New Economy and Stakeholder Theory: Promoting The Competitiveness of Companies in the 21st Century

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Summary

The New Economy is also defined as "the Information Economy" or "the Second Industrial Revolution" or "the Post-industrial Society". It finally arrived in the 21st century after being heralded for a long time. The New Economy is focused more on talent, knowledge and information based on the mobile devices such as email, internet and intranet which makes the dot com companies contemporary in the global market. This economy is global and will steadily increase the globalisation of business. The basic issue of the corporate governance debate in the new economy era is again on whether corporate directors should view themselves as solely stewards of their investors' capital and so aim to maximise shareholder value or should they view themselves instead as custodians of their companies' "human capital" and thus concentrate more on protecting the interests and developing the knowledge and skills of their employees. In the new economy era, people are playing an increasingly significant role in the corporate governance system as we are in the midst of a transformation from an industrialised to an information-oriented society. Therefore, in this article, the role of the employees will be mainly discussed as one of the primary stakeholders in order to answer the question why is human capital the centralised capital in the New Economy in the 21st century and what kind of legal rules should be adopted to implement this measure to promote the success of the company.

Keywords: New Economy, Stakeholder Theory, Human Capital, Duties of Directors

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It is not the strongest of the species that survive, nor the most intelligent,
But the ones most responsive to change.
--- Charles Darwin

Chapter 1: Introduction

Social organisation and technological innovation have become two crucial simultaneous thrusts which have interacted to create a need for new goals and new institutions to serve them with the progress of our capitalistic institutions. The economic situation that the world experienced in the last two decades was, strictly speaking, a novel one. The novel economy is increasingly based on knowledge. Globalisation and information technology are changing every single aspect of the approach by which we work according with.[2] The productions in the modern economy are more likely in the form of intangibles comparing to the productions in the old economy, based on the exploitation of ideas rather than material things. This is also the so-called weightless economy. Therefore, many academicians and practitioners turn to the term "New Economy" in order to describe the economy of the world, especially in developed world, since 1990s. Technological development had brought on a higher sustained level of productivity growth which allowed faster economic growth with less inflation.[3] On the European perspective, the importance of putting investment in human capital at the forefront of policies aimed at promoting economic growth and social cohesion is explicitly outlined in the Lisbon Summit for turning the EU into the most competitive and dynamic knowledge-based economy in the world after the European Council March 2000.[4]

The necessity in investing in human capital was repeatedly emphasised since the Lisbon Strategy's policy. This message is given by its recent communications to lifelong learning, quality of work and mobility.[5] It is held that "measures aimed at increasing the quantity and quality of the stock of human capital should be an important part of any growth-promoting policy package".[6] Under the human capital investment, perspective and current employees' interests should be specifically paid attention by company directors. The interests of employee, as the

[2] C. L. Fisk, 'Knowledge Work: New Metaphors for the New Economy' (2005) 80 *Chicago-Kent Law Review* 839 at 839-840
[3] R. Formaini & T.F. Siems, 'New Economy: Myths and Reality' (2003) 3 *Southwest Economy* 1 at 1
[4] A. da la Fuente & A. Ciccone, *Human Capital in a Global and Knowledge-based Economy: Final Report,* Employment Social Affairs, European Commission Directorate-General for Employment and Social Affairs Unit A.1. (2002)
[5] *Ibid* see page 2
[6] *Ibid* see page 11

primary and internal stakeholder of the company, are always primarily discussed among the debate of shareholder primacy and stakeholder approach. In the new economy, the employees are more likely being regarded as resources of company investment, the protection of the company resources is largely depends on the corporate governance decisions. The reform of the corporate governance will definitely promote the efficiency of human resources in new economy. Furthermore, there are many insecure and vulnerable employees, especially in the third world where the information is not efficiently disclosed on employees' working environment and remunerations etc., who needs more protection through the corporate governance approaches and therefore locally change the trend of corporate governance. Therefore, the fully or partially adoption stakeholder approach might be a great way in **enhancing and promoting the quantity and quality** of human capital by focusing on directors' duties towards employees and directors' duties on information disclosure.

The convergence of changes on the economy creates the need to address the demands of companies, employees and society for a fundamental rethinking of corporate law and policy. The questions arise on, what is the relationship between new economy, human capital and the stakeholder approach? If the human capital is so important in the new economy, what are the measures in protecting the interests of employees as a basis of human capital in order to promote the competence of the company? Is the adoption of the stakeholder approach the right way and how to adopt it in order to make the directors of the company more responsible in the new economy era?

The layout of this essay, **firstly** there will be a **introduction on the conceptions** of new economy, the relationship between it and corporate governance together with the relationship between it and one of the primary stakeholder namely employee and human capital; **secondly the employees' interests** will be discussed especially on their position upgrading from servants to stakeholders who have a crucial and indispensable interests in promoting the success of company; **thirdly,** how to enforce the stakeholder approach under English enlightened shareholder primacy model will be argued, critical arguments upon Section 309 and Operating Financial Review will be specially presented afterwards.

Chapter 2: New Economy, Stakeholders' Interests and Human Capital

2.1 What is the New Economy and how does it differ from Old Economy

The term "new economy" was proposed for the first time by *Business Week* in 1994.[7] However, there is no common definition of the new economy. The new economy discussion has been regarded inclusive partly due to the reason that the term "new economy" means quite different things to different people.[8] Therefore, it is worthwhile to have a brief discussion on the economists' ideas on new economy.

Although academicians could mean very different things when they refer to new economy, almost everyone of them offers a crucial position to the significance of information. Nevertheless, the new economy is defined by economists in both broad and narrow way. In a broad perspective, the Bureau of Economic Analysis described the new economy as economy of "strong growth in real GDP and per capital GDP, higher rates of investment as well as low inflation and unemployment"[9]. Davis redefined the new economy as a "new paradigm" with the driving forces including technical progress, globalisation, product market structure modifications and labour market structure modifications.[10] Both of the arguments concluded three basic characteristics of the new economy including: firstly, there are always greater stability upon GDP and prices in the new economy; secondly, there is a potential drop in unemployment and inflation; thirdly and most importantly, there is a great potential long-term wealth creation opportunities mainly result from the impact of technological innovation over the last decades which started to show its tremendous economic result from the mid-1990s onwards.[11]

As for a narrow perspective, the new economy is always closely rated to the notion on development of information technology and internet together with their impact on economy. Gordon understood the new economy as equivalent to acceleration in the rate of technical advance in IT without taking into account its contribution prior to 1995 when he defined the new economy as encompassing the "mid-1990s acceleration in the rate of price decline in computer hardware, software and telephone services, the corollary of an acceleration of exponential growth rate of computer power and telecommunications capability and the wildfire speed of development

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[7] See J.W. Verity, 'The Information Revolution' (1994) 3372 *Business Week* 10; M.J. Mandel, 'The Digital Juggernaut' (1994) 3372 *Business Week* 22

[8] J. Triplett, 'Economic Statistics, the New Economy, and The Productivity Slowdown' (1999) 34 (2) *Business Economics* 13 at 13-14

[9] B. Fraumeni & S. Landefeld, 'Measuring the New Economy' Bureau of Economic Analysis Advisory Committee Meeting available on http://www.bea.gov/bea/about/newec.pdf

[10] G. Davies, M. Brookes & N. Williams, 'Technology, the Internet and the New Global Economy' Goldman Sachs Global Economic Paper, (2002) March

[11] N. Jentzsch, 'The New Economy Debate in the U.S.' John F. Kennedy Institute for North American Studies, Section of Economics, Working Paper 125/2001

of the Internet"[12]. Similarly, the analysis of Bosworth and Triplett on new economy focuses on the role of IT as an accelerator of the economy's trend rate of output and productivity growth when they claimed that New Economy embraces IT, namely "computes, peripherals, computer software, communications and related equipment.[13]"

The next question facing us is **what makes the new economy new.** Several distinctions were detected and discussed by Atkinson and Court[14] based on several characteristics of both economies, namely economy wide characteristics, industry, workforce and government. It is argued that, in the new economy, market is more **dynamic, unclear and unpredictable**. Companies are always facing the competition on an **international scope.** The rule of the game on the competition is the **fast eats the slow.** The Dot Com companies and networked companies are common organisational form with interconnected subsystems which are flexible, devolved, employee empowerement, flat or networked structure. The key drivers in supporting enterprise are people, knowledge, capabilities. The success of the company is measured upon market capitalisation of the company based on the market price of the entire company composed of elements like share price, reputation of the company, value of the trade mark etc. The leadership is always based on shared power structure with employee empowerment and self eldership. Employees are always regarded as investment of the company.

On the other hand, the old economy is based on the notion of stable, liner and quite predicable markets and companies are competing on a domestic basis with a hierarchical bureaucratic structure.[15] The key driver to growth of enterprise is capital. The rule of the game on the competition is the big eats the small. The success of the company is measured upon profit. The leadership of the company is purely vertical. The employees are always seen as expenses of the company.

For an example, dramatic changes have taken place as for *Levi Strauss*. Currently, it is estimated that 80% of the company expenses spend on make and sell a pair of jeans is spend on information rather than denim, dye, cutting or sewing which is the main expenses before the

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[12] R.J. Gorden, 'Does the New Economy Measure up to the Great Inventions of the Past' NBER Working Paper, Aug 2000, http://paper.nber.org/papers/W7833

[13] B. Bosworth & J. Triplett, 'What's New About the New Economy? IT, Economic Growth and Productivity' Brookings Economic Papers, October 20, 2000, available via website (visited on 2nd March 2006) http://www.brookings.edu/views/papers/bosworth/20001020.pdf

[14] R. Atkinson & R. Court, *The New Economy Index Report: Understanding America's Economic Transformation,* Progressive Policy Institute, Technology, Innovation and New Economy Project, Nov.(1998), for more detailed content see via website: http://www.neweconomyindex.org/index_nei.html#Table_of_Contents

[15] Ibid see page 7

launch of the new economy. The company becomes a marketing, design and trademark holding importer.[16] The employees' interests in these companies in new economy are more professional and company input on human capital should be more. The notion of corporate governance and basic debate upon shareholder stakeholder will be introduced under the new economy perspective.

2.2 New Economy and Corporate Governance

The New Economy is also defined as "the Information Economy" or "the Second Industrial Revolution" or "the Post-industrial Society". Successful companies in the new economy era will engage effectively with key stakeholders in the markets for goods and services, finance, labour and political patronage.[17] Under the European perspective, due to the fragmented European research community, new economy was less taken care of than the old economy comparing with the US. However, the key issues which have initially and always been motivating the potentials of research on corporate governance still rest on for whose interests the corporations should serve for.

The benefits brought by new economy are, in various aspects, **benefiting** various stakeholders in companies or are **brought by progress and distinguished performance** of stakeholders. The respectable performance of **employees** in technological innovation has accelerated not only the pace of innovation but also the pace at which new products gain widespread use and produce significant sales.[18] If the preferential considerations on shareholders' interests could be justified by the claim that they bear the greatest risk relative to a company, the duties of directors on employees can be justified by their direct relationship with the company. The employees always feel difficult to find a similar new job after leaving one job when the company goes to insolvent. Employees also have to be charged with the losses of income, skills, confidence and health in their wake perhaps permanently.[19] Compared to the risks borne by shareholders who can and do diversify their risk through portfolio of shareholding, the

[16] T. A. Stewart, *Intellectual Capital: the New Wealth of Organizations*, London: Nicholas Brealey (1997) see page 14
[17] S. Zadek, N. Hojensgard & P. Raynard, 'The New Economy of Corporate Citizenship' in S. Zadek, N. Hojensgard & P. Raynard (edns) *Perspectives on the New Economy of Corporate Citizenship*, Copenhagen: The Copenhagen Centre (2001) see page 19
[18] R. Formaini & T.F. Siems, 'New Economy: Myths and Reality' (2003) 3 *Southwest Economy* 1 at 2
[19] J. Williamson, 'A Trade Union Congress Perspective on the Company Law Review and Corporate Governance Reform since 1997' (2003) 41 (3) *British Journal of Industrial Relations* 511 at 513

risks borne by employees seemed disproportionate. Therefore, how to protect their interests becomes an issue that needs to be considered. The quicker and more comprehensive information on the products for **consumers** has wakened the producer pricing power. The information also perfects the market towards a fair competitive model. The modern information technology makes the **supply-product-consumer chain** easier to manage and create timelier inventory, rapid production and delivery system.[20] The **customers** are being provided better services through new technology in the new economy via internet or wireless communications. Besides, the information technology in the new economy also benefits the **local communities**. For example, it will promote the situations of local school and hospital etc.

Therefore, basic issue on the corporate governance debate arise in front of us again in the new economy era on should corporate directors view themselves as solely stewards of their investors' capital and so aim to maximise shareholder value or should they view themselves instead as custodians of their companies' "human capital" and thus concentrate more on protecting the interests and developing the knowledge and skills of their employees.[21] In the new economy, more extensive education and training should be ensured to employees to allow the new technologies of the company to be developed and adopted. Directors should also accumulate the human capital for scientific research in order to consider the long term interests of the company in the new economy era even if the educations to the employees are might at the expenders of the company shareholders' for short term. The dominant role of employees in the new economy era enhances and accelerates the adoptions of stakeholder approach in certain shareholder friendly jurisdictions in order to promote the long-term interests of the companies. In the next section, the relationship between new economy and human capital will be discussed in order to illuminate the importance of employee protections in modern corporations.

2.3 New Economy, Human Capital and Employees

Information networks are extensively established and are giving people everywhere inexpensive access to huge amount of information classified into various databases. Thousands of successful

[20] Ibid

[21] J. Aoi, 'To Whom Does the Company Belong? A New Management Mission for the Information Age' in D.H. Cew, (edn.) *Studies in International Corporate Finance and Governance System: A Comparison of the U.S., Japan, & Europe,* Oxford: Oxford University Press (1997) see page 244 at 246

cases inform us that investment in human capital contributes significantly to productivity growth, especially for high technology science companies. It is, *de facto*, one of the huge successes of the modern corporation in attracting the talent of workers, who otherwise might have been independent entrepreneurs, without offering them ownership, control, or even the obligation of directors' considerations towards their interests.[22] It is estimated that human capital accounted for 22% of observed productivity growth over 1969-90 and 45% of the productivity differential with the sample average in 1990.[23] The employees, as providers of human capital, play a key role in fostering innovation and alteration of the company.

In the new economy era, the information obtained by the consumers will demand for customised products which will indubitably result towards a more demanding role for employee initiative and creativity. Knowledge or intellectual capital and talent of them will greatly promote the innovation and modifications on products of the company and company itself. The value of intellectual property is becoming increasingly crucial in knowledge economy. For example, in 1999 copyright became the United State's number one earner of foreign currency, outstripping clothes, chemicals, cars, computer and planes. The knowledge, talent and technology of employees, like electricity, are in the form that exists only when it is being used.[24] Company directors should identify and encourage the development of the **"human assets"** in ways of individual in order to contribute to the company's success with employees' highly subjective tastes and idiosyncratic ways of thinking.[25]

The massive shift on manufacturing capacity from Western economies to those countries that offer access to cheaper labour will continue be a main trend in new economy. This will not only create job to local communities in developing countries but also create severe pressure for unskilled worker for unskilled workers in more advanced economies.[26] However, this transition will also cause social problems concerning the employment working environments in developing countries where the interests of employee cannot be efficiently and soundly protected by employment law. Disasters might happen and unethical phenomena might prevail in developing

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[22] C. L. Fisk, 'Knowledge Work: New Metaphors for the New Economy' (2005) 80 *Chicago-Kent Law Review* 839 at 843

[23] A. da la Fuente & A. Ciccone, *Human Capital in a Global and Knowledge-based Economy: Final Report,* Employment Social Affairs, European Commission Directorate-General for Employment and Social Affairs Unit A.1. (2002) see page 4

[24] P. Druker, Chapter 15: 'Leadership --- More Doing than Dash' in *Managing for the Future,* London: Butterworth-Heinemann, (1992) see page 119-125

[25] J. Aoi, 'To Whom Does the Company Belong? A New Management Mission for the Information Age' in D.H. Cew, (edn.) *Studies in International Corporate Finance and Governance System: A Comparison of the U.S., Japan, & Europe,* Oxford: Oxford University Press (1997) see page 244 at 247

[26] P. Sadler, *Building Tomorrow's Company: A Guide to Sustainable Business Success*, London: Kogan Page (2002) see page 19

countries due to negligence of the company directors. Meanwhile, the employees have not got relative information to protect themselves with less developed information system for them compared with those countries which have stepped into new economy era in advance. For example, in the Bhopal incident, 20,000 people including company employees were killed or harmed by a chemical leak from American owned chemical works in the city. The leak could have been prevented if procedures, management and maintenance had been rigorous. For another example, the use of child labour by multinational companies, in factories in the third world, to produce products selling in western market became an international issue in the 1990s and the first decade of the new millennium.[27] Therefore, directors should pay special interests on employee as key stakeholders if the company is based in the third world countries in order to secure the health and safety of employees and customers. The employees should be offered more information of the company by directors including the operation and safety knowledge. Also they should be aware of the both domestic and international legal requirements and should give the local managers sufficient training on legal and local ethical policy issues.

It is claimed that "participation and intervention at local, national and global level" in order to "unleash extraordinary development benefits and real social and environmental gains".[28] New Economy will most effectively deliver a positive balance of benefits and costs if we ensure that "societies are fully able to take advantages of the arising opportunities by encouraging socially and environmentally responsible business conduct."[29] This can be ideally realise through partnership with various external stakeholders and create synergies with various stakeholders like local communities, local organisations and societies, labour organisations and certain international bodies.

Chapter 3 Interests of Employee in the Company--- from Servant to Stakeholder

Before arguing employees' interests in company, it is worthwhile to mention the notion of stakeholder briefly. The actual term "stakeholder" first appeared in management literature in an internal memorandum at the Stanford Research Institute in 1963 and was meant to generalise the

[27] C. Fisher, A. Lovell, *Business Ethics and Value: Individual, Corporate and International Perspective*, Harlow: FT Prentice Hall, (2006) see pate 53
[28] J.D. Wolfensohn, Foreword in S. Zadek (edn.) *The New Economy of Corporate Citizenship*, Copenhagen: The Copenhagen Centre, (2001)
[29] *Ibid*

notion of stockholder as the only group to whom management need be responsive.[30] The use of "stakeholder" to refer to the various interests who participate in a business has commonly been accepted since 1980s from the landmark book in the business literature of Freeman's *Strategic Management*[31]. The concept of stakeholders was defined as "those groups without whose support the organisation would cease to exist" and originally include shareowners, employees, customers, lenders and society.[32] The most famous and frequently cited definition was given by Evan and Freeman in their essay[33] namely that the "stakeholders are those groups who have a stake in or claim on the firm."[34] The stakeholder can be divided into primary stakeholders and secondary stakeholders according to the relationship between their interests and the company. They can be also divided into the internal and the external stakeholders depending if they are those who are members of the company.

The employees have an interest in the company as it provides their livelihood in the present day and at some future point, employees may often also be in receipt of a pension provided by the company's pension scheme.[35] They should be a key group of people in the stakeholder groups who can enhance sustainability of the company they work for by providing their own convictions and experiences in order to contribute to innovation and alteration. Employees should be in the front of queue by various stakeholders in qualifying to embody a company. They are the ones who create, invent and produce products, deliver its professional services to the company and create its profits and represent it to the external world.[36] Some stakeholder approach proponents even suggest that workers, together with shareholders, shall be recognised as the residual claimants of the company. In practice, the employees might be invited to join the board of directors and some of them might be chosen as the representatives to join the meeting when directors want to consult employees in corporate decision-making.

The employee can be divided into substitutable employees and none-substitutable employees based on the services they are providing to the company as stakeholders. The football players, for example, could be the none-substitutable employees in the football clubs as companies. The

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[30] E. Sternberg, 'The Defects of Stakeholder Theory' (1997) 5 *Scholarly Research And Theory Papers* 3
[31] R.E. Freeman, *Strategic Management: A Stakeholder Approach* Boston and London: Pitman (1984)
[32] ibid, see page 31-32
[33] W.M. Evan & R. E. Freeman, 'A Stakeholder Theory of the Modern Corporation' in Snoeyenbos, Almeder & Humber (eds.), *Business Ethics* 3rd edn. New York: Prometheus Books (2001) see page 101-114
[34] Ibid see page 102
[35] C. A. Mallin, *Corporate Governance* Oxford: Oxford University Press (2004) see page 45
[36] J. Williamson, 'A Trade Union Congress Perspective on the Company Law Review and Corporate Governance Reform since 1997' (2003) 41 (3) *British Journal of Industrial Relations* 511 at 514

none-substitutable employees are also very frequent hired in high technology companies like software companies or pharmaceutical companies and the employees are specialist in certain areas which are very difficult to be replaced. When the company try to create long-term well-organised relationship with employees, these employees are especially important since their existence is crucial to the running and development of the entire company. However, although they are substitutable, it is not the case that their interests can be ignored. Powers of employee organisation, such as strikes, will easily put the company into difficulties.

The important position of employees, in my opinion, depends on the facts that employees create the net profits for the company and sustain the entire beneficial running of the company. Any negative actions by employees will definitely have tremendous influences on the company. The company has to guarantee the occupational safety and health of the employees which is regarded as one of the most important comprehensively legislated and well regulated elements of good stakeholder management.[37] In the next part, the protections of employees' interests will be discussed under the English corporate law perspective although it is might be fully aware that duties of directors towards employees will go beyond corporate law such as employment or pension law.

Chapter 4 Protection of Interests of Employees under English Company Law

English company law has traditionally paid little attention to the contention that directors should woe duties to person other than company shareholders, preferring instead to focus and support the shareholder wealth maximisation approach.[38] However, different from and more progressive than American corporate governance which remains firmly focused on shareholder value, the UK appear to be setting out on a "**third way**" that mergers elements of the shareholder and stakeholder approaches. Britain has emerged as a leader as for the realm of corporate social responsibility.[39] Its "**third way**" explicitly advocates a shift in focus on "long term interests of

[37] D. Wheeler & M. Sillanpää, *The Stakeholder Corporation: A Blueprint for Maximizing Stakeholder Value* London: Pitman Publishing (1997) see page 223

[38] S. Goulding & L. Miles, 'Regulating the Approaches of Companies towards Employees: the New Statutory Duties and Reporting Obligations of Directors within the United Kingdom' in S. Tully, (edn.) *Research Handbook on Corporate Legal Responsibility*, Cheltenham: Edward Elgar (2005) see page 88

[39] J. Moon, 'An Explicit Model of Business-Society Relations' in A. Habish, J. Jonker, M. Wegner & R. Schmidpeter (edns) *Corporate Social Responsibility Across Europe*, Berlin: Springer (2005)

the company” and “enlightened shareholder value” which requires the directors of the company recognise and report their business performance effect on extended stakeholder constituencies such as employees, communities, and the environment. The UK’s goal appears to maintain its corporations’ financial accountability to a constituency of dispersed, independent shareholders while simultaneously using market forces to nudge companies in the direction of greater social responsibility by taking stakeholders’ interests into account.[40]

Directors, under the UK’s third way model, have to consider the interests of stakeholders by following several attainment levels to obtain perfect overall stakeholder relationship.[41] More extensive duties on directors will be focus on their duties towards various stakeholders apart from shareholders. The first level **awareness** requires directors be aware that business needs to maintain good relations with a wide variety of stakeholders; the second level **understanding** requires directors recognise the key stakeholders of the company and respond accordingly; the third level **application** requires directors to take part in the activities actively in building relations and consulting with stakeholder representatives; the fourth level **integration** requires directors to be responsible for their decisions that systematically take into account the impact on stakeholders; the last level **leadership** requires directors to help companies develop a business strategy that balances potential competing demands of stakeholders groups.[42] Furthermore, whether the company is useful is measured by seeing how it assists society gain a richer understanding of community by respecting human dignity and overall welfare.[43]

It is apparent to us that employees, as the internal stakeholder of the corporations, are more vulnerable than any other constituency to management adoptions in the company. Dealing with employees is the academic area where all of us are most likely to encounter currently. Whether it is a question of fair wages and conditions, sexual harassment in the work place, or maybe just taking advantage of company resources such as the phone or internet for personal use, employee related ethical problems are unavoidable for most contemporary directors of the company.[44] However, the discussion in this essay will only limited within th scope of directors’ fiduciary duties towards employees under corporate law rather than employment law and pension law etc.

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[40] C.A. Williams, J.M. Conley, ‘An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct’ (2005) 38 *Cornell International Law Journal* 493 at 500

[41] CSR Academy, *The CSR Competency Framework,* Funded by DTI, (2004) see page 8

[42] Ibid

[43] D. Sullivan and D. Conlon, ‘Crisis and Transition in corporate Governance Paradigms: Te Role of the Chancery Court of Delaware’ [1997] *Law and Society Review* 713

[44] A. Crane, D. Matten, *Business Ethics: A European Perspective Managing Corporate Citizenship and Sustainability in the Age of Globalization,* Oxford: Oxford University Press (2004) see page 223

although directors' duties under those legislations also consist a significant part on their duty scheme.

The shareholders of the company always have a proprietary view since they are the always being regarded as the owners of the company and are enjoying rather different priorities namely dividend payments and the capital growth in the value of their shares. Directors, both the manager and the employee of the company, are appointed by shareholders and can ultimately be removed by shareholders. They will definitely and naturally consider the interests of shareholders. As for employees, when they essentially sell their labour to companies in exchange for a salary and other benefits, such as pension and technique training, the duties and rights contained in current employment protection legislations extend well beyond the bounds of their contractual relationship with the company.[45] The directors of the company are responsible for the compliance of the requirements in related employment legislations. However, the company may make a claim against directors if their misconduct of acting in a fraudulent or negligent manner is being detected for failure to act in the best interests of the company. In this section, the directors' duties towards employees, as one of the most important stakeholders, will be discussed not only legislatively but also judicially.

4.1 Historical Review

Historically, in the mid-nineteenth century, employees were perceived as having no legitimate interests within the business of the company or its assets. Therefore, directors owe no duties towards the companies' employees. However, employees will benefit from directors' decisions but just upon their operations on managerial discretions and the interests of the employees have to be consistent with benefit accruing to the shareholders.[46] Judicially, in the case *Hampton v Price's Patent Candle Co.*[47], it was held by the judge that keeping the workforce happy and satisfied was a prudent capitalist policy but it was not a legal requirement. The refusal of the Court in considering the interests of the was once again reflected in practice by the operation of the *ultra vires* rule by the court in *Hutton v. West Cork Rwy. Co. Ltd.*[48] in which the Court of

[45] M. B. Fcis, *Rights and Duties of Directors*, 7th Edn., Sussex: Haywards Heath: Tottel Publishing (2005) see page 277
[46] D. Milman, 'From Servant to Stakeholder: Protecting the Employee Interests in Company Law' in Feldman & Meisel (eds), *Corporate and Commercial Law: Modern Developments* London: LLP (1996) 147 at 149
[47] *Hampton v Price's Patent Candle Co.* [1876] 44 LJ Ch 437
[48] *Hutton v. West Cork Rwy. Co. Ltd.* [1883] 23 Ch. D. 654

Appeal confirmed that it was beyond the capacity of a company to make gratuitous payment to past or present employees. In sum, employees' interests were not formally considered by directors under English Law in the early years of Company Law.

The government attempted to make a change. **Bullock Report**[49] on Industrial Democracy 1977 was set up by the Labour government in order to advocate a radial extension of industrial democracy through a requirement that unions be given the right in law to protect the employees' interests. There are **three proposals** which were considered by the Bullock Committee. **Firstly**, the Trade Union Council, which would have given trade unions the right to demand that employees elect half of the directors in large companies.[50] **Secondly,** a proposal was that of the EEC Commission, which would require large companies to have, in addition to an executive board, a supervisory council in which one-third of the members would be elected by employees.[51] **Thirdly,** it is proposed by the Confederation of British Industry that companies would be required to negotiate employee representation schemes with their own employees, without any legislative prescribed format or proportions.[52]

The Bullock Committee concluded in recommending the creation of a **Commission** to observe, encourage and recommend specific step towards **employee representation.**[53] In detail, it is required to elect representatives to the board of directors of private companies employing more than 2000 employees. The key features of the recommendations were that union representatives should be equal in number to those of shareholders, with a smaller group of agreed "independent outsiders", and that, unlike in some continental European countries, they should be elected by trade union members, rather than by all employees. However, the response of British employers was universally hostile, and that of the unions ambivalent, since many were worried that the proposals might undermine established collective bargaining machinery. A report to Parliament was suggested by the Labour government recommending adoption of a law that would require companies to discuss employee representation with their labour unions and either to reach a solution within a reasonable time or to submit to a plan that would be imposed by

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49 *Report of the Committee of Inquiry on Industrial Democracy* 1997 Cmnd 6706 at 84 (Lord Bullock, Chairman); the committee also commissioned and has published two comparative research reports: E. Batstone and P.L. Davies, *Industrial Democracy --- European Experience* (1976)

50 *Report of the Committee of Inquiry on Industrial Democracy* 1997 Cmnd 6706 at 84 (Lord Bullock, Chairman) see page 26-28

51 *Ibid*, see page 28-30

52 *Ibid*, see page 30-32

53 *Ibid, see page* 160-166

another committee created for their purpose.[54] As far as **directors' duties** are concerned, the Bullock Report called for a reform of the basic directors' duty to act in the best interests of the company. It also further proposed that directors should be entitled to take account of the interests of shareholders and works in subsidiary companies.[55] However, the Labour government fell from power before any of these proposals were actually adopted by Parliament.

In the event, the **return of a Conservative government** in 1979 removed the issue from the dominant political agenda. The Labour Party remains committed to a form of industrial democracy, and proposals for employee participation emanating from European Community initiatives may reinvigorate debate on this issue. There was a sharp division of opinion with in the trade unions.[56]

Apart from the realisation of Bullock Review upon employees' interests, the directors' duties in considering the interests of employees was also realised in 1977 when a **Government White Paper,** the *Conduct of Company Directors,* acknowledged that directors that directors ought to consider their employees' interests:

> "The Government believes that employees should be given legal recognition by company law. The statutory definition of the duty of directors will require directors to take into account the interests of employees as well as of shareholders. They will also be required to send the annual report to all employees as well as to shareholders."

A *Companies Bill 1978* also proposed the statutory codification of the directors' duties towards employees. It was provided in Clause 46 of the Bill that: "(1) The matters to which the directors of the company are to have regard in the performance of their functions shall included the interests of the company's employees generally, as well as the interests of its members." However, the Bill was never enacted since it was lapsed on the 1979 General Election.[57] In White paper 2002 and 2005, **long-term view and not just immediate return** was specially emphasised when directors make decisions on purpose of establishing the effective framework of the company law to help the performance of the Britain's Companies. Moreover, "wider factors such as **employees, effects on the environment suppliers and customers** besides shareholders were explicitly stated

[54] See Industrial Democracy 1978 Cmnd 7231
[55] See *Charterbridge Corporation v Lloyds Bank* [1970] Ch 62.
[56] See O. Kahn-Freund, 'Labour Law and Industrial Relations in Great Britain and West Germany' in Lord Wedderburn, R. Lewis & J. Clark (edns) *Current Direction in Labour Law: The British Perspective*, Arbetsrattslica Uppsatser (1982) see page 7
[57] S. Sheikh, *A Practical Approach to Corporate Governance*, London: LexisNexis UK (2003) see age 332-333

in the Bill in order to implement the **enlightened shareholder approach**.

4.2 Assessment of Article 309

Under company law legislation, Section 309 of Companies Act 1985 imposes upon the directors a statutory duty to consider the interests of employees when carrying out their duties and disclose information in the annual accounts on employees and employment practices. Section 309 specifically claimed that the duty it imposes on directors is owed exclusively to the company. This should mean that the duty to consider the interests of employees is not owed to, and is not enforceable by, the employees themselves.[58] Therefore, the duty is no great burden on directors since the law just simply require the director to **consider** rather than **acting in the best interests** of employees. And the directors will not give priorities to employees over shareholders in making decisions.[59] In another word, the section does not impose a positive duty on them which is owed directly towards employees. It is merely enough for directors "to have regard" to their employees' interests in which their corporate decisions may have the harmful effects on their employees. An aggrieved employee is effectively denied any remedies as they have no *locus standi* to complain, unless they are directors or shareholders in the company as the same time.[60] Therefore, Section 309 is perceived as "mere window dressing"[61] and "statutory provision without teeth"[62].

Practically, Parkinson also argued certain deficiencies of Section 309 when he thought the section would not have much effect on the way companies operate in practice.[63] Apparently, current duty imposed by Section 309 is a subjective duty. Directors have to act in accordance with what they believe to be an appropriate balancing of the sometimes conflicting interests[64] while the Court is unable to intervene merely because it disagrees with the way in which the directors have weighted those interests.[65] Besides, there is no guidance in the section for directors on how they should interpret their responsibility under this provision. There is also no guidance on directions or practical method on how will directors balance the interests of

[58] S.W. Mayson, D. French & C.L. Ryan, *Mayson, French & Ryan on Company Law,* 21st Edn., Oxford: Oxford University Press (2004) see page 522
[59] G. Proctor, L. Miles, *Corporate Governance,* London: Cavendish Publishing (2003), see page 43
[60] S. Sheikh, *A Practical Approach to Corporate Governance,* London: Lexis Nexis UK (2003) see age 333
[61] *Ibid*
[62] B. Hannigan, *Company Law,* London: Lexis Nexis (2003) see page 206
[63] *Ibid*, see page 83-84
[64] *Ibid* see page 83
[65] *Ibid* see page 84

shareholders and employees.[66] The managerial ability will mostly base on the discretions of the directors. Therefore, if the action is going to be brought on, it is necessary to prove the management policy is injurious to employees' interests or the directors' disregard or do not honestly consider their policy will constitute a well balance between the interests of shareholders and those of the employees. This means the directors' decisions which are injurious to employee interests can be only attacked on the grounds that the directors lacked good faith which is extremely limited and difficult to improve.

Furthermore, this specific duty is appear to be unenforceable because there is no direct means in enforcing it, either individually or collectively. According to Section 309 (2), the duty is owed to the company (and the company alone) and is enforceable in the same way as any other fiduciary duty owed to a company by its directors. Therefore, if employees of the company and other parties challenged the directors' decisions and conducts, the actions will definitely be brought by the Company. If people in control of the company at the relevant timing do not authorise the company in bringing an action against the directors when they fail to have regard to the interests of the employees, employees have no remedy under Section 309 even when their interests are adversely affected as a result of actions taken by directors.[67] Moreover, proceedings for breach of fiduciary duties may be commenced by a member on the company's behalf in derivative form under certain circumstances. "This raises the possibilities of an employee with a shareholding being allowed to enforce the section 309 duty derivatively."[68] However, recent rulings effectively "bar any derivative action that does not have the approval of a majority of shareholders other than those who are defendant".[69] So the only possibility that section 309 can be enforced might be for employees are also the shareholders who own majority of shares in the company and subsequently bring an action against the directors. Therefore, a claim into the requirements for a derivative action would demand greater judicial creativity than can perhaps in the circumstances be realistically expected.[70] It is also significant to reconfirm that section 309 is permissive rather than mandatory, and that it clearly states that the employees cannot sue for any

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[66] S. Goulding & L. Miles, 'Regulating the Approaches of Companies towards Employees: the New Statutory Duties and Reporting Obligations of Directors within the United Kingdom' in S. Tully, (edn.) *Research Handbook on Corporate Legal Responsibility*, Cheltenham: Edward Elgar (2005) see page 90

[67] Ibid see page 90

[68] J.E. Parkinson, *Corporate Power and Responsibility: Issue in the theory of Company Law* Oxford: Clarendon Press (1993) see page 83

[69] L.S. Sealy, 'Director's Wider Responsibilities—Problems Conceptual, Practical and Procedural' (1987) 13 Mon U L R 164

[70] J.E. Parkinson, *Corporate Power and Responsibility: Issue in the theory of Company Law* Oxford: Clarendon Press (1993) see page 83

claimed breach of duty to them. These characteristics of non-mandatory nature and absence of enforcement through litigation--are typical ongoing of the constituency statutes based on the relative legislations in US.

In spite of all those deficiencies, section 309 is still a provision with positive significance which represents a tentative step towards recognising the employees' role in the enterprise.[71] Nevertheless, the Company Law Review Steering Group stipulated that section 309 should be repealed. In their view, there is a danger that it might be interpreted as enabling directors to prefer employees' interests to those of shareholders, which would threaten the principle of shareholder supremacy. Directors, therefore, should consider employees' interests only in the process of promoting shareholders' interests.[72] This proposal is not convincing as it failed to consider the importance of sustaining the relationship between shareholders and other stakeholder, including employees, in the process of pursuing the objective of long-term shareholder value.

4.3 The Operating and Financial Review

The CLR proposed that companies of economic significance prepare an **Operating and Financial Review**, which is intended to be qualitative in character, containing all information that is material in assessing the performance and future prospects of the company including its relationships to employees and its impact on the community and environment.[73] It was acknowledged by CLR that stakeholders such as employees, customers and the community had legitimate interests in the activities of the company, especially those companies wielding significant economic power.[74]

The new OFR was introduced by British government as draft regulations which require 1290 British-based companies listed on the London Stock Exchange, the New York Stock Exchange or NASDA publish an annual report after an extensive public consultation process on May 5th, 2004. The new OFR will require companies to identify material social and environmental risks and to disclose information about those risks.[75] The regulation has operated to give much greater

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[71] See J.H. Farrar & B.M. Hanningan, *Farrar's Company Law* 4th edn., London: Butterworth see page 386
[72] Company Law Review Steering Group, *Modern Company Law for a Company Law for a Competitive Economy: Strategic Framework* (DTI), 1999; available on DTI website: http://www.dti.gov.uk/ see paras 5.1.20 to 5.1.23.
[73] R. Goddard, 'Modernising Company Law: The Government's White Paper' (2003) *Modern Law Review* 402 at 405
[74] Company Law Review, Modern Company Law: Final Report, (2001) 3.28-30
[75] C. A. Williams & J. M. Conley, 'An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct' (2005) 38 *Cornell International Law Journal* 493 at 500

prominence to issues related to corporate social and environmental responsibilities. Specifically, the OFR is based on an existing, non-statutory model for company reporting which is recommended by UK Accounting Standards Boards and is already widely spread and adopted by many listed companies. The intentions of OFR is to give directors a chance to explain to shareholders and other stakeholders on issues such us how they have looked after their social responsibilities, employees, the environment, consumers and the community. The Review is regarded as concerns against the negative implications and effects of the excessive focus upon the shareholder short-term returns. The ultimate aim of the inclusive approach would be achieved by establishing successful relationships with members of the supply chain and the community and the environment.[76]

It is also proposed by the White Paper that rather than composing **duties** on directors, the **"wider interests"** will be taken care of by providing "a narrative report covering main factors underlying the company's performance and financial provisions"[77], namely the **OFR**[78]. It is intended to be qualitative (e.g. the balance sheet) and historical (e.g. the financial results in the past years) and about internal company matters (e.g. the size of the workforce) in character,[79] containing all information that is material in assessing the company's performance and future prospectus including its relationship with employees, customers and suppliers[80] and its impact on the community and environment.[81] The Government also makes suggestions on proposed legislations for OFR to illuminate the important role of it in company reporting. "Annex D provides a commentary on a preliminary draft of the relevant clauses and invites comment on a range of issues on how the OFR should be implemented."

The legal requirements on the OFT for quoted companies were once again stipulated in Company Law Bill 2005 in which the directors are required to prepared an OFR for each financial year.[82] Directors who failed to comply with the requirements will be committed to an offence and be liable on conviction on indictment to a fine not exceeding the statutory

76 L. Roach, 'The Legal Model of the Company and the Company Law Review' (2005) 26 *Company Lawyer* 98 at 102
77 White paper 2002 "*Modernising Company Law*" available via <http://www.dti.gov.uk/companiesbill/part2.pdf> para 4.28
78 The Review was first published by the ASB in 1993
79 White paper 2002 "*Modernising Company Law*" available via <http://www.dti.gov.uk/companiesbill/part2.pdf> para 4.30
80 *Ibid*, see para 31
81 *Ibid*
82 See Company Bill 2005, Section 393

maximum.[83] The Secretary of State may make provision by regulations as to the objective and contents of OFR.[84]

However, the legislations and enforcements of the OFR reporting policies for directors are still open for debating and further modification enable to perfect it. In practice, if the enlightened shareholder primacy means balancing the interests of shareholders and stakeholders for the benefits of the long-term interests of companies, the reporting and disclosures of relevant issues on the OFR cannot of itself generate meaningful change in corporate practice. The mechanisms on directors' behaviours and company policy have to be modified so as the directors can fully realise the importance of relationships between company and stakeholders in a fresh perspective so as to establish the information disclosure provisions.[85]

Chapter 5 Conclusion

From the discussions above, it can be concluded that the new economy finally arrived in 21st century after has been heralded for a long time.[86] The New Economy **focus more on talent, knowledge and information based on the mobile devices** such as email, internet and intranet which make the dot com companies simultaneous in the global market. It is kind of economy with greater stability upon GDP and prices together with a potential drop in unemployment and inflation. In the new economy era, the company will always benefit from the impact of technological innovation in creating potential long-term wealth. Compared to the old economy, the information technology is playing a massive role and the success companies are always companies who obtain the information at the first place. The scope of the competition extends to the international scope.

In the new economy era, successful companies always engage with various stakeholders not only inside company but also outside company for goods and services, finance, labour and political patronage effectively. The good relationship with employees, consumers, local communities, media are significant in promote the competence of company. The weight of

[83] *Ibid*, Section 395
[84] *Ibid*, Section 394
[85] J. Williamson, 'A Trade Union Congress Perspective on the Company Law Review and Corporate Governance Reform since 1997' (2003) 41 (3) *British Journal of Industrial Relations* 511 at 514
[86] P. Sadler, *Building Tomorrow's Company: A Guide to Sustainable Business Success*, London: Kogan Page (2002) see page 17

respectable performance of **employees** in technological innovation has and will continually accelerate the entire development of the company especially in high technologic companies. Therefore, it is deduced that human capital plays a crucial role and contributes significantly to productivity growth in the new economy and, rather than be regarded as expenses of companies, employees are gloriously and naturally be regarded as investment of the company.

Under the classic corporate governance shareholder vs. stakeholder debate, the employees belong to the primary and internal stakeholders. Under the stakeholder approach jurisdictions, the interests of employees should be considered and further protected by company directors, as the deciding mind of the company. It is deduced that stakeholders approach, if practically implemented, is an efficiently way in protecting the interests of employees in the new economy era. The interests of employees are always in conflict with shareholders and other stakeholders, how to protect their interests under corporate law becomes another questions. After discussing directors' duties towards employees under English Law as a model, we found, under enlightened shareholder value model, although government are adopting Section 309 in Company Law Act 1985 on defining directors' duties towards employees and Operational Financial Review on information disclosure requirements to protect employees' interests, the enforcement of the duties and review is still problematic. The employees do not possess practical approaches in claiming for remedies if directors' decisions which are injurious to their interests. Even there are exceptions, the chances are extremely slim.

The further researches on enforcement of directors' duties towards employees under corporate law not only under English Law but also law under other jurisdictions will be beneficial both academically and practically. And law economic studies on relationship between advantages of stakeholder approach and new economy in the narrow and broad perspective will be also crucial.

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