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Perspectives on Workforce Directors
Opportunities & Challenges
Webinar Takeaways | September 5, 2024

Background

Recent pressures on people at work, including the surge in inflation, the Covid-19 pandemic, and developments in technology and the climate transition have shone a spotlight on the materiality of workforce issues to company performance, demonstrating that a company's relationship with its workforce is a source of great potential value, or risk.

To effectively manage these challenges, it is important that senior decision-makers hear the views and concerns of the people they employ. Among a growing range of approaches to employee engagement that businesses might consider, one potentially under-utilized mechanism is the appointment of board directors drawn from and/or appointed by the workforce. It is a common feature of the corporate governance systems in many European markets but largely absent from UK and US companies. This could be a missed opportunity in many cases, with suitability of the solution depending on context.

Speakers

- Brandon Rees, Deputy Director of Corporations and Capital Markets, American Federation of Labor and Congress of Industrial Organizations (AFL-CIO)
- Caroline Escott, Senior Investment Manager, Active Ownership, Railpen
- David Foster, Board of Directors, Kaiser Aluminum and Evraz, North America (retired District Director, United Steelworkers)
- Velika Talyarkhan, Director of Engagement, EOS at Federated Hermes Limited
- Moderators:
    - Tom Powdrill, on behalf of Railpen
    - Delilah Rothenberg, Executive Director of The Predistribution Initiative (PDI)

Tom Powdrill

Workers have experienced a plethora of challenges, particularly due to the pandemic and recent inflation spikes, as well as emerging challenges relating to technology and the climate transition, which have prompted investors to focus more on workforce quality and treatment. As a result, companies' methods of engaging with their employees have gained prominence. A key topic of discussion for this webinar is the concept of workforce (or employee) directors, a model common in Europe but rare in the UK and US, which is seen as underutilized despite its potential benefits.

Railpen launched the Workforce Directors Coalition in 2023 with several other asset managers and pension funds. The Coalition's collective goal is to encourage companies to consider appointing workforce directors as a means of improving workforce engagement. More information can be found on the Investor Guidance on Workforce Directors.

Railpen has been actively engaging with a dozen companies in the UK and US to promote this model, and despite supportive public policy initiatives, like the UK Corporate Governance Code, many companies and investors remain hesitant. The objective of this webinar is to normalize the concept of workforce directors, improve investor understanding, and highlight both the challenges and opportunities of implementing this model.

Velika Talyarkhan, Director of Engagement, EOS at Federated Hermes Limited

EOS at Federated Hermes Limited is a leading stewardship provider that advises on around $2.1 trillion worth of assets on behalf of global institutional investors and provides company voting recommendations and corporate engagement. Their purpose is to support clients to be active and responsible owners seeking alignment between their investee companies and the long-term fiduciary interests of their investors. Velika is based in Pittsburgh and leads engagement with retail, consumer goods, and utilities companies and co-leads human capital and executive remuneration thought leadership.

Corporate boards must effectively address a range of risks, from geopolitical to reputational to market risks. There is growing prominence of issues relating to worker representation and voice, unionization, and the need for equity - for instance relating to race, gender, and disability. The pandemic and death of Georg Floyd highlighted social inequities that were previously ignored. Board and workforce composition and the inequitable impacts of business practices on diverse communities reflect and perpetuate underlying racial and ethnic injustices that create systemic risk.

Boards with more inclusive culture and higher cognitive diversity could be better placed to manage the systemic risk of social inequality and create long term value. Boards should have a mix of technical skills, diverse perspectives, and enough independent directors with sufficient time to challenge management effectively and contribute to the success of the company.

The inclusion of workforce-appointed directors is a governance mechanism that could enhance cognitive diversity on boards and improve decision-making. However, for this model to work, particularly in the US, workforce-appointed directors need to have the same fiduciary duties as independent directors and robust skills, such as financial literacy, strategic insight, and ability to oversee the company's collective bargaining agreements (e.g., EOS considered these factors in the averted Starbucks proxy contest) to complement their employee experience.

Workforce-appointed directors could also help manage the transitions related to climate, artificial intelligence, and automation. Sectors like retail and consumer goods and services with a large majority of lower wage workers, healthcare (given risks of worker burn-out), and industries with high unionization rates could particularly benefit from workforce-appointed director perspectives on boards. Workforce-appointed directors should not replace other forms of employee engagement, such as engagement with union representatives, grievance mechanisms, or employee surveys.

Workforce-appointed directors might be particularly useful in companies facing collective bargaining issues or other controversies, helping to rebuild employee trust and refresh governance. There are examples to build the business case for treating workers fairly, like the United Auto Workers strikes and UK rail disputes, where ignoring worker concerns negatively impacted productivity. Other relevant factors to consider include establishing an inclusive board culture, strong governance mechanisms - like an independent chair, and the integration of human capital oversight in committee charters to ensure workforce-appointed directors.

Over the last four years, EOS has also seen a rise in shareholder proposals on this topic and took a nuanced approach, recommending support when they felt it was critical to elevate employee voice. For instance, this included companies where leadership may have been involved in controversies related to worker rights, discrimination, and safety. In those situations, a workforce-appointed director can rebuild trust and offer perspective.

Caroline Escott, Senior Investment Manager, Active Ownership, Railpen

Railpen is an asset owner / allocator and one of the largest pension schemes in the United Kingdom. It manages the pension assets for the railway industry, providing retirement benefits to hundreds of thousands of current and former railway workers. Railpen serves as both the in-house investment manager and administrator for the UK railway pension schemes, overseeing the strategic management of assets.

A key characteristic of Railpen is its highly unionized workforce and the structure of its trustee board, which is composed of 50% representatives from the wider workforce, and which Railpen has seen as a particularly powerful model of governance because the Railpen Sustainable Ownership team sees for itself the benefits of the ‘at the coalface’ perspective. This structure gives it a unique perspective on employee engagement, governance, and worker inclusion in decision-making processes which are important factors for long-term financial performance.

As one of the largest UK pension schemes, Railpen frequently engages with companies on worker voice and inclusion, emphasizing that a fulfilled, motivated, and engaged workforce is crucial for long-term financial performance. As Railpen held more conversations with companies about workforce directors, it realized there was little existing guidance on the topic that was company, investor, and workforce-friendly. The Railpen team therefore helped create the Workforce Directors Coalition and developed practical guidance and a possible framework for workforce directors – after wide-ranging conversations with investors, companies, existing workforce directors and academic experts – to help companies understand how to implement workforce directors in a meaningful way and support investors to understand how they can better engage with companies on this issue.

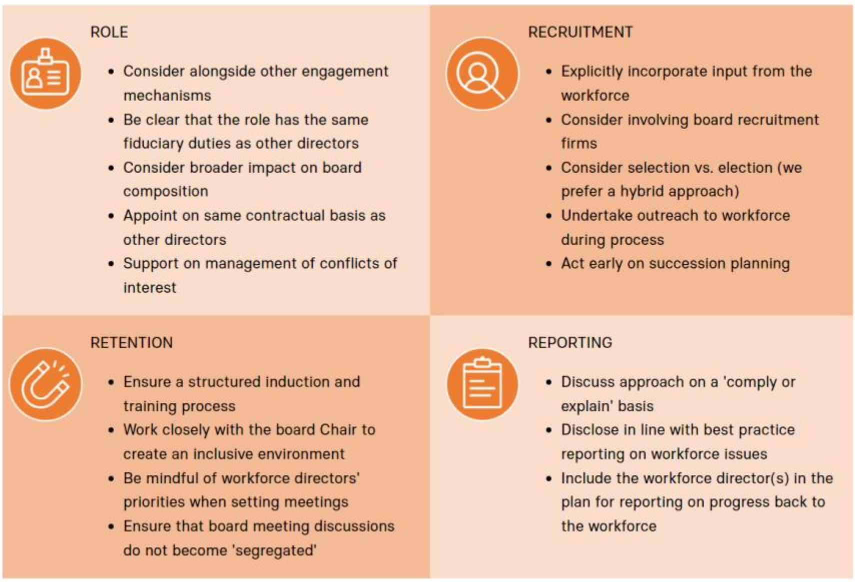

Figure 1 the Railpen workforce director model, as outlined in its 2023 guidance

While some companies believe that investors are not supportive of workforce directors, Railpen and other investors in the coalition aim to send a strong signal that they are in favor of this approach. However, workforce directors are not a "silver bullet" and should complement, not replace, other forms of employee engagement, such as union representation. Indeed, this approach may often be most effective when combined with other solutions, as well. Additionally, the Coalition recognizes that this is a solution that may not work for every company. Railpen's work hopes to be able to raise awareness of this matter, including for investor audiences, through policy work, and further company engagement.

David Foster, Board of Directors, Kaiser Aluminum and Evraz, North America

David is a former Director of United Steelworkers over a 15-state region that included a large number of companies across sectors relating to the commodity, as well as iron ore and aluminum. This gave him perspective across downturns, including the decline in US domestic manufacturing in the 1980s and 1990s.

As industries have faced economic downturns, having a voice in company governance has become a priority for labor unions. In order to create a more functional company within the industries and have better communication between management and employees, aligning workforce needs, company culture, strategy, and governance is a key. David was thus part of negotiations to win the rights for worker-appointed board directors across many companies.

When David retired from the union, the union asked him to be one of their nominees for a publicly traded steel company - Oregon Steel Mills - and subsequently for Kaiser Aluminum, a 75+ old integrated aluminum company (at the time). David saw these as opportunities to try to revamp the entire set of relationships between the corporations, their workforces, and the union in particular since Kaiser Aluminum had a longstanding relationship with the union which was troubled at times.

David has now been on the Board of Kaiser Aluminum for 16 years and has witnessed how the balance of interests of workforce needs, company culture, and governance are of extreme importance to the effective functioning of a company. A key milestone occurred when Kaiser Aluminum emerged from bankruptcy in 2006, with the union gaining the right to nominate 40% of board members. This was largely due to the union's VEBA (Voluntary Employees' Beneficiary Association) holding 60% of the company's shares as it emerged from bankruptcy due to the loss of pension and health insurance benefits. Even after VEBA sold most of its shares a decade later, the board and management agreed to maintain the union's right to nominate 40% of the board of directors due to the positive impact this arrangement had on company culture and performance.

The deep engagement between union leadership, the lead board director, and senior management helped shape the business strategy, workforce issues, and board composition. This type of model offers valuable lessons for corporate governance in the US since it shows that, when a balance between employers and workforce is achieved, it can drive a much higher functioning company as a consequence.

Brandon Rees, Deputy Director of Corporations and Capital Markets, AFL-CIO

The American Federation of Labor and Congress of Industrial Organizations is a federation of trade unions in the United States. Brandon is responsible for the AFL-CIO's proxy voting guidelines and is a trustee of the staff pension plan. The AFL-CIO's guidelines have long supported the concept of workers on boards of directors. They have further refined that to clarify that rank-and-file employees should not be considered insiders or members of management, and therefore can serve as independent directors.

The concept of employee representation on boards in the US is not a new topic. Going back to 1919, Massachusetts was the first state to pass a law authorizing manufacturing companies to appoint an employee to serve on boards. It is voluntary and not a requirement, but something that has been talked about for decades. As David illustrated, labor unions have long negotiated for this. This has been particularly common in the steel and airline industries but has often grown out of situations of financial distress. The solution of bringing worker representation to boards as part of corporate turnarounds shows the value of their presence.

There are implementation questions in the US. Compared to Germany and other countries that have a history of co-determination union density in the US is low, and without collective bargaining, it is hard to imagine how employees would identify and nominate a worker representative. It could be via the nominating committee or democratic election of the representative by workers, with the latter being the AFL-CIO's preference. It would not be appropriate for a member of the management or executive team to represent workers. There would also be challenges for companies with a fissured workforce, where a significant number of workers are not direct employees but nonetheless important to business operations.

There have been legislative proposals such as various bills introduced by Senators Baldwin, Sanders and Warren which would have required the boards of large cap US companies to have between one-third and 45% employee representation. The bills also proposed a democratic process for workforces to be able to select representatives.

There is a growing trend of private ordering efforts, both via shareholder proposals on workforce-appointed directors and union-led proxy contests. Shareholder proposals have varied in levels of support with the most successful at Amazon, filed by Oxfam America in response to numerous human capital concerns. The AFL-CIO filed its own proposal act Activision in response to allegations of sexual harassment and a hostile work environment. At Starbucks the SEIU and SOC Investment Group ran an innovative proxy contest aiming to introduce directors with human capital and labour relations expertise to the board. Ultimately the board revised its approach to labour relations.

Questions

How can we measure the success of interventions around the workforce-appointed director model?

- Caroline Escott - The discussion in the UK is at an early stage because the model is rare. Therefore, the Workforce Directors Coalition is measuring its success by the number of constructive conversations they can foster with companies about this idea. Despite several positive policy interventions, there is still significant resistance from companies, many of which have opted for alternative workforce engagement mechanisms rather than appointing a workforce director.

  Among a group of FTSE 350 Non-Executive Directors (NEDs), only a small number showed support for the idea of a workforce director, indicating that the approach is still in its early stages. The coalition's goal is to raise awareness, generate interest, and demonstrate to companies that investors are ready to support meaningful efforts in this area. Ultimately, the coalition hopes to encourage companies to adopt workforce directors where they otherwise might not have considered it.

  Brandon Rees - The success of employee representation on boards should ultimately be measured by the financial performance of companies. In today's knowledge-based economy, where 90% of the S&P 500's value is intangible and relies on intellectual property and workforce skills, employee engagement is crucial for company performance. Having employee representatives on boards can enhance engagement by giving workers a voice and addressing issues before they lead to turnover. Employee turnover is a key intermediate measure of success, as it is costly and indicates underlying problems. Employee surveys are limited in capturing genuine feedback, whereas direct board representation could be a more effective way to obtain honest input from employees.

- David Foster - While financial performance is crucial, the way in which management communicates the value of employee representation to financial analysts and investors is also critical. At Kaiser, senior management effectively communicates to investors and analysts how their close relationship with the steelworkers contributes to the company's business strategy, including focusing on high-value products and long-term customer satisfaction.

  High employee turnover can lead to lower product quality. A stable, long-term relationship with the workforce is essential for executing a successful business strategy.

  Having well-structured systems for handling employee views and complaints is also important. Kaiser uses an internal committee to review anonymous complaints, ensuring they are addressed properly without retaliation. The audit committee chair has access.

  Maintaining strong workforce engagement serves as a safeguard against short-term financial strategies which have been the common practice of private equity players. The involvement of the steelworkers in the board structure helps protect the company from these practices and supports long-term strategic planning. The company is viewed well in independent governance analysis as a result of its long-term strategic approach.

How do you socialize workforce engagement internally?

- Caroline Escott - At Railpen, the integration of this concept was relatively straightforward due to the pension fund's own existing governance structure, which already included a wider workforce perspective. It was also straightforward because effort was put into explaining how the model could work in the guidance document. The proposal for a workforce director is based on a hybrid model: a board member drawn from the broader workforce or representing it, who holds the same responsibilities as other board members but brings a workforce perspective.

  While it is important for management and the board to be involved in the selection process for this role, the approach has to incorporate input from the broader workforce as well. Many investors have supported Railpen's initiative from its launch and others have joined since. Even those who could not join the coalition offered feedback and have included the topic of workforce directors in their own engagements with companies.

- Velika Talyarkhan - The Railpen guidance is particularly useful in establishing appropriate boundaries and legal frameworks, especially concerning fiduciary duties in the US. This helped EOS at Federated Hermes Limited get comfortable with the concept. While the concept of a workforce-appointed director is more developed in the UK, where it aligns with existing stewardship codes, it requires careful adaptation to different markets. Thus, the approach needs to be tailored to fit local regulatory and legal contexts.

How do you navigate challenges and feasibility to workforce-appointed directors in a multinational corporate context with a global workforce?

- Brandon Rees - Independent worker organizations are quite relevant in facilitating the selection of employee representatives for boards, particularly given the complexity of varying legal systems across different countries. In the US, fiduciary duties of directors, including employee representatives, are governed by state law, such as in Delaware, where all directors owe duties to the corporation and its shareholders.
- This should not be a barrier to employee representation on boards, as it benefits shareholders, the workforce, and the company's long-term success. The situation becomes more complex in multinational contexts with different legal frameworks, such as co-determination practices in some countries compared to the US model. There is also a history of US labor unions collaborating with international unions to ensure US workers have a voice in multinational companies where there is co-determination, demonstrating that employee representation can be made to work at a multinational level.

What are the qualifications for a workforce-appointed director role?

- David Foster - The qualifications for a workforce-appointed director role vary depending on the situation, but having a deep understanding of labor law and industry specifics is highly valued. However, simply knowing labor law is not enough given the obligations of the role. A workforce-appointed director must also enhance their financial skills, engage with corporate governance education, and meet broader corporate governance standards. The role requires ongoing learning and improvement to effectively fulfill board responsibilities.

Concluding remarks

- Tom Powdrill - It is clear from David's experience and engagement with other workforce-appointed directors that those that do this role take it seriously. Workers want people on boards who are effective and constructive. Executive directors in markets that have this model see the value. Railpen would welcome further collaboration with investors and others in the US and elsewhere.

Further Information

- Learn more about the Workforce Directors Coalition.
- The Predistribution Initiative also looks forward to offering ongoing programming to support the Coalition and will share updates and opportunities to engage regularly through newsletters and social media.