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The Jerome A. Chazen Institute of International Business

COLUMBIA BUSINESS SCHOOL

2005 Annual Jerome A. Chazen Lecture

Transforming Labor-Business Relations in European manufacturing

Dr. Wolfgang Bernhard, CBS '88, Member of the Board of Management, Volkswagen AG

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Having recently assumed the position of Member of the Board of Management of Volkswagen AG, Dr. Wolfgang Bernhard, alumnus and member of the Board of Overseers, Columbia Business School, is widely regarded as Volkswagen's key strategist in its bid to modernize labor relations and ensure a sustainable industrial manufacturing presence in Europe.

Holding both a Master Eng. and a PhD in Political Science, Dr. Bernhard is uniquely positioned to comment upon current business developments in Europe within the broader context of European political and economic history. During the inaugural Jerome A. Chazen address, he offered candid assessments of the challenges faced by not only Volkswagen but also the global automotive industry and European businesses encumbered by high labor costs.

Opening remarks from Professor Charles Calomiris, Academic Director of the Chazen Institute, Columbia Business School, highlighted Dr. Bernhard's embodiment of Dean Glenn Hubbard's vision for the school: he is a dynamic business leader who is able to translate complex ideas into practice. Professor Calomiris also stressed the fortuitous timing of Dr. Bernhard's lecture: the results of the German national elections were just three days away.

Jerome A. Chazen, the institute's founder, also attended the lecture, and was warmly welcomed by the audience.

Student support for the coordination of lecture came from the Operations and General Management Association and the European Society of Columbia Business School.

Summary of the Lecture and Discussion

With the aim of creating a two-sided discussion for students as a dynamic learning experience, Dr. Bernhard's lecture educated students, faculty, and others in the audience not only on the management crises faced by organizations with codetermination agreements, but also on the comparative history of labor relations in the US and Europe. To engage the audience he concluded with a challenge: "How would you work through the power struggle of corporate governance at a large company?"

Comparative Labor Relations in the US and Europe

In the US, labor organizations found their origins as protective associations against immigrant workers, usually company unions focused on organizing against other worker organizations, not against corporations. Today, unions in the US are undergoing dwindling membership numbers and fierce corporate resistance that have combined to dramatically decrease the influence of organized labor within corporate structures.

In Europe, labor organizations found their roots in socialist political movements of the 19th century. And in Germany, labor's position within the corporation is quite strong, including significant representation on the board. At VW, for example, there are ten representatives for shareholders and an equal ten representatives for employees on the Board of Directors. In addition, the State of Lower Saxony—a political institution with significant worker constituency—also elects two representatives to the board, thereby giving labor an even stronger voice in corporate governance at VW. Furthermore, the State of Lower Saxony holds special voting rights of veto power—so strong that even a controlling shareholder could not overrule the vote of the State of Lower Saxony. This framework for corporate governance creates a political struggle within the corporate governance structure.

Codetermination and Its Consequences

On the surface, there are several positive consequences of codetermination within the corporate governance framework. First, management can make legally-binding labor agreements, which allows for agreements to be executed exactly as negotiated. Furthermore, labor relations have traditionally been very peaceful. There is no history of strikes in Germany at VW—all potential disputes have traditionally been settled amicably before disputes came to a public head. Additionally, workers are thought to be loyal to the company under this system, though there is some question as to whether the framework engenders worker loyalty to the company, or to labor organizations within the company. And finally—potentially-- there is a higher usage of skills by labor for the corporate good, as workers feel more aligned to the company.

The negative consequences that are produced by such a system are startling from both a manager's and a shareholder's perspective. First, because management and labor are in disagreement about the goals of the corporation, the company experiences an internal fight, instead of acting as a team in the external fight for customers in the marketplace. Second, codetermination encourages non-merit-based compensation. This often results in a social culture instead of a performance culture within the company. Third, this system in-fighting and complex web of rights of consent within the corporation makes the company inflexible and slow in executing in the marketplace, which eventually leads to losses in the competitive landscape. And finally, codetermination leads to remarkably high labor costs and low productivity, as jobs are guaranteed by labor politicking instead of worker performance. As noted by Professor Calomiris in his opening remarks, firms that are subject to codetermination rules suffer an average of 31% value destruction.

Need for Improvement

It is the breadth and severity of potential negative consequences that suggest a dire need for improvement in the corporate governance structures of those in the German automotive industry. With the backdrop of the German elections, the future of political structures and balance within Germany seemed as much at the forefront of the popular press as at the forefront of the corporate struggles that codetermination raises. And while there is no simple answer for management today, changes within the balance of power in corporate governance—in fact, changes in the political rules of corporate governance-- seem called-for in European corporations, as well as in German national politics.