The Governance of Flexibility:
Contemporary Politics and the British Company

By

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Dedication

For Deirdre Martinez, who waited
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Abstract of the Dissertation

I evaluate political and economic factors conditioning British corporate governance since 1989. Corporate governance concerns the relative power of managers, investors, and ‘stakeholders’ (chiefly employees & environmentalists) in publicly traded companies. I ask why reform of national governance structures has favored investors and managers rather than stakeholders during fifteen years of politicization and economic change. New regulatory institutions strengthened investor protection after corporate collapses during the early 1990s, but they did so at only marginal cost to managerial autonomy. Notwithstanding the European Union and the Labour Government’s wide-ranging debate on company law between 1998-2001, stakeholders gained no more than token accountancy provisions. Instead, the Blair Government pursued a weak strategy of cajoling managers and promoting ‘corporate social responsibility.’ Ministers increased state regulatory oversight in governance following Enron/WorldCom in 2002, but again did not take aggressive action against managers. What explains these outcomes? Despite suggestions to the contrary, I argue that economic, private, and coalitional routes to stakeholding are not viable. Only decisive state action could transform companies and regulatory traditions protecting investors while preserving managerial flexibility. But while cabinet government is very strong, political-economic structures sustained by global capital markets make the costs of dramatic change extremely high. Institutional complementarities mean reform would be necessary across the economy. Moreover, pluralist coalitions between employees and investors will support only innocuous
challenges to managers. Despite sharing the stakeholder critique of corporate governance, Labour ministers were unwilling to act decisively. I conclude with a brief discussion of stakeholding reform and liberal democracy.
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Introduction

Corporate governance is chiefly a distributive matter. The primary conflicts are between managers, investors, and employees. The investor-manager conflict is often exaggerated, but becomes salient at times of managerial fraud and failure. This occurred during in Britain during the early 1990s and again with the Enron/WorldCom and Arthur Andersen collapses. Conflict over employees’ exclusion from governance arose between 1998 and 2001, when Labour ministers explored a weak form of industrial democracy and environmental reporting in the guise of stakeholding reform. The European Union has also demanded greater employee consultation in UK companies. What do these events tell us about British politics, and about liberal corporate governance more generally? Why have stakeholders—employees and environmentalists—not won more than token accountancy provisions? What has been the effect of new private and public authority forms in this formerly loosely regulated area of policy?

I provide a political history of UK governance and explore the puzzle posed by corporate power in capitalist democracy. Specifically, I trace two aspects of British corporate governance policy since the late 1980s: its distribution of power within corporate governance and its distribution of authority over corporate governance. Power
is the ability to achieve one’s will against the resistance of others. It may be embedded in law or derived from financial advantage. Authority is the ability of an entity to regulate: to make decisions and legitimately expect compliance. It is divided between private bodies working with state sanction (such as the London and New York Stock Exchanges, and in the case of the Cadbury, Greenbury and Hampel reform committees) and the state itself (for example, the UK Department of Trade and Industry, or the US Securities and Exchange Commission). Markets are also effectively a form of regulatory discipline in governance.

I answer two empirical questions and address a theoretical puzzle. First, what were the effects of different authority forms? This is most obviously of interest to those tracking regulatory innovation.1 Second, why did workers and their allies in the ‘stakeholding’ movement not gain more power in governance? This is interesting to a wider audience, perhaps, because it goes to the heart of business-government relations and power in advanced political economies.2 Both questions contribute to an emerging debate in political economy about pro-reform coalitions in corporate governance.3 And

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3 John W. Cioffi and Martin Hopner, "The Political Paradox of Finance Capitalism: Interests, Preferences, and Center-Left Party Politics in Corporate Governance Reform" (paper presented at the Conference of
both are related to the broader theoretical problem of how capitalism is reconciled with liberal democracy.4

I. The economics of governance and the connection to public policy

Corporate governance structures the relative power of a company’s investors, managers, employees, and other participants in enterprise.5 In doing so it helps determine the amount of autonomy enjoyed by managers, their incentives, and to whom they are accountable. It therefore conditions the allocation of risk, resources and returns: how managers choose to compete in product markets, how they organize production, and how they distribute a company’s revenues.6 Will managers prioritize shareholder dividends and capital growth to the exclusion of, for example, research and development and employee training? Are workers laid off as soon as turnover or profits suffer in turbulent markets? What about environmental practices where these might conflict with shareholder value? In short, corporate governance matters because it shapes what society’s most pervasive institutions do, and to whom they are amenable. It is, therefore, about corporate power.

Governance processes result in part from market dynamics—chiefly from the efforts of shareholders to protect their investment. For example, investors may hold

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shares in many companies and trade them frequently in order to minimize the costs of monitoring individual companies. They may also demand that company boards set managerial pay in line with share-price performance. These strategies, in Britain and the United States, focus managers on sustaining or increasing equity value. They also reflect the financial strength of shareholders who can move their capital at will—a source of power in governance. Neo-classical economists applaud this dynamic as promoting allocative efficiency across the economy as a whole.

However, the state also has a crucial role in creating, maintaining, and transforming governance forms. Although states do not ‘govern’ companies in the sense of overseeing managers directly, they do shape the norms, markets, and other institutions that together constitute a nation’s governance system. Public policies can reconfigure the power relations at work inside and outside companies. In order to reduce the shareholder-orientation of companies, for example, governments might require employee representation on boards or at the shop-floor level. These representatives, we can assume, would try to ensure that labor is not treated as a strictly variable input of production. Of course, where such reforms threaten powerful interests they are difficult to achieve, whether initiated by elected parties in government or pressed for by societal coalitions. Managers can mobilize significant corporate resources against changes they oppose.

Investors collectively have the financial might to discourage reform. As I show in Chapter One, the problem of corporate governance—of power relations within the large company—is really a problem of democratic accountability.

Accountability is complicated by the alternative kinds of authority states create or support. Broadly they can choose among market pressures, self-regulatory private institutions with public purposes (‘private-franchise authority’), or direct state intervention. The chief virtue of private-franchise authority for participants is its insulation of regulation from politics. Removing policy-making or implementation to private bodies—even bodies ultimately under governmental authorization—restricts agenda expansion, interest group influence, and ultimately also popular control. If power is interesting because it lies at the heart of politics as distribution, authority is of interest chiefly to the extent that it permits subsequent redistributions of power. Regulatory authority is, therefore, only partly about guiding or confining corporate behavior to fill some policy goal. Fundamentally it is about distributing power within companies.

II. Comparative variations: liberal and coordinated market governance

The fact that the governance varies across nations highlights its political nature. As I recount in Chapter One, the ‘varieties of capitalism’ scholars in comparative

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9 Governments might also want to promote private self-regulation for reasons of information (stock exchange executives know more about market dynamics than ministers and civil servants, for example), and cost (existing professional organizations in accountancy can implement policy without adding to the civil service).
political economy demonstrate that the distribution of power in the Liberal Market Economies—the UK and US—is the exception, not the rule.\textsuperscript{10} In brief, the Liberal Market Economies (LMEs) orient boards to shareholder protection and wealth generation. Protections for minority shareholders, strong anti-trust enforcement, insider trading rules, and stringent accounting requirements promote dispersed share ownership and hostile takeovers. By contrast, Coordinated Market Economies (CMEs, including Germany, Sweden, and in a different way, Japan), are characterized by more concentrated shareholding, less protection for minority shareholders, and less threat of hostile takeover. Two-tier boards separate the supervisory and managerial functions of directors. Partly as a result, managers tend to be less clearly motivated to create shareholder wealth than in LME systems. Investors are less obviously advantaged. There are also quite different arrangements for employee representation. CMEs in Europe have legally mandated structures to attenuate class conflict within large companies. As part of the codetermination system, supervisory boards include employee directors and works councils give employees a voice at the workplace level. Employees have no formal role in LME governance. They are expected to pursue their welfare through the employment contract and their trade union (where available). They are also protected by labor law and health and safety regulations.

III. UK reform: enhancing or transforming the liberal model?

Efforts to ameliorate the effects of business, restrain managerial behavior, or rearrange company structures to transform managerial incentives appear with some regularity in all democratic polities. It is the latter that affect corporate governance policy, and these gathered new momentum over the past fifteen years in the UK. They did so in two contexts: one of corporate collapse and fraud, the other when the New Labour Government considered ‘stakeholding’ reform. The former arose because of significant corporate failures at the onset of the early 1990s and again after 2001. The problem was apparently that managers were not sufficiently attuned to shareholders’ needs: Liberal Market governance was failing on its own terms.11 I address these failures and the policy response in Chapter Three. The latter, ‘stakeholding’ reforms, would have remade British governance in the image of the Coordinated Market Economies. Their fate is explained in Chapter Four.

The stakeholding critique of corporate governance is the more controversial of the two. It implies companies should be run in the interests of its multiple constituencies, not merely for shareholder’s gain.12 At the least, they should not be beholden to the valuation of short-term equity markets.13 Some take the more sympathetic position that running

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companies in its constituencies’ interests will actually promote shareholder gain. Broadly, stakeholding reform would have given workers a voice in large companies and so instituted a form of industrial democracy. It would have encouraged longer-term investment horizons, especially in the manufacturing sector. Finally, it would have required managers to consider the social and environmental impacts of their operations on affected communities, and made more information available about what those impacts might be.

IV. What dramatic change would require

Ultimately stakeholding did not take hold. The Labour government required only minor reporting requirements, unenforceable directors’ duties, and a statement of investors’ policies (if any) on social responsibility. In each case they maximized managerial flexibility. Why? What would a more radical departure from the British liberal tradition have required? Many will think it fanciful to expect the democratization of British companies. Neo-liberalism is largely triumphant in supply-side economic policy, and industrial democracy was debated and buried in Britain during the late 1970s. It seems absurd to think stakeholding advocates might win ground against (now global) investors and their managers. This is more of an empirical than theoretical puzzle. Yet the fact that reform is so difficult raises troubling questions about the democratic

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claims of modern polities. I will argue in my concluding chapter that stakeholding offered a way to reconcile these claims with market capitalism, and that it would not have required a dramatic reorientation of democratic theory (as opposed to practice).

Before addressing the problem of democracy and capitalism, however, we need to understand the competing forces at work on governance. In the next two sections, drawing on Chapter Two, I summarize what scholars of economics and politics predict about change and stability. They suggest two paths to stakeholding: the economic and the political. I will argue that only the latter is sustainable, but that its costs were too high for a centrist (or center-right) Labour Government.

Economics and the private path to stakeholding

Neo-classical and progressive institutional economists diverge on the dynamics of corporate governance. For the former, it is about approaching allocative efficiency by allowing holders of scarce capital to identify the most profitable projects. The latter show why employee and environmentally friendly governance might promote greater wealth creation.

Finance scholars, broadly inspired by the neo-classicals, emphasize manager-investor conflicts. The logic is simple: managers who are not also providing finance capital may be less than careful in its allocation and use. They will not guard a company’s assets as they would their own. This is conceptualized as a principal-agent problem, and corporate governance is the means by which it is resolved. But beyond

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providing the institutional minima (for example, contract enforcement the state should allow organizational forms to develop autonomously. If self-interested investors seek and reward arrangements to prevent managerial self-dealing and negligence, corporate governance will improve over time. In this view, an interventionist state is more likely to be a problem than solution.¹⁷ Note as well that investors will also oppose bringing employees or others into governance, since they will want managers to be single-minded in their attention to shareholder interests.

Some institutionalist and progressive economists, by contrast, argue that aspects of stakeholding might emerge privately as a result of market processes. Managers might restructure operations—with investor support—to promote profitability, productivity, or competitiveness. To the extent that employees and their intellectual assets are more valuable to companies, we would expect them to command higher pay, greater job security, and even a greater role in the governance of enterprise.¹⁸ On the environmental and social front, we should see changing business practices or organization to reduce the risks and costs of disaster or mishap. In this widely held view, stakeholding is a positive-sum idea: managers, investors, and stakeholders can all gain.

There are other market routes to stakeholding. Employee and environmental interest groups could use economic leverage as investors to transform governance. Where activists own shares in a company, they can raise difficult questions at annual general meetings. Financial institutions might exploit the growing market for ‘green’ and socially aware investment opportunities. To the extent that these investment products spread, they will moderate the shareholder-value maximization goal. Finally, the nature of shareholder demands might change since investment funds are made up in large part of the retirement savings of workers able to save. This might have the opposite effect, however. Employee-shareholder beneficiaries might well choose higher returns and capital growth rather than protections for other workers or social/environmental responsibility.

Finally, private governance authorities might adopt or be co-opted to pro-stakeholder ends. They might do so, for example, to spread the business case for reform. Or they might adopt stakeholding because of successful member activism. This would bear out the recent interest of political economists in the possibilities of organized civil society to resolve problems beyond (state) political control.
The private economic path to stakeholding governance

1. Managers and investors adopt new ideas about proper organizational forms for profitability in liberal market economy (for example, long term employment, employee consultation, better environmental and social controls in production, distribution, and marketing);

2. An expansion in the financial resources controlled by stakeholding activists, or by fund managers who invest on behalf of stakeholding-sympathetic beneficiaries (more green or socially aware share ownership);

3. Reduced expectations among investment beneficiaries—for example about how much they will need on retirement—or their trustees, in order to permit stakeholder-friendly practices even if these produce lower returns over the long and short terms;

4. Greater participation of employees and environmentalists in private authoritative bodies that regulate governance (such as ad hoc policy committees, the Stock Exchange, and accountancy bodies).

Politics & the public realm

Turning to politics, a host of institutional, structural and electoral reasons make dramatic stakeholder gains unlikely. I explain these arguments in Chapter Two before looking for evidence of their explanatory power in my descriptive Chapters Three and Four. First, governments are constrained by inherited policy tools and traditions. These are embedded a set of connate institutions of finance, business, and labor market policy.19

Currently in the UK these favor managers and investors. Institutional complementarities mean reform in one area is undermined by conditions in another.20

Second, the beneficiaries of the existing system—investors and managers—are economically and politically powerful. They can demonstrate theoretically and in practice that profit-threatening reform will damage prosperity, on which governments rely.21 Where divided on an issue their influence may be less decisive, but they unite on issues as threatening as stakeholding. This is what it means to say that business is structurally powerful. Investors in particular are likely to be strong given their mobility, and, hence, threat of exit in the face of hostile policies.22 Moreover, their lobbying and public relations capacities enable them to effectively communicate to elites and electorate alike.23

Third, recent party-political and ideological trends give little reason for stakeholder optimism. Thatcherite Conservatism clarified British liberalism, arguing that over the long term all economically active groups would benefit from allowing markets to balance supply and demand on the one hand, and risk and reward on the other.24 The ability of investors to make large profits, it followed, was essential to economic well-being. In practice this meant reducing trade union power and privatizing the nationalized

23 Grant, Pressure Groups and British Politics.
sector. In government, the Labour party did not change the state’s directions on either front. Despite internal divisions, the Labour leadership followed the Conservatives to the right on economic issues.\textsuperscript{25} At the very least its policy rhetoric differentiated itself from ‘Old Labour’ and argued that globalization was a legitimate constraint on public policy.\textsuperscript{26}

However, as also I show in Chapter Two, politics also provides reasons for thinking pro-stakeholder change was not out of the question. The first is supplied by neo-pluralists and others in political science.\textsuperscript{27} Whatever the pros and cons of neo-liberal economics, the liberal character of the polity still entails associational activity to demand legislation. Emphasizing the demand side of politics, pluralist scholars argue that business need not always win policy battles—given the right circumstances.\textsuperscript{28}

More important than the general pluralist observation that groups matter is the possibility that new coalitions could emerge between traditional antagonists in corporate governance. Gourevitch and Shinn observe that labor and investors (or at least investors who are not otherwise conflicted) can ally against managers in a ‘transparency coalition’ to demand governance reform.\textsuperscript{29} Both workers and investors benefit from increasing the

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\item Vivien Schmidt, \textit{The Futures of European Capitalism} (New York: Oxford University Press, 2002), 266-70.
\item Peter Gourevitch, "Testing Political Explanations of Corporate Governance Patterns" (paper presented at the Conference on economics, political institutions, and financial markets, Social Science History Institute,
\end{enumerate}
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amount of information available to markets (although intuitively it would seem that shareholders have more to gain). These cross-class coalitions are not out of the question. In the United States, for example, workers and managers allied against investors in order to prevent hostile takeovers that shareholders would have welcomed because they would result in job losses or new management.\textsuperscript{30}

A third reason for thinking dramatic change is possible is the constitutional strength of British cabinet government and the distorting effects of the first-past-the-post election systems. These often produce strong Parliamentary majorities and party leaderships in cabinet can steer the state in new directions.\textsuperscript{31} Parliamentary sovereignty confers unmatched formal power on cabinet Government, and overall the state is very strong.\textsuperscript{32} As Labour came to power after eighteen years in the wilderness they had at their disposal a good deal of institutional and political potential. The question remains, why did they not use it?


As Neil Mitchell argues, policy makers have their own projects and must calculate whether anti-investor or anti-managerial policies are sustainable despite (or because of) public opinion. What is relevant, then, is a marriage of leaders’ political ideas and the policy-making environment. John Cioffe notes that Center left legislators in Germany, the United States, and Britain opportunistically embraced (pro-investor) reform in the wake of recent scandals. Dramatic losses in legitimacy are also highly significant in pro-employee governance initiatives. During these times, policy makers can initiate, respond to, or draw support from mobilized public or interest groups.

The political path to stakeholding

Political analysis thus sustains both pessimistic and optimistic views of the possibilities of stakeholding reform. Considerable political will in the executive branch would be required for major change. A dramatic departure from the liberal tradition—that is, a restructuring of the governance and purposes of British companies—would entail:

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33 Mitchell, *The Conspicuous Corporation*.
The political path to significant reform

1. A commitment by ministers to undertake reform. This is likely to be driven by some combination of:
   a. Ideological consensus in the governing Cabinet; this means a common analysis of the governance problem, a view of how reform would help, agreement on how it would fit the Government’s overall goals, and the rhetorical means to sell it to public, media, and interest groups;
   b. A calculation that the move is sustainable in Parliament; this is likely to be guaranteed by the large majorities Britain’s first-past-the-post system produces at times;
   c. A calculation that the electoral benefits outweigh the costs; the reform would need to be, at some level, popular, or at least not unpopular; it would likely have to have been sold as a manifesto commitment at the previous General Election;
   d. A willingness by ministers to shape and lead public opinion on the issue;
2. Supporting coalitions between mobilized interest groups;
3. A receptive problem environment; this effectively means a significant loss of business or authoritative legitimacy;
4. A willingness to undertake radical complementary reforms so that reform is not undone in the implementation phase by unintended effects and participant reactions;
5. Leadership on the international front to coordinate with other economies.

This is a demanding and unlikely—though not inconceivable—set of criteria. Exploring whether they were met will allow us to learn something not only about British politics, but about democracy and capitalism more generally.

V. My argument

My argument is, briefly, as follows. Economic routes to stakeholding are not viable. The neo-classical economists are correct: in a financially driven market economy investors are well placed (on average) to identify governance arrangements and managerial approaches that maximize their returns. This does not include stakeholder-
governance. Moreover, the financial strength of pro-stakeholder investors pales into comparison with that of shareholders seeking maximum returns for a given level of risk. And finally, those representing employee-shareholder beneficiaries of invested retirement savings maximize returns rather than promote stakeholder-governance.

Second, private authorities in governance must be democratized for them to promote stakeholder-friendly governance. As presently constituted they reflect the conventional interests—investors, managers, and professionals (accountants and lawyers). None have an interest in promoting stakeholder governance.

Third, it follows that decisive state-led intervention would be required to advance the stakeholding agenda. Government would need to change the economic calculus of participants in governance and democratize private authorities over governance. Without significant and complementary reform, the stakeholding project will not succeed.

Fourth, despite the arguments of Gourevitch and Shinn, coalitions between employees and investors will not support decisive reform. They ally only to challenge managers in marginal ways. They do not promote or support reforms that threaten investor interests or advance employee interests except in the most innocuous manner. More generally, pluralist optimism about countervailing interest groups is not borne out. Investors and managers both win in corporate governance battles against employees and environmentalists.

Fifth, although British governments clearly have the capacity to produce significant reforms, political-economic structures sustained by investors’ economic
power and global capital markets make the political costs extremely high. Institutional complementarities mean that reform would be necessary across the economy to sustain governance reform. Labour ministers decided not to bear these costs. Without the will to overcome these costs, Labour is left with a weak strategy of promotion and cajoling, and, as Cioffe anticipated, protecting investor interests.

VI. Structural power, stakeholding and the problem for liberal democracy

What are the theoretical implications of these findings? Corporations and corporate governance pose something of a problem for liberal democracy. The first relates to the nature of corporations themselves. The second relates to their political power. First, although companies are private, they have a social character. They are institutions that wield considerable collective power and, at the same time, are the site of interest-based conflict.36 Managerial decisions affect what goes on within the spheres of production, exchange, and society. But they are also obviously not democratic, and so are inherently somewhat paradoxical in modern society.

The second reason is more important and is derived from my empirical findings. Liberal democracy encourages ambitions of popular control and associational activity to press for reform. Large companies constantly arouse these urges –precisely because of their social character. But while liberalism confers opportunities for citizens to contest corporate power, they often wilt in the face of political-economic structures. Indeed, it is corporations’ economic and political activities that reproduce these structures. Even

where parties of government are electorally strong and have their own projects they answer convincing arguments from business about economic competitiveness and flexibility. This is all the more true in an age of mobile capital and production. The corporate threat of exit hangs over governments that threaten profitability in the name of democratization. As I show in this dissertation, the force of argument is complemented by the argument of force.

Yet as much as politics is the art of the possible—a counsel of compromise—liberal democracy entails possibility. For stakeholding activists, public policy is open-ended: change is possible. As an ontological position this flies in the face of the institutional and structural obstacles I explain here. But it has strong support in democratic policy theory. Moreover, positivist political science, in its readiness to discover constraint and failure, would do well to explore as well what is required to escape those constraints.

VII. A note on research design & methodology

This dissertation has descriptive, explanatory, and normative ambitions. The politics of UK corporate governance is significantly under-researched, and understanding governance generally requires an expansive inter-disciplinary approach. Thus, my study should be of use in specifying the kinds of economic information needed in future research. My explanatory strategy is chiefly one of process tracing, built around a single case study. I am aware of the limitations of this strategy, but it is appropriate in new areas

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of inquiry and in order to transmit (as opposed to generate) knowledge. Extension to further cases—especially within the liberal market world—is desirable but requires additional funding. My claims to generalization are therefore limited; this is a work of political history, not nomological positivism. It should be of interest to scholars of governance as well as political studies.

I built an account of events, participants and trends based on primary and secondary sources. Information was gathered by public document review, mining of research by scholars in other disciplines, and by in-depth elite interviewing. Interviews have the virtue of understanding the rationales interested parties hold for their own preferences and interventions. Establishing actors’ rationales (as opposed to ‘rationality’) helps to link actions and subjective understanding. This helps avoid problems imputing objective interests in political economy. Rationale is a part of causality because actors’ ideas matter: problem definition, strategic interaction, and policy choices all require significant interpretation and are reflexive processes. Decisions and rationales are conditioned, of course, by situational context. The key problem, on the one hand, is to explore the policy-political context as understood by actors (including their view of history, circumstance, and the views of others) and, on the other, to learn how they view

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38 Catherine Marshall and Gretchen B. Rossman, *Designing Qualitative Research*, Second ed. (Thousand Oaks, CA: Sage Publications, 1989), 89, 90. I compiled and coded a database of events using the software program Filemaker Pro. Among the documents consulted were: formal policy statements, press releases and letters, minutes, industry news sources, and newspaper reports. Where not in the public domain, organizations were contacted for copies. Because of privacy concerns, internal administrative documents were not widely available, and much material has yet to be archived. I also used existing research in law, finance, and business studies.

their own interests, strategies, and choices, relative to others. In-depth, qualitative and non-standardized interviews are therefore called for.40

Finally, I relied heavily on government consultation documents (the so called ‘green bricks,’ because of their color and weight) and archived responses published by the Company Law Review Steering Group. These are available for inspection at the Department of Trade and Industry, and have been exhaustively summarized for the DTI website. They enabled me to track the development of proposals and interest group responses over time. Although decision-making meetings were not publicly recorded, the information provided by the Review offers a highly detailed picture of the issues agenda, participant preferences, and outcomes. I have only included the most relevant material in these chapters.

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40 Michael J. Healey and Michael B. Rawlinson, "Interviewing Business Owners and Managers: A Review of Methods and Techniques," *Geoforum* 24, no. 3 (1993): 345. Interviewees were selected because they took part in the process, or because of their expertise. Identifying interviewees was straightforward, since participants in the Company Law Review (and earlier initiatives) are listed by affiliation, and respondents to the consultation are listed in each document. The next step was to review references to the organizations and individuals in the print-media, following up with publicly available information (much of which is Internet-based)
Chapter 1. Corporate governance at work: how it varies and why it matters

This chapter explains what I mean by corporate governance, shows how it varies across nations, and explains its political import. This will help readers understand the policy arguments in Chapters Three and Four. I show here that governance is important for three reasons. First, it affects performance at the company and arguably also national levels (Part IV below). This implies that governance is about preventing disastrous corporate collapses and, more generally, promoting economic prosperity. Second, and even more convincingly, governance matters because it conditions how the corporate product is divided between investors, managers, and employees (Part V). It is essentially distributive. Although conditions within any one firm will vary, the national company law framework and prevailing governance structures will help pattern distributions across the economy as a whole. Finally, it is most explicitly political because it affects the way companies behave and so helps shape the public effects of private enterprises (Part VI). For these reasons, governance sustains a demand-driven group politics, in which economic actors and those affected by companies seek to bring them to account. I explore
the ways these demands interact with other political variables and political-economic structures in the next chapter.

I. Conceptualizing corporate governance

Corporate governance refers to the ways large, publicly traded companies are directed and controlled. Its rules and processes condition “the distribution of power in the firm, shaping who makes decisions, who monitors the decision makers, and what measures are used.” Most importantly, it distributes power between shareholders, managers, and employees. Shareholders want managers to focus on maintaining or advancing equity value and/or distributing the enterprise’s surplus. They want governance arrangements that protect their investment from poor or fraudulent management. Managers, who run companies, prize flexibility and autonomy: they want to be left alone to pursue their projects, pay and perks. Employees want employment security, wages, and possibly also increased control over their working environment. Where their representatives control employees’ retirement savings, they may also want to increased equity values and more investor protections (rather than less).

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1 I conceptualize corporate governance more broadly than most of the Anglophone financial, business, or legal literature. I do not limit my analysis to board structures or ownership patterns. Nor do I confine the politics of governance to the shareholder-management conflict. Managerial autonomy is usually conceived as a problem for investors, not for others. Comparative studies demonstrate that the latter view is too narrow. Note, however, that I do not include labor, environmental, and consumer regulations, which set the context within which firms operate. Contrast Shawn Donnelly et al., "National Political and Legal Systems of Globalization: The Public Interest and the Company in Germany and Britain" (paper presented at the American Political Science Association Annual Meeting, Atlanta, GA, 2-5 September 1999). Cioffi, "Governing Globalization: The State, Law, and Structural Change in Corporate Governance.”

There are clearly also others who claim a stake in corporate governance, including most notably in this dissertation, environmentalists. During the late 1990s they joined organized labor in pressing for a ‘stakeholding’ reform of British governance. The stakeholders called for elements of industrial democracy and corporate accountability to wider constituencies. The term ‘stakeholder’ stems from business schools, where it is often used to refer to all the differing participants in enterprise. They include as well as the above, creditors, contractors and suppliers, customers, and the broader community. For present purposes I confine my analysis to the three core interests: labor, managers, and shareholders.

There are broadly three kinds of governance mechanism: direction, control, and transparency. Corporate boards generally direct companies, and in Britain the term ‘director’ is confined to members of boards. Boards, again in Britain, are accountable to shareholders, and in theory are controlled through liquid equity markets, the threat of takeover, and election. Finally, transparency is provided through a regime of financial reporting and audit, supplemented by commercial analysis of corporate performance. By supplying information to markets, the transparency mechanism facilitates accountability, both to shareholders and potentially also to stakeholding activists. It is in these three areas which I track continuity and change in Chapters Three and Four.

Before discussing how governance varies and its political import, I offer a series of vignettes of British corporate governance in action.

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3 Shinn and Gourevitch use slightly different terms. They refer to ‘direction’ as ‘oversight’ and to ‘transparency’ as ‘information.’ Ibid.
II. Corporate governance at work

At the end of May 2003, several thousand employees of the Manchester-based Accident Group were made redundant—by text message to their mobile telephones. Adding insult to injury on that spring payday, the messages announced, "Unfortunately salary not paid." Employees were surprised to learn that the firm had run out of cash. When creditors discovered exaggerated earnings and spiraling costs they cut the firm off. Operations ceased immediately. The case is now legendary for its corporate callousness.

While the method of termination is mercifully rare, Accident Group is illustrative of two common features of corporate collapse: the failure of board governance and the inability of employees to control or know their fate. Generally the consequences for board members are less severe than those for employees.

As is often the case, Accident Group grew rapidly under the leadership of a forceful and widely admired entrepreneur. It cleverly exploited a new market with aggressive and unorthodox sales and accounting practices. Its stock was closely held (by its founder and an offshore trust company) but the business had grown beyond its roots as an owner-controlled firm. New board members had been brought in to provide expertise and improve control over the existing managers, but they were unable or unwilling to wield effective control or oversight. They later claimed that the management team

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4 In fact, employees were asked to call into the office, where a telephone message from receivers PricewaterhouseCoopers told them: “All staff who are being retained will be contacted today. If you have not been spoken to you are therefore being made redundant with immediate effect.” Michael Paterson, “Firm Sacks Staff by Text Message,” Daily Telegraph, 31 May 2003.

5 The company sold no-win/no-fee insurance products to claimants in injury compensation cases. The British government had ended legal aid for such claims and the Accident Group saw an opportunity for rapid growth. The similarities to Enron are striking. The company rose to prominence by creatively exploiting opportunities created by changes in government policy. In Enron’s case, it was deregulation in energy markets; for the Accident Group, it was the withdrawal of funding for state legal aid.
refused to give the board necessary information or to act with greater probity. Still, directors paid themselves well and shareholders enjoyed significant dividends even as the company ran into trouble. Employees, on the other hand, were the great losers. They had little input in personnel affairs and knew nothing about their immediate future, let alone long-term prospects. Most would have been considerably less financially diversified than the company’s directors and investors. Thus, their economic livelihood was bound up with that of the company, but they had no participative or consultative role.

Naturally during economic downturns company collapses are more frequent, but throughout the business cycle and even (especially) in well run companies, creative destruction assures constant change. What is interesting, however, is that the winds of capitalism blow warmer on some than on others. Managers constantly make allocative and distributive decisions that impact employees, shareholders, and other constituencies.

In 1999 managers at the food and chemicals conglomerate Unilever made a special dividend payment of £5B to its shareholders. It had amassed a large amount of cash following the recent sale of a major division. With an eye on investors in New York, London, and the Netherlands, the board submitted the proposed payment to the annual general meeting. Shareholders gladly approved it. This dramatic distribution of cash came after several years of corporate down-sizing and layoffs and was, for this reason, the subject of union and employee protests. As a Transport and General Workers’ union representative remarked at the time, “there was a feeling that Unilever has been getting away with murder and that its workers are not being treated as stakeholders in the
company’s fortunes.” European Works council representatives in the Netherlands complained that the money should have been invested by the company in new plant rather than given to shareholders. Retired employees did not see any increase in their pension payments, although clearly they had helped to generate part of the surplus that was distributed. Instead, the question for directors and shareholders was whether the cash on hand could be better used exploiting new acquisition opportunities or distributed and (presumably) reinvested in the markets by shareholders. They opted for the latter.

Historically, the locus of power in British companies is in the boardroom. In principle, directors respond to shareholder demands. The public usually notices this at annual general meetings, but it also goes on behind closed doors and through the constant pressures of the equities market. Managers are wont to see direct shareholder oversight as intrusive and unwelcome, however, and much ink has been spilled during the past fifteen years on shareholder efforts to improve their position. Some have responded to this movement better than others.

In 1992, facing severe financial difficulties, the board of the oil giant British Petroleum fired its authoritarian chairman and chief executive, and split the jobs between two people. Increasingly the business world outside the United States was rejecting the idea that the person responsible for leading the board of directors—the main source of direction and oversight of senior management—should also be the lead corporate executive. At the same time BP created a committee of the board to be responsible for

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nominating new directors. This, it was hoped, would avoid suspicions that the Chairman or Chief Executive was hand-picking a collegial board. Both measures brought the company up to the ‘state of the art’ in shareholder-friendly corporate governance during the early 1990s. The subsequent recovery in BP’s fortunes took some time, and cost a good deal in financial and human terms. The company’s dividend—annual payment to shareholders—was cut for the first time since World War One. Worldwide cuts of 20,500 were made in the workforce. But BP was subsequently cited as a text-book case of good governance for shareholder value.

Other executives resist change, and shareholders may take matters into their own hands. In 1993, Lord Hanson, the chairman and chief executive of an eponymous Anglo-US conglomerate, attempted to insulate his company from investor activism—activism that might have been directed at board reform. Management were concerned that ‘vexatious’ and ‘irrelevant’ resolutions were being submitted by and to shareholders at annual general meetings. “To facilitate the orderly conduct of meetings,” Hanson proposed higher thresholds for submitting nominations and resolutions (for nominations, the threshold would increase to as much as ten percent of share capital). This and other changes drew a storm of criticism from the largest investors—institutional investors including pension funds and insurance companies. Among these were US investors, who owned about 25% of the company. Prominent among them were the Florida and

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8 However, the former CEO Bob Horton was later paid £1.5M in compensation for the loss of his contract—although it was only a year-long contract paying approximately half that amount.
Wisconsin state investment boards. Lord Hanson explained that his non-executive directors (board members who are supposedly more independent of management) had not been able to “read the fine print.” Had they done so, he said, they would have advised against taking the proposals forward in the first place. The company was forced, in the words of the *Daily Mail*, to “beat a hasty retreat.” The incident was an early loss for managers in the ‘shareholder value’ movement.

Anthony Bolton is the kind of man lesser corporate moguls than Lord Hanson might fear. He is the fund manager at Fidelity, a major—and until recently mostly inactive—British investment fund. He is known as the ‘Quiet Assassin’ for his role in a 2003 board coup at the large television concern Carlton. As Carlton merged with another broadcaster investors insisted that its chairman go. Other Carlton directors were subsequently dismissed for approving an astonishing £15M payout to their ousted leader. The following summer Bolton was coordinating shareholder demands that specific financial targets be met by the chairman of the new company.

On occasion shareholder activism is turned to quite different ends. In 2000, for example, the annual general meeting Rio Tinto (a mining concern) was targeted by a coalition of employee rights activists. Among them were British, Australian, and US trade union federations, together with various advocacy groups. The coalition—which owned enough shares to guarantee entrance to the meeting—sponsored resolutions on improving governance structures and protecting human rights in the workplace. The first would have installed an independent deputy chairman of the board to create greater
accountability to investors. The second, more radically, would have insisted on compliance with International Labour Organization standards. Rio Tinto was selected because it had prominently supported legislation in Australia that would have hurt union organizing. While the resolutions were heavily defeated the percentages voting in favor (and therefore against management) were high in both cases and the initiative gained widespread publicity for ‘socially responsible investment.’ Again, public pension fund investors were the mainstay of support for the activist resolutions.\textsuperscript{10}

Multinational oil companies like Royal Dutch/Shell have also been targeted. In 1997 church groups and activists gained ten percent of shareholder votes for a resolution designed to improve environmental performance, reporting, and audit at the Anglo-Dutch oil giant.\textsuperscript{11} Among the complaints were possible human rights violations and environmental degradation at its Nigerian operations. Activists used an estimated 1\% share stake in the company to gain the leverage necessary to introduce and publicize the resolution. It gained support from pension fund trustees in the public sector and some private shareholders. Reportedly the Trades Union Congress asked its trustee contacts to support the measure and the Pensions Investment Research Consultants Ltd. (PIRC) provided advice. Insurance companies and corporate pension fund managers joined managers in opposing the resolution, which was rejected amid wide publicity.

\textsuperscript{10} In this case, they were British: the Co-operative Insurance Society, the West Yorkshire Pension Fund, the South Yorkshire Pension Authority, and Friends, Ivory and Sime, (a global investment management firm).
\textsuperscript{11} “Shell wins vote but loses ground to green lobby,” \textit{Times} (London), 15 May 1997.
III. Comparative political economy and the varieties of governance

National corporate governance arrangements vary greatly. Although my research focus is Britain, the following paragraphs review these broad differences in order to guard against analytical provincialism. They show that the British (or North American) pattern is neither natural nor necessarily preferable for some groups. Indeed, during the late 1990s, stakeholder activists tried to shift power within British companies towards employees and away from investors and managers. Their stakeholding program would have moved the British system, which privileges the investors and managers, toward the Continental European pattern, which accommodates workers to a greater extent. Readers will find greater detail on the situation facing investors, managers, and employees in Britain in Part IV below.

Modern capitalist economies differ dramatically in institutional and distributive terms.12 These cross-national differences are sometimes portrayed in political science as two durable ‘varieties’ of advanced industrial capitalism.13 In this influential account, Britain and the US are liberal market economies (LMEs); Germany and other Northern European countries are coordinated market economies (CMEs, sometimes called Organized Market Economies). Briefly, the approach distinguishes LME and CME forms by their solutions to common economic coordination problems, of which corporate

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13 Hall and Soskice, eds., *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*. 

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governance is one. These are dilemmas for both policy-makers and private participants in enterprise. A complete account of political economy must account for the efforts of both to resolve them.

In broad theoretical strokes, LMEs and CMEs differ as follows. LMEs maintain a framework state ensuring freedom of contract, fairness, and legal redress. Although politically powerful groups are protected, creative economic destruction is encouraged in principle. Enterprise should come into and go out of existence as the market dictates: they are best seen as private rather than social organizations. A narrowly conceived safety net provides help to individuals unable to adapt, so preserving systemic legitimacy and stability. The result is that business autonomy and profitability is highly favored. Workers have the right to organize unions (although these rights vary over time), but relations with business are strictly private and contractual in nature. By contrast, CMEs combine capitalist market price signaling and politically arranged coordination to promote negotiated modernization, greater stability and strategic rationality. Well-organized and publicly authorized intermediaries—peak associations of labor, employers, and agriculture—coordinated semi-public bargains on issues of pay, training, and economic adjustment. Social overheads for the public and private sector are high: it is costly to hire and fire. The result is that economic adaptation takes place within

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14 Recent studies emphasize five problems, each on the supply side of the economy: industrial relations as a whole, vocational training and education, corporate governance (chiefly meaning the relationship between finance and the corporation), inter-firm relations, and within firm employee relations.

15 Although the approach has produced excellent empirical research, I will argue in Chapter Two that the ‘varieties’ approach suffers by not emphasizing more the differences of power that lie behind the creation and reproduction of institutional coordination.
enterprises rather than in markets overall. Creative destruction becomes creative restructuring.

Corporate governance mirrors these broader differences. In brief, liberal governance is strongly oriented to shareholder protection and wealth generation. Boards are more clearly subject to shareholder influence, if not control. Protections for minority shareholders, strong anti-trust enforcement, insider trading rules, and stringent accounting requirements promote dispersed share ownership. Dispersed ownership means that many shareholders own small parts of each company and frequently trade their shares. As a result, share prices are important signals of potential profitability. Together with a strong takeover market, this helps focus managerial attention on generating wealth for shareholders. In the neo-classical view this promotes efficient ordering of productive resources because high returns attract investors.

CMEs, by contrast, are characterized by more concentrated shareholding and less protection for minority shareholders. There is cross-shareholding (when one company owns the shares of another), family ownership of large stakes, and shares are less frequently traded on the secondary markets. There is less of an aggressive takeover market, and so managers need not fear acquisition by hostile investors or management

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teams seeking to improve shareholder returns in ‘badly managed’ companies. Two-tier boards separate the supervisory and managerial functions of directors. Partly as a result, managers tend to be less clearly motivated to create shareholder wealth than in LME systems. Institutional economists argue that this produces a longer-term view of returns and so greater investment in human and physical capital. Neo-classical economists suggest this reduces efficiency and so the overall economic product.

In addition to these differences in ownership and shareholder protection, there are quite different arrangements for employee representation. In the Coordinated Market Economies, there are legally mandated structures that attenuate class conflict within larger companies. As part of a system called ‘codetermination,’ supervisory boards of large companies explicitly include (usually elected) employee representatives. Through works councils, employees have greater consultation and information rights even in small-scale workplaces. This balancing of worker and manager/investor interests in corporate governance is part of a wider orderly structure of industrial relations underpinned by ideological goals of social partnership and harmony in the post-War era.17 Companies are seen as social as well as economic institutions and their political (i.e.: internally conflictive) nature is recognized in positive law rather than left to contract.

In part because social democratic parties were not a strong force in Liberal Market Economies, employees have no formal role in LME governance. They are expected to pursue their welfare through the employment contract and their trade union

(where available). They are also protected by labor law and health and safety regulations. These arrangements are supported in liberal theory, and the British Labour Party did not threaten them during its intermittent periods in office after World War II. Labour’s revisionist socialism emphasized nationalization, unionization, and redistributive taxation rather than employee participation in enterprise. There were efforts during the 1970s to arrange national wage and price restraint through bargaining between the social partners, but corporatist coordination was not entrenched in Britain. In fact, Labour did not question the private nature of companies, and its trade-union allies preferred collective bargaining to codetermination.

On both the right and left of the political spectrum, companies in the Liberal Market Economies are seen as private institutions legitimately created to generate profits. The common presumption is that government should not interfere with the behavior of contracting adults. Intervention is justified, of course, where the product of these contracts harms the general welfare, but this is essentially not meant to interfere in the contract itself. There are exceptions—employment discrimination law, for example—but these only highlight the oddly protected nature of the corporate form. They reveal the conflict between private agreement and public welfare.

Table 1.1 summarizes the key LME/CME differences.
Table 1.1: Major variations in national corporate governance systems

<table>
<thead>
<tr>
<th>Model &amp; Examples</th>
<th>Liberal Market Economies</th>
<th>Coordinated Market Economies</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Britain, USA</td>
<td>Germany, Netherlands</td>
</tr>
<tr>
<td>Direction</td>
<td>CEO led unitary board with non-executives performing supervisory functions</td>
<td>2-tier board splits supervisory &amp; executive functions</td>
</tr>
<tr>
<td></td>
<td>Employees excluded from governance; covered in labor law</td>
<td>Codetermination includes employees in major firms.</td>
</tr>
<tr>
<td>Control</td>
<td>Dispersed ownership</td>
<td>Concentrated and stable ownership, frequently by families and other companies</td>
</tr>
<tr>
<td></td>
<td>‘Shareholder democracy’ + equity market signaling</td>
<td>Few takeovers—inactive market for corporate control</td>
</tr>
<tr>
<td></td>
<td>Active market for corporate control</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Protections for minority shareholders</td>
<td></td>
</tr>
<tr>
<td>Transparency</td>
<td>Stringent accounting &amp; audit rules</td>
<td>Accounting and audit less developed</td>
</tr>
</tbody>
</table>

Free capital and the problem of convergence

During the 1990s many journalists and some scholars argued that CME governance was vulnerable to convergence on the Liberal form because (in large part) of the enhanced mobility of investment capital. This pressure is identified with the financial aspects of globalization and the resulting erosion of national policy capacities. Specifically, cross-border capital flows created the need for common reporting standards, better protections for minority investors (those with small stakes in companies) and,
overall, for higher returns to equity. With capital mobility came the ‘shareholder value movement,’ spreading from Wall Street through the City of London, across the Channel and onwards to Asia. This was led by the US public pension funds, and most famously, the California Public Employees Retirement System (CALPERS).\(^{19}\) CALPERS raised the pressure on local companies to introduce investor-friendly governance. Thus, to attract and retain mobile investors, the argument ran, governments would have to help corporate governance mechanisms converge on the highly effective Anglo-American model.

Comparative political economists have generally resisted this conclusion, finding instead that pressures from globalized investors and product markets were mediated by national politics.\(^{20}\) The convergence debate is not crucial to this dissertation, but it does suggest three powerful points: first, there are, indeed, forces for convergence, and they work for clarification of the Liberal model as much as forcing change in the CME

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\(^{19}\) The public retirement funds face less conflict of interest in monitoring managers, as I discuss below. Private sector fund managers may have other relationships with companies that reduces their desire to ‘rock the governance boat.’ This was obvious in the cases of Enron, WorldCom, and other new economy companies.

models; second, these have significant distributive effects;\textsuperscript{21} and third, national distinctiveness persists. This means that in Britain change should favor investors over managers, and both over employees. But it also suggests that domestic political struggles matter, and that economic processes—even highly globalized economic processes—are not determinate. The findings of the varieties of capitalism literature suggest that different varieties of capitalism remain viable.

IV. Governance and economic performance

In the next three parts of this chapter, I explain at length the political import of corporate governance. This arises chiefly out of its distributive economic effects: by helping to determine ‘who gets what, how, and when.’\textsuperscript{22} By reporting the interest in governance of economic and political actors, I lay the ground for understanding the political conflicts I explore in coming chapters.

In the first place, governance is obviously of political interest if it helps produce the prosperity governments crave. There are varied and conflicting explanations why it might do so. I outline five in this section, without evaluating their competing claims. They offer distinct analyses of what corporate governance is about, what is wrong with existing systems, and what can and should be done. The first two, and the fifth, are arguments for pro-investor reform; they underpin demands that Coordinated Market Economies become more like the Liberal Market Economies and enhance investor power.


\textsuperscript{22} Harold Lasswell, Politics: Who Gets What, When, How (Cleveland, OH: Meridian Books, 1936/1958). My emphasis on distribution is not meant to imply that politics is reducible to economics, or that distribution exhausts the content of politics. It is, however, the focus of this dissertation.
and protection. Their logic also sustains the view, reported above, that convergence on the Anglo-form is underway, since in a globalized financial economy investors are better able to move into high-return markets.

The third and fourth arguments are more sympathetic to the stakeholder advocates. They imply that the success of CMEs is rooted in the effects of non-Liberal governance, and they give reasons why the emphasis on investor-returns is misplaced. They argue that stakeholder capitalism will outperform liberal market capitalism (as well as producing a fairer distribution of economic value).

1. Corporate survival and investor protection

The most straightforward and commonly accepted view of corporate governance is that it is about protecting investment in complex modern companies. Because the people who own our largest companies no longer run them, the argument goes, we must then carefully monitor how well they are run. The notion that boards were a locus of unmonitored—and possibly also under-performing—power was known as the ‘managerialism’ thesis. Governance institutions are put in place by governments and emerge out of market ‘best’ practice in order to ensure that managers steer companies

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23 Micro-economists offer a more sophisticated statement of the same point. Governance is a set of constraints at the company level that shapes bargaining over ‘quasi-rents’ generated by firms. Quasi-rents are returns (surpluses) generated in excess of short-run opportunity costs. They are not therefore included in contract. Since not all contingencies can be anticipated by contracting (for example, between suppliers of capital and managers), some means of control or decision is necessary to settle these contingencies. See the entry on corporate governance by Zingales in Peter Newman, *New Palgrave Dictionary of Economics and the Law* (New York: Stockton Press, 1998).


effectively. Since effectiveness is, in the Liberal Market Economies, identified with maximizing the returns on investment (see the following section 2), it follows that managers must be accountable to shareholders.

When large companies collapse or when managers engage in unrestrained fraud, these institutions and processes are called into question. Adrian Cadbury noted, for example, that in all recent headline company failures, the firms were out of compliance with best practice. Ensuring greater take-up of best practice was the source of the governance reform effort during the early 1990s in Britain, and again after the Enron/WorldCom/Andersen events. I deal with the politics of these issues in Chapter Three.

2. Market discipline and the shareholder value maximizing company
Microeconomic theory persuades many that the shareholder-value maximizing company best serves national prosperity. By allocating resources to the most productive projects—by definition where returns to invested capital are highest—liquid financial markets ensure efficiency. Thus, if managers embrace shareholder value, society as a whole will benefit. They should not be distracted by social goals. Stock ownership need not be stable, but boards should be independent of management, which may be wedded to outmoded products, practices, or projects. Executive compensation should be tied to

27 Shleifer and Vishny, "A Survey of Corporate Governance." Many of the same scholars argue that governance arrangements are the product of economic competition. Thus, they assume that economics governs institutions. This view marginalizes politics and understates power.
share value, and under-performing management teams must be replaced through takeovers. Faced with such a system, managers will have little opportunity to engage in wasteful ‘empire building,’ which might include, for example, building plants in uneconomic locations or pursuing unsuitable acquisitions. Rapid adjustment will occur both within companies and across the economy overall as new companies start-up and inefficient companies close. All will benefit as a result. British and North American economists (and investors) promoted this argument in the Coordinated Market Economies during the 1990s, and they deployed it against stakeholding activists in Britain.29

3. Market myopia and short termism

A second, opposite argument, is that companies in the LMEs are too concerned with short-term financial returns (especially on equity investment).30 The problem is that fixed capital formation, human capital development, and basic research and development each requires using a company’s retained earnings.31 This may run counter to stockholders interest in short run equity growth or dividend payments. The alternative is to raise new funds in the financial markets, which again subjects managers to pressures of short-term returns. Thus, managers would under-invest in those areas that would promote...
long-term corporate and national health. Instead, managers needed access to ‘patient’
capital and relationship or ‘insider’ corporate governance based on stable ownership.

This view was common on the British left during the 1980s and early 1990s, but
was also held by managers in manufacturing industry who felt their projects were
insufficiently funded by British finance.\(^32\) As early as the 1970s the City feared political
pressure might be brought to bear on pension funds to invest in the public interest.\(^33\)
Even some prominent Tories, including former Prime Minister Ted Heath, were hostile to
the neo-liberal idea that unrestrained finance should be the primary determinant of
business organization. Later, casting an envious eye at Germany and Japan, Michael
Porter and others suggested that companies would do better to invest for long-term
growth rather than simply maximize short run share price. German and Japanese
advances in international product markets seemed to bear this out. They were better able
to invest because capital was more ‘patient.’

German and Japanese managers were also less likely to treat workers as a variable
cost to be regulated with an eye on equity prices. One implication of this was that CME
firms were better able to adapt to new conditions (including the introduction of new
production technologies) because they had the cooperation, rather than opposition, of
employees. Workers are cooperative and flexible—they can take on new functions—

\(^32\) See also the economic discussion of Kevin J. Laverty, "Economic 'Short-Termism:' the Debate, the Unresolved Issues, and the Implications for Management Practice and Research," *Academy of Management Review* 21, no. 3 (1996).

\(^33\) The Wilson Committee gathered evidence from many, including the trade unions, that investments
should emphasize domestic development. Harold Wilson said financial institutions “could very well be
transforming the nature of our society more than any government would dare to.” Quoted in William M.
because they are more secure in employment and participate in decision-making. By contrast, labor proved famously inflexible in the British context where new technology was primarily seen as a labor-saving device. CME companies were less able (because of labor market law) or less desirous (because of less pressured financial markets) to constantly rationalize the workforce.

In short, the ‘market myopia’ argument is that the constant pressure of earnings reporting, share-based incentives, and the ‘market for corporate control’ are distractions from sustaining healthy companies. As Michel Albert remarked, the kind of shareholder governance implied by the market discipline argument “reinforce(s) the status of the market as the most powerful economic mechanism and the ultimate arbiter of the fortunes of business and industry.”

The chief problem of the ‘myopia’ analysis is its comparative aspect: as the 1990s wore on it was increasingly hard to recommend emulation of Japan (suffering a decade of no-growth) or Germany (unable to produce the jobs needed to absorb Eastern European workers). Anglophone economists argued that, on the contrary, the coordinated economies needed more discipline from the financial markets—short term or otherwise. Moreover, myopic or not, the large returns that LME governance was producing multiplied the retirement savings of Britons and Americans while lower employment growth in the CMEs threatened their current-funded pension schemes.

4. Building trust and cooperation within firms

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34 Albert, Capitalism Vs. Capitalism; How America's Obsession with Individual Achievement and Short-Term Profit Has Led It to the Brink of Collapse, 182.
A less common variation of the market myopia critique argues that competitive, sustainable enterprise relies on cooperation between more than financiers and managers, and that these should be brought into governance. It builds on ‘stakeholder’ analysis of the groups that contribute to organizational wealth.35 Instead of relying on comparative analysis of business systems, however, this argument relies on micro-economic analytics. In this view, companies are ‘teams’ of economic actors, and successful managers must resolve ‘team production problems.’36 Each team member makes firm-specific investments. Investors in equity are one such group, but they are by no means the most at risk, or even the most essential. From this perspective, workers are equally significant, and often at comparatively greater risk (because not diversified). Boards must facilitate the trust necessary to ensure productive cooperation; in so doing they balance the interests of multiple constituents inside and outside the firm. At the least this is a call for greater employment protection. But it also implies that corporate governance should be—and already is—about more than shareholder value. I return to this view below, on page 53.

5. Competition for portfolio investment and incorporation

When overseas investors buy shares on a national stock exchange, companies benefit and the balance of payments improves. In an age of deregulated financial flows, countries compete for this kind of portfolio investment. They are likely to do better if

36 Blair and Stout, "A Team Production Theory of Corporate Law."
their governance system is investor-friendly—if the rewards are likely to be high. Less obviously, the quality of the legal system itself should be attractive to mobile managers and investors. Even in this globalized age, companies must incorporate in some national jurisdiction. They have a choice of venues in which to incorporate and exchanges on which to list shares. Hefty compliance costs burden managers while creating work for lawyers.37 Depending on the elasticity of the demand for corporate domiciles, costly legal regimes may reduce incorporations. Countries, by this logic, compete for companies. This argument gained currency as globalization came to dominate political-economic discourse during the 1990s. It was, again, an argument deployed against stakeholding.

**Economic performance: weak empirical evidence**

It is possible that beyond an essential legal framework of property rights particular governance arrangements do not matter for overall corporate or national performance.38 For individual companies, good governance may be a necessary but insufficient condition for success—or at least for survival. A host of studies now attempts to show that the reforms of the 1990s have improved British governance at the company level. But proving the firm-level link to performance is not easy, and extrapolating to national level outcomes is even more difficult.

37 Furthermore, the quality and complexity of the legal framework of corporate governance may have a marginal impact on overall national economic efficiency.
The evidence from national comparisons is mixed: countries with very different systems did equally well on measures of growth and employment, at least until the 1990s. During the Twentieth Century, both CMEs and LMEs performed well in terms of overall growth rates, although with different distributive consequences. CMEs tend to be more equal than LMEs, an outcome explored in the next section. Britain’s poor relative performance during the post-War period has been linked to myopic financial market governance, but the evidence is mixed. The rewards to shareholders have been comparatively good, and Britain has had little problem attracting international portfolio investment.

Britain has a poor investment and productivity record, however. This led, in part, to the myopia critique discussed above. The experience of manufacturing in particular seems to bear out this view.39 Indeed, British investment rates are low, and its workers have less equipment with which to work than in competitor nations. Together with the US, Britain allocated a smaller proportion of GDP to fixed capital formation in the post-War period than the leading coordinated market economies. Between 1980 and 1997, for example, the UK spent 7.9% of its GDP on machinery and equipment (the same as the US). This was below the figures for France (8.6), Germany (8.5), and Japan (10.9).40


40 Stephen B. Bond, "UK Investment and the Capital Market" (paper presented at the Economic Growth and Government Policy Seminar, 11 Downing Street, London, 12 October 2000), Table 1. Between 1960 and 1997 overall gross fixed capital formation (i.e.: including housing) was more than three percentage points of GDP lower than Germany and France and a good twelve points lower than Japan.
a result, in 1992 the British capital-output ratio was 1.8, compared to 2.0 in the US and 3.5 in Germany.  

Critics of the financial aspects of British corporate governance admire the constancy of CME finance. Historically, CME systems entail ‘relationship investing’ in which owners and financial intermediaries (financiers, including bank lenders and other firms) maintain stable equity holdings or hold long-term loans. More earnings can retained and devoted to investment. Intermediaries also have more incentive to monitor firms and encourage improved performance as opposed to switching their investments to better-run firms. Companies come to be seen less as mere investment opportunities than as socially and politically embedded entities. As a result, managers in the CMEs enjoy a more stable financial environment and may have longer investment horizons. Where monitoring is ineffective they are able to pursue their own interests to the expense of others; where monitoring is effective, the enterprise tends to benefit as a whole.

It is possible that the importance of corporate governance in economic performance may change over time. Different arrangements may be suited to different kinds of product markets and production techniques. For example, companies in liberal market systems enjoy relatively easy access to equity finance and are governed without participation by labor. This enables rapid adjustments to new product market conditions through innovation and cost cutting. Coordinated market governance systems have less ability to change rapidly because they must negotiate adjustment more carefully. They appear to do well in stable trading environments with incremental product changes. The

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41 Ibid., Table 2.
possibility that governance is of variable importance through time limits the appeal of the ‘business-case’ for pro-stakeholding reform in comparison to the power-based arguments I evaluate below.

V. Governance and investor, managerial, and employee interests
If the economic performance connection is uncertain, the distributive impact of governance is much less so.\textsuperscript{42} In this Part, I describe who investors, managers, and employees are; impute their objective interests in governance; and comment on how well the British system serves each.

\textbf{Investors & the shareholder value movement}
There are, broadly speaking, two classes of shareholders. The first are individuals who own shares directly, and the second are the beneficiaries of ‘institutional’ ownership on their behalf—for example by pension funds and insurance companies. Very few individuals directly hold and actively trade shares in UK companies.\textsuperscript{43} Only 2% of household income is derived from investments, together with another 7% from private pensions.\textsuperscript{44} Income from investments is concentrated at the top of the economic scale. The top quintile of households (ranked by disposable income) derived £3070 per year from investment income, compared to £920 for the next quintile and only £240 for the

\textsuperscript{42} O’Sullivan, “Employees and Corporate Governance.”
\textsuperscript{43} As many as eleven million Britons owned shares as the 1990s began. This was up from 3 million in 1979, indicating some progress towards the Conservative goal of a ‘share owning democracy.’ Still, the vast majority had subscribed to the privatizations, and most held only shares in only one or two companies. They were not regular traders, and did not have balanced portfolios. Securities accounted for £451B of total household assets of £5,740B in 2002. The stock market collapse had reduced this figure from £780B in 2000. The 2000 figure, in turn, was up from £340B in 1991. "Social Trends No. 34,” (London: Office of National Statistics, 2004), Table 5.25.
\textsuperscript{44} Ibid., Table 5.4.
bottom.\textsuperscript{45} 33\% of marketable wealth, excluding the value of dwellings, was concentrated in the top 1\% of adults. 86\% of wealth was owned by the top quarter, with \textit{only} 3\% held by the bottom half of the population.\textsuperscript{46}

By contrast, the great majority of people with an interest in equities are invested through financial intermediaries. These are ‘institutional investors’ such as pension funds, insurance companies, and investment companies. As of 2002, these large institutional investors owned fully half of UK listed shares.\textsuperscript{47} Foreign investors now own a further third.

What do shareholders want? They have an abstract interest in increasing the value of a company’s stock and in maximizing dividends over some preferred time horizon. But since this potentially conflicts with managerial interests (or abilities), they also have a secondary interest in improving corporate governance. They will want influence over managers and enough information to manage risk. However, collective action problems mean monitoring and influencing company management is not rational for most shareholders. Liberal Market governance, as I discussed above, helps resolve this problem through facilitating diversification and takeovers of badly managed firms. Investors hold small amounts of shares in many companies and trade these shares when managerial competence is in doubt (signaled, perhaps, by declining share prices). This is the ‘exit’ option—in New York, the Wall Street Walk.

\textsuperscript{45} Ibid., Table 5.18.
\textsuperscript{46} Ibid., Table 5.26.
Managers

The managerial class includes company executives and board members, including non-executive directors of firms. Their personal economic interest is financial, and they have a notorious ability to command ever more generous pay. More than this, perhaps, managers like to be their own masters: they crave autonomy in the guise of flexibility. As such they oppose interference from investors, employees, the state or other authority that threatens their autonomy. They oppose expanded oversight of board organization, efforts to rein in their compensation or regulate their terms of office, measures that make annual meetings more troublesome, increased reporting burdens, or increases in their legal liabilities. Where interventions are unavoidable, they are likely to prefer private over state authority. On the other hand they may welcome state legislation if it makes clearer their duties or reduces risk.

Marxist analysts are highly skeptical of the managerialist thesis: managers are both master and servant in the system, but their overriding strategic goal remains profitability. Their tactical departure from short-term shareholder interest in dividend maximization, for example, does not constitute a transformation of their essential role in reproduction. They remain the antagonists of workers in this account, by virtue of their institutional position if not their ownership of the means of production. Their “basic community of interests” with shareholders overshadows any differences of purpose and

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motivation. This is reinforced by and reflected in their common social milieu and ideologies. More recent business scholars confirmed this view.49

**Employees & stakeholding**

Who are the employees, and why should they care about corporate governance? There were approximately 24.7M employed people in 2001.50 Of these, about 6M worked for the leading, exchange listed FT500 firms. Additionally, of course, many work for companies who serve and rely on the larger companies. Naturally, they will want their companies to survive and prosper; corporate failures hurt employees a good deal more than it hurts most investors. Employment loss is particularly difficult because of lost income, broken social relationships, and the inconvenience of finding new work.51 Employed workers will also care about wages, work organization and employment security.

Governance affects managerial decisions about the way work is organized and rewarded. In shareholder-oriented enterprise managers are theoretically and institutionally driven to “seek better returns from their workers for the wages they pay them.”52 When the bottom line is made clear to them, employers are more likely to view employees as a variable rather than fixed cost. While employment in a market economy inevitably carries risks of lost work and income, these vary substantially along national

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50 *Labour Market Trends*, December 2001, Table B1. This figure does not include self-employed.
The long tenure and functional flexibility of German and Japanese workers (at least males in the largest firms) is related, the argument goes, to the relative patience of investors. In Germany, legal rules mandating participation in governance reinforce this tendency in large companies.

Two arguments from micro-economics establish an *a priori* employee interest in corporate governance. These are the ‘team production’ and ‘implicit agreements’ perspectives. In contrast to the conventional finance view, both deny that companies are theoretically or empirically reducible to contracts between finance and the inputs to production.

*The Team Production argument*

The first is Blair and Stout’s Team Production Theory. Firms are ‘teams’ of production combining the efforts of entrepreneurs, financiers, managers, employers, and suppliers. Each brings to the table capital (human, physical, or financial), and each

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53 Many factors affect employment security, including industry, occupation, race and ethnicity, and gender.


55 Labor market regulations preventing businesses from freely hiring and firing of course affect these differences. But variation appears also to be endogenous to the productive system, specifically to finance and the corporate governance system. For a review of the issues, see Christoph F. Buechtemann, “Introduction: Employment Security and Labor Markets,” in *Employment Security and Labor Market Behavior; Interdisciplinary Approaches and International Evidence*, ed. Christoph F. Buechtemann (Ithaca, NY: ILR Press, 1993). Note also that workers in the Liberal Market Economies arguably benefit from the dynamic nature of the economic system overall, but they may also bear short-term costs associated with commodity status. They benefit from labor market flexibility: they enjoy less employment protection but have greater hiring opportunities assuming they adapt wage expectations appropriately. Note, however, that this benefit will accrue to younger workers more than to older workers. I thank Harvey Feigenbaum for this last point. It is not clear whether this inter-generational conflict is borne out in politics. It does not appear to have been a factor in my case.

bears the risks of enterprise. The key point is that workers who have invested human capital in their firms also face the risks of losing that capital. It may not be fully reflected in current wages. Conversely, if workers invest in firm-specific assets they should also negotiate to protect them through control rights. Finally, to the extent that human capital is more important to the enterprise, investors will need more information about human-capital creation within firms in order to better value and select among alternatives. Employee concerns will become more significant to investors. This view appears to have taken hold among some of the New Labour cognoscenti, suggesting to them that state action might not be needed to improve the lot of British workers.

**Incomplete contracts and implicit agreements**

The idea of ‘implicit agreements’ relies on a similar logic. Labor economists note that employees are often paid less than their marginal product during early years of tenure, and more than their marginal product as their tenure at a company lengthens. This helps both firm and employee invest in training. Since this investment isn’t fully compensated in current wages, it is reasonable for workers to believe their employment will continue. Not included in any formal contract, this is an ‘implicit agreement’ between management and worker. The worker is less likely to shirk and more likely to stay with the firm. Managers and shareholders can exploit this situation by laying-off

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older workers, thus gaining for themselves the unpaid deferred compensation. They have an incentive to renege on the implicit contract just as workers begin to recoup this early investment. During times of corporate restructuring the protections offered by internal labor markets (seniority principles, internal promotion, etc) break down.\(^{59}\)

*Employees and stock ownership*

Worker’s indirect ownership of companies also gives them a stake in governance—where they have savings. Employee saving has long funded the bulk of institutional investment.\(^{60}\) The question is whether they take more interest in increasing investment returns (fiduciary capitalism) or use their ownership stakes to nudge managerial behavior in a more worker-friendly direction. Arguably financial intermediaries—professional fund managers—who do the investing obscure the owner-worker paradox. Fund trustees also have fiduciary requirements in law to act for members *qua* investors, not as workers, consumers, or citizens. Thus, the potential power of equity beneficiaries is not realized in liberal market system beyond their interest in maximizing or protecting returns. Finally, it is worth pointing out that in substantially segmented labor markets there are large numbers of employees who do not have retirement savings. The decline of defined benefit plans and difficulty saving in lower wage occupations—and among the long term unemployed—dilutes the argument that employees as a class

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\(^{59}\) Stone views the corporate restructuring and layoffs of the early 1990s as a systematic violation of this principle. Stone, "Labour Markets, Employment Contracts, and Corporate Change."

have a stake in investor-protection or shareholder value maximization. If there is a pension fund socialism, it is a bourgeois socialism.

*Employees and their governance role*

What kind of voice would workers want? Conventionally they have relied on collective bargaining by unions and state regulation (about lay-off notice periods, for example) to promote their ends. It is reasonable to expect that, should they have a weak position in corporate governance, their organized representatives would welcome state intervention to promote change. The history I recount in Chapter Four bears this out. It is not clear, however, whether employees would welcome greater participation in corporate strategic or financial decision-making, as opposed to issues of day-to-day working conditions and the design and distribution of tasks. There is only limited material available on what front-line employees want and it is not out of the question that they might oppose additional burdens on their time and energies. Traditional attitudes about managerial prerogatives may have faded, but the established specialization of worker and manager in their respective roles presumably raises the costs of greater employee involvement. Advocates of industrial democracy—full and equal participation of workers in enterprise—perhaps assume too much about what is desired by workers. I return to this issue in Chapter Four.

*Power and distribution: how it works and who gains*

As the paradigmatic Liberal Market Economy, Britain serves shareholders well, even where management is strong. While its governance systems were perhaps oriented
more toward protecting shareholders against fraud than growing their wealth, recent private reforms have put it at the top of the investor-friendly league.\textsuperscript{61} Moreover, in contrast to the coordinated market economies, British governance serves owner-interests with minimal regulatory burden to individual shareholders.

Equity market prices and the takeover market are key governance mechanisms rather than active monitoring, oversight and intervention. This is possible because of the shareholder rights regime and the takeover rules. Ownership rights are spread uniformly among different kinds of shareholders. There are restrictions on how far majority, controlling, or large shareholders can exploit their strength at the expense of minority or small shareholders. Stringent insider trading rules and demanding accounting and audit provisions increase market transparency. These factors mean that equity investors can better diversify their holdings, spreading and managing risk by portfolio trading. Companies are more likely to be widely held and actively traded than in Continental Europe. Thus, in France and Germany, four fifths of the largest 170 listed companies have a single investor holding more than 25\% of their stock. This is true for only 16\% of UK companies.\textsuperscript{62} Because most hold only small share stakes, they feel no need to engage in the governance of particular companies, by either close monitoring or voice. The equities market achieves this outcome, possibly more efficiently.

\textsuperscript{61} A widely reported ranking is conducted by the US-based consultancy Davis Global Associates. They rank eight advanced industrial economies on several indicators; Britain is consistently first. Davis Global Advisors Inc., "Leading Corporate Governance Indicators," (Newton, MA: 2002).

Despite complaints about managerialism during the 1970s and 1980s, board structures are also comparatively investor-friendly. Unitary boards combine supervisory and managerial functions. While they are often not as independent from management as some activists would prefer, boards are theoretically responsible to shareholders who can replace them en bloc should the need arise. In law, companies are to be run for the benefit of shareholders.\footnote{Geoffrey Mills, \textit{On the Board} (London: Gower/Institute of Directors, 1981).}

The result of these factors has been good for shareholders. Cassis reports that British companies “consistently produced higher profits than their French and German counterparts and they have achieved higher rates of return on their shareholders’ equity.”\footnote{Youssef Cassis, \textit{Big Business: The European Experience in the Twentieth Century} (New York: Oxford University Press, 1997), 233.} Dividend payments are generally higher as a share of profits than in Germany, for example, and they are more rigid over time than elsewhere.\footnote{Bond, "UK Investment and the Capital Market", 88. On the other hand, dividend ratios do vary through time. They grew from around 15\% in the early 1980s to almost 30\% by 1989 Lucy Chennells, "Growing Dividend Payments," \textit{Economic Review} 12, no. 3 (1995).} Over the long term, the UK’s equities performance does not look remarkable, however. Among markets with similar longevity, the US, Norway, Canada, Japan, and Sweden outperformed Britain. The United States was by far the best performer.\footnote{William N. Goetzman and Philippe Jorion, "A Century of Global Stock Markets," (Cambridge, MA: National Bureau of Economic Research, 1997), Table 1. From one source, Goetzman & Jorion estimate compound real returns from 1921-1995, including dividends, of 8.16\%. Without dividend payments, the figure falls to 2.99\%. Goetzman and Jorion, "A Century of Global Stock Markets," Table 3. Using a different series, they estimate compound returns excluding dividends, over the same period at 2.28\% in real}
1960 to 1980, UK compound annual returns on equities were above the European average (at 10.0% to Europe’s 8.4%), and the arithmetic mean return (14.7%) was the highest for all European countries except Norway.\textsuperscript{68} It should be noted however, that average returns were not significantly lower in the coordinated economies (but were much lower in Italy and France).

Yet managers are not themselves badly served. Leadership tends to be highly individualized and remuneration is very high by comparison to the CME economies. As noted above, they are subject to a lively market for corporate control but they also have relatively easy access to risk capital through equity finance, given the ability to generate the required returns.

If shareholders and managers do well out of British governance, employees do less well. Indeed, workers in the LMEs enjoy less continuous employment with a single employer than those in CMEs such as Germany and Japan. Employee commitment was likely to be higher, for example, under Germany’s model of Diversified Quality Production than under American Mass Production.\textsuperscript{69} By contrast, in the CME economies workers build greater firm-specific assets, and as a result are less easily viewed as a terms. The United States led the world at 4.73%. Goetzman and Jorion, "A Century of Global Stock Markets," Table 1.


\textsuperscript{69} See, for example, the range of production and employment models discussed in Eileen Appelbaum and Rosemary Batt, \textit{The New American Workplace: Transforming Work Systems in the United States} (Ithaca, NY: ILR Press, 1994). Appelbaum and others wanted convergence in the American workplace on best-practice from abroad: essentially more job-security, and longer relationships between employers and workers.
variable cost of production. Managers find it harder to adjust employment levels and other labor market institutions are adapted to this fact.

During the 1980s and 1990s fears arose in both Britain and the US that worker insecurity might be growing. Leading national newspapers and magazines contributed to a pervasive sense that formerly secure workers were threatened by permanent corporate restructuring, downsizing and outsourcing. Many said this was driven not just by global product competition but also by increasingly demanding, mobile investors. The debate coincided first with an aggressive takeover market and then with the shareholder value movement. Managers responded to these financial market pressures without having to build consensus or negotiate with employees. Instead, they reduced costs by cutting employment security. This would have been more difficult had governance been arranged differently.

It should be noted that liberal economists claim that employees—and society—benefit from managerial autonomy coupled with numeric flexibility in Anglo-economic labor markets. Numerical flexibility means companies can increase or decrease their labor costs easily depending on product market conditions and the cost of capital. It is enabled not only by loose restrictions on employment, but also by ensuring that managers do not have to consult workers before firing or hiring. The logic is that this promotes

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allocative efficiency, with the easier job-destruction guaranteeing greater employment creation. It is also possible that managers who cannot fire at will are less likely to hire at will. Britain and the US do have greater job creation, shorter unemployment spells, and lower long-term unemployment than the CME economies.\textsuperscript{72}

VI. The public’s interest in corporate governance: private decisions, social effects

The final argument that governance is politically significant rests on the pervasive influence and effects of companies. In this view they should be governed in the public interest because they are private bodies that have public effects. At the very least, argue some, they should operate with greater regard to the needs of those they affect.\textsuperscript{73} These complaints go beyond problems of under-investment or power inside particular companies to questions of democracy, power and social justice in the broader society. They invoke skepticism about the ability of imperfect (or even perfect) markets to produce social justice. For the late Professor John Parkinson, analyzing company law is:

\ldots a study of the rules that sustain and regulate a mode of decision-making that rivals the market and the democratic process as a mechanism of social choice.\textsuperscript{74}

\textsuperscript{72} A contrary view is that coordinated market governance and stable labor markets are preferable because they promote ‘functional flexibility’ – the ability of workers to adapt to new technology and work organization. The idea is that numerical and functional flexibility are substitutable. The latter would be preferable because of it imposes less risk on workers. Functional flexibility works in several ways. First, the argument goes, consensual industrial relations is more likely if managers and workers know that personnel decisions are a matter of mutual negotiation. Workers will be more willing to adapt to changing conditions. Second, since managers cannot fire and hire at will they will maximize the technological and organizational (that is, functional) flexibility of their work-forces.


\textsuperscript{74} Parkinson, \textit{Corporate Power and Responsibility}, 1.
This view contrasts sharply with the conventional view of companies as profit-maximizers in sovereign markets. Again, for Parkinson,

> Corporate freedom of action is bounded by law (the rights of employees, environmental controls, and so on) and constrained by markets, but within these limitations there is a core of real business discretion.\textsuperscript{75}

**Understanding corporate power**

Large companies exercise considerable social and political power. Its source lies first in the sheer quantity of resources they organize, command, buy and sell. These resources include not only land, primary, and intermediate goods and labor, but also capital itself. Companies and their managers are able to amass and control significant amounts of cash through retained earnings. To the extent that they do so, they even gain shelter from capital markets and investor (stock- and bond-holder) influence.\textsuperscript{76} Secondly, large corporations are frequently well coordinated amongst themselves through contractual arrangements and common directorships. Finally, the international nature of many companies—their considerable foreign output and employment—means they can view the globe as their playing field. This is not yet true for labor or, in many cases, for suppliers and consumers.

Managers’ asymmetrical strength with regard to stakeholders in the firm will vary with macro-economic conditions, in different sectors, and in different parts of production. But even given this, there are direct and indirect effects on broader community. Society

\textsuperscript{75} Ibid., 19.

is affected by managerial discretion over, for example, what product or service to market, where to site an operation, how a plant will be designed, at what point it might close, and which of various competing regions or countries might benefit from any relocation. Industrial concentration multiplies this form of power.

Moreover, these effects extend to consumers. Even absent monopoly and monopsony, firms are rarely pure price takers. Exaggerating consumer sovereignty ignores the ability of companies to shape consumer preferences and create new demand. And even given consumer power, managers make ‘delegated decisions’ about how to satisfy market demands. They must adjust to market conditions but have options as to how they will do so. These options have differing social impacts.

Finally, companies wield considerable influence in the political sphere through campaign finance, lobbying, philanthropy, and marketing. Questions during the 1980s about trade unions’ use of membership money to fund political campaigns were recently matched by concerns about managerial use of ‘shareholder funds.’ If corporate boards aggressively join party-political battles and lobby on policy questions, we have all the more reason to understand what controls them.

Although these questions have recurred throughout the history of advanced industrial nations, recent political-economic change gives corporate power and responsibility new resonance. Declining trade union membership arguably removes from economic contests a key countervailing national institution. The abandonment of laborite collectivism by the Labour Party at the end of the 1980s persuaded some progressives to
look more carefully at reform of companies themselves. As the sense grew that companies would be permitted to pursue their goals within a limited regulatory environment, the emphasis naturally shifted to shaping instead the goals of companies. Single-issue lobbying groups have taken up this challenge, trying to shape managerial commitments to their own ends. Indeed, the scope of corporate effects means almost unlimited claims could be made. They currently range from employees, ecologists, and feminists to racial minorities, human rights defenders, and the public health lobby.

**Using corporate power**

I introduced the ‘managerialist’ thesis—that owners were no longer managers and therefore had to be monitored or ‘governed’ in the interests of shareholders—in Part III above. In Britain, the separation of ownership and control appears to have come later than in the United States, where a large literature grew up around this phenomenon. But in either country it raises important questions.

First, if managers are no longer motivated by their financial investment in the enterprise, exactly what is it that motivates them? Any reform of governance must have some model of managerial behavior and its likely connection to various incentives and inducements. Preoccupied with the idea of principals and agents, finance theorists assumed that managers had their own interests in pay, perks and projects. But because of their deductive abstraction and methodological individualism, they did not tell us much about what managers were actually doing in the real world.
Liberal observers of business put a positive and justificatory gloss on managerial autonomy. Managers, although independent of owners, directed companies broadly in accord with the public interest. In somewhat circular terms, that interest was defined by the functional requirements of advanced industrial capitalism. JK Galbraith’s more critical approach underlined that what managers desired most was autonomy itself. This served their needs better than either the pursuit of profit or even high revenues. Their economic preferences would be for a minimum level of earnings, and then maximum corporate growth (measured in sales). It is not surprising that this both resonated with and reinforced the overriding national—public—economic objective of economic growth. It also facilitated various secondary corporate and public objectives, including technological advance, employment, stock dividends, education, health care. Thus even for Galbraith managerial autonomy was not system-threatening, given the appropriate countervailing institutions. Others observed that companies remain organizationally oriented towards profitability for stock-holders and so are private bodies presumptively free of state interference.

Marxist scholars did not deny the separation of ownership and control, but stressed that generating surplus was still the dominant motive. In Volume Three of Capital, Marx himself anticipated “the transformation of the actually functioning

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78 Ibid., 222-23.
79 Herman, *Corporate Control, Corporate Power*, 245.
80 Note that for Marxist theory managerialism poses several similar problems. First, what are companies for if not to generate a surplus for shareholders (that is, capitalists)? Second, what is the class status of managers, since they are not also shareholders? And finally, is ownership no longer the decisive source of economic (and so, in large part also political) power?
capitalist into a mere manager, administrator of other people’s capital, and of the owner of capital into…a mere money capitalist.”81 Still, Ralph Miliband denied that there was any “coolly detached, public spirited” technocratic managerial elite that was freed from the imperatives of their position within the institutions of capital accumulation. Even if profits were not the ultimate goal for individual managers, as Baran and Sweezy noted, profitability is the necessary means to all ultimate goals. Finally, Miliband cited the American economist J.S. Early’s observation in 1957 that economists, analysts, and consultants making managers more rather than less rational in their pursuit of profit.82 This observation starkly anticipates the clarification of business goals by fund managers during the shareholder value movement of the 1990s.

The status and purpose of manager-controlled companies is an important problem for political theory. If corporations are no longer purely private bodies created for generating profits, how should they be regarded? Liberalism stresses the connection between ownership and the private realm—which should be free of state interference. Clearly sole proprietorships are private in the way that labor power is private until it is exchanged for a wage. Business partnerships result from contractual exchange between individuals and so are also (as entities) private. But what of large, publicly listed corporations? There is only the most tenuous link between the beneficiary holder of a share and the organization and management of production. Does this describe a private, social, or properly public entity? Who is (or should be) in control? The presumption is

81 Quoted by Miliband, The State in Capitalist Society, 29.
82 Ibid., 35.
that private property confers rights to freedom from the coercive (and arbitrary) state, for example. In the Lockean sense, rights stem from the ownership of self and labor power, and they extend to contractual exchanges of labor and accumulated capital. They are protected by the caution that stems from ownership, control, and contract. I consider these issues at greater length in my Concluding chapter.

VII. Stakeholding and governance

The stakeholding perspective (in academia) and movement (in politics) gets around the managerialism problem by acknowledging the plural and social nature of companies. It also explicitly seeks to address the distributive and community impacts of Parts IV and V above. In its academic form, it can be seen as a descriptive, instrumental, or normative position. As description, it implies that companies are more than profit-generating enterprises and that managers (already) balance multiple constituencies’ needs and demands. They do so from a position of asymmetric power. The liberal theory of the corporation—that companies are private entities—hides this balancing act, and this view is hegemonic in UK law and ideology. Stakeholding as description challenges this hegemony.

The instrumental stakeholding position stresses that better cooperation and power sharing with these constituencies is consistent with or necessary for managers’ profitability goals. I explain this position fully in Chapter Two and look for evidence in

Chapter Four. As a normative position stakeholding asserts the Kantian idea that a company’s constituencies are ‘ends-in-themselves.’ Workers and others should, therefore, be full participants in decision-making. This sustains a much stronger notion of democracy than is held in contemporary British or American politics. Making it operational would call for a fundamental reorientation of political-economic theory. I believe this is probably desirable, but is unnecessary. Instead, the case for stakeholding should be made on the effects of corporate power in the community and the consequences of this power for existing politics. I flesh this out in Chapter Five.

As a policy program or movement, the stakeholding project implies a democratization of the large company. It would increase the voice of workers, environmentalists, and others affected by corporate power. Most particularly, it would bring greater—if more diffuse—accountability to managers. It would balance the financial interests of investors with the interests of stakeholders. Although this would dramatically change Anglo-capitalist financial markets, it need not undermine the viability or meaning of market capitalism. Instead it would shift the organizational forms of liberal market economies in the direction of the coordinated market economies (also democracies) discussed in Part II above. In sum, stakeholding comprehends the social nature of companies, expresses the wishes of stakeholders for a share in power, and lays out a program for doing so without destroying capitalism itself. For its proponents it has the virtue not only of ensuring a better (fairer?) distribution of the economic product of
enterprise, but of moderating managerial and corporate power by democratizing capitalism.

**VIII. Conclusion**

Taken together, the analysis of interests and power in this chapter supports a ‘demand-centered’ model of corporate governance politics. Corporate governance arrangements (including policy and market effects) condition managerial decisions, which lead to demands for a policy response. When groups realize the connection between governance and managerial decisions, these demands will include efforts to restructure governance itself. Figure 1.1 sets this out. In the next chapter I discuss the ways economic and political processes might affect how these demands are resolved.
Figure 1.1: A demand model of corporate governance politics

Relative power of investors, managers, and employees/stakeholders

= Corporate governance

⇒ Private managerial decisions and their
Effects on investors, managers, and employees/stakeholders in enterprise

+ 

Public effects (economic, social, and political)

⇒ Demands for accountability

+ 

Demands for new governance arrangements
Chapter 2. Explaining continuity and change in corporate governance

In Chapter One, I explained that corporate governance generates pressures for change by conditioning what managers (and their companies) do. In this chapter I introduce the dynamics conditioning the economic and political resolution of these demands. I want to determine what variables are likely to explain the events recounted in Chapter Three and Four. I turn first to economic explanations.

I. Economics and governance

There are three strands of economic argument that are relevant to my inquiry. One emphasizes investor-manager conflicts, the second brings in employees, and the third environmentalists’ concerns.

The conventional view

In the conventional economic view, corporate structures are the equilibrium or evolutionary result of the search for efficiency gains by voluntary participants in competitive markets. Governance evolves towards better investor protection and
economic efficiency. Capitalists, for example, diversified their portfolios as technological change increased the size and scope of the managerial task. Government intervention is, in this account, neither necessary nor desirable.

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**The neo-classical argument**

Competition between rational holders of financial capital

→ Corporate governance → Allocation

Since governance systems so frequently depart from the market model, however, scholars in this vein have turned to politics for an explanation. Mark Roe’s work is especially notable for being both comparative and political, although it is still strongly informed by the norm of efficiency. Public policy is still conceived as something that interferes or constrains market dynamics rather than an encompassing constitutive activity. Implicitly governments are still likely to disrupt market efficiency. Moreover, his conceptualization of political variables is weak in some points and he neglects (in his latest work) the role of interest group coalitions. A plausible political account of

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corporate governance will need to examine more than the ideology of governments (conceptualized by Roe on a simple left-right spectrum) and conflicts between capital, labor, and managers. Gourevitch suggests two additional variables: interest group activity which may cut across class divides, and political institutions (electoral laws, federalism, legislative systems-executive relations, and party systems). The literature I review later in this Chapter informs my approach to these matters.

The central problem with explanations derived from neo-classical economics, however, is that they obscure power. They replace the idea of coercion with the value of choice. Constraints in their account are based on the fundamental notion of universal scarcity, and this drives their concern for maximizing efficiency. Allocative efficiency will ensure that scarce resources are employed to produce the maximum societal utility. However, they are less sensitive to the distribution of constraint and opportunity, and the ways these are reproduced by markets. Only rarely and in textbooks do markets disperse power.

The progressive view of human capital in economic theory

The second strand in economic analysis is much less widely held. This is the progressive economic argument, and it helps sustain a ‘business case’ for stakeholding

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86 Gourevitch, “Book Review: The Politics of Corporate Governance Regulation: Political Determinants of Corporate Governance by Mark Roe,” 1835-6. I also drop the efficiency assumption, since it plays down the distributive aspects crucial to political economy and ignores the fact that it is not a central value in politics (although it may be in policy analysis—see David L. Weimer and Aidan R. Vining, Policy Analysis: Concepts and Practice, 2nd. ed. (Englewood Cliffs, NJ: Prentice Hall, 1992).)

reform: stakeholding will increase efficiency and the economic product, as well as distributing it more fairly.\textsuperscript{88}

I discussed the relevance to employees of the ‘team production’ and ‘incomplete contracts’ approaches to companies in Part V of Chapter One above. They imply that market dynamics should produce employee friendly governance in companies as human capital (intellectual labor) becomes more important in producing economic value:

As human capital grows in importance…we can expect its owners (the employees) and their individual and collective agents to seek greater influence and power in the key decisions that affect the organization.\textsuperscript{89}

Moreover, participatory governance and stable employment should be functional to the ‘team’ as a whole. Blair argues that the economic value added by companies is increasingly related to human rather than physical capital.\textsuperscript{90} This trend has long been underway in the heavily service-oriented UK. As I show in Chapter Four on stakeholding, evidence of increasingly flexible or risky employment relations challenges these expectations. And as Blair acknowledges, (for the US case) workers are receiving

\textsuperscript{88} Another version of the ‘business case’ is simply that doing good business already requires managers to consider carefully employee and environmental impacts. By extension, the argument goes, stakeholders should be included in decision-making. This argument is frequently accompanied by claims that best practice on this front is emerging and so legislation is not necessary.

\textsuperscript{89} Appelbaum and Berg, "High Performance Work Systems: Giving Workers a Say," 23. Looking across different industries, Blair suggests that human-capital-intensive firms tend to be structured as partnerships or have greater employee ownership. These forms should be spreading as managers and entrepreneurs seek to attract and retain labor.

\textsuperscript{90} Ibid., 1. Writing at the end of the 1990s, Blair claims that the excess of market over book-valuations of companies indicated that property, plant, and equipment were relatively less important to value-creation than human capital. She appears to discount the bull-market’s general effects on company values. When transformed into inflated asset prices, perhaps ‘irrational exuberance’ is itself a form of human capital, albeit fragile.
less of the benefits of enterprise and bearing more of the risks. As she notes, focusing on dynamics within enterprise or markets neglects the ways these trends interact with politics as powerful groups try to minimize their losses from change or their misunderstandings about what produces value.

The progressive economic argument

<table>
<thead>
<tr>
<th>Competition between companies + growing importance of human capital in corporate product</th>
<th>manager &amp; investor driven reform of corporate governance arrangements</th>
<th>Stakeholder-empowerment</th>
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</thead>
<tbody>
<tr>
<td>Stakeholder-empowerment</td>
<td>New distribution</td>
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We can explore this prediction by tracking whether, in fact, business is introducing greater employee involvement, and whether they support or oppose reform on this basis (as opposed to arguments about flexibility or the legitimacy of state interventions in business affairs, for example). I evaluate this view in Chapter Four.

Risk and governance

The third argument relies on the risks posed by ecological, social, and labor impacts and/or regulatory non-compliance. These risks are financial and legal (the costs of disaster or regulatory non-compliance) and reputational (the public relations problem associated with poor environmental and social performance. These risks are increased for companies by ecological, labor, and human rights activists who monitor companies (perhaps not in the most systematic way) and campaign against firms they perceive are

91 Ibid., 3.
behaving badly. Recognition of the risks by managers and investors, and of the substantial costs posed by neglect, should lead to organizational innovations which monitor and reduce the chance of disaster or non-compliance. This is the equivalent of financial internal controls. It may involve, for example, hiring environmentalists and regulatory specialists to audit the company’s operations and report to the board and/or public. Effectively it brings environmental and social concerns into the company and modifies the incentives facing managers. It is therefore a form of corporate governance.

**Risk and pro-environmental governance**

Environmental activism + Environmental regulatory oversight

→ Enhanced financial, legal, and reputational risk

→ manager & investor driven reform of governance forms

→ new distribution of power in company

**II. Politics and authoritative change**

The arguments I discussed in the previous section place market before politics in determining governance structures. I will evaluate their claims in my empirical chapters. I turn now to political variables.

States “formally constitute corporate governance institutions that mediate the opposing interests and the power relations within the corporation.”

92 Law defines corporate forms and establishes requirements on accountability and decision-making within firms. As I noted in Chapter One, for example, large companies in the

Coordinated Market Economies must include employee representatives on supervisory boards, while Liberal Market boards are solely accountable to shareholders. Thus, British law is clear that directors’ duties are owed to the company—interpreted as meaning the ‘members’ or shareholders of the company. These direct legal effects mean that, in large part, corporations exist in their present form because the state allows them to. And although they may choose not to, state elites can restructure power within companies. In shorthand, and ignoring for the moment what explains state policy:

<table>
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<tr>
<th>The state and corporate governance</th>
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<tr>
<td>State ➔ Corporate governance</td>
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<tr>
<td>➔ Distribution (at company &amp; societal levels)</td>
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This view has the democratic advantage of putting governance arrangements, and therefore distributive outcomes, at the heart of the polity. It is politics that determines the boundaries of public and private.

In addition to direct statutory effects of governance policy, policies in related arenas affect governance. Two instances are important. First, state dismantling of cross-border financial flows has internationalized share ownership. In the UK, this led to dramatically increased foreign ownership during the 1980s, to reforms in the City that kept London competitive with other financial centers, and to the breaking of the private regulatory arrangements historically dominant in the City. It helped produce a convergence in market expectations if not yet in returns. And it exposed British
managers to US pension fund managers bent on improving board performance. Second, Conservative privatization of UK utilities during the 1980s produced new share-owning opportunities and brought the logic of shareholder-value maximization into some of the countries largest companies. New management teams were installed, with much higher salaries and bonuses. This, in turn, exacerbated public dissatisfaction with executive pay in the UK and produced a policy response, first by the Conservatives and later by Labour.

Conventionally these kinds of policies are not considered a part of corporate governance, especially if governance is narrowly conceived as the domain of company law. They result from macro-economic policy choice and the need for state revenue (in the case of exchange controls and privatization). From the perspectives of company lawyers (and domestic managers) they produce spillover effects and unintended consequences. However, we might view them instead as elements in a wider pro-investor trend in economic policy. They each work together—with developments in company law—to improve the advantage of investors. They constitute both an assertion of investor power (because financial institutions supported the policies initially) and an enhancement of that power (because it increases their leverage in corporate governance).

Political institutional sources of conservative adaptation

The point, of course, is to explain when politics matters, and how. The varieties of capitalism literature (introduced in Part III of Chapter One) stresses how economic and political institutional arrangements work in favor of the status quo and conservative adaptation to new conditions. This might work at two levels: the political systemic level
(majoritarian versus proportional systems) and the political-economic level (secondary institutions, such as taxation, corporate governance, labor markets).

Governance structures apparently have deep historical-institutional foundations. These appear to coincide with the broad differences identified by the ‘varieties’ scholars discussed in Chapter One. Majoritarian governmental systems, for example, produced liberal market economic governance, while organized market economies arose in proportional systems. This, Wood argues, is consistent with the fundamentally different capacities for forcing change in the two systems. Majoritarian parliamentary governments are comparatively unconstrained by the need to negotiate compromises of the sort involved in proportional systems. Proportional systems, by contrast, prevent dramatic change because coalition building encourages compromise. Participants trust that evolved power-sharing arrangements in the political economy will be maintained. In the majoritarian systems, capital and labor cannot rely on the government to maintain its side of the bargain and therefore resist experimentation and innovation.

Paradoxically, then, while the majoritarian system contains the possibility of great change, its secondary political-economic institutions are shaped by powerful interests to prevent such changes. We can include among these arrangements the private or

95 It is not clear if this analysis is borne out in the US case. There are a wider variety of institutional opportunities for intervention in the US polity, for example at the various branches of the federal government and the different levels of federalism. These can be seen as either veto points or as points of
private-franchise approach to regulation. Self-regulation or quasi-public regulation insulates the regulated industry from political vicissitudes of strong states. In turn, this increases the political will required to implement deep reform, because it involves threatening entrenched institutional interests (and attitudes) as well as powerful economic interests.

Interdependencies between secondary political economic institutions pose a more proximate constraint. As I explained in Chapter One, the features of economic systems work together to produce economic success and sustain particular power relationships. Thus, for example, tax policy may make dispersed shareholding less attractive (as in Germany). Solutions to one problem influence which solutions are best to the others, and so institutional complementarities evolve together and are stable over the long term. It follows that, in terms of the questions I am asking here, we would expect little fundamental change in corporate governance or its distribution of burdens and benefits. There is empirical support for this conclusion. Dominant interest group and ideational coalitions block change and promote conservative adaptation instead. Vitols sees

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96 Some adopt the analytical metaphor of path dependence to establish the micro-foundational reasons for institution-induced stability. Pierson explains that positive feedback effects lead actors to reproduce interdependent and complementary institutions Paul Pierson, "Increasing Returns, Path Dependence and the Study of Politics," *American Political Science Review* 94 (2000). Path dependency theory thus suggests the following: often small, transient events with contingent outcomes have long term effects that are economically sub-optimal. The historic, system producing event is replaced by an ongoing, system-reproducing logic of increasing returns. This logic explains why actors do not wish to change their institutions. Exogenous shocks provide critical junctures which explain change when it does occur. Without a critical juncture—usually exogenous, though not necessarily dramatic—change will be evolutionary along an existing ‘path’ or direction. Deeg suggests that new paths arise when “the incentive structures for key actors and patterns of strategic interaction among them within the sector have changed significantly” Richard Deeg, "Institutional Change and the Uses and Limits of Path Dependence: The Case of German Finance," (Koln: Max Planck Institute for the Study of Societies, 2001).
incremental improvements in Britain and Germany designed to maintain or adapt existing advantages.\textsuperscript{97} Ziegler argues that externally provoked change in Germany builds on local institutions and interests but that ultimately adjustment hinges on ideational contests about the purposes of industrial enterprise.\textsuperscript{98} Institutional divergence is thus sticky across a range of governance concerns because of local group preferences.\textsuperscript{99} Dramatic change, it follows, would require new interest group and ideational coalitions and the willingness of reformers to address interdependency.

The power of coordination

Although the ‘varieties’ authors do not make the link, their analysis is similar to Russell Hardin’s conceptualization of political constitution-making as a coordination problem.\textsuperscript{100} Both are broadly functionalist and strategic, both emphasize the benefits to coordination, and both emphasize stability.\textsuperscript{101} Hardin argues that constitutions (like liberalism and democracy more generally) are about creating and sustaining social order. They establish a framework within which social and political disagreements can be peacefully resolved. They also permit settlements of disputes about economic contracts. Establishing this framework is a coordination problem between the dominant groups

\textsuperscript{97} Vitols, "Varieties of Corporate Governance: Comparing Germany and the UK."
\textsuperscript{98} Ziegler, "Corporate Governance and the Politics of Property Rights in Germany," 215.
\textsuperscript{99} Cioffi, "Governing Globalization: The State, Law, and Structural Change in Corporate Governance."
\textsuperscript{101} The ‘varieties of capitalism’ approach is based on a marriage of economic functionalism and strategic interaction between investors, managers, and employees. It is functionalist because it notices that economic production entails common problems of cooperation and control, and makes the not unreasonable assumption that contemporary institutions are at least in part adapted to solve them. These arrangements survive, roughly speaking, because they serve some economic purpose. However, the ‘varieties’ literature is strategic because it assumes that the solutions to these problems arise from competition between broadly rational, self-interested actors (managers, investors, employees, different parts of the state, and others). This competition for advantage and position plays out in both the political (i.e.: governmental) and the private (economic) realms.
(usually those who want to settle problems peacefully) since each will benefit from resolving the problem. Since the major groups benefit, and since change brings uncertainty, dramatic structural reform is unwelcome and unlikely.

### Institutional Coordination

Negotiation among powerful interests (‘constitutional moment’)

- Agreement on institutional arrangements to enable future exchanges
- Order (reproduction of existing power relations)
- Economic and political exchange

Neither Hardin’s view of constitutional settlements or increasingly popular path dependence views confront power directly. ¹⁰² Like other micro-economic theories, they offer parsimonious explanations for abstracted exchange. But they obscure the fact that these structures are pervaded by power. Acquiring and retaining the resources exchanged is a matter of power and the structures that precede exchanges. ¹⁰³ The contingencies from which path dependency theorists suggest conjunctural change can spring are not themselves independent of structures. Nor, as Hardin recognizes, are the situations in which parties agree their coordinating arrangements. ¹⁰⁴

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¹⁰² On path dependency in the varieties of capitalism literature, see footnote 96.
¹⁰³ Schwartz, Herman, "Down the Wrong Path: Path Dependency, Increasing Returns, and Historical Institutionalism," (Charlottesville, VA: Unpublished manuscript, 2004). On file with author. Schwartz comments wryly that the concept of path dependency has enjoyed increasing returns in political science as a linguistic short hand for institutional stasis. However, he says, increasing returns may be characteristic of language—since the more folks that use the term, the more value the term has—they are a not pervasive feature of political interaction.
¹⁰⁴ For Hardin it is generally the powerful economic groups that must agree. Systemic transformations that threaten these groups are ruled out prior to and as part of the agreement itself. I return to this critique in my concluding chapter.
Perhaps the problem is one of grand theory. Hardin and the ‘varieties’ authors privilege social and economic order. They follow Mandeville, Smith, Hobbes, and the public choice school in viewing social order as a matter of social exchange rather than, in the Marxist tradition, essentially coercive or, as for Locke, Durkheim, and Parsons, derived from shared values. I return to these questions in my Concluding chapter.

**Pluralism or structural power in business politics?**

What is necessary, then, for change? And what other factors restrain it or channel it to the benefit of one interest over another? The latter question returns us to power. This matter was explored by the debate between pluralists and those who emphasize the structural (i.e.: economic and ideational) power of business in capitalist economies.

On the one side, neo-pluralists observe that organized participant interests can shape policy where they are mobilized and build coalitions to pressure governments. Their empirical work suggests that neither capital nor its component parts consistently win policy battles, despite their obvious resource advantages.\(^{105}\) Even diffuse interests can organize, and when public pressure is correspondingly high they can produce dramatic policy changes regardless of institutional context.\(^{106}\) Thus, pro-stakeholder groups might organize to promote their interests and ally with some existing groups to alter policy on an area of intense concern to them. This interest group lobbying and countervailing mobilization should, according to the pluralists, influence policy-makers’

\(^{105}\) Vogel, *Fluctuating Fortunes: The Political Power of Business in America.*

\(^{106}\) Vogel, "Representing Diffuse Interests in Environmental Policymaking." Vogel compared environmental policy in parliamentary and divided-government systems. His cases were Britain, Japan, and the United States.
decision-agenda and the decision itself. The pluralist explanation would be cast into
doubt for this case if a reasonable degree of mobilization were not followed by reform in
their favor. The same would be true if groups mobilized against a restructuring of
authority but were unable to prevent it.

<table>
<thead>
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<th>Interest group pluralism</th>
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<tr>
<td>Interest group mobilization → Debate and accommodation to Government preferences →</td>
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<tr>
<td>Sate governance policy → Possibility of new distribution</td>
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A contrary view is offered by early American critics of pluralism such as Charles
Lindblom, and, in Britain, David Marsh and others.\(^{107}\) Lindblom, Marsh and others
cautions that neo-pluralist approaches are insensitive to economic and institutional power
because of their focus on overt contact between business and government.\(^{108}\) Business is
powerful, as Lindblom famously pointed out, because of its financial resources in
politics, its economic strength, and its ideological hegemony. The economy’s dependence
on business investment and job creation make this power structural. Threatened by
reform, business spokespeople would relate their objections to the wider economic goals
of the government: macro-economic or productivity growth, international competition,
and employment creation. They might threaten capital flight. This famously produced a
reversal of Francois Mitterrand’s democratic-socialist reforms in France during the early

\(^{107}\) For a review of the pluralist tendency in British policy studies, see Marsh, "Pluralism and the Study of
British Politics: It Is Always the Happy Hour for Men with Money, Knowledge, and Power."

\(^{108}\) Wyn Grant, Business and Politics in Britain (Basingstoke: Macmillan, 1987).
1980s. Governments are likely to weigh more carefully the cautions and threats of an economy’s managers than those of its employees.\textsuperscript{109}

In sum, government’s interest in economic growth and competitiveness precludes reforms that threaten the ability of business to operate profitably. The ‘public’ interest and business interests become closely identified. The threat of capital flight (overseas) or capital strike (at home) reinforces this identification. This does not mean that policy is determined, however. It does increase the political will required by reforming governments. I return to this problem in the final chapter.

Note that, for the structuralists, political \textit{is} does not imply economic \textit{ought}: the question is not whether investors and managers are right or wrong about negative economic consequences of reform. Investors and managers may be right when they claim that adding employee directors to boards would be a disaster for economic health of companies and the nation (given current understandings of economic health). The structuralist argument is that these claims inevitably carry greater weight with government and, crucially, that both investors and managers are in a position to realize these consequences. They can stop hiring or move elsewhere.

\begin{table}[h]
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\begin{tabular}{|c|c|c|}
\hline
\textbf{The structural argument} & \\
Company power (political, ideological, economic) & State governance policy & \\
Preservation of power at the company level & Preservation of existing distributions & \\
\hline
\end{tabular}
\caption{The structural argument}
\end{table}

\textsuperscript{109} Although this will vary with conditions in the industrial relations system and labor market: workers are stronger if extensively and cohesively organized or in a tight labor market. Obviously environmentalists are in an even weaker position.
The structuralist case is strong, but the pluralist emphasis on associational activity is also well founded. Some policy areas see greater competitive pluralism than others, and this changes over time.\textsuperscript{110} The organization of stakeholders into interest groups for advocacy purposes is arguably the most directly observable manifestation of political competition in periods of policy change. Interest groups figure large in both Mark Roe’s study of American corporate governance regulation and Davis and Thompson’s account of shareholder mobilization in the American states.\textsuperscript{111}

Interest group activism, of course, increases during times of economic or governance crisis, and when political leaders and entrepreneurs attempt to mobilize support. Baumgartner and Jones demonstrate that policy stability can be ‘punctuated’ by change when ‘slack resources’ (normally excluded groups) are mobilized.\textsuperscript{112} This often involves new issue definitions and venue shifting.\textsuperscript{113} Comparative historical analysis suggests that crises of legitimacy spark dramatic policy conflict. O’Sullivan’s review of Twentieth Century employee challenges to governance systems bears this out. Debates about employees’ role occurred when employers were “seen to be advancing their

\textsuperscript{112} Frank R. Baumgartner and Bryan D. Jones, \textit{Agendas and Instability in American Politics} (Chicago, IL: University of Chicago Press, 1993).
\textsuperscript{113} For example, the US merger boom of the late 1980s and early 1990s, was associated with asset stripping and mass layoffs. In many states it sparked successful worker-manager coalitions demanding legislative relief. The result was ‘stakeholder’ statutes permitting boards to consider the impact of merger on employees. Whether or not the measures worked, they are an example of redefining governance as an employee-relevant problem and shifting from the federal labor regulation venue to state corporate governance venues. The subsequent nation-wide fall in unemployment to post-War lows reduced the salience of the issue.
interests at the expense of society;” when they were “deemed to have used their power in ways that actively embraced or passively promoted non-liberal values;” when managerial power (as opposed to owners’ prerogative) was seen to be exaggerated; and when anti-authoritarian movements targeted work organization. These challenges tended to coincide with war and depression; their success helped shape the CMEs.

New interest group coalitions may also emerge because of less dramatic or longer-term economic changes. This is the thesis of some recent comparative scholarship on corporate governance. Gourevitch and Shinn argue that a diversity of coalitions is possible, and that these cut across conventional class lines (capital vs. labor) or those cleavages conventionally analyzed in the finance literature (investors vs. managers; managers + investors vs. labor). Most relevant for my study is the coalition between investors and labor against managers, which Gourevitch calls the ‘transparency coalition.’ Both workers and investors benefit from increasing the amount of information available to markets (although intuitively it would seem that shareholders have more to gain). Workers benefit from knowing more about the health of their company, and more importantly because of their ownership stake (as pension fund beneficiaries) in corporate governance. The question is how significant this coalition is in promoting stakeholder interests. The evidence in my descriptive Chapters 3 and 4 suggests that, first, the coalition is present on some reforms but weak overall, and second, that it does not

114 O’Sullivan, “Employees and Corporate Governance,” 118-19.
115 Gourevitch and Shinn, "Explaining Corporate Governance Systems: The Role of Politics."
116 Although perhaps less relevant for the UK case, where minority shareholder protections are already high, workers in the Coordinated Market Economies also support other pro-investor reforms.
produce dramatic gains for workers (although it may help guard the retirement savings of those who have them).

**British Governments and the constitutional capacity for change**

Interest group mobilization occurs within constitutionally bounded polities and relies on the ability—as well as willingness—of government ministers to respond to their demands. From a political institutional standpoint, the British state is very strong. Wood identifies two factors: constitutional power and political constraints. Wood notes that the British state has unmatched formal constitutional power among advanced industrial powers.\(^{117}\) This power is grounded in the doctrine of parliamentary sovereignty and plurality elections to the House of Commons which can generate large majorities. Cabinet government, recently highly centralized in the office of the Prime Minister, means the unitary executive can steer the government effectively. Moreover, normally the political constraints on British governments are also low by comparative standards. Opposition parties are relatively powerless, party discipline is ruthlessly enforced, cabinets are autonomous from parties, and the social partners are poorly organized.\(^{118}\) While companies have structural power (as explored by Lindblom), business associations

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\(^{118}\) Recent history bears out this view. As Richardson argues, policymaking has become “more fluid, unpredictable, and less controllable” than might be suggested by network models commonly used to describe British policymaking Jeremy Richardson, "Government, Interest Groups and Policy Change," *Political Studies* 48, no. 5 (December) (2000). The Thatcher administrations were able to seize agenda setting and policy initiation powers from established networks in a variety of areas.
are not highly institutionalized. For Wood, British capitalism is characterized by an unconstrained state and uncoordinated business.\(^{119}\)

The traditional ‘Westminster model’ of UK policymaking supports Wood’s argument. This organizes explanation around parliamentary sovereignty, ministerial accountability to an elected House of Commons, and the implementation of cabinet decisions by a neutral civil service. Different parties pursue different policies—for ideological or electoral reasons—and where ministers have a large Parliamentary majority the model predicts considerable capacity for change. As Hay explains, the Westminster model has major flaws. It neglects different kinds of regulatory authority deployed by the state, is insensitive to international and historical context, and most importantly, underplays the economic and ideational variables that I explore below. Still, its caricature underlines the comparative strength of the executive of the UK state.\(^{120}\)

**Broader regulatory change**

Examining financial *and* corporate governance regulation, John Cioffe argues that historical institutionalist scholars underestimate market and legal changes, in both the Liberal and Coordinated market economies.\(^{121}\) Moran concurs, seeing on an even

\(^{119}\) The paradoxical result is that capitalists demand that the state keep labor weak and structure incentives such that the labor market is flexible.

\(^{120}\) Comparing neo-liberal policymaking on both sides of the Atlantic during the 1980s make this clear. Thatcher’s cabinets had significantly more ‘decisional authority’ than any American incumbent. In the latter case, a Madisonian constitution “disperses power, limits the reach of the state, and inhibits legislative radicalism” so reinforcing liberal market governance structures. There are more veto points. Compared to the UK, the American neoliberal project was considerably more politically constrained. Wood, “Business, Government, and Patterns of Labor Market Policy in Britain and the Federal Republic of Germany,” 274..

\(^{121}\) The “use of law and regulation to structure markets and firms (in other words, markets and hierarchies) is becoming an increasingly important and perhaps dominant mode of state intervention in the advanced industrial economies” Cioffi, "Explaining Retrenchment: The Regulatory Politics of Corporate Governance
broader scale the rise of a new, ‘regulatory state’ . This is gradually displacing the laissez faire and privatized British regulatory tradition. It entails, for example, new statutory regulations of the accounting profession. Henry Laurence also sees Britain converging on a more formalized regulatory model of investor protection—typified, for him, by the US Securities and Exchange Commission. Cioffe makes the interesting case, moreover, that the governance reforms are being led by center-left governments, although he does not extensively address the British case in his recent work.

What might be driving these developments, and whom do they serve? They began even before the 1980s. London’s dominance of Euromarket bond trading in the 1960s brought new and foreign trading firms to the City. This made norms-based, informal and privatized regulatory arrangements more difficult to sustain, arguably leading to the re-regulation of the 1980s . The ‘Big Bang’ deregulation of financial markets in the mid-1980s was quickly followed by new, pro-competitive regulation . Vogel and Moran argue that they resulted from domestic ideological factors (the liberalizing impulse of Thatcherism) and interest group pressure (the need to ensure that competition was preserved in liberalized markets, and that Britain was competitive in its investor protection). International market developments certainly also promoted both moves: the UK needed to improve its ability to compete in international markets and had to respond to new entrants into its own market. For Laurence, the extension of regulation is a response to domestic interest group pressures, which in turn result from the internationalization of finance. In order to retain business, non-mobile domestic interests

Reform and the Foundations of Finance Capitalism", 575.
(such as banks) had to ensure that mobile interests were well served. Thus, the capital exit option changed the domestic policy calculus. These factors strengthened the City of London as an attractive financial center and served domestic and international investors well. Thus, the conventional interest groups—investors and financial services providers—pressed the state for new regulatory arrangements.

Moran cautions that these changes presage agenda expansion and regulatory creep. This occurs because of the formalization and politicization of formerly closed regulatory arenas. Institutionalizing regulation, whether through statutory or private codification, may start a self-reinforcing dynamic:

> Once financial regulation is ‘politcized’ there exist numerous individuals and institutions ready to seize on any regulatory failure to ask awkward questions…shape policy and…invade new spheres of jurisdiction.\(^{123}\)

State involvement can lead to Parliamentary oversight, for example. It might attract greater participation—or calls for greater participation. With institutionalization may come new groups to enter regulatory arena and demand relief. Organizations devoted to regulation are more likely to be targets of these pressures than informal networks of self-regulating actors.

The evidence thus points to a capable state and a state of change. New regulatory institutions in related areas of financial services indeed presaged similar changes in

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\(^{122}\) Laurence explained that holders of immobile assets demanded financial market reforms—reforms that would favor those with mobile assets—in order to prevent capital flight. Capital flight would have meant a lost customer base for those unable to flee. Hence, the logic of liberalization affected even those who might logically stand to lose.

\(^{123}\) Michael Moran, *The Politics of the Financial Services Revolution: The USA, UK, and Japan* (New York: St. Martin's Press, 1991), 18. “The more open and pluralist the political system, the greater the danger to the mystifying power of ideology and to the privileges of the meso-corporatist order”
corporate governance. These include, as Moran foresaw, agenda expansion that brought new social goals (ie: stakeholding) to governance. But why might these not have been carried to fruition? What might explain the refusal of Labour to do more for stakeholders and less for investors?

Policy makers and ideas

Why, and for whom, do Governments choose to use—or not use—their considerable potential? Policy makers do more than respond to interest group demands and public opinion. They bring their own ideas to office and must calculate when to implement these ideas. Governments must want reform and be willing to overcome the very considerable obstacles identified in previous sections. Their commitment will depend on some combination of world-view (is reform consistent with or demanded by our broader projects?), forward looking electoral calculation (will reform be popular at the next election?), and balancing of other priorities (what else must we do with our limited parliamentary time and political capital?). Ideology affects each of these.

For over a decade ideational explanation has been a growth stock in comparative politics. Hansen and King identified four distinct categories of ideas in the relevant literature: culture (“broad, shared understandings”); expert knowledge (within epistemic communities); solutions to collective action problems (abstractions such as class and religion that provide social identification); programmatic beliefs (with direct policy
The most important in governance are the culture and knowledge of the community and the programmatic goals of ministers.

Broad understandings include cognitive boundaries that mark politicians, interest groups, citizens and experts on such questions as the proper boundaries of public and private action. Together with the state of knowledge in the policy community, they condition how elites will interpret a problem and connect this to feasible solutions. I explore this at length for investor protection in Chapter Three, Part II. The dominant view of governance as it relates to the stakeholders was described in Chapter One, Parts III, IV, and V.

Dramatic policy shifts may occur with the exhaustion of prevailing programmatic policies when they coincide with the availability of new paradigms. Thus, alternative understandings or new knowledge must be available. These might be produced by academics and think tanks, and subsequently taken up by political leaders. Where they gain office they can be forced on a policy community through changes of personnel or organization—as did the Thatcher Governments on economic policy, for example.

But changes of government may not be followed by new ideological commitments. Labour showed no belief that the system was fundamentally broken, on either investor protection or stakeholding. That said, Labour’s rhetoric was more aggressive in opposition and there was intellectual support for stakeholding in New

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125 Peter Hall, "Policy Paradigms, Social Learning, and the State the Case of Economic Policymaking in Britain," *Comparative Politics*, April (1993).
Labour circles. I trace this support in Part IV of Chapter Four. Ministers might have developed the programmatic commitment once in office. The Company Law Review and Enron/WorldCom events gave them the opportunity to do just that. In a sense, stakeholding offered an alternative paradigm for governance.

But despite driving interesting historical studies, efforts to identify when and how ideas matter have not produced profound conclusions. For example, Hansen and King argue that interests will have policy impact when “there is a synergy between ideas and interests,” when actors have “the requisite enthusiasm and institutional position,” and “when timing contributes to a broad constellation of preferences reinforce these ideas.” Thus, they conclude, interests, institutional position and timing matter too.

The state/cabinet government approach

Neil Mitchell provides useful guidance on this front. In explaining why business sometimes loses in policy battles, he takes the goals of leaders seriously, but tries to specify when leaders choose to implement these ideas in the face of business opposition. Mitchell describes three moments when this happens. The first two are very rare: when the political system is threatened, and when policymakers are suddenly indifferent to public opinion (what he calls “two-o’clock-in-the-morning heroism,” because leaders idiosyncratically decide to do what they know will be unpopular). More commonly, business loses control over elite and public opinion because of some destabilizing event and mobilization by anti-business groups. This entails a loss of business legitimacy, whether legal, ethical, economic, or cultural. Policy leaders, at this point, may undertake
‘calculated heroic’ policy leaps and momentarily suspend politics as usual. The result is dramatic change—as when Britain abolished the slave trade, Congress passed the US Wagner Act, and on some environmental legislation. During these times, policymakers calculated that the business position would detract from their public support.

The literature considered in the previous three sections can be combined into a model of governance politics that stresses state capacity and the policymaking agency at the cabinet level. This is close to ‘party of government approach’, but I want to stress the importance of decisions by those in control of the executive (ie: the cabinet) rather than the views of the parliamentary party or the party in the country.

| The state/cabinet government argument |
| Choices of cabinet                  |
| (conditioned by electoral, ideological, and programmatic considerations) |
| + Constitutional strength of Parliamentary sovereignty            |
| ➔ State governance policy ➔ Change at company level ➔ New distribution |

III. Distinguishing international variables: globalizing governance?

It is somewhat artificial, when evaluating policy change in UK corporate governance, to deal with international variables separately. The structural power of business (and especially finance) has always been bound up with its international character. Nonetheless, for the sake of clarity, I consider here specific constraints on policy implied by ‘globalization.’
Globalization—financial market integration—is likely to work against employee interests, or more precisely against institutional reforms that increase the leverage of employees. Peter Gourevitch identifies several paths by which international forces might drive governance change, even as they work through domestic level groups and institutions. First, interest groups who stand to directly benefit or lose from a particular change may pressure politicians and regulators. This pressure will be more effective where the threat of ‘exit’ is real. Mobility means some can liquidate their local holdings and move them to a more profitable location. Investors are the most mobile interest in corporate governance. Managers of many companies can relocate operations or even their incorporation documents, but they are more restricted in their options than shareholders. Employees and those entities ecologists want to protect are of course much less mobile. Consequently, much of the emphasis has been on investors who own shares and may choose to move their money to other, ‘better’ governed jurisdictions.

Second, pressure might come from those able to link broader problems in global political economy to domestic governance mechanisms. Concerns about competitiveness or investment in productivity enhancing R&D might create demands for more stable

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126 One is the impact of market signals on managerial behavior in different contexts. Since I am interested in explaining state policy change, I emphasize paths that work through political system. There are various theories about how international forces might affect domestic outcomes. The most plausible is the ‘second image reversed’ insight that global forces are refracted through local interests and preferences. It is local politics that drives change, but local politics is influenced by international forces. Policy outcomes, then, are the result of domestic level forces but these forces are shaped internationally.

127 As I noted in Chapter I, The common assumption has been that this mobility has threatened the Coordinated Market Economies rather than the Liberal Market Economies. The ‘shareholder value movement,’ is blamed for bringing convergence pressures to bring the less investor-friendly economies into line with the British and American model. Managers can use this argument, and their own threat of mobility, against stakeholding reforms. We can, therefore, expect the same pressures to work against stakeholding reform in the UK.
ownership governance, for example. More likely, concerns about regulation might reinforce demands for deregulation, at least where regulation makes business more, rather than less profitable.\(^\text{128}\) The financial aspects of governance are the most exposed to global markets, and the need to ensure proper regulatory environment for finance is a key part of the ‘competition state.’\(^\text{129}\) Britain can be seen as a competitor for investors on the one hand, who want transparency and protection, and managers on the other, who want efficient and simple company law regimes and can choose where to incorporate.\(^\text{130}\)

<table>
<thead>
<tr>
<th>Globalization &amp; Business Power</th>
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<tbody>
<tr>
<td>Mobility of investors (and in some cases, also managers)</td>
</tr>
<tr>
<td>+</td>
</tr>
<tr>
<td>Efforts of domestic interests to respond to problems of mobility</td>
</tr>
<tr>
<td>→ State governance policy</td>
</tr>
<tr>
<td>→ Likely preservation of power at the company level → Preservation of existing distributions</td>
</tr>
</tbody>
</table>

Finally, international or supra-national bodies might drive domestic change. For Britain, the most important is the European Union. It has long sought a common legal

\(^{128}\) Gary Wilson, "Business, State, and Community: 'Responsible Risk Takers,' New Labour, and the Governance of Corporate Business," *Journal of Law and Society* 27, no. 1 (2000). The result might be a regulatory ‘race to the bottom’ feared by many opponents of globalization. On the other hand, the same mobile groups might want *increased*, not decreased protection. The result would be not a race to the bottom, but a race to the top. There is evidence that investors will pay more for better corporate governance, especially in emerging markets where systemic integrity is in doubt.


and accounting regime for companies. The UK government has generally resisted this, especially when it promotes employee participation in governance. In terms of power in governance, the EU has not had any dramatic effects, although it has promoted greater legal clarification of the role of private regulators. I address these issues in Chapter Three and the issue of employee governance in Chapter Four. For the most part, formal corporate governance authority remains a domestic affair.

The European Union
European Union directives and legislation ➔ Modification of UK state governance policy ➔ possibility of new distribution.

IV. State policy and authority over corporate governance
State regulatory policy can be decided and implemented in different forums. Legislating and enforcing rules bureaucratically is of course a typical modernist mode of governing. But an alternative is to establish markets in which incentives and opportunities are likely to lead to outcomes favored by policy. Another is to create private authority. Private authority is increasingly of interest to political economists. Thirty years of neo-liberalism has undermined the state’s normative standing, and the genius of markets and civil society are habitually lauded in political discourse. A. Claire

131 The EU is now implementing the International Accounting Standards Board initiative.
132 A prominent recent example from outside corporate governance is to allow electricity-generating companies to trade among themselves the right to emit industrial pollutants. The overall quantities are fixed by policy and the market determines distribution.
133 See the edited volumes: Cutler, Hauffler, and Porter, “Private Authority and International Affairs.”, Hall and Biersteker, eds., The Emergence of Private Authority in Global Governance. These scholars are primarily interested in private authority in international relations. My emphasis is on domestic political economy in Britain and the US, together with relevant international forces.
Cutler remarks that, when “the state appears to be challenged in so many ways,” private authority is essential to understand.  

Markets

Markets offer a lower cost (to the state) means of enforcing discipline through arranging incentives. They also generate new behaviors that are in a sense the analogue of regulatory policy changes. The problem is that the ability to lead or oppose these changes is derived from financial strength and market position. Both confer power that is non-democratic because they are not distributed equally (as, in principle, are voting rights). For example, while ecologically minded shareholders may seek to influence the companies in which they own share stakes, shareholders with more conventional preferences usually swamp their demands.

Private authority and franchising private authority

Market participants often organize more formally, and this is one source of ‘private authority.’ Frequently members may prefer to solve collective action problems and change behavior privately rather than suffer the heavy hand of the state. Private authority arises from non-governmental organizations (including associations of

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135 Markets involve exchange by self-regarding participants, generally for profit and without collective action. Prices convey information and are a source of discipline. Markets need not be perfect to have these effects. The actions of leading market players can influence smaller actors and change the overall direction of the market. Noting their innovative character is consistent with Hayek’s view that free markets are a source of spontaneous human organization.
companies) that wield some control or influence over their members or subscribers—through standards or rules of conduct, for example. It is constituted, funded, and controlled by trade and professional associations, companies, or other organizations. Some scholars even define NGOs and other ‘public interest’ groups as private authorities, although they have little or no power to enforce their diverse codes of conduct.\textsuperscript{136}

Often the state lends public purpose and sanction to private authority. I describe this as ‘franchising’ public authority.\textsuperscript{137} For example, governments lent state legitimacy and power to bodies such as the London Stock Exchange. The rationale for formal delegation is usually cost-effectiveness, technical expertise, or rule making flexibility.\textsuperscript{138} It has the effect of insulating rule making, implementation and enforcement from interference by elected officials. Since it generally preserves the status quo, this is frequently welcomed by powerful interests and opposed by weak interests.

**Why authority matters**

\textsuperscript{136} Scholte identifies a global civil society: a new political space where not for profit “voluntary associations seek deliberately to shape policies, norms, and deeper social structures.” Jan Aart Scholte and Albrecht Schnabel, eds., *Civil Society and Global Finance* (New York: Routledge, 2002). Does Amnesty International, for example, exercise authority? Lipschutz argues that its reports carry moral authority. Lipschutz and Fogel, "Regulation for the Rest of Us? Global Civil Society and the Privatization of Transnational Authority.” I would suggest instead that these publications have moral weight and might also be a source of power when used effectively by their authors or others. But they do not have authority in the sense of regulative, disciplinary power that can demand or expect compliance on the basis of acknowledged formal legitimacy.

\textsuperscript{137} Howard, “Private Authority in Liberal-Market Corporate Governance: Global Advance but Domestic Retreat?”

\textsuperscript{138} Flexibility is an especially common argument in the British case. Overburdened governments, the argument goes, cannot keep up with economic and technological change. Agency theorists find the opposite rationality in delegation. What governments lose in agency costs, they gain in policy credibility and predictability. Credibility and predictability derive from isolating the rules from interference by elected officials.
Different kinds of authority have various sources of legitimacy.\textsuperscript{139} The most important is exclusive to the state: the sense that public rules common to all are a matter for constitutionally constrained popular sovereignty. That is, in some sense, they are \textit{democratic}. State coercion is a factor in compliance as well, of course, but it is a distinct factor. Other sources of legitimacy are \textit{performance} (or rather the perception of performance) and, less frequently, \textit{morality}. Performance is especially important in private authority and in markets. The question participants ask of some collective arrangement is whether it delivers on its private and public purposes, and for whom it does so.

Private authorities (and governments speaking on behalf of private authorities) frequently claim legitimacy on the basis of performance –an argument of the form: “it works, so it is a legitimate substitute for direct state authority.” The relevant political question, however, is for whom it works. The answer may be that it promotes wealth overall, or that it does so for particular groups. Where it does not fulfill its purposes, it may be more likely to be replaced or augmented by state intervention.\textsuperscript{140} This raises some interesting issues and suggests one reason why state authority might replace private authority.

Private and semi-private collective action is sometimes celebrated for its voluntarist and non-hierarchical character. In this view, civil society is preferable to state

\textsuperscript{139} A legitimate authority can properly expect compliance and institutional integrity.\textsuperscript{140} There are other sources of legitimacy. For liberals, markets have moral legitimacy since they result from the interaction of free choosing individuals. For nationalists, states have moral legitimacy as the expression of the national will. Private authorities such as churches (some of which, after all, used to be public authorities) have moral legitimacy.
authority. Its domain is associated with a post-modern, less hierarchical regulation. It may be more efficient in economic terms. Participants may, of course, see it in a more self-interested light: it is a welcome, flexible alternative to the heavy hand of the state. It preserves their autonomy by insulating regulation from politics and so is generally applauded. However, private authority raises questions about the democratic character of governing. The state’s democratic nature, while deeply flawed, is generally more widely acknowledged than those of trade associations, unions, and other civil society groups.

The question of performance quickly leads to a second question: performance for whom? If private authority substitutes for state authority but changes nothing in distributive terms, is it significant? If the state displaces private bodies, but merely guarantees the preexisting social distribution, should we care? Thus, I am arguing that authority matters, if it does, because it can redistribute power. For changing corporate governance regulation, this is an empirical matter that I will evaluate in coming chapters.

Although the state may delegate its purposes and even sanction power to private bodies, I am still placing the emphasis on choices at the state level:

<table>
<thead>
<tr>
<th>Private and Public Authority in governance</th>
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<tbody>
<tr>
<td>State policy</td>
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<tr>
<td>➔ Private-franchise authority</td>
</tr>
<tr>
<td>and/or market and/or</td>
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<tr>
<td>Direct state regulatory authority</td>
</tr>
<tr>
<td>➔ Power (at the company level) ➔ Distribution</td>
</tr>
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</table>
V. Concluding comments

Applying my state-centric model of distribution at the company level in the UK case means explaining what ministers and the cabinet as a whole choose to do. Major change would require:

1. At the minimum, a commitment by ministers to use the substantial powers of state in reform; this may be apparent on entering office (and anticipated in an election battle) or a response to new conditions (as in a governance crisis):
   a. *Ideological consensus in the governing Cabinet, or at least the willingness of the Prime Minister to insist on reform*; by ideological consensus, I mean a common analysis of the governance problem, a view of how reform would help, agreement on how it would fit the Government’s overall goals, and the rhetorical means to sell it to public, media, and interest groups;
   b. A calculation that the move is *sustainable in Parliament*; this is likely to be guaranteed by the large majorities Britain’s first-past-the-post system produces at times; this is, of course, precisely what happened in 1997 and 2001;
   c. A calculation that the future electoral benefits outweigh the costs; the reform would need to be, at some level, popular, or at least not unpopular; it would likely have to have been sold as a manifesto commitment at the previous General Election;
d. A willingness by ministers to resist the public relations and lobbying campaign that radical reform would produce; ministers would likely have to (try to) shape and lead public opinion on the issue;

2. Mobilization by supportive interest groups and new coalitions of those likely to benefit or otherwise support reform;

3. Both group mobilization and ministerial commitment, in turn, might well require a receptive problem environment—that is, a governance system that was obviously in trouble or causing substantial damage to interests and the public; measures that threaten business interests are most likely to succeed—or get onto the agenda—where business legitimacy is severely damaged.

4. A willingness to undertake radical complementary reforms so that reform is not undone in the implementation phase by unintended effects and participant reactions; since capital mobility is frequently (and reasonably) cited as a constraint on government policy that threatens business, some restraint might be required;

5. Possibly also leadership on the international front to coordinate with other economies.

This is a demanding and unlikely—though not inconceivable—set of criteria. Exploring whether they were met will allow us to learn something not only about British
politics, but about democracy and capitalism more generally. The next two chapters provide case study evidence on these issues.
Chapter 3: Enhancing the Liberal model: private and state authority

This chapter traces the state response to corporate scandal during the 1990s and early 2000s. As I show in Part I of this chapter, both were moments of significant opportunity for pro-investor reform, and in both managers were targeted. The response was significant but not system transforming; it did not, for example, force greater shareholder governance. In the first period new private authority was created to modify board structures and transparency, and, in the second, the state sought to ensure that private authorities continued the reform process. The private response is consistent with Britain’s institutional history: private self-governance that is tightened in response to periodic crises at the prompting of ministers who want to restore public legitimacy.

As I discuss in Part II below, these reforms reflected the consensus that there were longer standing flaws in UK governance. But, as I show in Part III and Part IV, they reflected the common ideological commitment among ministers of both parties that the City should regulate itself where it could do so effectively. Neither the Conservatives, nor, as it turned out, Labour, wanted to directly force significant change on managers. They were supported in this view by the key affected interest group (institutional investors) who preferred the private route and believed they could bring market pressures
to bear on companies. The shareholder value movement in equities markets confirmed this belief. The supra-national EU had only a marginal effect on investor protection policy throughout the period. Finally, the private committees responding to the crisis did not include pro-stakeholding members and so were able to resist agenda expansion beyond investor-protection. Private authority was not democratic and did not redistribute power beyond investors.

The resulting private, authoritative ‘Combined Code’ was accepted by governance participants as legitimate and, with the exception of executive pay, was successful in reducing managerial neglect. However, once in place it attracted greater, not less, political attention. When Labour came to office they shifted the attention first to stakeholding (considered in the next Chapter) and later back onto the adequacy of private arrangements in light of Enron/WorldCom. The new Financial Services Authority presaged a willingness to use state influence directly, and it took control of the Combined Code when the London Stock Exchange was demutualized. Labour ministers were more direct in shaping the Combined Code than their Tory predecessors. But absent the persistent scandal of executive pay and the collaboration of Andersen in the collapses of Enron and WorldCom it is unlikely that they would have intervened at all. Even during their second term in office they were reluctant to alienate managerial representatives. This is reflected in the moderation of the reforms considered in Part IV.

I. Collapse, fraud and executive pay
The British state historically saw governance as a private matter for companies and their shareholders (or ‘members,’ as they are known). In principle legislation should protect investors while permitting the flexibility necessary for enterprise. The most prominent state role was in specifying matters to be disclosed—but not the standards by which they would be met—and prosecuting the worst violations. Given this framework, shareholders were to look after their own interests. The ability of shareholders to do so was cast into doubt, at the onset of the 1990s, by a series of dramatic and unexpected company collapses.

The early 1990s

The most prominent were the collapse of Polly Peck, criminal fraud at Maxwell Group and the BCCI, large losses at Allied Lyons and Queens Moat Houses and, in 1995, the Bank of Barings trading crisis. Table 3.1 lists the most important. Of these, the Polly Peck and Maxwell affairs are emblematic.

The first concerned Polly Peck, a £1.7B “bananas to videos empire” that was among the best performing UK stocks of the 1980s. It acquired Del Monte’s fruit division and a controlling stake in the Japanese audio group Sansui.\(^1\) However, the company’s growth strategy left the firm with outstanding debts of £550M and various uncertain business prospects in Turkey. When Polly Peck’s stock came under pressure in 1990, its chairman and CEO, Asil Nadir, unexpectedly and improperly suggested he would buy the firm. Although it temporarily inflated the stock’s value, the bid failed to materialize. Nadir broke Takeover Panel rules and traded his stock improperly from behind the


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'nominee veil.' Nominees are people or entities that hold stock on behalf of someone else, so hiding the investor’s real identity along with any possible conflicts of interest. The resulting board confusion and loss of confidence wiped out the company’s share price. Polly Peck’s capitalization fell three-quarters in five weeks –from £2B to £468M. Nadir, wanted for 66 counts of theft and fraud totaling £100M, fled to Northern Cyprus.

The Maxwell empire, publisher of the tabloid Daily Mirror, collapsed in 1991, again after a series of dramatic acquisitions and improper trading by its chairman. In the wake of Robert Maxwell’s mysterious watery death, a vast network of debt obligations and stock lending was discovered. Maxwell had appropriated money from the pension funds of his two main listed firms to support the dealings of his private firms. His businesses were found to have joint debts of £2.4B. Again, there was serious crime involved, but governance mechanisms had failed to prevent the collapse.

All the scandals did widely publicized damage to shareholders, creditors, and employees. Leading members of the financial establishment –banks and accounting firms—were implicated. Boards failed to keep management in line, institutional investors did not intervene, and auditors found nothing amiss or played down what they did find.

2 Under the Takeover Code, once a takeover bid is announced, any trade of more than 1% of a company’s shares must be reported. The trades were made by a Geneva based company apparently acting as a nominee for Nadir interests. Nominees hold stock for shareholders who may go unidentified.

3 Investigations by the Serious Fraud Squad and the Stock Exchange later uncovered extremely poor internal controls –procedures to keep track of financial flows—allowing Nadir to move money around at will. Board members had not ensured they had the information to monitor the company’s financial health. Furthermore, the firm’s auditors gave insufficient care to their task, casting doubt on the accountancy profession more generally. The scandal became highly politicized in part because several Members of Parliament intervened on Nadir’s behalf. The Attorney General later admitted that the Serious Fraud Office improperly cooperated with defense attorneys.

Since they coincided with a recession, they were coupled in the minds of outsiders to general concerns that British industry was under-performing.\(^5\)

Table 3.1 (following page) lists the significant failures during this period.

Table 3.1: Significant business failures during Conservative Governments

<table>
<thead>
<tr>
<th>Company</th>
<th>Date</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>House of Fraser/Harrods</td>
<td>1985</td>
<td>Controversial takeover by Fayed brothers</td>
</tr>
<tr>
<td>Guinness</td>
<td>1987</td>
<td>Share ramping scandal in bid for distillers, prosecutions last until early 1990s</td>
</tr>
<tr>
<td>Blue Arrow</td>
<td>1989</td>
<td>Improper loans to executives</td>
</tr>
<tr>
<td>Polly Peck</td>
<td>1990</td>
<td>Improper takeover attempt by chairman following large run-up in shares, followed by collapse</td>
</tr>
<tr>
<td>British &amp; Commonwealth</td>
<td>1990</td>
<td>Collapse of debt-burdened financial conglomerate following failure of Atlantic Computers subsidiary</td>
</tr>
<tr>
<td>Lowndes Queensway</td>
<td>1990</td>
<td>Collapse of furniture retailer</td>
</tr>
<tr>
<td>Rush &amp; Tomkins</td>
<td>1990</td>
<td>Collapse of property developer</td>
</tr>
<tr>
<td>Coloroll</td>
<td>1990</td>
<td>Collapse of debt-burdened household supplier</td>
</tr>
<tr>
<td>BCCI</td>
<td>1991</td>
<td>Bank collapse ruining many small depositors in UK</td>
</tr>
<tr>
<td>Maxwell Group</td>
<td>1991</td>
<td>Corporate collapse of debt ridden conglomerate with massive pension fraud</td>
</tr>
<tr>
<td>Allied Lyons</td>
<td>1991</td>
<td>Losses from unauthorized foreign exchange trading</td>
</tr>
<tr>
<td>Queens Moat Houses</td>
<td>1993</td>
<td>1992 results well short of expectations, resulting from excessive borrowing</td>
</tr>
<tr>
<td>Bank of Barings</td>
<td>1995</td>
<td>Rogue trader exposes bank to unlimited foreign exchange losses</td>
</tr>
</tbody>
</table>

Executive pay

Skyrocketing executive pay added insult to these injuries. If executive pay, as one wag said, is the “mad cow disease” of American boardrooms, it is clear that Britain’s boards were also long afflicted.6 Press coverage of outlandish salaries and bonuses

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6 The remark is attributed to Richard Finlay of Canada’s Center for Corporate and Public Governance in an article in Business Week magazine, May 6 2002.
continued throughout the 1990s, peaking in 1995 and again after equities collapsed in 2000-2002. The managerial elite appeared to be engaged in organized rapacity—on a magnitude that disturbed shareholders almost as much as the person in the street.

This was especially true for the utilities privatized by the Conservatives during the 1980s. New managerial teams commanded private sector-pay rates, and low flotation prices resulted in windfall gains on their stock options. Simultaneously, customer satisfaction at these household name companies nose-dived. Cedric Brown’s dramatic awards at British Gas were especially notorious, particularly his 75% pay increase in 1994 amidst poor service and layoffs. The pollster Peter Hutton claims that the Cedric Brown scandal helped convince the Labour party that it could get away with proposing a windfall tax on utilities.7

At the end of the 1990s, Britain led Europe in executive pay, with average CEO pay at £394,103.8 The Labour Research Department found double digit increases over eight years, with rises in 2001 of 18.8% and 21.2% in 2000.9 The Guardian reported a 23% increase for FTSE 100 chief executives during 2002.10 ‘Golden parachutes’ and

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10 “Special Survey: Executive Pay,” Guardian, 31 July 2003. Other sources find similarly large gains. A private consultancy estimated the average rise for all lead executives was 9.7% in 2002, compared to the average earnings rise of 3.8%. David Turner, “Fat Cat Jibes Expected as Executive Pay Soars,” Financial
pensions were also prominent news items. MPs made much of the figures: Ken Berry of EMI departed with £6.1M, Tony Ball of BskyB took £7.8M and Peter Banfield of BT left with £3.74M.\textsuperscript{11} The chief of Marconi received a large payoff despite leading the company into near-collapse. Railtrack, the troubled infrastructure successor to British Rail, paid £1.3M in severance to its departing leader. Even the Institute of Directors (a membership organization of board-members) admitted that the overall growth of pay rates was unusually high.

More importantly, the scandals helped destroy business reputation. MORI polling of general public attitudes to large companies shows a precipitous decline through the period. Asked whether the profits of large companies helps benefit their consumers, over 40\% of the public said yes in 1986. The figure dropped to near 25\% in 1996 before recovering slightly in the run-up to the Enron/WorldCom collapses. Two-to-one were hostile to company profits generally.\textsuperscript{12} By 2003 78\% of the public thought directors of large companies were overpaid.\textsuperscript{13} These reputational effects may help explain why business-friendly papers like the \textit{Financial Times} and the \textit{Daily Mail} joined in the hostility to the executive pay bonanza.


\textsuperscript{11} Commons Hansard, 13 March 2003, Col 144WH.


Initially the loudest complaints came from workers who objected to widening income gaps.\textsuperscript{14} But shareholders were also unimpressed. One leading fund manager later complained that, “if shareholders are unable to vote on huge option packages that would represent a clear transfer of value, this might, in other fields, be considered theft. How else would you describe the removal of value involuntarily?”\textsuperscript{15} The situation became more acute, of course, as share values declined after 2000. The chairman of the UK Shareholder Association’s commented, “What is extraordinary is the lack of correlation between negative news and positive remuneration.” PIRC explained that it was “a huge transfer of wealth from shareholders [which is] set to continue.” Comparing the pay of named executives to their companies’ performance became something of a journalistic parlor game.\textsuperscript{16} The Trades Union Congress underlined its outrage by comparing average national wage increases to elite directors’ contracts.\textsuperscript{17}

There seemed to be little connection between performance and pay.\textsuperscript{18} It appears that pay is driven by firm size rather than performance and is exacerbated by conflicts of interest on the board.\textsuperscript{19} Non-executive directors (who are supposed to be more independent of a company’s managers) should have the most say in agreeing contracts,

\textsuperscript{14} “Punters or Proprietors: Capitalism a Survey,” \textit{The Economist}, 5 May 1990.
\textsuperscript{16} See, for example, "Heads They Win," \textit{Guardian}, 9 May 2003.
\textsuperscript{17} Julia Finch, "Board Pay Rises at Three Times Rate of Workers'," \textit{Guardian}, 27 March 2002.
but they are drawn from the managerial class and so are sympathetic to overall escalations in executive pay.\textsuperscript{20} Where the market for executives is trans-Atlantic this will also tend to pull up pay expectations, because US pay leads the world.

\textbf{Trans-Atlantic contagion: Enron, Andersen, and the equities problem}

After a period in which executive pay was the main investor-related governance problem, the collapses of Enron and its accountant, Arthur Andersen, politicized corporate governance with a vengeance. If anything, evidence of malpractice at Andersen was the more significant because it cast doubt on the accounts of many major UK companies. The Big Five oligopoly compiled the books for the vast majority—sometimes all—of the FTSE100. Andersen alone accounted for 15\% of the market for accountancy services in 1998.\textsuperscript{21} In addition, there were substantial economic costs, not the least of which was the 1,500 UK jobs lost at the firm.\textsuperscript{22} Finally, Britain’s success in international professional services is a major point of pride. The integrity of the entire profession was called into doubt.

Enron was also highly symbolic. A decade of globalized privatization in commodities trading and retailing meant that even crime in Houston—especially crime in Houston—could have profound implications. The company’s banks and advisors were as prominent in the City as they were on Wall Street. The former Tory energy minister,

\textsuperscript{20} On the other hand, independence and firm size cannot be the only variables at work: Continental European and Japanese firms are large and their directors are not independent by British standards. But their executives command (demand?) much lower salaries and compensation.

\textsuperscript{21} Its market share had fallen to 11.7\% in 2000"Competition in Professions," (London: Office of Fair Trading, 2001), Figure 20. Accountancy is a £3.1B business.

\textsuperscript{22} Jill Treanor, "KPMG Sheds 7\% of UK Workforce," \textit{Guardian}, 16 July 2002.
Lord Wakeham, sat on the board’s audit and nominations committees. Enron’s UK utility interests included a major Teeside power station and Wessex Water, a privatized company serving 2.5 million customers.23 And again, the economic effects: Enron Europe’s trading operations were centered in London, and lost 1,400 staff. Finally, Barclays, the Royal Bank of Scotland, Abbey National had significant exposure to the company.24

Enron and WorldCom affected Britain dramatically for several reasons. First, UK markets are closely linked to Wall Street. The FTSE 100 index fell almost in tandem with the Dow, losing 20% of its value between September 2000 and March 2001.25 On the June day after WorldCom revealed its crimes every share on the FTSE100 was marked down.26 By mid-summer the FTSE100 had lost 40% of its value from the January 2000 peak. It fell below 4000 for the first time since 1996. Prices did not begin to recover until after America’s speedy occupation of Iraq in 2003. The close linkage in market prices suggests that a problem on Wall Street is a problem in the City.

Second, there are direct effects from across the Atlantic, since UK investors are heavily invested in New York-listed equities. Total UK portfolio investment abroad peaked at £942.5 Billion in 2001. British pension funds were among the world’s most exposed to overseas equities.27 Foreign equities worth £429.3B in 2000 dropped in
value to £333.6B two years later.28 Bad governance in the US directly affected UK institutions. This is compounded by a third factor: the heavy exposure to equities of UK life insurers. 60-70% of UK life insurers’ assets are in stocks (compared to nil in the US), and insurers account for 20% of market capitalization. Collapsing markets mean that they must sell stock to maintain solvency, driving stocks down further. A normally safe sector for investors, life insurance companies lost 54% of their value in the first six months of 2002 alone. Investors in non-life insurers lost almost 2/3 of their equity. Moreover, falling equities are not only a problem for shareholding institutions. Household wealth—conventionally in the UK tied up in housing—was increasingly equities-based. This meant falling share prices could hurt the wider economy by impacting consumer spending. Luckily the macro-economic and fiscal condition of the country remained healthy.

Finally, there were homegrown scandals, in new and old economy firms. The telecom giant Cable & Wireless fell from highs of £15.62 to 41p and Marconi (formerly GEC) fell from £12.50 to a mere 6p.29 Poor decision-making at both went unchecked by the board and ignored by shareholders. In 2002 the holiday operator MyTravel revealed significant accounting irregularities. And finally, massive pensions miss-selling created new hostility to the financial sector and compounded the sense of crisis.30

Kong, Ireland, and New Zealand were higher. Paul Hirst and Grahame Thompson, *Globalization in Question* (London: Polity, 1999), Table 2.9.


30 The headline problems were at Equitable Life, Independent Insurance, and Versailles.
II. Defining the problem and assigning blame

Governance policy is historically reactive rather than pro-active. It matters a good deal, therefore, how ministers and their advisers interpret a given problem when it arises—what outcome is unacceptable, what they think might have caused the problem, what mechanism can feasibly be reformed, and what kind of authority they favor. Normally they do so within the conventional wisdom, particularly when there is no clear alternative framework. The following sections explain how the media and academics diagnosed governance problems in each of three governance mechanisms. In Part III I explain how ministers responded and describe the nature of authority created.

Problems of direction: inadequacies on the board

In both periods, company executives and directors attracted the most media fire. This made sense in part because directors personify their companies and are often well known—and well paid—for their leadership. But board reform should also be seen in the historical light of enduring worries about the quality of British management. As early as the 1920s, the Liberal Industrial Inquiry argued that UK boards were ineffective.31 Early industrialization resulted in an overly empirical, informal culture of management.32 There were no formal qualifications for directors, and experience tended to be more important than professionalism.33 Geoffrey Mills wrote in 1981 that the British board is

31 Quoted in Cadbury, "Corporate Governance and Chairmanship: A Personal View."
33 That experience frequently included, until the 1990s, private education and Oxbridge degree. The supposedly detrimental economic effects of this classical education and its associated elite culture were famously posited by Martin Wiener.
“conservative, cautious, complacent and commonly just-too-slow-off-the mark.”

The leading company law journal opined that directorships were bestowed as rewards and indicated business status.

The problems were institutional, stemming from board structure and membership. British companies are run by unitary boards that give strategic direction, select and supervise executives, and produce company reports. Often board members were senior managers rather than ‘non-executive directors.’ Executive directors may lack the independence necessary to supervise the company’s managerial team. The selection and payment of directors lacked transparency and objectivity; market forces did not appear to function effectively. More importantly, the company’s chief executive might chair—and dominate—the board. One way around these problems is to create committees of the board to oversee audit, compensation, and nominations. Best practice was beginning to reflect these reforms by 1990: up to half of all boards had audit committees, for example.

Neither public nor private authority, historically, had much to say about these problems. Company lawyers, bureaucrats and ministers viewed the state’s role as establishing a flexible framework for markets rather than guiding behavior. Although company law includes detailed prescriptions and proscriptions to prevent directors from

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34 Mills, On the Board, 74.
35 R.I. Tricker, Corporate Governance: Practices, Procedures, and Powers in British Companies and Their Boards of Directors (Oxford: Gower, 1984). They direct resource allocation, corporate acquisitions, and the raising of capital. The alternative to unitary boards is dividing the managerial (direction) and supervisory (monitoring) functions. This ‘two tier’ approach is common in the Coordinated Market Economies.
37 Ezzamel and Watson, “Executive Remuneration and Corporate Performance.”
taking advantage of their position, it is almost silent on how boards should do their job. They must exercise the care of a reasonable person but are liable only for gross negligence. Imprudence and errors of judgment are not covered by liability. The Department of Trade and Industry (DTI) is responsible for company law and prosecutions, together with various police units such as the Serious Fraud Office. But DTI's responsibilities range across industrial regulation and policy and its company law division is not large. Nor was there any obvious private institutionalized forum for coordinating change. Senior managers’ membership association, the Institute of Directors, saw its role as promoting good practice (and defending director’s interests), but had no means of enforcing behavior. The Confederation of British Industry and Hundred Group of Financial Directors were chiefly engaged in promoting managerial interests in government rather than shaping new norms.

Problems of control: the failure of shareholder governance?

What responsibility did shareholders have for the collapses, or for their own losses? In both the earlier and later cases, analysts suggested that investors were either willfully ignorant of emergent risk, or insufficiently involved in governing companies, or both. With characteristically hard-nosed realism, The Economist newspaper blamed investors for neglecting their own interests.38 Since managers handle shareholder money, their editorialist wrote, shareholders must make them accountable. Instead, investors behaved like ‘punters’—gamblers on share values—than ‘proprietors.’

38 “Punters or Proprietors: Capitalism a Survey.”
The law also assumes shareholders will govern companies, at the least replacing directors when they go astray.\textsuperscript{39} It does not require any governance role, however.\textsuperscript{40} But investor oversight is hindered by high costs in time, effort, money, and by conflicts of interest.\textsuperscript{41} Monitoring is a public good and collective action is difficult. This is true for private shareholders, for the institutional shareholders, and for their beneficiaries. The next two sections explain these problems in detail.

\textit{Individual shareholders}

Overall, individual shareholders were a declining force by 1990. Nevertheless, they could be vocal, and during this period the small UK Shareholder Association was formed to advance their interests.\textsuperscript{42} Their governance role, beyond trading, extends to voice at the Annual General Meetings or, much less significantly, taking legal action. The latter is much rarer than in the US because of the legal difficulties and costs of bringing suit.\textsuperscript{43} It is not clear how responsible directors should be for poor management in law, although court decisions throughout the 1990s appeared to increase their culpability.

\textsuperscript{40} The idea that pension funds should be required to vote their shares, as they are in the United States, was seen as an intrusion into private affair. US pension funds covered by the Employee Retirement Income Security Act are expected to vote their shares as part of their fiduciary duties under the Department of Labor’s 1994 ‘Avon letter.’ Available Online: http://www.lens-library.com/info/dolavon.html Accessed June 17, 2004.
\textsuperscript{41} See, for example, Cohen. Lenin recognized the limited power of small shareholders “…in practice a certain number of small, scattered shareholders find it impossible to attend general meetings, etc. The ‘democratization’ of the ownership of shares…is, in fact, one of the ways of increasing the power of the financial oligarchy.” Lenin, \textit{Imperialism} (1916), Chapter 3. Available Online: http://www.marxists.org/archive/lenin/works/1916/imp-hsc/ch03.htm Accessed June 6, 2004.
Interventions at meetings are hindered by cost and logistical problems of getting to meetings and communicating with other shareholders.\textsuperscript{44} The Government suggested it would make these interventions easier in 1996 but did not take the reform forward.\textsuperscript{45} In any case, making a difference at the AGM is challenging because institutions and directors control the bulk of shares. Both institutional investors (who often don’t attend) and directors (who must) view the meetings as an expensive waste of time and money.\textsuperscript{46} Usually the worst outcome is the embarrassment of pointed questions and directors’ inevitably guarded or roseate answers.\textsuperscript{47}

\textit{Institutional shareholders}

The real power lies with institutional shareholders. By 1990, financial intermediaries held about 60\% of UK equities on behalf of future retirees and other investors. As much as 25\% of a large company’s equity is sometimes controlled by as few as five funds. Yet for decades analysts have complained that they are not using their influence.\textsuperscript{48} In 1980 the Wilson Report said that activism was essential to combat poor

\textsuperscript{44} At the AGM, shareholder input is generally confined to voting on changes to the company constitution, decisions on investment matters (especially mergers), and areas of directors’ conflict of interest. They can vote out the board, given a majority. Davies, "The Board of Directors: Composition, Structure, Duties and Powers", 5.
\textsuperscript{45} The Government consulted on ways to facilitate the recognition and distribution of shareholder motions. Greg Knowles, "Shareholder Communication: Proposed Changes to the Companies Act," \textit{The Company Lawyer}, June 1996. These involve financing the notification of fellow shareholders that an investor motion will be made during an approaching meeting.
\textsuperscript{47} Ezzamel and Watson, "Executive Remuneration and Corporate Performance."
\textsuperscript{48} Hadden argues that shareholders of any kind have three primary concerns: the control of self-interested conduct by management, monitoring of managerial efficiency, and control over major transactions. On the first point they would want to prevent self-dealing and undeserved compensation. On the second, they want to maximize the information available to them. On the final point, they want to prevent managers from blocking takeovers, for example by having non-voting shares, preemption rights, poison pills, and other
David Walker, an executive director at the Bank of England, told institutional shareholders in 1987 that they had “not been active enough” and were “insufficiently critical and insufficiently ready to exert their influence in a timely manner, so that drift in performance has tended to continue.”

The main structural problem is that institutions—the retirement and investment funds, insurance companies, and their managers—do not have strong incentives to intervene. This is true throughout the organizations, from trustees, to fund managers, to beneficiaries. Pension fund trustees may not be well trained in demanding accountability from their own investment managers. Fund managers (who do the investing) need not take the long view, engage in monitoring, supervision, or even vote shares. Where allied with merchant banks, investors may be more interested in getting a firm’s business than in overseeing its managers. Moreover, if price sensitive information is disclosed in meeting management, the investor will not be able to act in the equity markets on that basis without violating insider-trading rules. And finally, the ‘beneficiaries’ of mechanisms. Tom Hadden, "Corporate Governance by Institutional Investors? Some Problems from an International Perspective," in Institutional Investors and Corporate Governance, ed. Theodor Baums, Richard M. Buxbaum, and Klaus J. Hopt (New York: Walter de Gruyter, 1994).


50 Margaret Reid, All-Change in the City: The Revolution in Britain’s Financial Sector (London: Macmillan, 1988), 190. Walker went on to say that “the reciprocal of the accountability of the board to shareholders is the duty of the shareholder to satisfy himself as to the quality and composition of the board.” @ 201


institutional shares do not have any incentive to press for better governance. Control rights (to receive reports, accounts, notices, to attend and vote, to combine for resolutions and to demand meetings) rest with the legal owners of shares—nominees, depositories, fund managers, and so on, not the beneficiaries. This lengthens the chain between owner and manager.

Despite all this, the record on institutional influence is conflicting. More active interventions do occur, and some American lawyers looked enviously at the City’s ability to engage in direct governance.\(^5^4\) During the 1970s the Institutional Shareholders Committee –ISC, a group of trade associations—coordinated interventions in individual failing companies.\(^5^5\) There were high profile individual interventions in 1980-1982 as public pension funds acted on pay awards, mergers, and poor management.\(^5^6\) But the ISC activities varied with changes in leadership, tapering off during the 1980s.\(^5^7\) Later, the Institutional Fund Managers Association (IFMA) explicitly said it would not engage in governance activities with regard to particular companies.\(^5^8\) Going into the early 1990s, Gaved found “strong evidence that on occasions institutional investors played a


\(^{5^5}\) In the four years after its formation in 1972, the ISC examined about 20 cases and intervened in about 12 companies Clarke, Inside the City, 123. Another commentator, concerned about unaccountability in the City, argued in 1973 that investor activism was extensive and hidden, if not frequently coordinated. Richard Spiegelberg, The City: Power without Accountability? (London: Blond & Briggs, 1973), 59-63.

\(^{5^6}\) John Moore, " Institutional Shareholders; Increasing Degree of Involvement," Financial Times, 1 November 1983.

\(^{5^7}\) In strikingly un-Thatcherite fashion the Bank of England coordinated financial support to around 200 ailing companies during the disastrous 1981 recession. While the core of this “industrial lifeboat” effort was arranging for greater patience among creditor banks, the Bank asked institutional investors to put up new capital in some cases. Reid, All-Change in the City: The Revolution in Britain's Financial Sector, 218-20.

significant role determining board composition and other issues.” 59 Their activism tended to be less coordinated, although it might involve a very loose, informal coalition of institutions interested in a particular company. Typically, lead investors—fund managers holding the largest bulk of shares in a company—would initiate private discussions with senior managers of under performing companies. These interventions sometimes resulted in a change in management.

Despite evidence that investors were ramping up their governance activities, most commentators continued to insist that they should do more (and do more publicly).

**Problems of transparency**

The failures of the early 1990s and the early 2000s were associated with creative accounting, careless audit, and obscure misappropriations of funds. 60 The means of manipulating accounts includes selecting among optional methods as the health of the enterprise changes, misleading estimations and valuations, creating artificial transactions, and altering the timing of genuine transactions. One business journalist in 1986 complained that, “every set of published accounts is based on books which have been gently cooked or completely roasted.” 61 Even the Bank of England thought the company

collapses indicated systemic problems of transparency. Matters were not helped by a ruling in 1990 that auditors have no duty of care—or liability—to shareholders or potential shareholders.

Without reliable information boards cannot direct managers and shareholders cannot govern companies. Systemic problems arise when managers, who provide the information, and auditors, who check the ways it is compiled, do not have the right incentives. Some argue that the flexibility and judgment required by the British tradition of accountancy may promote ‘creative accounting,’ and worse. A clearer cause of problems was—and remains—auditor conflict of interest. These arise when accountancy firms audit the same firms they provide other services to. If an audit client also buys non-audit services, the accountant may be reluctant to endanger those revenues by questioning managerial accounts. EU rules incorporated into the Companies Act 1989 required measures to address this problem. They are discussed below.

III. The Conservative response: promoting private board reform

Conservative ministers initially argued that market forces would resolve governance problems and that prosecution would weed out criminality. This indicates their view that the problem was not systemic. Questioned in the Commons, Trade and Industry minister John Redwood served up the cant of shareholder democracy. Unhappy shareholders, he said, “can go to the meeting, organise themselves, write to the

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63 Caparo Industries plc v Dickman [1990] 2 A.C. 605
65 This was also the early view of the Bush White House in 2002 Justin O’Brien, Wall Street on Trial: A Corrupted State (Chichester: John Wiley & Sons, 2003).
chairman, and express their views in a variety of ways.” Investors and other financiers would discipline badly managed firms by selling stock and replacing poor managers. His lecture continued:

The hon. Gentleman knows how democracy works in the political sphere. The same is true within a company framework…The responsibilities are on the shareholders, who exercise them if they see the need to do so.66

The shareholder democracy myth fits with a broader ideology of self-regulation. Ministers shared CBI director Adair Turner’s view that it was “very doubtful that legislation can produce useful improvements” in corporate governance.67 Some were even hostile to the market-led changes that were underway. Following the Blue Arrow loan scandal, for example, Francis Maude told the Commons "I do not accept the assumption that the simple existence of audit committees solves all these problems."

Later, Neil Hamilton reiterated the view that board organization and internal audit functions are matters for individual companies, not for the Government. Even in light of the Maxwell scandal, he argued that self-regulation and a light burden on directors should remain the norm.

By coincidence, the Government was taking a company law bill (the 1989 Companies Act, CA1989) through the Lords as the early scandals broke. But although it moderately strengthened the existing regulatory regime the CA1989 was more legal tinkering than corporate governance reform. In no way is it comparable to the US

66 Debate on the Companies Bill (Lords) as amended, Commons Hansard, 25 October 1989, Col 910-911. See also, Col 960 and 934.
Sarbanes-Oxley Act of 2002. Instead, it implemented European Commission mandates, removed some regulatory burdens, required some new disclosure of directors’ share interests, and strengthened company investigations. It delegated of rule making on audit to the franchise investment exchanges, enhancing private authority and causing some confusion about what the final rules would be. Much amended during passage, the Act was widely criticized for its poor drafting and incoherence.

Although heavily amended, the 1989 Companies Act did not attempt to improve board or shareholder governance. Perhaps for that reason, it gained managerial support. The minister responsible, John Redwood, was happy to see boardroom change, but did not think it should be legislated. He noted that the government was already promoting non-executive directors through the Bank of England and a promotional organization, ProNED. Other desirable changes such as the adoption of board committees to oversee financial audit would emerge as managers responded to investor demands and spreading market norms.

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68 The Sarbanes-Oxley Act was passed overwhelmingly in the wake of WorldCom. Earlier responses to Enron had stalled, but the gathering sense of crisis in American markets during the late Spring prompted Congressional action. The Act required stricter personal certifications of company statements, new restrictions and penalties on miscreant directors, a new audit oversight board and new funding arrangements for the accounting standards setter.

69 Companies Bill (Lords) Debate on Second Reading, Commons Hansard, 3 May 1989, Col. 291


71 Later efforts to fix these problems came to naught. In 1992, the Government announced a rolling program of consultation and reform. "News: DTI to Improve Company Law," The Company Lawyer Digest, December 1992. The rationale was deregulatory: Neil Hamilton pointed out that the 1980 edition of Butterworth's Company Law, a basic reference work for the legal profession, was just 486 pages thick. By 1991 it had 3,544 pages. However, the effort was ad hoc: no single panel was created and there was no commitment to fundamental restructuring.
Ministers did step up law enforcement during the 1990s, applying powers of prosecution introduced since the mid-1980s. There were high profile indictments in the Guinness share ramping scandal and later over Polly Peck. Administrative disqualifications of nefarious directors increased. DTI set up a Director Disqualification unit in 1989 and the number of investigations rose throughout the 1990s, setting records in 1995 and 1997. Finally, the judiciary was becoming more aggressive towards directors in its interpretation of company law.

The lack of centralized enforcement powers was a problem, however. Prosecutions worked through disparate agencies, including the Department of Trade and Industry, the Serious Fraud Office, Inland Revenue, Customs and Excise, and Companies House. There was no centralization of financial services or corporate governance

72 DTI Annual Reports, various years. Britain had criminalized insider dealing in 1980, and re-enacted the legislation in 1985. The Stock Exchange and City Takeover Panel supported this move. Later, the EC Insider Dealing Directive was incorporated into UK law in the 1993 Criminal Justice Act. There were also changes on the administrative front. Finally, on the administrative front, there were improvements at the body responsible for registering companies and keeping information on file. Companies House was made an independent executive agency. The Commons Public Accounts Committee found in 1984 found that only 40 per cent of companies were complying with registration laws. By the end of the 1980s the compliance rate doubled, and targets were set to increase this in 1989. A database was created of registered directors and company secretaries to make discovery easier for complainants.

73 The Directors Disqualification Act of 1986, section 8, allowed the Secretary of State to apply to the courts for disqualification following an investigation. Additionally, under section 6, courts were to disqualify directors of insolvent companies found “unfit to be concerned in the management of a company.” Disqualifications rose from nine in the first year after the Act to 127 in the second and 252 in 1988-89. Although widely used, Labour members of Parliament expressed concern that the Department was not being sufficiently aggressive in particular cases. Most prominently, the Fayed brothers were not disqualified following the inquiry into the House of Fraser/Harrods affair.

74 For example, the Insolvency Act 1986 created a new offense of ‘wrongful trading’ making directors liable to suits by liquidators where business was continued even where directors knew insolvency was imminent. The case of Re Produce Marketing Consortium Ltd (in liquidation), before Mr. Justice Knox in March of 1989, signaled that courts accepted Parliament’s expansion of liability to cases where fraud—as opposed to negligence—was not present. Other cases demonstrated the courts’ increased willingness to second-guess good-faith managerial decisions called to suit. Perhaps as a result, take-up of directors’ liability insurance grew during the period.
enforcement in an SEC-type body.\textsuperscript{75} Investigations take a remarkably long time—the inquiry into Queens Moat House was begun in 1993 and did not report until 2004. Moreover, although criminalizing insider trading and company law violations made the British regime harsher on paper than the civil law penalties in other countries, the higher burden of proof in criminal cases meant the law was arguably less effective.

In the Commons, the Government’s response attracted Opposition fire. One accusation was that ministers were hostile to direct regulation and greater enforcement because they were drawn from the managerial class. Research in 1991 found 384 MPs had declared commercial interests, including 522 directorships and 152 consultancies.\textsuperscript{76} The \textit{Times} in 1990 listed twenty-one prominent former Conservative ministers, many still in Parliament, who held directorships.\textsuperscript{77} It is reasonable to conclude that Conservative MPs were intimately familiar with the needs of directors.

In 1993 Dennis Skinner MP badgered ministers about money received by the Tories from Polly Peck’s Asil Nadir. DTI failed to prosecute Polly Peck for breaching Company Act requirements on donations to political parties. Conservative MPs laid countercharges that Labour was too closely associated financially with Robert Maxwell. Nonetheless the Polly Peck affair kept the issue of managerial excess in the headlines.

\textsuperscript{75} Responding to a Commons Trade and Industry Committee Report, Nicholas Ridley denied rumors in 1990 that he would centralize financial enforcement under SIB, arguing that insider trading, at least, was not widespread.
\textsuperscript{77} Richard Ford, "Former Ministers Cash in with City Directorships," \textit{Times} (London), 16 May 1990. The author had searched the Directory of Directors, Who’s Who, and the Parliamentary Register of Members’ Interests. Among the directorships of troubled firms were Norman Tebbit’s at Blue Arrow and Michael Joplin at Atlantic Computers.
well after Asil Nadir’s post-indictment flight to Turkey. Northern Ireland minister Michael Mates was forced to resign over personal links to Nadir and new questions were raised about the Government’s handling of the prosecution. The press was delighted by Mates’ bathetic presentation to Nadir of a watch inscribed, “don’t let the buggers get you down.” This was the third ministerial departure in the year after the 1992 election, thus adding a corporate angle to the Government’s reputation for sleaze.

Table 3.2 (next page) summarizes changes in power and authority during this time.
Table 3.2: Power and Authority in UK Governance 1989-1998

<table>
<thead>
<tr>
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<th>Power within governance</th>
<th>Authority over governance</th>
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<tr>
<td><strong>Overall</strong></td>
<td>Managers face new restraints, investors benefit</td>
<td>Establishment of institutional regulation, albeit private.</td>
</tr>
<tr>
<td><strong>Direction (Board)</strong></td>
<td>Managers’ position weakened through forced board reorganization</td>
<td>New franchise authority; New policy committees and Code of practice appended to Stock Exchange Listing Rules</td>
</tr>
<tr>
<td><strong>Control (Shareholder)</strong></td>
<td>Shareholders advantaged by board reforms without any regulatory burden (i.e.: they are not forced to increase their governance role beyond the working of equities markets and takeovers)</td>
<td>No new authority affecting shareholders; franchise power of LSE and City Takeover Code remains</td>
</tr>
<tr>
<td><strong>Transparency</strong></td>
<td>Managers position weakened by new audit and reporting requirements; shareholders’ information advantages increased</td>
<td>First statutory clarification of audit rules and newly reorganized private franchise accountancy bodies created by CA1989 (implementing Dearing)</td>
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**Board reform: Cadbury, Greenbury, Hampel**

Beginning with the panel chaired by Adrian Cadbury, a series of committees were convened at the behest of ministers, the Bank of England, and existing semi-public authorities. These were dominated by private sector leaders and were named for their
chairmen—respectively, Cadbury, Greenbury, and Hampel. They represent the desire of the City to avoid a legislative response. Cadbury himself stressed the likelihood of legislation if business did not put its house in order.

These committees produced Codes of practice designed to improve the effectiveness of boards. This was to be done largely by requiring greater independence from management, by dividing the posts of Chairman (of the board) and chief executive (of managers), and by requiring that boards have committees devoted to particular tasks (for example, setting pay, nominating new directors, and contracting for audit services). These and other modifications, and the publicity surrounding them, help ensure that board positions would no longer be sinecures to be distributed by chief executives.

The coming sections consider each in greater depth in order to demonstrate the connection between ministerial intent and the private authorities that were created.

**Cadbury**

The Cadbury Committee was established in May 1991 to explore transparency issues. In light of the growing crisis, Cadbury expanded the Committee’s remit beyond financial reporting to include board organization. Ultimately that is where it made its mark, and the Government welcomed its work. It was formally created by the leading franchise and private authorities—the Financial Reporting Council, the London Stock

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78 There were others, including the Myners Committee on City Industry Relations, considered in the next chapter, and the Turnbull Committee on internal controls.
Exchange, and the accountancy bodies. Jones and Pollitt reported considerable Government influence on its constitution and remit, however. My interviewees alternately described it as an accountant’s initiative or as a case of government push and private response. The Bank of England—a key state regulator and the guardian of City interests—was important in encouraging its formation, and sent a senior advisor to the Committee. The Department of Trade and Industry seconded a civil servant to act as Secretary, and the heads of the DTI Companies Division sat as Observers. The committee’s membership was limited to City organizations and academics. Directors and managers (in effect, the IoD and CBI) were not part of the foundation of the Committee, although former leaders sat in a personal capacity. Thus, the Committee was a closed, inside initiative.

The Final Report and its Code emphasized reorganizing boards. Most controversial was the idea that distinct board committees be created to organize audit, nominations, and pay. Audit panels had been required in the US after Penn Central collapsed in 1970 and by the end of the 1980s were actually not uncommon in UK

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81 Reflecting the common conceptualization, Hampel later described Cadbury Committee as a private sector initiative.
82 Jones and Pollitt, "Who Influences Debates in Business Ethics? An Investigation into the Development of Corporate Governance in the UK since 1990," 33.
83 Sir Adrian Cadbury, "The Response to the Report of the Committee on the Financial Aspects of Corporate Governance," in Perspectives on Company Law 1, ed. Fiona Patfield (Kluwer Law International, 1995). It recommended companies split the chairman and CEO positions (but did not make this compulsory), that directors should be independent non-executives, and that new board committees be formed to deal with audit, compensation, and nominations. These were to be peopled by non-executive directors.
companies. Arguably, however, they challenged the unitary nature of boards by giving non-executives special responsibilities not shared by other directors. Nonetheless, CBI and the Stock Exchange had endorsed them in 1987 (at the initiative of ProNED). Compensation committees were also not particularly innovative; the Institute of Directors had advocated them for over a decade.

Participants in governance welcomed the Cadbury Code because it enshrined a principled (rather than prescriptive and legislative) regime. There was much talk about the virtues of flexibility, and about avoiding ‘box ticking’ and ‘one-size-fits-all’ rules. This was the main virtue of the Code for managers: it preserved their flexibility. They were able to depart from governance best practice if and when they saw fit and could justify it to shareholders. It introduced the notion of ‘comply or explain;’ companies would not be forced to comply, but would have to report that they were in compliance or explain why they were not. Given this degree of transparency, investors could judge for themselves whether departures from the Code’s recommendations were warranted in particular circumstances. By contrast, legislation on board committees was strongly opposed, particularly by the Confederation of British Industry but also by ministers.85

84 “A Study in Effectiveness,” Financial Times, 24 June 1988. Coopers and Lybrand found 42% of its audit client companies had such committees a year later.
85 Several times during his career a Tory MP Brandon Rhys Williams backed bills mandating both NEDs and Audit Committees. The reform would have increased directors’ independence from management. In 1988 the Government said it would no longer oppose Rhys Williams’ private bill in the Commons. The Bill passed the lower House with Conservative support but was strongly opposed—and defeated—by managerial interests (the CBI) in the Lords. Michael Skapinker, "CBI Attacks Companies Bill Ahead of Lords Debate," Financial Times 18 May, 1988.
Later, CBI also successfully opposed efforts to promote women NEDs, apparently fearing any statutory clarification of directors’ roles.\(^8\)6

*Greenbury and Executive Pay*

While companies responded to the Cadbury Code by reorganizing their boards, executive pay rises went unabated. The issue peaked first in 1995, with front-page stories, frequent oral and written Parliamentary questions on the subject, and a Commons Employment Committee hearing.\(^8\)7 A Tory campaign document acknowledged that pay was an embarrassment and called for heavier taxation of stock options.\(^8\)8 The party Chairman even called for pay restraint on national television.\(^8\)9

Prime Minister John Major met the heads of both the Institute of Directors and the Confederation of British Industry to discuss the issue.\(^9\)0 In the Commons, he sent stronger signals, saying that he found executive pay “distasteful,” that action was needed, and that he would legislate to back up Greenbury’s eventual proposals.\(^9\)1 Major’s comments were interpreted as tasking the Greenbury committee to evaluate not only disclosure of executive pay but also to ensure that pay was based on performance and not ‘windfall gains.’ Later Downing Street backed off the latter, which sounded too much

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like an ‘incomes policy.’ Nonetheless, Deputy Prime Minister Michael Heseltine had publicly threatened legislation were the private sector not to act.

Simultaneously, though, the Government expressed confidence in private action. Although reports that Heseltine had “set up” the Greenbury Committee are not repeated in the academic literature, it is clear that his presence was intensely felt in the City, and that Number Ten was acutely embarrassed by the issue. In the end, unconvinced that “legislation can produce useful improvements in…governance,” CBI was the sponsoring body. Separately, the Institute of Directors published guidelines to help remuneration committees do their business. With Greenbury underway, Ian Lang (Heseltine’s successor at DTI) appears to have adopted a less interventionist stance.

The political pressure was strong to produce results. CBI and IoD feared it would not be enough to stave off legislation in an anticipated Labour government. Ronnie Hampel, who later chaired the successor body to Cadbury, said publicly that Greenbury was overly influenced by political considerations and (he implied) would unduly burden companies. The institutional investors disagreed. Nonetheless, the Committee was

93 Heseltine had suggested intervention on pay restraint would be damaging in 1994.
94 See, for example, Written Answers: Treasury Questions, Commons Hansard, 2 February 1995, col. 791-792.
95 George Jones, "Options on Shares 'Should Be Taxed'," The Daily Telegraph, 12 July 1995.
96 Wallace, "Interview: Adair Turner."
99 Jones and Pollitt, "Who Influences Debates in Business Ethics? An Investigation into the Development of Corporate Governance in the UK since 1990."
dominated by those it was supposed to regulate, including the head of the leading association of board members (the Institute of Directors, IoD).\textsuperscript{101}

The Code produced by Greenbury required companies to have a remuneration committee of non-executive directors that would report to shareholders directly. This report would disclose directors’ pay, but would not need to be voted on at annual general meetings. The Stock Exchange implemented these reforms for listed companies. Later, the Government institutionalized Greenbury’s requirements in the form of a Statutory Instrument (regulation) stipulating that directors’ emoluments be reported annually.\textsuperscript{102} The Government did not go beyond Greenbury, and in fact the rules were less stringent for unlisted companies.\textsuperscript{103} The Greenbury disclosure rules, some claimed later, actually contributed to rising pay as companies and directors tried to keep up with their peers.

\textit{Hampel and the Combined Code}

As anticipated in the Cadbury report, the Financial Reporting Council convened a follow-up committee in 1996. In this case the prime movers were franchise and private bodies rather than the Government.\textsuperscript{104} Jones and Pollitt concur that Government intervention in its initiation, formation, and deliberation was low. The new committee’s chairman, Ronnie Hampel, said he expected a “full and frank debate” but had “no wish to

\textsuperscript{101} There were also two institutional investors. \textit{Directors’ Remuneration: Report of a Study Group Chaired by Sir Richard Greenbury}, (London: Gee, 1995), 5.
\textsuperscript{102} Company Accounts (Disclosure of Directors’ Emoluments) Regulations 1997. Statutory Instruments are ministerial regulation authorized under the Companies Act.
\textsuperscript{103} Lords Hansard 28 Feb 1997, Col. 1442.
\textsuperscript{104} Jones and Pollitt, "Who Influences Debates in Business Ethics? An Investigation into the Development of Corporate Governance in the UK since 1990." The sponsors were the Stock Exchange, CBI, the IoD, the NAPF, and ABI.
produce an earth shattering report.” He clearly wanted to rehabilitate management’s image, and managers were over-represented on the body. He wrote that, happily, the panel was not driven primarily by preventing abuse, but would be “equally concerned with the positive contribution which good corporate governance can make.” However, the Hampel’s own role was as controversial in the end as Richard Greenbury’s. Remarkably, he opined that the link between good governance and performance was not actually proven. This remark did not appear in the final Report. At the final press conference Hampel said he wasn’t sure which elements would be included in a code of codes. His recommendations came after the election of the new Labour government in 1997, and are considered in the second half of this chapter.

Control & shareholding

The Cadbury, Greenbury, and (later) Hampel reports each joined the charge that investors were not doing their part. There was no compulsion, however. While private authoritative committees were able to agree upon and impose board reform, no such coordinating authority existed for the shareholders. How could investors be encouraged to behave like proprietors rather than punters? Or, indeed, had they taken up that role already?

109 Appended to Hampel’s Final Report was a ‘Code of Principles and Provisions for Institutional Shareholders,’ who “have a responsibility to make considered use of their votes.”
The London Stock Exchange argued that there was, in fact, enough shareholder governance—but that it was informal and company specific, and therefore private. There were private associational initiatives to raise collective awareness, but they were promotional rather than compulsory. The Institutional Shareholders Committee published in the early 1990s statements of best practice both for directors and for its members.111 Separately, the Association of British Insurers and National Association of Pension Funds (NAPF) issued guidance to directors and to their own members, along with discussion documents on improving this mechanism. The NAPF tried to ensure that pension fund trustees tasked fund managers appropriately.

Arguably more important than these associational efforts, however, were the effect of newly aggressive players in the equities markets. The 1990s was, in the end, the decade of the “shareholder value movement.” This began as North American public pension funds bought into the UK markets—and sought higher returns. Most prominent among them was the leading institutional voice in US governance—the California Public Employees Retirement System (CALPERS). Joining some prominent UK public funds, they led the City in announcing buying, selling, and voting intentions, adding to the


111 Texts are archived online at: http://www.ivis.co.UK/pages/guidelines.html#sectioneight. ISC members were to encourage regular contact, discourage concentrating power at the head of the board, and encourage non-executive directors, compensation and audit committees.
effects of equities markets generally. By attracting media attention they helped shape
the governance debate more widely as well as the fears of managers.

Managers generally did not want the attention and were anyway ambiguous about
the exact role of their shareholder principals. Even Ronnie Hampel expressed some
confusion. He said that, although “shareholders’ primary responsibility is not to
governance [sic]” they were nonetheless the ultimate judges of companies’
performance. Another member of the committee said that shareholder activism –
specific interventions in particular companies—was “a reflection of the failure of
shareholder vigilance” rather than its affirmation.

In a remarkable speech in 2002 the president of the Confederation of British
Industry (CBI) complained that corporate governance was actually undermined by
institutional investors. Not only have they a range of conflicts of interest, he said, they are
interested only in shareholder value. The result is that “companies cut corners, ride
roughshod and rush fences in headlong pursuit and sometimes blinkered pursuit” of
shareholder value. Instead, he claimed, managers wanted to attend more closely to the

Note:
112 New governance products assisted these processes. A number of advisory services emerged to help
monitor companies, providing more information to market participants. The UK-based Pensions
Investment Research Centre, Inc. was founded in 1991 to represent public retirement funds (already more
likely to vote their shares). PIRC is something of an oddity in UK investment circles, because it is
sympathetic to stakeholder concerns. PIRC provides (fee-based) services to improve governance.
113 See for example, Moore, "Institutional Shareholders; Increasing Degree of Involvement."
114 Chris Hughes, "Investors to Blame," Investors Chronicle, 30 January 1998. A member of the committee
from the accounting profession remarked that, although the buck stops in the boardroom, institutional
investors were the “dominant influence” in governance. Peter Smith, "In Defence of Hampel," Financial
Times, 7 August 1997.
115 Tom Ross of Aon Consulting, quoted in Hughes, "Investors to Blame."
needs of “customers, employees, ordinary shareholders, and the wider community.”

The irony of these comments is that CBI and other managerial representatives stridently opposed pro-stakeholding reforms that would have facilitated such attention. What they really wanted was autonomy, not to “attend to the needs of” stakeholders.

The disruptive effects of these interventions on management underline the fact that they were led by public pension funds. These do not face the same conflicts of interest facing other financial institutions. They are not engaged in selling non-fund management services to companies, as in the case of investment houses and banks. Nor, as in the case of company pension funds, are they run by directors who dislike investor activism. Instead, their chief concern is to protect and grow their retirees’ funds. They have proven effective in reorienting British governance from simply guarding against abuse to enhancing shareholder wealth.

**Direct state activity on shareholders**

There was no direct state intervention on enhancing shareholder governance for investor protection beyond two abortive consultations and the Myners committee. The latter was launched in 1996 to evaluate the availability of long term finance to business and considered in the next chapter, because it is largely a stakeholder initiative.

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116 The speaker was Iain Vallance, former head of British Telecom CBI: Fund Managers Should Not Police Corporate Governance (Manifest-I, June, 2002 [cited 17 July 2002]).

117 Even some managers attempted to promote activism. In 1998, for example the grocery chain Sainsbury’s insisted that its own employee pension fund managers vote their shares. This was publicly explained as an attempt to set an example to others and so forestall government compulsion Mike Foster, "Sainsbury Insists on Share Voting by Fund Managers," London Financial News, 3 August 1998.

118 The independent and non-partisan judicial Law Commission was asked to consult and make recommendations on improving the ability of aggrieved shareholders to sue for legal redress (‘shareholder remedies’). However, the Government did not follow up. The Commission’s findings were later worked into the Blair government’s reviews of company law. Law Commission, "Shareholder Remedies."
An consultation was launched on easing the process by which investors can bring resolutions for a vote at annual general meetings. Shareholders had attempted to rein in pay at British Gas but had found the process of getting a resolution circulated ahead of the AGM prohibitively expensive. The Commons Employment Committee subsequently called on the Government to address the issue. A consultation document was published in April 1996, and later that year a second consultation sought views on private shareholder rights when shares are held through ‘nominees.’ Work flagged on this issue, however. As the election of 1997 approached, Alastair Ross Goobey of the Hermes fund said institutions were “all waiting for something to happen” and “it’s no good remaining silent” on the issue.

Transparency

These bodies modified board responsibilities for transparency. The accounting profession itself, for most of its history, was subject to the private and laissez faire regulation of its competing professional bodies. Although company law long required

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119 Resolutions are one means by which a shareholder can gain support for some governance change, but they are expensive to sponsor and distribute to other shareholders. Minister of state Ian Lang announced a consultation on when shareholder resolutions may be tabled and who should pay for them to be distributed. See the Departmental press release at http://www.newsrelease-archive.net/coi/depts/GTI/coi7603b.ok Accessed June 17, 2004 and on file with author.

120 Jane Martinson, "Call for Probe to Restart," Financial Times 1997. A related issue was the question of identifying shareholders during contested takeover bids. Takeovers are a matter for a franchise body, the City Takeover Panel, with some statutory reporting requirements. Boards, other shareholders, and the state can find it difficult to identify who is benefiting from a transaction when ‘nominees’ are buying or selling. This means conflicts of interest are hidden from the company and from others. A director may be trading shares, for example, through a ‘nominee’ who acts on his or her behalf. Shareholder governance was stymied in this way during the Polly Peck case. This might well have been resolved by the state. CA1989 gave the Secretary of State authority to facilitate the discovery of share beneficiaries in cases of takeovers. This would have required the Secretary to produce ‘secondary’ legislation—the equivalent of an American regulatory rule-making. This statutory authority was not taken up.
audited accounts, it did not specify the form and content of those accounts. Standards were not mandatory and tended to reflect existing practice. Inconsistencies in the preparation of accounts became increasingly problematic during the merger wave of the 1960s and with the discovery of significant failures. In 1970 the Institute of Chartered Accountants of England and Wales set up the Accounting Standards Steering Committee, in part to forestall government regulation. This was reorganized in 1976 and again in 1990. In both instances it was a peak association of the professional bodies rather than the state that led the reforms.

Thus, as the 1990s began, accounting standards were undergoing significant institutional reform, with a new, franchise self-regulatory organization, the Financial Reporting Council established and recognized by the government in 1990. New and reactive institutions were forced to deal with a severe test of their capacity. The poor timing of institutional reform would be repeated at the end of the decade.

CA1989 did make changes to transparency regime. First, it empowered courts to order financial restatements that had not given a ‘true and fair’ view of accounts. Second, it extended the Secretary of State’s legal powers to regulate the accountancy

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121 The requirement is to present a fair and extensive presentation of the figures. Statute left the details of what this would mean to general practice and professional guidance. David Alexander, Financial Reporting: The Theoretical and Regulatory Framework (Wokingham: Gee/Van Nostrand Reinhold (UK), 1986).
123 The Consultative Committee of Accounting Bodies brought together the various Institutes.
profession. Citing flexibility, however, the government preferred not to put the standards themselves on a statutory footing.\footnote{125 John Redwood, Commons Hansard 25 October 1989.} They were delegated to the new Financial Reporting Council and its subsidiaries on standards and review. This implemented the recommendations of a self-regulatory committee on accounting regulation (the Dearing Committee). It represented another significant franchising of private authority. Problems with the new regime were quickly apparent, however. Internal DTI reviews in 1992 and 1994 were critical of the new professional regulatory regime.

The 1989 Act also implemented EU Eighth Directive requirements to regulate auditing, including independence issues. Again, auditing standards were to be set through a recognized supervisory (franchise) body.\footnote{126 The Auditing Practices Board was established in 1991 to made standards and ensure competence.} In 1991 regulations were introduced to reduce auditor conflicts of interest by requiring companies to disclose non-audit fees paid to their auditing firm.\footnote{127 Companies Act 1985 (Disclosure of Remuneration for Non-Audit Work) Regulations) 1991} This was required by the EU, was a long-standing desire of the institutional investors, and was opposed by accountancy firms. In a subsequent deregulatory move, the Government \textit{reduced} the non-audit work falling within the regulations’ scope.\footnote{128 Disclosure of Interests in Shares (Amendment) Regulations 1993, 27 May 1993} DTI said it was “working on a wider package of proposals” for lowering statutory accounting burdens.

Analysis

Table 3.3 summarizes the Government’s approach. The Conservatives sought to balance the twin goals of investor protection and managerial flexibility through...
organizing private, code-based approach to the systemic reforms that investors and others identified as necessary. The rationale was two-fold: that the system could repair itself and that the Government must preserve flexibility. Existing board structures were adequate or moving in the right direction, shareholder democracy and the markets would rein in bad directors, and accountants provided the needed information. Only the participants themselves—with most at stake, after all—could respond appropriately. Legislation would be either redundant or destructive. Notably, however, the early notion that only a few individuals were to blame was replaced by a more systemic approach. Ministers then adopted the dual strategy of encouraging private authoritative reform while threatening—but not implementing—legislation on the more difficult issue of executive pay.
Table 3.3 State activity 1990-1997

<table>
<thead>
<tr>
<th></th>
<th>Enhanced enforcement of existing law</th>
<th>Promoting private authority</th>
<th>New and stronger law</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Direction (board)</strong></td>
<td>Increased investigations by DTI &amp; data collection at Companies House Executive pay disclosure requirements of Greenbury implemented by statutory instrument Courts increasingly hard on directors</td>
<td>Promotion, support and monitoring of Cadbury committee Promotion of Greenbury Committee Informal contacts promoting terms of reference for Hampel Committee</td>
<td>Little activity Some strengthening of insider trading rules Consultation on increasing privacy of directors’ home addresses</td>
</tr>
<tr>
<td><strong>Accountability (shareholding)</strong></td>
<td>No existing regulatory compulsion to vote</td>
<td>DTI initiated Myners Committee with CBI and investors</td>
<td>None significant Law Commission to investigate shareholder remedies</td>
</tr>
<tr>
<td><strong>Transparency</strong></td>
<td>Minor improvements to administration of timing of company reporting to Companies House</td>
<td>Promotion, support and monitoring of Cadbury committee Promotion of Greenbury Committee Informal contacts promoting terms of reference for Hampel Committee</td>
<td>CA1989 permits courts to order financial restatements Disclosure of non-audit fees paid by clients to auditing firms mandated by EU law; Gov’t weakens mandate Minor consultation on deregulation for small companies</td>
</tr>
</tbody>
</table>
Table 3.4 Summary of reforms during period by governance mechanism

<table>
<thead>
<tr>
<th>Mechanism</th>
<th>Major Reform</th>
</tr>
</thead>
</table>
| Direction   | Combined Code of Best Practice 1998: Statement of principles and code included in the Listing Rules of the London Stock Exchange—the major franchise body regulating corporate governance:  
  • Split roles of Chair and CEO; or justify not doing so  
  • 1/3 of board should be NED; independent NEDs should be identified in annual report  
  • Senior NED to be identified in annual report  
  • Recommends training for all directors  
  • Reelection of all directors every three years  
  • Performance pay; Recommended payment in shares, not options  
  • Full board reports on remuneration instead of committee report  
  • Audit, remuneration, and nominations committees, these should be independent  
  • Internal controls: Turnbull Report at behest of London Stock Exchange requires move to risk assessment for all controls, not merely financial controls |
| Control     | Various private voluntary/non-enforceable codes of practice, industry statements of intent to vote  
  Other state efforts on shareholding  
  • A consultation on when shareholder resolutions may be tabled and who should pay for them to be distributed  
  • Later a second consultation sought views on private shareholder rights when shares are held through ‘nominees.’  
  • Work apparently flagged on this issue  
  Role of shareholders remains ambiguous  
  • Eg Hampel: asserting that shareholders’ primary responsibilities should not be governance, but that they would ultimately nonetheless be the judges of companies’ performance  
  • This ambivalence makes sense given the difficulty in establishing the proper relationship between shareholders and directors. One senior accountant and member of the committee later remarked that, although the buck stops in the boardroom, institutional investors have a “dominant influence” in governance.  
  • Another member viewed shareholder activism as “a reflection of the failure of shareholder vigilance.”  
  • On the other hand, said Hampel, “shareholders’ primary responsibility is not to governance.” |
| Transparency | General                                                                                                                                                                                                     |
- Increased care by board on reporting
- Transparency has crucial role in lending teeth to the Combined Code, on the principle of ‘comply or explain’

**Audit and non-audit fees paid to auditors**
- In 1991 DTI Secretary John Redwood moved to reduce conflicts of interest by requiring companies to disclose non-audit fees paid to auditors.
- This was required by Brussels, was a long-standing desire of the institutional investors and was opposed by accountancy firms
- In 1995 the Government reduced the non-audit work falling within the regulations’ scope.

**Regulation of the profession**
- Internal departmental reviews of the accountancy profession’s regulatory regime were critical in 1992 and 1994
- No action taken

Deregulation suggested, especially for small business, but little action
<table>
<thead>
<tr>
<th>Development and Date</th>
<th>Problem &amp; Mechanism</th>
<th>Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investor coalition Institutional Shareholders Committee (ISC) issues “The Role and Duties of Directors” including statement of best practice 1991, updated 1993 to include Cadbury code</td>
<td>Problem: Corp. collapse &amp; accountability Mechanism: Board governance &amp; Shareholder governance</td>
<td>Focus on non-executive directors’ monitoring role; independence of non-directors; rec’s 3 year contracts; remuneration committees; split of CEO/chairman roles</td>
</tr>
<tr>
<td>ISC publishes “Responsibilities of Institutional Shareholders in the UK” including principles of good practice, 1991</td>
<td>Problem: Corp. collapse &amp; accountability Mechanism: Shareholder governance &amp; Board governance</td>
<td>Encourages shareholder contact with board; opposes non-voting shares; encourages use of votes; encourages monitoring of composition of boards; supports committees; fiduciary responsibility to investors overrides other responsibilities</td>
</tr>
<tr>
<td>Committee on the Financial Aspects of Corporate Governance (Cadbury) set up by the Financial Reporting Council, in response to high profile failures which had resulted in large losses for investors; December 1992</td>
<td>Problem: Corp. collapse &amp; accountability Mechanism: Board Governance Transparency</td>
<td>Recommended at least 3 NEDs, mostly independent, monitoring, recommended audit and remuneration committee, endorsed nominations committee; advocated but did not require separation of Chair and CEO; Code required disclosure about extent of compliance and reasons for non-compliance. Efforts needed to improve audits. Institutional investors should disclose their voting policies.</td>
</tr>
<tr>
<td>IVIS (Institutional Voting Information Service) created by the ABI to advise members on governance compliance in particular companies</td>
<td>Problem: Corp. collapse &amp; accountability Mechanism: Shareholder governance</td>
<td>Proprietary service: <a href="http://www.ivis.computasoft.com">www.ivis.computasoft.com</a></td>
</tr>
<tr>
<td>Tomorrow’s Company Inquiry Reports 1995</td>
<td>Problem: Competitiveness Stakeholding Mechanism: Transparency</td>
<td>Business friendly group advocates ‘inclusive leadership’ including new emphasis on relationships within companies and between companies and outsiders. Heavy emphasis on expanded, beyond-financial reporting and disclosure.</td>
</tr>
<tr>
<td>Directors’ Remuneration: Report of a Study Group Chaired by Sir Richard Greenbury (Greenbury Report) Set up January 1995, reports July 1995</td>
<td>Problem: Executive pay</td>
<td>Proposed code of best practice in determining and accounting for Directors’ pay; compliance should be expected and report on compliance issued including explanation of non-compliance; NED remuneration committee should be established and report to AGM (no separate vote required); few constraints on pay suggested; policy should be reported on but no performance reporting requirements.</td>
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<tr>
<td>Myners Report Private sector initiative “with the encouragement of DTI Innovation unit” into industry/City relations</td>
<td>Problem: Competitiveness Executive pay (minor) Mechanism: Shareholder governance</td>
<td>Staffed by DTI, but with managers and investors only on committee. Called for active corporate governance by investors; regular communication by investors with management, including transmission of objectives and evaluation of performance; training of fund managers; management should keep contacts open and regular; keep abreast of disclosure requirements; define and discuss remuneration policy.</td>
</tr>
<tr>
<td>Hampel established Nov 1995 as follow up requested by the Cadbury Committee and FRC Sponsored by LSE, CBI, IoD, Consultative Committee of Accountancy Bodies, NAPF, ABI. Draft report 8/97; Final report 1/98</td>
<td>Problem: Corp. collapse/Accountability (and to “enhance the standing of companies”) Mechanism: Board governance Transparency</td>
<td>Modest proposals advancing work of earlier committees; rec’s a lead or senior NED for each board; 3 yearly elections leading to 1 year contract periods; recommends nomination committees; recommends 1/3 of board be NED; no further guidance on remuneration; suggests liquidated damages provisions for terminations without cause; some AGM reforms; suggests reducing reliance by audit firms on large clients; directors to report on all, not just financial, controls. Report seen as effort to shift discussions to ‘prosperity’ and close off extension of debate into stakeholding arena</td>
</tr>
<tr>
<td>Combined Code incorporated into the London Stock Exchange Listing Rules</td>
<td>Problem: Corp. collapse/Accountability Executive pay Mechanism: All</td>
<td>Mandatory for accounting periods ending 1998; combines provisions from Cadbury, Greenbury and Hampel. Note that with flotation of LSE these are transferred to the new Financial Services Authority’s Listing Authority</td>
</tr>
<tr>
<td><strong>OECD Principles of Corporate Governance</strong>&lt;br&gt;May 1999</td>
<td><strong>Problem:</strong>&lt;br&gt;Corp. collapse/Accountability (economic development)&lt;br&gt;<strong>Mechanism:</strong> All</td>
<td>Focus on shareholder protection, especially through shareholder rights, equal legal treatment of shareholders, transparency and disclosure, and responsible boards. Stakeholder recognition permitted but not required; recommended that governance “permit performance-enhancing mechanisms for stakeholder participation”</td>
</tr>
<tr>
<td>---</td>
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</tr>
<tr>
<td><strong>IoD launches chartered director qualification including Code of Professional Conduct 2000</strong></td>
<td><strong>Problem:</strong>&lt;br&gt;Corp. collapse/Accountability&lt;br&gt;<strong>Mechanism:</strong> Board</td>
<td>Charter qualifications for directors</td>
</tr>
<tr>
<td><strong>Turnbull Report Internal Control: Guidance for Directors on the Combined Code, ICAEW</strong></td>
<td><strong>Problem:</strong>&lt;br&gt;Corp. collapse/Accountability&lt;br&gt;<strong>Mechanism:</strong> Board &amp; Transparency</td>
<td>Institute of Chartered Accountants of England and Wales guidance on internal control of risks, reporting, and compliance with law.</td>
</tr>
</tbody>
</table>
IV. The Labour response: state displacing private authority

Labour’s term in office began with two significant governance events. The first was the publication of the Hampel Report and the new Combined Code. Ministers gave only a lukewarm reception to this last private initiative, but they did not immediately move to strengthen it. There was no sense of urgency on corporate governance for investors at this point. Instead the Government was preparing the second event—the launch by Labour ministers of a modernizing Company Law Review (CLR). The chief import of the CLR was its attempt to rationalize the law and to consider the place of stakeholders. The first factor is, for the most part, not relevant to this dissertation since it did not represent corporate governance reform. Where the CLR’s efforts intersected with investor protection, I evaluate it below. The second is considered at length in the next chapter. Neither the CLR or the Hampel Report anticipated the crisis to come in the wake of Enron and WorldCom. There were no significant private initiatives during the period. I deal first with Hampel and then the CLR, before turning to post-Enron initiatives.

129 For a comprehensive and critical overview of the Hampel Report, see {Villiers, 2000 #990} and Alan Dignam, "A Principled Approach to Self-Regulation? The Report of the Hampel Committee on Corporate Governance," *The Company Lawyer*, May 1998. The Code was given to the Stock Exchange for minor clarifying consultations and implementation. The Stock Exchange required statements of compliance in company annual reports, thus codifying the rules more firmly. This was followed by additional clarifying guidance on the internal control aspects of Code compliance (the Turnbull Report) and more grumbling about corporate governance ‘overload.’ ICAEW, *Internal Control: Guidance for Directors on the Combined Code (Turnbull)* (London: Institute of Chartered Accountants in England and Wales, 1999). Turnbull is of interest because it involved a turn to risk management that ecologists in particular exploited to their own ends.
Table 3.6 Power and Authority in UK Governance 1998-2003

<table>
<thead>
<tr>
<th></th>
<th>Power within governance</th>
<th>Authority over governance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Overall</strong></td>
<td>Managers face further restraints, but no new legislation except on pay reporting; investors benefit.</td>
<td>Private regulatory arrangements seen by Labour ministers as properly subject to greater state influence; particular concern about failure of pay restraint.</td>
</tr>
<tr>
<td><strong>Direction (Board)</strong></td>
<td>New reporting requirements moderately weaken managerial position; managers not forced to undergo major new board restriction</td>
<td>Ministerial review bodies on Combined Code, with ministers selecting among proposals (rejecting most burdensome to managers)</td>
</tr>
<tr>
<td><strong>Control (Shareholder)</strong></td>
<td>Shareholder advantaged by new vote on managerial pay policy (not on pay itself); no regulatory burdens imposed on shareholders except reporting on their governance voting policy.</td>
<td>Financial Services Authority is major new, centralized, regulator but no coordination of shareholder governance role; Listing Rules transferred to FSA but no substantial change; City Takeover Code remains intact.</td>
</tr>
<tr>
<td><strong>Transparency</strong></td>
<td>Managers position continues to weaken marginally</td>
<td>Ministers reorganize accountancy profession twice, but do so in close cooperation with Consultative Committee Accountancy Bodies; essentially regulation still privatized.</td>
</tr>
</tbody>
</table>

**Hampel**

As noted above, Hampel’s committee was a consolidating and review exercise. Its most controversial proposal was the nomination of a senior non-executive director on each board. This, managers claimed, would split the executive and supervisory functions
of directors, sowing dissension and strife. Shareholders might be uncertain as to who was in charge of the company and would be tempted to view the senior non-executive as figure superior in influence to the Chairman or chief executive. Undoubtedly it challenged board chairmen—already under pressure to give up the chief executive function.

Still, the Combined Code produced by Hampel was only mildly burdensome. It failed to specify an exact proportion of non-executive directors, mandate a permanent governance board committee, propose compulsory institutional voting, or require shareholder approval of board pay.130 The Report was described as a “rear-guard” action by management.131 It implicitly criticized the corporate governance movement as threatening ‘flexibility’ on pay and board structure. A ‘box-ticking’ approach by investors and advisers meant directors had to monitor strict compliance rather than implement the spirit and intent of codes. Once the Report was in place, the pro-business Daily Telegraph urged ministers to “…leave these arrangements alone for ten minutes before digging them all up and starting all over again.”132 Hampel himself urged time for the private approach could “deliver the goods.”133 He “seriously hoped” there would be no more major committees.134

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131 On the other hand, a representative of the National Association of Pension Funds described the report as “subtly very much tougher.” Martinson, "Final Hampel Report on Corporate Governance Published Yesterday Accepts Need for Tougher Action."
133 Martinson, "Final Hampel Report on Corporate Governance Published Yesterday Accepts Need for Tougher Action."
The Company Law Review

The Company Law Review inevitably crossed paths with the Code, but ultimately was bypassed by the Government on investor protection. Still, its consultations rehearsed British hostility to state interference. Respondents supported existing Code requirements, but even those who favored change opposed a statutory treatment. Among the largest groups, only the TUC, PIRC and LAPF argued for strengthening and setting out NED requirements in law. In the end, the Steering Group decided not to embody the Code’s requirements on board composition in legislation, or to otherwise strengthen them. It did propose a franchise Standards Body to govern the disclosure of Code compliance in annual reports. But even this committee would not be responsible for substantive rule-making. SG implied that private and franchise bodies would continue to make policy decisions. Accordingly, the Government’s 2002 White Paper proposed nothing on board structures. By this point post-Enron reform initiatives would make any necessary changes.

Investor protection under New Labour: responding to Enron

As I explained in Part I above, at the end of 2001 fraud and failure again shot to the top of the agenda. The British response to Enron and, several months later,

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135 Thus, they rejected specifying NED monitoring role in legislation, separate reports to shareholders by NEDs, specifying the board’s monitoring role, requiring boards to have a majority of NEDs, requiring a majority of independent NEDs, requiring a nomination committee of independents appoint NEDs, and making clearer NED links to the company.

136 The only other advocates of this reform were the World Development Movement (the single stakeholder advocates responding to these questions) and the Association of International Accountants (without specifying why). Jonathan Charkham, formerly of the Bank of England, a member of the Cadbury Committee, and a well-known academic critic of existing governance practices, supported this reform.

137 Final report 5.60
WorldCom, was a mix of self-assurance (“it didn’t/couldn’t happen here”) to self-doubt (“we dodged a bullet and had best insure our future”). In the Commons, Select Committee hearings gave MPs the opportunity to voice their fears. In February 2002 the Commons Treasury Committee asked, “Could it happen here?” and reported the affirmative response of Sir Howard Davies, chairman of the new Financial Services Authority. The report also cited a remark by Derek Higgs that “the whole financial community has become terribly negligent.” Later Trade and Industry Committee hearings on company law reform were naturally distracted by new governance crisis. This was due in part to the continuing collapse in share prices.

In February 2002, Downing Street launched an inter-departmental ministerial group was formed in response to Enron. In what was becoming a familiar Labourite strategy of bureaucratic dissipation, ministers launched two semi-independent efforts to reshape the Combined Code. Still, this represented a more direct intervention than in the past: the Code was now seen as properly and openly a matter for Departmental influence. The first effort was the Higgs report on non-executives directors, and the second, less controversial, was the Smith group on audit committees. A coincident jurisdictional change had put the Code more clearly under ministerial responsibility. In 2000 the LSE

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138 See the remarks of the Chairman of the Commons Treasury Committee to Members during a Westminster Hall debate on the Committee’s Report: “We understood the inquiry because of a remark made by the chairman of the Financial Services Authority...when he said that the only honest answer to whether an Enron could happen here was yes.” Commons Hansard 13 March 2003 Col. 137WH.
140 Junior ministers from Treasury and DTI led the “Coordinating Group on Audit and Accounting Issues” (CGAAI). Its membership included the state’s Financial Services Authority and the key franchise regulators, but was clearly driven by ministers.
itself became a listed company and management of the Listing Rules was transferred to a new Listing Authority, part of the Financial Services Authority. The following sections trace the evolution of reform—and the managerial backlash—by mechanism.

**Board Governance: reforming the Combined Code**

Indications were that Cadbury and Hampel had exhausted the easier reform options, and open divisions now emerged among senior business people about how to improve boards further. Paul Myners, for example, had called NEDs, the “missing link” in corporate governance. Their role should be strengthened, he said, and they should even meet top shareholders occasionally *without* management.\(^{141}\) In contrast, the outgoing head of the Institute of Directors said NEDs were unreliable and called for their abolition. This was a remarkable comment by the head of a group that was publicly supportive of NEDs. His view was that the only result of a decade of “well-meaning, but…misguided effort” on governance was “that we are more concerned about corporate governance than ever.” Ministerial interference in boards was “dangerous nonsense.”\(^{142}\) In this atmosphere, the Government had problems finding someone to chair its NED review. In the end Derek Higgs was thought an acceptable choice for the City. As one banker said, “he is not a theoretician who will go away and work out how things should be.” Instead he would test issues “against the benchmark of practicality.”\(^{143}\)

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\(^{142}\) Dan Roberts, "Institute of Directors Head Calls for Non-Executive Posts to Be Abolished," *Financial Times*, 25 April 2002.

Higgs’ proposals came in December 2002. The *Financial Times* called them “radical,” and they provoked immediate complaints from managers about their prescriptive inflexibility.\(^{144}\) Investors were essentially supportive.\(^{145}\) The most controversial recommendations were that non-executives should meet without the rest of the board; that a lead independent should be appointed to interact with shareholders; that half of directors should be independent; and that directors should not chair more than one major company. Managers were aghast. This would threaten board comity and shrink the pool of qualified candidates, they charged. The fact that none of it was compulsory was little consolation. Higgs extending the norm-based tradition of “comply or explain” – welcomed in the case of Cadbury because of its flexibility. Managers now complained that this was too burdensome, because new norms spread through markets so quickly. Thus, they were as inflexible as regulations.

Much to the delight of managers, the FRC scaled back Higgs’ recommendations when it published the new Combined Code in July 2003.\(^{146}\) In part, it cultivated flexibility introducing a Byzantine distinction between ‘principles,’ ‘provisions,’ and ‘supporting principles.’ Managerial fears that the Senior Independent Director would undermine the role of board Chairman were also addressed. The Chairman would retain

\(^{144}\) Higgs had not entirely ignored managerial demands. For example, Higgs opted for the CBI’s preferred disclosure by NEDs of their multiple commitments and the extent of their availability rather than (as proposed by TUC, the Institute of Directors, and Tomorrow’s Company) a mandatory limit on directorships. Nonetheless, the proposals were received very badly.

\(^{145}\) The National Association of Pension Funds welcomed the Report, while the Association of British Insurers and Manifest (a voting agency) was looking forward to a more gradual approach.

his/her responsibilities as the leader of non-executives and the main source of information about shareholder’s views. He (or she) would be able to chair the nomination committee and so preserve their influence on board composition. Finally, smaller listed companies could escape with ‘at least two’ independents rather than the 50% proposed by Higgs. Managers and investors welcomed the changed provisions. The FRC’s modifications must be seen as a significant victory for managers and for the hands-off tradition.

Hewitt summed up her board reforms in January 2003. She avoided mentioning Higg’s most controversial aspect—that lead non-executives should meet separately with shareholders to act as a ‘sounding-board.’ She was asked about this in the Commons by her Conservative shadow but did not respond directly. Instead, she assured the House that the Higgs reforms were not “one size fits all” regulation. Incidentally, Hewitt said Laura Tyson would look into how industry might widen the pool of NEDs, including women NEDs.

Labour ministers would emphasize the caution of their response to Enron/WorldCom, arguing that it was much more measured than the US reaction. The crisis in the US generated considerably more political heat and resulted in a greater extension of law—at both the federal and state levels.147 Ministers viewed the US experience with the horror of leaders unburdened by the push and pull of an aggressive Congress or activist state attorneys general. DTI’s annual report said it opposed

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147 It is true that the response has been attacked as inadequate, and also that the Congressional response was stalled until the WorldCom failure.
“anything which could lead to Sarbanes-Oxley type prescriptive legislation.” DTI secretary Hewitt predicted it “could be an example of legislating in haste, repenting at leisure.” Thus, despite their willingness to use more muscular state influence on the private sector, they stood by their view that governance should be based on principles rather than rules and statute. In this sense, Labour has faced both ways at once on corporate governance. This is the assessment of the governance policy community.

Reacting to board-room pay
The problem of executive pay was not amenable to a private fix. Greenbury’s disclosure requirements apparently helped raise average salaries, since everyone now knows what everyone else is earning. A DTI study showed that only 7 of 270 firms studied presented remuneration reports to the AGM for a shareholder vote, despite a Greenbury’s view that they should at least consider this. The Institute of Directors (IoD) issued additional guidance, but to no avail.

Between 1999 and 2003 ministers sent strong but contradictory signals on regulating pay. Peter Mandelson issued a ‘final warning’ in 1998. Christopher Haskins of the Better Regulation Task Force hoped CLR would produce “overdue” reforms but that “in desperation the Government has appealed to shareholders.” On the other hand, Haskins was a member of the Hampel committee and elsewhere said, even as

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150 Sheikh, "Curbing Top Pay Bonanza."
he was appointed to the task force, said “it was not government’s business” to tell companies how to run themselves. In meetings with institutional investors and in a speech in 1999, the Stephen Byers warned that he was ready to legislate, and the Lords were told that DTI was actively monitoring compliance with Greenbury. Byers told institutional shareholders that he found “considerable room for improvement,” especially on reporting the link between pay, performance, and long-term company objectives. He said the Government might go so far as to require approval of pay policies—as well as the report—or even forcing directors to be reelected annually. Reportedly Chancellor Gordon Brown was ready to go even further than Byers.

Still, the Government acted without celerity. The CLR was not allowed to make proposals, although pay fell within its initial remit. Ministers surprised SG members by preempting them. In 1999 a consultation was launched, but three years and another consultation passed before the final regulations were enacted. During this time officials reassured the City that no action was imminent. Whatever they were telling the City in private, ministers announced the regulations to the media several times before sending them to Parliament for approval. Byers in March 2001 and Hewitt in October 2001

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153 Wighton, "Mandelson Gives Final Warning on Executive Salaries."
154 Lords Hansard 11 May 1999: Column 1083
157 Department of Trade and Industry, "Directors' Remuneration: A Consultative Document," (London: DTI, 1999). Strikingly absent from the document was any discussion of how the proposals might be divided between statute, franchise regulation (through the Stock Exchange Listing Rules), or the Combined Code. It gave no indication as to what would be mandatory, and what would be a matter for best practice. Thus the boundaries of private and state authority were further muddied. The Government seemed to be implying that private authorities should organize modifications to the Combined Code to implement ministerial concerns.
issued press releases touting the Government’s forthcoming reforms, but they were not laid before Parliament until June 2002. With equities markets well down on their earlier peaks, the rhetoric shifted. As Trade and Industry Secretary Hewitt remarked, “when workers are losing jobs and investors are losing money, then company directors should be sharing in the pain.” Nonetheless, the press reported internal division. The Prime Minister, in particular, was reluctant to force a vote on pay. The December 2001 proposals were “a compromise approved by Downing Street.”

The main problem, according to the Government, was the lack of disclosure—not of individual directors’ pay, but of the board’s pay policy. The new rule required better explanation and equity performance comparisons including, ministers stressed, US-style graphs! Shareholders would have an ‘advisory’ vote on the report, but not on the policy. Responses were mixed. The Association of British Insurers wanted no less than a vote on the policy itself. The other major shareholder representative, NAPF, was more satisfied. The TUC said the Government’s new thinking represented “a modest success,” especially since it required comparing top and bottom pay rates within companies. Meanwhile, the Law Society highlighted drafting problems and ambiguities with the regulation. Not the least of these was the absurd ambiguity of an advisory shareholder vote. Managers, who had opposed the regulation, have to be seen as the losers. IoD was most hostile,

saying that abuses were still the exception. Still, it might have been worse. CBI welcomed the final regulation, hoping that it would close the issue.

It did not. In early 2003, with headlines focusing now on large termination fees paid to failed departing executives, the Government announced yet another consultation. Indicating that best practice guidance generated by private actors was increasingly subject to state influence, it addressed more explicitly the mix of statute and private guidance. This time, too, proposals were emphasized direct controls rather than transparency mechanisms. Providing more information to markets appeared to be an exhausted strategy.

The most radical option was to amend the Companies Act to permit only ‘fair and reasonable’ compensation on loss of office. Even in the Consultation document, the Government expressed its reluctance to go the first route. It had already allowed a private member’s Bill doing just this to fail. Ministers believed legal remedies were already available, that burdensome litigation would result from new provisions, and that base salaries might rise in reaction to capped severance payments. Other options were to

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162 Shrimsley, "Plan for Investor Votes on Directors Pay 'Too Weak'."
164 By this point the relevant private initiatives were the October 2002 Institutional Shareholders Committee statement of principles, the December 2002 Association of British Insurers/National Association of Pension Funds joint guidance on contracts and compensation, and the Combined Code. In addition, there was a market advance in the provision of information on pay: Pensions Investments Research Consultants, Ltd. added a rating of share incentive and remuneration report to its proxy voting services. This would enable institutional investors paying for the PIRC service to better evaluate companies’ policies and practices.
165 The Bill was introduced by Archie Norman, a Conservative. Company Directors Performance and Compensation Bill, 2002-03, Bill HC 22.
change the severance terms and notice periods companies were around to give their managers. The consultation period ran to the end of September, 2003. Managers, of course, were outraged. Director-General Digby-Jones counseled that, if state limits were imposed, “it won't just be David Beckham who leaves the country.” Still, aware of the reputational problems caused by ‘rewards for failure,’ CBI announced its own, flexible guidelines.

In March 2004 the Government again refused to legislate, issuing yet another threat and demanding that shareholders do their duty. Indeed, 2003 was a remarkable year for activism. Several prominent company chiefs lost their job. Shareholders rejected GlaxoSmithKline’s remuneration report because of a possible severance payment of £22M to its chief executive.

Control & Shareholder Governance: Myners and after

Labour ministers often declared themselves unhappy with investors’ “culture of non-intervention,” despite evidence that the shareholder value movement brought new clarity to directors’ purposes. Both Margaret Beckett and her successor at Department of Trade and Industry, Peter Mandelson, called for greater investor stewardship. Gordon Brown implied that institutional investors were holding back “UK Plc.” Market mechanisms and private initiatives were not promoting sufficient change, ministers

167 This included: (i) restricting severance notice periods to one year and/or capping the liquidated damages; (ii) reducing the statutory contract period for directors from five to three years with one-year renewals; (iii) restricting the use of ‘rolling contracts,’ by which the contract is renewed each day to circumvent existing restrictions—a common practice; and finally, (iv) prohibiting the use of ‘covenants’ for severance payments separate from early dismissal compensation. Some of these measures were previously recommended by the Law Commission and the Company Law Review. Law Commission and Scottish Law Commission, "Company Directors: Regulating Conflicts of Interest and Formulating a Statement of Duties," (London: The Stationery Office, 1999).
argued. This indicates, in part, that they sympathized with the market-myopia argument about governance mentioned in Chapter One, Part IV. This, as I noted in Chapter One, is an argument for stakeholding reform.

However, the ministerial position was rather contradictory and in any case not firm. During the Government’s first Term in office, and prior to Enron/WorldCom, the problem was identified as one of market myopia and under-investment. This implies that shareholder-governance should be improved to in the public (or at least manufacturers’) interest. I pursue this line of thinking in the next Chapter. But after the corporate collapses of 2001-2 the emphasis shifted to improving governance for investor protection.

On both fronts the Government’s moves were tentative. In 1999 the Government required pension schemes to state with their investment principles “their policy (if any) in relation to the exercise of the rights (including voting rights) attaching to investments.”\textsuperscript{168} Note this does not in any way require exercising those rights. Subsequently, the Treasury appointed Paul Myners to head yet another review of institutional investment. His March 2001 Report confirmed that the problem lay with fund managers, consultants, and trustees. Myners recommended a legal duty on fund managers to intervene where it would benefit retirement plan beneficiaries. This mimicked a famous US Department of Labor letter of instruction to trustees covered by the Employee Retirement Income Security Act. The Government responded positively, but legislation was held off in light of intense opposition from the City.

\textsuperscript{168} The Occupational Pension Schemes (Investment, and Assignment, Forfeiture, Bankruptcy etc.) Amendment Regulations 1999. The regulations also required a statement on whether the scheme took into account social, environmental, or ethical matters in selecting investments.
The Company Law Review also addressed this issue, noting again the reasons for shareholder reticence: lack of expertise, the free rider problem, insider trading rules, and conflicts of interest. Institutional investors would clearly face additional costs if their governance role was formally enhanced, and there is no certainty that returns would increase accordingly.

However, the most controversial issue was investor conflicts of interest, because resolving it might close off lucrative business opportunities to fund managers who are part of larger financial services firms. Prompted by John Plender, a special CLR meeting was held on these obvious conflicts of interest. Plender had been chairman of PIRC and was sharply critical of large shareholders who also undertake other financial services. PIRC is allied with the Local Authority Pension Fund committee, which represents retirement funds for public employees. These non-profit investors do not suffer from the same conflicts, because they do not provide financial services to companies in which they invest. Later Jonathan Rickford told the Consultative Committee that several options had been considered and rejected.\footnote{Company Law Review Team, "Consultative Committee Meeting: 1 February 2001; a Note for the Record," (London: DTI, 2001).}

Nonetheless the SG argued that conflicts were a public interest issue and proposed disclosure as a solution. Should companies publicize their relationship with financial services firms who also held shares in the company? Should companies disclose how major shareholders had voted, or should investors themselves disclose votes?\footnote{Other suggestions included having an audit of shareholder resolutions and votes.} The usual lines were drawn in response. CBI and IOD denied there were any conflicts of
interest or even collective action problems. Investors acknowledged the problems but opposed legislative action—again with the exception of the PIRC and LAPF. As might be expected, accountants supported new disclosure.

In its Company Law White Paper, the Government evaded the issue, remarking that conflicts of interest were “difficult and controversial.” In any case, the problem was diverted into the Myners investigation. Separately, a joint Department of Work and Pensions/Treasury consultation began in February 2002 proposing a duty of activism for trustees and fund managers. Shortly thereafter the Institutional Shareholders’ Committee produced another code for investors, requiring that they develop policies on activism and intervene where necessary. Giving the private approach its chance, ministers announced that they would put legislation on hold for two years to await results of the private approach, warning, “We will monitor progress closely.”

Forcing voting would be a dramatic increase in state control over the City, and Labour is reluctant to go that far. This has not stopped investors taking the threat seriously. Voting agencies, such as Manifest, implicitly use the threat of Government action as a marketing tool. A recent, cajoling letter sent to the 750 largest listed

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171 The White Paper. The only mandate was that companies would have to publish the overall results of meeting votes on their website. In its Final Report, SG recommended disclosure of business relationships with investing financial institutions, making shareholder poll results public, audits where requested by a qualified minority of shareholders demand it, and forcing fund managers to tell their clients (but not the public) how they were voting. The final proposal required disclosure to investors but reserved the power to force public disclosure to the Secretary of State should it become necessary.

172 Kelly, quoted in HMT Press Release 108/02. Shareholders do have new rights to vote in AGMs. As noted above the Directors’ Remuneration Report Regulations 2002 set out detailed reporting requirements on how executives and directors are paid. The vote is advisory only, relying on the embarrassment potential in having a report rejected. Under the Political Parties, Elections and Referendums Act 2000 political donations must now be approved by shareholder vote. Finally, some provisions to encourage electronic voting of share proxies have been introduced.
companies from a group of very large investors called for managers to put the remuneration report to a vote. The letter acknowledged imminent government action on increased disclosure, and added that this “may be an indication that the government is prepared to use legislation to require a vote on remuneration.”

Transparency Governance

There was a good deal of attention to accountancy and audit in the wake of Enron. This took two tracks: regulation of the profession itself, and standards on how auditors interact with clients. The first involved questions about oligopoly conditions in the profession, self-financing of self-regulatory bodies, and the disarray of twenty-three entities overseeing accountancy. Ministers restructured these arrangements on coming to office, and revisited them immediately after Enron. In both cases they cooperated closely with the industry’s coordinating body.

DTI began its review of the system, itself only eight years old, in 1998. The Labour Party Business Manifesto had called for more independent regulation. Some academics and very few interest groups wanted a single, “SEC-type” state regulator. This would have resolved jurisdictional confusion and increased political control. But while the former may have attracted professional support, the latter certainly did not. The profession was well prepared, and the Department worked with proposals already worked out by the Consultative Committee of Accountancy Bodies. These were ultimately modified only slightly. Thus, in a clear victory for franchising, the Accountancy

\[173\] Letter from Manifest voting agency to clients on file with author.
Foundation was established in 2000.\textsuperscript{174} It gained control over the existing auditing, ethics, and investigations boards. The second review was announced after Enron and reported in January 2003.\textsuperscript{175} The implementation of these arrangements, now underway, simply means a shift of authority between two franchise bodies: from the Accountancy Foundation to the Financial Reporting Council. But in an even more important win for the profession, the Secretary of State did not insist that the Office of Fair Trading refer accountancy to the Competition Commission.

The audit relationship took on added significance with Enron/WorldCom, since managers deceived directors and shareholders alike. Structural conflicts of interest between companies and auditors make this more likely. The Commons Committees advocated re-tendering of audit contracts and/or rotation of audit firms. At the very least, audit partners should not spend too long on one account. This is important because close relationships necessarily develop between executives and those responsible for going over their books. Even more likely to cause problems is the provision of multiple services by one accounting firm to the same firm. Can a firm making more money from, for example, giving tax advice to a company also conduct an objective audit which may be worth considerably less? The obvious desire is not to alienate the client. Ensuring only

\textsuperscript{174} This established the Accountancy Foundation, together with its subsidiaries on Auditing Practices, Ethics Standards, Investigations and Discipline, and the Review Board. DTI was to be represented as an observer on each. On the other hand, the Foundation was peopled with client representatives rather than practicing accountants. Its membership was nominated by: the National Association of Pension Funds, the Bank of England, public sector audit commission, the national Consumer Council, the Trade Union Congress, the Confederation of British Industry, and the Central Bank of Ireland.

\textsuperscript{175} The initial consultation document was URN 02/1340; the Report was URN 03/589. The Secretary’s legislative proposals were laid out in “Review of the Regulatory Regime of the Accountancy Profession: Legislative Proposals,” (London: Department of Trade and Industry, 2003).
non-executive board members were responsible for the audit contract might also help. Equally, the Committees wanted to improve industry standards on ‘revenue recognition’ and ‘aggressive earnings management’—the sometimes-unsubtle ways numbers can be interpreted in compiling financial accounts.\(^{176}\)

The Company Law Review had identified independence as an area “which we believe require full consideration.”\(^{177}\) Investor and management groups did not express great interest, but the accounting industry uniformly opposed the CLR proposals. In the end, the Steering Group did “not believe further change is desirable at this time.” The Government’s 2001 white paper on company law did nothing substantive to address the post-Enron confidence problems. In July 2002 the Government’s post-Enron ministerial group issued strong interim proposals, however, together with a censorious announcement press release. It threatened mandating audit committees in law rather than in the Combined Code and enforcing mandatory rotation or re-tendering of audit contracts.

By Winter 2002-3 the familiar cycle of concern, review, threat, and retreat was complete. The CGAAI’s final report dropped the most controversial suggestions: there would be no referral of the industry to the Competition Commission, audit rotation would not be required, and audit committees would be regulated through the Combined Code. Additionally, audit firm transparency would be on a voluntary basis, subject to the threat


of legislation if this was not effective. Auditor conflicts of interest would be ameliorated flexibly through a ‘principles-based framework.’\textsuperscript{178}

V. The European Union and investor protection

The European Union has exerted a minor pull on the formal character of British governance with regard to investor-manager conflicts. As I noted in Chapter Two, EU legislation has had to be incorporated into UK law even when it does not actually change anything. This has worsened company law’s complexity for no obvious gain. It forced ministers to write new statutes on corporate governance for accountancy (with directives on audit, for example) and on stakeholding (in the case of workplace consultation). Responding to Enron/WorldCom, the EU’s High Level Group on Company Law (the Winter Report) has adopted a broadly liberal stance: that company law should primarily concentrate on the efficiency and competitiveness of business. As in the Anglo-systems, disclosure is key.

More logistically difficult is the Commission’s demand that members adopt international accounting standards, due to be implemented across the Union by 2005. As usual, the EU was seen more as problem than solution: overweening EC bureaucrats might threaten British ‘true and fair’ accountancy standards and code-based governance reforms.\textsuperscript{179} However, the UK appears to be able to shape IASB policy itself. It has a

\textsuperscript{178} This would carry a presumption against providing internal audit, and would frown upon providing valuation services, taxation services, and the design and supply of IT services. Again, however, all this was a matter of standards rather than law.

\textsuperscript{179} This was connected to problems of reconciling international standards across the Atlantic divide. Prominent among them were allegedly improper influence exercised by US industrialists on the International Accounting Standards Body. US industrialists threatened IASB with funding reductions, should the body bring forward stronger rules on expensing share options, pension cost accounting, lease
distinctly Anglo-capitalist bent. It is led by the pugnacious Scottish accountant David Tweedie. On a related tax issue, one senior EU official publicly disparaged the IASB as “fourteen guys in London.” Asking his audience whether they should trust the IASB, he said, “Don’t do it. Trust me, I know these guys.”

In practically all instances, UK ministers have managed to give themselves statutory authority to regulate to the EU’s standards, and then promptly delegated this authority to the relevant private-franchise bodies. Labour has used this tactic only marginally less than the Tories. Furthermore, the consensus is that UK investor protections are already more stringent in substance than those common in Europe, even if they are enforced privately.

VI. Concluding comments

Between the Companies Act of 1989—which was not a corporate governance reform bill—and the election of the new Labour Government in 1997, the Conservatives introduced no significant companies legislation. Neither investors nor managers could complain about burdensome state regulation. There was, however, a remarkable advance in private institutionalized authority over governance. It arose in an area accounting, and special purpose entities. Sir David Tweedie, IASB Chairman, said that managers told him that they spent $70M dollars opposing expensing stock options in the US Congress and would be happy to demonstrate their power to the IASB. Select Committee on Treasury, Examination of Witnesses, Sir David Tweedie, IASB Chairman, 2 July 2002, Q337.

180 Paul Volcker heads its Delaware-incorporated parent foundation.
181 The official was Karel Van Hulle, head of the Accounting and Auditing Unit in the Internal Market DG. “Taking Stock,” Accountancy Age, February 12 2004.
182 The Criminal Justice Act of 1993 somewhat tightened insider-trading rules. The Law Commission reviewed new proposals on corporate manslaughter, which might threaten directors with greater liability. And a new requirement was introduced for directors to report annually on their firms’ policies about paying accounts due in business-to-business trade. In addition, in response to Maxwell, rules governing the management of company pension funds were tightened, but these were only distantly related to corporate governance.
previously marked by little authoritative coordination of any kind. The result was coordinated change in board and transparency structures that favored investors. Although in part they merely codified existing ‘best practice,’ the Cadbury, Greenbury and Hampel Committees successfully altered board organization and directors’ behavior—except in regard to their ever-escalating pay. Despite complaints that they constituted a slur on UK managers, companies adapted.

There was little reason to expect a direct (legislative) state response during the first period. First, there was no institutional history of state rulemaking on governance, except on the minor details of transparency. Policy authority was fragmented between dozens of organizations. European Union directives were promoting creeping statism, but regulation above and beyond the market was either non-existent (on boards and shareholding) or highly privatized (on transparency). Second, Conservative ministers and the regulators themselves were committed in principle to self-regulation and the flexibility this requires. Shareholders were best placed to govern their companies, they believed. Flexibility is valuable because it allows market participants to innovate without having to fit within tight legislative bounds. It preserves the creative capacities of markets to promote change more intelligently than bureaucratic or legislative diktat. This was consistent with the Conservative’s broadly neo-liberal ideological disposition. Third, there was no interest-group demand outside the unions for greater statutory rulemaking. On the contrary, all the relevant trade associations and professional bodies were opposed to legislation. They argued that flexibility was a valuable characteristic of the privatized
British tradition and that it should be preserved. Finally, newly aggressive investors from the United States entered the UK markets during the 1990s and promoted better governance. That is, markets were responding to the problems as predicted.

Labour did not take office during a period of corporate crisis, although executive pay kept headline writers busy throughout the late 1990s. Despite their repeated efforts to reassure business, many saw the new Labour Government as likely to increase state interference. I detail their more threatening pro-stakeholding initiatives in the next chapter. On investor protection, Labour ministers did indeed move against managers in a more direct fashion. Again, however, they did not legislate significantly. First, they created an interdepartmental review body to look at accountability problems throughout the system. Secondly, they convened two groups to examine boards and audit. The links with the Department of Trade and Industry were more obvious than in the case of Cadbury, Greenbury and Hampel. Ministers were clearer that the remit of these boards was to come up with proposals to update the Combined Code, and that the Government would choose which to implement. In the end, the Secretary of Trade and Industry did not take up the most controversial of proposals.

The fact that it was a ministerial decision, however, marked a change from the Conservative era. Ministers appear to view the Combined Code as a vehicle for public policy onto which further rules can be loaded. That was the view of at least one member of the Company Law Review Steering Group.\footnote{John Parkinson, Interview with author, Bristol, June 5, 2000.} It was echoed by Jonathan Rickford, the Government’s project director of the CLR, who pointed out that the Combined Code and
its precursors “represent a new area of company law, opening up new techniques of concretization of legal norms and for their implementation.”

Did these changes in authority redistribute power in governance, however? How were the new regulatory burdens distributed among managers and investors? I explore impacts on employees and other ‘stakeholder’ groups in the next chapter. Of the more conventional participant-interests only managers could have any self-interested reason to complain. Board structures are clearly now seen as appropriate targets for Government intervention. The latest board changes, should they be fully accepted by companies, are potentially dramatic. However, under the ‘comply or explain’ philosophy, companies are free to not comply as long as they justify the choice. Conceivably this could become more widespread. Still, spiraling pay and declining equity values mean managers’ contracts are no longer a private matter. And investors are responding to ministerial pleas for action. Managers’ representatives complain about regulatory fatigue.

Investors fared better. The reforms were, after all, designed to protect them. And despite their apparently lax custodial exertions on behalf of shareholders, institutional investors endured no compulsion. They must state their policy on voting their shares, but need not actually have such a policy. Accountancy regulation was once again reorganized at the behest of the minister, but again under the guidance of their Consultative Committee of Accounting Bodies rather than any direct Departmental authority.

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Incidentally, their firms stand to benefit from increased disclosure produced by stakeholding reform. It is stakeholding to which I next turn.
Chapter 4. The failure of stakeholding

Albeit only briefly, stakeholding was a genuine ‘Third Way’ notion that could have been a ‘big idea’ for New Labour. Colin Crouch argues it is the only example of a genuinely non-social democratic, non-neoliberal economic policy that New Labour might realistically have adopted. That is, it departs from the traditional British logic of confrontational collective organization in industrial relations, but does not relegate individual workers to the status of atomized contract ‘takers’ in the labor market. It is neither Old Labour nationalization nor Thatcherite privatization. Still, as Crouch anticipated, the outcome was a “general advocacy of communication and consultation within firms” at employers’ discretion. Ministerial activities, both from the DTI and from the new minister of Corporate Social Responsibility, are now confined to regulation by cajoling. In Crouch’s terms, it is “little more than human resource management within a neo-liberal frame”.

The debate went on publicly between 1998 and 2001 when Labour’s Company Law Review debated the relative merits of stakeholding reform (which they called ‘pluralism’) and an ‘enlightened shareholder value’ approach based on developing managerial best practice. In the end, the one significant stakeholder-friendly reform was
the Operating and Financial Review (OFR), which increases disclosure in Annual Reports on employee, environmental, and social issues as company directors see fit. Although this caused some discomfort to managers, it was entirely consistent with the liberal and voluntarist history of British corporate governance. Moreover, the content of the OFR was to be left to managerial discretion. Also consistent with the UK tradition was the statutory clarification of directors’ duties so that they were not limited to short-run investor interest. Arguably this was already the legal reality if not the statutory language. Neither introduced new managerial liabilities or provided any means for judicial enforcement.

After explaining the dearth of stakeholding initiatives prior to Labour, I turn to the hope of some stakeholder-sympathetic economists and business people that state intervention would not be necessary. Instead, governance and industrial organization would have evolved economically. Subsequently, I review the EU’s weak early impact on stakeholding, a subject which I revisit in Part VII. In Part V, I explain how stakeholding emerged on New Labour’s agenda. Part V details the proposals themselves, and the interest group’s positions as expressed in the lengthy consultation process undertaken by the Company Law Review.

I. Pro-stakeholder policy before Labour

There were no significant efforts to introduce stakeholding reform prior to the 1997 Labour victory. The dominant emphasis in governance policy since 1989 (and indeed, before) was investor protection, and the need to balance this with managerial
flexibility. If anything the shareholder value movement, an expression of the market power of international and domestic equity investors, was undermining the position of workers. It increased the pressure on managers to keep costs low and returns high. And for ideological reasons, the Conservative governments of Thatcher and Major were never going to throw governance policy open to new areas of social activism. Echoing managers and investors, Tories argued that they should be dealt with through labor and environmental law rather than company law.

The only relevant stakeholding concern for Conservative administrations during this time was the supposedly limited availability of long-term finance for British industry (and especially for manufacturing). This was an implicit acceptance of the market myopia argument discussed in Chapter One, Part IV. Again, the ministerial approach was to promote private coordination. With the encouragement, staffing, and research services of Michael Heseltine’s DTI, a private committee was established to address shareholder governance and City/industry relations generally. Only managers and investors were members. Although largely concerned about competitiveness and market myopia, the committee also touched on how investors might monitor managers more effectively. The resulting ‘Myners Report,’ Developing a Winning Partnership, described what model institutional investors should do but did nothing to ensure they would do so.¹

¹ The Report made no surprising recommendations. It called for active institutional ownership, regular communication by investors with management, including transmission of objectives and evaluation of performance; training of fund managers. For managers it called for open and regular contacts, keeping abreast of disclosure requirements, and a well defined and discussed remuneration policy. The report was formally welcomed by the DTI, but there was no legislation. Department of Trade and Industry, "Developing a Winning Partnership," (London: DTI, 1995). This report should be distinguished from that
II. Stakeholding without the state? Economics and governance

What of the notion that state intervention was not necessary because stakeholding is economically viable itself? Is there any evidence of the private/market path to stakeholder-friendly governance? If economic forces were working in that direction, we would expect to see companies, representative organizations, or private authorities implementing, supporting in public policy (or at least not opposing) the following:

- Measures that increase employee voice in business; these might be at the enterprise level (for example, board participation or employee share ownership), or, more likely, at the workplace level (works councils or consultative committees). Where these resulted in genuine input into decision-making –requiring managers to seek consensus before making decisions that affect workers—they would constitute a move towards stakeholding.

- Measures that increase the quality and length of employment relationships. Longer employment tenure is conventionally seen as an indicator of stakeholding since it encourages investment in human capital and job-specific learning.

- Commitments by fund managers (at the finance level) and managers (at the company level) to adopt social and/or ecological criteria in selecting
between alternative investment projects; these criteria would have to have significantly equal weight to ordinary risk and return criteria.

- Greater and substantive disclosure of employment, ecological, and social effects of business operations; and possibly also auditing of these reports.

There are several ways economic forces might produce these outcomes. One is that managers or investors might themselves restructure companies’ operations to promote profitability, productivity, competitiveness, or (in the case of environmental aspects of stakeholding) risk-avoidance. For employees, these notions are prefigured in the ‘high performance workplace’ movement in industrial organization. In this view, stakeholding is a positive-sum idea: managers, investors, and stakeholders can all gain. Environmentalists hoped that the public relations disasters of the Exxon Valdez oil spill and the Shell North Sea platform disposal would prompt investors to demand better control over companies. I show below that these hopes are not borne out by the facts.

The second is that employee and environmental interest groups could use economic power as investors to transform governance. Where activists own shares in a company, for example, they can raise difficult questions at annual general meetings. However, this leverage is highly limited by activists’ scarce financial resources. It may produce highly visible media coverage, and even swing managerial decisions in particular cases, but little more of substance. Stakeholder activists simply cannot afford to do more; they have less economic power than value-maximizing investors. It is not a systemic
solution because it is in conflict with the essential operating principle of investment led capitalism.

A third mechanism arises from the exploitation by fund managers and others of the market for ‘green’ and socially aware investment opportunities. However, these funds are currently but a small part of the whole, their impacts on managers are uncertain, and they are not likely to satisfy the demand of aging populations for savings growth maximization. They are something of an oddity in the system.

Finally, new or existing private authorities might be co-opted to pro-stakeholder ends. This has not occurred, apparently because it is not in the objective interests of those who control these authorities. The Cadbury, Greenbury and Hampel committees were aware that agenda expansion was underway—from investor protection to new social goals—but their membership did not include labor or environmental representatives. They were narrowly constituted private policy authorities.

1. Stakeholding as an evolutionary practice in the modern economy

*The argument*

In Chapter One I reported the view of Margaret Blair and others that employees’ role in governance should increase where enterprise depended on ‘human capital’ (defined as the knowledge, skills, ideas and commitment of employees). The suggestion was *not* that industrial democracy, dramatic board reform, or restructured ownership was likely or even desirable. Rather, they suggested that competitive companies would find it in their interest to move in directions consistent with wider stakeholding goals. It would approximate, or even exceed, the best practice touted during Labour’s Company Law
Review as the inclusive model of ‘enlightened shareholder governance’ (see discussion later in this chapter). In fact, this reasoning touches on a web of related and variously fashionable notions about how companies can compete more effectively.

The core idea is that managers would have to build relationships with employees rather than treat them as a variable production input. They might move Britain from what some have described as a ‘low wage, low price’ mode of competition to ‘high(er) wage, higher price’ track. In this respect the UK would become more like the Coordinated Market Economies explained in Chapter One. Blair and others argue that this tendency should be especially evident in knowledge-based and other high-value added service and manufacturing industries. It implies several changes. First, managers might keep workers on longer to encourage and reward ‘firm-specific’ learning and commitments. Second, employee participation in decisions about production organization would become more widespread. Their pay might also be more closely aligned to the success of the enterprise rather than their individual productivity or labor market price. Finally, greater detail about a company’s workforce would be publicized to impress upon investors the firm’s ability to cultivate the intangibles supposedly necessary in the ‘new economy.’

In some ways these adjustments are similar to human resource management strategies, ‘high performance workplaces,’ and the growth of employee stock holding. These strategies, however, are open to multiple interpretations. Are they opportunities for

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2 Appelbaum and Berg, for example, found coordination responsibilities (i.e.: managerial functions) were given to front-line workers in several US industries. Contingent pay arrangements (for those workers, if not for all workers) signal to workers this newfound participatory role in the company. Appelbaum and Berg, "High Performance Work Systems: Giving Workers a Say."
manager/worker cooperation, new opportunities for managers to intensify the burdens on employees, or both? Still, the argument goes, where these arrangements benefit profitability—and cannot be blocked by workers—they should spread independently of public policy. This resonated with progressive British commentary during the 1990s, which claimed that the business-case for firm-level relationship building now accepted by managers “in theory at least.”3 The Royal Society for the Arts’ Tomorrow’s Company report, for example, argued, that “a majority of UK company leaders now appear convinced that an inclusive approach to business relationships provides a route to sustainable success.”4

At the same time, a related ‘business case’ for stakeholding practices was made specifically for ecological best practice. This highlighted the risks of doing nothing. These included the financial costs of ecological disaster (and insurance against disaster), regulatory risks of non-compliance, and, above all, the reputational risks of not attending to problems before they became public.5 Reputational risk arose because of the essentially hostile global public relations atmosphere created by non-governmental organization watchdogs during the 1980s and 1990s. These notoriously include Greenpeace and Friends of the Earth. But once companies and investors acknowledge these risks, better reporting (and, one presumes, enhanced performance) would become the norm. The accountancy profession happily promotes this idea. As one major firm tells

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5 The banking sector, for example, created a set of guidelines for its members (FORGE).
potential clients: “Tightening legislation and increasing pressure from investors, customers, the public and Non-government Organizations (NGOs) means environmental performance is becoming increasingly synonymous with business risk.”

In sum, even where managers were not personally committed to ultimate values of stakeholder protection, market mechanisms should spread better practice. Financial markets would punish managers who were not meeting the new, higher expectations. I evaluate the evidence for these claims in the next section.

The evidence

First, what of the economics involved? Is it really financially advantageous to adopt these ideas? This is often evaluated through a simple model whereby measures of ‘corporate social performance’ (CSP) for a sample of firms are compared to more familiar measures of ‘corporate financial performance’ (CFP). Since some companies have long expressed a commitment to CSP, there should be some evidence of its effects on CFP. Yet measuring the supposed positive effects of stakeholding governance on economic performance is deeply problematic. In their review of the literature for the Company Law Review, Cook and Deakin found evidence that stakeholder-friendly firms do at least as well on conventional objectives as non-stakeholder friendly firms. On the other hand, the CSP/CFP link was by no means conclusively demonstrated. Looking

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6 KPMG Sustainability Advisory Services, Environmental Due Diligence (Brochure) (London: KPMG, Undated), Brochure.

specifically at the effects of employee participation measures, the reviewers again reported uneven and inconsistent findings. Moreover, they argue that even tentative conclusions are severely undermined by measurement difficulties. First, parsing company principles, policies, and behavior is very difficult. Second, stakeholding performance effects may only be apparent at the national—rather than firm—level. That is, what large companies do may affect broader performance trends rather than immediate business outcomes. In addition to making evaluation more difficult, this means that firm-based CSP or stakeholding initiatives face the classic collective action problem. The incentives for companies to avoid—or break with—stakeholding commitments will be very high if corporate performance is measured by standard metrics of shareholder value. Hence, we would not expect significant market-driven reform, despite any public interest in these reforms.

Financial performance effects, then, may not be measurable at present. However, managers might buy the logic of the ‘business case’ anyway. If they do, we would expect to see ‘relationship employment’ and/or ecologically friendly practices diffusing through industry. I emphasize the former in the coming sections. Greater ‘relationship employment’ should mean more employment stability, better training, and more consultation or ‘partnership’ arrangements at work. What does the empirical evidence suggest?

1. Employee turnover and job stability
As Tony Blair often tells his Continental European colleagues, employment flexibility is very high in UK. In part this results from policies discouraging unionization, the failure of unions to enter emergent sectors, and liberal or non-existent laws on hiring and firing. Throughout the 1990s flexibility was identified with outsourcing, the fragmentation and casualization of employment, and the rise of a peripheral labor force, which could be drawn on as managers required. Together these factors contributed to the decline of the ‘internal labor market.’ Internal labor markets exist within companies as long-standing employees compete for and move throughout the firm to different posts. They can promote a high degree of commitment among employees, and they generally increase worker security. The observation that hiring and promotion has been turned inside-out since the 1970s undermines the notion of relationship employment at the outset.

Are employees, in fact, engaged in long term relationships with their companies? One measure is job turnover rates. Overall the UK turnover rate of 16% per annum, with levels as high as 50% in retailing, call centers and other low-paid sectors, and below ten percent in fire fighting, civil service and other well-paid sectors (incidentally also the unionized sectors, although they do not report this fact). In 2003 6% of men and 5% of women employees were looking for a new job, of which 15% were doing so out of fears that their present jobs might end. Another measure is the extent of part time and flexible

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8 “Social Trends No. 34,” 68. There has been much concern about declining job security, which is reflected in higher job turnover. However, the leading institute of personnel officers argues that the public is wrong to think turnover rates increased in recent decades, although they affirm that the rate for men is increasing while that for women declining. Mark Hall, *UK Implements European Works Councils Directive* (IRRU
work, although many report being happy with their arrangements. About 24% of UK employment is in part-time jobs, with a majority reporting that they work part time by choice. Growth during the 1990s in part time jobs appears to have been among men (from 7% to 10% of workers in part time jobs; the proportion of part-time female workers has remained stable at 44%). Finally, in 2003, 18% of male full time workers and 26.7% of women had some flexible work practices.9

It should be noted that flexible and part time work or job mobility does not imply that workers are unhappy with these arrangements. The Labour Government promotes flexible working not only as an aspect of supply side labor market policy but also as a way to improve the “work-life balance.” Only 8% of part timers reported they preferred but could not find full-time work. Still, Fagan reports that market uncertainty is a major cause of non-standard work arrangements; this implies that employers like the numerical flexibility this brings them. It also increases risks of lost income to workers. British managers enjoy the flexibility to modify employment and hours worked than price and capacity. This encourages a readiness to move between firms. Managers and economists argue this is one reason UK unemployment has been low since the early 1990s. But it gives little confidence in the diffusion of relationship employment in British workplaces.

2. Training

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9 "Social Trends No. 34," Table 4.18. These included flexible hours, annualized hours, a four-and-a-half day work week, a nine-day workweek, or academic year work. Similar figures were reported for part-time employees.
Another aspect of long-term cooperative employment is training. Occupational training in the UK is notoriously undervalued and under-funded. The system is voluntarist—it is not required by the state or trade associations. Managers initiate and terminate training at will (although it is more likely in unionized workplaces). Generally this is seen as a result of neo-liberal national training policy, and it is commonly thought to put British business at a disadvantage. Whether this is true or not, training is not as extensive as the business case for relationship employment would predict: it “remains very limited” in Britain.\(^\text{10}\) Nor are managerial commitments necessarily implemented. Of workers in companies including training in their strategic plans as many as one-third reported no training over the previous year.\(^\text{11}\) Interestingly, training was better developed in companies reporting lower product market competition and growing sales than in those reporting higher competition and lower sales. Finally, it appears that, despite the growth in formal skills in the workforce, employer demand for those skills has not kept pace.\(^\text{12}\) Many workers, it turns out, are over-skilled, rather than under-skilled. Perhaps managers are perfectly justified in not transforming their organizations.

3. Consultation, participation or partnership

There are no standard definitions of worker involvement, participation, or consultation. Clearly British workers have gained no decision-making power—and little if

\(^{10}\) Helen Rainbird et al., "Employment Relations Research Series Number 21: Employee Voice and Training at Work," (London: Department of Trade and Industry, 2003), 38. Nor are managers talking to workers about training: Rainbird’s analysis shows that consultation with workers’ representatives about skills training was as rare as 3%.

\(^{11}\) Ibid.

\(^{12}\) Ibid., 12. The Government continues to insist that business and workers have a shared interest in increased learning and training.
any influence—in corporate governance. New management trends over recent decades are encouraging to proponents of relationship employment. These generally operate at levels well below the company board. They include the rise of workplace teams, quality circles, and even (at the behest of the European Union for large trans-national firms) work councils. The latest iteration is ‘partnership,’ a notion adopted by the Labour Government in 1999 and so open-ended as to be vacuous. But few companies now publicly disdain employee involvement of some kind, and the Department of Trade and Industry provides grants to encourage its development. Do these trends indicate, as one company director remarked, that stakeholding advocates were wedded to an archaic view of the workplace as a site of conflict rather than cooperation? Have events passed them by?

Measurement of participation is, of course, difficult. Its advocates, who include consultants and trainers, may have their own pecuniary reasons to complain that it is not widespread enough. The Workplace Industrial Relations Survey found decline through the 1980s in the number of employees covered by joint-consultation committees. The 1998 (renamed) Workplace Employee Relations Survey gathered information on joint consultative committees. Overall, 42% of private sector workplaces

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had some form of committee.\textsuperscript{14} Information is not available on how much these committees extend worker input into decision-making. Take-up of government start-up moneys for participation has been low, and the programs did not guarantee an end to conflict in industrial relations.\textsuperscript{15} Michael Porter’s recent survey of British competitiveness did not, however, dwell on the lack of workplace cooperation as a significant problem.\textsuperscript{16} Thus, although some forms of consultation are spreading, it is not clear that it is an essential move for either companies or the wider economy.

4. Ecological and social impacts

It is not clear whether the economic case for better environmental corporate governance has been widely accepted. Research is needed as well to go beyond the process and institutional issues to determine whether ecological disasters have been averted or environmental impacts have been mitigated. Both are beyond the scope of this dissertation.

Clearly though, a cottage industry has sprung up providing environmental accounting and reporting products and services. Model reports are published. A “suite of tools has developed over the years” for companies to assess and publicize their integrity, collectively known as SEAAR (social and ethical accounting, auditing, and

\textsuperscript{14} Arrowsmith, Uk0309101t ([cited]).
\textsuperscript{15} Mike Terry and Jill Smith, "Employment Relations Research Series Number 17: Evaluation of the Partnership at Work Fund," (London: Department of Trade and Industry, 2003). As of 2003 86 grants were made, with the bulk going to very large and unionized workplaces (50 went to companies with over 1000 employees). The public sector attracted a large number of these grants (21), with utilities, services and food and beverage manufacturing taking fewer.
reporting). Evaluation of these products *themselves* now seems to be a problem: there are even scorecards to help choose between scorecards.

**Assessment**

The absence of these changes might suggest several things. First, there may be significant institutional and cultural obstacles to new arrangements (assuming they would improve performance). By this reasoning, state reform is needed to facilitate efficiency-based reform. Indeed, writing about the US, Blair argued that politics is a key variable. She thought legal changes would need to be introduced to move change through the economy.

A second conclusion may be that business does not need to reform its internal structures to be viable on its own terms, or at least that it does not need to apply relationship employment throughout its operations. One example is illustrative. Larcker cited a fast food chain that attempted to reduce employee turnover by providing annual bonuses. In fact, better performance was related only to low-turnover in supervisory staff, not to reduced turnover among front-line workers. Higher turnover at the counter-staff level was in fact positively related to performance. Larcker concluded that non-financial targets and measures were confusing to managers and did not necessarily lead to improved performance. High performance workplaces are clearly not necessary in many sectors.

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18 In 1998 the New Economics Foundation and the Institute of Social and Ethical Accountability (AccountAbility) collaborated with the Association of Chartered Certified Accountants (ACCA) on a “Quality Scoring Framework” for judging between SEAAR systems. Ibid.
Another supposed advantage of relationship employment is that it enables better technological upgrading. Workers’ participation is needed to properly introduce new technology, the argument goes, and so managers should promote employee participation. The tautology does not hold, however. In part, the problem seems to turn on what participation means. An EC sponsored study during the late 1980s ranked the UK in the middle of EC countries in worker participation in implementation of new technology, but ranked near bottom in participation in planning for technology. This suggests that the workforce can be mobilized to implement new technology without significant decision-making participation.

A third conclusion is that British business is simply satisfied with failure. This is inconsistent with the argument of economists, stakeholding advocates, and some managers that British firms are under great pressure to produce financial rewards for shareholders. It is also inconsistent with the evidence presented in Chapter 1 that shareholders have done well over recent decades.

2. Economic power and the possibilities of stakeholding

Some argue that stakeholders can directly affect control mechanisms in governance, even within current institutional arrangements. They would do so by owning shares and influencing management as investors rather than as employees or

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19 The European Commission on Workplace Involvement in Technological Innovation in the EC identified five factors that would help or promote participation: (i) management’s dependence on skills in technological innovation; (ii) management style and attitude to participation; (iii) bargaining power of organized labor; (iv) mandatory consultation or participation regulations; and (v) degree of centralization of industrial relations system. Only the first was favorable in the UK context. Jill Solomon, Andrew Tylecote, and Aris Solomon, "UK Corporate Governance and Innovation," (Sheffield: Sheffield University Management School and Department of Economics, 1999).
environmentalists. This leads to the broader idea that economic position in the economy might promote stakeholder reform. There are several ways it might happen. First, institutional investors may have to take a broader role in governance as they pursue profits. Some of their attentions will be taken up with stakeholding concerns. Second, some investors might actively prefer stakeholder-led investment strategies. Fund managers would exploit this niche by marketing socially-aware investment products. Third, individual shareholders who are also activists could directly influence managers. And fourth, employee share ownership might change governance dynamics. I briefly consider each in turn below.

Ownership: Strength of institutional shareholders who cannot divest

There are two contrary views of institutional investment. The first stresses their need to regularly show improved returns leads them to pursue short-term rather than long-term gains. As a result, they will necessarily have an instrumental view of stakeholders and will not discourage this view among managers who must produce the returns. In turn, this removes managerial incentives to build relationships with stakeholders. The second suggests they may become more active in ways that promote better management, including perhaps stakeholder-friendly management. Because of their dominant position in equity markets, some argue, they have a ‘universal’ interest in the health and competitiveness of British business generally. In this view, their interests are broadly in line with the overall state— and public—interest in the long viability of the

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20 Ibid., 3.6.
economy. Their outlook and behavior would accordingly become less myopic. This should become observable in the case of particular investors with large stakes in single companies. The largest fund management groups have very large holdings in the UK markets and some companies have very high ownership concentrations (ranging from 12-15% on average among the FTSE100, and as high as 20% in a few cases). They cannot easily divest these large holdings without affecting share price and so have to maintain equity stakes and act like long-term proprietor owners. One estimate is that institutional investors that hold stakes as little as 0.5% of a company’s shares are unable to rely on equities markets to manage their risks and returns.

There are two problems with the second view: there is only scattered evidence that institutional investors are taking the longer view of their shareholding. Increased one-to-one meetings between investors and managers is widely reported, but systematic details about these meetings is not available. With some exceptions, governance activism continues to be the preserve of the public pension funds and institutional trade associations. This makes sense given the likelihood of free-riding by fund managers on the efforts of others. In the meantime, the equities market continues to be the essential signaling device for managers and other shareholders. UK stock-market turnover was almost 150% of market capitalization in 2003, ranking well above the US in percentage terms and far higher than those of the European coordinated market economies.22

Second, it is not clear why even the large holdings would create pressure better for stakeholder-management. The evidence I have offered above points to the conclusion that there is no widely accepted demand for ‘high commitment’ workplaces. Government and stakeholder advocates alike argue that investors have failed to take up this potential. These effects are not apparent yet, despite the longstanding dominance of large funds in equities markets. Nor is their any comprehensive commitment to domestic companies, which might at least cultivate British business. UK funds are the largest purchasers of overseas assets in the world; there is no evidence that they prioritize UK investment.

All this is entirely reasonable given their imperative to maximize returns for their beneficiaries. Fund managers are not paid to govern companies, or to exercise voice where it does not enhance portfolio value. If some individual shareholders have views about how their companies treat their workers or exploit the environment, the judgment of fund managers is less readily clouded by these ‘ideological’ factors. Thus, by pooling savings and applying the rationality of professional investment management, financial intermediaries remove the proprietary moderation of share ownership. In short, there is no clear evidence of increased responsiveness to stakeholder concerns even where institutional investors—those controlling the corporate or individual retirement savings of workers and retirees—are strong.

**Socially responsible and sustainable investment**

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23 Exceptions arise where they can identify a retail market for socially responsible investment.
There is, perhaps an exception to my last conclusion. The late 1990s saw growth in the number of UK-based funds that marry ‘social, environmental, and/or ethical’ (SEE) considerations to financial goals when selecting investments and using their share ownership rights. In these cases portfolio value goals may be balanced or by other priorities, including environmental protection or community development. They pursue these goals in investment decisions but may also seek to influence governance reform.

Two minor Government initiatives were intended to promote this trend: a regulation that occupational pension fund trustees disclose to the markets what (if any) SEE considerations they have adopted; and a regulation permitting charity trustees to balance financial goals with their relevant SEE concerns when investing the charity’s money. A supportive group of British legislators has been active since 1998. Indeed, fund, company and association statements of SEE policy proliferated. Major fund managers see an emerging retail niche for managed SRI or green investment. In 2001, the FTSE indexing service launched a ‘FTSE4Good’ group of indexes to monitor performance (Dow Jones created an equivalent Sustainability Index in the US).

The potential of SRI to produce either stakeholding reform at the company level or substantial benefits at the national or international levels is not proven. As yet, SRI remains a small proportion of overall securities ownership. The European Social

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26 In particular, the Government has required that pension funds have a public SRI policy (Public Interest Disclosure Act, July 1999).

Investment Forum (Eurosif) evaluated the size of British SRI based fund management in 2003. Of a total share capitalization of £1,554B at the end of 2001, £224.5B or 14.5% had some form of SRI-based content. Moreover, it is difficult to determine exactly what the SEE content of these funds is. Investment screens—where shares are picked according to some SEE criteria—is used in only a tiny fraction of the market. Instead, fund trustees or directors request that their fund managers engage directly with companies in which they would have invested without an SEE policy (through monitoring reports and contacting managers, for example). This makes it much harder to evaluate the extent and quality of SRI. Advocates of greater SRI reported in 2002 that “poor practice…is the norm.” Only a handful of fund managers sponsor SRI resolutions, and even fewer of these have been UK-based.

**Individual shareholders**

Public interest groups tried to use economic opportunities to promote their agenda, although it is not clear how effective these efforts have been. They remain marginal actors in financial terms by comparison with their competitors in the global economy. Where they are able to purchase shares in companies, for example, they can raise concerns at Annual General Meetings. This is not a new strategy.

31 M. Marinetto, "The Shareholders Strike Back: Issues in the Research of Shareholder Activism," Environmental Politics 7, no. 3 (1998). For a historical perspective on activism of this kind in the US, see
Mimicking the anti-apartheid disinvestment movement of the 1980s, some activists attempt to discourage financial institutions from lending to or investing in projects they find unacceptable.\textsuperscript{32} Often this involves tactics that do not qualify as using stakeholder economic power, even when they target pension or investment funds. These tactics include conventional lobbying, publicity, and boycott campaigns, as in the case of the Goldman-Sachs sponsored initial public offering of PetroChina. More relevant here is the use of investment holdings to influence managers. A prominent early example was the vote by 17\% of Shell’s shareholders voted for a resolution on SEE principles. More recently, a shareholder resolution was sponsored by Domini Social Investments at the urging of International Rivers Network against management at Merrill Lynch & Co. The resolution called for a review of environmental and social impacts. It resulted in a dialogue with management and the resolution was subsequently withdrawn. These efforts do not rely on the quantity of shares owned by activists or social funds, which are of course miniscule in comparison to a company’s capitalization. Rather, they use these shares to gain access and as publicity vehicles to threaten managers with reputational damage. Others have targeted World Bank bonds, obtaining commitments from the City of Berkeley, some union locals, and several institutional investors to boycott the bonds.

The cumulative effects do not appear to be great. Johnson and Greening looked for evidence on two dimensions of corporate social responsibility: a ‘people dimension’ (affecting community, women & minorities, and employee relations); and a product quality dimension (affecting the environment). Public pension funds did better than private investment fund managers. Still, they found only marginal support for their hypothesis that public pension funds might be positively related to better scores on their ‘people dimension’ of corporate social responsibility.

**Employee share ownership**

Employee share ownership is frequently suggested as a way to improve productivity, in part because it should foster relationships within the company. They do appear to help in employee retention and greater sense of employee voice. Conventionally they were used to give incentives to management and senior staff. Their use for the wider workforce is spreading, but not spread quickly enough to see results on stakeholding concerns. In 1998 22% of employees and 11% of establishments had share ownership schemes. Profit-contingent pay was more prominent: 37% of employees and 28% of establishment had some profit-related pay scheme. As of 2003, 90% of the FTSE100 largest companies had all-employee share schemes. Overall, there were 3.5 million employees participating in 5,000 companies.

**Assessment**

34 Freeman and Conyon 2003
All this makes it apparent that the economic route to reform is not viable if institutional fund managers do not take up stakeholding for conventional reasons of value. They have not done so yet. Standing on their own, stakeholder capitalists do not have the economic power relative to shareholder value maximizing institutional fund managers. This does not imply any systemic conspiracy against them. Rather, their ideas about what is valuable are in conflict with the essential operating principle of investment led capitalism. This operating principle—to maximize returns over some time horizon—becomes all the more important as populations age and seek security in retirement.

3. Private authority as a driver toward stakeholding

If economic imperatives and economic strength have not entrenched stakeholding arrangements, can private authority do so? Such bodies might create agreements by managers, fund trustees, and fund managers to be bound by guidelines on employment and ecological practices or human rights. They would operate by disseminating information and guidance and somehow enforcing membership compliance. Various international standards programs and organizations might contribute to this effort. To date, however, there has been no such authority created.

The blue ribbon governance committees of the 1990s were not charged with considering stakeholder interests, and they explicitly resisted agenda expansion. Leading trade associations have since issued social, environmental, and/or ethical (SEE) principles for their members. The Association of British Insurers (ABI) and Institutional Shareholders Committee both encourage their members to consider SEE in investing. As
is to be expected, the emphasis is instrumental and capitalizes on the risks to badly run enterprise. ABI, for example wanted companies to expand reporting on reputational and other risks that might arise out of environmental, social, and ethical practices. This would allow investors to better select and monitor investments.

There are a great many UK-based promotional organizations engaged in SEE and corporate social responsibility. They are supported by private consultancies that have identified a growing market in establishing programs, monitoring compliance, and reporting. The Labour Government sees this voluntarist approach as the way forward, and now supports multiple campaigns to market SEE and CSR. These initiatives include sponsoring awards and rankings of companies with Business in the Community, making grants across the range of social, community, and environmental concerns, helping improve Third World supply-chain relations through the Ethical Trading Initiative, and promoting better environmental reporting. Through the Department of Trade and Industry Partnership Fund it helps business establish employee consultation arrangements.

As this brief survey indicates, the common thread is promotion rather than compulsion. Individual businesses adopting more radical stakeholder arrangements would face a considerable competitive disadvantage. Without coordination—and even compulsion—they are unlikely to take on those disadvantages. Currently no private authority provides either coordination or compulsion.

36 See the CSR web ‘gateway’ at http://www.societyandbusiness.gov.uk/
III. The European Union and UK corporate governance

Another factor that might have promoted reform is the European Union. Paul Hirst wrote in 1986 that, “the EEC is the sole significant force keeping the issue of industrial democracy on the agenda”. Still, Europe did not reshape the British system. This makes sense, because EU member states do not exclusively ‘take’ or ‘shape’ EU policies. Rather, they stand between domestic (elite and popular) political preferences and EU policy decisions. UK governments have supported the major business interests in resisting the more uncomfortable EU initiatives.

Most famously, the Draft Fifth Directive of October 1972 called for 2 tier boards for all companies of more than 500 employees, including employee representation. The Draft caused considerable resistance from the UK government and has not been imposed as a result. The Conservatives also obtained an opt-out from the European Works Council directive, which mandated consultation in cross-border enterprises. Labour ministers agreed to the directive and implemented it in 1999, although again in a highly flexible manner. The directive applied only to companies with operations in multiple countries. Consistently, UK ministers have adopted the weakest possible interpretation of EU legislation.

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37 The Transnational Information and Consultation of Employees Regulations 1999, Statutory Instrument 1999 No. 3323 See footnote 139.
38 For example, a 1994 European Court of Justice ruling found Britain out of compliance on requiring employee consultation in the event of redundancy and ‘transfer of undertakings.’ The problem with UK law was that trade unions were the only formal mechanism through which compliance consultation could occur. Since unionization was declining, many enterprises were out of compliance. The Court ruled that alternatives must be available where no union was recognized. UK regulations were tightened to that effect.
One important nudge towards employee-friendly reform was the Informational and Consultation Rights directive, discussed from page 248 below. It must be implemented by the states in 2005. Since it does not clearly define either what information is to be given to employees, or what exactly participation means, it is unlikely to threaten existing UK governance or industrial relations arrangements.

IV. Labour ministers’ ideas and stakeholding

Parts II and III above showed that stakeholding, even in its weaker variants, will not spread through the British economy of their own accord or by outside imposition. This shifts the spotlight onto domestic public policy. It affirms trade unionists’ and ecologists’ view that aggressive state action is needed to meet their goals. What prompted Labour ministers to consider such action, and what about their ideological dispositions might account for their failure to follow through?

Labour and the ideologies of corporate governance

The Labour Party leadership was, for most of its history, “uninterested in the legal form of the institution which controlled and shaped so much of their lives.”\(^{39}\) This is true as well for organized labor. The three ill-fated exceptions are the late 1970s Bullock inquiry into industrial democracy, the brief hold of the far-left Alternative Economic Strategy on the Party during the mid to late 1970s, and some secretive departmental

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interest in the matter during the first Wilson government. Otherwise, only the minority Liberal Party and isolated business thinkers consistently articulated any need for stakeholding reform. The following paragraphs trace this history, culminating in the foundation of the Company Law Review. It is a story of recurring questions about the democratic character of companies, but also of successive leadership failure to follow through.

Past company law reviews hardly touched on stakeholding reform, which was identified prior to the 1990s as ‘industrial democracy.’ The 1945 Cohen Committee investigated “safeguards afforded for investors,” and only incidentally also the public interest. In evidence, the TUC proposed Industrial Boards to provide some measure of worker input into sector-level governance but the structure of companies themselves was not challenged. The 1948 Companies Act included new disclosure requirements but nothing more radical. Labour and the unions were preoccupied with nationalized industries and planning. The Jenkins Committee, appointed in 1963 by a Conservative Government, was “no more than a technician’s tidying up.” Again, organized labor preferred collective bargaining, state level bargaining, or labor market regulation to any new corporate governance role.

41 Liberal Party’s doc from the 1930s; Goyder and Gower. For a detailed analysis of the Labour party and union movement, see Harris, "Parties, Pamphlets and Conferences (Political Economy of the Company Project)."
43 Ibid., 27.
During the late 1960s more fundamental restructuring was mooted. Among several relevant Fabian tracts was one issued in 1965, authored by Professor (later Lord) Wedderburn calling for “some focus of accountability for management other than the shareholder.” He argued that company law “cannot be allowed to go on pretending that the worker is not there.” His proposals for disclosure to aid collective bargaining, however, are in the tradition of privatized industrial relations than social democracy or industrial democracy. More promisingly, the Wilson government announced in 1967 that a new Companies Bill would “re-examine the whole theory and purpose of the limited joint stock company [including] the comparative rights and obligations of shareholders, directors, creditors, employees and the community as a whole.” A white paper was published but the effort was not carried forward. The Donovan Commission (1965-1968) on industrial relations considered mandating worker directors, but the majority report rejected employee or union representation of boards. Although the TUC’s submission to Donovan showed a shift towards industrial democracy, the Labour Party’s National Executive Committee that year debated and rejected any radical changes to the company board governance. Instead, legislation was to focus on reporting and

44 6/67 Labour Party report on ‘Industrial Democracy’ reported in Ibid.
46 On the other hand his proposals for audit, statutory definition of directors’ duties, and remuneration disclosure anticipated the agenda of the 1990s.
47 House of Commons Debates, 14 February 1967, col. 359, 27
49 Clift, Gamble, and Harris, "The Labour Party and the Company."
disclosure. Barbara Castle’s ill-fated white paper, In Place of Strife, merely “favored experimentation” on the appointment of employee directors.

The most famous domestic foray into worker representation was the high profile Bullock inquiry and its 1977 Report on Industrial Democracy. The majority proposed parity representation of employees on company boards, but was vociferously opposed by business. The Government essentially ignored its proposals. Denis Healey for one seemed almost embarrassed at the “inordinate amount of time” devoted to industrial democracy. A subsequent white paper instead proposed a voluntary approach, with unions and employers setting up their own schemes for power-sharing. The government took advantage of union fears that enforcing industrial democracy would have undermined their own role in collective bargaining. The measures did not appear in the subsequent election manifesto, and were lost as the first Thatcher Government came to power. Amendments dealing with representation and the public reporting of matters relevant to employees were offered to the 1980 Companies Bill but were defeated.

The one achievement was the insertion of what became Section 309 CA 1985. This required directors to have regard to the interests of employees (a regard, rather obscurely, they owe to the company itself). Unenforceable, this provision is mentioned only in passing in most guides to Company Law. It also allowed, under limited

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50 Department of Trade, "Report of the Committee of Inquiry on Industrial Democracy (the Bullock Report).", Harris, "Parties, Pamphlets and Conferences (Political Economy of the Company Project)."  
circumstances, companies to make provision for their employees on the transfer or winding-up of the undertaking.  

There was more interest within the Party than on the Front Bench (the Parliamentary Party leadership). The Alternative Economic Strategy shifted the Party’s stated policy ambitions dramatically to the left. The Institute for Workers Control explored participation in its pamphlets, and the TUC conference began passing hopeful resolutions. Rights to information, consultation, and representation were proposed in Labour Programs as late as 1983. This was the height of leftist influence within the Labour Party. On the other hand, the party leadership—in and out of government—were hardly wedded to the idea. By the 1987 election, industrial democracy was absent from the Manifesto.

The 1992 manifesto called only for expanded employee share ownership and rights to information and consultation—not for participation. By contrast, the Liberal Democrats declared, “every employee has a right to participate in decision-making in their enterprise.” Whatever the wishes of Britain’s third party, the Classical Liberal hegemony in British company law remained intact at the end of the Twentieth Century.

**The stakeholding moment**

Presentiments of something more radical came in 1996. In a now famous speech in Singapore, Tony Blair flirted briefly with ‘stakeholding. He said:

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It is time that we shift the emphasis in corporate ethos from the company being merely a vehicle for the capital market—to be traded, bought, and sold as a commodity—towards a vision of the company as a community of partnership in which the employee has a stake and where a company’s responsibilities are more clearly delineated.\textsuperscript{57}

In corporate governance this was interpreted to mean a reorganization of capitalism to give a participant voice to employees and others.\textsuperscript{58} It would make business more than “simply vehicles for capital market operations.”\textsuperscript{59} It appeared to offer a solution to ‘short-termism’ in British finance.

Labour elites were familiar with economic critiques of the British model, although they differed on its salience.\textsuperscript{60} In 1995 Will Hutton’s stakeholder critique, \textit{The State We’re In}, was a bestseller. Labour’s 1995 \textit{New Economic Future for Britain} mentioned short-termism as a cause of low investment, but referred only to ongoing consultations on specific proposals to deal with the problem.\textsuperscript{61} A year later, the Investors Chronicle reported that it was one of the two party priorities (together with protection of retail financial services consumers).\textsuperscript{62} Enthusiastic debate followed in various journals, including the pages of the New Labour-friendly \textit{Renewal} and \textit{Prospect} during 1996 and

\textsuperscript{57} Quoted in Smerdon, \textit{A Practical Guide to Corporate Governance}.
\textsuperscript{60} See the critique in Watson and Hay, "In the Dedicated Pursuit of Dedicated Capital: Restoring an Indigenous Investment Ethic to British Capitalism."
Part of its attraction was the potential for stakeholding to be a ‘big idea’ of empowerment and democratic renewal.\textsuperscript{64} It works by analogy across all areas of society and polity.

Policy entrepreneurs and businessmen close to New Labour formed a Commission to make proposals for a future left of center government. Associated with the centrist, New Labour-friendly Institute for Public Policy Research, the final report included a chapter on corporate governance and the need to promote “far sighted management.”\textsuperscript{65} It recommended a clarifying widening of directors’ duties, better employee share ownership, protections for workers in takeover situations, employee information and consultation (but not codetermination) rights, extended reporting requirements on non-financial matters, and increased shareholder governance through an institutional investor council. This was a moderate stakeholding agenda. The report, \textit{Promoting Prosperity}, was taken as an important indicator of where the Party was going, and the Conservatives leapt on it accordingly.

These New Labour debates were marked, however, by a supply-side rhetoric of enterprise and cooperation. The goal was framed as competitiveness and productivity rather than social justice and equity. Advocates tended to stress ‘the business case’ that good relationships would enhance profits. Robin Cook, for example, in his 1997 article

\begin{footnotesize}
\begin{itemize}
\item Gamble and Kelly, "Stakeholder Capitalism and One Nation Socialism.”
\item Commission on Public Policy and British Business, \textit{Promoting Prosperity: A Business Agenda for Britain}.
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“A Radical Agenda for a New Millennium,” said that the case for a stakeholder economy is “that those companies who will do best are the very companies who recognize their workforce have a stake in the economy as anybody else.” 66 On merger and takeover policy, the September 1996 policy document *Vision for Growth*, disappointed trade unions by stressing efficiency and competitiveness criteria rather than their impact on employee interests. 67 There was no admission that a gain for some may have to come at the expense of others. In this respect Labour’s position mirrored much of the conventional literature on governance. The business journalists John Plender and John Kay, for example, who became members of the CLR Steering Group, both argued that ‘inclusion’ was necessary to business success. Liam Byrne of the Social Market Foundation described the debate as “corrective therapy capitalism.”

The pre-election ‘prawn cocktail offensive’

By the time of the election, there was little left of the stakeholding agenda. 68 As little as eight months after Blair’s Singapore speech the FT declared that, “Labour has sought to bury the issue,” and to “play down the practical significance of the new idea.” 69 Blair may have misjudged the division between the more ‘radical’ stakeholder advocates (such as Hutton) and the more market friendly (such as Kay and Plender). 70 He appears to

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68 The term was transposed into unrelated reform of pensions.
70 This is the assessment of John Plender: Mike Naughton, "Human Face of Capitalism," *Tribune*, 28 March 1997. John Kay was reportedly influential in drawing Blair’s attention to stakeholding Wallace, "Interview: Adair Turner.".
have misunderstood its potentially radical implications, perhaps because of its modern and business-friendly vernacular.\textsuperscript{71} An alternative view is that Blair simply didn’t have the same meaning in mind.\textsuperscript{72}

Meanwhile, a ‘prawn cocktail offensive’ was launched to disabuse managers and the City. Over unappetizing lunches, Blair reassured business of his friendly, independent stance.\textsuperscript{73} The Party’s pre-election business policy document was moderate and short on specifics. It would allow two-tier boards, promote institutional investment, and set up an expert panel on governance. Treasury spokesman Alistair Darling tried to rein in expectations on finance and industry. He was skeptical of the short-termism argument and suggested that the government could only ‘get the fundamentals right’ and promote active ownership. He thought government not best placed to change managerial or investor culture. Blunkett appeared more frankly dissatisfied with the status quo, but also cautioned against expectations being too high. The accounting profession was courted by the shadow corporate affairs minister.\textsuperscript{74} There was a strong emphasis on the role of small business and the need to reduce their regulatory burdens.\textsuperscript{75}

In the end, the 1997 Manifesto mentioned stakeholding only in the context of a new private pension scheme, high and stable levels of employment (“this is the true

\textsuperscript{71} Ian Corfield has made the point that think tanks and academics are often a conduit carrying ideas from the business- into the political-world Ian Corfield, "Think-Tanks for the Memory," \textit{Tribune}, 14 February 1997.

\textsuperscript{72} Callaghan, \textit{The Retreat of Social Democracy}, 162.


\textsuperscript{74} Jim Kelly, "When the Bell Tolls," \textit{Financial Times}, 8 May 1997.

meaning of a stakeholder economy”), and the need for a strong voluntary sector. More serious were the commitments facing Margaret Beckett as she took over the Trade and Industry portfolio: toughening competition law, the minimum wage, and changes in regulation of the privatized utilities. She expressed at the time, though, an interventionists’ desire to fulfill the Department’s responsibility for competitiveness.

On the only question of direct relevance to corporate governance—the Social Chapter’s promotion of employee consultation—the Manifesto made the anodyne point that “successful companies already work closely with their workforces.” On the related issue of mergers and acquisitions, the Party angered trade unions by not including in its 1996 industrial policy document Vision for Growth a commitment to vet takeovers for their impacts on workers.

After the election, David Simon, a former chairman of British Petroleum and one of the country’s highest paid executives, was given responsibility under Beckett for corporate affairs at the DTI. This was reported as another signal to the City that Labour would not pursue a radical stakeholding agenda. Ian McCartney had responsibility for company law, and he was seen as a potential threat. At the same time an adviser briefed that the new government didn’t “have a great agenda of proposals in that area.” Chris (now Lord) Haskins led the new Government’s task force on better regulation and

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78 New Labour: Because Britain Deserves Better.
warned that the government should not be in the business of corporate governance.\textsuperscript{81} Haskins was a member of the Hampel committee and a senior Labour businessman. Beckett, in any case, had broader concerns, including the Euro decision, energy, the minimum wage, the European social chapter, and open government.\textsuperscript{82}

The issue came to prominence in the context of a lengthy, independent review of the legal underpinnings of corporate governance. This was announced by the Secretary of State for Trade and Industry, Margaret Beckett. It should be noted that this was not primarily or even prominently conceived as an exercise in stakeholding reform—although that issue garnered the headlines and ruffled boardroom feathers. Rather, the review was a legal rationalizing initiative with stakeholding added in. I turn next to the development of the stakeholding issue within that process. Its wider legal import is not considered in this dissertation.

V. The Company Law Review

Launched in 1998, the Company Law Review (CLR) was the most far-reaching effort to generate improvement of corporations law since Victorian times. Even without the stakeholding issue, it was a surprising undertaking for the new Government, especially since there are few votes in corporate governance and fewer still in company law. The scope—and future commitment to Parliamentary time it implied—makes it all the more mystifying that so little has changed in its wake. The legal profession and senior DTI civil servants, rather than any direct economic governance interests, appear to


\textsuperscript{82} Nyta Mann, "Trade Winds," \textit{Tribune}, 19 September 1997.
have wanted the review most. To their disappointment, as of the 2003-2004 Parliamentary session, ministers had still not introduced a consolidated Companies Bill.

The Review was promoted as a business-friendly exercise. It was to rationalize the law, so reducing costs and uncertainties for managers and investors. It would excise legal obsolescence and contradiction to provide “the maximum amount of freedom and flexibility to those organizing and directing the enterprise.” This would reduce business costs and help Britain compete with overseas jurisdictions where managers might otherwise incorporate. Insofar as it was rationalized as a pro-competitiveness initiative, it fits well with the globalization and structuralist theses. Company lawyers—as the interest group most proximately familiar with the poor state of the law—were well placed to convince a modernizing, ambitious government that change was long overdue. The country needed a modern body of law to enable efficient wealth generation and competitive enterprise.

The Secretary of State also tasked the Review with considering the relationship between different kinds of regulatory authority: between statute, regulation, and the Combined Code. Still, Beckett was careful to reassure business that “best practice is rarely achieved simply by government diktat.” In general, she said, the issues dealt with in the Code were suitable for best practice rather than legislation.

84 The key distinction is between primary legislation (passed in Parliament) and secondary legislation (regulations authored by ministers and requiring varying degrees of Parliamentary consent).
Three controversial issues appeared in the launching document, each related to power within companies. The first was directors’ duties, which would need modification if stakeholding governance were to be adopted.\textsuperscript{86} The document cited “wide discussions” in public about whether boards should take into account “a broader view of their responsibilities,” including those to “employees, creditors, customers, the environment, and the wider community.”\textsuperscript{87} Any reform would need to protect “through regulation where necessary, the interests of those involved in the company.”\textsuperscript{88} This proviso, of course, also introduced questions about the power of companies in society. Second, reform might need to make it easier for shareholders to table and vote on resolutions, or otherwise increase their powers. Finally, executive pay was mentioned once, in an ominous but low-key sub-paragraph saying that “Government is watching developments closely.” Again, however, Secretary Beckett was careful to console business that it need not fear “large scale upheaval of familiar requirements” or “change for its own sake.”\textsuperscript{89} Of these three issues, the second and third were later diverted onto a different policy track as ministers sought more direct control over the process.

Briefly, the process played out as follows. The CLR consulted and deliberated for almost three years, and issued a several lengthy reports.\textsuperscript{90} An independent Steering Group

\textsuperscript{86} Currently in law directors owe their duties to the company, which in law is identified as its shareholders (‘members’).
\textsuperscript{87} Department of Trade and Industry, “Modern Company Law for a Competitive Economy,” para. 3.7.
\textsuperscript{88} Ibid., 5.2. It should do all this in clear and concise language.
\textsuperscript{89} Ibid., para. 1.2.
\textsuperscript{90} Nine consultation documents were published: the three largest of these came to be known as “the green bricks” because of their size and weight. These were distributed on the World Wide Web and in print to a regular list of recipients as well as on demand at no cost. Hundreds of responses received from groups and individuals to each of the documents. In support of the Review, the SG commissioned from Cambridge
of eminent lawyers, academics, accountants, and businessmen headed the Review. The Review also created a widely representative Consultative Committee to be a “sounding board.” The latter had no decision powers and was described by some as a fruitless exercise in window dressing. It did not participate in decisions. Although CLR was independent, the Department of Trade and Industry provided secretarial services and sent senior civil servants to chair and monitor developments. Overall, however, the Steering Group directed the review. Finally, a year after its final report, the Government published a White Paper, describing its response and intent to legislate. No bill followed, however, and as late as 2004 there had been no rationalizing Companies Act. After the Enron/WorldCom scandals some measures were brought forward. In May 2004 the Government issued another consultation on giving itself new powers to reform the law without full Parliamentary deliberation.

Why include stakeholding? TUC activism and the CLR agenda

The peak association of trade unions, the TUC, was highly influential in shaping the Government’s agenda for the CLR. The TUC had significantly out-distanced the Labour Party in its approach to corporate governance, and was ready to promote stakeholding within the framework of a legal rationalization review. A cycle of meetings with civil servants discussing TUC ideas on company law began after Labour came to

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University an extremely detailed, ten-chapter literature survey on factual, empirical and legal issues. This was subsequently updated in November 2000 and March 2001. In February 2001, the Industrial Society provided a pilot study on the proposed Operating and Financial Review.

91 Much of the detailed work was done through working groups, to which outside experts were drafted.
power. Exchanging views with ministers on these issues was very easy, particularly with DTI Secretary Beckett and minister of state Ian McCartney. Jones and Pollitt concur that worker’s influence was high.

Trade unionist interest in governance grew during the mid 1990s with the particular support of General Secretary Monks. TUC was dissatisfied with the private committees, to which it had submitted evidence. It condemned Hampel for its “misplaced faith” in self-regulation and its failure to address ‘fat-cat’ pay. It was a “missed opportunity” and an “abdication of business leadership.” Although individual unions had little time to devote to the issue, a task group of General Council members was formed in 1995, met for a year, and produced a lengthy document (Your Stake at Work). This was a comprehensive analysis of the problems of governance, the means to include workers as stakeholders, and the special needs of small business and the public sector. It included a detailed, fourteen page chapter on proposals for company law in a stakeholding economy. It suggested longer-term shareholding (to reduce speculative investment), a ‘public interest’ consideration in mergers and acquisitions, mandatory pension fund voting of their shares, wider directors duties, consultation in the board and workplace, and expanded social reporting. The stake-holding approach was justified—as it often is—on grounds of economic efficiency and national competitiveness as well as on grounds of social justice. Taking a different tack, though, John Monks later wrote in

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94 TUC, "Your Stake at Work."
agreement with the concession theory of corporate responsibility: that companies benefited from grant of a ‘license to operate’ by state or community and thus should be accountable and responsible for their stakeholder relations.\textsuperscript{95} Your Stake at Work demonstrated a clear understanding of the mechanisms of governance, the authorities by which they are determined, and its supply-side appeal. The TUC would continue to hope for more than was on offer as the Company Law Review progressed.

Still, there were good strategic reasons for a stakeholder push from organized labor. The Conservative governments of the 1980s drew down both labor protections and trade union rights. The Blair Labour Party has defended these moves in the name of economic flexibility. Declining trade union membership reduces the possibilities of collective offense. Thus, unions saw corporate governance as a more hopeful avenue down which to pursue their quarry. This seems also to have been environmentalists’ view, as I explain in the next section.

**Environmentalist and other stakeholder group activism**

What of other interest groups? Jones and Pollitt report medium non-governmental organization influence and interest in the genesis of the Company Law Review—that is, more than business, but less than labor. In fact, most environmental groups had little access to the issues and, while interest in shareholder governance and green reporting had grown, company law remained an obscure area for most. Their interest grew once the Review was underway.

\textsuperscript{95} John Monks, "Trade Unions and the Second Term," \textit{Renewal} 8, no. 3 (2000).
However, the important role of personal leadership for non-traditional interests is demonstrated by the prominence of Traidcraft Exchange, a charity associated with Traidcraft Plc.96 A small group based in London, Traidcraft appears to have been instrumental in gaining recognition and access to the Review, and in coordinating the responses of other organizations.97 The organization’s leader, Rob Lake, noticed even before the 1997 election the significance of governance, and even the likelihood of reform by a new Labour Government. He had met Beckett and others in opposition. A second group of interested organizations included the World Wildlife Fund, Amnesty International’s Business Group, and Friends of the Earth. A variety of other groups signed on but couldn’t do more. They supported the inclusion on the Review’s Working Groups of David Wheeler of the Body Shop. Rob Lake himself joined the Consultative Committee and served on working groups.

Once the CLR was underway, these ‘public interest’ groups took advantage of conventional concerns about the information companies provide in their annual report. In this they share an interest with investors, who want as much information as possible from managers. In addition they have been supported in this effort by the accountancy profession,98 by advocates of ‘best practice’ in the business community,99 and by providers of social audit products.

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96 Traidcraft Plc trades in crafts, foodstuffs, and paper products, using ‘fair trading’ guidelines in purchasing and reselling. See: http://www.traidcraft.co.uk.

97 Interview by author with Rob Lake, Traidcraft, June 1, 2000.


99 For example, Centre for Tomorrow’s Company.
Most striking is their ability to exploit concern about risk in corporate governance, and to connect it to the systematic reporting of business information. They reframed claims about ecological damage in business terms: the risk of reputational damage, inadvertent regulatory non-compliance, and immediate financial costs of disasters. This resonated with the appearance of the term ‘risk’ as it relates to internal financial controls inside companies—an example is the sudden discovery of uncontrolled trading activities in the case of Barings Bank. Furthermore, managers are now highly sensitized to the risks they incur through operations exposing them to both environmental law and activists’ challenges to their reputation. A string of high profile ecological and human rights disasters have raised reputational fears, and at the same time increased the likelihood that public interest groups will be taken seriously by firms. What appears to be new is the fact that these risks are included in conventional corporate governance discourse. The OECD, for example, recognizes that shareholders have a right to risk-disclosure. By adopting the rhetoric of risk, environmentalists were able to better push their agenda in government and investor circles.

At the same time that groups such as Traidcraft, Friends of the Earth, and Amnesty International’s Business Group have pushed for greater transparency and information, service providers (including accountants, management consultants, and

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100 Interview by author with Rob Lake, Traidcraft, London, 1 June 2000.
internal auditors\textsuperscript{103}) are seeking new markets. As on the political front, public interest groups have allied themselves with other interests in the governance contest who seek to bring managers to account. There has even been an exchange of personnel, although the extent of this is not easy to judge. A leading proponent of the stakeholder model on the Company Law Review (David Wheeler, formerly of Body Shop International) went on to join KPMG after his hopes for governmental reform were “firmly crushed.”\textsuperscript{104}

In short, public interest stakeholders have allied with others who (for different reasons) want companies to produce more information, and with a government that sees this minimum as the acceptable limit of reform. One cannot help but remark, however, on the irony that public interest groups offer help in the calculation, reporting, and minimization of risk—risks that they have clearly made all the more real by engaging in what Newell calls ‘critical’ governance.\textsuperscript{105}

Deliberations of the CLR: Pluralism versus Enlightened Shareholder Value

Stakeholding first appeared in the CLR as a matter of the ‘scope’ of company law—fundamentals about who law should serve and to what ends. In its first document, the Steering Group (SG) said reform should facilitate business operations “so as to maximize wealth and welfare as a whole.”\textsuperscript{106} Efficient wealth creation would remain the main criterion: SG added that it wanted to avoid questions about “how such benefits

\textsuperscript{103} Ron Black, "A New Leaf in Environmental Auditing," \textit{The Internal Auditor} 55, no. 3 (1998).
\textsuperscript{104} Roger Cowe, "Stakeholder Law Plan to Be Axed, Resignation over Attempt to Curb Share Owner's Rights" \textit{Guardian}, 18 October, 1999.
\textsuperscript{105} Newell, "Environmental NGOs and Globalization: The Governance of TNCs."
should be shared or allocated between different participants in the economy, on grounds of fairness, social justice, or any similar criteria.”

That said, the SG identified two principal critiques of existing arrangements. The first was that they hinder good relations and trust between stakeholders, and that this hampers wealth creation. The second was that companies should behave ethically and attend to the public interest, for example by minimizing negative externalities or increasing philanthropy. The former is treated in greater detail than the latter. This reflects the efficiency criterion: a more ‘inclusive’ capitalism would be a more successful capitalism on its own terms. Given these critiques, two stylized reform alternatives were mooted: an “enlightened shareholder value approach” and a “pluralist approach.” In the first, shareholder value maximization is the key to securing overall welfare. Reforms would attempt to enhance the “enlightened” aspects of governance, including those that promote inclusion. The second approach sees the interests of other stakeholders as “valid in their own right” and admits that they may conflict with investor interests. This is an existentially radical move because it acknowledges diverse interests within the firm. It moves towards the normative, Kantian position on stakeholding. More importantly, it entails not only decision-making for stakeholders, but also decision-making by stakeholders. Steering Group member John Parkinson commented that articulating the pluralist alternative surprised the governance community, but also that it was seen as a ‘straw man’ to be quickly dispatched.107

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107 Interview with author, Bristol, June 5, 2000.
Nonetheless, the SG anchored the pluralist case in economic theory rather than philosophy. Betraying Parkinson’s authorship, the SG document relies heavily on Margaret Blair’s theory of the “firm-specific investments” discussed in Chapter One.108 This suggests Blair’s is currently the strongest economic-theoretical case for stakeholding. On the other hand, the document offers only a one-paragraph summary of the pluralist view followed by four paragraph-long theoretical counter-arguments and four subsequent paragraphs pointing out problems with its implied reforms.

In practice, a pluralist approach would require a directors’ power or duty to act in the interest of non-shareholders. In turn, this would involve the dramatic change of owing duties to those stakeholders, not to the company. As opponents pointed out, this would create chaos if it were enforceable in the courts. By contrast, only minor changes would be necessary if the enlightened shareholder value approach were to be adopted.109 Furthermore, enhanced reporting obligations within the enlightened shareholder value approach “could avoid the difficulties” inherent in the pluralist alternative. It might also help mitigate short-term pressures on directors.

The interests respond

Most of the responses to this first consultation document came from conventional governance participants, especially lawyers, accountants, and investors. The discussion of scope received the most comments (222 pages, 27% of the total), from the most diverse

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108 The present Anglo-American system of governance, argues Blair, does not sufficiently account for—or promote—investments made in firms by employees, which may indeed be greater in terms of economic risk, than those of shareholders.

109 Indeed, existing law does not in any case prohibit a more inclusive conception of duties. This could be clarified by statute, or through a ‘highway code’ approach (i.e., a pamphlet).
array of respondents. Most were implacably hostile to pluralism, or indeed to any addition to directors’ duties. The voice of petit British capitalism, the UK Shareholders Association, opposed both the enlightened shareholder value approach and pluralism.

Managerial representatives were more diplomatic, but no less unanimous in opposing pluralism. The Confederation of British Industry (CBI) called for a non-statutory clarification of duties, including the current flexibility to have regard to wider social and ethical objectives. Section 309 should be incorporated into this statement and abolished (effectively repealing it). Representing senior managers, the Institute of Directors (IoD), said it would accept the Law Commission’s proposed legal restatement of duties. Reflecting the views of the other groups, the Chamber of Commerce argued that company law was not the proper vehicle for social and environmental policy.

The institutional investors adopted a similar perspective, opposing pluralism and suggesting repeal of the confusing Section 309. The Fund Managers Association, rather more colorfully than NAPF or ABI, said it was “deeply skeptical about the efficacy of legislation to make management good.” It pointed out that the stakeholding approach would involve a one-off transfer of wealth from shareholders, increasing the cost of capital, and damaging inward investment. FMA added that short termism is not a problem, because shareholders promote proper managerial horizons and focused on future expected income streams rather than immediate gain. Sentiment was also against legal clarification (NAPF, ABI).
Accountants echoed these positions, as did lawyers. The Law Society—the loudest voice of its profession throughout the Review—reasoned that company law “should not be used to implement social and cultural changes.” A declaratory statement of directors’ duties, with no legal change, might be useful.

Employees and environmentalists made the case for the pluralist model, or at least for a more progressive enlightened shareholder model. Again echoing Blair, the TUC argued that interests in any reform might best be judged by cost benefit analysis: employees often bear considerably more risk than shareholders or others in modern companies. Thus, directors should be required to have regard to workers and employee representation should be permitted on corporate boards. The employee friendly business group Labour Finance and Industry Group called for clarification of S309 to make it meaningful. Traidcraft deployed the ‘license to operate’ argument about corporate responsibility: that incorporation confers duties to society as a whole that are neglected in the Anglo-governance model. A joint NGO submission (organized by Rob Lake at Traidcraft) reinforced this argument. Among the other groups responding favorably were the World Wildlife Fund, Amnesty International’s Business Group, CAFOD (a Catholic group), the World Development Movement, and Forum for the Future.

In addition, two business-supported advocacy groups responded. The Center for Tomorrow’s Company rejected the pluralist model but made the case for enlightened, best business practice, chiefly through an ‘entity’ conception of the firm where duties would be owed to the company, but the company would be recognized as more than its
shareholders. The Institute of Social and Ethical Accountability wanted reform primarily of disclosure and the keeping the option open for directors to consider others.

The Steering Group’s final proposal

Predictably, the follow-up consultation documented “provisionally” opted for the enlightened shareholder value approach. Still, the “objective should be pluralist in the sense that companies should be run in a way which maximizes overall competitiveness and wealth and welfare for all.”110 Directors were to ‘have regard’ —in pursuit of shareholder’s interests—to relationships, the community and the environment.111 In addition the SG would propose expanded disclosure of stakeholder relevant information.

In a brief comparative section, the SG noted that US stakeholder statutes are either of obscure impact or appear to be largely about frustrating takeover bids; that the Continental stakeholder model usually achieved through board structure reform and in any case existed in a different juridical/political environment; that these Continental systems are moving away from stakeholder orientation; and that organic development preferable to grafting outside models.

111 The duties would include the general legal principles of compliance and loyalty, independence of judgment, avoidance of conflicts of interest, fairness, and care, skill and judgment. Under “Compliance and loyalty” falls a new duty to exercise powers honestly and for proper purpose under the company’s constitution, “taking account of both the long and the short term,” to promote the success of the company for the benefit of its members as a whole. Furthermore: “The circumstances to which he is to have regard for that purpose include, in particular, (as his duties of care and skill may require): (a) the company’s need to foster its business relationships, including those with its employees and suppliers and the customers for its products and services; (b) the impact of its operations on the communities affected and on the environment; and (c) its need to maintain a reputation for high standards of business conduct.” This would replace the existing S309. Ibid., 3.40.
The general reactions to the SG position were predictable: TUC and UNIFI (the union representing financial services workers) regretted the rejection of the pluralist model. TUC thought it cursory and a response to company and company lawyer pressure. The SG had not answered the fundamental questions it was asked to. On the other hand, they welcomed the inclusive statement as far as it went, and thought it might help create a different context for corporate decision-making. UNIFI remarked that the SG had contributed little, since it had not effectively tied inclusiveness or the idea of workplace relationships to competitiveness. Meanwhile, the Institute of Directors expressed its fear of “creeping pluralism.” It opposed an exhaustive legal statement of duties, any list of those whom directors might be entitled to consider, and legally ambiguous phrases such as ‘success of company,’ and ‘exercising powers honestly.’ CBI supported a legal statement but also wanted to forestall confusion and ambiguity. Ownership interests were generally positive. Confirming its outré image in the investing community, PIRC called for mandatory consultation of stakeholders or at least full reporting on stakeholder engagement mechanisms.

The next major document confirmed the position on scope, marrying an inclusive statement of directors’ duties, owed to the company, to the requirement for an Operating and Financial Review. Presumably in light of ambiguity or of concerns about creeping pluralism, SG reiterated that the hierarchy of duties would be: to obey the company constitution and shareholder decisions; to promote what he calculates in good faith is
likely to promote success for shareholders’ benefit; and take into account the listed factors where relevant for that purpose. The Final Report reiterated these duties:

“to recognize, as the circumstances require, the company’s need to foster relationships with its employees, customers and suppliers, its need to maintain its business reputation, and its need to consider the company’s impact on the community and the working environment.”

112 The SG refused managerial suggestions that the list be excised from its proposal. Removing the list from the legislation would involve repeal of S309 and so would be undesirable and politically problematic. In addition, the list of possibly relevant considerations necessarily related to the OFR. SG also rejected calls to remove the reference to the “long term,” and to the “success of the company.” It rejected the Institute of Directors suggestion that an “entitlement” to take into account non-shareholder interests, rather than an obligation (where relevant) as in the proposed statement.
So as to preserve the power of Parliament in this key area, the list should be exhaustive, without the courts able to develop new considerations.

The ministerial white Paper

In the White Paper, the Government accepted the CLR proposal on clarifying directors’ duties. It rejected the CLR proposal that directors sign a statement that they had read and understood their obligations. This was seen as having no legal effect and therefore not relevant. Of the major interests, only the Law Society continued to publicly oppose a statutory clarification. CBI accepted the move but worried about conflicts with common law, preferring—as always—a Code approach. TUC and stakeholder activists wanted the statement to go further, and were unhappy that directors would not be made to sign the statement.

The CLR on transparency and stakeholding: The OFR

The second major plank in the Steering Group’s effort to prod companies in the direction of inclusive management is the Operating and Financial Review. This is the one area where the CLR’s proposals were implemented. It is consistent with the liberal British tradition of maximizing information to markets, and also with a ‘transparency coalition’ of employees and investors against managers. Still, it was controversial in its details.

Taking up again the business-case for reform, SG emphasized the importance of ‘soft’ or qualitative factors to modern business. SG asked whether mandatory reports on

113 Department of Trade and Industry, "Modernising Company Law," (London: HMSO, 2002), 26. Except for including a duty to creditors (which exists anyway in cases of insolvency). Imposing a general duty to creditors would, it was argued, foster excessive managerial caution.
employee, supplier, customer, community relations, philanthropic behavior or environmental performance were desirable.\textsuperscript{114} Responses were evenly divided, although the majority opposed a prescriptive approach. The main objections, as raised in consultative committee meetings, were contradictory: it was already widely done or expected, it would be too expensive, it would only produce more legalistic ‘boilerplate,’ and its accuracy could not be guaranteed. The minutes reported, moreover, that some thought accounting issues should not be on the CLR agenda at all. Given the strong presence of accountants on the Steering Group this was unlikely to be a fruitful avenue of complaint. The senior civil servant present, Richard Rogers, told the group that the issue of valuing intangibles was significant from a shareholder perspective and so relevant to the inquiry.\textsuperscript{115} It was also a politically feasible (because relatively inexpensive to companies) way to give stakeholding advocates a victory.

Managers alternatively complained that reporting requirements tend to be met by ‘boiler plate’ statements—devoid of substance and drawn up by lawyers—or that companies engaging in best practice voluntary disclosure put themselves at a competitive disadvantage. Substantive and detailed requirements that all companies would meet, of course, would meet both objections (although the problem of overseas competition may remain). In its consultation documents the SG never suggested detailed requirements be set out in law or standard, but it did argue that an equal burden would remove managers’ concerns about discrimination.

\textsuperscript{114} (Q6 (b) (i) and (ii)).
The SG reported in its follow up document that the OFR was a fundamental project for them. Its proposal was modest, however. Content would be specified in part by law and in part by a franchised standards body. Not all information was to be required; several items were to be included only so far as directors’ judged them materially relevant. These included the report on stakeholder relationships, corporate governance and the environment.

In responses to the proposal, employees, and environmentalists were supportive but also wanted an audit of the content and directors’ judgment on materiality.¹¹⁶ They also wanted any OFR standards-setting body be fully representative. Business (managers, investors, and accountants) was more concerned to keep the focus of the body financial. The Centre for Tomorrow’s Company warned that it not become “a Trojan horse” for special interests. The accounting industry was overwhelmingly supportive of the OFR proposal, and some even encouraged greater use of audit. Investors either supported it in principle or had no strong views (NAPF), although there was concern that some items not be mandatory (ABI). Investors were not decisively supportive of the Report. On the other hand, managers, including the Institute of Personnel, argued it was too prescriptive and were generally opposed. CBI saw no need for this to be statutory, although the IoD

¹¹⁶ A substantive OFR would have included the following: mandatory social and environmental reporting; a standards setting body including civil society representatives; mandatory audit of environmental and social reports and the judgments made by directors on what should be revealed; mandatory distribution of the reports; and disclosure of directors’ training and experience relevant to their new inclusive duties. Traidcraft initial comments on Modern Company Law for a Competitive Economy: Developing the Framework.
welcomed an audit of the OFR if implemented. Lawyers were divided: the Law Society of England opposed, although the Law Society of Scotland agreed with the change.

Considering these responses, the SG stated that it would maintain a “light-touch” statutory requirement, with standards developing the bulk of the OFR content and directors having “ownership” of the report. It maintained its view that the ‘materiality threshold’ should be whether, in the good faith judgment of directors, the information is “material for the understanding of the performance of the business.” Non-mandatory guidance would be given by the standards body on inclusion, but not on standards for preparation of the Review. The final proposals retained the materiality threshold and the content requirements, with occasional changes in wording. The environmental provisions were wrapped into the section on community, social, ethical and reputational issues. The SG had commissioned a pilot project conducted by the Industrial Society (headed by Will Hutton of stakeholding fame), but rejected two of its recommendations. The first was that more information be included on directors and corporate governance as a mandatory item. The second was that information on workforce development and training be mandatory.

*How many companies? The threshold for the OFR*

The SG initially proposed that the OFR requirement would apply to all public companies, as well as private companies with a turnover of more than £500M. The Stock Exchange wanted a narrower figure. CBI thought this an inappropriate threshold (it opposed the statutory OFR in any case), although IoD thought it should apply to all
public companies. In response, the OFR in Strategic Framework introduced a threshold for public companies of turnover exceeding £5M. The Final Report offered something of a compromise. Companies would have to meet two of the following threshold requirements: turnover of more than £50M, or balance sheet total of more than £25M, or more than 250 employees.

The view from elsewhere in government

Other state and franchise entities commented on the OFR proposal. The Financial Services Authority supported the OFR for large companies, but wanted to maximize flexibility. The franchise accountancy body, FRC, worried that ‘materiality’ would be very difficult to establish objectively. Furthermore, it remarked that the OFR will distract from reporting “what matters to the business,” and that other requirements should be directed through specific (non-company law) legislation. FRC’s subsidiary on auditing, the APB, called for clarifications. They argued that the drafting would encourage readers to assume, because the OFR process was audited, that it was verified as a ‘true and fair’ picture. The Environment Agency wanted wider requirements imposed—and imposed by statutory guidance rather than by the standards setting body. These increased obligations would include auditing of environmental performance statements and disclosure in Annual Report of any prosecution for environmental offenses.

117 Response number 198 to White Paper, Chapter 4.
118 Response number 344 to White Paper, Chapter 4. Sensibly, the EA also wants integrated reporting so regulatory information collected by the Government and EC has to be delivered only once.
The White Paper

The Government largely accepted the CLR position on OFR, though it stressed the “business case” alongside the stakeholder justification. It was introduced, however, in the context of the terribly uncontroversial 1993 ASB statement which first “provided a framework within which the directors could, if they wished, provide a narrative report” on the factors underlying companies’ performance. Going forward a modified Standards Board would take responsibility. The process used to produce the OFR would be subject to audit, but not the actual contents of the Report. The WP accepted CLR’s threshold company size for producing an OFR: “economically significant” companies, meaning public companies with a turnover of more than £50M, balance sheet totals of more than £25M, or more than 500 employees.119

Although hardly burdensome and widely accepted in CLR responses, the OFR proposal nonetheless attracted further negative comment. One hostile individual respondent colorfully described the OFR as “a back hander from the political elite to the accountancy trade.”120 Indeed, the largest UK accountancy professional body, ICAEW, welcomed the OFR but, naturally, wanted less detailed guidance from the Government. CBI regretted any further meddling with the OFR, pointing out that the standards’ body ASB had for a decade promoted OFRs and that many large companies already produced them. Directors’ discretion should be maximized in deciding what to include. The mining conglomerate, Rio Tinto, repeated the perennial concern of British governance

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119 WP announced another independent inquiry group (the OFR Working Group) to help develop guidance on what should be included in the new report. The OFR Working Group was established in December 2003 and published its interim report in June 2003.

120 Duncan Alexander, Response number 17 to the White Paper, Chapter 4.
participants: that any legislation would lead to a ‘box-ticking’ approach and boilerplate reporting. The Investor Relations Society, representing company managers who would, presumably, have a hand in the OFR, welcomed the reform.

Predictably, stakeholding advocates condemned the WP for not going further. They wanted less discretion for directors and more detailed, tighter rules on what should be included. The TUC specifically argued that the OFR, to have teeth, should be linked to the directors’ newly explicit inclusive duties instead of being formally still a report to shareholders. Finally, Linda Perham MP, representing the Parliamentary Group on CSR, argued that the WP threshold of £50M was so high that it would include only those companies responsible for 1/3 of national economic activity.

The CLR on shareholding: takeovers and the market for corporate control

One area where employees, in coalition with managers, had managed to win concessions in the American states was in the legal treatment of takeovers. Introduced in reaction to the late 1980s-takeover boom, ‘stakeholder statutes’ allowed managers to block acquisitions in part based on any potential impact on workers. In Britain, these kinds of measures are prohibited. The franchise Takeover Panel regulates the mechanics of mergers and acquisitions.121 The CLR Steering Group said it saw no grounds for using company law to inhibit takeovers. Aside from TUC and Friends of the Earth there was no articulated support for modifying the market to allow the Competition Commission to

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121 The panel ensures fair and equal treatment of shareholders and orderly framework for offers. They are also subject to indirect regulation under Financial Services Act via the Self Regulating Organizations and Regulated Professional Bodies. Finally, takeovers, mergers, and acquisitions are also subject to the competition regime under the Competition Commission and ultimately also the Secretary of State. Public interest considerations are covered by these authorities.
evaluate the social and environmental impacts of takeovers. Thus, even managers were unwilling to see state authority expand in this area. The SG concluded that changes to company law along these lines would be wrong because they would “weaken an important source of managerial accountability.” There was greater support for including information about the effects of takeovers in the OFR. Accordingly, the SG limited itself to encouraging managers to include these kinds of matters in the OFR.

Evaluating the CLR

By 2001 corporate governance had become an attractive target for group interests. This agenda expansion was given institutional form in the CLR. This was facilitated by the closeness of organized labor to the new Government and the sympathies of the Trade and Industry Secretary.

The Review’s consultations were unusually broad, but despite the unconventional analysis of some its Steering Group, it was unlikely to move radically. The Government had made clear its pro-business position on entering office. Changes at the Department of Trade and Industry reinforced this. Beckett had been enthusiastic about the Review and was sympathetic to the stakeholding position. The appointment of Peter Mandelson in July 1998 signaled a laissez faire shift, however. The Financial Times described him as the best business could hope for at the Department, and he was not as enthusiastic about the Review. Stephen Byers, his successor, had a history of hostility to the unions, even threatening to sever the Party’s links. He has few close contacts at TUC and was comfortable with the pro-business rhetoric of the Government. Accordingly, he told a

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122 Traidcraft, Amnesty International, and the World Wildlife Fund added their support on this.
joint TUC/Institute for Public Policy Research conference in 1999 that no “pure stakeholder approach” would emerge from the Review.\textsuperscript{123} Patricia Hewitt, Byers’ successor, is more sympathetic, although her focus remains competitiveness.

In addition, the civil servants seconded to the Committee were not likely to push a more radical position. Richard Rogers, Director of Company Law and Investigations at DTI chaired the steering Group, although officially in a personal capacity. Jonathan Rickford, seconded from DTI to be Project Director, joined Rogers on the Steering Group. He sat on all of the Working Groups and the Consultative Committee, and so was strategically placed to drive work forward and give DTI a monitoring voice at every point. Rickford was widely complimented in interviews for his intelligence, fairness, and skills as a chairman. He was no radical: predicting that, any reform would be permissive rather than compulsory. He told one audience that:

\begin{quote}
A company is…simply a convenient portmanteau expression for summarizing the complex set of legal relations between individuals which the law prescribes to facilitate and control human associations of a particular kind.\textsuperscript{124}
\end{quote}

This is the “nexus of contracts” view dominant in microeconomic analysis of governance. It is a highly under-socialized view of companies.

Finally, the public resignation of David Wheeler from a Working Group in October 1999 was an early sign of the overall direction of the Review. Wheeler formerly headed the Environmental Sustainability and Social Policy at the Body Shop and was a

\begin{footnotesize}
\textsuperscript{123} Quoted in IOD response to Developing the Framework—check with DTI text.
\end{footnotesize}
prominent stakeholding advocate. On resigning from the CLR, he was quoted by the Guardian as saying the Review was “timid and conservative” and essentially not worth his time.

The Final Report explained that it was a consensus document: “practically all our proposals are supported by a substantial majority of respondents.” Still, one participant viewed managers (the CBI) and lawyers as the major constituents. The SG had followed in some instances the views of minorities and changed its positions, but generally had not needed to change its views on the merits of any major issues in order to obtain consensus. Only a few feathers were ruffled, and no wings were clipped.

The government announced its receipt of the Final Report of the CLR with no reference to the term ‘stakeholder’. The Department’s press release focused on relief to small businesses, and featured the head of the Small Business Service as well as the Secretary of Trade and Industry. Modernization was a prominent motif: “modern expectations about corporate accountability and transparency,” and directors duties and conduct that reflects “modern needs and expectations.” On reporting, Hewitt said that intangible assets, such as the “skills and knowledge of employees,” “business relationships” and “reputation” would need to be included in information made available to the public.

Stakeholding advocates will be happy with the expanded reporting, but perhaps more because it provides a wedge for future requirements than for what it requires now. As it currently stands, the OFR is directed not at the public but at shareholders. Its purpose, according to the draft statutory language, is to allow shareholders to make an informed assessment of the company’s operations, its financial position, and its future business strategies and prospects. Having decided what to include on these matters, directors must then “consider” whether, to fulfill the report’s purposes, they need to include information about employment policies, policies on environmental issues, policies on social and community issues, and reputational issues.\textsuperscript{127} It allows directors to determine “precisely what information is material to their particular business.”

It is striking not only that shareholders are the presumed users of the report, but also that the emphasis is on policies—process—rather than on outcomes. This runs directly counter to the stakeholder advocates’ hopes that the report would give some comparable basis for assessing corporate outcomes. By contrast, the new regulations on reporting executive pay are much more specific. They insist on performance graphs laying out a company’s financial performance (shareholder return) to a comparator group. The OFR avoids prescription at all cost, professedly to avoid ‘boilerplate’ and ‘box-ticking.’

\textsuperscript{127} Draft statutory language for a Companies Bill, Part 5, Chapter 1, Sections 73 and 75, subsections 1 and 2, paras c), d), e), and g). This is found in Department of Trade and Industry, "Modernising Company Law," Volume II.
In conclusion, then, the CLR was liberal in direction and output, with very modest concessions to unions and others with social democratic instincts. Neither the CLR’s remit, nor its output, nor the Government’s response signals a shift towards the European social democrats’ (or the European Union’s) attitude that power in companies should be shared. It displayed a passing interest in new ideas and openness to discussion and wider consultation; stakeholding advocates see it as a lost opportunity.

Incidentally, as of 2004, lawyers have not yet seen the rationalization of law for which they were so eager, and for which the CLR was created. They have lost the battle over enshrining directors’ duties in statute. While a Companies Bill, if and when it comes, will have only the mildest of stakeholder reforms, they will complain that the proper purposes of company law have been muddied by new objectives.

VI. Labour’s Second Term: Partnership & Corporate Social Responsibility

Stakeholding activists felt their hopes of significant state intervention had been dashed by the end of Labour’s first term. In 2000, TUC General Secretary John Monks criticized the Government’s reluctance to introduce into company law some “countervailing pressure…to offset the relentless pursuit of shareholder value.” The problem was underlined by threatened job losses resulting from the unexpected disposition in summer 2000 by BMW of its Rover Car subsidiary. However, stakeholding—in terms addressed by the Company Law Review—did not figure prominently in Parliament. Neither the Treasury nor the Trade and Industry Committee

129 Monks, ”Trade Unions and the Second Term,” 24.
The ideology promoters of the Third Way—including Anthony Giddens—failed to bring any critique of business to the public discourse. The notion itself was widely derided on the opinion pages of left and right as an insubstantial euphemism for neo-liberalism. Stakeholding critics pointed out that the CLR had not imposed reciprocal obligations on business despite Giddens’ assertion that there were no rights without responsibilities. Instead of pointing to the negative social effects of Europe’s most flexible labor market, for example, New Labour’s friends kept the spotlight on successful businesses and the government’s framework role. Like neo-liberals, Labour stressed the power of business leadership, best practice and consumer choice to promote the public weal.

Within and without government, that weal became identified not only with general prosperity, but also with ‘corporate social responsibility’ (CSR) and ‘partnerships at work.’ If the rhetoric of stakeholding peaked in the mid-late 1990s, it was displaced

in the early 2000s by CSR and, to a lesser extent, partnership. Tony Blair announced a fund in 1999 that would help companies build better long term relationships with their workers. This would encourage better training and cooperation and should help increase productivity. In 2000 a new ministerial brief on CSR was created within DTI—the first in Europe, according to the Department. The move is promotional and coordinating rather than regulatory. The DTI CSR website describes its role as “developing the business case [for CSR], encouraging good practice, promoting CSR internationally, and ‘joining up action’ across Government.” A glossy annual report is published.  

Few publicly reject these CSR initiatives, although some managers fear the extension of regulation to which the notion of ‘responsibility’ might logically point. The Government’s promotional activities range widely across departments. DTI promoted new voluntary guidelines on environmental reporting in November 2001, gaining CBI’s imprimatur in a foreword. In 2003 it launched a consultation on reporting on human resource management. The Ethical Trading Initiative from Department for International Development formed (DfID) in 1998. ETI is a semi-private body, funded in part by the DfID, business, campaign groups, and unions. It works to ensure codes and ethical guidelines, especially those based on ILO recommendations, are implemented.

As might be expected, the many speeches delivered by corporate responsibility ministers tended to stress the natural harmony between social justice, opportunity, and a successful economy. Steven Timms’ bromidic comments to the Royal Institute on

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132 The first was Department of Trade and Industry, "Business and Society: Building Corporate Social Responsibility in the UK." (London: HMSO, 2001).
International Affairs in February 2003 were typical. He endorsed ‘high performance workplaces,’ closer community links, and improved environment. He rejected any state mandate that companies be responsible, however. Indeed, he mentioned only three positive measures. One was the new “light touch” requirement introduced in 1999 that pension funds state whether they do (or do not) have a policy on socially responsible investment. The second was Community Investment Tax Relief incentive program. Finally, the Operating and Financial Review. On the other hand, threatening rhetoric also has a role: speaking at the 2000 ACCA Environmental Reporting Awards ceremony, environment minister Michael Meacher issued a ‘final’ warning that new reporting requirements would be imposed on companies if they did not take the initiative.\textsuperscript{133} He mentioned the OFR as the government’s weapon of choice.

Hardly objectionable on the face of it, CSR found considerable back-bench support in Parliament. In 2001 an All Party Parliamentary Group on CSR was established to “promote debate and understanding in Parliament.” The group has corporate sponsors and 131 members as of 2002. Its secretariat is provided by Business in the Community, a corporate membership body with charitable purposes headed by Prince Charles. A Corporate Responsibility Bill was tabled in 2002 by the Labour backbencher Linda Perham MP.\textsuperscript{134} In dramatic contrast to the Government’s approach, Perham’s bill would have required extensive “environmental, social economic and financial impacts” reporting; advance stakeholder consultation on major projects; new duties for directors to

\textsuperscript{134} \textit{Corporate Responsibility Bill}, 2001/02, 145.
consider stakeholder interests; new directors’ liabilities on these fronts; and a Corporate Responsibility Board. Perham obtained the support of, among others, Amnesty International, CAFOD, Friends of the Earth, the New Economics Foundation and Save the Children, Christian Aid, Traidcraft, and several unions.

The bill was opposed by business interests, including the Chambers of Commerce and CBI, which called for “a carrot-led rather than a stick-driven approach.” Perham pointed out that 75% of companies had failed to meet Tony Blair’s call that the top 350 firms produce social and environmental reports.135 Perham’s original bill failed to get a second reading and she introduced a less ambitious, but still bold, measure several months later.136 That bill also failed. An ‘early day motion’ urging government action was signed by well over 250 Members of Parliament. The only other stakeholder-friendly private member’s bill was the Company Directors (Health and Safety) Bill. It would have mandated a single ‘health and safety’ director be appointed to all boards. The bill failed to receive a second reading.137

Outside Parliament, a new group emerged to push for these kinds of reforms. The Corporate Responsibility (CORE) Coalition “was formed in response to the Government's failure in the Modernizing Company Law White Paper to specify rules requiring companies to be more transparent and be held accountable to their wider

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136 The bill was not printed. It was Commons Bill 193.
137 Company Directors (Health and Safety), 2002/03, 82.
stakeholders.” Founding members were Amnesty International, Christian Aid, Friends of the Earth, the New Economics Foundation and Traidcraft. The coalition claims support from over fifty organizations.

The CSR movement shares with stakeholding advocates the hope that business will respond in its enlightened self-interest. It tends to focus either on reporting good practice and/or on promoting socially responsible investment. Among the best is the Centre for Tomorrow’s Company, which focuses more narrowly on reporting, is enthusiastic about the Operating and Financial Review, and had participated in the CLR. Others include FTSE4Good, The Global Reporting Initiative, the Just Pensions Guidelines, the Association of British Insurers Guidelines, and the Advisory Committee on Business and the Environment (ACBE). The Forge Group on behalf of the financial services industry published guidelines on the management and reporting of Corporate Social Responsibility. They provide ‘systematic structured advice from a business perspective.’

But the theoretical underpinnings of CSR are not well developed and much less threatening to the decision-making structures of British companies. Will Hutton’s The State We’re In, for example, condemned shareholder capitalism as part of a wider critique of the democratic deficit in Britain. CSR may be objectionable to those, like Milton Friedman, who emphasize profit-seeking as the one true path, but it has few other prominent detractors. While no managers brought workers and environmentalists onto

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their boards, many promote themselves as serious about CSR. The Corporate Responsibility Group of 60 prominent businesses has existed since 1987. Indeed, there are now ‘CSR practitioners,’ frequently allied to ‘ethics professionals’ to be found in large corporate bureaucracies.

VII. The European directive on Information and Consultation

Two European initiatives impinged on UK governance during this time. The first, and less significant, was the 1994 European Works Council Directive, from which the hostile Conservative Government had secured an ‘opt-out.’ The directive mandated works councils for companies operating in more than one EU country. Once in office, Labour agreed to its extension to the UK and, following the usual lengthy consultation, it was implemented in 1999. DTI estimated that this covered only about 100 UK-based companies, in addition to the same number of foreign (EU) companies operating in the UK already covered. It did not substantially affect UK corporate governance, although it set a precedent that unsettled business.

More important is the European Commission Directive on Information and Consultation. Clearly here EU law drove domestic law in the direction of

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140 Hall, Uk0001146n (cite).

stakeholders—albeit only marginally. It raises issues not of board-level codetermination, but rather of information availability and consultation within companies (particularly on issues of skill development and employment). Previously the Labour Government had failed to support similar measures in the Commons; there is no evidence that they would have undertaken it without the EU push.142 The EC measure met with hostility from Conservatives in the European Parliament, and was opposed by European business associations. Organized labor welcomed it, despite uncertainty about its possible effect on UK unions. The CBI put it on a ‘target list’ of the top ten biggest regulatory threats to business. After considerable debate—and opposition from the British Government—the Directive was approved in 2002. It requires member countries to implement mechanisms of employee consultation by 2005.143

The details of implementation were left to member countries. Professing enthusiasm, DTI minister Alan Johnson emphasized to a TUC conference in January 2003 that it would not upset existing arrangements and would maximize flexibility while representatives and the employer. The directive mandates information on business activities and economic situation; information and consultation on employment developments; and on any decisions likely to lead to changes in work organization or contract.

142 A private member’s bill (Kelvin Hopkins, MP) would have required companies with more than fifty employees to consult worker representatives on “large business issues which directly affect employees,” and to establish a consultation forum. Companies would have to provide “information on all relevant facts.” The Bill failed, but in any case did not go far enough to meet the obligations under the European Directive.

143 This measure is in addition to the European Works Council directive, which requires trans-nationals to set up employee councils.
ending the practice of surprise layoffs.\footnote{144} In late June workers at one Manchester firm were notified of imminent redundancy by text-message over their mobile telephones.\footnote{145}

The process by which draft implementing regulations were developed is interesting in itself. It demonstrates again the close working relationship between the Government and business. In formal tripartite bargaining, DTI agreed a framework for implementation with CBI and TUC.\footnote{146} The agreement allows companies to voluntarily agree procedures with workers. Those with consultation procedures in place as the rules go into effect will maintain them. Only a 40\% workplace vote would overturn existing mechanisms and set in train the imposition of government designed standard approach. Business was hardly enthusiastic, even about the compromise. In the DTI press release, CBI’s Director General was quoted as saying, “the Government has made sense of a poor piece of EU legislation.” It had “avoided overly rigid rules and damaging one-size fits all solutions.” Elsewhere, CBI made it known that “…Business never accepted that this was an appropriate area for EU legislation.”\footnote{147} Other managerial representatives were even less receptive. The head of the Institute of Directors said, memorably, “Firms will see this as one of the biggest ever attacks on the right to manage their own companies. If this improves productivity, efficiency and competitiveness, I'm a Dutchman.”\footnote{148}

\footnote{144} \textit{Financial Times} reported in advance that the minister was to tell the conference that implementation of the Directive would not be “about co-determination or joint decision-making.” The text of the speech archived at DTI does not include this remark. \footnote{145} Clay Harris, “We Rgrt 2 Infm U Yr Fired. Hv Nice Day,” \textit{Financial Times}, 31 May 2003. \footnote{146} Department of Trade and Industry, “High Performance Workplaces: Informing and Consulting Employees,” (London: 2003). An earlier consultation was: Department of Trade and Industry, “High Performance Workplaces: The Role of Employee Involvement in a Modern Economy,” (London: 2002). \footnote{147} Quoted in Jean Eaglesham, “Minister Shows His Mettle to the Unions,” \textit{Financial Times}, 8 July 2003. \footnote{148} Quoted in Darren Behar, "Firms' Fury as EU Restores Union Might,” \textit{Daily Mail}, 8 July 2003.}

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spokesman denied there was any problem with consultation in British firms. The Chamber of Commerce—unlike the CBI representative of small and medium enterprises—declared the directive anti-competitive and anti-jobs. The Federation of Small Business also opposed the move. In the end they surely had little to complain about. Implementation of the directive was consistent with the Government’s voluntarist approach to employee ‘participation’ in enterprises. The stakeholding advocate Will Hutton remarked on the Government’s timidity: the directive was, he said, “forensically watered down.”149

VIII. Concluding Comments

Stakeholding failed because the Labour Government did not impose reform. The institutional and structural hurdles were high, interest group support was non-existent outside the unions and a few ecological and other activists. Public salience was low. However, as Colin Crouch asserted, here was an opportunity for a genuine modernizing project, a project that claimed it could help to address the kind of demand politics I explained in my concluding remarks to Chapter One. I evaluate at greater length why Labour did not take up the challenge, and discuss the theoretical import of their decision, in the final chapter.

Chapter 5. Conclusions and theoretical discussion

My empirical chapters sustain the following conclusions, explained in this Conclusion. Chapter 4 demonstrated that economic routes to stakeholding are not viable and that private authorities as presently constituted will not redistribute power in favor of stakeholding because they are undemocratic. This means that comprehensive state intervention would be required to advance the stakeholding agenda, but the balance of forces make such an intervention very difficult and unlikely. In particular, supporting cross-class coalitions will not emerge to support interventions that do more than tinker with the existing system. In short, structural conditions raise the political costs of reform well above what Labour would be willing to undertake. What is left is a shiny veneer of promotion and cajoling. Based on these findings, I consider in Parts V-VII some implications for democracy. I conclude that these implications are the more troubling because stakeholding, although a problem for capitalists, also represented a solution that was consistent with both capitalism and a representative democracy.

I. Economics and the need for state intervention

The evidence I presented in Chapter Four confounds the idea that markets might produce stakeholder friendly governance. None of the four economic routes I considered
were borne out. First, there are few signs that UK business is evolving towards stakeholding as a way to compete (considered from p. 183 above). Despite the growing significance of human capital in production, and despite the supposed competitive advantage of cooperative workplaces, managers opposed increased employee voice. With very few exceptions investors joined this opposition. Few workers enjoy greater workplace participation, genuine job stability, or quality training. Thus, British business prefers to compete on grounds of low wages, low investment and numerical flexibility (that is, employment insecurity). I do not have enough evidence yet to evaluate the spread of new norms of environmental and social reporting, which is predicted by some stakeholder economists.

The economic power of stakeholders as shareholders is not enough to sustain change (see pp 208). Institutional investors have not abandoned their strategy of market diversification and turnover. They have not become ‘proprietors’ or universal owners. Fiduciary capitalism continues to seek short term gains. Nor have stakeholders had much impact through owning shares in particular companies or diversified green and socially aware funds. Instead, shareholder activism on socially responsible issues resembles propaganda by the (capitalist) deed. It attracts media attention and can raise the reputational risks of doing bad business. But it is not system transforming. Neither small stakes in ownership by stakeholding activists nor (more importantly) the institutional control of employees’ retirement savings has turned managers towards stakeholding reform.
II. Private authority and the reproduction of power in governance

What of the effects of different authority forms in governance? Overall, private authority has served both investors and managers well, and did not produce stakeholder gains. The transition to greater state influence in governance offends the sensibilities the current insiders, perhaps because it threatens greater politicization going forward. By democratizing regulation –exposing it to Parliamentary influence and ministerial whim—it increases uncertainty. These whims, as I explain later in this chapter, are in fact heavily constrained by structural factors, but they nonetheless create considerable managerial and investor fear.

Of the major mechanisms of corporate governance—direction, control, and transparency—only the latter was subject to positive public policy prior to the 1990s. Within a laissez faire legal framework (substantially through common law), economic actors were left to experiment and design suitable arrangements. In transparency, there was more regulation, but again within a non-statutory framework. Policy-making on standards and enforcement was delegated to the professional bodies that were periodically restructured as crises arose. This was consistent with wider patterns in British regulation: an ad-hoc range of quasi-governmental bodies conducting the business of state with public monies and ministerial blessings, but more or less distanced from political control.¹ Both investors and managers seemed well served by these arrangements (see above, pp 56).

In Chapter Three I charted the organization, at ministerial behest, of new private authority to improve investor protection and restore legitimacy to corporate governance. Responding to scandal, managers and accountants achieved reforms that met the Government’s wishes. Ministers would claim that their faith in managers’ ability to put their house in order was borne out. But most agree as well that private cooperation was forthcoming in no small part to avoid direct state intervention. The Institute of Directors viewed the Cadbury, Greenbury, and Hampel Reports as an effort to act “lest a legislative response was found to counter public disquiet” over directors’ derelictions.2

Still, the Cadbury, Greenbury, and Hampel committees and their Codes were, taken together, a striking institutionalization of new, private authority reforms. They were not successful in reining in executive pay, and this must be seen as their great failure. But their rules about new board structures were successful in prompting a more attentive atmosphere among senior management. Although these operated on the principle of ‘comply or explain’ to maximize managerial flexibility, the new norms diffused quickly. Specific rules were codified into the listing requirements for companies trading stock. Finally, state legislation ratified the codes in some particulars. They became juridically franchise bodies: they carried public purpose and statutory authority.

It is perhaps not surprising that the state would have chosen a privatized path. Throughout both Conservative and Labour governments none of the leading interest

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2 Watson and Hay, "In the Dedicated Pursuit of Dedicated Capital: Restoring an Indigenous Investment Ethic to British Capitalism."
groups were calling for increased state control (except the trade unions). The hostility of investors and managers to state mandates—on any issue other than contract enforcement—outweighs any mutual suspicion. This view is supported by most state actors, if not by all ministers. The ‘insider’ culture of UK business-government relations historically entailed a close, usually private exchange that brought the government information, policy consent, and cooperation in implementation. The City has long prided itself on its ability to regulate its own affairs, with a helping hand from the Bank of England and the acquiescence of the state. An American legal scholar cast an admiring eye at the British governance committees. They displayed, he said, a “shared commitment that would be unimaginable—though probably quite desirable—in the United States.” The US, he implied, is marked by less cohesion in the financial services sector, jurisdicational diversity, an adversarial tradition of rule-making, and formal regulatory arrangements that limit informal cooperation and consensus. Thus, franchising public authority to private self-regulatory bodies is consistent with historical practice in the UK.

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3 A few maverick businessmen called for greater legislation on board matters. Among them was Lord Gowrie, who went so far as to demand that non-executive directors—directors who are appointed to boards from outside the company—be vetted by the Securities and Investment Board to ensure their independence from management. Earl Gowrie, Lords Hansard, 22 January 1997, Col. 692.


6 In fact, the US has produced several private sector initiatives in which near-government elites cooperate to promote change. See, for example, the Conference of Sponsoring Organizations (COSO) of the Treadway Commission, which produced internal control guidance. On the American Law Institute’s role in producing corporate governance guidelines and legal reform, see Joel Seligman, "A Sheep in Wolf's Clothing: The American Law Institute Principles of Corporate Governance Project," George Washington Law Review 55, no. 325 (1987).
On the other hand, the trend towards greater privatized coordination in corporate governance *contrasts* with the transformation of financial regulation happening at the same time or before. Private, informal City regulation —‘club government’—was progressively replaced by more direct state regulation through a process of codification and juridification. As Stephen Vogel shows, the ‘Big Bang’ was quickly followed by pro-competitive state interventions on securities issues. The rise of “the regulatory state,” encompassed statutory regulation of financial markets and, later, statutory clarification of the public role of private accountancy regulators. Financial market regulation was advanced most with the creation of the Financial Services Authority (FSA), which took full form in December 2001. FSA is described as a ‘super regulator’ because it centralizes authority over a large number of disparate self-regulatory groups. Although no SEC, it is the first institution of its kind in financial services regulation. Corporate governance taken as a whole lagged this trend by some years.

In the wake of Enron/WorldCom, Labour ministers used a more direct approach than their Tory predecessors. This chiefly relied on creating review bodies more closely related to the Department of Trade and Industry and conferring authority over the Combined Code on the new Financial Services Authority. Its Listing Authority now controls the Combined Code as part of the equities listing rules. Both are regulatory documents that require policy choices, and for both ministers and MPs can point to public interest reasons for intervening more directly. Thus, by 2003, both the Government and

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the Commons were extending their oversight to the Code. This suggests that governance is likely to continue to be more politicized in the future—and not only because of stakeholder activism. On the other hand, ministers still apparently prefer to rely on private regulatory structures where organized and reasonably successful. This is borne out by their public statements and their reluctance, even in a second round of restructuring, to create a state-controlled body to regulate accountancy.

Finally, the EU has contributed to the codification of British governance, but not to transforming power within governance. It has helped produce greater state intervention, but not substantially shaped that intervention. Thus, the main political concern is the threat to Britain flexible and ad hoc mode of regulation represented by the EU’s approach. All interests—except for organized labor and environmentalists—opposed this. Again, it is politicization which scares powerful interests in governance.

III. Cross-class coalitions and liberal class coalitions

Peter Gourevitch and James Shinn, in their extensive cross-national study of politics in governance, point to the emergence in coordinated market economies of new cross-class coalitions that threaten managerial autonomy. In this view, investors find common ground with employees—who, after all, are also investors if they have retirement savings.⁹ Corporatist compromises in Germany and elsewhere (between managers, majority shareholders, and the state) are now threatened by the impact of the

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⁹ Some employee representatives in the Coordinated Market Economies apparently also believe according to Gourevitch and Shinn that their best hopes for creating sustainable growth and employment lie in defecting from the corporatist coalition and promoting investor value. This represents a significant ideational shift if it is true.
‘transparency coalition’ of workers and minority investors (especially North American public pension funds diversifying into European markets). Gourevitch and Shinn acknowledge that this coalition is viable only for some governance issues—such as increased accounting provisions and investor protection against managers and blockholding shareholders. Most importantly, it will not coalesce around anti-takeover provisions. This is because minority shareholders benefit from an aggressive takeover market in which their shares can easily be transferred to hostile bidders. Employees, like managers in many cases, will suffer from corporate restructuring that follow takeovers.

My research prompts several additions to the Gourevitch/Shinn hypothesis. First, the transparency coalition can attract support beyond labor and investors. Environmentalists and other activists will also benefit from improved corporate reporting. More importantly, accountants and other reputational intermediaries will also support transparency. These make a substantial contribution to government thinking on governance—as is demonstrated by the close cooperation between ministers, civil servants, and accountants on standards and professional regulation. The fact that accountancy is a major and internationally successful part of the large professional and business services sector in Britain contributes to this importance. Thus, depending on the case, Gourevitch and Shinn may find group-based political influence beyond the major social partners (labor, investors, managers).

Second, and more importantly, the investor/employee coalition is not viable on issues that threaten shareholder value, or remove investor discretion on what is in their
best interests. Nor is it only the pluralist model discussed in Chapter Four (see pp 223 above) that threatens investors. They provided only tepid support for the dictates of the enlightened shareholder model. This apparently includes even reforms that progressive economists and New Labour advisors on the Company Law Review believed would help enhance shareholder value. Investors may be enlightened, but they are enlightened on their own terms. And they appear to concur with managements’ current approach to production.

Finally, there is no investor/employee coalition on issues of authority. While employees (and other stakeholder activists) demand direct state interventions (because they are likely to better influence these through political parties and lobbying) investors will prefer private collective action. They do so, moreover, in the knowledge that private collective action for shareholders is not economically sustainable. That is, shareholders prefer portfolio diversification and the takeover market over direct intervention. They still prefer exit over voice, and they are rational in doing so. It is true that the larger and public institutional investors may be willing to engage the largest companies in direct monitoring and disciplinary action against managers (see next section). But they will resist state injunctions to this end—or to any less demanding requirements such as compulsory voting of their shares. It is not clear either that employees or environmentalists except in rare cases, will benefit from either form of intervention instead.
As Gourevitch and Shinn would agree, present investor strategies toward managers are entirely rational given the institutional framework and –above all—the absolute imperative that they must maximize retirement wealth. They may be more surprised, however, at the hostility of investors to direct state intervention even where this should promote their interests. Thus, investors have preferences about authority as well as about policy.

The special case of investors and their governance

Given the importance of institutional investors, any account of UK governance politics must deal with the problem of shareholder control. I have explained that diversification in equities markets, the possibility of takeover, and the strong norm of ownership-primacy were the primary mechanisms orienting managers to shareholder interests. But investors also sometimes took action on particular companies, and were encouraged to do so by policy makers. These facts raise two apparent paradoxes and point to an area for future research.

The first paradox is the disjuncture between calls for greater investor activism and the failure to take the regulatory steps necessary to make this happen. Ministers, academics and lawyers constantly reiterate the claim that investors are not doing their part to govern companies. They well understand the collective action problems that make activism difficult.\(^{10}\) Even stakeholding proponents claimed that investors could improve

\(^{10}\) Moreover, as Prof. Davies wrote in 1994, no one had yet demonstrated returns from active monitoring made it anything other than one possible strategy in portfolio management. Paul L. Davies, "Institutional Investors in the United Kingdom," in *Institutional Investors and Corporate Governance*, ed. Theodor Baums, Richard M. Buxbaum, and Klaus J. Hopt (New York: Walter de Gruyter, 1994), 285.
their returns by promoting better employee relations or environmental and social behavior. But the government was unwilling to require this activism—or even to mandate voting of shares at meetings. A blanket policy on this issue would have resolved the collective action problems of investor activism. But the Hampel committee merely appended a ‘Code of Principles and Provisions for Institutional Shareholders’ who “have a responsibility to make considered use of their votes.” Ministers stuck to their tactic of cajoling. And even the Commons Treasury Committee limited itself to a weak request that investors “face up to their important responsibilities.”¹¹ Neither state nor private authority was willing to insist on shareholder governance.

In fact, this is no paradox. The unwillingness to place demands on shareholders is consistent with the globalization hypothesis—that the most mobile asset holders will not be harmed by regulatory change. Requiring investor activism or shareholder voting would have made owning UK companies significantly more expensive. The policy position is also consistent, though, with managerial preferences. While managerial groups (CBI and IoD) paid lip service to investor governance, there was in fact considerable hostility. This likely reflects the dissonance between managers’ desire for autonomy, their loudly and oft-expressed commitment to shareholder value, and the possibility that shareholders might force them to make good on that commitment.

The second paradox arises because, while commentators complained about the absence of activism, the shareholder mechanism was in fact becoming more vigorous.

Moreover, it was public not private funds that were leading the charge. Public pension funds from the US led the shareholder value movement against managers (together with UK local authority funds and Hermes, formerly of British Telecom). What might explain this? Where were the private funds? The problem is one of conflicts of interest. If savings are managed by financial services companies that provide other services to the companies in which they are invested (or to companies with directors on target companies), they have reduced incentives to call managers to account. The fear of losing investment banking business, for example, is a powerful disincentive to activism. On the other hand, the public pension funds that manage investment directly are not engaged in any other business relationship with companies or managers generally. They are solely engaged in protecting or growing retirement savings for their members. The fact that those members are also workers has rarely entered into their investment calculation. Fund trustees must ensure that they can meet their retirement obligations and are not easily distracted by extraneous social goals.

This leaves an important area for future research. As much as the governance of modern corporations is important, so too is the governance of investment itself. How are funds and their managers controlled? What is the relationship between the economic imperatives of retiring populations and fund management? And what political role do these funds play? If these funds are as powerful as I have indicated, we need to better understand how they are governed.

**IV. Political-economic structures and Labour’s stakeholding decision**

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I next summarize the evidence on why Labour rejected stakeholding. This decision will not surprise many readers. As expected, the structural and globalization arguments appear to be borne out in this case. Opponents of stakeholding reform (and proponents of pro-investor reform) constantly reiterated values of flexibility and competitiveness. Their rhetoric, moreover, was underpinned by a common understanding that dramatic material consequences would follow anti-investor or pro-stakeholding reform. Ministers, financiers, and managers each argued that exit from UK equities was likely if companies were saddled with greater stakeholding responsibilities. Ownership of UK shares by foreign investors, and the willingness of UK investors to go overseas, reinforced these arguments. At the end of 2003, foreign investors owned 32.3% of ordinary shares, compared to only 12.7% in 1989. British shareholders held many North American stocks, where returns were high and unaffected by strong labor legislation or the threat of stakeholding. Domestic groups in the City—even those, like managers and professionals, who were not mobile—reiterated this threat. A second argument was that managers would incorporate or reincorporate overseas if UK company law was changed to include employee or other interests. The latter claim is less convincing, but in both cases the Government claimed the risk was real. Finally, managers argued that product

12 To reiterate, the structural mechanism works in the following way: political reforms that threaten profitability (or business preferences more generally) will be untenable because of the close identification of capitalist accumulation and the national welfare. Managers and investors can warn of capital flight or capital strike—thus reducing economic activity with destructive consequences to governments and workers alike. Government options are thus structured by economic conditions. This economic power is complemented by, on the one hand, financial and social resources for lobbying against particular provisions, and on the other, ideological resources that can help shape elite and public opinion. Each of these factors worked against stakeholding reform during the Labour Governments after 1997

13 “Social Trends No. 34,” Table B.
market competition would also be damaged by increased costs of cooperating more closely with labor. The country could not afford, it was said, to diffuse or confuse managers’ orientation toward shareholders.

Shareholder governance trends in the markets were running in precisely the opposite direction from stakeholding: it seems that, as presently constituted, when workers become investors they act like investors. The shareholder value movement arrived from the United States in the form of public pension funds seeking to shake up board complacency in London. They succeeded in articulating new governance codes (for example, the CALPERS governance code) that went beyond the domestic Combined Code in holding managers to account. Watch lists of under-performing companies were publicized. The UK financial press joined in the promotional effort to reorient corporate governance away from preventing fraud and neglect towards a more positive program of aggressive earnings and capital growth. Notably, the one stakeholder policy gain (the Operating and Financial Review) was welcomed by investors as increasing overall the information available to markets. It does not threaten their interests, and coincidentally also provides new commercial opportunities to the accountants who supported it.

The political and ideological resources of management and investors were also arrayed against stakeholding, and they were unmatched by stakeholding activists. They were displayed during the Company Law Review, its consultations and the (rather limited) press coverage it attracted. Although the Labour Government peopled the Review’s Steering Group with New Labour-friendly academics, lawyers, and business-
people, there was a clear consensus against stakeholding. This was not challenged by the senior Departmental staff seconded to assist the Review. When the Review published side-by-side radical and liberal options for reform it was swamped by lengthy and well prepared responses opposing the former. The mainstream press shared this hostility. The organizational strength of status-quo interests and their journalistic allies contrasted starkly with that of the pro-reform lobby. Only the Trade Union Congress and several small pro-stakeholder groups made the case for more radical reform. Whatever the economic merits of the arguments against stakeholding, these facts demonstrate the strong cognitive hold of the Anglo-Saxon model. The alternative, laid out on paper by the CLR Steering Group and in practice on Continental Europe, was given short shrift.

The CLR debate also casts doubt on the pluralist case that non-business groups can effectively influence policy, at least without great public support. At the very least it vindicates the skepticism of later pluralists such as Lindblom. It is true that stakeholder advocates were successful in bringing their concerns to the agenda, especially given the support of Trade and Industry Secretary Margaret Beckett. The trade unions, despite their declining membership, were close to ministers. But if the stakeholding policy debate is viewed as a contest between organized groups representing two sides there was a clear imbalance in resources and influence. Business had lost a good deal of legitimacy on the issue of managerial pay, and again after Enron/WorldCom. But these were not linked in the public’s mind with stakeholding—and the Government did not make clear that link.
Perhaps this mobilization might have been more effective during a time of macro-economic distress or massive layoffs. There was no great public support for stakeholding.

This case does *not* overturn the state strength/cabinet government argument discussed in Chapter Two (page 94), or negate the possibilities of dramatic change. Noticing this is a useful corrective to the pessimism engendered my otherwise structuralist conclusions. We know from other policy areas and from the Thatcher years that the British state has considerable policy strength and, in government, that parties can use this strength to promote political economic change. Ministers have agency as well as agencies. But they must be willing to take the initiative, press for public support, and address the incidental consequences of reform.

Although my empirical findings show structures at work, I argue here that theoretically that they are not determinate. Indeed, the stakeholding idea that corporate governance structures—and structures of corporate power—should be modified is a genuinely ‘third way’ proposition. It differs from the two alternatives historically provided by British politics: neo-liberal Tory privatism and nationalizing ‘old’ Labourism. The former was clarified institutionally and strengthened intellectually by the Thatcher decade. In response, the Labour Party abandoned the latter alternative. Yet it might have replaced Labour’s “socialist myth” of public ownership and reconciled
supporters to Blair’s pro-market economics.\textsuperscript{14} The failure of Blair’s government to take forward stakeholding reform belies New Labour’s claim to be distinctive.

The fact that, despite its considerable constitutional and Parliamentary resources, the New Labour government did not force these reforms was a positive and calculated decision. This decision may be interpreted in various ways. Stakeholder activists and leftists within the Party might claim that it was a failure of will. Ministers may have desired reform but not wanted to go forward for political-electoral reasons. There was certainly no strong electoral pressure for stakeholding.\textsuperscript{15} Comprehensive reform, they might reasonably fear, would have resulted in a lobbying, campaign finance, and media campaign that would have endangered the Government at the next election. In this scenario the Conservative Party would have benefited by portraying the Government as departing radically from private British traditions. They would also have noted that Labour was moving the country in the direction of Continental European governance rather than Anglo-American flexibility.

My findings confirm John Cioffi’s view that center-left parties can be even more of a force for investor protection than some conservative elements. It is also true that the British Conservative Party \textit{at least pre-Thatcher}, was the party of management before it

\textsuperscript{14} On the role of public ownership as Labour’s mobilizing myth, and the battle over its abandonment, see Tudor Jones, \textit{Remaking the Labour Party} (London: Routledge, 1996). See also Holtham, "Labour and the Private Sector: Is Stakeholding a Big Idea."

\textsuperscript{15} Note that a better developed local politics might have generated more demand for stakeholding, as it did in the United States, where states passed protections for workers during the takeover and merger boom of the late 1980s. See Martin Hellwig, "On the Economics and Politics of Corporate Finance and Corporate Control," in \textit{Corporate Governance: Theoretical and Empirical Perspectives}, ed. Xavier Vives (New York: Cambridge University Press, 2000), 124. In this interpretation, the unitary nature of British state nationalizes the problem and makes reform \textit{less} rather than more likely.
was the party of investors. There is a traditionalist Tory wing that has distinctly more pro-management leanings than the neo-liberals would endorse, perhaps because of the large number of company directors in Conservative ranks, or perhaps because of the threat of rapid change brought by investor- (as opposed to managerial-) capitalism. Thus, Peter Lilley worried that hostile takeovers were wasteful and short-termism in the City was destructive to traditional British industry. These fears were articulated later, during the DTI sponsored Myners review of City-Industry relations during the mid-1990s. But there was never any suggestion that there would be any reform to prevent takeovers in these cases, or otherwise to threaten the ability of finance to demand returns as it would see fit or the market would bear.

Labour did not threaten finance either. On the other hand, its anti-managerial reforms post-Enron were actually rather weak. Most importantly, it ignored the most controversial of the Higgs recommendations on board reform. Moreover, it did not require that managerial pay go before a shareholder vote. Instead, the board policy on pay would go before a vote—a meaningless gesture since it is not clear what effect a ‘no’ vote would have. Ministers appeared terrified of alienating the pro-business press. The Government’s pro-investor stance perhaps makes more sense. Their ideology of modernization and accommodation to globalized competition for investment is probably enough to explain their turn to pro-investor reform. In this sense they are indeed more neo-liberal than the shrunken Heathite old-Tory faction. Considered in isolation, pro-investor reform looked like a good thing for the Labour Government. Considered in
opposition to the stakeholding agenda, the structural costs were the more important variable.

Both positions are consistent with the view of Labour as a follower, rather than leader, in British politics. Richard Heffernan details the rightward shift of Labour’s programmatic commitments since the failures of 1983, 1987, and 1992. The result was a ‘politics of catch-up’ driven not chiefly by a strategic assessment of voter preferences but rather by inter-party competition. The Thatcher Governments led policy to the right, and Blair’s Labour party gambled that following would ensure success in 1997 and after.

Ministers would offer a different interpretation. They would agree with the Company Law Review steering group that radical stakeholding reform would have been economically disastrous. By this account, reform was not in the public interest. This interest is closely identified, however, with the structural position of business and investment as currently constituted. But this returns us to the structuralists’ argument: it is not merely that managers and investor representatives can mobilize to sway decisions, but that their needs are in this respect identical to the state’s interpretation of the public’s interest in stability and national economic well-being. This subjective notion of the public interest in capitalism is, by the nature of capitalism, also an objective interest. It might be reconceptualized by state elites, but this would require a radical reorientation of the political economy. Clearly this was beyond New Labour’s ken.

Ignoring threats of investors and managers would not have been an existential decision. The alternative is not to court economic or political disaster, but rather to alter

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16 Heffernan, *New Labour and Thatcherism*. 270
the structures themselves. Company law is one aspect of an interdependent, historically ‘evolved’ political economic system. This is the ‘varieties of capitalism’ and ‘social systems of production’ argument, discussed in Chapter One. It sustains their predictions that change is unlikely and even unwise. Importing one aspect of a foreign system (for example, employee codetermination) is not feasible because it would not ‘fit’ other aspects of the system. David Soskice argued that importing one element of the German system—codetermination—would fail because companies do not have long term relations with their owners, because unions and employer associations are not involved in regulating labor markets, because companies are not formally integrated into the employee training system, and because they do not cooperate in industry wide trade associations.17

But surely this implies a response that, if change in corporate governance is desirable, it must be connected to complementary changes in taxation, financial market regulation, and labor market regulation. For example, introducing employee representation at the board level might have been associated with changing business taxation in order to compensate for any predicted losses. More radically, the scope for capital flight might have been reduced by controls on mobility of domestic pension fund monies. The ‘globalization’ argument is thereby undercut by the introduction of a more radical political project. Structures there may be, but they too can be modified.

All of this, of course, would require a much more expansive notion of reform (or indeed, of politics) than is fashionable today. As Alasdair MacIntyre argues, it runs

counter to the liberal convention that problems are to be assessed in piecemeal fashion and confronted by pragmatic and empirical policies. The alternative view, that the political economy as an interdependent and dynamic whole might be the target of state-led reform, is greeted, in MacIntyre’s words, as an “ideological will o’ the wisp.”

V. Democracy and stakeholding

The discussions above lead back to my theoretical puzzle: how to reconcile the power of companies and liberal democracy. My premise that the state is prior to both the corporate form and regulatory authority is borne out by my findings. The state is the crucial source of authority in regulation—even when it relies on private organizations to make or implement policy. But this makes the question of constraints all the more crucial, since the state claims democratic legitimacy. In the following sections I show how stakeholding fits with democratic theory, offer a power-based justification for state reform of governance, and finally reconnect this to my findings on Labour’s decision not to implement stakeholding reform.

Democracy is, of course, a contested concept. The next few paragraphs are a brief and selective overview, offered chiefly to lay bare the connections between its meanings and the arguments used against stakeholding. I will argue subsequently that stakeholding would require a new democratic settlement, but that it is not incompatible with conventional democratic theory.

Conventional meanings

For most, democracy denotes procedural or institutional arrangements for producing representative government. In this circumscribed and descriptive view, it is an organized means for arriving at decisions, plus certain guaranteed rights to ensure fairness. Two influential variants are the competition of elites for the power to decide policy (in Schumpeter’s account), or of multiple minorities in society (in Dahl’s view). These views are conservative in their liberalism. They preserve a foundational order of individualism and property rights.

In several ways, these approaches to democracy can help to rule out interference in corporate affairs, although I believe they need not do so. First, they are liberal and so differentiate the public and private. The public is legitimately political, while the private is not. Since companies involve contracts between individuals, their internal affairs are private, although state regulation will be warranted in the case of public effects. I argue in the next section that the contractual defense is not sustainable. Companies are not, in my view, private. Second, these approaches tend to delimit the ‘political’ in institutional terms. Since companies are non-governmental organizations they are, by implication, excluded from democratic theory if that is confined to explaining how power is organized within the state. This seems to me an arbitrary demarcation of both political studies and politics as an activity; why consign politics in corporations to business schools? As Dahl later argued, the lack of democracy in companies is paradoxical. Third, as a sociological matter, they tend to assume that only a limited number of people want to participate in

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decision-making.\textsuperscript{20} It may be a common conceit of activists that others share their passion for politics. But this implies nothing about whether people’s concerns or objective interests are being met, or how many more might want to participate but do not because of a well-grounded sense of powerlessness. Given more of a role in –and over—companies, employees and the wider public might become more engaged. We should not read the normative ‘ought’ (they should not be given the opportunity) from the empirical ‘is’ (they are unlikely to take it up).

To similar effect, Russell Hardin recently framed democracy in game-theoretic terms.\textsuperscript{21} He argues that it is successful (i.e.: stable), when it is, because it resolves political coordination problems. It does so initially in a constitutional moment that achieves coordination on major issues among powerful groups. The key issues dividing society are resolved at this point. Going forward, this permits a normalized politics in which conflict is highly circumscribed. Departing from the consensus on fundamentals threatens the original order and causes the breakdown of coordination. Thus, for Hardin as for Dahl, politics is predominantly about the quotidian “chaff” that is not settled at the constitutional convention.\textsuperscript{22} The arguments that go on in the polity are (Hardin must hope) not the most important.

The most powerful negative implication of stakeholding for these theories is that it extends political debate (and therefore conflict) to the foundational structures of


\textsuperscript{21} Hardin, \textit{Liberalism, Constitutionalism, and Democracy}.

\textsuperscript{22} Ibid., 277.
capitalism. This is untenable because systemic stability—the workability of democracy—relies on ex ante agreement on fundamentals. Hardin’s sociology, for example, leads him to argue, “Democracy works only when there is mutual advantage in coordinating on order and any other extremely important background concerns.”23 This agreement is worked out between powerful groups. Moreover, he is clear that the relevant concerns are economic rather than ideological.24 In practice this typically means that the “middle class” and especially the entrepreneurial class must agree to be bound (in game-theoretic terms, coordinated) by a constitution.

Widespread popular mobilization against capitalism, then, would threaten democracy’s present settlement. So too would a defection by elites—trade unions, for example, or a party of government—from the consensus on basics. Many would resist painting stakeholding in such revolutionary political terms. It obviously does not imply a rejection of capitalism, although it was portrayed as such by investors and managers during the British debates. This was not, perhaps, merely a rhetorical strategy. The existing corporate order was genuinely threatened by the idea of stakeholding, not least because it threatened the idea of profit-making as the sole end of companies. The core interests of investors (in profits) and managers (in autonomy) would have been damaged

23 Ibid., 28. This view is shared by other procedural democratic theorists, including Schumpeter and Dahl. For Berelson, “intensity of conflict must be limited…social and economic stability maintained…and basic consensus must exist.” Berelson, quoted in Carole Pateman, Participation and Democratic Theory (London: Cambridge University Press, 1970), 6. The urge for stability may have been more obvious in the mid-Twentieth Century than today.

24 Hardin is explicit in demonstrating that the American founding was based on precisely such a materialist accord. In this he echoes, in a less critical manner, Charles Beard. See Hardin, Liberalism, Constitutionalism, and Democracy, 106.
if reform had been carried through. It helps, of course, that they were able to link these interests to broader societal goals of growth and wealth.

Hardin’s notion of democratic constitution-making (like other liberal theories) are not fatal to stakeholding, however. As new economically powerful groups emerge there is no reason in democratic theory why political arrangements could not be remade. This would involve renegotiating coordinating agreements that settle different fundamentals.25 It is obviously true that the present constitutions in Britain and the United States were achieved prior to the emergence of labor (let alone consumers and environmentalists) as powerful social forces. Moreover, as Britain’s constitutional framework was democratized over the Twentieth Century it excluded anti-liberal and anti-capitalist forces. Labour Party revisionism assured this. Labour Governments’ commitment to public ownership of the economy’s towering heights did not threaten capital nearly as much as Hayek and others anticipated. And, as I showed in Chapter Four, Labour did not contest private corporate governance structures—until recently.

More radical approaches

A second track for pursuing stakeholding in democracy is to reconceptualize democracy. Some stakeholding advocates have pursued this strategy, and so I recount its logic briefly in the following paragraph. I do not, however, believe it is necessary to justify stakeholding reform.

25 This might be compared, by analogy to the more limited efforts of Ralph Nader in the US during the 1970s to ‘constitutionalize’ the company. That is, agreement could be negotiated not on all the political fundamentals, but merely on the status of companies and those within them. Nader and Green, eds., Corporate Power in America.
Rejecting the Schumpeterian minimum, many have advocated a more expansive and substantive politics.26 There are several ways to connect this to democratization of companies. One is the normative claim that democracy should not be merely instrumental. It is not chiefly a means to improve the selection and decisions of isolated governmental entities. It is, instead, a way of life in which human potential can only be fulfilled when individuals are meaningfully participating in shaping their world. This necessarily involves ‘democratizing’ more than just the state and/or the public realm. It makes companies (and, indeed, families) the proper object of politics. Another path to the same conclusion is the sociological observation that inequality threatens democracy. This is, of course, a long-standing point. Tocqueville is frequently quoted as ascribing the success of the new American nation to its social and economic egalitarianism. Pateman quotes the British Fabian GDH Cole and makes the connection to equality: “vast inequalities of wealth and status, resulting in vast inequalities of education, power and control of environment, are necessarily fatal to any real democracy, whether in politics or any other sphere.”27

Stephen Bronner remarks that participative direct democracy entails the unreasonable expectation of “ongoing enthusiasm founded on an unqualified civic virtue” and “refuses to recognize the profoundly boring character of real, everyday, distributional issues, especially at the local level.”28 Workplace democracy may suffer from the same

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27 Pateman, Participation and Democratic Theory, 39.
28 Bronner, Ideas in Action: Political Tradition in the Twentieth Century, 80.
romanticization of decision-making. On the other hand, Carole Pateman argues that participation is learned and self-reinforcing.\textsuperscript{29}

Assessment

It would be foolish to rest my case that companies are legitimately subject to politics on the triumph of one or another competing theory of democracy. The circumscribed view is in any case now hegemonic on both sides of the Atlantic. Moreover, even non-radical scholars acknowledge the contradiction corporate power poses to conventional democracy. This is illustrated, as I discussed in Chapter One (see above, p.64) by the fact that a series of liberal thinkers sought to understand –and justify—managerialism during the 1930s, ‘40s, and ‘50s.\textsuperscript{30}

In any case, even if it is a problem for democracy, the stakeholding agenda was unlikely to be advanced on grounds of democratic theory. Rather it is the material conflict over distributing the surplus generated by companies that drove the debate, such as it was. These underpin the desires of employer representatives, ecologists, and others in the stakeholding coalition, even though their rhetorical strategies generally hide an embarrassed refusal to admit it. Even where they advance proximately non-material ends—such as environmental or human rights protection—the real debate is about restraining the corporate generation of surplus. Thus, it is on (political-) economic

\textsuperscript{29} Pateman, \textit{Participation and Democratic Theory}, 82.

\textsuperscript{30} For a review, see Bowman, \textit{The Modern Corporation and American Political Thought: Law Power and Ideology}, Chapter 5. The most important were Peter Drucker, Adolf Berle, and J.K. Galbraith. All somewhat critical of the newfound power of managers, they nonetheless believed that industrial free enterprise could serve democracy without becoming democratic itself.
grounds rather than political-philosophical grounds that state interference must be justified.

VI. Justifying state intervention in governance on the basis of power

I believe the best arguments for state reform of companies is that they are internally pervaded by power, and that, moreover, they are entities that wield power externally. I explained these claims in Chapter One (see above, p 61). To reiterate briefly: power works in three analytic spheres: production, exchange and –for want of a better term—the social and political spheres.

These facts about the spheres of production and exchange undermine an important argument against state interference in corporate governance. This is the view that companies are merely contractual entities: composites of mutually improving exchanges agreed by freely contracting parties (capitalists, managers, and employees). This notion may seem absurd, especially to scholars of politics. But it certainly informs the British legal and political tradition. It is more important because it sustains a deontological defense against the state: public policy should not interfere because firms are contractual in nature and contracts are inviolable. This joins a political-philosophical position (contracts should be free of state interference) to the economic position (firms are contracts). I have shown above that the latter claim is not sustainable. The previous claim can best be undermined, in my view, by the observation that contracts (i) rarely if ever fully account for externalities in society and (ii) are generally not negotiated in free and equal settings.
So again, it is power that is problematic. As Galbraith observed, the contractual perspective obscures power inside and outside firms. This, indeed, is one reason that emphasis is so popular: it helps justify the autonomy of companies in liberal polities that prize freedom of contract.

VII. The empirical problem of structural power and the possibilities for change

The deontological argument against interfering in governance is not often heard in public. More common is the consequentialist argument: that states should not interfere because they will damage economic outcomes that concern us all. This point returns us to the structural power of business to shape political decisions, and the choice of the Labour Government not to challenge those structures. Readers will recall that Labour appears not to have wanted to accept the economic and political costs of stakeholding. Thus, even if state interference to shape company affairs can be justified on theoretical grounds, it appears to be difficult to achieve as an empirical matter.

I have concluded that the structural constraints of business were the most politically significant variable explaining Labour’s decision. Yet my research in no way undermines the state/party of government argument. While this indeterminate outcome is of questionable consequence for explaining British politics, it nonetheless helps sustain my belief in the possibilities of politics. Change may not be probable, but that does not mean it is impossible.

The issue is one of structure and agency. Structural accounts of policy choice should not go unqualified. The view that governments have no choices in a global
economy is surely a post-modern canard. As I have argued, the issue is not that elected officials have no choice (that is, agency). Rather it is that they must evaluate the costs of change, take action to resolve interdependencies that raise these costs, and then accept the consequences. As Colin Hay explains, structure and agency interacts in dialectical fashion: neither is ontologically prior. This is a philosophical defense against the pessimism of totalizing arguments in political science and sociology: structures may be strongly conditioning, but they are not determinate.

Naturally, if the change is radical, it will involve heavy costs to existing powerful interests, and this will be politically and perhaps also electorally uncomfortable. Yet when constitutions confer significant state capacity, as in Britain, these costs may be tolerable. For these reasons, it is hard not to see the developments recounted here as a missed opportunity for the Blair Government. This is especially true given its modernizing ambitions. Taken together, New Labour’s early interest in stakeholding, willingness to use greater direct intervention, and the desire of Europe to see its coordinated model of governance more firmly established all pointed in a direction not taken. Old Labour posed no challenge to powerful interests in corporate governance. New Labour might have, since it asked the right questions, but even if it had answered them positively it would not have threatened capitalism. Ultimately it answered them in line with investors’ and (less so) managers’ hopes. As such, a cynic might say observe

that the Third Way debate in corporate governance has been resolved in favor of the neoliberalism plus better public relations.
Appendix

List of Abbreviations Used

ABI Association of British Insurers
ASB Accounting Standards Board
CALPERS The California Public Employees Retirement System
CBI Confederation of British Industry
CC (Company Law Review) Consultative Committee
CEO Chief Executive Officer
CLR Company Law Review
CME Coordinated Market Economy (Organized Market Economy)
CSP Corporate social performance
CSR Corporate social responsibility
DTI Department of Trade and Industry
FOE Friends of the Earth
FRC Financial Reporting Council
FSA Financial Services Authority
FTSE Financial Times Stock Exchange (index)
IoD Institute of Directors
ISC Institutional Shareholders Committee
LME Liberal Market Economy
LSE London Stock Exchange
NAPF National Association of Pension Funds
NED non executive director
NYSE New York Stock Exchange
OFR Operating and Financial Review
QCA Quoted Companies Alliance
SG (Company Law Review) Steering Group
TUC Trades Union Congress
UNIFI Financial employees union
UKSA UK Shareholders Association
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