

# TOP FLOOR

News from the Centre for Business Research, University of Cambridge

Issue 2: Summer 2001

## A partnership of equals?



But some are more equal than others

page 8

### NEWS

**Social Science makes it to the Lords**  
page 2

### VIEWS

**Paul Myners on the responsibilities of share ownership**  
page 4-5

### FOCUS

**More money for start-ups?**  
page 6



### CLOSE UP

**Rover revisited: how the law saved 24,000 jobs**

page 3

## Editor's note

The question of how we should run our companies has seldom been so topical. Over the last few weeks, while the Centre for Business Research has been preparing to host a conference on Corporate Governance, some of the country's biggest business names have been criticised over their behaviour and management.

Marks & Spencer was rebuked by a French court over plans to shut 18 stores there, apparently without following the employee consultation procedures required under French law. Meanwhile back in Britain, BT moved quickly to quiet investors' concerns over its mounting debts when its new chairman announced two new deals in his first week in the job.

So it's very timely that on Saturday May 19th the CBR, along with the Centre for Corporate and Commercial Law at Cambridge University, will host a one-day conference on Corporate Governance. Entitled "Reassessing ownership and control", speakers will debate how best to govern today's increasingly global and increasingly complex corporations. This issue of TOP FLOOR features some of the arguments presented there.

Among them, Simon Deakin and John Armour revisit Rover one year after it was bought by Phoenix, to discuss whether changes to the law have given employees a greater say in corporate rescues. (See page 3.) Marleen O'Connor from Stetson University, Florida, looks at Grey Power, and how the union pension funds became a force to be reckoned with. (See page 7.) And our guest contributor this issue is Paul Myners who, fresh from completing his review for the Chancellor of institutional investment in the UK, tells shareholders that they should intervene more quickly when companies are underperforming. (See pages 4 and 5.)

For more details about the conference, or any of the papers given at it, please contact the CBR at the address below.

**Rachel Simpson, Editor, Top Floor.**

Direct line: (01954) 780873.

E-mail: [rachsimp@email.msn.com](mailto:rachsimp@email.msn.com)

Centre for Business Research  
University of Cambridge  
Austin Robinson Building  
Sidgwick Avenue  
Cambridge CB3 9DE

Tel: (01223) 335244  
Website: [www.cbr.cam.ac.uk](http://www.cbr.cam.ac.uk)



## CBR News

### Read all over

CBR work is obviously read in high places. Lord Steyn quoted two of our social science articles in his contribution to a recent House of Lords judgment on an important wrongful dismissal case. The case of *Johnson v Unisys* was a test to the current law which prevents a worker receiving damages for future loss of earnings, even if being sacked in breach of contract damages his reputation and therefore his attempts to find another job.

The current law was upheld by four of the Law Lords. But the dissenting Lord Steyn quoted academic writing including CBR research by Burchell and others on "Job Insecurity and Work Intensification", and CBR research by Brown, Deakin, Nash and Oxenbridge, 'The employment contract: from collective procedures to individual rights', which was carried out under the ESRC 'Future of Work' programme. His Lordship used these two articles to argue that contracts are increasingly important in protecting workers' rights as global competition among firms makes their employment future more insecure. Simon Deakin, assistant director of the CBR, says: "It is very rare for House of Lords judgments to cite social science articles in this way. It is a great feather in our cap."

### Funding success

The support of the Economic and Social Research Council (ESRC) for our work continues with funding for our second five-year programme of research. This will support the three key areas of research with which the CBR is associated: productivity and competitiveness; governance, contracts and incentives; and small and medium-sized enterprises, and entrepreneurship.

### Congratulations

To Suzanne Konzelmann who is visiting the CBR for a year from Indiana University South Bend. In March Sue, Associate Professor of Economics there, received both a Distinguished Teaching Award from Indiana University South Bend, and the state-wide Indiana University President's Teaching Award. Congratulations, Sue.

### GM foods debate

Tackling bribery, and the use of child labour, will be discussed on December 7th when the CBR hosts a conference on "Understanding how business ethics develop". But the liveliest debate may be about biotechnology firms promoting GM foods, with speakers invited from both Monsanto and Friends of the Earth.

# TUPE OR NOT TUPE -

CLOSE UP

## That was the question at Rover Group.

Rachel Simpson reports.

You're reading this almost a year to the day that the Phoenix consortium rescued Rover from extinction. The car manufacturer's collapse was avoided; so was the economic decimation of the local community around the Longbridge car plant. And 24,000 jobs were saved.

The story of the role played by the law in this rescue has not been fully told - until now. But at the Corporate Governance Conference on May 19th, the CBR's John Armour and Simon Deakin retrace the steps that lawyers acting for the unions took, following key changes to employment laws over the last decade. And they discuss whether these changes really give employees a stronger voice in the corporate rescue process - an important debate if the UK follows the US into a downturn, and the number of insolvencies and corporate rescues starts rising.

### Consultation rights

When BMW began discussing selling the loss-making Rover Group to venture capital firm Alchemy Partners in October 1999, there was a possibility that TUPE - or the Transfer of Undertakings (Protection of Employment) Regulations - might threaten the sale. As Simon Deakin, CBR assistant director, explains, "These rules make rescuing a company expensive for the buyer. They require it to take on the whole workforce on their previous terms, or pay them full compensation for not doing so. TUPE also gives employees the right to be consulted during the rescue process."

During the discussions, BMW split up Rover into seven different businesses in order to separate the parts being sold to Ford (Land Rover) from those going to Alchemy (the Longbridge car plant). It then sold the shares in



Rover: its rescue provides lessons for the future.

those businesses to its UK holding company, and proposed to transfer shares in the Longbridge assets to Alchemy. It could thus be argued that there had been only a transfer of shares, not a change of employer, and therefore the TUPE rules did not apply.

However, the High Court had recently shown it was unwilling to let companies avoid the TUPE rules by complex transactions like this. Lawyers acting for a group of managerial employees pointed this out. Other snags also arose. There had been no consultation of employees anywhere across the Rover group, giving the unions the right to start litigation. And a recent ruling - *Kerry Foods Ltd v Creber* - meant that the cost of this failure to consult would be passed on to Alchemy.

### Legal claims

From these various bases the unions' lawyers lodged claims covering all 28,000 Rover employees. Empowered by recent changes in employment law made by the European Court, the lawyers could apply for workers' contractual pay, and then ask for the sum to be doubled as compensation for the lack of consultation. Along with other claims, the potential cost of this litigation exceeded £300 million.

With all this going on, Alchemy finally withdrew from the deal

a day from the deadline for completion. The sale to the Phoenix consortium was finalised just two weeks later. Phoenix did not face the same legal liabilities, as it had begun consultation with the unions at an earlier date, and it was also not planning large-scale redundancies. The unions did not formally waive their claims - in fact many of the same legal issues arose. But most were resolved by negotiation. As it ultimately turned out, the unions' involvement in the rescue process led to the success of the one bid which was consistent with maintaining Rover as a volume car producer.

How much this happy ending was because changes to employment law have strengthened stakeholders' voice during a corporate rescue is not clear. Armour and Deakin point out that several key issues - which posed enormous potential risks for Alchemy - were never tested in court. In launching litigation, meanwhile, the unions took the risk that the Rover group could ultimately fail.

But overall, says Simon Deakin, "the Rover case suggests that the strengthening of employee rights, both individually and collectively, over the last decade is compatible with an active rescue process which takes a balanced approach to the recognition of stakeholder rights."

## TAKE THE FLOOR...

### PAUL MYNERS

#### Investing for the pensioners of the future

Eighty per cent of shares in British companies are owned by institutional investors, like pension funds. We entrust them to invest our savings for our retirement. But for our benefit, they need to do a better job, says Paul Myners, of running themselves and the companies they invest in.

Institutional investors now own eighty per cent of the shares in UK companies. The Chancellor Gordon Brown commissioned me to review the industry in part because there were concerns about whether this institutional ownership of corporate UK was operating effectively.

It needs to do so, for we now live in an environment in which the typical employee changes jobs repeatedly over a lifetime, and savings must provide for the possibility of literally decades of retirement. Are the institutional investment industry's structures up to this job?

In some places, the answer is no, they are falling short. The Review found, for example, that we make unrealistic demands of pension fund trustees, who are often asked to take crucial investment decisions when they may lack the resources or the expertise. In turn, their heavy reliance for advice on a small number of investment consultants with a narrow range of expertise provides little encouragement or room for specialisation. And one consequence of that is that asset allocation - the selection of which markets to invest in - is an under-resourced activity. This can have a critical effect on funds' investment performance. The Review recommends more pay, training and resources for trustees to make them more professional.

Another key finding was that fund managers remain unnecessarily reluctant to intervene actively in

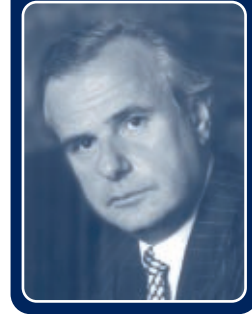
underperforming companies - even where this would be in their clients' financial interests. The institutional owners of our companies seem uncomfortable with the responsibilities of ownership. There is often more noise than action when the chief executive of a public company is awarded a huge bonus on the completion of a deal or for producing results a little ahead of market expectations. But there is really no alternative to the owners exercising their responsibility, unless they simply allow the take-over mechanism to be brought to bear on underperforming companies. Evidence suggests that take-overs tend to deliver rather less than their proponents expect. And allowing another company to take over your poorly managed business must be less rewarding than fixing it yourself.

My Review does not prescribe the micro-management of firms, but it is a call to institutions that says, where you perceive companies to be misdirecting themselves, you must speak up. I quote a United States Department of Labour interpretative bulletin from 1994. It points out to institutional investors that they have votes and must exercise them in the best interests of their clients, on issues like the independence and expertise of directors; levels of executive pay; the nature of the firm's long term business plans; and the level of investment in training, and other workplace practices. It also says that in using their votes, they must avoid conflicts of interest, and consider solely



Left, Pensioners' savings must provide for decades of retirement.

Right, Mr Myners, talks about his recommendations for the future of institutional investment. On page 6, Professor Colin Mayer of Oxford University looks at whether these changes will free up more investment money for start-ups.



the factors that will affect the value of their clients' investment. Clients should agree with fund managers that their manager will actively intervene in the company when appropriate. The Review recommends that the principles laid out by this bulletin should be incorporated into all fund management mandates, and in due course be more clearly incorporated into UK Law.

Within the Review, I was also specifically asked to look at Private Equity. The Government was seeking to understand whether UK institutions were less willing to support small and new enterprises for reasons which were not well justified. I found that there were some unnecessary obstacles to Private Equity, like the controversial solvency measure, the Minimum Funding Requirement, and recommended they be removed.

However, I really don't think it is any more difficult for UK pension funds to invest in Private Equity than it is for funds in the United States. The two industries are different, of course. US pension funds are typically much larger than UK funds, and therefore may have a greater propensity to invest in Private Equity as they have more management resources at their disposal and a better capability to bear risk.

It is also true that here, the Private Equity industry tends to be staffed by chartered accountants and financiers with fewer experienced businessmen

and entrepreneurs than it is in the US. But this is changing rapidly in the UK.

Historically, there has been a barrier to Private Equity investment from the lack of a specialist, independent intermediary sector to provide information. But this situation is also changing for the better: some entrepreneurs are now establishing Private Equity partnerships with new skills, and I think that will continue. I also think that, by encouraging trustees to look more actively at Private Equity, and to consider a number of different routes to this by investing in a broad range of funds, we will encourage a more diverse range of skills to become available here. I am not prescribing Private Equity investment for all pension funds. For some it simply wouldn't be suitable. But I think that solving the problem of a lack of investment in Private Equity requires the encouragement of different behaviours. I would hope my approach - which includes making pension fund trustees more businesslike in their conduct would encourage them to look with greater enthusiasm and professionalism at Private Equity. The benefits to be secured from incremental improvements in all parts of the investment value chain are considerable."

Paul Myners is the chairman of Gartmore Investment Management plc and the author of "Institutional Investment in the UK: A Review", which was published by the Treasury on 6th March 2001.

A space will be open in every issue for a guest contributor to air their views. The editor welcomes submissions.

## Too much risk aversion - or not enough returns?

### Why pension funds really don't want to back Britain's entrepreneurs

By Professor Colin Mayer

**W**hy are pension funds so reluctant to invest money in start-up firms? The answer suggested by Paul Myners' recent review of UK institutional investment, is the current structure of the UK pension fund industry. Among its findings, the Review sees some of the problem as lying with pension fund trustees, who are not well equipped to make complex investment decisions. It recommends they should be better trained, better paid and subject to Cadbury Committee-style corporate governance codes.

But does the problem really lie here? Or could it be that returns on private equity are insufficiently attractive to provide investors with adequate incentives? The Review itself notes that there has not been an overall under-investment in private equity so much as an under-investment in particular types - most notably venture capital funding of early stage activities. This suggests that the problem may not be risk aversion on the part of pension funds so much as inadequate returns from investing in start-ups to compensate for the risks involved.

One possible reason for this may be that general partnerships, which in the US allow pension funds to invest in portfolios of

start-ups, are not so widely available in the UK. These intermediaries (frequently run by previously successful entrepreneurs) provide the technical expertise for evaluating and monitoring companies that fund managers lack.

If there is a problem on the supply side it probably has more to do with the regulation of financial institutions than the training and pay of trustees. The Review's recommendation to remove the Minimum Funding Requirement (MFR) - which values pension fund liabilities against benchmark government securities yields - will help eliminate a bias towards investing in safe assets. However, the effect of regulation on investment choice may go further.

Financial regulation in the UK and much of Continental Europe takes the form of what might be described as "public contracting". This involves providing investor protection through compensation schemes and prescribing the rules by which institutions conduct their business. In the US, regulation is less prescriptive and relies more on "caveat emptor". It encourages competition by emphasising disclosure of information, auditing of performance, enforcement through the courts and insurance. The effect is to



Conference speaker Professor Colin Mayer is Peter Moores Professor of Management Studies at the Said Business School, University of Oxford.

create a greater degree of entry and competition in the investment business and a greater degree of diversity in investment selection.

The appropriate policy prescriptions may therefore be quite different from those described in the Review. They may have less to do with the nature of the pension fund trustee than with the regulation of financial institutions and the promotion of entrepreneurship, through, for example, encouraging more spin-offs from universities.

### Change of address.

The next issue of this newsletter will be produced from the CBR's brand new offices on the Top Floor, South Wing, Judge Institute of Management Studies, Trumpington Road, Cambridge.

We are moving there on 2-3 July.

Our new telephone number will be (01223) 765320. Our e-mail addresses will also change. The first half remains the same, but the second half will alter from @econ.cam.ac.uk to @hermes.cam.ac.uk

Our website address (www.cbr.cam.ac.uk) is unchanged.

# GREY POWER -

## How US pension funds became a force to be reckoned with.

By Professor Marleen O'Connor

In the USA, the hour of the employee-shareholder has come. Over the past few years workers - through their pension funds - have become one of the most active players in the investment arena.

Unions have been devising some novel methods of using their rights as shareholders to wield unprecedented power over company bosses. For example, they target under-performing companies with apparently routine shareholder proposals about executive pay, or adding more independent directors to the board. They then use the ensuing "behind the scenes" meetings with management to express displeasure with the firm's performance, or to negotiate over corporate governance issues.

### Shareholder activism

These employee-shareholder activists have scored some important victories for both investors and workers. But their potential is only just beginning to be realised. The AFL-CIO (the American equivalent of the TUC) has begun co-ordinating the voting practices of union pension funds. If these efforts succeed, the unions of lorry drivers, service workers and carpenters would together constitute one of the largest blocks of organised shareholders in the United States.

However while promoting their own interests, employee-shareholders face a major challenge. How can they use their rights as shareholders to improve company performance without

damaging their own prospects as workers? For if union pension fund managers demand higher profits from a firm, it may result in job losses. As Richard L. Trumka, the Secretary-Treasurer of the AFL-CIO, says: "There is no more important strategy for the (organised) labour movement than... stop(ping) our money from cutting our own throats".



► Today's pensioners, or tomorrow's stakeholder capitalists?

I have been examining ways in which employee-shareholder activists can best further their interests. One way forward is to take a view of the firm that focuses on creating shareholder value by using high-performance workplace practices.

One of the largest institutional investors, California Public Employees' Retirement System (CalPERS) has taken three steps to promote high-performance workplaces. Since 1994, it has included an evaluation of labour relations - for example, the availability of staff training - in its investment analysis. Since then it has also worked with trade unions to formulate restrictions that prevent CalPERS from investing in construction projects that do not meet specific labour standards.

### Better workplaces

Then in 1996 it published a statement criticising firms that lay off staff to get a short-term share price rise. In this statement, CalPERS' Richard Koppes explained: "We will be looking for measures of performance that are based not simply on quarterly earnings and the most recent rise in the share price. CalPERS intends to prevent such short-term vision by encouraging companies to add quality independent directors to their boards."

CalPERS justifies its concern over workplace issues as a means of measuring firms' long-term economic performance. It bases its decision on research suggesting that human resource policies improve corporate performance. One report prepared for the fund concluded: "Firms with poor workplace practices have lower valuations than their peers with reputations for positive workplace practices".

So far, CalPERS is the only fund that has taken steps to promote high-performance workplace practices. But in time, it may prompt other institutional investors to realise the goals of stakeholder capitalism by promoting high-performance workplaces.

► Conference speaker Professor Marleen O'Connor is from Stetson University College of Law, Florida. These are edited extracts from her conference paper, 'Union Pension Power and the Shareholder Revolution'.

# A partnership of equals?

Partnership is one of the hottest buzz-words in business at the moment. The Government, for example, is committed to a policy of encouraging 'partnership' in employment relations.

In theory, this means workers and bosses should be equals. In practice, they often aren't. "Unfortunately," says the CBR's Suzanne Konzelmann, "it is difficult for publicly quoted businesses to sustain genuine partnership relationships with their labour forces unless there is some factor that is helping insulate them from the pressures of the global market".

She adds: "We interviewed one manufacturing firm that has recently been bought by a company in continental Europe. Before the buy-out, it was talking about partnership with its workforce. Afterwards, because of differences in the exchange rate and other pressures, it has been closing factories and laying off workers."

Konzelmann, a visiting Professor from Indiana University South Bend, is co-author of a conference paper on "Partnership, ownership and control". With her CBR colleagues Simon Deakin, Richard Hobbs and Frank Wilkinson, she will discuss how corporate governance - if it is defined as the structures and systems for

making organisations run most efficiently - has an impact on employee relations.

"In theory," Konzelmann says, "managements and labour forces should be equal partners, because production is a co-operative effort. If firms model themselves as partnerships, then labour and management should achieve outcomes which benefit them both. In reality, however, partnership is often no more than an empty phrase".

Most large private-sector organisations in the UK are listed companies. Hence they are under intense pressure continually to increase profits and shareholder dividends.

UK company law allows company boards to take a view based on "enlightened shareholder value", that the long-term interests of shareholders and other stakeholders (i.e. workers) essentially coincide. But in practice, as the paper's authors argue, the interests of a firm's suppliers, customers, communities and its own staff are ultimately less important than the interests of shareholders. In other words, all stakeholders are equal, but some are more equal than others.



"We have been looking at companies across a range of industrial sectors," explains Konzelmann. "including some that are publicly listed and some that have a dominant, long-term shareholder."

**"All stakeholders are equal, but some are more equal than others..."**

"From these case studies it is evident that some UK companies have been able to reconcile shareholder demands with a "partnership" approach. However, in other cases, shareholder pressure has undermined partnership relations of the kind which have endured under more concentrated forms of ownership".

"It seems as though the pressure from shareholders for short-term returns makes it difficult for management to sustain truly co-operative partnerships in the longer term," Konzelmann says.

▶ Front and back page pictures show (top) Simon Deakin, (middle) Suzanne Konzelmann and (bottom) Richard Hobbs posing as investor, manager and worker. Photographs by Michael Hall.

Our communications programme is sponsored by

**Abbey National**  
Treasury Services plc