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Co-determination and strategic integration in German firms

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Looking at the economic development and importance of German companies in Europe, one might expect that an important aspect of a good economic performance is a well-functioning HR system. Although a number of scholars claim this, the empirical evidence seems to point to the opposite. Several comparative studies have found that HRM in German companies is less strategically integrated and proactive than that of comparable firms in other countries. This article argues that the empirical results reported fail to grasp the essence of HRM in German firms. This lacuna is partly due to the co-determination structure. HRM in large German firms has to be evaluated within the co-determination structure, with the Betriebsrat (works council) being an important actor. For German firms co-determination might even be a strategic resource. By examining this issue within such a framework, a more favourable picture of HR integration in German firms emerges.

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The aim of this article is to examine whether Anglo-American conceptualisations of strategic HRM can apply in a distinctively different context such as the German one. The strategic HRM literature, which originated in the US and is still dominated by Anglo-American authors, has suggested that a fit between HR policies and business strategy leads to superior organisational performance. Therefore it prescribes an integration between HR strategy and business strategy (Boxall and Purcell, 2000; Fombrun *et al*, 1984; Gennard and Kelly, 1994; Guest, 1987; Hendry and Pettigrew, 1990; MacDuffie, 1995; Miles and Snow, 1984; Schuler, 1989; Ogbonna and Whipp, 1999). While this clearly applies to the Anglo-American economies, is it as universally applicable as is often suggested or implied?

The German business system is different and has recently drawn attention from scholars of various disciplines, including political science, industrial relations and corporate governance (Albert, 1991; Casper *et al*, 1999; Ebster-Grosz and Pugh, 1996; Fukuyama, 1994; Lane, 1989; Locke, 1996; Marsden, 1999; Pfeffer, 1998; Thomas III and Waring, 1999; Turner, 1998; Wever, 1995). The very notion of 'national business systems' (Whitley, 1994) focuses on the peculiarities and 'functional equivalences' of institutions in different settings. Germany is a good case in this respect. It has followed a path (North, 1990) in its industrialisation process that is quite different from that of its neighbours. It also has a long tradition in participative management, it has a unique corporate governance structure – only to be compared with that of Japan – and the role of government and intermediate agencies, such as employers' associations and unions, is strikingly different (Albert, 1991; Bühner *et al*, 1998; Muller, 1999a; Wächter and Stengelhofen, 1992).

Whereas the literature cited above widely perceives Germany as a role model, assessments about the extent of strategic integration of HR issues are more negative. It is widely assumed that firms operating in Germany are less strategically integrated than those elsewhere (Begin, 1997: 192-3; Sparrow and Hiltrop, 1997). However, this lack of fit does not seem to have an adverse effect on business performance. Since human resources are a major factor for competitiveness on the world market, and since German companies have performed, since the 50s, quite successfully on this level, the above findings are rather puzzling.

The strategic HRM literature defines strategic integration as 'the degree to which HRM issues are considered as part of, and explicitly taken into consideration in, the formulation of business strategies' (Brewster *et al*, 1997: 3). It assumes that integration is achieved not only by professional HR staff but also by rational economic actors who are free to determine firm strategies for the sole benefit of shareholders. A number of studies have attempted to measure the level of strategic integration (*see*, for example, Budhwar and Sparrow, 1997; Guest and Peccei, 1994; Heijltjes *et al*, 1996; Marginson *et al*, 1993; Martell and Carroll, 1995). Three indicators have mainly been used. First, the HR director is present on the board, as this is supposed to assure that business strategy and HR strategy are considered at the same level and are owned by the same people. Secondly, the existence of a written HR strategy could indicate that HR issues are considered seriously at the top level. Thirdly, the early involvement of the HR function in the strategic planning process is supposed to indicate a willingness to incorporate HR issues in major organisational decisions (Guest and Peccei, 1994). This article will argue that such an operationalisation of strategic integration may be appropriate for the Anglo-American context where labour management tends to have a low strategic priority (Boxall, 1996), but is not universally applicable. Using Germany as an example we will show that actors other than the HR function can have a decisive influence on the integration of HRM and business strategy.

Assessments of the low level of strategic integration of HR issues in Germany are largely based on data from the Cranet-E project of European HRM. This is the only study that measures strategic integration with a large-scale cross-national sample. Arguably, there are countries where better survey data exist. An example is the Workplace Industrial Relations Survey in the UK (Millward *et al*, 2000). Germany, which has a relatively weak tradition of empirical research in this area (Muller, 1999b), is among those countries surveyed where the Cranet-E data is the best quantitative data available. The 1992 survey, on which a comparative analysis of strategic HRM in Germany by Brewster *et al* (1997) is based, relies on 884 usable responses (response rate 17 per cent) and is therefore arguably the most representative quantitative account of HRM in Germany (Brewster and Hegewisch, 1994).

Grounded in the Anglo-American strategic HRM research tradition, the Cranet-E survey operationalises strategic integration with three variables. These are the HR function's representation at the board level, its involvement in the development of corporate strategies and the existence of an HR strategy. An analysis of this data shows that German firms are among the least integrated in Europe (Brewster *et al*, 1997: 13). However, the authors themselves suggest that 'in the German case the integration of HR issues through the collective cultural consciousness and in legislation may be a more important influence on corporate strategy than the direct integration of HRM through the personnel department' (1997: 19). Without providing any further evidence, they appear to challenge the universal applicability of the Anglo-American conception of strategic integration.

This article will examine, using the Cranet-E data, whether Anglo-American conceptualisations underestimate strategic integration in the German context. The analysis is restricted to large firms. One reason is that the data cover only organisations that have at least 200 employees. Another reason is that in Germany elaborate systems of co-determination exist mainly in large companies. Smaller firms very often do not have a works council (Hassel, 1999), or the employee representatives in such organisations have only limited resources to use their influence.

THE GERMAN CONTEXT

Using the Cranet-E data, we will now examine whether the Anglo-American conceptualisation of strategic integration draws an accurate picture of the degree to which HR issues are considered by large German firms in the formulation of business strategies. We will separately discuss the HR function's representation at the board level, HR involvement in the development of corporate strategies and the existence of an HR management strategy, and suggest that these are not sufficient indicators for strategic HRM in the German context.

Board-level HR representation

Starting with board-level representation, HR directors in Germany are – compared with their colleagues in other European countries – underrepresented at the board level (see Table 1). The data suggest that in fewer than a third of medium and large-sized German private sector organisations, the HR department is represented on the board. This result is supported by a representative 1987 survey of 369 German firms, which found that in only in 32 per cent of them the head of HRM sits on the board (Mendius and Semlinger, 1991: A 3.45).

We do not want to challenge the view that board representation fosters the consideration of HR issues at the top level but instead want to point out that, particularly

TABLE 1 *Strategic integration in Europe: 1992 Cranet-E survey*

	Denmark (n = 330)	West Germany (n = 884)	Spain (n = 265)	France (n = 651)	Finland (n = 225)	Ireland (n = 140)	Norway (n = 280)	Netherlands (n = 128)	Portugal (n = 93)	Sweden (n = 322)	UK (n = 1,243)	Turkey (n = 123)
HR director represented on board	49	30	73	84	61	44	71	42	46	84	49	37
Involvement of HR function in development of corporate strategy from outset	47	55	54	54	48	50	65	50	42	56	53	45
Existence of written HR strategy	72	18	37	34	52	41	71	44	34	73	50	29

Source: Brewster *et al*, 1997

in the German context, this is difficult to measure. One problem is the comparatively small size of boards and another is the role of the labour director – *Arbeitsdirektor*.

First, the relatively small size of German boards could account for the comparatively small percentage of German HR directors represented at this level. German companies with a workforce of up to 2,000 employees usually have only a maximum of three people on the board. In contrast, US subsidiaries in Germany tend to have a larger management committee at the top. Even in medium-sized US affiliates these bodies often consist of six or more members (Muller, 1996). Therefore, it is not surprising that an analysis of the 1992 Cranet-E data found that US transplants in Germany were significantly more likely to have the head of HRM represented at board level than indigenous companies (Muller, 1996). German management is less functionally specialised at the top than in comparable firms elsewhere. If the HR function reports to the financial director or to the top executive himself, is this poor integration? It might be just the opposite: HR matters are so important that they are not being delegated to a specialist down the line.

Secondly, the role of the labour director has to be considered. Companies operating in Germany with more than 2,000 employees are required by the 1976 Co-determination Law (Section 33) to have a labour director on the board. Like his or her peers, the labour director is elected by the supervisory board. Only in the coal, iron and steel industries, for which a special co-determination law applies, does a majority of employee representatives on the supervisory board have to support the appointment of a labour director, who is required by law to be responsible for HR and social policy issues. Labour directors in German firms very often also supervise other functions or business units. A 1989-90 survey of German firms falling under the 1976 Co-determination Law ($n = 282$) found that only a quarter of labour directors were solely responsible for the HR function (Wagner, 1993: 652). The co-determination law also does not require the labour director to be the most senior HR manager. This explains why, although firms with more than 2,000 employees are legally required to have labour directors, their most senior HR manager – the head of the HR department – is not necessarily represented on the board. Nevertheless, labour directors ensure that HR policy decisions are taken at board level (von Eckardstein, 1990: 1723). This is supported by some of the HR managers interviewed by Muller (1996) on the influence of the HR function on strategic decisionmaking who suggested that their labour director gave the HR department the opportunity to play an influential role at board level.

At this point it is worth noting that in Germany all board members formally have the same rights and responsibilities. The position of the board chairperson in relation to the other board members is much less powerful than the one of a chief executive officer in the US or a PDG (*président-directeur général*) in a French firm. Each board member, for example, has the legal right to discuss with the whole committee issues that are the responsibility of other members (Klinkenberg, 1991). Formally, the chairperson cannot overrule majority decisions of the board. In addition, board-level co-determination ensures that HR issues are raised on the supervisory board. As board members are elected by and have to report to the supervisory board, it seems likely that the HR implications of strategic decisions will be carefully examined there.

All in all, taking board representation as an indicator for the strategic importance of HRM is a complex question with respect to German companies. Smaller companies are not very specialised at the board level. In larger companies the question is ambiguous because it is not clear whether it is the HR specialist or the legally imposed labour director who is under scrutiny. In most cases the labour director

plays an active and important role in the policy of the board and assures a large playing field for the HR department. The question then boils down to the orientation of this department. In this respect it can be said that its traditional role has been that of an agency that functions as an arbiter between management and the workforce (Bosch, 1997). In other words, being responsible for negotiations with the works council has increased the power of the HR function. Nevertheless, in this role the HR manager, using the well-known typology of Tyson and Fell (1986), has had the role of a 'contracts manager', with no high discretion.

However, with the restructuring of many German firms over the last 10 years, the role and philosophy of the HR department has vastly changed to that of a proactive unit that is under scrutiny from the controller of the company to prove its economic effects and profitability (Muller, 1999a; Scholz, 1999; Wunderer and Arx, 1998). This is also reflected in the aims and policy of the leading professional institution in this area, the *Deutsche Gesellschaft für Personalführung* (DGFP), which has promoted the introduction of new concepts and methods such as quality management, benchmarking, value-added measures and 'balanced scorecard' in German firms. Hence the limited evidence available seems to suggest that the German HR function develops or aims to become what has been described in the Anglo-American literature as 'change maker' (Storey, 1992), 'employee champion' (Ulrich, 1997) or 'change agent' (Caldwell, 2001).

HRM and corporate strategy

Regarding the second criteria for strategic integration used by Anglo-American authors, the involvement of the HR department in the development of corporate strategy, the Cranet-E survey paints a more favourable picture of Germany. Compared to other European companies, German firms occupy a top position. Fifty-five per cent of those surveyed involve their HR department from the outset in the development of corporate strategy (see Table 1). Below, we will suggest that this involvement of the HR department, as well as a general consideration of HR issues in the strategic process, is fostered by the German system of co-determination which, besides the initial vocational training and collective bargaining systems, is a cornerstone of German labour market institutions (Muller, 1997). The 1976 Co-determination Law stipulates that the works council can veto management decisions on HR and social matters *eg* dismissals, wage structure and working time. The law provides for a range of participation rights, short of a veto, such as information on, and consultation over, business plans, expansion, relocation and major technological and organisational changes.

There are three factors that explain why this gives employee representatives a potential influence on corporate strategy. First, in large firms a number of works council members, in particular its chairman, are exempt from their regular jobs; they are full-time employee representatives. As a consequence, much professional knowledge and tactical skill has developed. Moreover, some German companies provide their works councils with professional staff who enable employee representatives to analyse business plans and to exercise participation rights efficiently. For example, at the car maker Volkswagen the head of the works council leads a 50-strong department which employs full-time works councillors, professional staff with university degrees and secretaries (*Handelsblatt*, 1999a).

Secondly, although the previously mentioned worker representation at board level and in works councils have completely separate legal bases and are quite different in scope and action, there is an interplay of these two levels of co-determination in large

firms (Wächter, 1997). Board representation widens the scope of action for the works council and provides information on company goals and strategies, whereas the works council feeds the worker representatives on the supervisory board with insider knowledge that helps to exert tighter control on management. This is a peculiar principal-agent relation which – in our opinion – enhances control over, and responsibility of, management.

A good example of how employee representatives on supervisory boards can influence product strategies and organisational restructuring is the hostile takeover of Mannesmann by the British company Vodafone in 2000. The employee representatives in Mannesmann's supervisory board, who were either works councillors or trade union officials, supported the eventual merger deal after their demands had been fulfilled. These were not to separate core parts of the company from each other and to guarantee a continuous capital investment (Jurgens *et al*, 2000).

An example of the potential impact of employee representatives on investment decisions is BMW's 2001 decision to locate a new factory in Leipzig. Among the major reasons why the eastern German site was chosen instead of a plant in the Czech Republic was an innovative working hours model. This was developed by the head of BMW's company works council and uses a 'time account' to provide the employer with maximum flexibility without having to pay overtime premiums in times of high demand (*Süddeutsche Zeitung*, 2001).

Thirdly, in order to understand the functioning of the German system, it is important to understand that the works council is legally required to pursue the 'company good' – however that might be defined. The prescription of the Works Constitution Act – that employer and works council should work together in good faith – and the extensive legal rights of employee representatives have led German employers to work closely with them and to develop a 'trust-based co-operation'. In this way the German industrial relations framework encourages firms to develop a co-operative strategic relationship with the works council (Streeck, 1997) which may include the active involvement of its members or its chairperson in developing strategies and their implementation. This has led some German scholars (*see*, for example, von Eckardstein, 1997; Müller-Jentsch, 1995) to attribute a co-management role to the works council – an attribution that has a derogatory connotation with some union officials, but in Germany is widely perceived to foster profitability.

One of the main tasks of the HR department is to develop procedures to cope with works council influence – to neutralise it where it seems detrimental and to channel it in such a way that it supports, not impedes, business strategy. In the course of such wheeling and dealing, the paramount objective of employee participation, namely to secure employment for the core workforce, has attained the rank of an important imperative of the firm strategy. Not surprisingly, research has demonstrated that labour turnover in German works council firms is lower than in non-works council establishments (Backes-Gellner *et al*, 1997). This 'functional flexibility', as compared with 'numerical flexibility', is a precondition for strategic action of German companies (Garnjost and Wächter, 1996). Furthermore, it is not unusual for the works council itself to demand from management the development of new strategies, the opening up of new markets or the implementation of new technology. Far from insisting on maintaining current jobs and job descriptions, employee representatives and trade unions can be a driving force for the development of new strategies.

The role of employee participation in the implementation of strategy is even more striking and quite easy to discern. As much as the consensus-seeking process of goal

setting and strategy formulation is time consuming and can be a nuisance for management, once an agreement has been reached the implementation of strategy is a smooth process. Resistance to change is not to be expected at this stage.

Here we have to introduce a note of caution. Although works councils potentially have a decisive influence on the development of company strategies, this is not necessarily advantageous for the non-core workforce or the unemployed. For example, a comparison of vocational training in works council and non-works council firms by Backes-Gellner *et al* (1997) suggests that the former have a lower percentage of apprentices in initial vocational training.

Taken together, in the German case it is not possible to measure the consideration of HR issues in the development of corporate strategy by examining only the involvement of the HR function. Independent of its relative influence, co-determination ensures, at least to some extent, that HR issues are considered seriously in the development of business strategy.

Written HR strategies

Turning to the third criteria for strategic integration commonly used in the strategic HRM literature, the existence of a written HR strategy could indicate that HR issues are taken seriously at the top level. On this dimension the Cranet-E data suggest that German firms are, among the 12 countries surveyed, the least likely to have a written HR strategy (*see* Table 1). We will argue that this finding may again be influenced by co-determination.

Muller (1996), who between 1991 and 1994 conducted 12 case studies of German firms, asked about the existence of a written HR strategy. However, during interviews the author discovered some confusion about this term. One HR manager suggested that his company's mission statement was the HR strategy, and another that the unwritten rule that executives must have international work experience was an element. Sometimes the answers changed when the researcher asked different managers within the same organisation. For instance, in one bank two local HR managers did not know about the existence of an HR strategy, whereas a third one, who was working at the corporate level on the development of new HR instruments, suggested that one did indeed exist, claiming that figures such as the number of people employed and training costs were calculated on the basis of the business strategy for a period of five years and, on this basis, HR targets were set. Muller was told of the existence of such an annual long-term HR strategy at only one other firm. In general, he encountered the problem that, besides their scant understanding of the term, HR managers were reluctant to tell what content such strategies had. One reason for this could be co-determination rights.

Since most HR changes have to be negotiated with the works council, it may well be a strategy of management not to disclose a whole change programme but to discuss it in a piecemeal way; it is one thing to have a strategy at the top, another one to make it public and thus negotiable. Even in a system of trust-based co-operation, it could be politically 'dangerous' for a manager to spell out strategic plans because it would set into action the formal process of consultation with the works council. Hence, particularly for the German case, Mueller's (1996) suggestion that 'the preoccupation among both managers and researchers with explicitly formulated, codified HRM policies is a position for which there is neither sufficient theoretical nor empirical justification' (1996: 759), seems to be appropriate.

The lack of a written HR strategy does not necessarily imply the absence of strategy altogether. It is rather the informality and negotiated character of HRM that provides a

company with the necessary requisite responsiveness in their human resources towards changing business needs. Although a written overall HR strategy may be lacking, a multitude of established negotiations, procedures, documents and 'common understandings' provide a strategic resource, which could well be a functional equivalent to a top-down, written HR strategy in a company without employee representatives' rights.

The range of participative rights in German companies, from working time and piece rates to manpower planning, has brought about an elaborate system of workplace information and skills inventory which leads to high mobility within the internal labour market (Muller, 1997). As the works council can demand consideration of internal candidates for job openings, there is much self-selection from a large pool of talent. However, since the employer has the final decisionmaking power on these issues, the optimal matching of person and job remains likely. In a system that relies on a tight match of a person to a predefined job, a sophisticated manpower plan helps to attain an efficient deployment of staff. In a system that relies more on the development of human resources, such a perfect plan may prove to be unnecessary (*cf* Marsden, 1999).

The positive economic effects of worker participation in Germany are not limited to internal mobility. Representatives of the system also assume a role of boundary spanning that alleviates conflicts with powerful groups outside, such as unions and state agencies, and gives access to valuable resources, including skilled workers. A good example is the car producer Volkswagen. The head of the works council of Volkswagen's plant in Hannover also has a senior position in the Social Democratic Party. As this party rules the state of Lower Saxony, which partly owns Volkswagen, this contact helps the company (*Handelsblatt*, 1999a). Another example is the implication of the Federal Government in the Holzmann crisis through contacts between the works council, union officials and top government representatives. Holzmann, a large construction company, was saved from bankruptcy by a joint effort of banks and the federal government providing additional credits (FAZ, 1999). (In 2002 the firm had to file for insolvency proceedings anyway.) Respect for the rights of worker representatives also enhances the acceptance of a company in the community and society at large. Co-determination is being used to develop strong ties to powerful stakeholders and to boost the legitimacy of entrepreneurial action in Germany – an essential aspect of strategic decisions. However, this carries a price which may be seen in a rapid response to market changes.

Of course, there are many companies in other countries that successfully use their human resources as strategic assets. What makes German companies different is the institutionalisation of participation. Co-determination is deeply embedded in the country's norms, values, regulations and expectations. Individual firms can make use of this 'institutional capital' and in doing so both deploy human resources effectively and reproduce the norms and values that define socially acceptable behaviour (Oliver, 1997: 698). Thus the institutional and legal context both enables and forces German companies to pursue a unique HR and business strategy that sets them apart from foreign competitors. Hence, the example of Germany shows that the social system in which strategy is being made makes a difference to the strategic goals and processes (Whittington, 1993) and has to be taken into account in interpreting survey results.

CONCLUSIONS

Survey evidence suggests that German firms consider HR issues to a lesser extent in the formulation of their business strategies than firms from other countries. However, a closer examination of the variables used to measure strategic integration suggests that these tend to underestimate the degree to which HR issues are strategically integrated in Germany. The main reason for this is that the Anglo-American literature tends to assume that this is achieved by professional HR staff. Such a conceptualisation may be appropriate for the UK and the US, where employee representatives and trade unions have little or no influence on business strategies. In contrast, in the German context co-determination legislation provides employee representatives with an opportunity to exert pressures on top management to take HR issues into consideration in the formulation of business strategies. In our view the involvement of employee representatives as 'co-managers' can actively shape the employment policy of a German company and accords a high strategic priority to labour management. In this way German firms can use co-determination as a strategic resource. All in all, the example of strategic integration in Germany points to the difficulties of measuring and comparing managerial concepts across countries. Superior HR and business outcomes might be achieved in different ways.

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