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Citation: Veldman, J. ORCID: 0000-0001-8615-5844 (2017). Self-regulation in international corporate governance codes. In: Du Plessis, J. J. and Low, C. K. (Eds.), Corporate Governance Codes for the 21st Century. (pp. 77-95). Springer. ISBN 9783319518688

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Permanent repository link: https://openaccess.city.ac.uk/id/eprint/20322/

Link to published version: http://dx.doi.org/10.1007/978-3-319-51868-8_4

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Self-regulation in International Corporate Governance Codes

Jeroen Veldman

1 Introduction

Soft law refers to a deviation from hard law that begins with the weakening of legal arrangements 'along one or more of the dimensions of obligation, precision, and delegation'.[1] Such a weakening of legal arrangements is considered potentially beneficial.

> Soft legalization ... provides certain benefits not available under hard legalization. It offers more effective ways to deal with uncertainty, especially when it initiates processes that allow actors to leant about the impact of agreements over time. In addition, soft law facilitates compromise, and thus mutually beneficial cooperation, between actors with different interests and values, different time horizons and discount rates, and different degrees of power.[2]

A gradual conceptual shift away from mandatory regulation has been evident over the past few decades[3] on the basis that: 'soft law offers many of the advantages of hard law, avoids some of the costs of hard law, and has certain independent advantages of its own.'[4] The Global Compact asks that companies voluntarily 'embrace, support and enact' internationally recognized standards', while the 2002 EU Green Paper on Corporate Social Responsibility broadly relies on a 'concept whereby companies integrate social and environmental concerns in their

[1] Abbott and Snidal (2000), p. 422.

[2] Abbott and Snidal (2000), p. 422.

[3] Macleod and Lewis (2004), p. 2.

[4] Macleod and Lewis (2004), p. 422.

business operations and in their interaction with their stakeholders on a voluntary basis.'[5]

However, it could be argued that a strong reliance on self-regulation has failed to create conditions to forestall ongoing corporate governance crises, including the 2007 financial crisis.[6] Moreover, specific instantiations of soft law, like the UK Corporate Governance Code (hereafter: the UK Code), which serves as a model for 'soft law' approaches to corporate governance worldwide, have been critiqued for four main reasons:

1. While the UK Code explicitly argues against mandatory legislation, this takes place in a context in which suasion exercised by business and regulatory elites is considered the implicit backdrop. The explicit reliance on self-regulation in the UK Code is thus framed by a trust in the capacity of strong informal institutions to provide compliance. As this context remains implicit in the Code, spreading assumptions of self-regulation beyond the UK might have unintended consequences in jurisdictions with different regulatory institutions and with different ownership and control structures for public companies.
2. Although the UK Code adopts a self-regulatory regime based on the capacity for informal suasion, this approach seems to fail in the face of non-compliance with respect to the comply or explain regime and with regard to the exercise of sufficient self-constraint in the face of major irritants to the broader public like rising executive pay. This adds a problematic empirical aspect to consider with regard to the adoption of self-regulation.
3. The discourse of the UK Code entrenches a notion of political economy that projects a problematic shareholder value-oriented compass for corporate governance. This compass creates a set of institutional conditions that makes it largely illusory to rely on boards or market agents to provide adequate protection for other constituencies' interests or to provide a long-term perspective to companies. As such, the UK Code exports a model for self-regulation into corporate governance codes worldwide that protects specific notions of political economy.
4. Self-regulatory codes like the UK Code conceptualise corporations as entities that, in principle, operate as integrated entities 'under the law' that can be directly monitored. As the evasive nature of transnational corporations (TNCs) remains opaque, this leaves TNCs free to operate in a transnational domain, while it puts regulatory bodies at a distinct disadvantage.

Overall, it can be argued that the use of the UK Code as a blueprint for the development of corporate governance codes based on self-regulation in a transnational domain facilitates the spread of highly specific corporate governance arrangements without a proper sense of their effects in other jurisdictions. To engage with these issues in a consistent way, ideas of corporate governance need to be contextualized and diversified to a far greater degree in the transnational

[5]Macleod and Lewis (2004), p. 9.
[6]Veldman and Willmott (2016).

domain. At the same time, the status of and relative relations between concepts like citizens, states, TNCs, and non-govemment organisations (NGOs) in a transnational regulatory domain need to be more closely scrutinised and understood.

I will start by exploring the UK Code of Governance as a model for the spread of notions of self-regulation into Codes of corporate governance worldwide. I will then briefly discuss some limitations and problems of the UK Code, arguing that it implicitly operates on the basis of suasion; that its assumptions have not been re-shaped on the basis of empirical refutation; that it embeds a specific type of political economy; and that it conceptualises corporations as integrated and ultimately controllable entities, thereby ignoring the status of TNCs operating in a transnational domain.

2 The UK Code of Corporate Governance: An International Example

'Corporate governance' refers to the way in which (public) corporations are structured and administrated. More specifically, the theory and practice of corporate governance defines how value created by public corporations is created and divided by setting the conditions for the relations between the corporate entity and its stakeholders, such as shareholders, creditors, boards, managers, workers, and other stakeholders, such as communities, trade unions, and the state.[7] Therefore an understanding of corporate governance has a direct impact on the way contemporary economies function.[8]

Corporate governance codes play a central role in how corporate governance theory becomes embedded and institutionalised.[9] Although it was not the first Code to be issued,[10] the impact of the Cadbury Report—the first instantiation of the UK Code—'cannot be overstated'[11] as it 'sparked a debate on good governance that resulted in the rapid introduction of codes in other countries'[12] and is currently 'widely regarded as an international benchmark for good corporate governance practice'.[13]

The Cadbury Report sparked a debate on corporate governance in response to a longer history of concern by institutional actors (in particular the Financial Reporting Council (FRC), the London Stock Exchange (LSE), and the Institute of

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[7] Aglietta and Reberioux (2005) and Tricker (2015).

[8] Ireland (2005) and Jansson et al. (2016).

[9] Veldman and Willmott (2016).

[10] Aguilera and Cuervo-Cazurra (2009): The first code of corporate governance was issued in the USA in 1978, the second came from Hong Kong in 1989 and Ireland came third in 1991.

[11] Jones and Pierce (2013), p. 31.

[12] Aguilera and Cuervo-Cazurra (2009), p. 378.

[13] Arcot et al. (2010).

Chartered Accountants in England and Wales (ICAEW)) about inadequate board-level controls over management and a string of corporate scandals between 1989 and 1991, which put into question the capacity of the accounting profession to provide adequate transparency and of financial markets to provide adequate monitoring to limit fraud and failure.[14] In response to concerns about the legitimacy of the accounting profession, market monitoring and private regulation, the FRC; LSE; and the ICAEW established the Committee on the Financial Aspects of Corporate Governance, chaired by Sir Adrian Cadbury.[15] Against the historical background, the mandate for this committee was to propose a remedy that would re-legitimate the accountancy profession and market monitoring, while keeping mandatory regulation at bay and keep corporate governance a private and voluntary matter. Through the patronage of its business and government sponsors, the Cadbury Code and the large number of updates and reviews that would together make up the UK Code of Corporate Governance would eventually become a central part of the UK corporate governance system and a formal part of the listing requirements for the LSE.[16]

The Cadbury Report argued that mandatory regulation is counter-productive, both in terms of acceptance and uptake, and in terms of business results with the argument that it 'shackles' corporate activity, distorts or constrains the effective operation of markets, and defeats the purpose of identifying best practices to be emulated.[17] In response, a bespoke approach that offers '... flexibility and intelligent discretion and allows for valid exception to the sound rule.'[18] would become a hallmark of the UK Code. To assuage fears that the Code could be perceived by companies as 'sets of prescriptive rules'[19] or that it would become a 'one size fits all' approach, it is consistently made clear that the Code is not meant to be rigid and that harder regulation is counterproductive as it fosters 'tick-box' behaviour.[20]

Change is perceived to come from ongoing adjustments to corporate strategy by boards on the basis of an ongoing and active process of reflection on the spirit of the Code and the identification and dissemination of 'best practice' in corporate governance. It is assumed that if these processes fail to provide sufficient nudges, the 'comply or explain' procedure will provide sufficient transparency and accountability for vigilant market agents to act on.[21] As the objective is recognition and

[14] Spira and Slinn (2013).

[15] Sir Adrian Cadbury, knighted in 1977, was Chairman of Cadbury Schweppes from 1965 until 1989 before becoming a Director of the Bank of England from 1970 to 1994.

[16] Spira and Slinn (2013) and Jones and Pollitt (2004), p. 10.

[17] Cadbury Committee, 1.9.

[18] Arcot and Bruno (2006), p. 2.

[19] Hampel Report (1998), p. 7.

[20] Arcot and Bruno (2006), Pye (2013), FRCUK (2012) and Roberts and Clarke (2012).

[21] Although the Code is formally a part of the Listing Requirement of the LSE, this element of quasi-compulsion has always been considered the 'nuclear option' and has never been used (Spira and Slinn 2013; Varotill 2017 - this volume). As such it is a formal requirement, but presents an idle threat. (Parkinson 2000, p. 262).

explanation of practices by boardroom members which exceed, or fall short of, 'best practice'[22] it is acceptable, and indeed it is expected, that deviations from the Code will occur and that these will be accompanied by an explanation (hence 'comply or explain'). Against this background, the UK Code explicitly champions non-statutory solutions to corporate governance issues,[23] particularly disclosure, and depends on voluntary compliance by boards and market agents.[24]

The UK Code provided a model for international corporate governance codes that came after it[25]: 'Nearly every corporate governance development in the UK and throughout the world in the past two decades has derived much of its content and inspiration from the Cadbury Report'.[26] Even though the US, particularly after Sarbanes-Oxley, developed a more mandatory rules-based system[27] and although recent developments in the EU, like Directive 2014/95/EU[28] may also spell a move away from a comply or explain approach, the principles-based UK Code of Corporate Governance continues to serve as a model for the development of codes of corporate governance outside the UK. In sum, it can be argued that the soft law 'comply or explain approach to corporate governance developed in the UK Code has become regarded as the 'best practice' of corporate governance in the EU[29] and worldwide.[30] As such, it has provided the basis for a 'more general global governance model'[31] and a worldwide conceptual convergence[32] on standards for corporate governance in a remarkably short period of time during the 1990s and the early 2000s.[33]

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[22]Cadbury Report (1992), 3.10.

[23]Parkinson and Kelly (1999), p. 102.

[24]Cadbury Report (1992), 1.10.

“Backed by transnational institutions such as the World Bank, OECD, IMF and the EU (Aguilera and Cuervo-Cazurra (2009), Horn (2012), Overbeek et al. (2007), but also through the WTO and the Basle Accords (Morgan (2008), p. 641). 64 countries had issued a total of 196 codes by mid-2008 (Aguilera and Cuervo-Cazurra 2009, p. 376).

2SJones and Pierce (2013), p. 31; see also Aguilera and Cuervo-Cazurra (2004, 2009).

“Tricker (2015) and Varotill (2017).

[28]http://ec.europa.eu/finance/company-reporting/non-financial_reporting/index_en.htm.

[29]Keay (2014), p. 282.

“Henry (2008), p. 400; Jordan (2013), p. 9, 26; Varotill (2017).

3'Aguilera and Cuervo-Cazurra (2009), p. 381.

'2'Convergence'... can be described as the way in which a series of actions are driven towards a central point of reference. Convergence is a process towards a common set of principles and objectives ... The word is currently used in the process of convergence between US Generally Accepted Accounting Principles (US GAAP) and IFRS. The process aims at analysing the standards of each of the systems and deciding the best standard. Ugeux (2004), p. 341.

[33]Ugeux (2004).

3 The UK Code and Self-Regulation

The fact that the UK Code has acted as a blueprint and spread assumptions of self-regulation into codes all over the world, invites a critical survey of the way the UK Code functions and the possible consequences of the spread of these assumptions.

3.1 Institutionalisation and Regulation

It has been argued that ‘soft law’ appears as arrangements including principles, voluntary codes, practices, and standards that are not an *absence* of law, but rather present many types of alternative conceptions of control.[34] In the case of the UK Code, we find that the UK’s pattern of enforcement has a distinctly informal hue. Regulation formally takes place through public agencies, but ‘the lion’s share of the interventions by the relevant agencies—the Takeover Panel, the Financial Reporting Review Panel, and the Financial Services Authority—is of an informal character, not resulting in any legal action’. As ‘strong informal private enforcement has historically therefore been the flipside, in the UK, of weak formal private enforcement’ and as ‘suasion, rather than sanction, is the order of the day’,[35] it makes sense that formal private enforcement plays little or no role in controlling managers, and shareholder lawsuits are conspicuous by their absence.[36]

The UK Code can be understood as the continuation of a specific approach to regulation:

> even prior to the Cadbury Code, a standing example of a self-regulatory code has been the City Code on Takeovers and Mergers to establish a flexible mechanism ... with ‘soft’ powers of enforcement such as ‘cold-shouldering’, which strike at the heart of the reputation of various players in the takeover market ... the erstwhile practice of relying on voluntary compliance by various market players largely continues.[3] ’

The UK Code can also be understood as an approach to regulation that is preferred by particular types of agents[38]: ‘the role of a small community of institutional investors, who interacted frequently with one another and with investee firms, facilitated the establishment of self-regulatory bodies and lobbied for rules that protected shareholder entitlements and have gradually been put upon a

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[34]See Gopalan, this volume.

[35]Armour (2008), p. 2.

[36]See also Armour et al. (2009) and Varotill (2017).

[37]Varotill (2017).

[3s]Varottil similarly argues that ‘... a voluntary approach has been orchestrated in the UK by its large and influential pool of institutional investors’ who ‘... preferred a voluntary mechanism for regulating their affairs as well as those of the companies in which they invested’ and who saw 'the use of a voluntary code of conduct... as an effective method to forestall more stringent mandatory rules.’ (Varotill 2017).

formal legal basis, such that they are now public agencies. This has led to a situation where ‘their approach to enforcement still retains much of the informality and focus on reputation that characterised self-regulation.’[39] In a context where reliance is placed on control that is typically exercised behind the scenes, and the capacity of business elites to adopt best practices and reflect on the spirit of a Code, the reliance and focus on self-regulation in the UK Code of corporate governance can be understood in relation to a belief that particular agents, notably government agents and institutional investors, are best placed to provide effective guidance to business elites through informal means.[40] In this context, the Code’s explicit argument against mandatory legislation, the explicit reliance on self-regulation and the belief in the capacity of anonymous market actors to provide monitoring and control can be related to the trust that is placed in the capacity of strong informal institutions to provide monitoring and compliance, notably through suasion and peer pressure by business and regulatory elites.[41] [42]

It may be argued that this implicit reliance on informal institutions is problematic in an international context for two reasons. Firstly, the overall necessity for the presence of strong institutions to deal with corporate governance issues is clear. As Varottil argues:

> a market-oriented approach would function effectively only if it is supported by a system of legal institutions and mechanisms with strong foundations. These include a robust company law (such as fiduciary duties imposed on directors) and an efficient enforcement mechanism through courts. The presence of sophisticated market players and gatekeepers such as independent directors, auditors and compliance professionals will ensure third-party monitoring as a means to ensure enhanced corporate governance.[42]

What we find in the UK context is that the type of self-regulation presented in the UK Code is explicitly premised on self-regulation, but mitigated by the presence of strong formal institutions and by a reliance on the effectiveness of informal suasion. If it is not clear that notions of self-regulation are mitigated in these ways, they may well have unwanted effects in other jurisdictions. Secondly, as the principles-based UK code increasingly presents the dominant model for ‘good’ corporate governance and ‘best practice’, and as such notions of ‘best practice’ increasingly come to permeate benchmarks for capital market actors and insurers, regulators and standard setters in other jurisdictions are increasingly faced with the necessity to adopt the ‘comply or explain’ approach and the soft law assumptions it represents, irrespective of their particular assumptions about regulation, and irrespective of its applicability to their jurisdictional ownership and control structures.[43] However,

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[39]Armour (2008), p. 61.

[40]Within the UK, reliance on such behind-the scenes arrangements is increasingly being questioned, particularly in the light of the changing composition of ownership and control in the UK as a result of increasing foreign ownership (see Tsagas 2014).

[41]Arcot et al. (2010), p. 200; see also Van Bekkum et al. (2010), p. 29.

[42]Varotill (2017).

[43]Larsson-01aison (2014) and Varotill (2017).

the UK Code is premised on very specific notions of ownership, board structures, and control. These notions include dispersed shareholding; a separation between ownership and control; a unitary board structure and well-functioning capital market controls.

Using these assumptions in relation to other shareholding and control models may well have unwanted consequences. Varottil argues that 'companies with concentrated shareholding are less likely to promote voluntary disclosure due to their ability to generate private information and benefits' and that 'the incidence of non-compliance with voluntary norms [are] greater among firms owned by business families, founders or heirs.' This leads him to argue that because the UK Code puts 'little emphasis ... on the equitable treatment of different groups of shareholders' it is 'not tailor-made to a context where dominant shareholders, e.g. promoters, control management and where the corporate governance problem is chiefly one of the protection of minority shareholder rights.'[44] [45] In fact, using the assumptions underlying the UK Code in blockholder-controlled systems may well be counter-productive, as 'opacity without mandatory rules is likely to adversely affect the interests of minority shareholders.'[4j] Similarly, there is evidence to suggest that companies under strong managerial control and with limited minority shareholder influence provide an ownership structure that allows managers 'not to commit themselves to transparency requirements' if they have incentives to do so.[46] Consequently, commentators have argued that in jurisdictions like Sweden, India and Hong Kong, regulators merely pay lip service and show outward compliance to the UK model, as this is necessary in order to secure continuing access to international capital markets. In practice, however, they will tweak the (informal) understanding of and compliance regime for corporate governance codes in their jurisdictions in such a way that they are better suited for the conditions in their own jurisdictions.[47]

3.2 Empirical Issues and Political Economy

Basing corporate governance codes worldwide on ideas of self-regulation may be problematic, but the trust placed in these informal institutions in the UK is arguably just as problematic. When the Cadbury Report was presented, it was understood that it was a rather urgent attempt to restore public confidence in self-regulation by boards, the accounting sector, and market actors.[48] In this context, it is interesting to note that reflection on the 'spirit', rather than the letter of the Code, is, at best, lacklustre. It has been reported that the Code has been met with 'creative

[44] Varotill (2017).
[45] Varotill (2017).
[46] Andres and Theissen (2008) and Arcot et al. (2010).
[47] Larsson-01aison (2014) and Varotill (2017).
[48] Spira and Slinn (2013).

compliance'[49][50] and with boilerplate 'comply or explain' statements.[30] A recent review of the operation of the Code undertaken by accounting firm Grant Thornton observed that full compliance, including 'creative compliance', with the Code has been in the region of 50%.[51] It has also been reported that explanations are rarely evaluated, and that non-compliance is typically not followed by a clear market response.[52] Similar responses have been reported from India.[53] We may argue, then, that the adoption of the principles behind the UK Code model of regulation has resulted in 'weak monitoring and enforcement mechanisms'[54] and has not managed to restore the broad public confidence in boards, accountants, or private market actors in the way that it was envisaged by the authors of the Cadbury Report and the subsequent iterations of the UK Code.

3.2.1 Political Economy

The empirical problems with the UK Code are compounded by its broader embedding of a very specific idea of political economy in corporate governance. The UK Code presents corporate governance as an exclusive dyadic relation between two constituencies: owners (shareholders) and senior executives (board of directors). In this reduced dyadic conception of core constituencies, serving the shareholders becomes central to the purpose assigned to boards, and concepts of accountability, transparency, compliance, and disclosure become directed exclusively toward these two constituencies.[55]

This limited framing of corporate governance for Public Limited Companies (PLCs) is problematic in relation to a broader concept of the legitimation of PLCs, and its outcomes in terms of political economy in the economies in which they operate.[56] More specifically, this limited framing is problematic in relation to the UK Code's conceptions of self-regulation. The UK Code legitimises self-regulation at least in part on the basis of an appeal to 'enlightened shareholder value' in boards and executives, and 'stewardship' by market parties (notably institutional investors) as a safeguard for broader interests, such as a long-term perspective on the firm and its operations, and the interests of other stakeholders. However, as the Code imparts a clear shareholder value-oriented notion of corporate governance, not just in its basic assumptions about monitoring and accountability, but also in its institution and operation, the UK Code consistently directs shareholders, boards, and

[49] Spira and Slinn (2013), pp. 190-191.

[50] Aguilera and Cuervo-Cazurra (2009), Arcot et al. (2010), Keay (2014), Spira and Slinn (2013).

[51] Grant Thornton (2013).

[52] Aguilera and Cuervo-Cazurra (2009) and Keay (2014).

[53] Varotill (2017).

[54] Aguilera and Cuervo-Cazurra (2009), p. 383.

[55] Blair (1995), Gospel and Pendleton (2003), Horn (2012), Parkinson (2003) and Tsuk (2003).

[56] See www.themodemcorporation.com for a broad academic project on these topics.

executives to run companies for the production of shareholder value, while obscuring the role of long-term perspectives and broader stakeholders interests in the exercise of corporate governance.[57]

3.2.2 Shareholder Value and Stewardship

An example of the limited uptake of such broader perspectives and interests is provided by the way institutional investors relate to calls for stewardship. In the UK Code, shareholders are the main providers of adequate oversight and compliance. As Varottil argues, 'the "comply or explain" approach works only if shareholders shed their passive stance and take on a more active role in companies based on disclosures made by them regarding compliance (or otherwise) with the corporate governance norms.'.[58]'Enlightened shareholder value' is invoked to coax shareholders to work with a long-term view toward companies. In the case of institutional investors, the FRC has produced a 'Stewardship Code' aimed at pension funds and other institutional investors to emphasise that adopting a longer-term perspective and the interests of broader groups of constituencies—notably by aligning with the broader interests of their end beneficiaries—promotes the long-term success of companies 'in such a way that the ultimate providers of capital also prosper' and, thereby, will benefit 'companies, investors and the economy as a whole'.[59] The notion of 'stewardship' is thus a more specific notion of 'enlightened shareholder value', which focuses on the capacity of institutional investors to monitor boards and to coax them through their market positions and through direct engagement to improve long-term, risk-adjusted returns to shareholders and to address the broader short-termist tendencies of markets and boards alike.[60]

However, the concept of 'stewardship' works on the basis of a number of problematic premises. For instance, to make 'stewardship' work, institutional investors need to be able to operate as a relatively tight and coordinated front, with clear and coordinated goals. However, in the UK in 2012 institutional investors held only 41% of shares while foreign investors also held 41% of shares.[61] Foreign investors may be assumed to be not very interested to work together with local investors, and more interested in a direct return on investment (ROI) and will engage less with boards on long-term outcomes.

Another problematic premise is the idea that institutional investors would operate in the interests of end beneficiaries. Although the Myners Report (2001) found that a misalignment between asset managers' incentives and end

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[57]See Veldman and Willmott (2016).

[58]Varotill (2017).

[59]FRC (2012), p. 1.

“See Cheffins (2013) and De Graaf and Williams (2011).

[6I]UK Office for National Statistics (2012), p. 3.

beneficiaries' interests could provide a problem in the provision of 'stewardship', it has since been argued that the practical diversity of interests in end beneficiaries, and the fact that these interests can shift over time, makes the imposition of presumed shared interests, other than financial ones, very complicated.[62] Melis (2014) finds that institutional investors identify their relative financial performance as their primary interest, while Calpers, a major Californian pension fund, virtually invented the concept of shareholder value, even as it was explicitly acknowledged that this goal could harm the interests of its own end beneficiaries.[63]

Another issue is that institutional investors are not always free to choose their investment strategy. They have to be wary of the role of rating agencies, who use a limited set of benchmarks to evaluate their performance. Similarly, insurers—including those who insure board members' liabilities—apply a limited set of benchmarks to assess adequate strategy setting. Under these conditions, it is not surprising that the Kay Review[64] noted that asset managers working for institutional investors typically have a 'short performance horizon'. Moreover, institutional investors gain advice on engaging with corporate strategy from a very limited set of proxy advisers, who have specific ideas about how to use their considerable proxy voting rights.[65] Finally, shares are often held in and traded by intermediaries, who also operate under conditions in which they need to produce ROI.

There is, then, a mutually reinforcing relation between an institutional setting that clearly prioritizes shareholder value, and the directedness of (institutional) investors toward the market, rather than the firm. Under these conditions, the belief in the willingness and capacity of (institutional) shareholders to act as old-fashioned quasi-owners[66] who can and will provide effective oversight and control for the benefit of (long-term) interests of companies and other constituencies[67]; who can and will retain their long-term liabilities were other investors would not[68]; and who will not apply pressure on corporate boards to serve their own short-term interests, even if other might do so to engage in free-riding behaviour at their cost, seems a rather romantic and misplaced idea.

As a regulatory framework that appeals to self-regulation will in practice orient the objective of the company and its control, and the objective of the monitoring by market-based parties directly toward the creation of shareholder value, the notional appeal to 'enlightened shareholder value' and 'stewardship' will become subsumed by the overriding political economy presented by the Code.[69] In turn, a shareholder value-oriented compass for corporate governance creates a set of institutional

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[62]Archer (2011) and Mayer (2013).

[63]Archer (2011).

[64]Kay Review (2012), 5.18.

[65]Johnson and Millon (2005).

[66]See Johnston and Morrow (2015).

[67]See Millon (2013).

[68]See Tsagas (2014).

[69]For a broader discussion, see Veldman and Willmott (2016).

conditions that makes it largely illusory to rely on market parties like institutional investors to provide adequate protection for other constituencies' interests or to provide a long-term perspective to companies.[70]

As such, the UK Code exports a model for self-regulation into corporate governance codes worldwide based on highly specific notions of political economy, which stacks the odds against a long-term perspective on corporations and the inclusion of broader constituencies' interests. It is noteworthy that this approach to regulation and to political economy is not fundamentally questioned, even in the face of quite overwhelming empirical problems, including non-compliance by companies, lack of adequate monitoring by market actors, and corporate governance crises of increasing severity.[71]

3.3 Transnational Domain and TNC

The reported theoretical and empirical problems provide reasons to wonder whether business and regulatory elites are de facto capable of providing informal enforcement through suasion in the UK itself. I have also illustrated why a reliance on informal enforcement may be even more problematic in relation to the spread of Codes internationally. I now add a final concern, which is the spread of the assumptions behind the UK Code in relation to the transnational corporation (TNC).[72]

Ideas of regulation, whether self-regulation and principles-based, or 'hard law' and rules-based, are typically built on the assumption that a state can control and regulate a clearly defined business entity. In this framing, the object for self-regulation, also in the UK Code, is typically conceptualised as a singular entity, operating in one jurisdiction. When these assumptions are spread into codes around the world, however, they come to permeate regulatory assumptions that apply not just to jurisdictionally constrained singular 'entities', but also to the corporate group, commonly understood as a TNC.

Arguably, the emergence of the TNC has enabled an enormous turnaround of the organisation of the worldwide economy and a move toward transnational organisation of global value chains. However, the TNC continues to operate as a very

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[70] See also Arcot et al. (2010), Mayer (2013) and Tsagas (2014).

[71] Veldman and Willmott (2016).

[72] TNC: 'a multinational or transnational corporation refers to a firm with subsidiaries located in two or more countries. The subsidiaries of a transnational corporation, moreover, are generally involved in production or in an economic activity (...) The structure and operations of the transnational or multinational corporation, however, do foster a global perspective within the enterprise in the sense that decisions are made from the standpoint of the corporation's global activities and needs.' Bowman (1993), p. 61.

poorly theorised legal and economic construct. As Robe has argued, TNCs are not corporations, because they do not exist as coherent ‘entities’.[73] Corporate groups consist of separate legal entities, which all hold their own separate attributions of agency, ownership, and rights, and which are all endowed with limited liability. As the TNC is only recognized as a group of separate national companies established under the laws of different countries, it is not an integrated entity and cannot be addressed as such under international law.[74] These corporate groups without a clear conceptual status operate in a transnational domain where states have no direct jurisdiction and limited capacity to regulate.[75] The law applicable to subsidiaries is generally the law of the jurisdiction in which that ‘entity’ has been set up. As a result, the attribution of legal responsibility or liability has to be established with the help of collections of entities, constituted in different jurisdictions and set up for various purposes.[76] These issues spread into corporate governance arrangements. As fiduciary duties for directors extend to subsidiaries, rather than to the group, the question is how board duties relate between entities in corporate groups.[77] Moreover, as neither the country of incorporation nor the country where the holding company is based can be designated as the exclusive ‘seat’ of the corporation[78] it is ‘... hard even to identify to which country multinationals ‘belong’.[79] For these reasons, it has been observed by some that the gradual spread of the TNC from the 1950s onwards necessitates the introduction of a new transnational framework for regulation.[80]

However, rather than a comprehensive regulatory framework under the auspices of citizens and states, the production of international corporate governance codes and regulations that apply to the transnational domain are typically produced by

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[73]‘Any legal analysis of the enterprise comes up against this irritating fact: although the enterprise is perceived in economic and social life as a unit, positive law is not in a position to assemble its various components in a unitary construction.’ Robe (1997), p. 52.

[74]In a transnational domain ‘... only states and individuals are currently considered to be subject to international law, conventions and jurisdictions.’ Queinnec and Bourdon (2010), p. 57.

[75]Abbott and Snidal (2000) and Veldman (2013).

[76]See Hansen and Aranda (1990), Morgan (2008); The multiplicity of assumptions at play in relation to the TNC can be used to '... choose among various legal systems, applying economic criteria to their choice of which set of labor, social, and environmental regulations they will operate under’ (Scherer and Palazzo 2007, p. 1101), and to evade ‘. . . the regulatory claims of national and international law’ (Teubner 1997, p. 770). As a result, the TNC can be used to construct special purpose vehicles, defensive asset partitioning, and transfer pricing that enable the containment of legal and financial liabilities. This facilitates the division of liabilities and assets in separate legal ‘entities’, the routing of financial streams through particular tax regimes, and the sheltering of wealth in tax havens, the continuing evasion of criminal liability and taxes; and provides the conceptual means for regulatory evasion and arbitrage (see Jones and Haigh 2007; Palan et al. 2010; van Oosterhout 2010; Robe 2011; Wilks 2013).

[77]See Keay and Loughrey (2015).

[78]Dine (2006).

[79]Avi-Yonah (2011) and Scott (1981).

[80]Hansen and Aranda (1990) and Macleod and Lewis (2005).

private industry and professional associations.[81] As these often include the very TNCs that are the object of these governance codes[82] such codes are typically conducive to the adoption of 'norms and institutions conforming to the interests of enterprises'[83] and aim at self-regulation.[84 85] Devolving state powers to regulatory 'agents' like NAFTA, ASEAN, IMF, and the World Bank, which chain nation states to supra-national regulatory principles, makes this situation even more problematic.[83] In the absence of both a clear conceptualisation of the corporate group and a clear transnational framework for the regulation of TNCs, the adoption of self-regulatory regimes in jurisdictions worldwide seems to create an accountability gap.[86]

4 Discussion and Conclusions

I have explored the role of the UK Code as a prime example of 'soft law' and found that the architects of the Code provided a nominally private Code that endorsed an explicitly voluntaristic framework for regulation in the hope to forestall calls for mandatory regulation and provide a re-legitimation of self-regulation and market-led monitoring.[87] The spread of these assumptions of self-regulation into international Codes seems problematic for four reasons:

Firstly, in the functioning of the Code regulation is not absent, but rather becomes implicit as the capacity of elite actors to provide suasion behind the scenes becomes the primary means for enforcement. Implementing self-regulatory codes of corporate governance in other jurisdictions without embedding such codes in this implicit institutional background misrepresents the locus and capacity for regulation. The potential issues with this misrepresentation will become exacerbated in jurisdictions that lack sufficiently strong regulatory institutions of an explicit or implicit nature. The potential issues will also become exacerbated if exported to jurisdictions that have different ownership and control mechanisms, where the push toward self-regulation may effectively be counterproductive in terms of producing more monitoring and transparency. In both respects, it is worthwhile to consider the specificity of jurisdictional contexts before considering the UK Code an example of 'best practice' in the development of corporate governance codes.

Secondly, and in relation to this institutional background, a substantial number of empirical problems with the operation of the UK Code seems to be recognized

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[81] Morgan (2008).

[82] van Oosterhout (2010), p. 257.

[83] Robe (1997), p. 71.

[84] Crane and Matten (2005) and Scherer and Palazzo (2007).

[85] Robe (1997), p. 62.

[86] Jones and Haigh (2007), McLean (2004) and Veldman (2013).

[87] See Henry (2008), Parkinson (2000), Parkinson and Kelly (1999) and Pye (2013).

but left unaddressed. The apparent failure by regulatory elites to produce enough 'suasion' to convince business elites to address consistent empirical failings and non-compliance with respect to the comply or explain regime, but also to exercise sufficient self-constraint in the face of major irritants to the broader public like rising executive pay,[88] seems to indicate a failure of the capacity for effective informal behind-the-scenes pressure that was the basis for the adoption of a self-regulatory regime. The importance of a failure to provide effective suasion was well recognized by Cadbury, who repeatedly warned that the failure of regulatory and business elites to comply with the Code, would eventually invite consideration of stronger interventions and mandatory regulation by regulatory authorities.[89] It was well understood at the time the Cadbury Report was presented that hard law, direct intervention by regulators, and potentially even calls for nationalisation were the elephants in the room that would not be addressed in the discourse and practice of the UK Code, in exchange for the unmitigated active adoption of the 'spirit' of the 'comply or explain' regime and its unspoken assumptions by business elites.[90]

Thirdly, the UK Code projects a restricted notion of corporate purpose subsumed under the political economy of shareholder value, which limits concepts of accountability, transparency, compliance, and disclosure to a reduced dyadic conception of core constituencies and the object of monitoring to the production of market value. In this institutional setting appeals to self-regulation will in practice orient the objective of the company and its control exclusively toward the creation of shareholder value, while appeals to monitoring by market-based parties directly on the basis of ideas like 'enlightened shareholder value' and 'stewardship' will similarly remain subsumed by the overriding political economy that is endorsed by the Code. The shareholder value-oriented compass for corporate governance adopted by the UK Code thus creates a set of institutional conditions that makes it largely illusory to rely on boards or market agents to provide adequate protection for other constituencies' interests or to provide a long-term perspective to companies. As such, the UK Code exports a model for self-regulation into corporate governance codes worldwide based on highly specific notions of political economy, which stacks the odds against a long-term perspective on corporations and the inclusion of broader constituencies' interests.

Fourthly, the unclear legal status of the TNC, especially with regard to its legal status in a transnational domain leaves states with little or no means to regulate such 'entities'.[91] Applying assumptions of self-regulation beyond the clear and confined context of a single jurisdiction like the UK and effectively applying these assumptions toward TNCs in their capacity as corporate groups further complicates the

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[88] See Cadbury (2002) and Tricker (2015).

[89] Cadbury (2002) and Spira and Slinn (2013).

[90] See Arcot and Bruno (2006), Bowden (2000), Cadbury (2002), Cadbury Report (1992), 1.10; Spira and Slinn (2013).

[91] Murphy and Ackroyd (2013), Robe (1997) and Veldman (2013).

basis for the development and application of regulation for entities that operate in the transnational domain.

Overall, the use of the UK Code as a model for corporate governance codes internationally should be scrutinized for four main reasons. Firstly, the UK Code relies on highly specific implicit assumptions about the institutional framing that governs corporate governance arrangements, and notably the capacity for control. In this respect, the specific political and control conditions that govern corporate governance arrangements in other jurisdictions should be considered carefully before adopting the assumptions of the UK Code as 'best practice'. Secondly, the UK Code implicitly relies on active compliance by business actors, diligent monitoring by capital market actors, and effective suasion by regulatory actors. However, these actors fail to effectively address ongoing non-compliance, ignoring the 'spirit' that allowed for a self-regulatory code. Thirdly, the UK Code entrenches a notion of political economy that projects a problematic compass for corporate control and monitoring. Finally, applying self-regulation beyond the clear and confined context of a single jurisdiction and toward the regulation of entities that operate in the transnational domain undermines the capacity for states to regulate such transnational entities.

For these reasons, it may be considered that reliance on self-regulation, principles-based regulation, or 'soft law' may have some beneficial outcomes,[92] but that these ideas of corporate governance and regulation need to be contextualised in relation to the effectiveness of the institutional structures that shape and sustain the global political economy.

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[92]Abbott and Snidal (2000).

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