ILO ENTERPRISE FORUM

The "Human Development Enterprise": Seeking Flexibility, Security and Efficiency

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The "Human Development Enterprise": Flexibility, Security and Dynamic Efficiency

1. Introduction

"A just system must generate its own support."[1]

Labour markets function in and around "firms", and the labour and employment practices of firms help shape the type of society in which we live. By no means everybody who works does so in identifiable firms, let alone in large well-established firms. Yet large and medium-sized firms continue to set the lead in shaping the production and distribution system of almost all economies.

We are in an era of "globalisation" and "flexibility", reflecting the opening of economies, more diversified technological options and more managerial options for changing and shifting the location and type of production. In labour and social policy terms, we are also in an era of social *experimentation,* in which old protective policies and institutions have been demonstrably enfeebled or discredited, and in which there is no consensus on what should be put in their place. The old forms of statutory protection and national welfare and labour market policies seem to suffer from both an incapacity to protect the vulnerable and an incapacity to promote efficiency and flexibility.

In that context, we need to think more about three fundamental questions:

1. **What sort of labour market would we regard as Good?**
2. **What sort of regulatory system is feasible and desirable for such a labour market?**
3. **What sort of "firm" should be promoted to be consistent with the answers to the first two questions?**

Answers to the first two questions are attempted elsewhere. With regard to the first question, suffice it to note that because open, flexible labour markets tend to produce greater inequality and labour force fragmentation, we should define a Good Labour Market in terms of seven forms of *security* for those involved in it, as summarised in Box A. An important caveat is that such security should be coupled with compatible mechanisms for promoting economic efficiency and labour flexibility. With regard to the second question, suffice it to state a belief that improvements in redistributive justice will depend on achieving a better balance between the three forms of labour regulation (statutory, market and voice) and on escaping from the current era of excessive faith in *market regulation,* into one in which *statutory regulation* more effectively establishes basic standards of decency and in which there are adequate measures to promote and facilitate *voice regulation.* By the latter, as elaborated later, is meant that mechanisms should exist to enable *all* groups to bargain and put pressure on the powerful to redistribute the gains of economic growth and development.

1 John Rawls, A Theory of Justice (Oxford, Oxford University Press, 1973), p.261.

BOX A

Form of Security	*Objectives and Policy Examples*
Labour market security	*High employment,*
	Low unemployment
	Government as last-resort-employer
Employment security	*Prevent arbitrary lay-offs*
	Adequate notice periods
	Statutory retrenchment procedures, etc.
	Minimum age of employment protection
	Pensionable age regulation
Work security	*Limits on working time*
	Occupational Safety procedures
	Leave entitlements, including sick leave, annual leave
	Rules on shift work and continuous work
Job security	*Measures facilitating job/skill mobility*
	Mechanisms controlling grading systems
Skill reproduction security	*Incentives to on-the-job training and retraining*
	Regulations on equal opportunities for training, etc.
Income security	*Minimum wages*
	Wage bargaining rights
	Rules on non-payment of remuneration
	Rules on forms of payment
	Entitlement to employment contingency benefits (e.g., sickness and maternity)
	Unemployment benefits
Work representation security	*Freedom of association rights*
	Existence and protection of bargaining mechanisms
	Social group (e.g. disabled, unemployed minorities) representation

It is the third question with which this paper is concerned – identifying and promoting exemplary labour and employment practices that combine the pursuit of dynamic efficiency and sustained profitability with the extension of human capabilities and the improvement of distributive justice. However, before turning to consideration of exemplary practices of firms, it is important to recognise that firms exist in local, national and international spaces and that labour markets are much broader than encompassed by the firm as the nexus of decisions and outcomes. Policies and practices that constitute a good firm must be complemented by policies and institutions that provide complementary characteristics of security and flexibility outside the firm, in the surrounding labour market.

With all the emphasis on ideas embodied in such catchphrases as "Human Development" and "Sustainable Human Development" (used extensively by the UNDP) and "Adjustment with a Human Face" (UNICEF) and other variants of the basic idea that development and structural adjustment must be guided by a normative perspective, it is remarkable that in the extensive international debate on structural adjustment and economic restructuring little attention has been devoted to the unit in which most people spend most of their lives, the *working establishment*.

This neglect has been mirrored in the dominant economic strategy supported around the world since the 1970s, namely supply-side economics. This has given *institutional* concerns minimal attention, and has been marked by an hostility towards collective entities of any sort. The supply-side economists' agenda has been oriented to the liberalisation of all markets and the privatisation of economic and social policy, backed by a residual welfare state epitomised by a recent slogan, "Save money and focus on the needy". At the level of the firm, the Chicago variant of neo-classical economics has been clear – business exists for one purpose only. As one of the fathers of the dominant approach of the past twenty years, the Nobel Prize winner, Milton Friedman, put it,

"The social responsibility of business is to make a profit."[2]

In this line of reasoning, it is commonly believed that enterprise performance and adjustment to market forces would be assisted by the removal of regulations, by which is meant statutory and institutional mechanisms, most notably protective labour regulations, including minimum wages, employment protection rules, labour codes and even trade unions. This adheres to what is called the Chicago school of law and economics, in which the guiding ethical principle is "Pareto optimality", leading to the view that regulations can be justified only if they promote economic growth and if some people gain while nobody loses. This restrictive view leads to support for wholesale "de-regulation", which as argued elsewhere is a misleading term since it is impossible to imagine a labour market that is unregulated.[3]

In contrast to the Chicago school, which in recent years has dominated so much of the economic policy in countries undergoing major economic restructuring, the following starts from a basic ethical principle closer to what is known as the Rawlsian "difference principle".[4] This states that, assuming an institutional framework providing for *equality of opportunity* and *equal liberty,* distributive justice improves if and only if a change in a practice or regulation improves the position of the "worst off" – or most vulnerable – groups. A second ethical principle guiding the following analysis and proposals is:

The powerful need protecting from themselves.[5]

In less abstract terms, the main alternative to the orthodox perspective is one that looks to regulations, institutions and incentive-structures to encourage and strengthen human development, while recognising that flexible markets are essential for economic growth. One can put this in several ways. Yet the starting point for constructive rethinking about social and economic strategy is the need to create conditions for thriving competition that is "regulated" to ensure that it is based on competition between strong partners who are simultaneously rivals and co-operative. Paradoxically, such competition must promote both social equity and dynamic efficiency, and as such it is important to recognise that it is a fallacy to depict a simple trade-off between

2 M. Friedman, "The social responsibility of business is to increase its profit", New York Times Magazine, Sept.13, 1970, pp.32-33. Emphasis added. See also, M.Friedman, Capitalism and Freedom (Chicago, University of Chicago Press, 1962).

3 G.Standing, "Labour regulations in an era of flexibility", in C.Buechteman (ed.), Employment Security and Labour Market Behaviour (Ithaca, Cornell University Press, 1993), pp.425-41.

4 Rawls, 1973, op.cit., p.75. It also relates to the less discussed ethical principle of fraternity.

5 It has been stated aptly that power is the facility not to have to learn. In effect, restricting an individual's power induces pressure on that person to learn, and to keep learning, which is the ultimate source of dynamic efficiency.

"equity" and "efficiency". *Dynamic efficiency* is derived from having rivals that are strong, and this is the ultimate justification for promoting co-operation and social consensus as the guiding principles for corporate governance. Managers may not *like* having strong, well-informed negotiators sitting opposite them, and vice-versa. And they may not *like* the prospect that they will have to sit opposite them again and again in the future. But these conditions tend to be the best because those involved tend to be best placed to know when to compromise and when to press the other side to improve *their* efficiency and competence. By the same token, societies are dynamic to the extent that their major organisations reflect internal pressures to be equitably efficient.[6]

This perspective is the basis of this paper, which focuses on the normative issue of identifying the type of working environment that should be promoted to promote human development.

As we move towards the end of the 20th century, a basic question should be: **What is a Good Enterprise for the 21st Century?** The notion of "good" conjures up images of socially decent, and this may prompt a sceptical reaction from those who adhere to a neo-liberal perspective. Accordingly, one must state at the outset that the notion of good enterprise cannot and should not be divorced from the pursuit of dynamic efficiency and profitability, for without efficiency an enterprise will cease to be economically viable. So, in discussing what constitutes a good firm from a labour and employment viewpoint it should be understood that it must be compatible with efficiency.[7]

In many countries, most people spend most of their adult lives working for enterprises and this experience shapes "human development", both in terms of competencies and status, as well as mental and physical health. A sweatshop does not contribute to the human development of those required to work in it, and an economy of sweatshops is unlikely to do well on human development generally. Nor does working in polluting, dangerous, noisy, hierarchically-controlled factories. On this most analysts would agree. Yet what *is* wanted is harder to determine – or agree – than what is *not* wanted.

In the following, an attempt is made to conceptualise and operationalise what is called a **Human Development Enterprise (HDE),** that is, a type of firm that in the late-1990s could be regarded as having exemplary labour and employment practices and mechanisms to ensure development in terms of *skill reproduction security, social equity, work security (health and safety), economic equity (income security)* and

[6] Arguably, the competitive strength of industries and nations reflects the learned organisations capabilities of their main industrial enterprises. A.D.Chandler, "Organisational capabilities and industrial restructuring: A historical analysis", Journal of Comparative Economics, Vol.17, No.2, 1993, p.310.

[7] The notion of "efficiency" is more complex than most who use the term in a rhetorical sense seem to believe. In this analysis, we use the term to imply dynamic efficiency, whereby there are mechanisms to induce flexibility and co-operation that contribute to future efficiency as well as a high (long-term profit maximising) level of utilisation of existing resources.

democracy (representation security). Although none are easy to define, those various objectives are equally vital and are inter-related.[8]

Human development involves all those dimensions. Thus, as individuals we need to develop and refine work skills, which we can achieve only in and through work. We need equitable treatment, in which discrimination based on non-changeable human characteristics is a denial of human rights and development. We need a fair distribution of the income generated by the efforts of workers, managers, employers and those working on their own account in some way. And we need to have Voice in the work process, recognising that an absence of democracy in the most crucial of places for human development is a denial of meaningful democracy in general.

All the remainder of this paper does is identify *indicators* of each of these dimensions and then, for illustrative purposes, applies the concept of the HDE to data from several of the **Enterprise Labour Flexibility Surveys** (ELFS) that we have been conducting in the past few years.[9] It is recognised that the resultant indicators are only proxies. However, the longer-term objective is to define an approach, then clarify the type of practices that we could regard as exemplary, and then find ways of measuring them.

Let me pre-empt a concluding recommendation to give context to the building blocks that are contained in the following sections. If we could identify and agree on the characteristics of HDEs, it should be possible to establish an HDE Award scheme, giving awards (a la Baldridge) to firms with exemplary labour practices, within specific national (or even sectoral or size group) contexts. The contextual issue is an intriguing caveat to what follows, since it might be possible or desirable to modify some criteria to fit the capacities of certain types of firm and economies at different levels of income and development. For instance, in 1996 a good firm in Russia or Ukraine or in South Africa is likely to be rather modest by the standards of a good firm in Switzerland or the USA. However, the basic *principles* should be similar in, or adaptable to, all countries.

What is being proposed in the following is not very novel, although it is an attempt to present an empirical approach and take some well-known themes in a certain direction. Besides the Malcolm Baldridge National Quality Award scheme in the United States, others have mooted somewhat similar ideas. In an interesting report issued in the United Kingdom by the Royal Society for the Arts in 1995, the authors spent a great deal of effort referring glowingly to their proposed "inclusive approach" to "tomorrow's company".[10] The Report did cite as possibilities the *Balanced Business*

[8] *Work security*, or occupational health and safety, is a prerequisite for the other objectives. Note that we reject the term "human resources", which conjures up images of treating workers as objects to be utilised.

[9] We refer to a good enterprise, yet what most people would have in mind is what in statistics is an establishment or firm. In this era of multinational corporations and conglomerates consisting of dozens or hundreds of firms, it would be more correct to refer to the good establishment, to "establishment restructuring", etc.

[10] Royal Society for the Encouragement of Arts, Manufactures and Commerce, Tomorrow's Company (London, RSA, 1995).

Scorecard, proposed by several US scholars.[11] And it did mention the "self-assessment models" developed by Baldridge in the USA and by the European Foundation for Quality Management.[12] However, they stopped short of trying to give actual measurable indexes, and they skirt round several crucial issues, notably the positive value of *adversarialism* in labour transactions. It is hoped that this distinction will become clear in the following.

2. Constructing HDE Indexes

To identify the type of enterprise that could be described as oriented to human development, we need to identify proxy indicators that capture the essence of the practices, principles and outcomes that deserve to be promoted.[13] In most cases, these would have to be measured by an indirect or proxy variable. Inevitably, this means there will be some subjectivity and pragmatism, in part due to the absence of data or the difficulty of obtaining measurable information on some issues.

A few methodological points should be borne in mind. We make a distinction between an *index* and an *indicator*. In developing what we may call an "index" of an HDE with numerical values, we construct sets of "indicators" of underlying phenomena. In putting indicators together as a composite index for any particular area of concern – such as the firm's orientation to skill formation and training – there are difficulties of "weighting" the different variables, or indicators.[14] There are various statistical techniques for dealing with these issues, including factor analysis and discriminant analysis. However, in this sort of exercise there is a great virtue in transparency. *The more complex the way an index is constructed, the greater the suspicion that the data and reasoning have been "massaged"*. It is better to be able to interpret an index than to have to unravel it to try to make sense of it, even if we have to sacrifice a little in terms of 'scientific' accuracy. This is the main justification for the chosen technique in this analysis, of using an ordinal scale for the indexes that are constructed. In subsequent refinements, that could be modified.

In that context, a crucial point to make at the outset is that inclusion or exclusion of any particular indicator in an HDE index is a matter of preference, and does not affect the essence of the approach. Thus, if the authorities chose to promote the HDE idea and did not believe that, say, economic democracy should be regarded as a desirable attribute, then the relevant indicators could be excluded. In contrast, if environmental

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[11] R.S.Kaplan and D.P.Norton, "The Balanced Scorecard – Measures that drive performance", Harvard Business Review, January-February 1992, pp.71-79; idem, "Putting the balanced scorecard to work", Harvard Business Review, September-October 1993, pp.134-47.

[12] European Foundation for Quality Management, Total Quality Management – The European Model for Self Appraisal: Guidelines for Identifying and Addressing Total Quality Issues (1992).

[13] Earlier variants of the approach developed in this paper were developed for comparing industrial enterprises in south-east Asian economies. See, for example, Guy Standing, "Towards a Human Resource-oriented Enterprise: A South-East Asian Example", International Labour Review, Vol.131, No.3, 1992/3, pp.281-96.

[14] In constructing any complex index, conceptual and measurement difficulties abound. For the proposed HDE index, the most important concern *scaling* (the justification of any particular weighting of indicators), *aggregation* (the summarising of multi-dimensional information in any single index) and *patterning* (determining that additivity is more or less appropriate than, say, a multiplicative approach).

concerns were deemed desirable, indicators capturing those concerns could be included.

In constructing HDE indexes, we need sets of indicators that should reflect four general considerations, as follows:

(1) There should be indicators of *revealed preference*, or *ethical principles*, reflecting the firm's commitment to certain desirable practices and outcomes;

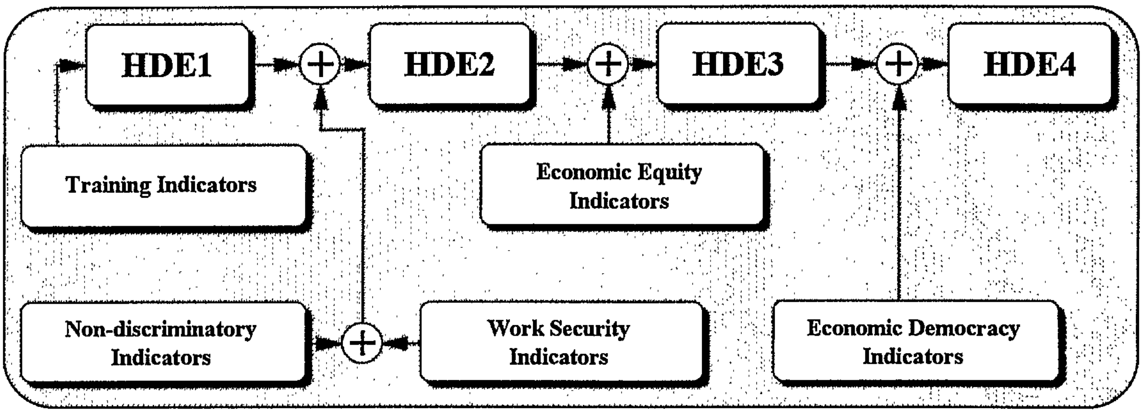
(2) There should be indicators of *institutional mechanisms*, or *processes*, by which desirable outcomes could be translated into actual outcomes;[15]

(3) There should be indicators of *outcomes*, which should reflect whether or not preferences and mechanisms are working;

(4) The indicators selected must be *sustainable*, since they must not be idealistic to the point where they would seriously jeopardise the enterprise's long-term viability, profitability and dynamism.

In this exploratory exercise, a major objective is to construct an *hierarchy* of HDE indexes, each of which is built by adding a new set of indicators of one of the basic spheres of labour and employment practice – skill orientation, social equity, work security, economic equity and economic democracy, in that order. We will proceed to construct four HDE indexes, as illustrated in Diagram 1, starting with skill orientation, then moving to integrate non-discriminatory practices, work security, economic equity and finally economic democracy.

Diagram 1: Hierarchy of Human Development Enterprise Indexes



3. HDE1: Enterprise Skill Formation

A Good Enterprise should provide opportunities for skill acquisition. Ideally, it should promote a *voluntary learning environment*. There is much talk about making firms centres of learning, which is surely an exaggeration of their potential. One must

[15] In what follows, little explicit attention is paid to an important set of concerns linked to mechanisms. A good enterprise should have mechanisms that minimise internal transaction costs, that is, costs required to ensure internal co-operation. It should also have mechanisms that reduce tendencies towards bureaucracy, that is, a hierarchical control system that exists because of high degrees of performance ambiguity and goal incongruency (or even goal indifference). On these issues, see, for instance, William Ouchi, "Markets, bureaucracies and clans", Administrative Science Quarterly, Vol.25, 1980, pp.129-41. A bureaucracy tends to have very high transaction costs.

also be careful about idealising notions of training. In particular, the notion of *lifelong learning,* or continuous learning, is not unambiguously good, if it entails job insecurity. The thought of having to learn new competencies every few months could be unsettling and a source of discordant performance, even deterring some workers from trying to become excellent in a particular set of skills. Thus, the emphasis must be on *opportunities* for learning, coupled with reasonable prospects of a personal intrinsic and instrumental 'reward' from the investment in the training. And there must be a *voluntary* culture of learning, in that those opting not to train or acquire new skills will not be penalised in any punitive fashion. The right to do something must always be matched by a right not to do it.

What we can consider as basic indicators of an orientation to skill formation are the three layers of training, namely:

(i) entry-level training for newly recruited workers,
(ii) retraining to improve job performance or to transfer workers to other jobs with similar skills, and
(iii) retraining for upgrading workers or promotion.[16]

In addition, we need to take account of the type of training provided. If a firm only gave informal, on-the-job training, that would deserve less weight than if it involved "class room" and structured training, including apprenticeship. Accordingly, for each of the three levels of training, a distinction is made between "informal" and "formal" training, with the latter being presumed to have greater value, which is not always the case. Given the economic and institutional realities in enterprises, the difference between formal and informal may be exaggerated. Yet concentrated training that involves a quantifiable cost should be preferable to "on-the-job-pick-it-up-as-you-go" training.

Finally, to construct the first index, HDE1, we include a factor measuring whether or not the establishment pays for training directly, either by funding a training institute or by paying the training fees to an institute to where it sends workers for training or by giving stipends to workers who go on training courses.

Thus, the first index is constructed by a simple addition of the factors as follows:

HDE1 = (TR + TRF) + (RETR + RETRF) + (UPTR + UPTRF) + TR.INST

where the components are defined as follows:

[16] Possibly, the second and third forms of training deserve greater weight than the first, yet in most labour market analyses only the first that is considered.

TR	=	1 if training was usually provided to newly recruited workers, 0 otherwise;
TRF	=	1 if TR was apprenticeship or off-the-job in classroom or institute, 0 otherwise;
RETR	=	1 if there was training provided for established workers to improve job performance or transfer between jobs of similar skill, 0 otherwise;
RETRF	=	1 if that retraining was formal, in class or institute, 0 otherwise;
UPTR	=	1 if training was provided to upgrade workers, 0 otherwise;
UPTRF	=	1 if that retraining for upgrading was in class or institute, 0 otherwise;
TR.INST	=	1 if the firm paid for trainees at institutes, directly or indirectly, 0 otherwise.

So, the basic HDE1 index has a value between 0 and 7, with a zero value meaning that the firm gave no training of any sort. What the index implies is that we give each level of training an equal importance, and give formal training twice as much significance as informal.

To illustrate the application of this and subsequent indexes, we can compare industrial enterprises included in two of our recently-conducted enterprise surveys:

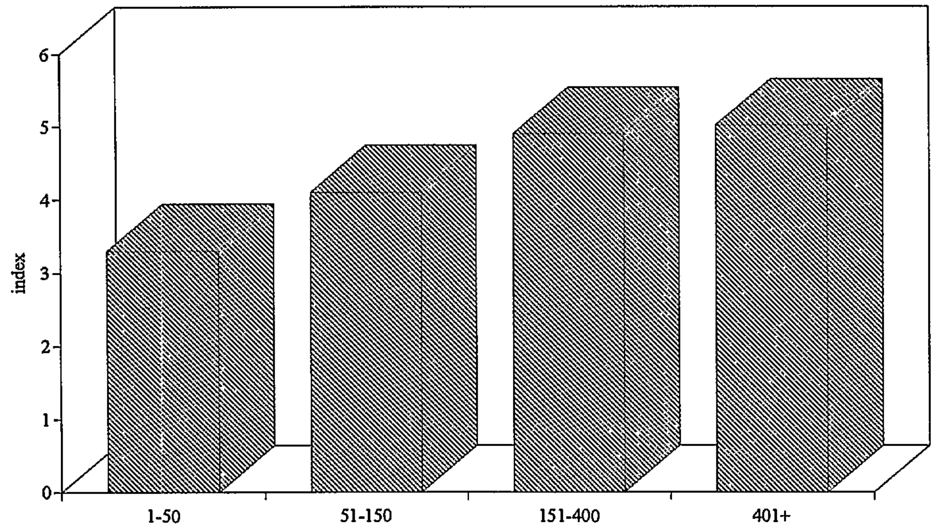
1. **The Russian Enterprise Labour Flexibility Survey** (RLFS5). This is a detailed survey, based on information collected from managements and others, that has been monitoring and analysing changes taking place in industrial firms since 1990. The fifth round was carried out in mid-1995, and covered 482 industrial enterprises in seven *oblasts* (regions).

2. **The South African Enterprise Labour Flexibility Survey** (SALFS1). This is a similar survey, covering 399 manufacturing enterprises and conducted in October 1995.[17]

For Russian factories the basic HDE1 index, based on an ordinal scale, had values ranging from 0 to 7. For the whole sample of firms, the modal value was 3, the mean 3.0, with only 2% having a value of 7 and with 4.6% having a value of zero. For South African enterprises, the mean value was 4.3, with a high of 5.1 in food processing. The mean was higher in foreign firms (4.8) than in local firms (4.2), and there was a positive relationship between the HDE1 score and employment size of enterprise (Figure 1).

[17] The enterprise labour flexibility surveys cover a very wide range of labour and employment issues, and have been conducted in Albania, Armenia, Bulgaria, Chile, China, Hungary, India, Kyrgizia, Malaysia, Mexico, the Philippines, the Russian Federation, South Africa and Ukraine. Their design can be adapted to industrialised and industrialising economies, and it is hoped that comparable surveys will be conducted in western European countries in the near future.

Figure 1: Human Development Enterprise Index (HDE1), by Employment Size of Establishment, South Africa, 1995



Source: SALFS1, n = 336

4. HDE2: Incorporating Work Security and Social Equity

A second concern in defining a good firm relates to *work security*, or the pursuit of occupational safety and health. Human development is scarcely compatible with poor working conditions. Identifying good working conditions with a few proxies is not easy, but there is possible *input* mechanisms and reasonable *outcome* variables that can be used. We did not collect appropriate data on work security in our earlier Eastern European enterprise surveys, but did do so in the fifth round of the RLFS and in South Africa, where there already exists a scheme for encouraging and rewarding good occupational safety practices, known as the NOSA star system. For our purposes, a work security index is defined as follows:

$$\mathbf{WS} = \mathbf{S + A + I}$$

where

S = 1 if the firm has a department or formal worker-employer committee responsible for safety and health at work, 0 otherwise;

A = 1 if the number of accidents in the workplace in the past year, expressed as a ratio to total employment, was less than 50% of the sectoral mean, 0 otherwise;

I = 1 if the number of work days lost through illness or injury in the past year was less than 50% of the sectoral mean average, 0 otherwise.

One could quibble with these, but they are reasonable proxies for good performance, and this is what we need to establish at the outset. However, in the first round of the SALFS it was not possible to estimate I, since data on that were not collected. Data on accidents and on the existence or otherwise of mechanisms dealing with safety issues were collected, and thus a basic WS index was estimated.

For Russian enterprises, the input mechanism is whether or not there was a safety committee or department in the factory. In most Russian enterprises one or both have existed, although the survey suggests that there has been some abandonment. The outcome variables consist of, first, the number of working accidents requiring at least one day off work expressed as a percentage of the size of the workforce, and second, the number of working days lost from sickness and accidents at work. These are not perfect proxies, since the sickness may not reflect work-related factors and the work accidents may or may not be the responsibility of the enterprise. Nevertheless, they are the easily understood and reasonable first approximations.

Thus, the index of work security used in the Russian survey is as follows:

WS = SAFETY + ACCID

where

SAFETY = 2 if there was a safety committee and/or department,
1 if there was an engineer or specialist dealing with safety,
0 otherwise;

ACCID = 1 if the number of work accidents as a proportion of the workforce was less than the mean average, 0 otherwise.

As for *social equity*, non-discriminatory labour practices are essential in identifying a good firm. To be exemplary, an enterprise should act in ways that reduce or avoid labour segregation based on personal characteristics such as race, gender or disabilities. Although measuring labour discrimination and disadvantages is notoriously difficult, at a minimum, both employer attitudes and revealed outcomes should be taken into account. Neither preferences nor outcomes alone would be sufficient. For instance, one might have a "preference" but not put it into effect, or one might have no preference yet discriminate by hiring on the basis of characteristics that had the (perhaps-inadvertent) effect of excluding certain groups from various jobs.

Again, complexity in measuring social equity would be the enemy of progress at this stage. In our enterprise surveys, we have measured a social equity index in terms of non-discrimination in recruitment and training. In the eastern European enterprise surveys, the selected indicators of non-discrimination were mainly related to gender. In terms of hiring workers, if the management reported that there was no preference for either men or women, this was regarded as a positive factor.

Note that it would be an inequity for men if we gave a positive value if the management said they preferred women, as was the case in some factories. However, this reasoning could be stretched too far, because we are *primarily* concerned with redressing the typical case of discrimination against women.

A second indicator of non-discrimination that we select is a commitment to provide training opportunities equally to men and women.[18] Preferences here are also likely to be revealed, especially as there is no law against discrimination in such matters. Thus, there was some readiness on the part of managements to admit to a discriminatory preference for men, and in some cases for women.

[18] In an interesting commentary on this approach, Stephen Smith suggested, with respect to training in particular, "Under the diminishing marginal utility principle, a social welfare function might weight HDE characteristics for those at the "bottom" of the firm more than for those at the top." S.Smith, "The firm, human development and market failure", paper prepared for an ILO Meeting on Enterprise Restructuring and Labour Markets, Turin, May 31-June 2, 1995, p.10.

Stated preferences are weak proxies, sometimes being rationalisations of what has happened, more often being norm-induced. To ignore preferences altogether would be unjustifiable, yet it is particularly important to complement the preference factor with actual outcomes. Accordingly, we incorporate an outcome variable of sex discrimination, one which may not be ideal but which is a reasonable proxy for what we need. The proxy selected in the RLFS5 was the percentage of higher-level "employee" jobs taken by women. If that was greater than 40% then the firm was given a positive score in the index. This measure is not ideal, because the outcome could reflect differences in the relative supply of men and women. However, it does focus on the better type of jobs and identifies relatively good performance in a key area of discrimination.

One could modify the selected share level to be sectorally specific, giving a positive score in the index if a firm had a relatively high percentage of women in training relative to the average for all firms in the sector. This could be justified because the ratios varied considerably be sector. But this is not as easily justifiable as it seems at first. It seems to allow for gender-based industrial segregation of employment.[19]

Besides the gender variables for employment equity, another indicator of discrimination is whether or not the firm was employing *workers with registered disabilities*. So, it is appropriate to use an indicator of whether or not the firm was employing any workers with disabilities. Coupled with the gender variables, this results in an index of non-discrimination suitable for Russian enterprises, as follows:

$$\mathbf{ND} = \mathbf{R_S + T_S + FWC + D}$$

where ND is the index of non-discrimination, and

R_S	=	1 if the management has no preference for either men or women in recruiting production workers, 0 otherwise;
T_S	=	1 if management stated that they had no preference for either men or women in providing training for production workers;
FWC	=	1 if the female share of employees (managerial, specialist or general service workers) was greater than 40%, 0 otherwise;
D	=	1 if the firm employed workers with disabilities, 0 otherwise.

This approach would be inadequate in the South African context. For there, we defined non-discrimination to give a primary focus to racial with the following proxy variables:

$$\mathbf{ND} = \mathbf{R_r + R_s + T_r + T_g + TF + RWC + FWC + D}$$

where

[19] For instance, it would be inappropriate to give a positive score to a firm in the energy sector in which merely 12% of its higher-level "employees" were women just because the industry's average was 10%.

R_r = 1 if the firm is operating an "affirmative action" recruitment programme in favour of non-white workers, 0 otherwise;
R_s = 1 if the firm has no preference for men or for women in recruiting workers, 0 otherwise;
Tp_r = 1 if the firm has a training programme and has provided production workers with more than 10% of all training course places, 0 otherwise;
T_g = 1 if firm has no preference for men in providing training, 0 otherwise;
TF = 1 if women's share of those receiving training within the firm was greater than women's share of total employment in the firm, 0 otherwise;
RWC = 1 if over 50% of employees ("white collar") consist of non-whites, 0 otherwise;
FWC = 1 if over 50% of employees consist of women, 0 otherwise;
D = 1 if over 1% of the firm's employees are workers with disabilities.

In South Africa, the value of ND varies from 0 to 8. This and the WS index should be added to make a socially equitable index, HDE2, which for South Africa and the SALFS has a range of 0 to 17. In the Russian case, if we add the work security index to the non-discrimination index and the skill formation index, we obtain what is designated the Socially Equitable Enterprise. This had a modal value of 9 in early 1995, and a mean value of 7.2.

We now turn to the complex and more contentious issue of economic equity.

5. Economic Equity in Enterprises

The literature on the notion of economic equity is vast, yet there is little on the issue of economic equity in terms of the micro-economics of the firm. What is an economically equitable firm? It is surely one in which the differences in earnings and benefits between members of it are minimised to the point where economic efficiency is not jeopardised. This might be called the *Principle of Fair Inequality* or Efficient Inequality. It is rather utilitarian, and one should add a Rawlsian caveat – with priority given to improvement of the "worst off" workers in the firm.[20]

There are also dynamic efficiency reasons to favour economic equity, whatever the bargaining position of various groups in an enterprise. Labour productivity depends in part on cooperation as well as on individual effort and performance. If there were wide differences between groups in the enterprise, the more disadvantaged – or those who feel they are inequitably treated – would tend to withhold "tacit knowledge" and not commit themselves to the voluntary exchange of knowledge that contributes to dynamic efficiency.[21] There would also be a tendency towards implicit or explicit *sabotage* in factories. Equity induces loyalty, which induces productivity improvement.

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[20] Rawls, 1973, op.cit. This point relates to what Rawls called the Difference Principle.

[21] For related points, see Geoffrey Hodgson, Economics and Institutions: A Manifesto for a Modern Institutional Economics (Oxford, Polity Press, 1988), p.259. Others have shown that narrow pay differentials within firms are associated with group cohesion and trust of management, as well as with productivity gains. D.Levine, "Public policy implications of worker participation", Economic and Industrial Democracy, Vol.13, 1992, pp.183-206. It has also been argued that narrow pay differentials induce worker commitment to management goals. D.M.Cowherd and D.Levine, "Product quality and pay equity between lower-level employees and top management: An investigation of distributive justice theory", Administrative Science Quarterly, Vol.37, No.2, 1992, pp.302-20.

To create a proxy Economic Equity Index we again took slightly difference approaches in our two illustrative country surveys. In Russia, we considered three factors, giving greatest weight to the first, appropriately since this relates to treatment of the "worst off" in the firm.

First, one of the worst phenomenon to emerge in Russian industry in the mid-1990s was the growth of groups of workers in a firm paid much lower wages than anybody else, and typically there are some who receive very low wages indeed. An economically equitable firm should have few if any workers paid a small fraction of the average in the firm. So, we took the minimum wage received by the lowest paid full-time workers as the initial yardstick. If more than 5% of the workers received this wage then the firm was given a low score on economic equity. But as that does not capture any distributional factor, we also gave a positive score to any firm in which the minimum payment was equal to or greater than 50% of the average wage. These two indicators are only proxies for what we would like to measure, yet with the type of data one can collect in large-scale establishment surveys they are reasonable proxies.

A second consideration is whether the average wage itself is equitable relative to that paid in other firms. Here, we took a sectorally relative measure, to reflect technological and market factors. The proxy used is whether the average wage in the firm is greater than the industry's average. If it was greater, then a positive score was provided.

Finally, equity is improved if the enterprise provides benefits and entitlements that represent security against various personal contingencies and that improve the stakeholders' standard of living. Since wages and incomes are only part of the remuneration system, we take as a proxy whether or not the firm provided ordinary workers with more than ten types of fringe, or non-wage, benefits.[22] Thus, the Economic Equity Index is defined as follows:

EE = Min/Emp + M + AW/AWM + FB

where EE is economic equity index, and where

Min/Emp	=	1 if the percent of the total workforce of the firm paid the minimum payment is below 5%, 0 otherwise;
M	=	1 if the minimum wage paid was greater than 50% of the average paid in the firm, 0 otherwise;
AW/AWM	=	1 if the average wage in the establishment was above the average wage for the industrial sector, 0 otherwise;
FB	=	1 if the firm paid more than ten types of identified fringe benefits, 0 otherwise.

If we add EE to HDE2 we have what we can call the **Socio-Economically Equitable HDE**. In the Russian case, this can take a value of between 0 and 18, and had a modal value of 10 and a mean value of 8.5.

In the South African case, our measure of economic equity is slightly different. Bearing in mind that South Africa has one of the most unequal income distributions in

[22] In a different environment this threshold might be lower. Yet in Russia, and in other countries of central and eastern Europe, where it was the norm to provide an extraordinary array of benefits coupled with a low money wage, the wage measure of income is misleading.

the world, including large wage and salary differentials, economic equity must be part of the definition of the exemplary firm. It is proposed that the following index captures the crucial dimensions:

$$\mathbf{EE = Min/EMP + M + AW/W_s + W_{nw}/W + FB}$$

where

Min/EMP	=	1 if less than 5% of the workforce is paid less than half of the average wage in the firm, 0 otherwise;
M	=	1 the lowest wage in the firm is greater than 50% of the average wage, 0 otherwise;
AW/W_s	=	1 if the firm's average wage is above the sector's average wage, 0 otherwise;
W_{nw}/W	=	1 if the average wage of non-whites is more than 80% of the mean average of all workers, 0 otherwise;
FB	=	1 if the firm provides workers with more than 8 specified non-wage or "fringe" benefits, 0 otherwise.

Finally, we move into the politically most sensitive sphere of corporate governance.

6. The Economically Democratic HDE

"To be governed by appetite alone is slavery, while obedience to a law one prescribes to oneself is freedom."[23]

There is something missing from Rousseau's famous aphorism. To be ruled by laws and regulations alone is not freedom either. What is crucial is that there should be Voice regulation. In the workplace, as anywhere else, the direct "stakeholders" who bear the greatest risk and uncertainty should be able to regulate decisions affecting labour and employment practices. Put differently, what is Human Development without empowerment?

This is perhaps the greatest quandary of corporate governance for the 21st century. Can the functions of management and productive decision-making be made more democratic and accountable while promoting dynamic efficiency for the benefit of all representative stakeholders, which may include shareholders not working for the enterprise?[24]

Democracy must be more than casting a vote every few years. Democracy is also about institutional safeguards, and the most effective of those is the capacity of the vulnerable to exercise restraint and direction on those in decision-making positions, giving substance to the Rawlsian "maximin" principle, mentioned earlier. Democracy is also about attempts to ensure co-operation in the interest of all representative groups. As some analysts have put it, successful co-operation requires "the shadow of the

[23] Jean-Jacques Rousseau, The Social Contract, book 1, ch.viii.

[24] The popular aphorism that we have reached "the end of history" with the collapse of "state socialism" is silly. Now, the challenge is to consider how to reverse atavistic thinking. Instead of the socialisation of property and essentially private management, is there an acceptable sphere in which one could envisage the privatisation of ownership, through genuinely democratic, widespread and accountable share ownership, etc., coupled with socially accountable management?

future", that is, mechanisms to ensure that competitive interest groups will know that they will have to deal with each other and cooperage with each other in the future.

In the nature of an industrial enterprise, one side (management) has the scope for various forms of opportunism through control of information, a limited circle of people and a capacity to take unilateral decisions (by fiat).[25] To limit opportunism by authorities, there must be a process of reciprocal monitoring and a capacity to impose sanctions when abuses are detected.[26]

This is vitally important in the area of enterprise restructuring in both Russian and South African industry, for unless there were mechanisms for voice regulation of the restructuring, the capacity of the vulnerable to influence the outcomes would be minimised. It is also unlikely that the process would succeed in achieving an atmosphere of dynamic efficiency if the workers are sullen and become "excluded insiders" in factories.[27]

So, to complete our idea of a Human Development Enterprise we need to construct an Economic Democracy Index. Once again, necessarily there are differences in what we wish to measure in the two contexts chosen to illustrate the approach, although the principles are the same. We start with the Russian case, with its historically specific transformation process. We can define fledgling economic democracy in terms of five indicators:

First, we take it as axiomatic that, potentially at least, workers' Voice (in the memorable term coined by Albert Hirschman) is strengthened by a high degree of unionisation of the workforce. Quite simply, having a mechanism to represent workers and employees creates the basis for dynamic efficiency and the proverbial "sword of justice". Without a trade union, there could not be the shadow of the future to concentrate the minds of managers and workers on developing and maintaining decent, viable and efficient employment and labour practices. This does not mean that we presume that unions will always behave appropriately. However, a strong representative mechanism is a necessary condition for Voice regulation.

In the Russian case, this is defined pragmatically as being the case if more than 50% of the workers in a firm belonged to a trade union, because of the traditionally very high (artificially) level of unionisation. Ideally, it would be appropriate to identify the breadth of the union, since in principle an industrial union should be representative of a broader group of workers than a craft union, and a union that had members who were

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25 Smith delineated five types of managerial opportunism, all of which could be moderated if workers had a monitoring role inside the enterprise. S.Smith, "On the economic rationale for co-determination law", Journal of Economic Behaviour and Organisation, Vol.16, 1991, pp.261-81.

26 G.Dow, "The function of authority in transaction cost economics", Journal of Economic Behaviour and Organisation, 1987, p.22. Dow elsewhere makes the valid point that unilateral control by management may distort the choice of production technique away from the provision of firm-specific training. G.Dow, "Why capital hires labour: A bargaining perspective", American Economic Review, Vol.83, No.1, pp.118-34.

27 One rarely appreciated reason for encouraging the establishment of effective Voice mechanisms in enterprises is to limit the growth of a "survivor syndrome". In factories subject to steady employment cuts, the remaining workers are likely to suffer from a sense of anger and insecurity that could reduce labour productivity. If workers are involved in the bargaining process, the "shadow of the past" can be controlled, to some extent at least.

potential workers as well as those actually in employment would be more likely to ensure that the concerns of those in the labour market were also taken into account. The character of trade unions would have to change before such refinements would make much sense in the Russian labour market. Elsewhere our indicator would need refinement.

Second, the democratic potential is greater if the main union is an independent one, which in the Russian context means, above all, that the administration or management should *not* be members of it.[28] Traditionally, in 'Soviet' enterprises management belonged to the union and both managers and trade union representatives were subject to the commands of the Communist Party. Thus, symbolically and as an indicator of growing independence in bargaining, the non-membership by management is an important indicator of independent Voice in a country such as Russian industry. Elsewhere, an alternative indicator of union independence would be more appropriate.

Third, to be meaningful there should be evidence of the existence of an operational mechanism for bargaining. For this, a collective agreement between the union and the employer is taken as a positive sign, even though it is recognised that in the mid-1990s, a collective agreement would in most cases have been more formal than substantive.

Fourth, there is deemed to be a greater degree of democracy if workers own a large percentage of the shares of the company, which has been a feature of property form restructuring of Russian industry. The critical level for a positive value is taken to be 30%. Although this aspect of enterprise democracy has been controversial for many years, many empirical studies have suggested that minority employee ownership is conducive to efficiency, economic restructuring and equity.[29]

In Russian industry, given the lack of imbued work discipline and the legacy of the Soviet era in which workers' effort bargain was low and erratic, and in which monitoring of it was ineffectual, if not wholly distorted, worker ownership and governance should have considerable *potential* benefits as a best-option means of overcoming the intrinsic incompleteness of labour contracts.[30]

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[28] In South-east Asia, the relevant difference is whether the union is an industrial union or a company union. It turns out that this makes a substantial difference to such outcomes as wage levels, wage differentials and training. G. Standing, "Do unions impede or accelerate structural adjustment? Industrial versus company unions in an industrialising labour market", Cambridge Journal of Economics, Vol.16, 1992, pp.327-54.

[29] See, inter alia, H.A.Henzler, "The new era of Eurocapitalism", Harvard Business Review, July-Aug., 1992, pp.57-63; D.I.Levine and L.D'Andrea Tyson, "Participation, productivity and the firm's environment", in A.Blinder (ed.), Paying for Productivity (Washington, DC, Brookings Institution, 1990); Z.Acs and F.FitzRoy, "A constitution for privatising large Eastern enterprises", Economics of Transition, Vol.2, No.1, 1994, pp.83-94. The argument against worker shareholding is often presented most forcefully by some trade unionists. One claim is that it would weaken the workers' resolve to push for improved training.

[30] The theoretical point was brought out in a famous article some years ago. A. Alchian and H. Demetz, "Production, information costs and economic organisation", American Economic Review, Vol.62, No.5, December 1972, pp.777-95. It is notable that worker ownership in the USA is greatest in such 'service' spheres as legal practices, where monitoring of work is extremely difficult. It is ironic, however, that in what is often regarded as the bastion of capitalism, the states have *required* all law firms to be *worker owned*. This is not normally highlighted by those who regard worker ownership as incompatible with a capitalist economy.

Ownership of a flow of income should be distinguished from ownership of property rights. In terms of corporate governance, minority worker share ownership could be interpreted as turning workers into *outsider principals* – monitoring the performance of the agent (manager), and indirectly providing a mechanism for selecting, dismissing and replacing managers. The objection to sole existence of *insider principals* is that a coalition between managers and workers as insiders could result in short-term concerns predominating over long-term strategy. However, if share ownership is the mechanism, workers and managers effectively become outsider agents as well, having a direct interest in the long-term flow of income from their shares as well as their earnings from work.[31]

Fifth, at least in the Russian context, it is taken as a positive element in enterprise democracy if the top management were elected by the workers, rather than be appointed by a Ministry or by an enterprise board. This is likely to be the most controversial factor, for well-known reasons, although to some extent it is institutionalised in Germany in the system of codetermination. But we introduce this specifically for the special circumstances of Russian enterprises in the mid-1990s, when other appointment mechanisms were more dubious and less accountable. The essence of our pragmatic decision is that it recognises the positive value of direct accountability to actual stakeholders in the enterprise, limiting managerial opportunism and thus encouraging behaviour in favour of sustainable long-term profit maximisation, dynamic efficiency and human development practices.

In the 1990s, there has been a diversification in the means by which Russian managements have been appointed and reappointed. Achieving a balance in accountability of managements to workers and to the firm is difficult, since commercial decisions might be jettisoned in favour of decisions that enjoyed the short-term support of the workforce. Appointment by the workers could result in general managerial conservatism and a reluctance to restructure. This is an endemic problem in democracy.[32] Yet in the emerging Russian firms, workers have become broader stakeholders, which makes behavioural "short-termism" less likely, although this argument is a justification for appointments to be for sufficiently long periods to

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31 One recognises that the argument could not stop there. In central and eastern Europe, there have been efforts to promote institutional *blockholders* – large-scale financial intermediaries holding large blocks of shares – that could control insider managements. See, for instance, E.S.Phelps, R.Frydman, A.Rapazynski and A.Shleifer, Needed mechanisms of corporate governance and finance in eastern Europe (European bank for Reconstruction and Development, Working Paper No.1, London, March 1993). An important consideration is that whatever blockholder is created, it should be *active* in corporate governance, and in this respect workers having a block of shares as a group (through the union?) could be beneficial. The danger to be avoided is workers being in substantial control, for then the *management* function would be distorted. One should be wary about one claim, which is that worker share ownership would lead to short-term investments and profit maximisation, on the grounds that they would be solely interested in the income flow during their work tenure. This cannot be valid. If the workforce own shares, younger cohorts of workers would always be looking to a long-term future. By contrast, it is managements that are more likely to take a short-term perspective, since their tenure is likely to be short and on average they will be likely to be closer to retirement age than the average worker. The conventional argument against workers becoming principals and for managers to turn from agents to principals could be reversed.

32 In established democratic societies, anybody over the age of 30 knows of past elections when incumbent politicians have indulged in tax cutting and the avoidance of budget cuts in the period beforehand.

encourage managements to take decisions that combine concern both for today's workers and the future of the firm.

Sixth, economic democracy is taken to be greater if there is a profit-sharing pay system in operation, implying a sharing of risks and rewards. This is a particularly sensitive issue, since many trade unionists have been against profit-sharing pay on the grounds that it introduces income insecurity for workers who are not involved in the decision-making and who rely almost entirely on their wage income to maintain their standard of living. However, if one is giving a positive value to the broadening of democratic decision-making, it is appropriate to balance that by valuing mechanisms that share the risks and potential benefits. Moreover, a firm with high income dispersion ("delevelling" in the jargon favoured by Russian labour economists) that is due to the working of incentive systems should be regarded differently from one in which high inequality reflected power relations and managerial fiat.

In sum, taking account of the various considerations specific to Russian industrial enterprises, we define an Economic Democracy Index (ED), which can take a value of between 0 and 6, as follows:

ED = **TU + IND + COLL + SH + MA + P**

where

TU	= 1 if more than 50% of the workforce is unionised, 0 otherwise;
IND	= 1 if the management is not in the trade union, 0 otherwise;
COLL	= 1 if there is a collective agreement, 0 otherwise;
SH	= 1 if more than 30% of the firm's shares are owned by workers and employees, 0 otherwise;
MA	= 1 if the top management is appointed by the workers, 0 otherwise;
P	= 1 if there is a profit-sharing element in the wage determination system, 0 otherwise.

By adding the ED index to the HDE3, as shown earlier in Diagram 1, we obtain the full **Human Development Enterprise Index**, which we designate as HDE4. For Russian enterprises, this has a maximum possible value of 24, and if the index is supposed to identify exemplary standards, there should be a tapering in the distribution of firms, with relatively fewer as the scores rise above the median value, and no excessive bunching of values. As it was, in 1995 the modal value was 14, the mean value was 11.5. There were 153 firms, or 31.7%, with values below 10, and 12, or 2.5%, with values above 18, with two firms having a value of 22. One might suggest that those with scores above 18 were exemplary in the Russian industrial context.

For South Africa, the economic democracy index is measured more simply than in Russia, as follows:

ED = **TU + COLL + WF + SH + P**

where

TU	=	1 if there is a recognised trade union in the firm with more than 50% of the workforce in the union, 0 otherwise;
COLL	=	1 if there is a collective agreement operating in the firm, covering wages and other labour matters, 0 otherwise;
WF	=	1 if there is a Work Forum (or the equivalent) in operation, 0 otherwise;
SH	=	1 if the workers possess more than 10% of the shares of the firm, 0 otherwise;
P	=	1 if there is a bargained profit sharing payment scheme for workers, 0 otherwise.

Two points about this should be noted. First, the share-owning level is arbitrary, although it does suggest a reasonable level of commitment to broadening capital ownership to those most directly involved in generating the output. Second, a profit sharing scheme is regarded as a mixed blessing by many trade unionists, since it can be abused to make wages downwardly flexible. However, profit sharing is spreading around the world, and can be a means of promoting efficiency and employment, as much empirical research has demonstrated.

Again, by adding the ED index to HDE3 we obtain the full Human Development Enterprise Index, HDE4. Across the spectrum of South African firms, the HDE4 values could range from zero (hard to imagine) to a maximum of 27. It is most unlikely that any firm would have a maximum value, although a good socially responsible firm is likely to have a score of 20 or more.

We have estimated the distribution of firms by the scores attained on most of the dimensions of the HDE index. But the most important point at this stage is not the actual values in the exercise, it is the concept.

7. Applying the Human Development Enterprise in Russian Industry

An attraction of the HDE index is that we can look at a firm to assess its performance in absolute terms or to assess its performance relative to others in the country or even within a sector, region or size category. Thus, in discussing the values of the indexes and patterns, the following refers to Russian industry, and is primarily concerned with identification of those enterprises performing relatively well as an HDE in the context of Russian industry.

There are four points to bear in mind. First, the way the HDE4 index is constructed, a relatively heavy weight is given to skill formation (the base of Human Development in many models). Second, there was a low correlation between the four component indexes, for non-discrimination, social equity, economic equity and economic democracy, implying that they were measuring distinctive and different phenomena. Third, the few "social organisations" included in the sample are excluded from the analysis, since they have been special enterprises. Fourth, in considering inter-enterprise patterns, note that differences in the averages for various components may not translate into substantial differences overall, since in many cases firms that did well on some indicators did relatively poorly on others.

Turning to distributional patterns across the 482 firms in 1995, we start with HDE1. In terms of mean values, the average was highest in the construction materials and chemicals sectors, and lowest in textiles and garments. It was lower in private establishments than in other property forms, reflecting the low degree of training given in the private sector thus far (Figure 2). And it was highest in large-scale firms (Figure 3). In terms of corporate governance (defined in the appendix), it was highest in establishments designated as "worker controlled", followed by "employee controlled". The patterns could be interpreted as suggesting that policymakers should concentrate most on improving training in small-scale firms, in textiles and garments and in private firms. The message is that there is a need to couple property form and size restructuring and corporate governance reform with a policy of promoting enterprise training and retraining.

Adding the non-discrimination index, in HDE2, made little difference to the structural pattern. However, adding the economic equity index strengthened the relative performance of closed joint stock firms, as would be expected, and worker-controlled governance was associated with a statistically significant higher value of economic equity, translated into a high value of HDE3. For HDE3, in terms of mean values, open joint stock firms appeared to perform better on average than other property forms, whereas state firms did relatively badly.

Finally, in terms of economic democracy, larger firms tended to score higher than smaller-scale firms, and open joint and closed joint stock enterprises tended to score much better than other property forms. In terms of HDE4, the average values were higher in closed and open joint stock establishments than in other property forms and appeared slightly higher in large-scale than small firms (Figures 4-5). Worker and employee governance types performed best, as expected given the positive value to economic democracy.

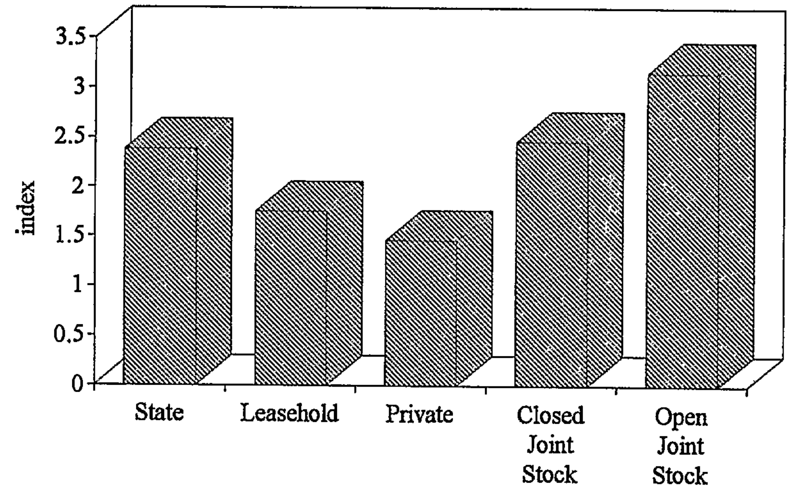
To attempt to assess the structural determinants of the values of HDE1, HDE2, HDE3 and HDE4, an ordinary least squares multiple regression function was estimated, as follows:

$$\mathbf{HDE = a + b_1\Sigma\ IND + b_2EMPSIZE + b_3\Sigma\ PROP\ (or\ CORP) + b_4\Sigma\ REG + b_5EMPCH + b_6\Sigma\ ELECT + b_7CHSALES + b_8UNION + e}$$

where

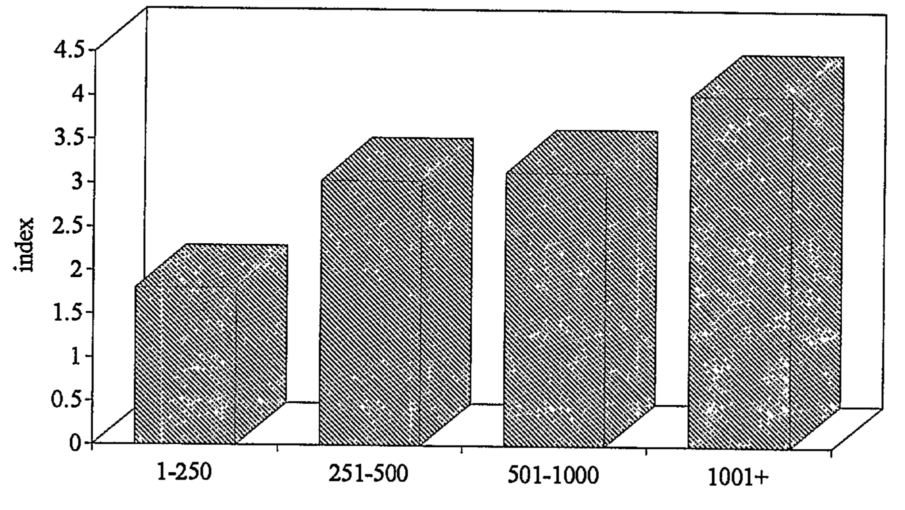
Σ IND	=	binaries (1,0) for industrial sector, the omitted category being food processing;
EMPSIZE	=	employment size of establishment;
Σ PROP	=	binaries for property form of establishment, the omitted category being state establishments;
ΣCORP	=	binaries for corporate governance form of establishment, the omitted category being state governance;
EMPCH	=	percent employment change over the past year;
Σ ELECT	=	binaries for method of appointment of senior management, the omitted category being appointment by a Ministry;
CHSALES	=	binary, 1 if sales rose in real terms over the past year, 0 otherwise;
UNION	=	percent of workforce in a trade union;
e	=	error term.

Figure 2: HDE1 by Property Form, 1995, Russia, All Regions



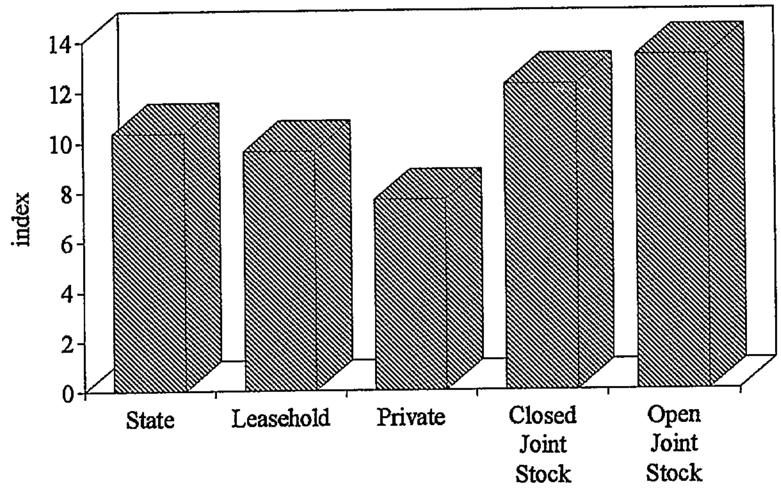
Source: RLFS5, n = 480.

Figure 3: HDE1 by Employment Size of Establishment, 1995, Russia, All Regions



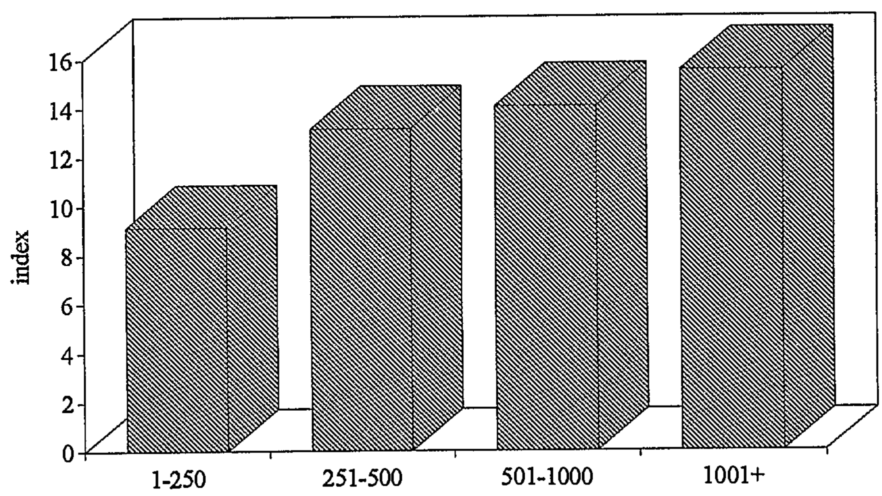
Source: RLFS5, n = 482

Figure 4: HDE4 by Property Form, 1995, Russia, All Regions



Source: RLFS5, n = 480

Figure 5: HDE4 by Employment Size of Establishment, 1995, Russia, All Regions



Source: RLFS5, n = 482

The equation was estimated with and without the union variable, since it was included in the definition of HDE4, and with and without the variable measuring the means of appointment of top management, for the same reason. Whether included or not, the results in Table 1 suggest that, *controlling for the influence of other factors*, open joint stock companies were more likely to score higher than other property forms, larger firms tended to have higher values of HDE4 and economic performance in terms of sales change was inversely related to the value of the HDE index.

Table 1: Determinants of Human Development Enterprise, Russian Industry, 1994 (OLS Regression Results)

Variable	HDE1	HDE2	HDE3	HDE4
(Constant)	2.2716	5.2796	6.7062	9.9106
Industry				
Metals	0.3590	-0.3414	-0.2994	0.9882
Engineering	0.1728	-0.6937 **	-0.8313 ***	-0.6895 *
Food processing	0.4103	-0.1128	-0.0379	0.8554 *
Construction Materials	1.2574 ***	0.2105	-0.0097	0.0694
Chemicals	0.5994 *	0.5237	0.3890	0.4384
Wood & paper	0.0831	-0.3894	-0.5879	-0.1468
Corporate Governance				
Purely Private	0.0338	0.0466	0.1027	0.5295
Workers Controlled	-0.1284	-0.3906	-0.4457	0.8363 *
Employees Controlled	0.2205	0.2269	0.2755	1.6975 ***
Region				
Moscow Region	-0.3106	-0.4168	-0.3647	-0.1431
St. Petersburg	-0.2646	0.2136	-0.0233	-0.4614
Nizhny Novgorod	0.1730	0.2361	0.1372	0.4060
Ivanovo	-0.4577	-0.6921 *	-1.1814 ***	-1.9137 ***
Employment Size	0.0002 ***	0.0001 **	0.0002 ***	0.0003 ***
% Employment Change	0.0008	0.0010	0.0015	0.0028
% Sales Change	0.0000	0.0000	0.0000	0.0000
Unionisation Rate	0.0049 **	0.0110 ***	0.0106 ***	
R^2 =	0.1524	0.1480	0.1578	0.2107
F =	3.6814	3.5565	3.8364	5.8215

Source: RLFS4, n = 348

Of course, there is the possibility that correlations between some of the explanatory variables and the HDE indexes mix cause and effect. The regression is little more than a check on the tabulations underlying the figures. In some respects, the property form defines the scope for the score on the HDE indexes, but in all cases there was considerable intra-group variation, and as the correlation matrix showed, a firm scoring high on one component index or indicator did not necessarily score high on another. This is important, for if high scores were simply a reflection of size or one property form, the policy prescription would be restricted to a straightforward industrial strategy, leading to a simple recommendation to promote a particular enterprise size and property form. That is not the case. There were large firms with low HDE scores and small firms with high scores, and private firms with high and low scores. This implies that *if* one wished to promote the characteristics of an HDE (or variants of them), incentives to move in those directions would be advantageous.

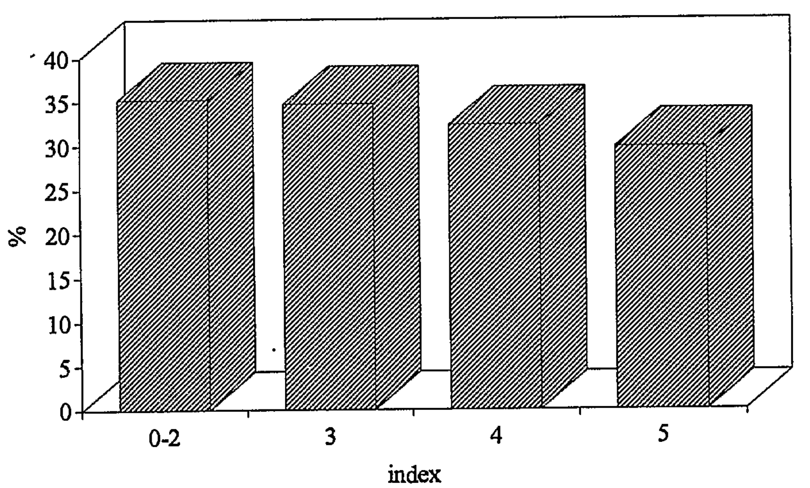
Much more research is needed into the determinants of relatively good or bad enterprise performance in terms of 'human development', and this should be assisted by the data from the sixth round of the RLFS conducted in mid-1996. The purpose here is merely to identify a way of approaching enterprise restructuring. It would surely be regrettable to talk about restructuring without having a reasonable set of criteria to guide that restructuring.

8. Economic Performance and the HDE

Having identified a measurable set of indexes of the HDE, three potential criticisms should be addressed. All three are likely to come from the orthodox, neo-classical economist. First, and more importantly, a critic is likely to claim that by being a good enterprise the firm would undermine its commercial viability. If it were shown that scoring high on HDE was associated with low dynamic efficiency and poor responsiveness to market forces, the long-term viability of the enterprise would be jeopardised, and thus the rationale for promoting an HDE would be weakened.

In other words, an orthodox neo-classical – or anti-institutional – economist might claim that the pursuit of the characteristics of an HDE would result in escalating costs, stronger internal rigidities, plunging economic performance and inadequate responsiveness to market forces, leading to higher costs, labour hoarding, and so on. This is a legitimate concern.

Figure 6: Labour Cost Share of Production Costs by Economic Democracy Index, 1995, Russia, All Regions

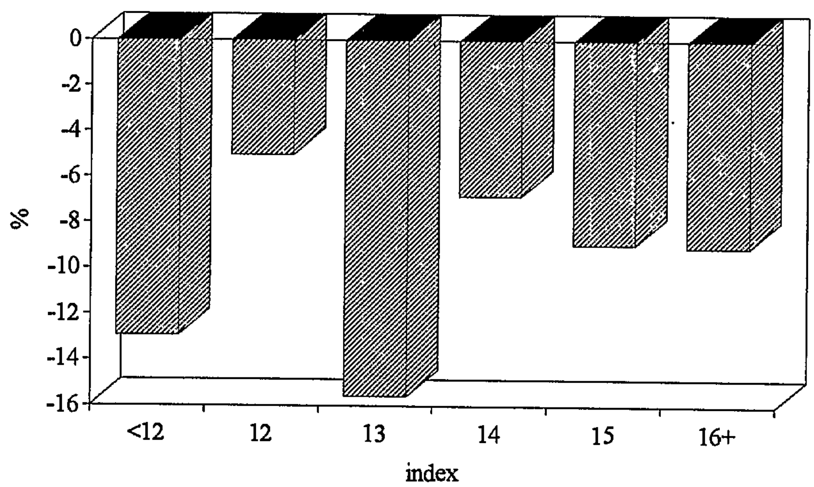


Source: RLFS5, n = 481

What is the evidence? Again we focus on Russian enterprises for our illustrative examples. First, while correlations do not demonstrate causation, it appears that *labour costs* as a share of total production costs were lower in firms with high values of HDE and were lower in firms that scored high on the Economic Democracy Index, which would probably be the most contentious set of indicators in the construction of the HDE (Figure 6). These are encouraging results. What they suggest is that if a firm does well on its HDE index, and practises economic democracy, it has higher levels of labour productivity.[33] At the very least, this is *prima facie* evidence against the potential sceptics.

Second, since in Russia and other parts of the former Soviet Union, it has been claimed that enterprises have not been responsive to market pressures, it might be claimed that high values of HDE would be indicative of resistance to change and a strong protection of "insiders". High levels of "labour hoarding" have been attributed to the persistence of the "soft budget constraint" and a lack of concern over labour costs. In fact, all forms of enterprise had cut employment by large amounts, and it is notable that firms with low values of any of the four indexes of HDE had cut employment by more than those with higher values, although this was least clear with the full HDE index (Figure 7). One might interpret these results as implying that firms with higher HDE values performed better in terms of employment. However, this is neither necessary to support our concept, nor necessarily correct. It merely means that there is a *prima facie* case for believing that firms with an orientation to being a "good enterprise" in human development terms were compatible with a favourable employment performance. So, in terms of both labour costs and employment, high HDE is favourably correlated, which should weaken one potential objection to the concept.

Figure 7: Percent Employment Change by HDE4, 1994-95, Russia, All Regions



Source: RLFS5, n = 482

[33] For a review of theoretical arguments and evidence from other countries to suggest that economic democracy per se has positive effects on labour productivity, see H.Hansmann, "When does worker ownership work? ESOPs, Law Firms, Codetermination and Economic Democracy", The Yale Law Journal, Vol.99, No.8, June 1990, pp.1751-1816.

A second criticism might be that strengthening what has been called voice regulation would jeopardise attainment of those basic aspects of the HDE that management's and owners would value, so that a composite approach would be undermined by internal contradictions. In this respect, one basic question to pose relates to the effect of trade union presence. For instance, are unions associated with higher values of HDE1 (skill formation practices) and HDE2 (skill formation and non-discriminatory labour practices)? If not, then one would have to raise questions about the effectiveness of unions in two crucial spheres.

The evidence suggests a positive association, albeit a fairly weak one. Firms with higher scores of HDE1 had a higher average unionisation level, and this was also the case with HDE2.

Another question relating to Voice regulation that is sure to arise concerns the association of HDE indexes with the wage level in the firm. If the value of HDE was inversely correlated with wages, then the appeal for workers and their representatives would be weakened. In Russian factories, the average wage was positively correlated with the Economic Equity index, as expected, but was not correlated with either HDE4 or the Economic Democracy index.

This leaves a third potential criticism that a neo-classical economist might raise. This is the standard argument against market intervention. If an HDE, however it were measured, were so desirable and if it were associated positively with economic performance, why intervene? Let the market work itself out, and if firms with high HDE perform well then they will drive those that do not out of the market or force them to become better in terms of human development policies.

There are two ripostes to that line of reasoning. To be *compatible with* good performance (or not to be a cause of poor performance) does not necessarily mean that one causes the other, or that good commercial performance would lead to a socially desirable outcome of a particular type. And the criticism makes implicit assumptions, mainly about "externalities", market failures and the dynamics of enterprise restructuring and the reversibility of change. In a period of major economic upheaval, firms taking a low-wage, anti-union, trainee-poaching approach, discriminating against women or those workers with disabilities, may easily undercut the firm that pays decent wages, legitimises a genuine trade union, provides training and so on. This is more than a matter of externalities, although the poor firm can be a "free rider". It is the nature of a fundamental disequilibrium. And once a highly fragmented labour market has been created, vital pressures to generate a virtuous path are removed. Once a mechanism has been eroded it is harder to resurrect it or create something better that would be derived from it than it would be to create it in the first place. Once unionisation in Russian industry has declined it is most unlikely that it will rise again, which does not mean that unions per se do not or could not play a positive role for workers or for firms.

9. Conclusions

Promoting Good Enterprises is a key to the promotion of a Good Society for the 21st Century. This is particularly so in a country such as the Russian Federation where for generations the industrial enterprise has been, for better or for worse, a crucible for almost every aspect of civil society. It is also conspicuously true for South Africa where the apartheid system was entrenched and strengthened through enterprise behaviour. Yet it is true in every society, and accords with those who have argued in favour of "mutual gains" enterprise in the United States.[34] It is also apparent that the character of enterprise restructuring is a key to effective structural or social adjustment.

The idea of a Human Development Enterprise, defined in terms of democratic, equitable labour practices, is suited to an era in which there is, and should be, an increasing emphasis on incentives to good practice rather than sanctions against bad practice. If "labour standards" are presented as something obligatory and rigid, then even those who support them would be inclined to do so with reservation. Some would pay only scant attention to the sins of others in case their own sins, real or imaginary, be exposed to scrutiny and condemnation. Rewarding good practices and shining the light on exemplary cases would be in keeping with mature social cultures.

It also corresponds to advanced management thinking, epitomised by top companies in the USA and elsewhere.[35] Enterprises that put the interest of their workers first appear to perform better than others.[36] There are also important externalities. Thus, economically democratic firms – and this is the issue that is most ideologically controversial – are likely to promote democratic behaviour *outside* them.[37] One does not have to turn this into an ideological battleground. Rather one has to seek ways of refining the approach to secure a broadly-based consensus, and to foster communities of Human Development, bearing in mind the "network externalities" that come from large numbers of enterprises adopting systems of practices oriented to human development.

There are many lacunae, and it may be useful to conclude by mentioning a few of them. We have applied the concept of the HDE to two inauspicious cases, and believe that actually it would apply more easily in the USA or western Europe. In the USA, Robert Reich apparently has recently proposed that firms that fail in their "responsibility" to maintain jobs should pay more tax. If that meant using financial sanctions rather than incentives to good practice, then one could anticipate considerable opposition and certainly a lack of consensus on promoting good practices that way.

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[34] T.A.Kochan and P.Osterman, The Mutual Gains Enterprise: Forging a Winning Partnership among Labor, Management and Government (Boston, Mass., Harvard Business School Press, 1994).

[35] See, for instance, R. Waterman, The Frontiers of Excellence: Learning from Companies that Put People First (London, Nicholas Brealey Publishing, 1994). In the USA, this was published under the title What America Does Right (New York, Norton, 1994). Waterman, with Tom Peters, was the management guru who first promoted the concept of *self-managed teams*, and recognised a basic principle of good management: "Today's leaders understand that you have to give up control to get results." For an academic view, see T.A.Kochan and P.Osterman, The Mutual Gains Enterprise: Forging a Winning Partnership among Labour, Management and Government (Boston, Mass., Harvard Business School Press, 1994).

[36] J. Pfeffer, Competitive Advantage Through People (Cambridge, Mass., Harvard Business School Press, 1994). The danger of corporate paternalism is not really recognised in the analyses of Pfeffer or Waterman. This is where our model is potentially more robust, through emphasising voice regulation.

[37] There is empirical evidence that skills learned in participation inside firms improve participation in the wider community. S.Smith, "Political behaviour as an economic externality: Econometric evidence on the spillover of participation in US firms to participation in community affairs", Advances in the Economc Analysis of Participatory and Labour-managed Firms, No.1, 1985, pp.123-36.

What constitutes an HDE could be decided by negotiation. The way it has been measured in this paper is illustrative, since it corresponds to the features of Russian and South African industry. In south-east Asia, where we conducted two similar enterprise surveys in Malaysia and the Philippines, a further set of indicators was included to measure *employment security*, i.e., comprising an index to measure whether the firm gave all or most of its workers employment protection that was as good as or better than the average. Firms that relied on casual or temporary labour to any substantial extent were regarded less favourably than those that gave all or most of their workers regular employment contracts. Use of contract labour and sub-contracting was also taken into account. If one were to extend the idea of employment security to include elements of *labour market security*, one might give positive values if the firm gave relatively long notice periods in retrenchments and if they gave reasonable redundancy payments, and one could positive value to firms that had "social plans" ready for implementation to assist workers affected by structural adjustment or large employment cuts.

One reason for putting the emphasis on incentives to good practice rather than tax or other sanctions against those that do not measure well on the sort of measures we have been proposing is that in modern more flexible production systems there are many small firms on the technological frontier that are inherently risky ventures. They tend to come and go with short dynamic lives. For instance, it has been argued that "silicon valley" has thrived in part precisely because small firms have risen and closed quickly, so that the economy's success has been built on the high failure rate of firms.[38] Such "flexible re-cycling" is surely an integral part of the future flexible production and labour market process, just as "flexiworkers" and unattached "proficians" (respectively those with low-skill and high-skill competencies in varying work statuses) will be part of the process. The HDE leaves out such phenomena. This is why the HDE must be complemented by community-level mechanisms of Voice and *income security*.

This leads to one of the biggest challenges for those wishing to promote something like the HDE. It depends critically on the *existence* of viable Voice mechanisms. In Russia, there is still a high level of unionisation, although its character is questionable and the decline has probably been the fastest in history. In South Africa, the apartheid era led to mass unionisation as a mechanism of "the struggle". Yet in most of the world, traditional trade unionism is on the wane, with only a minority of workers being unionised (led by France with only 9%). Can we realistically envisage enterprise democracy and voice regulation without strong collective representative organisations?

The time has come to re-examine entities such as "independent local unions", as long as ways could be found for overcoming the traditional drawbacks to "company unions" and as long as such unions could cross sectoral and occupational boundaries in securing members. In south-east Asia, where the HDE idea was first applied, a positive value was given in the index if the union was classified as an *independent union*, as opposed to an *enterprise union*. For both workers and enterprises, there appeared to be advantages from independent unions, although enterprise unions were better for workers than no union. The reason for concern about the capacity of enterprise unions

[38] H.Bahrani and S.Evans, "Flexible re-cycling and high-technology entrepreneurship", California Management Review, June 1995.

is that they seem likely to be coopted by management, if not set up by management to pre-empt independent union formation or strength.

A similar ambivalence has existed in the USA about so-called "employee involvement programmes"(EIP), which seem to be an alternative to unionism or a means of eroding workers' interest in adversarial unionism. Yet enterprise unions and EIPs (or their equivalents outside the USA) are spreading, while traditional craft and industrial unions are shrinking. The old-style "craft", the basis of working-class culture, was an ideal of a past age. In this era, industrial unions are facing the fate of craft unions of the past, and industrial solidarity is under increasing pressure almost everywhere. Increasingly, loyalties cross craft and sectoral boundaries, and typically workers and employees identify more consciously with their local community – to the extent that they identify with any social grouping.

For the HDE to be viable, worker representation of some sort is essential. The more that representation were *autonomous*, the more meaningful would be the Voice. Some analysts in the USA have sought the ideal in the form of *independent local unions* (ILU).[39] Those were mostly established in the wake of the Wagner Act, which made it an unfair labour practice for an employer to dominate, to interfere with, or to provide financial assistance to a union.

Difficulties with ILUs and unaffiliated small unions of any sort include their *vulnerability* through financial fragility, and their tendency to suffer from the "golden handcuffs" technique of managements – to induce cooperation in return for wages and benefits. The positive features of ILUs is that potentially at least they are relatively democratic because their officers come from a smaller community. But they are likely to have insufficient "clout" to force themselves into the boardrooms to shape corporate strategy. The ILUs also fail the test of traditional unionism, which is the desire to take wages and work standards out of the sphere of "competition" by standardising them throughout an industry or an occupation. The trouble is that industrial unions cannot do that either! With internationalisation of production and labour market flexibility, national industrial unions cannot set rules of labour practices with much effect.

Here is not the place to try to give an answer to what type of voice mechanism offers the best prospect for effective democracy. But the need is fundamental. In part of the literature on socially responsible companies there has been neglect of the tendency for "good employers" to turn into "paternalistic employers" and from that into questionable Orwellian creatures of 2004. Recently, a book was published on what it described as successful US companies.[40] The Economist, without irony, summarised some of its main messages:

> *"Successful companies put a huge amount of effort into turning new recruits into company men and women, sending them on in-house training courses (both McDonald's and Walt Disney have their own "universities"), influencing the way they speak and dress, and encouraging them to spend time with other company people. Procter*

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39 S.M.Jacoby and A.Verma, "Enterprise unions in the United States", Industrial Relations, Vol.31, No.1, Winter 1992, pp.137-58.

40 J.C.Collins and J.I.Portas, Built to Last – Successful Habits of Visionary Companies (New York, Century, 1995).

and Gamble, a consumer goods company, ruthlessly rejects applicants who do not conform to the "company type". Wal-Mart, a discount retailer, gets new recruits to raise their right hand and swear to smile at their customers, "so, help me, Sam". Until recently IBM expected its workers to wear white shirts. "Nordies", as the employees of Nordstrom, a retail chain, happily call themselves, start every day with the collective chant: "We want to do it for Nordstrom"."[41]

This does not seem too attractive. Indeed, as put by The Economist, it is frightening. It is a powerful argument for an independent Voice regulation process and for economic democracy that can constrain the tendency to go from management to manipulation, from incentives to cultural coercion. This is the biggest concern for the development of good enterprises.

In sum, the HDE is a useful heuristic device. Undoubtedly, it could be refined, its components can be challenged and modified to take account of different points of view, and it can be adjusted to meet the specific conditions of different countries. It is an organising concept, which can be used to grade enterprises by explicit criteria – principles, mechanisms and outcomes – that can be justified as desirable or otherwise. That is its potential appeal.

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41 "Career opportunities", The Economist, July 8, 1995, p.69.

HDE Awards – A Proposal

A major objective in identifying HDEs is to encourage industrial enterprises to develop labour and employment practices that are exemplary. To assist in the promotion of such enterprises, a foundation or commercial organisation might wish to launch and finance a national HDE Award scheme, with annual competitions, award ceremonies and badges of recognition.

It is proposed that a few member countries be selected, and a detailed Enterprise Survey of the type conducted in Russia and South Africa be carried out to identify HDE performance criteria. In an ideal world, the survey should be an industrial census. However, it need not be more than a representative sample survey, initially. The underlying objective should be to have a demonstration effect. In other words, once the process were legitimised, it could lead to interest and support from leading companies, trade unions, and government officials.

In each case, once the data from the enterprises had been analysed, a conference of managements, government officials and trade unionists should be convened, and **HDE Awards** should be presented to the top 5% of firms (or 10% if merited on the basis of absolute values emerging from the survey). The personnel departments of the top ten companies might be presented with financial awards, if suitable national or other funding agency were prepared to sponsor the process, while exemplary enterprises would be awarded with an HDE Certificate and Plaque of approval. The conference at which the awards were presented could be televised, and the public relations given to the firms in question would surely be welcomed by those companies and have a beneficial demonstration effect on other firms in the country.

There are many other such award systems. Once the process had been launched, other companies could apply for the Award or the survey could be extended to a new sample each year. Questions of renewal of the Award could then be addressed, much as other such schemes, such as Export Performance Awards, have developed continuity. At the same time, the concept of an HDE could be used for framework legislation, and collective bargaining in enterprises could be oriented to pushing the firm closer to the desirable model.

Once you focus on this proposed initiative, you wonder why this has not been done. It is consistent with an orientation to standards, and in the 1990s it is consistent with the desirability of focusing on incentives to Good Practice. Most people relate to the enterprise in which they work for most of their adult lives. Their character and practices shape our achievements, our development, our humanity. Yet there is scarcely a mention of what makes a Good Enterprise in any of the UN system's various international reports. Most notably, the United Nations Development Programme publishes an annual Human Development Report, which contains a Human Development Index to rank countries on performance, which conspicuously omits the sort of issues covered in the HDE proposed in this paper. Now is the time to rectify that glaring omission. It would be risky; it would be a bold initiative. However, if there were a will to do something, we could turn this into a useful instrument to give the ILO or any other appropriate organisation a promotional edge in a vital sphere of human development.

Appendix: Modes of Corporate Governance[42]

One of the most controversial and unresolved issues of "enterprise" – permeating much of the discussion of structural and social adjustment, the economics of "transition" and the future directions in systems of production and distribution – is the messy issue of corporate governance. A vast international literature is taking shape, led by economists, business theorists and political scientists. Some of the elements of governance are incorporated in the proposed HDE indexes. However, it seemed useful to make an exploratory attempt to define the emerging types of corporate governance in Russian industrial enterprises (and elsewhere) to see whether the form of governance influences the level of performance in terms of HDE. The issue has more widespread relevance, and should not be regarded as specific to Russian industry, or even just to firms in countries of eastern and central Europe.

The starting point is the belief that as critical as property form restructuring for enterprise performance is *management restructuring*, or what might be called "*corporate governance restructuring*", and the two developments may not and need not correspond. Governance involves issues of ownership of property rights and possession of control rights, and as such firms or establishments should be analysed in terms of governance structures rather than simply in terms of production functions.[43] Essentially, governance concerns *accountability*, which means the range of responsibilities and controls exercised by management, by workers, their intermediary institutions and the internal pressures influencing decision making within the firm.

For the longer-term revival of Russian industry, perhaps the most important changes in industrial relations in the mid-1990s are the changes taking place in the position of senior managers. Some have described the major change as the "privatisation of management".[44] This does not seem the correct term. It would be better to describe the changes as the "destatisation of management". Whatever the term used, the transformation of management and the "management labour market" have been distinctive aspects of enterprise restructuring, and may have been as important as the transformation of the property rights of ownership. For dynamic efficiency, management governance requires *incentives* to risk taking and profit orientation combined with substantial *monitoring* of their behaviour. Adequate incentives for managerial agents without monitoring could lead to recklessness, short-termism and opportunism, to the detriment of the interest of their principals, whether the latter be

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42 This appendix should be skipped by those not interested in the specifics of corporate governance restructuring in countries of the former Soviet Union. The directly relevant issue is the definition of the four forms of corporate governance used in the analysis of HDE, and those definitions are given at the end of the appendix.

43 This perspective is usually attributed to the seminal work of Ronald Coarse in 1937, which has generated an increasingly fertile literature in the 1980s and 1990s. See, e.g., O.E.Williamson and S.G.Winter (eds.), The Nature of the Firm: Origins, Evolution and Development (New York and Oxford, Oxford University Press, 1991); O.E.Williamson, The Economic Institutions of Capitalism (New York and London, The Free Press, 1985).

44 Z.L.Sadowski, "Privatisation in eastern Europe: Goals, problems and implications", Oxford Review of Economic Policy, Vol.7, No.4, Winter 1991, pp.46-56.

the workers, qua shareholders, or others. Rigid monitoring without adequate incentives is likely to promote *shirking* or sloth, illicit appropriation of assets and an unwillingness to take risks. Epitomised by the giant agencies and enterprises of the Soviet system, bureaucratic organisations are chronically prone to 'hard' (rigid) monitoring coupled with 'soft' budget constraints that produce both opportunism and shirking.

Issues of corporate governance relate to many aspects of labour market restructuring, so it may be useful to make some conceptual distinctions. One can distinguish between *external governance* and *internal governance*. The former refers to the structure of managerial, employee and external stakeholder rights of ownership or property and to rights of control over the distribution of assets and investment. The latter refers to relations of production and distribution within the work process, and the incentive and monitoring structures within it. Most of the literature on privatisation and the "economic transition" in central and eastern Europe has dealt with aspects of external governance.

In the Soviet era, external enterprise governance involved a primary role for the Communist Party, in which managers of industrial enterprises were induced to behave opportunistically in a hierarchical series of transactions, with line Ministries, with party functionaries, with local authorities, with worker brigades, with union leaders and with consumers. Industrial managers were motivated by the desire for revenue maximisation subject to a predetermined profit constraint. Total revenue or sales determined their bonuses, and the establishment's output and size of workforce that determined not just their earnings but their local power and status. This ideal type manager was answerable to a line Ministry and was linked into some regional network of reciprocal relationships.

Decentralisation and moves to "self-management" in the late 1980s increased the scope for opportunistic behaviour by managements, since the relaxation of central control reduced the directive strength of regulations and external bureaucracies. It strengthened the scope for local coalitions between managers, local authority representatives, party functionaries and union leaders. The nature of the changes must have influenced the balance of control between those agents, weakening the position of union leaders, since they were fatally compromised in serving a managerial function. In that regard, the reforms of the late 1980s probably strengthened the position of managers. But there was little to suggest that the resultant decentralisation fundamentally altered the structure of incentives so as to encourage greater orientation to profit generation and dynamic efficiency.

In 1992, with price liberalisation and pressure for commercialisation, it was expected that there would be changes in management behaviour but that only with privatisation would the primary motivation be "profit maximisation". That was the expectation, on the grounds that only when management was answerable to external shareholders would they cease to be concerned primarily with matters other than profit.

The evolving property form restructuring had implications for both external and internal corporate governance. One can make a distinction between what have been called *outsider* models of privatisation and *insider* models.[45] Outsider models have figured strongly in reforms in central Europe in the 1990s, reflecting the dominance of advice from national and international financial agencies based in the USA and western Europe. This follows US and UK practice, for example, in which share ownership is expected to be dispersed and in which incumbent managements are pressurised to maximise profits by the existence of large-scale external stakeholders. Acceptance of the outsider model has often meant a search for large, single stockholders in the form of a mutual fund or other financial institution. The insider model is closer to the system in Germany and Japan, in which commercial banks hold equity and are involved in management of the firms.

The relevance to corporate governance restructuring is that the outsider model relies on financially strong intermediary institutions, and puts a premium on *uncertainty*. If managements are uncertain about the identity or stability of intermediary groups of stakeholders, they will be inclined to act opportunistically and focus on short-term benefits for themselves. This was a feature of the difficult transition in corporate governance in the early 1990s. In Russian industry, there was a hybrid form of privatisation in that the dominant model adopted after 1991 involved a process by which insiders were allowed and encouraged to acquire up to 51% of the firm at 1.7 times book value, unadjusted for inflation, while investment funds were limited to 10% of the shares. This brought insider acquiescence and gave insiders incentives to restructure, while the authorities promoted it because they anticipated the emergence of a substantial secondary market for shares.

The danger of any hybrid model is that it could create more uncertainty than a clearly-defined alternative, and thus induce greater short-term opportunism by both managers and workers. Thus, in Russian industry the slow process of corporate governance restructuring and the lack of enterprise restructuring, in terms of breaking up the huge entities that dominated the Soviet system, meant that the "debt overhang" that emerged in the early 1990s gave unclear signals to creditors about management, which undermined the effectiveness of the hybrid form of property form restructuring. If the objective were to guide investment to potentially profitable firms through financial stakeholders, that was impeded by the unclear character of enterprise indebtedness. Was it due to inefficient management *or* to efficient management having to respond to distorted incentives and information *or* to a lack of viability that exonerated management from direct responsibility?[46]

Management behaviour could be expected to depend on whether property form restructuring gave a high or low degree of ownership to workers, to managers or to outside stakeholders. The crucial element may be the degree of uncertainty. Thus, if managers were faced by indebtedness and imminent accountability for inadequate profits, they might respond by accelerating the firm's decapitalisation, if they perceived the debt as a threat to their personal survival as managers. In that way, they could

[45] P.Hare, "The assessment: Microeconomics of transition in eastern Europe", <u>Oxford Review of Economic Policy</u>, Vol.7, No.4, Winter 1991, p.7.

[46] This was one reason why restructuring should have preceded "privatisation", because the new agents could not respond to appropriate informational signals. S. van Wijnbergen, "Enterprise reform in eastern Europe", <u>The Economics of Transition</u>, Vol.1, No.1, Jan.1993, p.22.

increase their short-term income and provide surplus for distribution to stakeholders to bolster their chances of reappointment.

Similarly, if managers do not know what property rights are going to be, they cannot decide rationally between short-term and long-term investment and behavioural strategies. This is probably more important than the more common distinction, between employee-owned and outsider-owned firms. If outsider stakeholders are in control, the firm's management is likely to be oriented to particular objectives, and be more concerned with short-term profits to be paid out as dividends. If insider stakeholders, notably workers, are the main shareowners, there will be desired trade-offs between wage levels and employment stability.[47] There is no reason to suppose that outsider control would reduce managerial opportunism, since worker shareholders are more likely to have information to identify opportunism and threaten management with retribution. Both workers and managers require reciprocal monitoring and a balanced capacity to impose sanctions.[48]

Thus, the *type* of short-term and long-term objectives would vary according to mode of managerial governance, rather than be oriented to or away from short-termism. By contrast, *uncertainty* of ownership or management rights could be expected unambiguously to orient managers' behaviour to short-termism and opportunism.

Various aspects of corporate governance restructuring are highlighted in the RLFS. Possibly the most important changes are the mechanisms by which senior management were appointed and reappointed. Although change in management roles was a feature of *perestroika* in the late 1980s, when work collectives were given the right to elect heads of enterprise administration, at that time production decisions and financing decisions were still concentrated in Ministries and other state agencies. So-called "self-management" was mainly restricted to questions of distribution and social functions.[49] This began to change after 1991. By the mid-1990s, decentralisation of managerial decision-making had gone much further, often as a precursor of property form restructuring and as a part of that process.

Information on management appointment was not sought in the first two rounds of the RLFS, in 1991 and 1992. In 1993, at the time of the third round, most managers had been appointed by line Ministries, but by 1994 merely 5.7% of senior managers had been appointed by Ministries and 2.4% by local authorities, compared with 32.6% who had been formally appointed by the work collective (corresponding to the

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47 It is incorrect to *presume* that employee ownership leads to pressure to maintain employment. With high labour turnover and where management bonuses and earnings are a positive function of employment size, a shift to strong worker shareownership could lead to managed downsizing, in which departing workers are simply not replaced. Frydman and Rapaczyski presumed the opposite, and claimed that the Russian reforms in corporate governance were inadequate on the grounds that they had not led to "any significant unemployment". R.Frydman and A.Rapaczynski, "Insiders and the state: Overview of responses to agency problems in East European privatisation", The Economics of Transition, Vol.1, No.1, Jan.1993, p.56.

48 G.Dow, "The function of authority in transaction cost economics", Journal of Economic Behaviour and Organisation, Vol.8, 1987, pp.13-38.

49 S.Peregudov, A.Zudin and I.Semenko, "Social accord: The experience of the west and our problems", ["Sotsial'noe soglasie: Opyt zapada i nashi problemy", Svobodnaia mysl, No.18, 1992, pp.25-35.]

predominance of closed and open joint stock enterprises as the main property forms), 31.8% who had been appointed by enterprise boards, which would have consisted mainly of appointees from outside the establishment, and 11.5% by shareholders' meetings, which would have consisted largely of workers.

This diversified forms of appointment means that it would be too simple to state that by the mid-1990s managements were in control in enterprises.[50] Another reason for doubting that characterisation is that the duration of appointment was variable, and had become generally much shorter than had been the case in the Soviet era, which was surely having an effect on the climate of decision making. Over a third of general managers (36.3%) had been appointed for two years or less, 14.3% for three or four years, 27.1% for five years and 22.4% for no fixed term, without a formal contract. Managers in open joint stock firms were more likely to have been appointed for two years or less (57.3%), whereas state enterprise managers typically had longer-term contracts. Managers appointed by enterprise boards or by shareholder meetings were more likely to have been appointed for two years or less than those appointed by a Ministry or by local authorities.

In the restructuring of corporate governance, by mid-1994 *worker share-ownership* had become extensive. On average, including those state firms and social organisations where there were no shares, workers and employees of the firms owned 46.4% of the shares, with their possessing 93% of the shares in closed joint stock companies and 56% of open joint stock companies. This substantial worker "stakeholding" was creating the basis for a possibly unique evolution of corporate governance, a reversal of the old socialist vision – privatisation of ownership coupled with socialisation of management.

Much has been said in Russia about managements taking advantage of property restructuring to acquire financial control through the acquisition of shares. It was reported by the accounts departments of factories visited in mid-1994 that 11.6% of the shares of those firms that had issued them were possessed by managements. In closed joint stock firms, they had nearly 26%, which meant that their capacity to control decision making was considerable, since apart from the state agency they were the largest shareholder.

An aspect of restructuring of corporate governance is the additional *rights* associated with worker shareholdings. In 1994, in most firms (82%), there were none, according to managers. A few said that worker shareholders could obtain low interest loans, and a few said that such workers would receive privileged employment protection in the event of mass releases. Worker-shareholders were more likely to have privileges in closed joint stock firms, in which 31.2% had additional privileges, than in open joint stock companies, where 14.3% had extra privileges.

With all these changes taking place, we could divide corporate governance structures into three main types:

- *state* (in which managers had been appointed by Ministries or local authorities, which accounted for 8.1% of the total),

[50] J.Blasi, "Corporate ownership and corporate governance in Russia: 1994 findings", paper presented at the Industrial Relations Research Association Meetings, Washington DC, January 8, 1994.

- *internal* (in which they were appointed by the 'work collective' or at shareholder meetings in those firms in which workers and employees owned more than 50% of the shares, which would have accounted for up to 44.1% of the total), and
- *external* (in which appointment was by an enterprise board or by a mixed process, usually involving the State and external bodies having an influence, which would have accounted for up to 47.8% of the total, possibly plus some of those appointed by shareholder meetings).

This approach leaves some haziness in classification. An alternative way of classifying corporate governance structures – and one used for our purposes – is by taking account of property form, the character of share-owning and the form of management appointment. Accordingly, we classify governance into four main types:

- *State governance* is where the establishment is still state-owned and where the senior manager is appointed by a line Ministry or local authority, or state-owned and where nominally the work collective and the Ministry or local authority are responsible for managerial appointment.
- *Private governance* is where there is private ownership or a joint-stock arrangement in which employees do not own more than 50% of the shares and where the manager is appointed by an enterprise board or at a shareholders meeting, as long as employees do not possess more than 50% of the shares.
- *Employee governance* is where the property form is joint-stock, where the workers and management together own more than 50% of the shares, *without the workers owning 50% or more*, and where the top manager is appointed by an enterprise board, a shareholder meeting or some other non-state mechanism.[51]
- *Worker governance* is where the property form is joint-stock, where the workers own 50% or more of the shares and where management is appointed by the workers or a shareholders' meeting.

As of mid-1994, the distribution of governance types in the industrial establishments covered by RLFS4 showed that 20.5% were state governance structures, 17.1% were private governance, 23.5% were employee governance and 38.9% were worker governance structures.

[51] Also included were the few cases where the management was appointed by a line Ministry or a local authority but where the establishment was a joint stock company with majority employee ownership. Such cases arose from the timing of appointment and timing of property form change, and it is assumed that behaviourally managers would become accountable to current governance form.