FRIEDRICH EBERT STIFTUNG

high pay centre

# WORKERS ON BOARDS

## INTERVIEWS WITH GERMAN EMPLOYEE DIRECTORS

## About the High Pay Centre

The High Pay Centre is an independent non-party think tank established to monitor pay at the top of the income distribution and set out a road map towards better business and economic success.

We aim to produce high quality research and develop a greater understanding of top rewards, company accountability and business performance. We will communicate evidence for change to policymakers, companies and other interested parties to build a consensus for business renewal.

The High Pay Centre is resolutely independent and strictly non-partisan. It is increasingly clear that there has been a policy and market failure in relation to pay at the top of companies and the structures of business over a period of years under all governments. It is now essential to persuade all parties that there is a better way.

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## About the Friedrich-Ebert-Stiftung

The Friedrich-Ebert-Stiftung is a non-profit German political foundation committed to the advancement of public policy issues in the spirit of the basic values of social democracy through education, research, and international cooperation. The foundation, headquartered in Bonn and Berlin, was founded in 1925 and is named after Friedrich Ebert, Germany's first democratically elected president.

Today, the Friedrich-Ebert-Stiftung has six adult education centres and 13 regional offices throughout Germany, maintains branch offices in over 90 countries and carries out activities in more than 100 countries.





## German lessons

**Deborah Hargreaves and Luke Hildyard**

In recent years there has been a growing interest in the German model of corporate governance.

The German economy emerged from the financial crisis in better shape than most of its European neighbours. Germany also hosts many successful world-leading companies in key sectors.

While criticisms have been directed at the German way of working, they run counter to those heard in Britain. German companies are sometimes accused of being slow to reach decisions and to react to changing circumstances. However, in the UK, short-term decision-making is highlighted as a particular problem.

Employee democracy is an established way of business life in many European countries with the UK an exception. The European participation index compiled by the European Trade Union Institute puts the UK second from bottom for workers' participation in the EU league. It looks at formal and informal ways of employees getting involved in corporate decision-making – only Lithuania has a higher ranking than the UK.

At the High Pay Centre, we believe that employees have an important role to play in company decision-making. We therefore wanted to explore how this works in Germany. This report is based on interviews with employee, union and shareholder representatives on supervisory boards and with a corporate governance expert.

VW factory, Wolfsburg

## How it works

Germany leads the way for employee involvement in company decision-making. Its two-tier board structure and network of works councils gives the workforce a strong voice. Employees sit on the supervisory board that exercises oversight over the executive management and hires and fires directors.

This means employees make important contributions to discussions about sensitive subjects such as executive remuneration and corporate strategy.

Coal and steel companies have had a supervisory and management board structure since 1951. The so-called co-determination law was strengthened in 1976 and extended to cover all listed and state-owned companies.

Companies with more than 500 employees based in Germany must all establish a supervisory board with at least a third of employee representatives. The numbers of workforce and shareholder representatives required to sit on the supervisory board vary depending on the size of the company.

Big companies with more than 2,000 employees have a 12-20-member supervisory board. Companies are required to have equal numbers of employee and shareholder representatives with union reps, workers and a management member representing the staff. In big companies there are 6-10 employee reps: 2-3 from the union, 3-6 from the workforce and a management representative .

All employee reps are voted for by the company's German staff; voting is either directly for candidates or by electing a delegate assembly.

The remaining 6-10 members are voted on by shareholders and represent investors with a stake in the company. The chairman is always a shareholder representative and has a second vote in the event of a tied decision at the supervisory board.

The supervisory board has the right to appoint and dismiss the executive board that runs the company – voting is by two-thirds majority.

In 2009, the supervisory board was given an extended remit to set executive pay including bonus and share plans as well as the requirement to fix a maximum level for variable (or share-based) remuneration. (This was previously the responsibility of the remuneration committee of the board.) Some boards have responded by imposing pay caps (Deutsche Bank) or even cutting the chief executive's pay (VW).

The Bundestag, the lower house of parliament, voted in July to give shareholders the ultimate responsibility for voting on pay at the company's annual meeting. This still needs approval in the upper house, the Bundesrat.

Germany revised its corporate governance code in 2009 in response to the financial crisis, to give companies a broader set of responsibilities other than just a duty to shareholders.





The code reads:

*The management board is responsible for independently managing the enterprise in the interest of the enterprise, thus taking into account the interests of the shareholders, its employees and other stakeholders with the objective of sustainable creation of value.*

### What do employees bring to the table?

Employee representatives stress that they provide a bridge between the management and the workers. "My expertise is to tell the board what issues really touch the workforce and what they think. I always say 'I won't tell you how to run a balance sheet, but if you want to know what the employees think, ask me," says Martina Klee, employee representative at Deutsche Bank.

The issue of women in management is currently pre-occupying much of the bank's workforce and the supervisory board has told the executives that more women must be promoted in the next two years.

Employee reps point out that they make an important contribution to company strategy in this way and can help explain management thinking to the wider workforce. "We look at the strategic plan for the next five years and we look at where VW is investing. Of course, if you want to be the top auto company in the world, you have to invest in China, but we want a significant part of the investment to go to German companies," says Hartmut Meine, union representative at VW and Continental, the tyre and car components company.

*"It's not just about profit, there is a general understanding at VW that we don't shut plants: job security and profitability are the two goals of this company."*

The VW worker representatives then look at productivity gains to be made in German factories. They can talk to the workforce about short-time working and changing shift patterns to fit in with a temporary lull in production. Since the workforce has a voice at the top table, these agreements can be made in a collaborative environment.

"In an informal way, we have to make strategy in the board transparent to the workforce," said Mr Meine.

Hans-Peter Fischer who is the management representative on the VW board agrees.

*"Employees are the ones who ask the best questions as they have direct knowledge about running the company. How do shareholders know what is going on in the factory? They have to rely on reports from the executive directors."*

Christoph Danzer-Vanotti who sits on the supervisory board of the German state-owned rail company, Deutsche Bahn, as a shareholder representative, points out that when the rail operator had to cut 150,000 jobs over a 10-

Martina Klee, employee director at Deutsche Bank

Hans-Peter Fischer, Volkswagen supervisory board year period, it could agree this with the employee side of the board. This meant there were no lay-offs, but that the workforce was reduced through early retirement and re-deployment.

He has worked at Eon which has a large UK arm where he says the relationship with the union was more confrontational, but there was a huge turnover in staff and it was easier to reduce the workforce.

Many employee reps talk of the need to work as partners with the managers and shareholders to ensure the best decisions are taken for the company and its staff.

Andreas Schaedler at Deutsche Post

Andreas Schaedler, employee representative at Deutsche Post, also believes it is important to incorporate the interests of employees even though those overseas do not have direct representation on the supervisory board.

## Role of unions

The supervisory board system appears to function smoothly in workplaces with more homogenous union representation such as the IG-Metall union. In the banks where union membership is much weaker, and there are a number of smaller, pro-management unions, it is more challenging.

Beate Mensch from the pan-banking sector Verdi union who sits on the board of Commerzbank, says:

*"Generally speaking, unions were never very strong in the banking and finance sector. The union culture was based on social partnership, but that has changed since the financial crisis and there is much less trust between employees and management. It makes it much more challenging to make the supervisory board system work."*

The system of collective agreements on pay is also weaker in the banking sector and employee representatives are often more hostile towards the union representatives. "Sometimes the internal employee reps don't dare to vote against the management. The external union reps have differing views because they look beyond the company, at the sector and even at society as a whole," says Ms Mensch.

*"It is quite hard to keep the balance, we don't want to destroy the company, but we have to try and represent employees. There is a danger on the supervisory board that the management may try and win us over and we have to be careful about that."*

Martina Klee who is not a union member and sits on the Deutsche Bank board as an employee representative says:

*"In the financial sector, unions want to get involved in issues they have no idea about."*

Deutsche Bank is currently integrating Postbank, a German-based savings institution which is heavily unionised. This is causing some culture clashes.

Hartmut Meine from the IG Metall union says:

*"the structure of co-determination works better the stronger the union is. The structure on its own is important, but that's not enough. The union provides a lot of training and back-up for its board members."*

Union representatives commit to pay 90 per cent of their board fee back to the union in order to pay for training and support. Much of this goes to fund the Hans-Boeckler Foundation, a research organisation that provides expertise and training to back up the employee representatives.

"Mutual trust is the base for the German system," says Mr Danzer-Vanotti.

*"Confrontation between both sides doesn't work."*

This means it can take longer to make decisions and this has led to some criticism of the system in Germany, but it leads to buy-in and understanding for the subsequent decisions from employees, managers and shareholders.

Petra Reinbold-Knape, from the German mining, chemical and energy union, sits on the supervisory board of Bayer. She mostly operates in the former East Germany where it has been difficult to establish the supervisory board structure.

The chemical industry has just reiterated its commitment to a social partnership model which has served the industry well through tough times.

"In the crisis, works councils and unions agreed to short-time working and without that there would have been massive lay-offs, so employers appreciate it too," she says.

"German unions are not just orientated towards getting more money, but they are also looking for safe jobs in the future and they want to influence the decisions of the company," said Mr Fischer. Many employee representatives were keenly aware of the danger in high inequalities with the resentment and extreme politics that can lead to.

## How supervisory boards set pay

The issue of executive remuneration is a controversial one for the supervisory boards with often intense negotiation between investor and employee representatives.

At VW, the supervisory board agreed this year to cut the pay of Martin Winterkorn, chief executive, to €14 million. Hartmut Meine says three years ago, the supervisory board put in place a bonus and long-term incentive plan for Mr Winterkorn.

*"Our mistake was; we didn't see how well VW would develop. It's been very profitable and all the key features of the LTIP exploded. The last two years have been the best years at VW."*

In 2011, Mr Winterkorn's package reached €17 million, he was the best paid executive in Germany and at a time of austerity, there was a public outcry. Mr Winterkorn would have been on track to earn €20m last year.

This prompted a long debate on the supervisory board between the employee directors, the shareholders and executives. At first, the executives argued that the amount was justified by the system in place, but the employee and union directors tried to convince them the ratio to employees was too high. This was against a background of a public debate about fat cats and a pay ratio at VW that Mr Meine estimates at 340 to 1 between top and bottom.

In the end, the supervisory board managed to convince Mr Winterkorn to cut his pay-out to €14m and accept tougher bonus targets. Everyone agreed apart from the two investor representatives from Qatar who didn't understand what the fuss was about.

In the general debate, there were concerns that if top bosses are not paid enough, they will leave and go to the US. But Mr Meine points out that this hardly ever happens:

*"Mr Winterkorn is one of the best car managers in the world, but no-one would ever offer him the job of running General Motors."*

Martina Klee has also been involved in controversial decision-making over pay at Deutsche Bank where there is a joint chief executive.

*"We discussed a cap on pay for several months before we could agree. It still sounds too high to me, but the CEOs did not like it and said they could earn more elsewhere. Well, why did they take the job then?"*

The chief executives of Deutsche Bank have had their pay capped at €9.8m each.

At Deutsche Post, executive pay is partly tied to employee engagement which involves completion of a company-wide questionnaire – if the return rate is more than 70 per cent, the executives are entitled to 10-20 per cent of their bonus for this.

While there has been a public outcry over top pay in Germany, Martin Winterkorn is the only executive whose package comes close to those in the UK. His €14m (£12m) compares with £16.9m for Angela Ahrendts who runs fashion company, Burberry, and was the highest-paid boss in the FTSE 100 last year.

Dieter Zetsche who runs Daimler is the second highest paid in Germany on €8.3m (£7m) and Peter Loescher at Siemens is third with €7.8m (£6.8m). In the UK Angus Russell at Shire was second on £12m and Graham Mackay at SABMiller was third on £9.7m.

## Do employees outside Germany have a voice?

The employees who work outside Germany do not vote for supervisory board members and do not get a say in company issues. This is a concern for those on very international companies such as Deutsche Bank and Deutsche Post.

"Finding a balance is very difficult because the cultures are different, but it is important to meet international labour standards across the Group," says Andreas Schaedler, employee representative at Deutsche Post. DHL, the DP overseas brand is active in more than 220 countries worldwide and the company as a whole has 460,000 workers.

However, there are issues from overseas that make it to the supervisory board in Germany. Mr Schaedler points out that the Group's compliance with labour standards for staff recruitment is not consistent with the use of lie detector tests, for example.

At Deutsche Bank, there are 80,000 employees worldwide, half of them in Germany. But Ms Klee is concerned that means half of the employees are not represented on the board.

*"I don't know how they think. I think there should be people from abroad on the supervisory board. Employees overseas say they would like to share our model."*

## Conclusion

All of those we interviewed spoke of the hard work, the intense negotiations and the necessity to compromise that comes with a seat on the supervisory board. It is clear that the structure and way of working has not grown up overnight, but taken many years of constructive co-operation.

Interestingly, the co-determination system was strongly resisted in Germany when it was first introduced and shareholders even took the government to court to try and block it. Employers have often resisted some of the obligations it imposes on them.

However, many of our interviewees said that since the financial crisis, there had been much more of an acceptance of the system by executives and shareholders as they perceived more of its advantages and had stopped trying to undermine it.

Any move towards a German system in the UK would take some time to develop and would need a significant amount of goodwill on both sides. But if the German experience is anything to go by, employers and workers alike would come to value a system that enables them to work together to build productive and successful companies.