

TITLE OF MANUSCRIPT: THE ROLE OF GOVERNMENT IN CORPORATE GOVERNANCE: PERSPECTIVES FROM THE UK

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Abstract

Incessant corporate failures have led to increasing governmental participation in the governance of the modern corporation. In this conceptual paper, we examine and propose that the role of government in the UK corporate governance system is four fold, namely: to enhance competitive advantage; to compensate for the failure of self-regulation; to prevent corporate scandals and restore investors' confidence; and owing to significant public pressures and associated political undertones, to suggest to the public the government is still an effective overseer in the existing prominence of self-regulation. We contribute to the literature on corporate governance, politics, policy making and regulatory institutions, whilst raising important issues that are of practice and policy relevance.

Keywords: Government, Regulation, Policy, Corporate Governance, UK

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1. Introduction

Unlike the 1970s and 1980s, the last two decades have marked an extensive and increasing growth in corporate governance research. Specifically, the scandals at Maxwell, Enron, Parmalat, Adelphia, Conrad Black, WorldCom and HBOS have acted as an energetic catalyst, at different times, to the scrutiny of corporate governance, across the academia, practice and polity, due to the enormity of their impacts. Indeed, in the post-Enron age, the paradigm of corporate governance regulation changed globally. Most notably, we witnessed several corporate governance reforms around the world. Indeed, during the last two years, we have seen shareholders accruing huge investment losses, employees have lost their jobs, national economies have receded; these have all-together reiterated the importance of good corporate governance to the world economy and humanity as a whole. Consequently, these events have enriched discussions on the subject, especially in the area of regulation. In this regard, doubts have been cast on the efficiency of self-regulatory institutions to curb corporate malpractices and safeguard against the loss of investors' money whilst maintaining economic stability. Thus there have been calls for increased regulation and more governmental participation. Discussants in favour of regulation have reckoned that it will take more than just corporate leadership to ensure corporate vitality, but government's action in the form of reformed regulatory systems and

enhanced law enforcement are paramount factors (Coglianese, et al. 2004).

In this paper, we discuss some conceptual challenges associated with the increasing governmental involvement in corporate governance. What is the rationale behind government's increasing participation in corporate governance? Is there any justification for this? What are government's intentions in corporate governance? This paper examines relevant literature, codes of conduct and best practices, company law and legislation and other regulatory guidelines to provide an overview of the rationale behind the role of government in the UK corporate governance system. Viewing the UK as a global corporate governance innovator, the role of government in the UK corporate governance system could become a "model of best practice" particularly for the countries of origin of the companies listed on the LSE (see: Aguilera 2005; Mallin et. al. 2005). However, whilst we conduct a UK specific study, we nevertheless draw on insights from the corporate governance regulatory frameworks of other countries in order to provide a richer and more comparative analysis. The rest of this paper is structured as follows: in the next section, we examine the relationship between the firm, corporate governance and the government. Following on, we examine the UK corporate governance system, including the code of corporate governance, and the UK company law reform. From these analyses, we proceed to present our deductions and key arguments in relation to the

role of government in the UK corporate governance system. Finally, we present our conclusions.

2. The Firm, Government and Corporate Governance

Here, we provide a framework to understand the role of government in corporate governance and indeed why government should possibly intervene in corporate governance. This will enable a better understanding of the subsequent scrutiny of government's agenda. To start with, it is important to query why companies exist? For whose benefit should a corporation be operated? While answers to these questions are not straight-forward, they raise a bigger question of "Why should government intervene in corporate governance?" Considerable controversy has been generated as regards the sole priority of the existence of a company. Nevertheless, most scholars agree that the primary objective of corporations is not only to make profit but to maximize profit (Shleifer and Vishny 1997). Businesses in the 21st century require enormous amount of funds which are most times efficiently drawn from the stock market. In simple terms, investors allow their money to be used for business and it is just morally right that the business's sole priority should be to maximize returns to the people and institutions that have trusted them enough to invest in them their money. Nonetheless, corporations have come to amass great economic power and as such, their existence has been perceived to extend beyond profit maximization. Essentially corporations are the engines of any market economy and their proper behaviour is key to economic, hence human, security (Okabe, 2004).

No doubt, the categorisation of large corporations and essential sectors of activity such as banking as 'private' in the modern context is problematical – and whilst the de jure analysis is undeniable, the political and social reality is of a nexus of dependencies across the public/private divide that are not reflected in mainstream concepts of ownership. The recent liquidity crisis in the UK is an example of this – where a lending policy, supported by the regulatory regime creates a private problem for individual banks and a public crisis for nations. Whilst stakeholder theory or CSR or virtues are expressions of a 'something else' but in the absence of a legal vocabulary we essentially fall back on the agent/principal model. Thus, while the primary objective of private sector corporations may be to maximize returns to investors, the government is vested with the responsibility of ensuring the welfare of its citizens. This includes guaranteeing their human rights, providing the basic amenities of life, ensuring the security of lives and properties, creating jobs and means to create them amongst others. Consequently, a part of government's responsibilities to its people is also to ensure that their investments are not stolen and that their pensions and life savings are not lost

through corporate fraudulent activities and accounting manipulations as in the case of Enron. As such the role of the government extends indirectly to the welfare of corporations. Thus, despite the difference in the primary concerns/objectives of the government, and of corporations, part of the duties of government is to ensure that there is a regulatory corporate governance framework which indirectly contributes to the welfare of its citizens. The government is among the numerous stakeholders in the corporate governance framework of every country, but the extent of their role, participation and influence differ from one jurisdiction to the other.

What then is corporate governance? The media uproar and extensive debates among business circles and academics with regards to regulation in corporate governance has got the authors thinking about what exactly is the term corporate governance. What is the aim of corporate governance? While the volume of research on corporate governance is increasing, its scope, concerns and extent remain a subject of extensive controversy and discussions on the subject could easily become distorted. Since most firms operate within a competitive environment, the shareholder-primacy theoretical view of the firm, which stipulates that the objective of the firm should be to maximize profit, continues to dictate academic and institutional approaches to corporate governance throughout the world, even though their underlying assumptions have been widely criticised (Learnmount, 2002). This is vital to discussions on corporate governance which is generally accepted to have risen due to the problem created by the separation of a firm's ownership from its control. When firms are not controlled by their owners, then there must be a mechanism in place to ensure that the management act in the interests of the shareholders, which forms the essential basis of the agency theory (see Shleifer and Vishny 1997; OECD 1999), upon which mainstream corporate governance discussions have been premised. Whilst this analysis held at the turn of the 20th century, as a private analysis of defence, is it a suitable public analysis in the light of government interests? While advocates of the stakeholder view (for example, see: Hutton, 1995; Kay and Silberston, 1995; Solomon 2010) have tried to ensure the appreciation/recognition of other stakeholders such as employees, customers and government, the shareholder (agency theory) perspective remains the cornerstone model of exploring corporate governance relations.

3. The Model of Corporate Governance in the UK

In recent times, there have been active debates between the adherents of the shareholder and stakeholder model of corporate governance in the UK context. In the light of the shareholder model, corporate governance regulation provides the

structures and processes which ensure that companies are managed in the interests of their owners (Higgs, 2003). Gamble and Kelly (2001) have however queried this long assumption that shareholders (both current and future) among all the numerous parties with interests in a company should be so privileged to be the ruling conception of the UK corporate governance system. No doubt, it should be noted that shareholders bear the residual risks of the enterprise (although Blair and Kochan (2000) have argued against this stating the residual risks bore by employees as well); thus they remain the definitive owners of the enterprise (Easterbrook and Fischel, 1991). Secondly, maximising shareholder value serves two purposes; accountability (on the part of managers to shareholders for their stewardship of the assets of the enterprise) and efficiency (absolute focus on a single clear objective leads to the most efficient outcomes) (Gamble and Kelly, 2001). However, since the recent global financial crisis, it has been worth revisiting the residual risk argument. For example, in the banking sector we have seen shareholders lose wealth but has that been the end of the story? The government bailouts reflect an assumption of risk bore by the government on the public's behalf as well as the welfare cost of redundant employees which also constitutes a 'residual' risk for the public purse. As a result, the extant literature is limited in providing theoretical foundations for the involvement of government in corporate governance other than it being a pragmatic response to the 'public' nature of corporations, particularly in the banking sector.

In relation, the active debates regarding the benefits of the stakeholder model of corporate governance, which has been fuelled by the collapse of major Anglo-Saxon corporations, has suggested that history is still in the making. For example, Armour et al, (2003) note that while some corporate governance/law scholars (Hansmann and Kraakman, 2001) have argued that the shareholder model has defeated the stakeholder model as far as the fundamental issues of corporate ownership and control are concerned, the UK corporate governance has not come to the 'end of history', as the shareholder model is less deeply entrenched than is generally suggested. A manifestation of this is the changes to the director's duties in the Companies Act, 2006 requiring UK directors to consider a wide range of stakeholders before they act. In an attempt to reconcile both models of corporate governance, Adegbite and Nakajima (2011) noted that some scholars have talked about the "enlightened shareholder value" or "instrumental stakeholder theory" or "strategic corporate social responsibility" or "the good firm" (Parkinson 1995; Jones 1995; Kay and Silberston 1995; Filatotchev, et. al. 2007; Solomon 2010), as the hybrid model. This hybrid possibly points in the direction of good corporate governance, given that it harmonises the strengths of the two traditional models.

4. Regulating Corporate Governance in the UK

In order to enable a subsequent analysis of government's agenda, we provide a brief review of the development of the Codes of Conduct and Best Practices in the UK corporate governance system, which is followed by a review of the company law reform.

4.1. The Codes of Conduct and Best Practice

Since the past twenty years, a series of committees have led to series of reports that tackled a variety of corporate governance issues in the UK which have all together enriched the corporate governance debate in the UK and indeed globally. Before the Cadbury Code, the term corporate governance was already a known concept in the UK. However in the wake of the Polly Peck scandal, a committee was set up in May 1991 by the Financial Reporting Council (FRC), the London Stock Exchange (LSE) and the accountancy profession to address the financial aspects of corporate governance (Cadbury 1992). This scope was further broadened by the scandals at Maxwell Communications (Stiles and Taylor 1993) and Guinness (Hughes et. al. 1998). These unexpected corporate failures and the criticisms of the lack of effective board accountability in the area of directors' pay further exacerbated the concerns about the workings of the corporate framework (Cadbury 1992). The essential feature of the Cadbury Code is the undertone that compliance of companies with a voluntary code coupled with disclosure is more effective than a statutory code (Cadbury 1992).

The Cadbury Report laid the foundations for a set of corporate governance codes, not only in the UK but as far as in Russia and India, which have integrated its key principles into their own corporate governance codes (Mallin et al, 2005). About two years after the Cadbury Code, a survey among FTSE100 companies showed that it had been implemented and that its compliance was virtually absolute in large firms (see: Bostock (1995) and Cadbury (1995)). Nevertheless, Doble (1997) observed fewer major changes in small newly listed companies and questioned the appropriateness of the code for small and newly listing companies. Furthermore, it is important to note that newer versions of the Code have resulted in declining compliance.

Building upon the Cadbury report, the Rutteman Report on Internal Control and Financial Reporting was published in 1994. Following on from this, the Greenbury report sought to address the issue of directors' remuneration which was not sufficiently tackled by the Cadbury report. The report concluded that if the issue of excessive executive pay is not to

dominate the headlines in the future, as it did during the mid 1990s, then its recommendations will need to be taken seriously (Hughes, 1996). Unfortunately this is still happening; more than a fifth of BP shareholders voted against the substantial early retirement package for former CEO John Browne. Indeed this practice is still very prevalent, as recently made evident by the Royal Bank of Scotland (RBS) and Bellway Homes. Also at the 2010 annual general meeting (AGM) of Marks & Spencers, approximately 8.6% of shareholders voted against directors pay.

Nevertheless, the Greenbury report came about when there were concerns about the increasing adoption of US style of executive compensations in UK companies, specifically in the utility companies that were privatized at that time. The report tied executive compensation with “how skilled and talented an executive is”, and also required more comprehensive disclosure on directors’ compensation in the annual report of listed firms (Greenbury Report 1995). However directors’ compensation is still a matter of concern. While the Greenbury report recommended the comparison of a company’s performance with other companies to determine executive compensation, a large percentage of companies still operates annual or other short-term bonus schemes for directors, alongside a longer-term incentive plan with many lacking specific performance criteria and involving substantial discretion (see: Williams 1998) and/or favouritism.

The Hampel Committee sought to review the Cadbury Code and its implementation to see if it was achieving its aim and also to tackle issues that resulted from the Greenbury report. In addition to this, the committee looked afresh at the roles of directors, shareholders and auditors in corporate governance in the context of minimising regulatory burden on companies and to substitute principles for details wherever possible (Hampel Report 1998). There is an important point to be noted here. Unlike the Cadbury and Greenbury committees, the Hampel Committee was set up, not as a response to events which were perceived to have gone wrong such as corporate failures in the case of Cadbury and unjustified compensation packages in the privatised utilities in that of Greenbury, but was expected to provide the non-cynical and positive contribution which good corporate governance can make (Hampel Report 1998). Following several consultations and changes, the Combined Code was created and published in June 1998 and it essentially continued the ‘comply or explain’ principle. In 1999, the Turnbull Committee developed guidance for companies regarding these provisions, especially in the area of internal control. The Myners Review in 2001 highlighted the need for effective communication between institutional shareholders and companies and also emphasised the need for investors to act as responsible owners. The Tyson

Report, in 2002, dealt with the recruitment and development of independent directors.

In 2003 the government initiated the review of the Combined Code with the aim of re-examining the role and effectiveness of non-executive directors, and the Higgs Committee was set up. At that time, the Company Law review was also going on. Both reviews represent the first time that the collapse of an American company (Enron) has initiated a scrutiny of the effectiveness of UK laws (Davies, 2002). Nevertheless the report re-emphasized the “comply or explain” principle as opposed to legislation which can lead to “box-ticking” but supports a counsel of best practices capable of being intelligently implemented with discretion. As previously suggested, it is, however, important to note that further developments from the Cadbury Code have resulted in declining compliance. For example, the 2003 version of the Code produced notable non-compliance in the areas of independent directors and the constitution of various committees. Thus, the percentage compliance with the 2003 Code was initially lower than that with the earlier and less stringent 1998 Code. Indeed, each alteration of the Code seems to result in an initial fall in compliance leading to a gradual rise in compliance until the next iteration (see for example: Grant Thornton 2009).

In the post 2008-2009 global economic crisis, the UK Corporate Governance Code was developed, which followed a review of the Combined Code carried out during 2009 and consultation on a draft of the revised Code that ended in March 2010. As with the 2003 code, an essential feature of the 2010 Code is that some of the provisions of the Code require disclosures to be made in order to comply with them. The two other key features of the 2010 Code are that all directors will be up for election each year and that the external review of the board’s performance is to be carried out every three years.

4.2. The Company Law Reform

As indicated earlier, parallel to the development of the UK codes, a fundamental review of the company law was also taking place. The apposite goal of corporate law is to promote the “aggregate welfare of a firm’s shareholders, employees, suppliers, and customers without undue sacrifice...and, if possible, with benefit....to third parties such as local communities and beneficiaries of the natural environment.” (Hansmann and Kraakman, 2004: 18) The Companies Act (2006: 1) aimed “to reform company law and restate the greater part of the enactments relating to companies; to make other provisions relating to companies and other forms of business organisation; to make provision about directors’ disqualification, business names, auditors and actuaries; to amend Part 9 of the Enterprise Act 2002; and for connected purposes”. It is generally believed that the Companies Act 2006 is not a product of a “rush job” but that done

with extensive consultations with relevant parties within an ample time. Here we review the notable amendments to the company law in the domain of corporate governance particularly the new amendments on directors' duties and their remuneration, auditors' responsibilities amongst others.

The UK government set up an independent body (the 'Steering Group') to review the company law in May 1998 in order to allow it to break free of its outdated 19th Century roots and to provide a modern framework (Ferran, 2005; Department for Business Innovation and Skills (DBIS), 1998). After a series of consultation documents and reports, the government published a white paper (specifically in response to the final report in July 2002) which was criticised to be a very unsatisfactory document that left considerable doubt about government's plans, and as such the government reaffirmed its commitment to reform company law and announced that it would publish companies' bill to make certain "Enron-related changes" (Ferran, 2005). The Companies (Audit, Investigations and Community Enterprise) Act 2004 aimed to improve confidence in corporations and financial markets, and amended relevant provisions of the Companies Acts 1985 and 1989 (DBIS 2004a). Another issue that the Companies (AICE) Act 2004 tackled is that of directors' liability with sections 19 and 20 aimed at relaxing the prohibition on provisions protecting directors and other company officers from liability (DBIS 2004b).

The Companies Act 2006, the most comprehensive reform of UK company law for several years, has received Royal Assent and has become law. It has codified the rules governing directors' duties, which is perhaps the most relevant to our subject of discussion. For example, the Act introduces a statutory right allowing shareholders to sue directors in the name of the company (known as the 'derivative action'). Based on certain common law rules and equitable principles, the Act now specifies a new statutory statement of 'general duties'. According to the Act, these include the duties; to act within powers; to promote the success of the company; to exercise independent judgment; to exercise reasonable care, skill and diligence; to avoid conflicts of interest; to reject benefits from third parties; and to declare interest in proposed transaction or arrangement. Again let us consider the second general duty. In order to promote the success of a company, the Companies Act 2006 (Section 172 (1)). notes as follows:

"a director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to-

(a) the likely consequences of any decision in the long term,

(b) the interests of the company's employees,

(c) the need to foster the company's business relationships with suppliers, customers and others

(d) the impact of the company's operations on the community and the environment,

(e) the desirability of the company maintaining a reputation for high standards of business conduct, and

(f) the need to act fairly as between members of the company."

4.3. The Role of Government in Corporate Governance

Incessant corporate failures have led to increasing governmental participation in the governance of the modern corporation, especially through the Companies Act 2006 and revisions to the Code of corporate governance and best practices. Here, we propose that the role of government in the UK corporate governance system is four fold, namely: to enhance competitive advantage; to compensate for the failure of self-regulation; to prevent corporate scandals and restore investors' confidence; and owing to significant public pressures and associated political undertones, to suggest to the public the government is still an effective overseer in the existing prominence of self-regulation.

4.3.1. To Compensate for the Failure of Self-Regulation.

The aim of regulation is to govern behaviour and to change attitudes. Until the 1970s, when commentators began to criticise the tradition command and control form of regulation as being over-intrusive, regulators were seen as experts who controlled private sector behaviour with the interest of the public at heart (Baldwin, 2000). By the 1990s, less-restrictive forms of regulation that encouraged self-regulatory practices began to gain preference. However firms do not comply with regulation because they are profit-seekers and will only comply if the legal penalties for non-compliance exceeds the costs of compliance, or when there are substantial incentives to comply, but will be less enthused to comply if the probable legal fines of non-compliance are less than the costs of complying (Corneliusson, 2004).

Indeed, the evolution of regulation in corporate conduct dates back to many decades ago. Nonetheless, corporate governance is not normally seen as a "regulated" activity (Dewing and Russell, 2004), at least in terms of strictness. This is because corporations are private institutions, and as such, should they be burdened with regulation in the first place? Already there are laws in place in every country; these include company laws. They are the foundation upon which companies are formed and controlled. Thus, self-regulation has been traditionally

prominent in the operation of securities markets (Coglianese, et al 2004).

Self-regulation can be described as any regulatory regime which has been developed, funded and is enforced exclusively by industry (Maaseen, 2003). Self-regulation is a voluntary mechanism. While self-regulatory schemes extend beyond the concept of corporate governance, it helps put corporations in check with no intervention from the government. Corporate self-regulatory bodies have played a traditional role in monitoring both corporate behaviour and the conduct of professionals (e.g. accountants, auditors, corporate consultants, lawyers amongst others) involved in corporate matters. Is the increasing government's intervention due to the failure of self-regulatory institutions, such as the FRC and the Financial Services Authority (FSA)?

The economic literature has been at the forefront of self-regulation discussions which models self-reporting of legal violations as a means to optimize enforcement regimes that reduces the costs of monitoring and compliance (Short and Toffel, 2008). Innes, (2001) notes that self-regulation optimizes the allocation of enforcement resources by lowering avoidance costs for the regulators and those being regulated. It also increases the chances of remediation and also lowers its' costs (Innes, 2001). Furthermore, Turnbull, (1997) argues that self-regulation simplifies corporate law by reducing the need for government to maintain the already immensely prescriptive laws and regulations. Self-regulation also protects the interests of stakeholders including investors and indeed the most efficient regulation can be achieved by incorporating as much self-regulation as possible into firms (Turnbull, 1997). Indeed following Melville's research into the potential of control self assessment in evaluating non-financial control systems, he made a case for the adoption of a 'soft' control mechanism in a corporate governance framework (Melville, 1999). Also, self-regulation gives room for proximity being that self regulatory institutions are closer to the industry being regulated giving them access to more detailed and current information about the industry thus increasing the chances of compliance; the more the involvement of industry in setting their own rules, the more those rules appear reasonable to abide by (Coglianese, et al 2004). Self-regulatory organizations can secure funding easily being that they are not susceptible to changing legislations and they can conduct their operations with flexibility and can aggregate the collective interests of the industry (Coglianese, et al 2004) Maassen further examined the applicability of self-regulation in Indonesia and argues that self regulation even works better when incentives are in place and when the nature, opportunities and costs of problems are understood (Maaseen, 2003).

However Short and Toffel, (2008) argue that "self-policing" programs in the context of self-regulation only shift the task of monitoring regulatory

compliance from the government to the private sector. In this context firms are active participants in their own governance which begs the question of whether companies are actually regulating themselves or trying to avoid regulation altogether (Short and Toffel, 2008). A self-regulated corporate governance system puts objectivity in doubt and gives room for bias. Also the proximity and flexibility in self-regulation could lead to conflict of interests which may result in insufficient monitoring and under-enforcement (Coglianese, et al 2004). There is also evidence that confirms the scepticism (for example, see: La Porta, et. al. 2000) about substantive legal and political action due to strong opposition from self-interested parties; this has cast doubts on the success of self-regulation in countries such as Germany (Jong, et al. 2005). Self regulation allows a great deal of "window dressing"; with no clear recognition of the problems and thus cannot provide real solutions to them and where there are solutions, they are often controversial (Maaseen, 2003).

Indeed, if self-regulatory institutions have been successful in curbing corporate misconducts, perhaps the role of government would have been that of an overseer and not a major player in corporate governance regulation, as we see today. Or is the government tampering with the paradigm upon which firms have successfully dwelled? The public uproar over the recent scandals has made it clear that the status quo is no longer acceptable; as such, the government's role should be to restore corporate integrity and market confidence without undermining the dynamism that underlies a strong economy (Coglianese, et al 2004). Thus, whilst self-regulation has been traditionally prominent in the operation of securities markets, the government has stepped in, sharing regulatory authority and oversight with various self-regulatory institutions (Coglianese, et al 2004) due to the realisation of laxity in self-regulation. Essentially what we have now is a "hybrid" regulatory framework where self-regulatory institutions and the government are the two main players. The latter now share regulatory authority with the former and its becoming increasingly involved in regulating corporate conduct. The lapses in self-regulation have created more avenues for government to intervene in corporate governance by coming up with stricter rules and laws to complement existing regulations to make them more effective and well implemented.

4.3.2. To Prevent Corporate Scandals and Restore Investors' Confidence.

Most academic literature and media reports on corporate governance in recent times have begun by citing the collapse of the once seventh largest company in America. The Enron's scandal can be seen as a catalyst to the recent scrutiny of corporate governance due to the enormity of its impact, which is

still being felt. The scandals at Enron as well as those at Parmalat and WorldCom have placed the governance of corporations under extensive scrutiny. Corporate misdeeds and questionable business practices in the last decade have undermined investors' confidence in the capital markets. We have seen business leaders, high-ranking senior managers and high profile auditing firms labelled thieves, some jailed and generally these have impacted upon the public's faith in corporations. At this juncture, the case of the "Natwest Three" is relevant where three Britons, on the 29th of November 2007, pleaded guilty to stealing about £4m in a single count of fraud in connection with the scandal-ridden Enron. Thus one should not be surprised that the public has demanded that business practices be ameliorated.

As a result, academics, the media, investors, managers, and regulators have all spoken, written and taken measures with the aim of achieving good conduct in corporations. Corporate governance reforms are not new, but we have witnessed so many reforms in the last four years that have sought to address several issues on different aspects of the subject. Indeed, corporate crisis and reforms have been essentially cyclical (Clarke, 1998). Most times, corporate governance scrutiny and subsequent reforms have followed a sequence of corporate scandals. While the government has not been totally passive in these developments, most of the reforms, until very recently after the Enron's case, have been championed by self regulatory organisations and stock exchange authorities. The government's general aim is to regain the lost confidence of investors by ensuring that there exists a proper, efficient and a workable structure through which companies can be run by an effective and honest management that strives to promote the interests of the company.

The UK has a more specific aim founded on the premise of avoiding corporate scandals and fashioned along the path that there is a need for aggrieved stakeholders to be able to seek redress in court. For example, a report by the DBIS in conjunction with a team of academics suggests a more specific objective which stipulates that corporate governance regulation should "ensure an effective framework exists to underpin the relationship between an organisation and those who hold future financial claims against that organisation. Holders of such claims may include shareholders, commercial lenders and other stakeholder all of whom are important from a public policy perspective." (Filatotchev, et al. 2007: 6). Also the UK system places a great emphasis on the financial aspects of corporate governance as the principal factors that a regulatory framework must address to ensure good governance. For example, major UK governmental policies and initiatives have developed in recent years to enhance transparency and quality in corporate financial and non-financial disclosure, to encourage shareholder participation, to promote effectiveness and accountability among

board of directors, and to foster a lasting investment culture (Filatotchev, et al, 2007).

Indeed corporate governance in the UK originated from a series of corporate misdeeds in the late 1980s and early 1990s, such as the collapse of the BCCI bank and the scandal at Robert Maxwell pension funds, both in 1991 (FRC, 2006). Following on from our previous discussions on the development of the codes of conduct and best practices, it is important to note that every other report, except for the Hampel committee that came up with the first Combined Code, has been a reaction to something that has either gone wrong or perceived to be on the verge of going wrong. The 2003 revised Combined Code can be seen as a response to the Enron's scandal in the US whilst the 2010 UK Corporate Governance Code was developed in the post of 2008-2009 global economic crisis. Corporate misdemeanours have awakened the government from its slumber. Regulation of corporate governance has become a major priority for policy makers in the bid to prevent corporate fraud. However could it be that the government is just being too proactive and overreacting to the Enron's scandal? Indeed there are numerous companies listed on the LSE, NYSE and the stock exchanges of other countries; most of these companies have performed well by creating more firm value as well as protecting the interests of investors. Should these few and 'unrepresentative' corporate misdeeds change the paradigm upon which firms have successfully dwelled? Or perhaps, the recent corporate scandals are just indicative of the massive decadence and fraudulent behaviour of most companies' management. This might suggest that US investigators are more diligent in searching out scandals (than those from Europe). Regulation will never totally prevent them but it is hoped they will become less regular. As it is, there seems to be a cycle of scandal followed by crisis followed by regulation followed by cries of overregulation followed by relaxation of regulation followed by scandal and then new regulation! As businesses get more complex with unusual group structures, it becomes more and more difficult to regulate them (Clarke and Dean 2007). This other line of thought undoubtedly means stricter regulations by the government must be in place to curb corporate misdeeds.

4.3.3. To Promote Competitive Advantage.

As London and New York continue to wrestle to become the world's financial nerve centre, we propose that the UK government is trying to ensure that there is a corporate governance regulatory structure that allows the UK to attract investments and remain competitive. Margaret Hodge MBE MP, the former DBIS Minister of State for Industry and the Regions, while giving a speech on the Companies Act 2006, stated that "our role is to increase the

competitiveness of the UK” (DBIS 2006). She further noted that the government is committed to ensuring that a simple, accessible, flexible yet robust legal/regulatory framework exists within which business can operate to promote enterprise and growth, while providing the right conditions for investment and employment, so as to produce a successful and competitive economy. There is evidence that the UK is perceived as a good location for business. Studies by the FTSE, the National Association of Pension Funds in 2005 and Oxera (on behalf of the LSE) in 2006 all confirmed that the UK model has a dual advantage of high standards of corporate governance and relatively low associated costs; this has been seen by some companies as one of the main factors influencing the preference of a UK listing to a US listing (FRC, 2006).

Indeed some corporate governance scholars and practitioners alike have attributed the “demise” of the US as the world financial hub, to the burdensome and investment-unfriendly form of regulation entrenched in the Sarbanes Oxley Act. There is no doubt that the costs of compliance with Sarbanes Oxley Act for US and overseas companies listing in the US have been substantial for all and particularly for smaller companies. Companies may feel particularly frustrated that despite bearing the costs, there is a lack of flexibility concerning the requirements. In addition, the costs that the State has faced are significant and include drafting and agreeing legislation, implementation arrangements and enforcement and monitoring costs (Anand, 2006). The question is whether the alternatives are actually significantly cheaper. Anand (2006) states that the partially enabling regime will produce a high level of compliance at a lower cost.

Although a more flexible system may not incur the same degree of costs, there are a number of disadvantages with the ‘comply or explain’ system. Disadvantages listed by Coglianese et al., (2004) include inadequate sanctions and under enforcement. Investors may find it hard to compare different companies where the degree of compliance is different and where there is a high degree of interpretation. These problems do not appear to be fully addressed by Anand (2006). Thus, although from the US perspective, the UK’s system may seem very attractive, in reality, it is debateable whether the benefits actually exceed the costs particularly when *all* the costs are taken into account. Nevertheless, from a business perspective the flexibility of the ‘comply or explain system’ is undeniably attractive and may possibly be a factor in encouraging companies to base their operations in the UK over the US, which helps to achieve the UK’s government desire for competitive advantage.

Indeed there is increasing evidence that the UK is becoming the 21st century prime location for setting up business. We suggest that UK’s competitiveness has been at the centre of governmental motive in

corporate governance and company law. Here the government’s approach is based on the belief that a principle based corporate governance regulatory framework reduces the costs of regulation, allows the effective operation of a free market, creates wealth, eradicates poverty and facilitate innovative business practice (FRC, 2006). Furthermore, the Companies Act, 2006 was engineered to make the UK, a more attractive place for investment and doing business, for both small business owners and large multinationals. And as the battle between London and New York continues, (and with new emerging markets rising up in contention) it is expected that continuing UK governmental intervention in the domain of corporate governance will occur in order to ensure that the UK remains a pace-setter in the today’s competitive world of trade and finance.

4.3.4. To Convince Investors that the Government is Addressing their Concerns.

There is no doubt investors have become increasingly sceptical of the legitimacy of large organisations. For example, banks have become increasingly under fire as they appear to be able to rely on the public yet the public is not rewarded for their willingness to act as the “lender of last resort”. Indeed, shareholders have faced substantial losses and in particular, they seem to bear the costs in terms of poorly performing shares. By way of contrast the directors seem to be able to claim bonuses despite poor or inadequate performance. Investors become angry when governments promise that these issues will be addressed yet they appear to be as widespread as ever. One particular concern is that despite all the scandals of the past nothing seems to change and in some ways scandals appear to be more prevalent than ever. Authors such as Clarke and Dean (2007) quote extracts from Thomas Lawson, which appear to be highly relevant to today yet in reality they were written *more* than one hundred years ago. Thus, they comment that:

“Its resonance with the current state of affairs serves to highlight that over 100 years of ever increasing regulation, all the ensuing corporate governance measures have achieved limited investor and public protection” (Clarke and Dean, 2007: 14).

As Clarke and Dean (2007) articulate throughout their book, it does appear that very little seems to be learnt from financial disasters and scandals in the past and that investors seem to have a very poor memory. In the United States, regulation in terms of the Sarbanes Oxley Act introduced in 2002 by the then George Bush government, appears to be much more stringent than the Code introduced in the UK (with its zero tolerance approach), however there seems to be little enthusiasm for introduction of such complex and costly measures in the UK. The UK government seems to appreciate that UK investors have felt

cheated in the past (witness events at Polly Peck, Marconi, Northern Rock and more recently the Royal Bank of Scotland) but it has to be balanced with the preference of the City for self regulation. It may be that investors feel that, as in the US, it would ultimately be them that have to finance increased regulation.

It is interesting that at present in the UK investors are only too willing to join the attacks on bankers by government and opposition ministers but seem slightly more reluctant to attack the government for failing to bring in adequate regulation. Countries such as France, Germany and Australia do not appear to have suffered so much in the recession and this may be down to better control of the banking systems in those countries. The government seems to be able to intervene just sufficiently to convince investors and sceptical public, that it is addressing their concerns (e.g. by instigating the Walker report regarding banks and other financial institutions and introducing the 2010 Corporate Governance Code) without upsetting the City. Government's role in corporate governance could thus be suggested to retain a huge political undertone. In particular, owing to significant public pressures, following corporate scandals, the government is keen to suggest to the public the government has not forgotten about corporate governance regulation and that the government is still effective in the existing prominence of self-regulation.

5. Further Discussions and Conclusions

We are witnessing the evolution of government's intervention in the corporate governance of many countries. In some, it is increased participation. For example in the East Asian countries where governments generally have a close relationship with business enterprises via formal or informal means, either helping businesses when there is a market failure or through ties that result in corruption and crony capitalism (Qian, 2000). In some other countries, as we have examined in the UK context, we already have codes of conducts and best practices. In many other countries, either these codes are lacking or are just a matter of "paper work". Nevertheless, we suggest that, the role of government in corporate governance in different national economies is attributable to the afore-discussed four factors - namely: to enhance competitive advantage; to compensate for the failure of self-regulation; to prevent corporate scandals and restore investors' confidence; and owing to significant public pressures and associated political undertones, to suggest to the public the government is still an effective overseer in the existing prominence of self-regulation.

For example, in Asia, several problems characterize the State-owned commercial banks in China such as the pursuit of multiple state objectives that compromises their commercial goals, lack of transparency in their reporting practices and several

other internal and external organisational problems (AFDC 2007). This has made the government demonstrate a high level of commitment to enforce a good governance model and processes that bolsters companies' competitiveness in their domestic and international markets, by clarifying the banks' objectives and ensuring shareholder diversification (AFDC 2007). Also, in order to enhance the soundness of corporate structures (many of which are family-run with non-transparent financial disclosure) and prevent the likes of the Enron case from happening in Taiwan, the Taiwanese government has established a task force, comprising relevant ministers and experts from academia and practice, to draw up a set of corporate-governance reform guidelines (Li, 2003).

In Australia poor corporate governance practices such as lack of disclosure of corporate information, and a number of high profile corporate collapses in the 1980s led to the government's continued fine tuning of disclosure requirements in the corporations law and accounting standards (Hockey, 2001). The aim is to achieve best corporate governance practices through transparency and disclosure rather than by undermining the substantive rights of numerous stakeholder (Hockey, 2001). In Africa, corporate governance matters are often discussed in relation to corruption which has been a hindrance to social, economic and political development. Sound corporate governance which encourages the efficient use of resources and also accountability for the stewardship of those resources is gradually being seen by African governments and the African Capital Markets Forum as one of the most effective tools to minimise corporate corruption (Mensah et al, 2003).

Globally, more governmental regulatory intervention is increasingly being favoured as key to restoring public confidence in corporations. Corporate governance failures, such as those which preceded the 2009 global economic recession, have led to increasing governmental participation in the governance of the modern corporation. In this paper, we have provided an evaluation of governmental motive in the UK corporate governance regulatory framework whilst subtly examining developments in other countries to allow for a conceptual scrutiny of the role of government across diverse jurisdictions. The role of government in corporate governance (including future regulatory initiatives) in varieties of capitalism would have to take into account specific institutional arrangements and challenges which are peculiar to different national environments. The literature on corporate governance regulation, politics, policy making and regulatory institutions must especially take note.

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