

# A STUDY OF INSTITUTIONAL CHANGE: CORPORATE GOVERNANCE REFORM IN BRITAIN

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**Abstract:** This article analyzes corporate governance reform in Britain from the viewpoint of historical institutionalism. There have been three stages of reforms since the early-1970s: pure self-regulation, semi-statutory self-regulation and statutory regulation. Despite these changes, however, there appeared institutional persistence, the maintenance of the Anglo-Saxon Corporate Governance Model. Although there had been several movements that had intended to introduce the Germany-originated Rhine Model to Britain, they all failed. This phenomenon resulted from three institutional structures: the Outside Initiative Policy Agenda-Setting Model, finance-dominating finance-industry relationship and the relatively strong and autonomous status of the British economy within the world economy.

## INTRODUCTION

This study analyzes the reform of corporate governance in Britain from the standpoint of historical institutionalism. There have been three stages of reforms since the early-1970s. The first stage of 'pure self-regulation' lasted until the end of the 1980s. The stage of 'semi-statutory self-regulation' followed from the beginning of the 1990s through early 1997. The subsequent stage of 'statutory regulation' has been emerging since 1997. Despite these reforms however, the 'Anglo-Saxon' model of corporate governance has not gone through any significant changes. The model has been immune to the influences of the 'stakeholder' model prevalent in Germany and Japan. This article aims to explain this phenomenon from the perspective of historical institutionalism. The core argument of this paper is that, as the three institutional variables interwoven within corporate governance has remained unchanged, British corporate governance cannot be reformed.

Corporate governance is a series of procedures and an institution of sort because it is beyond the actors involved and it affects their actions. This article defines corporate governance as the processes and structures through which executives are held accountable to owners and external actors keep the corporate power of executives in check. This definition has two aspects: internal and external. Within corporations, the core of corporate governance is that owners check managers through directors. On the other side, as large corporations seriously affect the core issues of the national economy such as employment, growth and investment, they should be identified as public actors, not just private ones (Lindblom, 1977: 170~174; Block, 1977: 14~24). These influences justify the external control through which the State and civil society prevent corporate executives from impairing public interest. As corporate executives normally wield three levels of corporate power i.e., instrumental, structural and discursive, the external control of corporate executives can be analyzed at the same levels (Levy and Egan, 1998: 337~361). Corporate governance and its changes seem to be perceived as being concerned with private organization and

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as the subject of management study. However, as seen above, large corporations carry huge weight in modern capitalistic society and thus must not be underestimated just as private organizations. In particular, corporate governance is a mechanism to control executives, who decide basic direction of corporations, and also seriously affects public interest. In addition, political rather than profit-seeking actions are involved in corporate governance: representation, agency, information disclosure and assigning accountability. Thus public administration or political science needs to pay attention to this area of concern.

This study is from the viewpoint of historical institutionalism. Thus it focuses on the resultant historical-political context. It defines institution as 'persistent values and norms which people accept as natural and the structures that embody them'. According to this definition, the stable relationship among actors or social forces, which relevant actors accept as natural, is also a form of institution. Specifically, it posits that three institutional structures contributed to the maintenance of the model. To support this position, it stresses the close relationships among institutions. As corporate governance i.e., a kind of institution, has been shaped under the influences of historical-political contexts, it has different appearances in countries with different contexts. Currently, corporate governance is categorized into the Anglo-Saxon Model vs. the Rhine Model or the Shareholder Value Model vs. the Stakeholder Model or the Agency Model vs. Trusteeship Model (Albert, 1993; Keasey and Wright, 1997; Kay and Silberstone, 1995). The Anglo-Saxon Model is another expression of the Shareholder Value Model and the Agency Model. The Rhine Model is another name of the Stakeholder Model and the Trusteeship Model. The former is prevalent in so-called English-speaking countries. In contrast, the latter is popular in Japan and Germany.

The subsequent section discusses theoretical issues. Concretely, it deals with the variants of corporate governance model, institutional changes and the three institutional variables of this article. The third section analyzes the institutional characteristics in Britain. These would act as restraints on the reform of corporate governance. The next section presents the British corporate governance. It also reveals its advantages and disadvantages. Finally, the disadvantages are connected with the three staged reforms in the fifth section.<sup>1)</sup>

## **THEORETICAL BACKGROUND**

### **Variants of Corporate Governance Model: The Rhine Model**

As mentioned above, corporate governance of the world can largely be classified into the Anglo-Saxon Model and the Rhine Model. The Anglo-Saxon Model is presented in the fourth section below under the heading "Corporate Governance In Britain" in more detail. Thus the Rhine Model alone is roughly discussed here. The discussion focuses on the scope of ownership, the

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1) This article depends on several kinds of information sources. Face-to-face interviews are, firstly, used. Twelve interviews were conducted between October 16, 2000 and November 11, 2000 in London. Most interviewees are the officials in charge of corporate governance issue in their organizations and had drawn up written responses to the Department of Trade and Industry (DTI) with reference to the consultation for legislation. One hour or so were spent per person for interview and nearly the same questions were asked because the main purpose of the interviews was to identify the policy attitude of each organization. Email was also used in data collecting. In addition, this study analyzed 11 consultation documents issued by the DTI between March 1998 and November 2000 and written responses which came from civil society. Finally, the information on the existing corporate governance model and its reform process before 1998 was selectively collected from antecedents.

performance evaluation standard, the mechanisms to hold executives accountable to the owners and the market for corporate control. Although German and Japanese corporate governance is generally classified into the Rhine Model, there are specific differences between the two countries.

As to the scope of ownership, owners are stakeholders including employees and suppliers in the Rhine model. A company is a social institution and a nexus of long established trust relations, not only a product of private contracts. The skills of employees, the expectations of customers and suppliers, its history and its reputation within the community belong to the assets of the company. Thus stakeholders as well as shareholders have partial ownership of the company.

Concerning the performance evaluation standard, the goals that managers should seek are not simple and clear but multidimensional. They comprise the survival of the company, sustained company growth, enhancing the interests of other stakeholders such as suppliers and customers, the maintenance of the reputation and status of a company within the community and the financial gains of shareholders.

As for the mechanisms to hold executives accountable to the owners, the two countries reveal (some) differences. German companies have a two-tier board composed of the management board and the supervisory board. The former deals with the day-to-day running of the company and the directors usually have an engineering background. The supervisory board consists of the owners' representatives and exists to supervise managers i.e., the management board. Overlap in membership between the two boards is forbidden within the same firm. Symmetric cross-overlap among plural firms is prohibited as well. Japanese companies have larger boards than in Anglo-Saxon companies. The board in Japanese companies seems to attach greater weight to employees' interests than those of shareholders and

place more importance on the interests of relational investors than on those of individual shareholders.

The primary shareholder is the main bank in German companies. It acts as a shareholder, a proxy of other shareholders and a lender. The main bank has extensive information on the client companies in order to maintain long-term relations. Also, the bank dispatches its officials to the supervisory board of client companies in case of financial difficulties. Conversely, individual shareholders are less effective in overseeing managers. In Japanese corporations, sister companies of the same business group are main shareholders. Major affiliates flock together in the presidents' council. They keep each other in check and ostracize an underperforming company, although they do not value short-term financial gains from their equities. In particular, financial affiliates including banks and insurance companies have strong influences on the other companies. Meanwhile, the annual general meeting is not a significant mechanism to keep managers in check in Japanese corporations.

Employees have significant power in both countries. In German corporations with more than 2,000 workers, the representatives of employees participate in the supervisory board. Thus they can affect important decision-making crucial to their status and wage. In Japanese companies, most directors are promoted from lower level employees. Therefore the survival of the company and the welfare of the employees are most valued goals. As the voice of individual shareholders is low and sister companies do not expect short-term profits, the interests of employees come before any other interests.

The market for corporate control is not a significant balance mechanism in both countries. Shareholders keep long-term relational investments, so they tend not to sell off their equities for short-term financial gains. Additionally, the num-

ber of listed companies is very small in Germany. Only 66 of a total 3,219 corporations were listed in 1992 (OECD, 1995: 95). That is, targeted takeovers are very few and the mechanism for doing so is not effective. Japanese corporations form a strong alliance network among sister companies of the same business group. Thus they never sell off the equities of the sister companies to bidders. They formed this alliance system when U.S. capital tried to take over Japanese companies in the 1960s (Gerlach, 1992; Clark, 1979; Abegglen and Stalk, 1985).

### **Types of Institutional Change and Three Independent Variables**

Institutional changes can be categorized into radical-discontinuous, gradual-continuous and gradual-discontinuous according to the degree and frequency of change (Ha, 2001). Radical-discontinuous change would occur if both a focal institution and others interwoven with the focal institution change at the same time. Nonetheless, if there are serious political struggles, gradual-discontinuous change would occur. Meanwhile, if interwoven institutions do not change radically, a focal institution would show gradual-continuous change i.e., path-dependent change (North, 1990).

Corporate governance is interwoven with the surrounding political-social institutions. For instance, the shareholders-corporation relationship of a focal company is interconnected with the culture of the society on time preference and risk-taking. Thus it is needed for students, who analyze corporate governance, to study the institutions which are interconnected with and affect governance. However, it is physically impossible and also undesirable in efficiency terms of study to analyze all the variables involved. Thus this paper focuses on just three institutions. Relating to these variables, it argues that the three institutions interconnected with corporate govern-

ance affected its reform process and contributed to the maintenance of the Anglo-Saxon model. The three institutions are the policy agenda-setting system, the stable relationship between finance and industry and the relationship between the domestic economy and the global economy. This article posits that it took a long time for these institutions to take their present forms.

The policy agenda setting system affects how quickly and correctly policy-makers can perceive problems caused by the existing corporate governance. Cobb and his colleagues present three models in connection with policy agenda setting: The Outside Initiative Model, the Mobilization Model and the Inside Initiative Model (Cobb, Ross and Ross, 1976: 127~128). Policy agenda setting is influenced by the degree of democratization. A country with a long history of democracy would keep the Outside Initiative Model. In contrast, those with a lower degree of democratization would utilize the mobilization model.

The second variable is the relationship between finance and industry. The essential relationship in corporate governance is between shareholders and executives. In particular, the relationship between institutional shareholders and executives has recently attracted many scholars. In the same vein, the ongoing relationship between finance and industry in a country is a very important issue.<sup>2)</sup> If industry has the upper hand over finance, the governance problems created by executives would be corrected slowly and vice versa.

The third variable is the relationship between the domestic and global economy. Corporations are representatives of each country in modern capitalistic markets. The national power of a country depends on the rise and fall of its corporations. Meanwhile, the corporations are interconnected

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2) This relationship is closely related to the history of industrialization.

with political, economic, social and cultural environments and are reflections of them. As a result, industrialized countries tend to make their corporate cultures global standards in order to help their corporations in global markets and in the end strengthen their national power. In this context, the reform of corporate governance cannot avoid the influence by the status of the national economy in the global economy. Advanced countries would be relatively independent of the influence, but late comers cannot escape the influence of global standards imposed by advanced countries and international organizations such as the International Monetary Fund.

## **INSTITUTIONAL CONTEXTS IN BRITAIN**

As to the three institutional variables above, Britain follows predictable characteristics.

Relating to the policy agenda setting system, Britain has developed the Outside Initiative Model. Civil society was activated quite early and the Parliament i.e., representative system, was developed early on. Consequently, policy-making processes were democratized. In addition, in connection with this, Britain developed the tradition of self-regulation. As civil society became more active, it tended to solve social problems by itself before the government took actions. In the case of governmental intervention, the government tended not to impose self-made policies on civil society but to decide and implement public policies taking into account the demands of civil society. Accordingly, Britain experienced relative gradual changes.<sup>3)</sup>

As for the relationship between finance and industry, British industry began to depend on

finance significantly in the mid-twentieth century.<sup>4)</sup> In order to compete with large German and U.S. corporations which had made inroads into British markets right after the First World War, Britain needed to rebuild family-oriented small and medium-sized companies into large-scale corporations. To this end, there had been many mergers among small companies. No small companies, however, had adequate funds required for the mergers. Thus they had no other choice but to depend on financial entities such as insurance, pension, and trust investment companies for the large amount of funds. Since then, finance has been able to affect industry seriously. As the existing financial regulations were eased in the 1980s under Thatcherism, the influences of finance were greatly strengthened. Also, as the Sterling became stronger than before, export of commodities dropped and the status of industry worsened. As a result, shareholders i.e., financial companies, were able to quickly perceive governance problems caused by corporate executives and they launched many reforms to correct the problems.

As to the relationship between the domestic and global economy, the British economy enjoyed relatively higher independence than in other European countries. Britain is the only country that began industrialization for itself and the origin of the Anglo-Saxon capitalism together with the U.S.A. In addition, it has played a leading role in setting global standards on accounting and credit evaluation. Furthermore, it influences other countries by the media of financial industries and overseas investments. Although there have been many indications which mention the decrease of British influences on the world, Britain restored its vitality in the 1980s and 1990s. Even after the Labour Government took

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3) For detailed comparison among Britain, France and Germany, refer to Birnbaum (1980) and Birnbaum (1988).

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4) Up to that time, both sides had been kept separate. For more explanations, see Hannah (1983).

political power, its economy enjoys prosperity. In fact, it still has the fourth largest economy in the world. Based on these situations, the British economy actively leads global trends rather than passively accept incoming influences. In corporate governance reform as well, it seems to actively lead other countries.

## **CORPORATE GOVERNANCE IN BRITAIN**

The British corporate governance is normally understood as the Anglo-Saxon Model and thought to be similar to that of the U.S. The following presents the British model with focuses on the scope of ownership, the standard of performance evaluation, the mechanism which holds executives accountable to shareholders and external control. This model has remained intact despite several trials for reform.

### **The Scope of Ownership**

The owners are restricted to shareholders. Unlike Japan and Germany, employees and transaction partners are denied any ownership. Even in privatized utilities such as water corporations, stakeholders such as consumers are denied ownership even though the service provided by the company is closely related to public interest.

Shareholders were originally individual investors. Yet, as the size of corporation increased and large amount of funds were needed, their relative equity went down and institutional shareholders emerged as the main capital providers. In particular, the institutional shareholders have provided a considerable amount of funding since the 1960s. The equities of institutional shareholders in the entire British stock markets rose from 29.0 percent in 1963 to 59.8 percent in 1994. Including the equities of foreign institutional shareholders, the weight in 1994 rose to 76.1

percent. Compared with the equity ratio in the USA i.e., 45 percent, the equity ratio of British institutional shareholders seems extraordinary high (OECD, 1998: 133).

An employee share ownership plan was introduced in the 1980s by the Thatcher Government, which aimed to make employees shareholders by lending money to employees. This plan, however, was no more than an attempt to weaken labour unions and strengthen the loyalty of employees. Its aim was never to enable employees to check executives significantly. This aim is well proven by the fact that the average equity of employees in their corporations is less than 1 percent (Parkinson, 1993: 424~425). Meanwhile, banks have not been the main shareholders under the influence of the history of industrialization, where finance and industry were separate from each other. The Big Bang administered by the Thatcher Government also made banks face cutthroat competition and repeal the lingering relational investments. Due to intense competition, keeping long-term investments in badly managed companies were disadvantageous to the banks (Wilks and Faraj, 1999: 12).

### **The Performance Evaluation Standard and Mechanisms of Accountability**

In this model, the performance of corporate executives is evaluated on the basis of the interests of shareholders. That is, the standard is the sum of paid-out dividends and financial gains arising from the changes of stock prices. The bigger the sum, the more likely it is that corporate executives can gain the confidence of shareholders. The mechanisms keeping executives in check are fourfold: the board, the annual general meeting, the informal control by institutional shareholders and the market for corporate control. Compared to governance in the public sector, corporate executives are the Administration, shareholders are the electorate, directors are the Members of

Parliament representing the electorate and the board is the Parliament. The market for corporate control is like the political arena where different political forces are competing with each other to take political power.

#### The Board

The board i.e., a representative body of shareholders, is the first mechanism to supervise managers, but it does not achieve its mandate in reality. As the *Companies Act of 1985* does not include specific provisions on directors, executives served as both executives and directors. This combined service enabled executives to hold sway of the composition and operation of the board. For instance, the Chairman of the Board was chosen by the CEO in most companies until the beginning of the 1990s. Accordingly, directors and the board could not exercise their original duty i.e., to supervise managers instead of shareholders.

#### The Annual General Meeting

The meeting can control the self-interests of the directors, decide the conditions of the remuneration of managers and impose fiduciary duty on executives. However, the meeting has not been able to wield these powers over executives. Initially, this was because it was difficult for individual shareholders to utilize credible information about the company. As the shareholders have no rights to demand information disclosure, they ascertain information only through solicitation in the meeting. Therefore it is virtually impossible for shareholders to control executives due to insufficient information. In addition, class suits and derivative suits are prohibited in Britain. Thus it is not easy for a shareholder to take legal action bearing all the court costs. Finally, a shareholder should bear all the costs related to circulation should the shareholder make proposal

in the meeting. Consequently, there were quite a few shareholder proposals in Britain. There were only 4 proposals in 1997 (Mallin, 1999, 252-253).

#### Informal Control by Institutional Shareholders

As the equities of institutional shareholders have been relatively high as discussed above, they cannot depend on the so-called exit strategy but voice option (Hirschman, 1970). Yet they did not officially raise their voice in proportion to their equities. Rather, they have controlled executives through unofficial means. They have continued to keep contacts with the CEOs, chairmen of the Board and Financial Directors. In particular, these particular types of meetings were usually held directly after the preliminary reports were issued. They tended to confide in the existing executives, but resolutely removed them when their performances were notably bad (Mallin, 1999: 253).

#### The Market for Corporate Control

The control mechanism that executives are most afraid of is the market for corporate control, which threatens their management rights. As all companies are potential targets of takeover, executives cannot help but be worried. In connection with corporate governance, the function of hostile takeovers is to remove the executives of poorly performing companies. That is, the main function of stock markets is to discipline executives through takeovers rather than to provide new capital. Takeovers began to notably occur in the 1950s, were accelerated in the 1960s and jumped dramatically in the 1980s (Charkham, 1994: 304). As there were many takeovers in the 1950s and 1960s, the Board of Trade, the predecessor of the DTI, set up the City Panel on Takeovers and Mergers in 1967. The panel is composed of professionals from financial, industrial and legal societies and a lawyer has usually presided over it. Although it is not a statutory

apparatus, the panel actually plays both a parliamentary role by formulating rules and a judiciary role by applying the rules to individual cases. It established the *Non-Statutory City Code on Takeovers and Mergers* and on the basis of this code solved disputes involving takeovers. The code is not a law and thus can be quickly revised with the change of corporate climate. In addition, as this panel has its own appellate system, even courts do not intervene in the panel's decisions.

### **External Checks on Corporations**

#### **Instrumental Level**

The DTI of the Thatcher Government repealed all political links to trade associations to break up the Corporatism of the 1970s. That is, in 1988 Lord Young removed all sponsorship divisions which had contact with trade associations. The Thatcherites of the day viewed the officials of trade associations as corrupt and incompetent people who merely tried to obtain governmental subsidies rather than as business professionals. Thus they met individual managers when they needed industrial information, not the officials of trade associations. In addition, the Confederation of British Industry (CBI) i.e., the peak organization, was very weak in solidarity and thus also weak in lobbying the government. Also, the CBI did not have binding power to enforce its decisions over member companies. Other trade associations were also quite weak in budget, professional competency of staffs and solidarity (Grant, 1993: 70~75).

#### **Structural Level**

The British government controlled the structural power of corporations through regulation and competition policies. Economic regulation was strengthened under the Thatcher Government. In addition to the reregulation in the environmental and financial sectors, many new regulations were

introduced to prevent privatized utilities from exploiting their monopolistic status. Yet, as the British government implemented the policies taking into account the situations of regulated companies rather than one-sidedly enforced harsh regulations, the policies were not effective in controlling the structural power of corporations. Thus concern was raised that corporations were too powerful.

#### **Discursive Level**

Corporations enjoyed very strong power at this level. Since the 1980s there have been no forces to check the discursive power of corporations. Labor unions usually controlled this power of corporations, but they became very weak in the 1980s. British labor unions had traditionally been organized by club-style membership system, not by industry. As a consequence, plural small unions had disorderly stood for an industry and experienced a vicious cycle of weakening themselves. To make matters worse, the Thatcher Government destroyed several exceptionally powerful unions. Resultantly, unions did not dare to question the discursive power of corporate executives. Other bodies such as the environmental and the consumer movement groups, although there were some exceptions, were incapable of investigating large corporations. They were all fragmented and thus weak in political influence (Grant, 1993: 34~35).

#### **Pressures for Reform**

Some features of the model suggest it will persist. It has an unitary board, so the accountability of checking managers is not dispersed unlike in the Germany. Thus, although its independence is weak, the board is relatively efficient in supervising managers. In addition, as the influence of employees on management is weak, the model is in a better position to attract



incoming foreign investments. In particular, the British model is a better option for capital than the German model where the influence of employees on management is strong. It is well evidenced by the fact that Britain attracted on average 30 percent of the incoming foreign investments to Europe (William, 1996: 209~217). Furthermore, as the relationship between a corporation and its stakeholders is flexible, it is easy for the company to cope with the business cycle. When needed, a corporation can lay off its employees and change transaction partners without bearing high expense. Moreover, the model can produce an overnight millionaire. Thus it is more splendid than the German model and evokes strong impression, thrill and excitement (Albert, 1993: 180, 191, 204).

Conversely, some features of the model suggest pressures for change. Firstly, executives did not faithfully report company information to shareholders. Most executives did not operate companies transparently by acting as both CEOs and the Chairmen of the Board. Consequently, shareholders had to bear unexpected damages. This problem occurred during the late-1980s and the early-1990s when Britain faced economic recession. At that time the Maxwell Media Group and the Bank of Credit and Commerce International (BCCI) enjoyed a high profile, but collapsed overnight. As a result of investigations, it came to light that executives had not disclosed correct information to shareholders although the companies had serious financial problems for several years.

The second problem is with short-termism brought about by hostile takeovers. As discussed above, executives had to satisfy shareholders to defend their management rights. Thus they reduced the investments, which would decisively affect the potential of long-term growth, such as R&D investments and paid out the saved money to shareholders as dividends. The international

average ratio of R&D investments to turnovers was 4.85 percent in 1994. In contrast, the ratio was no more than 2.29 percent in Britain. Except the investments by several leading companies such as pharmaceutical firms, those by other companies were quite meager (Hutton, 1996: 8, 187).

Finally, the excessive remuneration of executives was politically problematic. Managers received inordinate pay disproportionate to their performances. The average increase of profit from 1985 to 1990 was only 17 percent. In stark contrast, the remuneration of executives rose 77 percent at the same period (Tricker, 1995: 1). The main problem-makers were the privatized utilities. The companies continued to occupy monopolistic status in markets although private shareholders had replaced public owners. Yet they discharged employees after privatization. That is, although the executives of these companies made profits by exploiting monopolistic status and dismissing workers, they collected huge remuneration through stock options (Corporate Governance Editors, 1996: 24~28). In addition to the three problems above, other problems also emerged. Therefore the reforms of corporate governance were pushed ahead to solve the problems.

## **THREE STAGED REFORM PROCESSES**

As mentioned in the introduction, the corporate governance reform in Britain can be categorized into three stages: pure self-regulation, semi-statutory self-regulation and statutory regulation. These reforms were pushed forward under the influence of the three institutional characteristics outlined in section three.

### **Pure Self-Regulation (1970s-early 1990s)**

At the start of 1970s already, there was a

prevailing perception that it was difficult to remove inept managers. This perception was strongly raised especially by the Bank of England that had been deeply involved in the bail-out operations of bankrupt banks. Just then a Conservative MP submitted a bill that purported to strengthen the board by external intervention. Yet the Conservative Government of the day did not legislate it but commissioned the issue to the Watkinson Committee established by the CBI and the financial interest. This committee published a report, which preferred flexible self-regulation to legislation. However, the problem was beyond the capacity of self-regulation.

The Labour Government that took political power in the late-1970s began to search for methods to raise the accountability of private companies, realizing that the platform of nationalization was already unattainable. In addition, the *EC Fifth Company Law Directive* stipulated the participation of employees in the board meetings. Due to these two trends, the Bullock Committee set up by the Labour Government published a report that prescribed the participation of employees in management and recommended legislation in this direction. The CBI, the financial interest and labor unions then strongly resisted the report. The industrial and financial interests worried about the possibility that their power would shrink due to the participation of employees in management and profit-seeking actions would be restrained. Meanwhile, labor unions also opposed this report, fearing that their participation in management would weaken their bargaining power and this would compromise their power in the end. Facing the unexpected opposition of labor unions, the Labour Government could not legislate any laws according to the recommendation. Additionally, as the Conservative Party won the 1979 General Election, the recommendation of the report was naturally abandoned (Parkinson, 2000: 254 ~ 257).

As this problem continued, the Bank of England took the initiative of establishing the Pro NED in 1981. The prime goal of this body is to provide corporations information on competent candidates for NED, make companies appoint NED and thus oust underperforming managers. Yet this movement was not effective either. This led in 1990 to the publication of guidelines by the Association of British Insurers, which were reissued in 1991 by the more broadly-based Institutional Shareholders' Committee as its statement of best practice on *The Role and Duties of Directors*. Despite these self-regulations, however, the problem was not yet solved and ushered in the Maxwell and BCCI scandals in 1991.

#### **Semi-statutory Self-regulation (early 1990s-1997)**

As a series of pure self-regulatory actions were ineffective, semi-statutory self-regulation began to emerge from the early 1990s. First of all, the Cadbury Committee was set up on the initiatives of the Stock Exchange and the Institute of Accountants. The principal purpose of this committee was to raise the transparency of the financial sector in order to keep London's reputation as an international financial center. In December 1992 the committee published a report and the code of best practice, which prescribed the disclosure of accounting information, the appointment of at least 3 NEDs on the board and the ban on combining CEO with Chairmanship of the Board. The Stock Exchange forced all listed companies to abide by the code of best practice by making it a requirement for listing. In cases where companies did not follow the code, they had to include the reasons for noncompliance in the annual report to shareholders. Yet the effect was insignificant. Most companies did not comply with the code but circumvented the regulation by shortly explaining the reasons of noncompliance in the annual report. The main reason for this result is that most members of the Cadbury

Committee are higher executives (Cadbury Committee, 1992: 61~62). Due to self-regulation, higher executives who should have been regulated, decided the contents of regulation. Consequently, they would have loosened the regulation.

The second movement was the Greenbury Committee set up on the initiative of the CBI. The prime mandate of this committee was to solve the problem of excessive salaries of corporate executives, which evoked hot criticism. Yet this committee was composed of the Chairmen of the Board and CEOs. The list of committee members was like the members' list for the social club of Sirs (Greenbury Committee, 1995: 5). That is, those people whose remuneration should have been cut flocked together in order to solve the pay problem. Resultantly, this committee went ahead against primary expectation. The report published by the committee in July 1995 argued that the executives' pay was never excessively high. Furthermore, they regarded the public view that executives' pay was excessively high as a mistake, a misunderstanding and a misjudgment (Greenbury Committee, 1995: 10). Finally, this committee did not solve the pay problem. Rather, it aggravated the problem by irritating the public. Like the Cadbury Report, although the prescriptions of the report were implemented by the Stock Exchange as listing requirements, the contents were not up to the expectations of the public.

The third move was that the Hampel Committee organized in November 1995. This committee was set up by the leadership of the Stock Exchange, the CBI, the IoD, the NAPF and the ABI. The committee appeared to have no intention to control managers from the start. Instead, it aimed to examine whether or not the recommendations by the Cadbury and Greenbury Committees had worked well. The final report of this committee argued that the recommendations by the two committees had placed too much burden on

executives and thus should be reduced.

The system of semi-statutory self-regulation since 1991 was not successful in solving the problems in corporate governance. Due to the enforcement mechanism, it went a step forward from pure self-regulation. Nonetheless, it was incapable of solving the problems because of its fundamental limit i.e., self-regulation.

### **Statutory Regulation (Developments since 1997)**

As both the pure self-regulation and the semi-statutory self-regulation went awry, the Labour Government taking political power in 1997 began the consultation processes for the revision of the *Companies Act of 1985* in March 1998. This was the expression of intent that the government would regulate corporate governance through the revision of the law since then, because self-regulation had been ineffective. In addition, another argument was raised that the complicated company law needed to be put in order. As a result, there was increasing support for the revision of these laws. The law was legislated in the mid-19<sup>th</sup> century and then it was revised only through addition and supplementation. Thus it has been difficult for corporate executives, not legal professionals, to understand the law. This led to strong public opinion to revise the law in order for executives to easily understand it. Meanwhile, there were still many people who opposed the governmental intervention through legislation. What is interesting is that even the DTI Secretary Margaret Beckett, who launched the consultation processes, disliked government intervention.<sup>5)</sup>

#### **The Progress of Consultation**

The DTI issued 11 consultative documents from March 1998 to November 2000 and received 1,407 written responses from civil society (DTI

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5) Speech of DTI Secretary at the PIRC Conference on 4 March 1998, [www.dti.gov.uk](http://www.dti.gov.uk).

Information Centre in London). Each consultation document assigned three months or so for written responses. Consequently, some respondents even conducted surveys and wrote responses to the DTI on the basis of the survey results.

#### The Bodies Managing Consultation

The DTI did not manage the consultation processes on its own but established the Steering Group composed of distinguished professionals. This organization managed the overall processes of consultation. It set up the thirteen Working Groups, which dealt with specific issues of the consultation. The members of these groups were professionals of each area who had been recommended by the members of the Steering Group. Among them, Working Group E, F and G1 treated corporate governance issue. Lawyers and financial analysts overwhelmingly participated in the Steering Group and the Working Groups. Of 182 professionals in total, there were 33 lawyers, 32 financial analysts and 22 accountants. More importantly, many lawyers acted in plural working groups. Thirty-three lawyers took 73 chairs in total, which meant that a lawyer worked in two groups on average (DTI, 1999: 161~164; DTI, 2000: 368~374). In addition, the DTI organized the Consultation Committee to stave off the criticisms concerned with interest representation. This committee was organized on the basis of interest representation. Thus the representatives of all interests related to corporate governance impartially participated in the committee.

#### Jurisdiction of Each Actor

The Working Groups asked specific questions in the consultation documents, collected written responses from civil society and put them in order. The Steering Group published the consultation documents and decided the direction of the revision of the law considering the written responses. The Steering Group followed the ma-

jority rule when making decisions.<sup>6)</sup> Considering that the professionals participating in the Steering Group and the Working Group asked questions and published consultation documents, professionals seemed to set the stage for consultation. That is, the professionals wielded discursive power over consultation.

#### Main Forces

Interviewees revealed that several respondents had been influenced by others. Specifically, the ABI, the NAPF, the PIRC and Hermes, which represented the interests of finance, had been influential on other respondents. Considering that the majority of respondents responded in the interest of finance, especially the interest of institutional interests, the answers of the interviewees seemed credible. The influential respondents had consistently presented the necessity and direction of the reform of corporate governance through their websites and policy seminars long before the consultation processes. Meanwhile, the organizations that represented the interests of stakeholders i.e., the TUC, environmental movement groups and consumerist movement groups, did not significantly affect the consultation processes. Some of them did not send any written responses. In the case of the responses, their quality was relatively low and their volume was also small (DTI Information Centre).

#### The Direction of Revision of the Law

There are many issues, which deserve to be dealt with on a case-by-case basis. Yet the issue of perspective on stakeholders' interest is discussed here in detail. This is because this issue was treated at the earliest stage and decided the future direction of the revision of the law. At the same time, the issue is the most intense one concerning

6) Email from Edwin James, secretary of Company Law Review, DTI.

corporate governance and seriously affects the distribution of interests such as the rights of participating on the board.

As to how to protect the interests of stakeholders, two approaches were presented: the 'enlightened shareholder value' approach and the 'pluralist' approach. The former was a slightly weakened version of the existing shareholder-oriented approach, which intended to protect the interests of stakeholders through information disclosure. The latter was prevalent in European countries, which intended to protect the interests of stakeholders by providing equal power to shareholders to stakeholders. For instance, the representatives of stakeholders participate on the board in this approach. If the majority of written responses had supported the latter approach, this would have been a patent breakaway from the existing Anglo-Saxon model. In connection with this issue, the Steering Group received 222 written responses and a clear majority of opinion was against the adoption of a pluralist approach (DTI Information Centre; DTI, 1999: 17, 18, 398). The Trade Union Congress and the British Chambers of Commerce, the association of small companies, advocated the pluralist approach, but they were not so influential on the other respondents. Like in other issues, the organizations supporting the interests of stakeholders could not go beyond those supporting the interests of shareholders. Consequently, the consultation for the revision of the law was from then onwards unfolded towards correcting the problems of the existing Anglo-Saxon model and at the same time strengthening it.

## CONCLUSIONS

As discussed above, there have been many attempts in Britain to reform the Anglo-Saxon style of corporate governance since 1971. A series of reforms gradually intensified from pure

self-regulation to semi-statutory self-regulation to statutory regulation. Nonetheless, the macro institutional framework i.e., the Anglo-Saxon model, remained unchanged. In particular, although there was an opportunity to change the path following the Bullock report in the late-1970s, this did not happen. Consequently, it resulted in the path dependence in institutional change as raised by North. This result was possible because the institutions of corporate governance were interwoven with other institutions and these other institutions did not change.

In Britain, the outside initiative model of agenda setting was developed quite early due to the long history of democracy. Also, relating to this, civil society disliked the interference of the government and had the tradition of self-regulation, which tried to solve social problems on its own. This tradition was well reflected in the reform of corporate governance. As this tradition strengthened, the target of regulation drafted the regulations and thus there were few opportunities to change the corporate governance model radically. This led to path dependence in the end.

In addition, the overwhelmingly higher position of finance over industry, which has been maintained since the mid-1920s, affected the corporate governance reform. In particular, the Stock Exchange, the Bank of England and institutional shareholders such as insurance companies and pension managers wielded overwhelming influence on the corporate governance reform. The financial circle has acted as a core force which maintained the tradition of self-regulation. It staved off the governmental intervention by establishing civil committee for self-regulation when the problems related to corporate governance occurred. In addition, after the revision of the law began, it exercised strong influences on the consultation processes. It strongly supported the enlightened shareholder value approach, where shareholders' interests come before those of

stakeholders, and this decisively contributed to the maintenance of the Anglo-Saxon model. It was a force, which made the path dependence possible.

Furthermore, the relationship between the British economy and the global economy i.e., the status of the British economy in the world economy, contributed to the result that Britain has kept the Anglo-Saxon model and exported it to other countries. Sir Cadbury made a tour to 28 countries to advise corporate governance reform in the countries, after the Cadbury Committee had been disbanded in 1992 (Cadbury, 2000: 7). If Britain was not one of the earliest industrialized countries, a country with the fourth largest economy in the world and dependent on its own natural resources, it would be very difficult for Britain to keep its own corporate governance model. To be sure, even in the absence of the conditions above, Britain could maintain its own model for a moment due to the 'lock-in effect' and the 'operation of informal institutions', as put forward by North. Yet, if the international economy imposes a different model on Britain and Britain is in a position to receive it for survival, it would be very difficult for Britain to keep its own model for thirty years.

It is an enormous task requiring exorbitant efforts to identify all institutions interwoven with a focal institution and their influences on the focal institution. Thus students tend to reach a compromise by weighing the degree of explanation with the feasibility of research. This study has also made a compromise by choosing three independent variables. Undoubtedly, the degree of explanation may be impaired due to this kind of compromise. Nonetheless, this study has many implications for analyzing corporate governance reforms in other countries in which efforts for reform have not been effective.

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