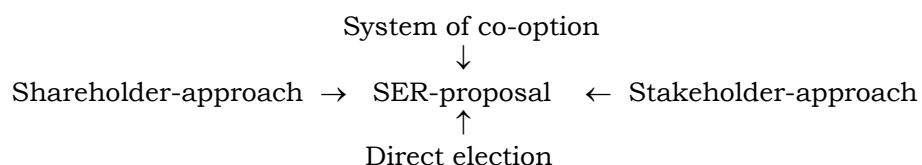


Figure 2. Factors that have influenced the SER proposal.

Shareholder versus stakeholder approach

In the shareholder approach (dominant in the Anglo-Saxon culture) shareholders are consid-

ered to be the only owners of the company. The main purpose of the company is to maximise shareholder value. The other stakeholders are considered to be 'contracting parties' with whom

the management has to make contracts on financial and labour conditions aspects.

The stakeholder approach, on the other hand, emphasizes the importance of a good relationship with all the relevant stakeholders for effective functioning and value creation of the company. In the stakeholder theories, shareholders' interests cannot be served unless the company takes into account its other key constituencies and stakeholders: satisfying stakeholders is essential in ensuring shareholder value (Stiles and Taylor, 2001, p. 96). Stakeholder-management is focussed on the dialogue with the different stakeholders and balancing the stakeholder interests. The actual corporate governance debate in the Netherlands takes place within this state of tension. The issue is one of good governance, monitoring and accountability on behalf of the shareholders but also on behalf of the other relevant stakeholders.

In the shareholder approach, corporate governance has to be structured in such a way that the management can best serve the shareholder interests. Management is generally under high pressure and has to realise value creation for shareholders. The main criterion in decision-making is the (short-term) shareholder value. And in the one tier board system the shareholders are more directly linked to, and have more influence on, the management than in the two-tier board model.

In the stakeholder approach (dominant in Rhineland countries) however, the shareholders are only one of the relevant stakeholders. Decision making is focussed much more on a certain equilibrium between, and value creation for, the different stakeholders. In this philosophy the corporate board structure is based much more on the opportunities for balancing all stakeholder interests (Goodijk, 2001). Wheeler (1997) for instance, has stressed the relevance of stakeholder-inclusive management, especially in the Anglo-Saxon context. A culture of stakeholder-relationship can also contribute to the attractiveness of the company and to image-building (corporate identity). The Dutch SER has, in principle, chosen the stakeholder approach that best fits Dutch labour relations and the culture of consensus. But the SER has also proposed to strengthen the position and influence of the shareholders by giving them the formal right of appointment of members of the Supervisory Board.

Co-option versus direct election

Both Germany and the Netherlands (Rhineland countries) have a two-tier corporate governance system with a strong tradition of stakeholder involvement in decision making. Shareholders have only limited influence on (strategic) policy mak-

ing by representation on the Supervisory Board (or the Aufsichtsrat) or participation (intervention, voting) in the General Meeting of Shareholders.

The German model, however, has focussed more on institutionalising stakeholder interests in the corporate governance structure. In contrast with the Dutch co-option system, shareholders and employees are directly represented in the Aufsichtsrat (the principle of direct election). And the Betriebsrat, unlike the Dutch Works Council, focuses more on the social consequences of decisions and the social interests of the employees.

The German model seems to provide better formal opportunities for stakeholder participation and governance watching at the board level, via the Aufsichtsrat. But the representation of stakeholder interests in the board system and the decision-making process at corporate level can easily introduce negative forms of coalition and conflicts of interest (the weaknesses of the German model). This explains why the German direct election system does not automatically result in greater stakeholder influence. The Dutch co-option model is more consensus oriented and less dependent on direct stakeholder interests, but co-option can also easily lead to an old boys' network (the weaknesses of the Dutch model). In the Dutch system, the Works Council is more involved in the strategic policy-making process (based on articles 23-25, Works Councils Act). The Works Council has the legal right to give advice on all major decisions including investments and restructuring. If the company does not follow this advice the Works Council can challenge the decision in court. Compared to the German relationship between Aufsichtsrat and Betriebsrat, there is more interaction between the Dutch Supervisory Board and Works Council. Research (Bos and Goodijk, 2002) shows that Dutch Works Councils of the larger companies are generally involved in the composition of the board and make agreements about exchanging information on company policy. Two-thirds of the larger companies have a Supervisory Board which contains at least one member recommended by the Works Council; and the Works Council is more or less involved in formulating a profile for the board in half of all the large companies. Because of the strengths and weaknesses of both the Dutch and the German system, the SER has looked for a model in between the two forms in order to reduce the weaknesses of the Dutch model without imitating the German model of direct election. The viewpoint of the SER is that the German system would not really fit with Dutch labour relations and the consensus-oriented culture.

6. Alternatives and stakeholder interests

As has already been mentioned, a discussion on improving the functioning of the supervisory board in the Netherlands has been underway for several years now. The co-option system is under severe pressure to be replaced by a form of direct election. The alternatives being considered for the Dutch model and the main pros and cons of each alternative, especially regarding the interests of the different stakeholders, are summarized below. The following alternatives, pros and cons and solutions have been considered as possible changes to the Dutch system (these findings are based on the codes and literature referred to above):

a) Improving the controlled co-option system

In this alternative the Dutch co-option model is continued. The Dutch co-option model is not based on election or representation but on the principle of 'specially having a relationship of trust' with the stakeholders. Improvements should be realised in line with the Peters Committee recommendations, such as: drawing up a profile for the Supervisory Board, selection of more professional board members, dividing tasks, setting up (auditing, remuneration) committees, having more access to sources of information, organising evaluation procedures, etc.

Pros: high degree of independence
appointments based on quality and trust

Cons: danger of old boys' network
low degree of stakeholder involvement

Shareholders and employee representatives should be mobilized to become more involved in company governance by actively participating in drawing up the profile and selection of supervisors.

b) Changing the co-option model without introducing direct election

The SER proposed some essential changes in the co-option model by giving the shareholders the formal right of appointment (and veto) of board members, selected and recommended by the Supervisory Board itself. The Works Council, on the other hand, should be given the right to select and nominate at most one-third of the board.

Pros: increasing awareness of shareholder value
higher degree of employee involvement

Cons: certain imbalance in stakeholder influence
lower degree of independence

This alternative is in some respects more in line with foreign governance systems, such as in Belgium where the shareholders have the formal right to appoint board members. The Belgian corporate governance debate is centred around ways to improve the independence (and accountability) of non-executives. And in Belgium they consider whether the involvement of the Works Council should be increased by giving the council the right to become informed before appointing the candidate. The independence of non-executives should also be related to the interests of the employees. The 'independent supervisor' is considered to protect the total company's interests, including those of all stakeholders (De Grauwe Corporate Governance Committee, 2000).

c) Choosing the direct election system

The co-option model can also be transformed into the German model of direct election by both the shareholders and the employee representatives: a system based on other starting points and principles but still within the context of stakeholderhood.

Pros: high degree of stakeholder influence
more transparency and accountability

Cons: danger of dominant conflicts of interest
low degree of independence.

The German system of corporate governance has often been described as providing shareholders and employees with substantial influence at the board level while still giving the management a relatively strong position in decision-making. Since the mid 1990s however, some of the larger German companies have changed their company policy towards increasing shareholder orientation. Some companies (such as Deutsche Bank) have even changed their corporate governance model to the Anglo-Saxon variant.

Stakeholders' interests

As has been argued before, it is in the company's interest to involve most relevant stakeholders in an effective way in creating and maximizing the company's value, including both shareholder and employee value as well as customer and societal value. Stakeholder involvement can also be considered as an instrument for commitment and transparency. One of the real issues of corporate governance is managing the stakeholder involvement and balancing the different interests.

The Supervisory Board has to monitor this balancing act, become more focussed on optimising all the different interests and values instead of maximizing just one specific value. It is not only

the managers but also the supervisors who need a fundamental change in attitude (Goodijk 2001; Hummels et al. 2003). Good governance but also good supervision depends mainly on personal behaviour. Good and responsible supervision also depends on the willingness for openness and dialogue: is there a real willingness among supervisors to consider stakeholders as critical governance watchers (Van den Berghe, 2002)?

In the Dutch two-tiered system it is fairly common for parties such as supervisors, management and Works Councils to meet each other periodically in tripartite meetings to discuss the policy and future of the company. Companies are also being challenged to organise longer-term involvement of the shareholders, for instance by activating and encouraging shareholders to attend and use their right to vote at general meetings and/or providing opportunities for shareholders to participate in the process of strategic decision-making, or by organising discussions with investors. Regarding other stakeholders such as customers, suppliers or the society as a whole, companies can organise platforms or special meetings to discuss the longer term policy of the company, the price-quality relationship and other matters.

David Wheeler (1997) stressed that the long-term value of a company rests primarily on the expertises, abilities and commitment of the shareholders, investors, employees, customers and society. Both outside and internal stakeholder involvement benefits the company's value creation.

Companies are being challenged under increasing pressure, to change rapidly, both within the organization (renewal processes, stimulation of employee involvement) and outside, at the corporate level (balancing stakeholder involvement, renewing strategic relationships, being more market-oriented). Within the organization, management is being challenged to stimulate and organize participation, to manage the innovation processes, to organize meetings for vision-making and value-marketing, to provide opportunities for networking and to create a culture of diversity and respect. All this demands a change in management attitude from management control to value creation, a change from control and certainty to openness, dialogue and creativity.

Internal governance is focussed on managing the internal organization, on policy-making, setting goals and targets, adopting plans, allocating funds and mobilizing involvement. At the corporate level, top management has to build relationships with external stakeholders, giving them opportunities for dialogue and involvement and acting in a transparent manner and being accountable to them. Stakeholder management, then, is a really important aspect of good corporate governance.

Recent research and literature (mainly based on Tricker, 1984; Garratt, 1990; Strikwerda, 1997) argues that there is a link between corporate and internal governance, focussed on organizing and mobilizing different – external and internal – relationships and responsibilities, monitoring policy making and controlling the – internal – implementation. Both internal and corporate governance are focussed on new, more open and transparent ways of governing, the involvement and participation of stakeholders in decision making and the creation of networks.

Supervisors have the responsibility to monitor all these management processes.

Monitoring requires information about the company's policy making but also data provided by internal auditing. Mostly, internal management processes and daily business are out of supervisors' control.

7. Conclusions

The most important issues in the present Dutch corporate governance debate are how to improve the functioning and the composition of the Supervisory Board and a reconsideration of the roles of the various stakeholders with reference to the composition of the board. We considered that improving the monitoring function of the Supervisory Board can have a substantial impact on the quality and performance of the management of the company.

In the Dutch two-tier governance model, the Supervisory Board is now being challenged to take more account of the financial interests of the shareholder than before, to build stronger relationships and trust with all the different stakeholders and to act more transparently and accountably (see the committees, codes and recommendations mentioned above). Since the mid-1990s, both the Dutch and the German system of corporate governance have come under severe pressure from shareholders, resulting from various changes in the international product and capital markets. Some at least of the larger companies are considering to introduce more shareholder-oriented elements.

Politicians in the Netherlands have preferred the second alternative given in section 6 (changing the co-option model), in line with the SER proposal. It is considered that the SER proposal will indeed contribute to a real improvement in the monitoring and controlling function and performance of the Supervisory Board in the Netherlands, in line with the specific Dutch culture and labour relations. The concept of equal involvement of both shareholders and employees is changing. But although the formal position of the shareholders (the general meeting) will be strengthened more in comparison with the formal

position of the Works Council, stakeholder involvement for both parties is still guaranteed.

The recommendations of the Tabaksblat Committee will undoubtedly lead to more detailed rules on the functioning and composition of the Supervisory Board. And it is not impossible that in the next few years the typical Dutch structure regime will - under even severer pressure - be abolished.

Whatever happens, independence, trust towards all the stakeholders and quality are considered to be - and to remain - crucial for the functioning and performance of the Supervisory Boards within the Dutch context. This research confirms the importance of these aspects of monitoring, shown schematically in the figure below. Further research should be carried out to verify the meaning of these key factors and to identify possible other factors.

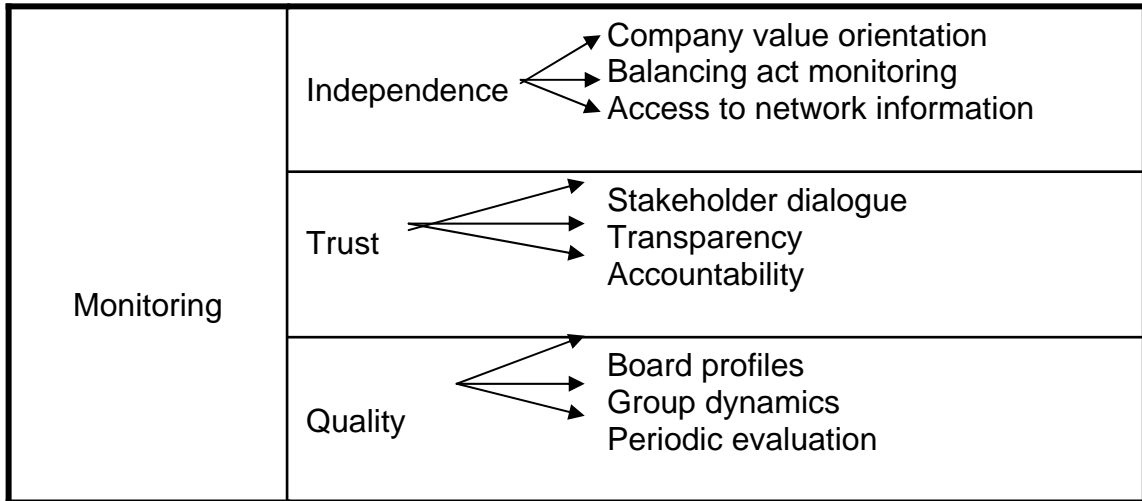


Figure 3. Key factors for improving the functioning of boards

Independence can be realised or improved by a strong focus on company value creation (focusing on the interests of the company as a whole), by monitoring the balancing act (how do managers take into account the different stakeholder interests?) and being given access to network information (not being dependent only on the information provided by management). Trust requires frequent stakeholder dialogue and transparent and accountable behaviour. And quality should be proved and improved by the preparation of good board profiles (also used for selecting candidates), by paying more attention to group dynamics and, last but not least, by periodic (self-)evaluation. Most of the above-mentioned codes also stress the importance of periodic evaluation by supervisors.

Employee representatives are challenged to provide relevant information for the board and to organise bilateral or tripartite meetings, to become involved in drawing up board profiles and to use their right of recommendation more than they have done up to now (Goodijk, 2001). And shareholders should recognise their responsibility for the longer-term development of the company by increasing their active involvement in the company's strategy and policy making. Perhaps it is now time to distinguish between different types of shareholders. Shareholders with longer-term

strategic interests and a real care for company policy could perhaps be treated differently from shareholders who are focussed only on short-term financial outcomes.

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