Research report 125

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Shareholder Primacy in UK Corporate Law: An Exploration of the Rationale and Evidence

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Glossary

BIS	Department for Business, Innovation and Skills
CA 2006	Companies Act 2006
CLR	Company Law Review
CLRSG	Company Law Review Steering Group
ESV	Enlightened shareholder value
MSV	Maximisation of shareholder value
OFR	Operating and Financial Review

Executive summary

The aim of the research project described in this report was to examine the rationale for the traditional business objective in the UK, which is the maximisation of shareholder value (MSV). The project included an analysis of relevant aspects of the Company Law Review (CLR) process in the UK, which ultimately led to the Companies Act 2006 (CA 2006) and which determined that shareholder primacy would be maintained as a key principle of UK company law. The CLR had raised the central question: 'in whose interests should companies be run?' and put forward two alternatives: one based on shareholder primacy, and the other based on balancing the interests of a range of stakeholders. The two alternatives were described as 'enlightened shareholder value' and 'pluralism'.

Specific objectives of this research report included a review of the relevant literature; a study of the official documentation issued in connection with the CLR, insofar as this related to the question 'in whose interests should companies be run?'; an examination of contemporaneous views and debate about the CLR process by studying media coverage of the issues; and ascertaining the views of key individuals who carried out the CLR about how the central question of 'interests' was considered, and about the evidence that was used as the basis for their recommendations.

The main findings of this report are based on interviews held with 15 individuals, most of whom were directly involved in the CLR, as well as evidence from the literature. The CLR was typically seen as a useful tidying up and modernising exercise; it was also generally thought by those involved to have been very ably led. Even so, one of the most striking findings from these interviews was the frustration and strength of feeling about the real value of the CLR exercise among some of those who were closely involved.

The CLR's consideration of the central debate between enlightened shareholder value and pluralism was described as a 'waste of time' by one steering group member, who thought that there was never any intention to have a 'meaningful discussion of the issues'. Another steering group member said there was little interest in discussion of principles or 'the bigger picture'. Other participants took a quite different view: it appeared to the researchers that those who supported the 'enlightened shareholder value' outcome were generally content about the quality of the examination that took place, while those who leaned to the 'pluralist' view, which was rejected, were very much less so. Having said that, a number of interviewees, even some who were supportive of its outcomes, felt that the breadth of expertise and opinion represented on the CLR was rather narrow; and a more critical view was that it was set up to fail.

One response to a question about the evidence that was considered as part of the CLR was that the process was 'less a matter of evidence and more one of debate', though it was also suggested that the knowledge and experience brought to the CLR by the participants meant that evidence was not lacking. Nonetheless, a very specific criticism was the absence of discussion of comparative international evidence. A detailed consideration of differing types of capitalism, including the significance of legal traditions, is a feature of the literature review in this report. A key part of that review is the description of two competing approaches to capitalism that are widely acknowledged. One approach, the Anglo-American, is found in the developed English-speaking countries, and is sometimes characterised as 'stock market capitalism', in contrast to what may be called 'social market' capitalism, which can be found, in differing forms, in continental Europe and in Japan. Arguably, the central feature distinguishing these two approaches is the objective that companies pursue. In the Anglo-American countries this is typically MSV, while traditionally in the other group a balance is struck between the interests of different stakeholder groups. Thus the two approaches may be characterised as 'shareholder value' and 'stakeholder' capitalism respectively, corresponding to the alternatives presented by the CLR. It is also worth noting that, within the literature and in the business media, there have been calls for the 'shareholder value' model to be adopted in what have traditionally been 'stakeholder' countries, though such arguments have also been strongly challenged.

Interviewees were asked about the new wording for directors' duties introduced by CA 2006. This wording requires directors to 'promote the success of the company for the benefit of its members…' while having regard to the interests of others (see Appendix 1). This form of wording is regarded by some as giving more acknowledgment to the interests of stakeholders (other than shareholders) than the wording it replaced. There is also a view that it does the opposite. Since the old wording referred to 'the company' rather than members, the new wording can be seen as making shareholder primacy more explicit. The wording was summed up as 'a fudge' by one of our interviewees. What was made very clear in the interviews was that shareholder primacy was the intended outcome – and this was the unequivocal understanding of all the interviewees.

Interviewees were asked whether directors' duties amounted to a duty to maximise shareholder value, and broadly speaking this was agreed. While there were differing views over whether this meant maximising share price in the short term, interviewees from the corporate sector thought that this was exactly what it meant. Some interviewees questioned the importance of the legal wording on directors' duties and noted that shareholder-value rhetoric in the US and UK was a result of pressure from the financial markets rather than legal requirements. It was also thought, however, that a 'shareholder primacy legal framework' readily lent itself to a shareholder-value rhetoric whose emphasis on a single financial metric was implicated in the phenomenon of 'financialisation', and specifically in high levels of executive remuneration and the financial crisis.

In relation to differing forms of capitalism, interviewees did recognise MSV and shareholder primacy as identifying characteristics of Anglo-American capitalism, though some interviewees were also quick to point out some differences between the US and UK. Evidence that poorer societal well-being is associated with the Anglo-American model of capitalism was presented to interviewees for their reaction. Such evidence is extensive and shows that a range of health and other 'quality of life' indicators are highly correlated with income inequality. Among the developed OECD countries, higher inequality is associated with countries that have traditionally followed a 'shareholder value' rather than a 'pluralist' approach to business objectives. In particular, interviewees were asked whether such evidence could be considered relevant to any review of the laws governing corporate conduct. Views varied a great deal; some were sceptical about the evidence and some were not, but most interviewees thought that the evidence merited serious consideration in any future review of the legal framework governing companies.

Although it was not a main focus of the research, the critically important question of the compatibility of MSV with ecological sustainability was also addressed in the interviews. Some interviewees thought the two could be compatible if a long-term view were to be taken of MSV; others took the view that a maximising ethos could conflict with, and encourage resistance to, regulatory constraints.

RECOMMENDATIONS

The extensive literature reviewed as part of this project and the evidence provided by the empirical work suggest that the issues outlined above justify a re-examination of central aspects of company law in the UK. The findings suggest that the question 'in whose interests should companies be run?' was not seriously examined as part of the CLR, and this is certainly the view of a number of the participants. MSV, as an established corporate objective, and the accompanying shareholder-value rhetoric have arguably contributed to the recent financial crisis through the pursuit of a single objective at the expense of long-term prosperity and wider social considerations. In particular, there is evidence to suggest that Anglo-American countries have a 'case to answer' in regard to their consistently poor measures of social well-being relative to those of other developed economies that typically pursue a 'stakeholder', rather than a 'shareholder' model of capitalism. This evidence was not considered as part of the CLR and, according to some, though not all, of the interviewees, this should be considered in any reappraisal of company objectives.

In addition to the central focus of the research, the interviewees raised other specific issues as meriting re-examination in any such future review of company law. They gave some emphasis to four issues, in particular. First was the need for greater corporate accountability: the original proposals for the Operating and Financial Review were thought to merit particular reconsideration; another was a recommendation made by the CLR (which the government had not adopted) for a standing body to keep company law under review. The other two issues were linked to potentially perverse consequences of maximising shareholder value: these were the regulations governing the market for corporate control in the UK, and the level of directors' remuneration.

1. Introduction

This report examines the rationale for what is arguably the central characteristic of the 'Anglo-American' business model. This central characteristic is the widespread acceptance of the maximisation of shareholder value (MSV) as the fundamental objective of business activity.

In the UK context, this subject was explicitly considered during the process that culminated in the introduction of the Companies Act 2006 (CA 2006). That process included the Company Law Review (CLR), which began in March 1998 and whose *Final Report* was issued in June 2001, and continued through various parliamentary stages before the new act became law in November 2006.[1]

The CLR explicitly addressed what it termed 'the question of "scope" – ie in whose interests should companies be run' (CLRSG 2001: 41). The outcome of the CLR was clear support for shareholder primacy with 'the basic goal for directors' being 'the success of the company in the collective best interests of shareholders' (CLRSG 2001: 41). The resultant CA 2006 requires a director to 'act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole', though directors must also 'have regard to' a range of other interests, including those of employees, the community and the environment (Ch. 2, Pt 10, 172 (1)).[2]

The scope of this research project included an examination of the process that led to this conclusion in the CA 2006, and a consideration of its outcomes. The methods used included a review of relevant documentation; an examination of the coverage of the CLR in the business media; and interviews with a range of interested parties, including members of the CLR Steering Group (CLRSG), members of other CLR working groups, and individuals with board-level experience of listed companies. A detailed outline of the research methods employed is given in Appendix 2. While the main empirical focus of this research was therefore the UK, a key aspect of this study is a consideration of the wider international context as a basis for evaluating alternative approaches to the conduct of business. This wider context is provided by a review of the relevant literature.

A very important implicit restriction in both the empirical and literature-based components of this research should, for clarity, be made explicit here. The focus of the research was 'large companies with real economic power' (to borrow a form of words from CLRSG, 2000a: 13), not smaller private companies that happen to share a similar legal status but that are, in substance, very different entities. It should be noted that the CLR explicitly highlighted this difference and sought to recognise the needs of small companies separately in its deliberations.

The study was motivated firstly by interest in what have been termed different 'varieties of capitalism' and the evidence that the literature on that topic may provide in assessing the case for or against MSV. Secondly, there is growing evidence among wealthy countries of systematic differences across a range of indicators that measure quality of life and are correlated with income inequality. One aim was to explore what links this evidence may have, or be perceived to have, with corporate law and culture. Thirdly, the recent and continuing financial crisis has given a fresh impetus to questions about the ways that business activity is financed and conducted in different parts of the world.

The current study explores one conjecture implicit in the previous paragraph. It is that the fundamental objectives that guide business strategy and operations can have both economic and social impacts and that evidence about the latter in particular could play some role in assessing the regulatory framework within which business operates. This conjecture appeared to be uncontentious, according to a ministerial statement made during the CLR process.

> *The key to shaping the market in ways that achieve our twin objectives of efficiency and social justice lie in the framework of rules within which companies do business and make a profit. So company law and corporate governance are at the heart of our debate about the kind of society we want and the nature of our economy.*
> (Byers 2000)

There is, of course, a lively debate about the interests that business should serve, which arguably reflects the perceived significance of the issue for wider society. The central dispute concerns the right of one particular stakeholder group in business, the shareholder group, to have its interests maximised. This debate is, of course, deeply political although within the disciplines of accounting and finance it scarcely seems to take place at all, at least within Anglo-American culture, possibly because the language of accounting precludes it. 'Profit' is the share of the cake allocated to shareholders while the slices going to all other participants are called 'costs'.

1. The provisions relating to directors' duties – which are the main areas of interest of this study – came into force on 1 October 2007.

2. The relevant form of words in the CA 2006 as well as the superseded wording in the Companies Act 1985 are reproduced in full in Appendix 1.

While there are a number of different models of capitalism in developed economies a distinction is often made between two broad approaches. These may be characterised as the Anglo-American 'stock market' model in which MSV is the typical objective of companies, and the 'social market' model of capitalism in which, traditionally, a balance is struck between the interests of different stakeholders. The social market model, in differing forms, is associated with a number of continental European countries and Japan (Albert 1993; Coates 2000; Dore 2000; Hutton 1995, 2003). This dichotomy is examined within the literature review and its relevance highlighted for the debate that occurred within the CLR.

The rest of this report is organised as follows. Chapter 2, which follows, reviews the literature concerning shareholder primacy and possible alternatives. The chapter initially examines different models of capitalism before rationales for and against shareholder primacy are discussed. Finally, aspects of law and legal traditions are considered in this chapter.

Chapter 3 presents a brief overview of relevant aspects of the CLR process and the subsequent events that led up to CA 2006. It also reviews how the central issue of directors' duties was reported and discussed in the business media, specifically the *Financial Times*.

Chapter 4 contains the main empirical contribution of this project; it reports on a series of in-depth interviews with a range of interested parties, the majority of whom were directly involved in the CLR itself. Interviewees were asked their views about: the CLR process, including the range of expertise and opinions upon which it drew; the evidence that was considered; and the potential significance of its outcomes for the operation of companies and for wider society.

Chapter 5 concludes this report by providing a summary of the findings and offering recommendations.

2. Literature review

Given the broad economic and social significance of the legal framework governing corporate conduct, this study draws on three broad contextual areas and our review of the literature reflects these groupings. These areas may be labelled: 'varieties of capitalism', 'the rationale for shareholder primacy', and 'legal issues'. While this classification facilitates a broad analytical structure, it is intentionally simplified. There are obvious links between these groupings, some of which we explicitly identify; and much of the literature does not, of course, fit neatly into any one area. The issue of shareholder primacy has occasioned a great deal of debate and that debate is reflected, albeit briefly, in this chapter. The case for, or against, shareholder primacy may be based on evidence of its outcomes and on a priori reasoning. The next section, on varieties of capitalism, provides some of that evidence while the subsequent section considers the reasoning that has been advanced by a number of parties. This order of presentation is chosen because reasoning must be based on assumptions and arguably the validity of such assumptions is best judged by reference to evidence. The final section considers explanations based on legal traditions to account for differing approaches to capitalism: it also outlines the legal literature that has directly addressed shareholder primacy in the UK.

In addition to these areas of literature, another 'analytical component' of significance for this review, and for the project as a whole, is the time dimension. This is not explored as a separate section but the dynamic nature of the issues considered in this report should be borne in mind and will be highlighted where appropriate. Key developments have been, firstly, the phenomenon of 'financialisation'. This term may be open to a number of interpretations (see Epstein 2005) but one of these is 'the ascendancy of "shareholder value" as a mode of corporate governance' (Krippner 2005: 181; and see also Dore 2000: 4–5) in recent decades. Secondly, there were the company scandals of 2001 and 2002 that prompted some debate about corporate governance and the objectives of the corporation. Thirdly, of course, the recent financial crisis generated topical and fundamental debate about the nature of markets and capitalism (see, for example, the series of articles published on 'The Future of Capitalism' (*Financial Times* 2009). All these changes occurred during the period covered by the analysis discussed here.

VARIETIES OF CAPITALISM

The first literature review area explicitly acknowledges the existence of different 'varieties of capitalism' (Hall and Soskice 2001a), with a particularly significant dichotomy between the Anglo-American (or 'Anglo-Saxon', or 'stock market' or 'shareholder') variety and the 'social market' (or 'welfare' or 'stakeholder' or 'Rhine model') variety[3] (Albert 1993; Hutton 1995; Dore et al. 1999; Coates 2000; Dore 2000; Hutton 2003). The terminology of Hall and Soskice (2001b: 8), in which they refer to 'liberal market economies' (LMEs) and 'co-ordinated market economies' (CMEs) also broadly distinguishes between these groups. According to Hall and Gingerich (2009: 452) these terms describe a spectrum in which, at one end, stand LMEs 'where relations between firms and other actors are co-ordinated primarily by competitive markets' and at the other end are CMEs 'where firms typically engage in more strategic interaction with trade unions, suppliers of finance and other actors'. They state that the US, the UK, Ireland, Canada, Australia and New Zealand are generally identified as LMEs. In other words, LMEs equate to the Anglo-American model of capitalism while the CMEs, broadly speaking, equate to the social market economies previously mentioned. Within these groupings the US and the UK are identified 'as relatively "pure" cases' (Hall and Gingerich 2009: 459) of LMEs while the Nordic countries, Japan, Germany and Austria are the countries most readily identifiable as CMEs.

The difference between the ways in which companies influence societies is one of the distinguishing features between these 'varieties of capitalism'. In Hall and Soskice's widely cited analysis, in which they aspire to 'build bridges between business studies and comparative political economy', they argue that companies are 'the crucial actors in a capitalist economy' (2001a: 6). Indeed the fundamental importance of the way companies are run was noted in the following way by Lane (2003: 80).

> *Because forms of corporate governance structure most other relationships within firms and even in society as a whole, they are inherently connected with a distribution of power and material welfare. They therefore decisively shape the logic of the whole political economy.*

Hall and Gingerich (2009) argue that the promotion of economic performance in either LMEs or CMEs will best be achieved through complementarity between the way firms are run and the institutional characteristics of the

3. While 'varieties of accounting' are not the focus of this study, it may be noted that differing approaches to accounting practice are associated with differences in varieties of capitalism. In particular, Nobes (1998) has persuasively argued that accounting differences are largely driven by the relative importance of external shareholders as a source of corporate financing, and their emphasis on public disclosure of information, especially about 'performance and the assessment of future cash flows' (Nobes 1998: 169). It has also been argued that the Anglo-American influence on international accounting standard setting is a factor in spreading Anglo-American economic values (see, for example, Botzem and Quack 2009).

broader 'political economy'. In the case of LMEs, they argue that both labour markets and markets for corporate control are more fluid and flexible than in CMEs; shareholders have more power than other stakeholders and therefore firm and manager autonomy is more dependent on current profitability. Such flexibility leads to efficiency, they argue, since staff can be quickly shed or wage levels held down as needed in order to maintain the profitability required under this model of capitalism.

By contrast, in CMEs, corporate autonomy and access to financial resources are less reliant on profitability but depend more on longstanding relationships and reputational monitoring. These institutional practices are deemed to complement employment security and 'strategic interaction' between representatives of employers and employees such that overall national economic efficiency is the outcome. Neither Hall and Soskice (2001a) nor Hall and Gingerich (2009) take an explicit normative position on which type of capitalism is preferable since 'both liberal and coordinated market economies seem capable of providing satisfactory levels of long-run economic performance' (Hall and Soskice 2001a: 21).

This dichotomy between types of capitalism is not static: 'social-market' or 'stakeholder' economies have, for some time, been exhorted to move towards the Anglo-American business model, and this may be seen as a particular aspect of 'financialisation'. For example, with reference to the European social and economic model, Turner (2002: 17) gave the following advice.

> *It should embrace, even more than it has already, the benefits of market competition and accept as highly likely the evolution of its corporate governance structures towards the Anglo-Saxon model of overt shareholder wealth maximisation.*

Contributors to the *Financial Times* (FT) in particular, have often wagged a finger at the countries of continental Europe and Japan for not being sufficiently shareholder friendly. Writing in the FT, Riley (1996) points out that shareholder value could not 'be released as aggressively' in continental Europe as it could in the US because governments were 'overburdened by social security commitments'. Also in the FT, and in the context of mainland European labour markets, 'treasured social cohesion' was held to have impeded 'a more robust, Anglo-Saxon style of capitalism' (Plender 1997). The importance of Anglo-American accounting practice has also been highlighted as having a role in moving companies away from social market values. For example, FT editorials have expressed concern about social barriers to 'widespread restructuring' in Japan and prescribed 'the discipline of modern management and accounting' (FT 1999a; 2000). An FT feature on Japan in 1999 noted that the imminent implementation of consolidated accounting would help to change attitudes by highlighting the poor performance of underperforming subsidiaries (Nakamoto 1999; see also Kinney 2001).

In recent years Japan has provided a stark example of the relevance of business objectives for wider society, which suggests that change in the former can cause change in the latter, notwithstanding deep-seated cultural traditions. Writing in 2006, Dore, a long-time observer of the socio-economic and business culture in Japan, noted that political rhetoric and policy changes in that country reflected a desire for 'economic reform'. But he regarded such macro issues as relatively insignificant compared with what he termed: 'the big change, the "shareholder revolution", the fundamental shift in what managers consider their job to be' (Dore 2006: 22).

Dore quotes some striking figures issued by the Japanese Ministry of Finance for two 4-year periods: 1986–90 and 2001–05; these two periods are reasonably comparable since in both cases the country was recovering from recession. The figures record that in each period, value added per firm rose by similar amounts (6.8% and 7.9% respectively), but wages per employee, which had risen by 19.1% in the first period, fell by 5.8% in the second. Directors' remuneration increased by 22.2% in the first period and by 97.3% in the second; increases in profits per firm were 28.4% in the first period and 90.0% in the second, while equivalent increases for dividends were 1.6% and 174.8%.

Dore reports that there is growing concern in Japan over the social impact of such changes in income distribution,[4] with a much-quoted consequence being the increasing proportion of school children qualifying for free school meals. But he also notes that there is as yet no political force to mobilise the growing resentment and '[u]ntil that happens investors can relax'. Part of the explanation, according to Dore, for this change in culture is the rise to influential positions of high-flying students who studied for MBAs and PhDs in the US in the 1970s and 1980s: 'These true believers in agency theory and shareholder value have become a dominant voice in ministries and boardrooms' (Dore 2006: 24).

In a notable paper whose title, 'The End of History for Company Law', suggested that the triumph of the Anglo-American approach was assured, Hansmann and Kraakman (2001: 441) argue that 'there is today a broad normative consensus that shareholders *alone* are the parties to whom corporate managers should be accountable' (emphasis added). This so-called consensus, however, is by no means complete; for example 'institutional complementarities' (Amable 2000; Hall and Gingerich 2009) associated with different 'varieties of capitalism' suggest that convergence on the Anglo-American model is not a foregone conclusion.

4. The social impact of income inequality is discussed further below.

Therefore it has been argued that 'institutional complementarities' may mean that an attempt to shift companies towards a shareholder-value orientation could be counterproductive: 'comparative institutional advantage' can mean that nations prosper 'not by becoming more similar but by building on their institutional differences' (Hall and Soskice, 2001b: 60; see also Ahlering and Deakin 2007). While such an analysis puts into question the 'consensus' in favour of shareholder primacy asserted by Hansmann and Kraakman it does not remove the reality that convergence to the Anglo-American model is widely supported in some quarters and is, at least to some extent, taking place as discussed above in the case of Japan.

Criteria for judging varieties of capitalism

The recent financial crisis has caused some questioning of the relatively *laissez faire* approach to markets that characterises the approach of the LME, or Anglo-American, countries. Nonetheless, it still has robust support in the influential business media.

> *There has been a change in Europe's balance of economic power; but don't expect it to last for long…. For there is a price to pay for more security and greater job protection: a slowness to adjust and innovate that means, in the long run, less growth…If there is to be an argument about which model is best, then this newspaper stands firmly on the side of the liberal Anglo-Saxon model.* (Economist 2009)

The appeal to economic growth as a deciding criterion in judging socio-economic systems is of course questionable, if not positively dangerous, because of 'limits to growth' within a finite biosphere (see Meadows et al. 2005 and Jackson 2009). Even by the conventional yardstick of GDP the unquestionable superiority of the 'Anglo' approach is a matter of debate, as is clear from the comparable levels of economic success to be found under both models of capitalism.

Hansmann and Kraakman choose the criterion of 'aggregate social welfare' by which to judge models of corporate governance and assert that 'as a result of logic and experience' this is best achieved by making 'corporate managers strongly accountable to shareholders' interests and, at least in direct terms, only to those interests' (Hansmann and Kraakman 2001: 441). The logic by which maximisation of shareholder value leads to optimum social welfare is not spelt out by Hansmann and Kraakman; indeed one might question the use of the term 'logic' to decide what has been called 'a profoundly ideological and political argument' (Clarke 2009).

The relevance and strength of an argument based on 'logic' is something considered below in an outline of rationales that may be put forward for the competing capitalist models. Given the difficulty of finding ideological common ground on which to base rationales, Hansmann and Kraakman's appeal to experience, in other words to direct evidence of social welfare, seems an entirely appropriate way of judging the relative merits of versions of capitalism. Such evidence is not provided by Hansmann and Kraakman, but a wealth of very compelling evidence does exist and shows, on the basis of key measures of social welfare, that countries that have traditionally pursued the shareholder value model of capitalism perform systematically badly compared with the social-market countries. It is to such evidence that we now turn.

The impact of income inequality

Income inequality has been identified in the literature as a fundamentally important reason for international differences in social welfare among developed countries. The evidence for this assertion from the epidemiological research literature is now overwhelming (see, for example, Wilkinson 1996, 2000, 2005; Wilkinson and Pickett 2006, 2009).[5] The social impact of relative inequality is encapsulated by Wilkinson and Pickett (2009) when they exemplify how societal health would be different in the US and the UK if their levels of income inequality were to be the same as the level in the most equal of the 'social market' countries (Japan, Norway, Sweden and Finland). In the US, levels of trust in other people would be likely to rise by 75%, rates of mental illness and obesity could be expected to decline by almost two-thirds and prison populations to decrease by 75%. Figures for life expectancy would be expected to rise. In the UK levels of trust should rise by two-thirds, teenage birth rates could reduce by two-thirds, homicide rates could be expected to fall by 75% and 'the government could be closing prisons all over the country' (Wilkinson and Pickett 2009: 261).

Particularly stark findings concern child mortality: a paper published in the *Journal of Public Health* (Collison et al. 2007) provides an analysis of mortality figures (produced by the United Nations) among children under five, for the richest 24 OECD countries. Three key pieces of evidence emerge. First, when these countries are ranked according to their level of child mortality among the under-fives, the six countries with the worst figures for the period investigated are the US, UK, Australia, Canada, New Zealand and Ireland.[6]

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5. Social well-being can be assessed in a number of ways; some methods are based on readily observable and measurable health indicators while others, such as self-assessments of happiness, may be regarded with some scepticism given their apparently subjective nature. Nonetheless, extremely robust techniques do indeed exist for measuring happiness, and these are persuasively and rigorously documented in *Happiness: Lessons from a New Science* (Layard 2005).

6. It should be noted that based on more recent figures covering the years 2005–07, the five countries with the worst figures are the US, UK, Australia, Canada and New Zealand; Ireland is no longer in this bottom group (see Collison et al. 2010).

These are, of course, the liberal market (or Anglo-American) economies identified by Hall and Gingerich (2009). It is striking that the two countries with the very worst figures were the US in 24th position and the UK in 23rd; these are the two countries that Hall and Gingerich identified as having the most 'pure' form of liberal market economy. The second piece of evidence was longitudinal: although the 'Anglo-American' countries are at the very bottom of the ranking over the years 2001–4 (the years investigated by the study), several decades earlier they had generally been among the better performers from the same group of 24 countries. Although the figures for all the countries investigated had improved *in absolute terms* over recent decades, the *relative* position of the Anglo-American countries had systematically worsened. This period has also seen the growth of financialisation, with its rhetoric of maximising shareholder value. The third piece of evidence that emerged from the study was the exceptionally strong statistical association[7] between the child mortality figures in the 2001–4 period and figures for income inequality – which is entirely consistent with many other findings in the epidemiological literature, as alluded to above.

The evidence on social welfare suggests that if convergence towards one model of capitalism is desirable then it might be expected to be away from, and not towards, the Anglo-American model. This is not, of course, what we observe, which makes explicit consideration of the rationales for and against shareholder primacy particularly important. These will be outlined in the next section.

7. At the 0.1% significance level.

THE RATIONALE FOR SHAREHOLDER PRIMACY

Maximisation of shareholder value: intellectual roots and critique

In their overview of the debates surrounding the intellectual underpinnings of shareholder value, a number of leading authors distinguish between two traditions:

(i) the 'reformist liberal collectivist critique of the *rentier* and the financier from the 1920s and 1930s', and

(ii) the emergence of agency theory in the 1980s (Erturk et al., 2008: 30; see also Aglietta and Reberioux 2005).[8]

The former primarily considers the legal position of the shareholder resulting from the separation of ownership and control and whether the rights of property should extend to passive owners. Berle and Means' *The Modern Corporation and Private Property* (Berle and Means 1932) is often identified as the seminal text in this tradition, although their contribution did not emerge in isolation. The agency theory perspective seeks to re-establish the primacy of the shareholder. While associated, in particular, with the work of Jensen and Meckling (1976) and Fama (1970, 1980), the earlier contributions of Coase (1937, 1960), Demsetz (1967), Alchian (1965, 1969) and Manne (1962, 1965) were pivotal to the development of this tradition.

Shareholder primacy and company law – the liberal collectivist critique

One can trace contemporary views on the role of management and the rights of shareholders to the celebrated exchange between Adolf A. Berle Jr and E. Merrick Dodd Jr during the early 1930s. According to Macintosh (1999: 139):

> [Berle argued] *that the management of a corporation could only be held accountable to shareholders...whereas Dodd held that corporations were accountable to both the society in which they operated and their shareholders* (see also, Weiner 1964).[9]

In many respects, the solutions proposed by these protagonists can be viewed as a precursor to the shareholder/stakeholder debate that permeates the literature today. As Macintosh (1999) points out, despite

8. For example, Aglietta and Reberioux (2005) distinguish between the propositions of Berle and Means (1932) and perspectives developed in the traditions of property rights theory and agency theory; Biondi et al. (2007: 4–5) contrast the positions of 'American institutionalism' and 'the continental tradition of accounting business economics' with 'purely market theory' perspectives; Gomez and Korine (2008) distinguish between Berle and Means (1932) and the 'pure economic model' associated with agency theory; and Erturk et al. (2008: 30) contrast the 'liberal collectivist critique of the rentier', drawing on both American Institutionalism as well as British contributions, such as those by Tawney (1921) and Keynes (1936), with mainstream finance perspectives that draw on agency theory.

9. See for example Berle (1931) and Dodd (1932).

the different solutions proposed by these academics, the assumptions underpinning their analyses are 'quite compatible'. In particular, both Berle and Dodd recognise that the corporate form leads to the separation of ownership and control, which requires corporations to be held accountable by law and the actions of management to be controlled by those with an interest in the entity. Dodd reasons that because the corporation becomes a distinct legal entity upon incorporation, then it cannot be considered to be an 'aggregation of shareholders'; therefore, he argues that directors should be considered fiduciaries for the institution rather than agents for its members (Macintosh 1999: 144). In this respect, he argues that corporations are economic institutions that have broad social responsibilities, and thus, should be held accountable to society (Macintosh 1999). While similarly concerned with the unaccountability of management, Berle argues that the solution lies in the strengthening of the fiduciary duties of directors to shareholders. As Ireland (2001: 149) argues, however, Berle's position was not motivated by 'reasons of principle' but rather, 'because he could see no other way of preventing managers from feathering their own nests'. As Macintosh (1999: 146) and Ireland (2001: 150) point out, Berle's position within this debate has shifted over time and in later work he begins to acknowledge the 'validity of Dodd's views'. While Macintosh (1999) suggests that the change in Berle's perspective became evident in the 1950s, Ireland (2001) argues that, 'by the time of the publication of *The Modern Corporation and Private Property* in late 1932 Berle's own position had begun to shift'. In particular, the concluding chapter of this text 'quite explicitly' asserts the interests of the community above the 'passive property' rights of the *rentier* (Erturk et al. 2008: 47).[10] For example, Berle and Means (1932: 313) state:

> *It seems almost essential if the corporate system is to survive, that the 'control' of the great corporations should develop into a purely neutral technocracy, balancing a variety of claims by various groups in the community and assigning to each a portion of the income stream on the basis of public policy rather than private cupidity.*

10. Berle and Means (1932) are often 'conventionally enrolled' to support an agency theory perspective – ie that the separation of ownership and control leads to inefficiency and ought to be addressed by according primacy to the shareholder and aligning the interests of managers with those of shareholders (Erturk et al. 2008: 46). According to Aglietta and Reberioux (2005: 28), the primacy of shareholders advocated by agency theory is 'in complete contradiction' to the conclusions of Berle and Means (1932), leading Erturk et al. (2008: 46) to observe that *The Modern Corporation and Private Property* is 'one of the most cited and least read of classic twentieth-century texts'. Similarly, Collison (2003: 862) argues that Berle and Means have 'become misleadingly linked with a particular agenda'.

Agency theory

The primacy accorded to shareholders in contemporary mainstream finance owes much to the influential work of Jensen and Meckling (1976) and Fama (1980). These financial market theorists emphasised the disciplinary role of the market and asserted that 'discretionary management objectives [were] not in the (financial) interests of owner-shareholders' (Erturk et al. 2008: 30; see also Aglietta and Reberioux 2005). According to Ireland (2001: 153), the intellectual roots of agency theory are inextricably linked to the work of Henry Manne, 'one of the founding fathers of law and economics'. Manne (1962) expresses concern with contemporary views on the corporation, in particular, those informed by Berle and Mean's suggestion that shareholders should receive only a 'fair' return and that the interests of other stakeholders should be considered. One of Manne's key contributions was to stress the disciplining role of markets – especially capital markets. In particular, Manne (1965) asserted that dissatisfied shareholders could sell their shares, leading to a decrease in the company's share price, and potentially leading to the removal of management (see also, Ireland 2001). It was the threat of removal that led Manne to conclude that the interests of the manager are therefore consistent with those of the shareholder. In this respect, Manne 'attempted to transform the externalisation of the rentier shareholder...from a vice...into a positive virtue' (Ireland 2001: 154).

Drawing on Manne's assertion that the discipline of the market would ensure economic efficiency, both Demsetz (1967) and Alchian (1969) develop the justification for maximising shareholder value by 'connecting all behavior to the property rights system' (Aglietta and Reberioux 2005: 28). According to this view:

> *the residual rights of the shareholders create an appropriate incentive for them to activate the relevant disciplinary mechanisms…since the shareholders, standing last in line but with an unlimited right to the surplus, gain most from top quality performance,* [and] *have a powerful reason to hold managers to the profit maximization objective.* (Parkinson 1993: 47)

The profit maximisation objective is ostensibly justified on the basis that 'companies contribute to the maximization of society's total wealth when they seek to maximize their own profits' (Parkinson 1993: 41). According to this residual rights perspective, shareholders play a key disciplinary role in ensuring that profit maximisation is pursued, acting as a countervailing power to management and thus ensuring society's welfare is optimised (for further discussion see Parkinson 1993; Gomez and Korine 2008; McSweeney 2008).

Agency theory emerged out of this intellectual context, according to Erturk et al. (2008: 84), by neatly tying a simple principal–agent concept to a 'nexus of contracts' theory of the firm. Agency theory represented a more radical opposition to the popular liberal collectivist views of Berle (1954, 1963) and Galbraith (1967) (see Aglietta and Reberioux 2005; Erturk et al. 2008; Ireland 2001). Unlike Demsetz (1967) and Alchian (1969), who promote the residual rights theory, Jensen and Meckling (1976) and Fama (1980) reject the concept of ownership, claiming that the firm is merely a 'device to facilitate contracting between individuals' (Parkinson 1993: 178). According to Fama (1980), while shareholders own the capital contributions, this should not be confused with the ownership of the firm. The notion of an 'agency relationship' was introduced to describe the relationship between shareholder (principal) and manager (agent), with the assumption that the 'principal retains the power to control and direct the activities of the agent' (Clark 1985, quoted in Aglietta and Reberioux 2005: 29). In order to reduce 'agency costs' (ie the loss to shareholders resulting from management decisions that are not in the shareholders' financial interest) within this setting, shareholders will seek to align managers' interests with their own through monitoring and incentive mechanisms (Parkinson 1993; Aglietta and Reberioux 2005). According to Aglietta and Reberioux (2005: 29), Jensen's work in particular:

> *contributed to legitimizing hostile takeovers in the United States...as well as certain complicated financial structures, such as leveraged buy-outs...the proliferation of which between 1984 and 1989 marked the renewal of* [interest in] *shareholder value.*

Financialisation and the critique of shareholder value

The publication of Jensen and Meckling's work (1976) on agency theory coincided with a more prominent role for capital markets in the economy – as discussed earlier in this chapter, this phenomenon is frequently referred to as 'financialisation' (Arrighi 1994; Aglietta and Reberioux 2005; Krippner 2005; Froud et al. 2006; Erturk et al. 2008;). According to Aglietta and Reberioux (2005: 1):

> *financialization is driven by two movements. The first is the growth in the liquidity of capital markets...the second is the upsurge, in these same markets, of investment funds, responsible for the management of continually increasing savings.*

In terms of growth and liquidity in financial markets, Erturk et al. (2008) draw attention to the liberalisation of markets and the creation of sophisticated financial products. For example, they note the rapid growth of derivative products such as options, swaps, futures and forwards and a 'bewildering variety of new instruments' that are traded over the counter rather than on open exchanges (see also, Aglietta and Reberioux 2005; Froud et al. 2006).[11]

In explaining the reasons for an upsurge in investment funds, Erturk et al. (2008) point to the 'the growth of company pensions increasingly invested in ordinary shares by intermediary fund managers' in both the UK and US towards the end of the 1960s. For example, in 1957, 65.8% of shares in the UK were held directly by households and 34.2% held by institutions. By 2003, this pattern had radically shifted, with 14.9% of shares being held by households and 85.1% by institutions (see Froud et al. 2006: 40). According to Aglietta and Reberioux (2005: 8), this shift to institutional ownership changed the dynamic of financial markets, giving institutional shareholders considerable power and influence over corporate management either directly through 'participative influence (voice)' or through the 'sale of securities (exit)' (see also Froud et al. 2006). The growth of corporate pensions and the increasing role of institutions in financial markets are famously lauded by management guru Peter Drucker (1976), who describes an era of 'pension fund socialism' whereby, in the interpretation of Erturk et al. (2008: 84), 'workers had become owners, albeit virtual ones, who delegated management to an assortment of intermediaries'.

These structural changes to financial markets have had a profound impact on listed companies, where the 'ideology of shareholder value has played and continues to play an essential role' (Aglietta and Reberioux 2005: 1). The 'rhetoric' of shareholder value has both emerged from this historical context and contributed to its trajectory by defining the contours of contemporary Anglophone capitalism. The emergence of a shareholder value discourse in the 1990s and its propulsion to the *sine qua non* of business success has engendered significant changes at the level of the firm as well as transforming the macro social and economic landscape (Aglietta and Reberioux 2005; Froud et al. 2006). The following section draws on the extant literature that considers the impact of shareholder value on corporate behaviour and its significance for wider society.

11. For example, Erturk et al. (2008: 6) state that derivatives grew from 'nothing in the late 1970s to a value of more than $415 trillion...in 2006'. Similarly, Erturk et al. (2008: 8) also note that 'securitization' was another 'financial innovation' in the early 1980s – a market which grew from just under $7 billion in 1996 to $8 trillion in 2006.

Shareholder value and corporate behaviour

According to Erturk et al. (2008: 21) while 'the quest for sustained higher shareholder returns through management effort was always utopian' it has, nevertheless, had 'real consequences' for firms. As Aglietta and Reberioux (2005: 1) note, the doctrine of shareholder value has altered 'the power relations within the firm', and unquestionably affected the strategy of corporations.

One of the consequences of a focus on shareholder value has arguably been an increase in income inequality (the significance of which was reported earlier). For example, one reason cited in the literature is the increase in earnings achieved by company executives as a result of agency-theory-informed incentive schemes based on an MSV objective. As Froud et al. (2006: 58) note, 'the increases enjoyed by the CEO and other key senior managers are not shared by the majority of other employees in the giant firms'. For example, they note that the ratio between the earnings of ordinary workers and CEOs in the US grew from 50 times in 1980 to 281 times in 2002. While the disparity was more modest in the UK, there was still a similarly proportioned shift over the same period – from 10 times in 1980 to 50 times in 2002 (see also, Dore 2008; McSweeney 2008; Monks 2008). In linking inequality to the emergence of the emphasis on shareholder value, Dore (2008: 1107) notes that 'measures of income inequality are rising…faster in the most 'financialized' Anglo-Saxon economies', adding: 'median incomes stagnate while the top percentile, and especially the top permille make spectacular gains'. Moreover, the top earners 'are not traditional rentiers…with the highest incomes going to those in financial services at the expense of everyone else' (Dore 2008: 1107).

Several other consequences of shareholder value that affect individual firms are identified in the extant literature. These are, to an extent, summed up by Williams (2000: 6), who notes that 'shareholder value, in its current Anglo-American form' has led to, 'an intensification of all forms of restructuring such as horizontal merger, divestment and downsizing, which…reduce the capital base and sweat out labour for usually transitory gains' (see also, Lazonick and O'Sullivan 2000; Ellsworth 2002, 2004). For example, as Lazonick and O'Sullivan (2000: 13) point out, US corporate strategy was historically orientated towards the retention of earnings, which were then re-invested in the firm. With the growing market pressure that accompanied the pursuit of shareholder value in the 1980s and 1990s, however, corporate strategy shifted 'to one of downsizing of corporate labour forces and distribution of corporate earnings to shareholders' (Lazonick and O'Sullivan 2000: 13). As Williamson (2003: 512) observes, a similar trend emerged in the UK, where 'dividend growth…outstripped investment growth by a ratio of nearly 3:1' between 1987 and 1997. She adds that the emphasis on shareholder value 'encourages a short-termist, low investment and low productivity approach to business'.

According to Dobbin and Zorn (2005: 185) this increasing emphasis on shareholder value provided justification for hostile takeovers because it 'focused corporate attention on stock price'.[12] One of the outcomes of the takeover trend, premised on shareholder value, was that it effectively 'put an end…to diversification'. In the 1970s, when CEO remuneration was primarily salary based, the general consensus among senior executives was that the bigger the company, the bigger the salary, leading to a trend in conglomeratisation (Dobbin and Zorn 2005). With the emergence of a shareholder-value theory of the firm, 'takeover firms broke conglomerates up, demonstrating that the component parts could sometimes be sold for more than the previous market valuation' (Dobbin and Zorn 2005: 187). In this respect, hostile takeovers, according to their proponents, serve a fundamental economic function by punishing inefficient management and ultimately leading to higher share prices (Jensen 1984).

In outlining how the emergence of shareholder value theory led to the increasing influence of financial analysts, Dobbin and Zorn (2005: 191) describe how this constituency discouraged organisational diversification by promoting an 'obsession with stock price' and an 'obsession with meeting...profit projections'. As a consequence of these increasing market pressures, 'executives and CFOs responded by trying to game the numbers' through the use of 'accounting gimmicks' (Dobbin and Zorn 2005: 193; see also Levitt 1998). Taking Enron as a case in point, Aglietta and Reberioux (2005: 227) illustrate how 'shareholder sovereignty' leads to inappropriate corporate strategy and accounting fraud. In particular, three accounting 'policies' are noted in the Enron case:

(i) off-balance sheet accounting

(ii) abuse of fair value accounting, and

(iii) manipulation of the income statement.

Although public opinion and academic analysis relating to the Enron case highlight the failure of governance mechanisms, including the ineffectiveness of the audit function, Aglietta and Reberioux (2005: 232, emphasis added), argue that this case exemplifies a '*systemic crisis*' engendered by an emphasis on shareholder value and the predominance of financial markets (see also Froud et al. 2004).

12. They also note that 'inflation in the 1970s, the invention of the 'junk bond' and the leveraged buyout (LBO) and Reagan's regulatory changes' also contributed to the creation of a social context which permitted the rise of takeovers (Dobbin and Zorn 2005: 185).

Critique of the rationale and moral justification for shareholder value

Agency theory informs the assumption that the interests of shareholders should be given primacy. Although this view is predominant in both the extant literature and policy prescriptions, the liberal critique of the *rentier* has not been confined to the ash heap of history. Indeed, as Horrigan (2008: 88) notes, the key issues raised during the Berle–Dodd exchange of the 1930s are 'not simply part of a long-finished debate'; they have informed discussion on the duties of directors and the role of the company throughout the 20th century and this continues to the present day. Among other issues, discussions in this area have drawn attention to problems associated with assumptions of shareholder ownership, shareholders as bearers of risk, and directors' duties to shareholders vis-à-vis other corporate stakeholders. Each of these issues will be discussed separately below.

Myth of shareholder ownership

As Horrigan (2008: 104) observes:

> *much of the conventional economic, contract-based and business thinking in support of shareholder primacy is predicated on the idea that those who invest in a company are its true 'owners'.*
> (See also, Ireland 1999, 2001)

In fact, this core assumption has been continually challenged in the literature. For example, in the early 1950s, George Goyder (1951) began to express views similar to those previously delineated by Dodd. Alluding to the doctrine of separate legal personality, he notes that technically, 'a company is self-owning': the idea that it belongs to the shareholders is a legal 'fiction' (Goyder 1951: 23). While acknowledging that under company law shareholders have certain rights, Goyder (1951: 24–5) points out that 'these rights do not constitute ownership. They are a right to participate in the residual income of the going concern and to repayment of the capital'.[13]

In a more recent articulation of the same argument, Williamson (2003: 514) argues that 'the idea that shareholders own a company should also be challenged. What shareholders own is some proportion of the company's shares' (see also, Kay 1997; Parkinson 1993; Ireland 1999, 2001; Horrigan 2008). Parkinson (1993: 34, emphasis added) acknowledges that 'shareholders are not the owners of the company's assets as a matter of strict law, they are *in substance* the owners by virtue of being the contributors of the company's capital'.[14] In many respects, this view corresponds to the position held by contract theories of the company, which acknowledge that shareholders are not the owners of a company's assets, but are the owners of capital. For Ireland (2001: 163), however, this position reflects something of a 'mythology' and is underpinned by the assumption that 'shareholders actually give something to corporations, rather than simply place bets on their future profitability'. Not only does such an assumption clearly ignore the relative insignificance of the stock market as a source of finance (Ireland 1999; Mumford 2000; Froud et al. 2004; Aglietta and Reberioux 2005),[15] it also obscures the 'distinction between the corporate assets and shares' (Ireland 2005: 163). As Ireland (1999: 49) argues:

> *in peddling this sentimental view, which denies the reality of the corporation's autonomous existence…*[agency theory] *tries to bridge the gap between the corporate assets (owned by the company) and its shares (owned by shareholders).*

Under agency theory, these 'distinctive and autonomous property forms…are 'conflated under the rubric of capital' (Ireland 2001: 163). Drawing attention to how these assumptions affect accounting, Mumford (2000: 5–6) notes:

> *much of* [a company's] *capital is in effect self-owned – that much of its capital comes from its own earnings, and that most of the 'reserves' represent the proceeds of its own endeavours. To show these all as part of shareholders' funds* [in a company's balance sheet] *is a fiction that to my mind has little merit.*

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13. Ireland (1999: 41) states that such views began to emerge in the 1830s in the context of more developed stock markets whereby shares became more freely tradable. He notes that in 'the seminal 1837 case of *Bligh v Brent*, it came to be held that shareholders had no direct interest, legal or equitable, in the property owned by the company, only a right to dividends and a right to assign their shares for value. By 1860, the shares of both incorporated and unincorporated joint stock companies had been established as legal objects in their own right, as forms of property independent of the assets of the company' (Ireland 1999: 41). Such economic and legal changes led, according to Ireland (1999) to the doctrine of separate legal personality. While acknowledging that shareholders have no legal right in the property owned by the company, Goyder (1961) accepts that providers of capital have a justifiable claim to a 'return on their investment with profit'. Even so, he argues that 'there is nothing sacrosanct about a system which makes such rights perpetual' (Goyder 1961: 21). In a striking turn of phrase, Goyder (1961: 105) states that, 'to confer immortality on a financial obligation is to tie the hands of future generations'.

14. Parkinson (1993: 34) also acknowledges that some may view it as a 'mistake to regard shareholders as owners at all; they are mere investors' and that company law fails to acknowledge the 'complex reality of the modern large corporation'.

15. For example, drawing on O'Sullivan (2000), McSweeney (2008) notes that since the late 1920s, 'corporate retentions overall in the US have never been less than 66 per cent of all sources of funding over any five or six year period', while 'during the period 1982–7 shares provided only 3.1 per cent of net sources of funds for the 100 largest US manufacturing companies'.

Given the questionable ownership status of shareholders in company law, Williamson (2003: 514) concludes that the assumption that companies should be run in the interest of shareholders, on the basis of their ownership of company shares, 'is not a rational basis for organizing accountability and interests in companies' (Williamson 2003: 514).

Shareholders as bearers of risk

The justification that the interest of shareholders should be given primacy because they are risk takers by virtue of being residual claimants has also been questioned. Not only is the 'link between risk-taking and the right to control…a fragile foundation on which to base shareholder value', but the actual risk assumed by shareholders is, arguably, relatively small (Aglietta and Reberioux 2005: 34). For example, Goyder (1951: 17) notes that a shareholder's risk is limited and hence 'known in advance', whereas the employee's risk is often 'unknown and unforeseeable' (see also, Ireland 1999; Aglietta and Reberioux 2005). Furthermore, the liquidity of stock markets allows shares to be traded and for shareholders to diversify and spread their risk – again, options not readily available to employees and other stakeholders (Goyder 1951; Aglietta and Reberioux 2005). As Mumford (2000: 6) notes:

> *the argument that the shareholders are the principal risk-bearers accords ill with the observable facts. Employees, managers, suppliers and customers are also likely to suffer alongside debt-holders when a company collapses, and some of these groups may enjoy less portfolio diversification than the average shareholder.*

Directors' duties

Despite the absence of proprietary rights to the company's assets and the (relatively) negligible degree of risk assumed by shareholders, the 'outworn and defective legal structure' still forces directors to act in the sole interest of shareholders (Goyder 1951: 25).[16] For Goyder (1951) privileging the interests of shareholders over those of workers, the community and consumers, amounts to a lack of accountability, leads to unrest and friction within the structure of industry, and is simply 'indefensible on the grounds of justice'.

One influential argument in favour of framing directors' duties in the interests of shareholders is based on the need for managers to have a single objective function in order to engage in 'purposeful behavior' since 'it is logically impossible to maximise in more than one dimension' (Jensen 2001: 297). On this basis, Jensen (2001) trenchantly dismisses 'stakeholder theory' because it lacks an analytical prescription of how managers should address trade-offs. But in his influential paper he acknowledges that value maximisation cannot occur if the interests of stakeholders are ignored, and he introduces the concepts of 'enlightened value maximization' and 'enlightened stakeholder theory', which he regards as precisely equivalent. Jensen's criterion for making trade-offs between stakeholders is based very explicitly, but with arguable circularity, on long-term value maximisation.

Such arguments have, of course, been challenged on a number of grounds. For example, taking a legal perspective, Mumford (2000: 6) acknowledges the view that 'directors need to have a single, simple maximand – one over-riding group to whose interests the company should be primarily answerable'. He argues, however, that 'a similar case could be met just as simply by requiring that the main purpose of the directors is to maximise the value of the company itself' (Mumford 2000: 6). As Mumford (2000) correctly asserts, such an objective would be more logical, since it 'accords with the way that the duty of directors is often phrased'. Others have questioned the need for a single maximand at all, arguing that:

> *a belief that directors cannot handle a range of responsibilities* [is questionable]*…we all juggle our various responsibilities all the time. My cab driver must balance his responsibility to me, his client, with his responsibilities to other road users. My cleaner must, in the time available, reconcile responsibility for cleaning the kitchen with responsibility for cleaning the bedroom, all within the context of her overall responsibility to me. Even if they find this difficult, they manage to do it, for remuneration a great deal less than corporate executives receive* (FT 1999b).

16. While, strictly speaking, 'the standard formulation of the duty of directors in running the business is expressed not in terms of benefiting the members, but benefiting the company', Parkinson (1993: 76) notes that 'a requirement to benefit an artificial entity…would be irrational and futile'. He adds, 'an enterprise's purpose can only be understood in terms of serving human interests or objectives. The correct position is that the corporate entity is a vehicle for benefiting a specified group…traditionally defined [in law] as the interests of shareholders' (Parkinson 1993: 76).

Economic and Social Welfare Assumptions Underpinning MSV

The identification of MSV with maximised social welfare can be challenged on a number of grounds, including the existence of externalities and of monopoly behaviour (see, for example, Parkinson 1993[17] and see Gray et al. 1996 for a broad but succinct critique). In addition, the popularised argument that 'we are all shareholders now', which may be seen as a rephrasing of the social welfare argument, was critically examined and forcefully rejected by Ireland (2005). Ireland (2001: 69) also points out that:

> *the money that wage-earners hand over to money managers simply joins the general pool and is managed no differently…Even more importantly, perhaps, these workers are very much in a minority, a modern-day 'labour aristocracy', for even in the wealthiest parts of the West, let alone elsewhere in the world, many working people have no financial property at all and many others have insufficient to fund comfortable retirement.*

After considering comparative international evidence on varieties of capitalism, including evidence about social welfare, and then a range of arguments and counter arguments that have been put forward in relation to MSV, we now turn to pertinent legal considerations and legal prescriptions.

LEGAL ISSUES

In this final section, we look specifically at legal perspectives, and first we consider the relevance of legal traditions in explaining international differences in how companies function within society. It has been asserted (Solomon 2007) that the most influential contribution to the literature on international corporate governance is that made in a series of papers by La Porta and colleagues (see, for example, La Porta et al. 1997, 1998, 1999 and 2008). Much of their work appears in the literature on corporate finance but they have also influenced research across disciplinary boundaries; their work includes 'some of the most-cited pieces in economics, finance, and law' (Siems 2005). Their perspective, developed over more than ten years of evidence gathering and analysis, is summed up in one of their more recent papers: 'our framework suggests that the common law approach to social control of economic life performs better than the civil law[18] approach' (La Porta et al. 2008: 327).

At the heart of their findings is the evidence they have presented that common law countries offer stronger legal protection for investors than their civil law counterparts and provide a better environment for the funding of enterprises by dispersed shareholders, and for the development of stock markets. Their work is very clearly based on an agency theory perspective, and it is arguable that it has helped to marginalise the competing stakeholder perspective. Ahlering and Deakin (2007: 866), for example, state that their claims have been: 'highly influential, not least in informing the policy and working methods of the World Bank and other international financial institutions'.

The developed common law countries share the Anglo-American 'shareholder-centred' version of capitalism, while the differing categories of civil law countries may be characterised as more 'stakeholder-centred'. La Porta et al. (2008: 303) suggest that: 'The literature on the variety of capitalisms has long looked for an objective measure of different types; perhaps it should have looked no further than legal origins'.

The work of La Porta et al. has been studied in some detail by Collison et al. (forthcoming; see also Armour et al. 2009). They have revisited La Porta et al.'s analysis by extending it to include some direct measures of social welfare and development published in the United Nations Human Development Reports. This work corroborates the evidence adduced above in showing that civil law (stakeholder-centred) countries do consistently better than common law (shareholder-centred) countries when the assessment is based on measures of social well-being,[19] rather than measures linked to the rights and legal protection of financial stakeholders.

Another perspective on the significance of different legal traditions for corporate governance has been provided by Berle and Means (1932), whose classic study in *The Modern Corporation and Private Property* was referred to above. Their analysis led them to conclude that 'the ancient preoccupation of the common law with the rights of property' (p. 296) is ill suited to the governance of large and therefore powerful corporations. They continue with the observation that 'the common law did not undertake to set up ideal schemes of government. It aimed to protect men in their own.' Berle and Means argue against the 'sole interest of the passive owner', which 'must yield before the

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17. For example, both McSweeney (2007) and Parkinson (1993) question the Efficient Market Hypothesis (EMH), which they view as the intellectual edifice underpinning agency theory and its associated shareholder value assumptions. In particular, Parkinson (1993: 91) notes that the EMH assumes that 'the underlying value of a company's business is accurately reflected in the market price of its share'. In this sense, the disciplining role of the market is only valid in so far as the propositions underlying EMH hold. According to Jensen (1978) there is 'no other proposition in economics which has more solid empirical evidence supporting it' (quoted in McSweeney 2008: 60). As McSweeney (2008: 60) points out, however, there is a considerable body of evidence that does not support this view. Similarly, Parkinson (1993: 91) states that empirical analysis consistently demonstrates that share prices fluctuate in a manner which is not always consistent with economic reality (see also Akerlof and Schiller 2009). In this sense, any discrepancy between the underlying value of the firm and the value of its shares would imply that 'the maximization of underlying value will no longer necessarily maximize shareholder wealth' (Parkinson 1993: 91). For Parkinson (1993), the limitations of the EMH also suggest that the assumption that pursuing an MSV objective is good for society as a whole is flawed.

18. Three different variants of the civil law tradition, French, German and Scandinavian, have been identified (Reynolds and Flores 1989) and this classification was central to the investigations of La Porta et al.

19. Measures included income inequality, prison population, child mortality and the percentage of women in national parliaments.

larger interests of society', and envisage that courts would have to change their traditional common law position on property rights.

Berle and Means' argument is based on reasoning rather than comparative evidence but it is arguable that their position is largely vindicated by the evidence of societal well-being adduced and alluded to in this chapter. Certainly their analysis, based on the principles embodied in the common law legal tradition, offers an intriguing contrast to the position advanced by La Porta et al.

Perspectives on shareholder primacy from the legal literature

Shareholder primacy has traditionally been regarded as the core of Anglo-American corporate governance principles and this is reflected in the structure and framework of UK company law, which requires directors to advance shareholders' interest as a whole (see Gamble and Kelly 2001: 110, and Stoney and Winstanley 2001: 617–8). The historic defence of the importance attributed to shareholder value is grounded in four perceived advantages. The first of these is efficiency: shareholder primacy maximises directors' knowledge and experience. Requiring them to deal with other social considerations is inefficient and unreasonable (Salacuse 2004: 77). Secondly, shareholder primacy and the notion of shareholder value require companies to be accountable to their owners (Vinten 2001: 91). Thirdly, shareholder primacy places the concept of private property in a position of centrality and recognises that shareholders should be free to resolve how to deal with their wealth (Pettet 2001: 61) and, finally, in generating wealth, companies by definition meet and satisfy other social needs and requirements (Wallace 2003: 121). The principal criticisms levied against the shareholder primacy concept are that it encourages a short-term directional focus within companies at the expense of longer-term strategy and that it diminishes the likelihood of the development of 'stakeholder' relationships. Those in favour of stakeholder engagement argue that there should be: 'a fair division of the pie created by the firm since all stakeholders have a role in determining the ultimate size of the pie' (Wallace 2003: 61).

Although shareholder value continued to retain pre-eminence in the UK as the primary objective of the firm, the unquestioned nature of this pre-eminence began to change from the 1970s onwards, and notions of stakeholder value and the perceived benefits accruing from positive engagement with stakeholder value concepts gained increasing prominence in the relevant legal literature (for a fuller discussion see Deakin and Konzelmann 2004: 136). Nonetheless, the principal legal mechanisms that have protected shareholder value concepts have remained largely untouched at a policy level, even although the mechanisms have been the subject of evolution and change in their practical application. In UK company law, the principal mechanism that protects the interest of shareholders is the directors' duties regime. Although it is clearly established that these duties are owed to the company and not to the shareholders (*Percival* v *Wright*, 1902, 2 Ch. 421), shareholders are nonetheless entitled to raise derivative and personal actions against directors for their breach of duties.[20] The derivative action remedy was historically available to shareholders as a matter of common law and was often referred to as 'the rule in *Foss* v *Harbottle*' (1843, 67 ER 189) after the leading case on the subject matter. Although the common law derivative action was an apparent mechanism by which individual shareholders could pursue litigation on behalf of the company against allegedly wrongdoing directors, this mechanism was arguably one-sided in its operation. The safeguarding provisions built into the rule to ensure that any such action was being brought properly, in the interests of the company and not those of the individual shareholder, had the effect of making individual shareholder access to the courts on behalf of the company very limited. The rule was of little use in correcting the problems associated with group decision making by shareholders. These problems had long been recognised and in 1997 the Law Commission for England and Wales made recommendations for an alternative approach to the common law derivative action.

The CLR process was the first recent opportunity for consideration of the notion of shareholder primacy and the associated company law mechanisms that so robustly protected and enshrined the notion of shareholder primacy and value. The CLR set out to reconsider explicitly the objective of the company and to question in whose interests companies should be run. It did so against the backdrop of a considerable body of preceding work, which had substantially developed the UK's overall approach to corporate governance (in the form of reports such as Cadbury, Greenbury, Hampel, Higgs, Myners, Turnbull, and Smith) but which had not fully revisited the fundamental issues of the objective and purpose of the company.

CONCLUSION

This chapter has provided a historical and comparative international context in which to consider the question 'in whose interests should companies be run?' Chapter 3 presents an outline of the process whereby this question was considered prior to CA 2006; and subsequently Chapter 4 provides contemporary perspectives on that process and its outcomes.

20. The statutory derivative action and the unfair prejudice action available under s.994(1) of the Companies Act 2006 are perhaps the most obvious examples of the wider range of control and accountability measures available to shareholders. Additional measures include, for example, the right of shareholders to ask for a report on a vote on a poll and to require public display of a report regarding the resignation of auditors.

3. Review of Company Law Review documentation

This chapter provides an overview of the CLR process and the aspects of CLRSG's *Final Report* that were subsequently enacted into law. In particular, it supplies a timeline of the key stages that characterised the CLR and discusses the documents that were published by the CLRSG as well as the responses to these publications. Further, it traces the legislative process that followed the issuing of the final report from the Steering Group; specifically, it highlights certain milestones from the first publication of the Companies Bill in 2002 to the granting of the Royal Assent, by outlining some of the discussions and amendments that were debated within Parliament, as well as the comments about the legislation both in the financial press and among various interest groups.

This overview should provide the reader with the background necessary to understand the interviews that are reported in Chapter 4 of this report. In addition, the timeline is worthy of study in its own right as a guide to the important topic of company law reform: a study of the debates that took place and the issues that generated public discussion may highlight the priorities of different interest groups and their success at lobbying for a desired outcome. Further, the whole question of whether the CLR and the subsequent legislation were sufficiently discussed in the media may have policy implications for future reforms in this area.

The remainder of this chapter is structured as follows: the next section focuses on the CLR and the pre-legislation phase of the process; there follows a description of the passage of the Companies Bill through Parliament. An examination of the financial press during the CLR from 1998 to 2006 is then provided in order to examine (i) the coverage of the CLR in the press and (ii) those CLR issues that generated the most discussion.

THE WORK OF THE CLR

Table 3.1 provides a representation of the process followed by the CLR. From its launch in 1998 to the issuing of the *Final Report* in July 2001 (CLRSG 2001), four major documents were produced, six consultations took place, two informal soundings occurred and well over 1,000 responses were submitted. Therefore, it represents one of the largest investigations into company law that the UK has ever witnessed.

The sheer scale of the project is all the more surprising when one considers that the process began with an 18-page document, *Modern Company Law for a Competitive Economy* (DTI 1998), which the Secretary of State for Trade and Industry – Margaret Beckett – issued to launch the CLR in March 1998. This document provided an overview of the issues to be examined, the objectives to be met and the terms of reference for the work. In particular, it stated that there would be 'a wide review' that would 'actively consider the current balance of obligations and responsibilities [for companies]'. On page 6, the launch document noted that 'the test for new arrangements must be that they establish a more effective, including cost-effective, framework of law for companies and so contribute further to national growth and prosperity'. This emphasis on a business case for changes to company law was reiterated in the launch document, which emphasised that:

> *we need clear and simplified arrangements, starting from first principles, to better capture the balance of obligations, protections and responsibilities which are required to underpin the modern marketplace so as to ensure that participants can be confident about fair dealing.*

Indeed, the terms of reference for the CLR placed business at the centre of the investigation when it emphasised that the CLR would consider:

> *how company law can be modernised to provide a simple, efficient and cost effective framework for carrying out business actively which* [permitted]*...the maximum amount of freedom and flexibility to those organising and directing the enterprise*

while at the same time protecting 'through regulation where necessary the interests of those involved with the enterprise'.

The relatively narrow terms of reference for the CLR were an issue that was highlighted by a minority of the 156 responses to the launch document. For example, a small number of respondents agreed that the CLR should address questions about public interest aspects of company law reform, while others emphasised that fundamental issues such as the purpose of the company should be considered. Some respondents thought that the scope of the CLR could be more 'radical' than that proposed in the launch document by considering a stakeholder view of the corporation. This point was reiterated in the DTI's own summary of the responses when they noted that 'there was agreement that the "stakeholder" issue lies at the heart of the Review, though no consensus on the most appropriate approach [emerged] from the responses'. Indeed, a full page of the DTI's summary of responses to the launch document was devoted specifically to stakeholder issues and a delineation of the viewpoints of those who wished to retain the traditional focus on shareholders and those who 'favoured a more wide-ranging concept of the interests [that] a company should acknowledge'.

Nonetheless, although there was some discussion about the overall scope of the CLR, many more launch document responses related to specific issues such as the relatively narrow framing of the duties of directors. Indeed, the DTI's summary of the responses pointed out that 'issues surrounding directors and especially their duties were the areas to attract most comment'. Such a procedural emphasis among the responses to the launch document is hardly surprising when one considers that the largest number of responses 'came from...business (37%) while business representative organisations were a close second with 34%'.

The CLR process was led by an independent Steering Group (the CLRSG), whose work was in four main stages, each evidenced by a published, and widely distributed, document which:

- identified the work undertaken by the Steering Group at that stage, and
- presented questions and thoughts for the response of the interested parties.

In addition, a 52-member consultative committee, representing 'all the interested constituencies, business, the professions, the trade unions, investors large and small, government departments, regulatory bodies and non-government organisations' (Rickford 2002: 18) acted as a sounding board and discussion forum for Steering Group proposals as these emerged. This committee met 10 times over the three years of the CLR period.

The CLRSG issued its first consultation document in February 1999: *The Strategic Framework*. The 224-page document outlined the work that had been undertaken to date as well as a proposed way forward; it presented an analysis of a number of key issues and, in some cases, identified a preference as to what the authors thought the outcomes should be. Chapter 2 of *The Strategic Framework* set out the overall approach that the CLRSG had adopted; in particular, it identified key areas where two sets of working groups were to be established. These working groups were to operate in two phases. Specifically, the First Phase working groups were set up to examine broad topics:

- the scope of company law and the needs of small and closely held companies
- company formation, capital maintenance, regulation and the boundaries of the law, and
- international issues as well as information and communications technology considerations.

The Second Phase working groups were established to look at a narrower set of issues:

- the range of legal forms available to business
- corporate governance
- accounting reporting and disclosure matters, and
- progress on issues covered in the First Phase as well as areas of overlap.

Table 3.1: Company Law Review – pre-legislation document trail

1998	**March**	**Launch**: *Modern Company Law for a Competitive Economy*	156 responses (including Yorkshire Corporate Law firm survey of Yorkshire's top 500 companies)
1999	**Feb**	**(1) *The Strategic Framework***	137 responses
1999	**Oct**	Consultations: (i) overseas companies (ii) company formation (iii) shareholder communication	(i) 25 responses (ii) 55 responses (iii) 97 responses
2000	**March**	**(2) *Developing the Framework***	449 responses (including Lancaster University Conference on Corporate Governance)
2000	**June**	Consultation: (iv) capital maintenance	
2000	**Oct**	Consultation: (v) registration of company charges	
2000	**Nov**	**(3) *Completing the Structure***	195 responses
2001	**Jan**	Consultation: (vi) trading disclosures	69 responses
2001	**Feb**	Informal sounding: (a) registration of companies with different status	
2001	**March**	Informal sounding: (b) unanimous consent rule	
2001	**July**	**(4) *The Final Report*** of the CLRSG	

Note: This table aims to provide an impression of the broad scope of the CLR process, most of which lies outside the remit of the current study. See footnote 22 in this chapter. It has been produced by the authors of the report.

The interests that company law should serve were discussed in Chapter 5 of *The Strategic Framework*; enlightened shareholder value and pluralist approaches were presented at the start of the chapter. At the end of this presentation, *The Strategic Framework* stated:

> *It is in our view clear, as a matter of policy, that in many circumstances directors should adopt the broader and longer-term ('inclusive') view of their role…But we do not accept that there is anything in the present law of directors' duties which requires them to take an unduly narrow or short-term view of their functions. Indeed they are obliged honestly to take account of all the considerations which contribute to the success of the enterprise. There is nevertheless considerable evidence that the effect of the law is not well recognised and understood (CPP/IPPR 1997; Goyder 1998)* [cited in *The Strategic Framework* (CLRSG 1999: 40)].

The Strategic Framework outlined some of the options and the potential difficulties involved in clarifying directors' duties. It also articulated the arguments for and against a more pluralistic notion of directors' duties within the context of established British business culture; it also discussed the nature and extent of any change required for implementing proposed adjustments. (A critical examination of these arguments, and their even-handedness, is provided in Appendix 3 on page 47.)

A large number of the 137 responses to this *Strategic Framework* concentrated on this issue of directors' duties. For example, on the question of whether directors should 'have regard to wider social and ethical objectives…at the expense of the interests of the members' – the pluralist approach, the DTI's summary of the responses suggested that 'there was a substantial majority against the concept'. Some of the respondents objected on the grounds that the 'existing law provided adequate powers to allow directors to consider social and ethical objectives'. Others argued that such an approach 'would give rise to litigation' or 'make Britain a less attractive place to incorporate'. More strident critics of the proposal stated that 'such an obligation would appear to be totally unworkable in practice, highly dangerous in principle and totally alien to the British system of justice'. Respondents worried about whether the 'conferring of such powers on directors might encourage the possibility of shareholder funds being used for personal motives'. Indeed, some went so far as to suggest that the placing of 'wider social interests ahead of the interests of members would inevitably create a conflict with the efficient running of the company'.

Not all responses on this issue were so critical. For instance, while one respondent accepted that there was 'a strong case against pluralism', he commented that:

> *companies might recognise that the pluralist approach may provide commercial advantages and there was no reason why a company could not include in its constitution a declaration by shareholders as to the achievement of social, cultural or environmental objectives.*

Another commentator argued that:

> *if such an approach could be accommodated and directors' duties clearly articulated, this could be a useful method of allowing a more pluralist approach for those that wished to follow that route.*

One of the other issues that generated a lot of comment related to the role of accounting and reporting requirements – especially the proposed Operating and Financial Review (OFR) – in ensuring that companies were operated for their 'proper purposes'. According to the DTI's summary of the submissions, respondents 'were divided almost equally between those advocating and those resisting change'. Respondents who did not wish to see any change emphasised the additional cost that might be incurred from any increased disclosure, and the competitive disadvantages that such disclosure would impose on UK companies, relative to their international counterparts. Further, they questioned the need for additional disclosures on the grounds that there was no demand for extra information and that such an increase in reporting was unlikely to improve 'genuine understanding' among the 'small number of people' who might read what was produced.

The opposite view was also put forward by other respondents. For example, some suggested that this reporting 'would be a very effective way of monitoring directors in the context of a non-enforceable pluralist approach'. They argued that:

> *access to* [such information] *could assist stakeholders in asserting their rights…*[and] *in a democratic society of which companies were a part, the wider public had a right to information on corporate standards and the social and environmental impact of companies.*

Others' support was based solely on a business case; for example, one respondent suggested that 'non-financial statements could contribute to a more vibrant market and enhance Britain's stock market position'.[21]

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21. In addition to these responses to *The Strategic Framework* document, the CLRSG consulted on (i) overseas companies, (ii) company formation and (iii) shareholder communication in October 1999.

Following this period of consultation, the CLRSG issued its second main strategic document, *Developing the Framework*, in March 2000 (CLRSG 2000a). This second document sought views on the Steering Group's analysis of and proposals for company governance, as well as on small and private companies. In this document the CLRSG's two-proposal approach for the accountability of companies became clearer; in the executive summary of *Developing the Framework*, the Steering Group proposed the twin components of:

> *an inclusive Enlightened Shareholder Value (ESV) approach to directors' duties that requires directors to have regard to all the relationships on which the company depends and to the long, as well as the short, term implications of their actions with a view to achieving company success for the benefit of shareholders as a whole; and*
>
> *wider public accountability: this is to be achieved principally through improved company reporting, which for public and very large private companies will require the publication of a broad operating and financial review which explains the company's performance, strategy and relationships (eg with employees, customer and suppliers as well as the wider community).*

Specific questions were then presented in the consultation document on directors' duties and other matters. An overview of 'the research and information gathering work' undertaken was presented while details of the CLRSG's plans for the remainder of the CLR were outlined at the end of the document.[22]

Unlike the launch document and *The Strategic Framework* consultation document, for which summaries of responses received were published by the CLR Team,[23] only a 'cut and paste' of responses for each question was made available for analysis in the *Developing the Framework* consultation document. The matters of interest for this research project, such as 'the question of 'scope' – ie in whose interests should companies be run' and the related question of to whom companies should report were not addressed in this part of the consultation process, having been covered in *The Strategic Framework*.

Nonetheless, in a CLR Team summary of responses entitled 'General Comments', some respondents did make reference to these issues and these are summarised in Table 3.2. An analysis of this table indicates that nearly half of these general responses focused on two issues: the enlightened shareholder value approach and the duties of directors, even though it had not been a specific matter of that consultation.

Some of these pertinent responses arose at a major international conference on Strategic Directions for Corporate Governance organised by Lancaster University Management School in July 2000; a transcript of the conference presentations and discussions was submitted as one of the 449 responses to the 'Developing the Framework' consultation.

Finally, in addition to reviewing the consultation questions for their pertinence to this research project, a search of the responses for the words 'pluralism' and 'ESV' was undertaken. The results of this work indicated that only six respondents noted the relevance of ESV to what the document referred to as 'the directors' duty of loyalty', while two respondents welcomed the CLRSG's rejection of the pluralism approach.

Table 3.2: An overview of general responses to *Developing the Framework*

Topic of response	Number
Scope of CLR	1
Scope of companies' activities: ESV and/or pluralism	15
Owner/manager distinction	1
Clarification of directors' duties	10
Mandatory ethical and environmental reporting	1
Other matters	13
TOTAL	41

Note: This table has been prepared by the authors of this research report.

22. For the purposes of this research report, it is worth noting that the question of whose interests a company's board and company law should serve was addressed in the previous document – *The Strategic Framework*. Subsequent CLRSG documents moved on to consider and consult on the detailed matters that any proposed legislation would need to address. Thus, with the exception of discussions about responses to *The Strategic Framework* document, the 'scope' issue was not raised again after February 1999.

23. This term 'CLR Team' was used in relation to the issued summaries of the consultation responses.

The last of the three major CLRSG consultation documents – *Completing the Structure* (CLRSG 2000b) – was issued in November 2000; it asked interested parties to address questions on a number of topics, such as small and private companies; corporate governance, including the nature of directors' duties and the function of the OFR; and the proposed regulatory and institutional framework for company law. There were some 195 responses to the largely technical questions in *Completing the Structure*. As with the previous consultation document, no overview of these responses was produced by the CLR Team; instead, a list of responses was made available for each question asked. As the questions to which responses were sought were largely technical, a review of the comments organised by consultation topic unsurprisingly revealed no single mention of either pluralism or ESV.

In summary, the CLRSG recognised early on in the Review process that the question of in whose interests should a company be run, was central. It was recognised that the UK's existing approach to this issue was reflected in a shareholder-value predicated stance in which companies were managed for the benefit of shareholders who were given primacy in terms of control insofar as directors were required to manage companies on behalf of, and in the interests of, their members. The CLRSG also recognised, however, that another possible approach to the central question was to consider a pluralist perspective. Such an approach to the central question of whose interests should be reflected in the running of a company would involve directors conducting those affairs for the benefit of all the company's stakeholders and balancing the interests of a wide and diverse range of parties who might be affected by the company's activities.

In the *Final Report* of June 2001 (CLRSG 2001), the CLRSG did not adopt either the shareholder value or pluralist approaches in their purest forms but recommended another approach, which was described as 'enlightened shareholder value'. The concept of enlightened shareholder value still required directors to act in the best interests of shareholders but that obligation was, arguably, tempered by a broader and more inclusive approach to the obligation, which required directors to take account of the interests of others and could be interpreted as placing less emphasis on short-term wealth generation. In rejecting the pluralist approach, the CLRSG took the view that it would confuse the issue of directors' duties and offer directors little by way of guidance when making decisions. The key role of directors' duties, along with the OFR as the 'two pillars' of the proposed approach to the 'scope' issue, had been prominent in the CLRSG's third document (2000b: 33). The enlightened shareholder value approach was accepted by the government and ultimately found its way into CA 2006.

THE LEGISLATIVE PROCESS AFTER THE CLRSG'S FINAL REPORT

After the *Final Report* of the CLR was delivered in June 2001, the government issued its first legislative response in the *Modernising Company Law* White Paper of July 2002 (DTI 2002). This White Paper seemed to generate very little interest. Nearly three years later, another White Paper (the *Company Law Reform* White Paper of March 2005) (DTI 2005) was published. This White Paper appeared to give impetus to the legislative process; in November 2005, the Company Law Reform Bill was first debated in the House of Lords. This bill took 12 months to progress through Parliament before receiving Royal Assent on 8 November 2006.

Table 3.3: The legislative process post-CLRSG *Final Report*

2002	
July	*Modernising Company Law* White Paper CM5553
2005	
March	*Company Law Reform* White Paper
July	Further explanatory material on March 2005 White Paper published
November	Company Law Reform Bill, House of Lords
2006	
January	Second reading of the Bill in the House of Lords
April	Amendments to Company Law Reform Bill
May	Company Law Reform Bill – House of Commons
June	Second reading of the Bill in the House of Commons
July	Standing Committee Scrutiny of the Bill; Bill renamed 'Companies Bill'
October	Report stage and third reading – House of Commons
November	Royal Assent for Companies Act 2006

The lengthy time scale from the publication of the final report of the CLR to the enactment of CA 2006 is hardly surprising. This Act is the longest piece of legislation ever to have been passed by Parliament. It contained over 1,300 sections and represented a comprehensive attempt to codify, in one single piece of legislation, different aspects of the law relating to corporations. Those provisions of CA 2006 that did not come into immediate effect were introduced by means of a total of eight commencement orders, the last of which was dated 1 October 2009. Only five minor provisions in the Act remain to be brought into effect and for all meaningful purposes the Act should be considered to be in full force and effect. A full table of commencement dates can be found at BIS (2009).

Another factor, which may have contributed to the time taken to enact legislation after the deliberations of the CLRSG, was that the issue of directors' duties became the subject of a number of Private Members' bills. These were presented to the House of Commons following several well-publicised corporate governance scandals that became known at this time. For example, on 12 June 2002 a draft Corporate Responsibility Private Members' Bill was published which aimed to place very explicit responsibilities on directors in relation to the need for consultation with stakeholders. A subsequent Private Members' Bill, introduced on 15 October 2002, sought 'to require...companies to consult on certain proposed operations [and] to specify certain duties and liabilities of directors' in the area of corporate responsibility.

Although the second Private Members' Bill ran out of time, in the subsequent parliamentary year, an Early Day Motion[24] in support of the bill's aims was supported by 210 MPs. The proposal was also supported by the 'CORE' (Corporate Responsibility) Coalition of over 130 organisations, including a range of NGOs (see www.corporate-responsibility.org). This organisation mounted an effective campaign to widen the scope of directors' duties as the Companies Bill went through Parliament during the 2005/06 session. For example, CORE claimed that over 100,000 UK voters contacted their MPs in 2006 through emails, postcards, letters and local lobbying; they distributed thousands of postcards, which members of the public were encouraged to send to BIS.[25]

In addition, CORE and its constituent organisations lobbied MPs to support an Early Day Motion (No 697) on 'Modernising Company Law', introduced in December 2005, which urged the government:

> *to enshrine in new company law a duty for directors to identify, consider, act and report on any negative social and environmental impacts caused by a company's activities in the UK or overseas.*

During the process from CLRSG consultation to legislation, the specific wording designed to incorporate the enlightened shareholder value concept in legislation went through an evolutionary process. This saw it become a more focused and rather more detailed statement than the version that had first appeared in the draft bill that accompanied the 2002 White Paper. Clause 19 of that draft bill stated that:

> *A director of a company must in any given case act in the way he decides, in good faith, would be the most likely to promote the success of the company for the benefit of its members as a whole...and in deciding what would be most likely to promote that success, take account in good faith of all the material factors that it is practicable in the circumstances for him to identify.*

The material factors to be taken into account were defined as being:

> *the likely consequences (short and long term) of the actions open to the director, so far as a person of care and skill would consider them; and all such other factors as a person of care and skill would consider relevant, including such matters in Note (2) as he would consider so.*

In Note (2) those matters were:

> *1. the company's need to foster its business relationships, including those with its employees and suppliers and the customers for its products or services;*
>
> *2. its need to have regard to the impact of its operations on the communities affected and on the environment;*
>
> *3. its need to maintain a reputation for high standards of business conduct;*
>
> *4. its need to achieve outcomes that are fair as between its members.*[26]

24. EDMs are another device whereby MPs can enlist and demonstrate support. They too have a set of rules and traditions, which can be explored in detail in HC Factsheets – Procedure Series No 3.

25. This postcard campaign was so successful that sources within BIS indicated that extra staff had to be appointed to deal with the significantly increased volume of mail that was generated.

26. (DTI 2002: Volume II, Schedule 2: 112–13).

When the House of Commons considered the proposals set out in the 2002 White Paper[27] it noted that:

> *The majority of the evidence we received was generally supportive of both the ESV approach towards defining directors' duties contained in the White Paper and to the draft statement of directors' duties it suggests.*[28]

It also noted that:

> *The pluralist approach did, however, retain some strong advocates who did not consider the ESV approach to provide a sufficiently robust framework to guarantee that the interests of those other than shareholders would be properly taken into account in the company decision-making process.*[29]

The Trade and Industry Committee recognised that:

> *it does seem that those seeking an increased input into company decision making by a broader range of stakeholders may be disappointed. However, whilst their direct input might be minimal, under the White Paper's proposals there is an onus on directors to take such stakeholders' interests into account and to consider the impact of their decisions on other interested parties as well as shareholders.*[30]

In re-affirming acceptance of the ESV perspective established by the CLRSG and built on in the 2002 White Paper, the conclusion reached by the Committee was that:

> *the aim of the law should be to provide a framework to promote the long-term health of companies, taking into account both the interests of shareholders and broader corporate social and environmental responsibilities. The specific duties of care required of companies to their employees and society at large will normally best be set out in other legislation, covering areas such as health and safety, environmental and employment law. However, the proposed statement of directors' duties in the White Paper does represent a step forward as, for the first time, it explicitly recognises that good managers will have regard to a broader range of considerations than value to shareholders, which on its own may lead to short termism...*[31]

27. This consideration was effected via the Trade and Industry Committee.

28. House of Commons Trade and Industry Committee, Sixth Report of Session 2002–03, The White Paper on Modernising Company Law, HC 439, para.17.

29. Ibid, para 18.

30. Ibid, para 21.

31. Ibid, para 22.

When the second White Paper on Company Law Reform was published in 2005 the accompanying draft bill adopted a more direct and focused approach to those issues that had been referred to as 'material matters' in the 2002 White Paper. Clause B3 of the draft bill stated that in carrying out the first half of their duties (ie to do that which they considered, in good faith, was most likely to promote the success of the company for the benefit of the members as a whole) directors had to take account of the following points.

> *(a) The likely consequences of any decision in both the long and the short term*
>
> *(b) any need of the company:*
>
> *(i) to have regard to the interest of its employees*
>
> *(ii) to foster its business relationships with suppliers, customers and others*
>
> *(iii) to consider the impact of its operations on the community and the environment, and*
>
> *(iv) to maintain a reputation for high standards of business conduct.*

The directors of the company also continued to be required to consider the need to act fairly in respect of members of the company who might have different interests.

When the Company Law Reform Bill was finally introduced into the House of Lords in 2005, the provisions set out in Clause B3 had been further refined[32] to read as follows.

> *(1) A director of a company must act in a way that he considers, in good faith, would be most likely to promote the success of the company for the benefit of the members as a whole.*
>
> *(3) In fulfilling the duty imposed by this section a director must (so far as is reasonably practicable) have regard to:*
>
> *(a) the likely consequences of any decision in the long term*
>
> *(b) the interests of the company's employees*
>
> *(c) the need to foster the company's business relationships with suppliers, customers and others*
>
> *(d) the impact of the company's operations on the community and the environment*
>
> *(e) the desirability of the company maintaining a reputation for high standards of business conduct, and*
>
> *(f) the need to act fairly between the members of the company.*

32. In the form of clauses 156(1) and 156(3) of the bill.

During the passage of the bill the most significant change in these provisions was the removal of the qualifying and potentially limiting words 'so far as is reasonably practicable' from the wording that ultimately became section 172(1) of the Companies Act 2006.

In substantive terms, therefore, from the time of White Papers to the 2006 Act there was no change in approach to the treatment of the provisions that most manifestly reflect, to a fundamental extent, the ESV perspective. What can be seen, however, is an incremental rise in the focus on, and directness of application of, these provisions in the broader context of the restated provisions on directors' duties that ultimately appeared in CA 2006. Despite this arguably broader stakeholder context of directors' duties in section 172(1), other sections of CA 2006 remained focused on the interests of shareholders. In particular, the CLR and the subsequent CA 2006 pursued the reform agenda in relation to the common law derivative action and allowed derivative claims to be brought under statute by shareholders against directors for breach of duties. The derivative action (in both the earlier common law and new statutory formats) is not the only action that may be taken by individual shareholders. Section 994(1) of CA 2006 repeats the unfair prejudice provisions (which are personal in nature) previously found in section 459 of the Companies Act 1985, which provide a direct personal right of action to any member on the basis that:

> *(a) the company's affairs are being or have been conducted in a manner which is unfairly prejudicial to the interest of its members generally or some part of the members (including at least himself) or (b) that any actual or proposed act or omission of the company (including any act or omission on its behalf) is or would be so prejudicial.*

A CONTENT ANALYSIS OF A SAMPLE OF BUSINESS MEDIA COVERAGE

Our analysis of the media impact of the debate about shareholder primacy around the time of the CLR has concentrated on newspapers. Specifically, all UK newspapers on the Nexis database were searched for articles that included the term 'Company Law Review' for the period January 1998 to December 2006.[33] The relevant articles were downloaded and a document analysis undertaken. In particular, each article was read by two members of the research team and its contents scrutinised using a template that had been developed for the purpose.

This scrutiny then concentrated on articles from the *Financial Times* newspaper, since references to the CLR in other publications were relatively scarce;[34] the articles were scrutinised for:

- the type of article (eg letter, editorial, feature)
- the topic being discussed
- the number of mentions of the 'Company Law Review'
- the background of the author(s) of the piece, and
- the views expressed.

The results of this analysis are reported in Table 3.4. In particular, this table shows the findings from the content analysis for each individual year (1998 to 2006) as well as for the total period. An initial inspection of the findings reveals that the CLR is mentioned in only 146 articles published over the nine-year period studied. Furthermore, these articles contain only 1.3 mentions of the CLR on average, and are typically just over 600 words long. These articles were written mainly by journalists (89) although CLR members (26), business leaders (11), academics (5), NGOs (4) and others (11) contributed to the debate. Most of the mentions are in articles (108) although some are contained in letters to the editor (16), commentaries (9) or series/features (13).

A more detailed inspection of Table 3.4 shows a great deal of variability in the number and content of the FT texts across the nine-year period covered by the analysis. In particular, over 50% of the pieces were published in just three years: 1999, 2000 and 2001. Most of the texts in these three years were articles written by FT journalists. By 2005–06, there were only 23 items in the FT referring to the CLR and a majority of these were letters to the editor.[35] Indeed, there is a marked difference between the authors of these FT texts for the period 2005–06 and those for earlier years. In 2005 there were fewer mentions of the CLR by journalists and more references to it by business and NGO contributors. One reason for this variation appears to have been the different issues discussed in the FT texts that mention the CLR. By 2006, most related to the OFR and are probably explained by the unexpected decision of the then Chancellor to drop this requirement, which the CLR had been in favour of mandating. By contrast, a lot of the CLR mentions in the early part of the period investigated relate to 'enlightened shareholder value' and 'reporting'.

33. Other variants of this phrase such the 'review of company law' were also tried but yielded no additional 'hits'.

34. There were far fewer mentions of 'Company Law Review' in other papers. For example, the next highest number of mentions of the term was in *The Times*, where the term 'company law review' occurred 17 times over the nine-year period of our search.

35. This is perhaps not surprising since the *Final Report* of the CLRSG was issued in 2001, although the period of 2005–06 did correspond to the passage of the Companies Bill through Parliament.

Over the years 2001 to 2003, issues such as institutional investors, directors' remuneration and corporate governance were the main focus of FT texts that mention the CLR. Such a finding is hardly surprising, since these years witnessed government proposals on disclosure of voting records by institutional investors, a review of directors' remuneration and a debate about the adequacy of corporate governance requirements following the demise of Enron.

What emerges from this content analysis is that discussions about the CLR in the FT were relatively scarce and did not raise fundamental questions about those in whose interests corporations should be run. Rather, FT discussions were issue-based and usually made reference to the CLR only in passing; regularly only one reference to the CLR was included and this reference typically noted that the CLR was considering the issue being discussed in the FT.

EVALUATION OF THE 2006 COMPANIES ACT BY BIS

Although it has not been long since the Act came into full force, BIS has already conducted a post-implementation evaluation of CA 2006. Details of the evaluation can be found in BIS (2010). In the particular context of this project, two conclusions from the summary of the main findings of the evaluation are worth highlighting:

- the Business Review is 'seen as one of the least helpful areas of the Act'
- there is 'high awareness but minimal changes in behaviour' as a result of the section 172 duty of directors (BIS 2010).

The executive summary of the *Evaluation of the Companies Act 2006* (BIS 2010) emphasised that each of these issues required 'added clarity'; on the matter of directors' duties this clarity was sought 'in order to increase behavioural change'.

The next chapter presents findings from interviews with a range of individuals who were involved in, and affected by, the CLR.

Table 3.4: Summary of *Financial Times* coverage

	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total
Number of texts	5	23	25	27	23	9	11	14	9	146
Average length (words)	586	637	655	603	641	687	629	469	464	608
Average number of mentions	2.2	1.3	1.2	1.3	1.1	1.1	1.2	1.1	1.7	1.3
Type										
Letter	1	0	0	3	1	0	1	4	6	16
Article	3	20	21	21	22	7	9	5	0	108
Commentary	1	0	3	3	0	0	0	1	1	9
Series/feature	0	3	1	0	0	2	1	4	2	13
Author										
Academic	0	0	0	1	1	1	0	1	1	5
Journalist	2	21	22	15	15	3	9	2	0	89
CLR member	1	2	3	6	6	4	1	2	1	26
Business	1	0	0	2	1	1	0	4	2	11
NGO	0	0	0	0	0	0	1	3	0	4
Other	1	0	0	3	0	0	0	2	5	11
Issue										
OFR	0	0	0	0	0	3	5	9	1	18
Directors' duties	0	2	5	0	2	0	0	1	4	14
Enlightened shareholder value	4	5	5	0	0	0	0	0	2	16
Institutional investors	1	1	0	5	6	0	0	3	0	16
Capital maintenance	0	0	0	1	1	1	1	0	0	4
Auditor liability	0	3	2	1	3	1	3	0	0	13
Directors' remuneration	0	0	1	9	2	2	0	0	0	14
Corporate governance	0	1	0	0	8	0	0	0	0	9
Reporting	0	2	7	1	0	0	0	0	0	10
Harmonisation	0	4	0	0	0	0	0	0	0	4
Other	0	5	5	10	1	2	2	1	2	28

Note: This table has been prepared by the authors of this report.

4. Perceptions of the Company Law Review

Our interviewees (see Table 4.1) included nine direct participants in the Company Law Review Process: four of these were members of the Steering Group (and they also sat on working groups); four were members of working groups, one was a member of the consultative committee and one was a leading politician in the government department (the DTI)[36] under whose aegis the independent review was carried out. In addition, there were two leading figures in the NGO movement who had lobbied during the legislative process that had followed the CLR and that led up to CA 2006, and a commentator from an independent think tank who was informally involved in the CLR process and whose contribution to the broad debate surrounding it had been acknowledged by other interviewees.[37] Members of boards of directors of listed companies were also asked about the impact, in practice, of the new wording on directors' duties introduced in CA 2006.

In order to allow the interviewees to speak candidly, the interviews were carried out on a non-attributable basis. Therefore the backgrounds of the interviewees are not described here in great detail. This is because, given the publicly visible roles that most of them fulfilled as part of the CLR process, their identities could be too readily apparent. Nevertheless, an inspection of Table 4.1 indicates that all the interviewees shared a great deal of interest in, and knowledge and experience of, the matters explored in this project. Overall, their different backgrounds and varied perspectives supply a reasonably broad and very well informed basis for the present report.

Excluding the board members (B1, B2), the other interviewees' backgrounds and expertise included: policymaking at a very senior political level, the legal and accounting professions, institutional investment, board-level business experience, management consultancy, employee representation, the NGO sector, academia and journalism. Typically, each interviewee had experience of more than one of these categories. Thus, a mix of perspectives was sought about the CLR process and the role of shareholder primacy in the UK.

Table 4.1 Summary of interviewees

	Role	CLR	Other
S1	CLR Steering Group	X	
S2	CLR Steering Group	X	
N1	NGO		X
N2	NGO		X
S3	CLR Steering Group	X	
W1	CLR Working Group	X	
P1	Secretary of State	X	
S4	CLR Steering Group	X	
W2	CLR Working Group	X	
T1	Independent 'think tank'		X
W3	CLR Working Group	X	
W4	CLR Working Group	X	
C1	CLR Consultative Committee	X	
B1	Board member		X
B2	Company secretary and board member		X

Note: Interviewees are listed in chronological order of interview. Two of the working group interviewees were from Working Group G1, which dealt with 'Accounting, Reporting and Disclosure', and two were from Working Group E, which dealt with 'Corporate Governance: Purpose of the Company and the Role of the Directors'.

The interviews were semi-structured as outlined in the description of the research methods given in Appendix 2; and a 'template' of 15 questions was used as the basis for the interviews, although not every question was relevant to every interviewee.[38] The first four questions related to each interviewee's participation in, and views about, the CLR process; specifically, opinions were solicited on the operation of the CLR, the range of expertise and opinion drawn upon, and the nature of the evidence that was considered. The next three questions focused on the interviewees' views about the outcomes of the CLR process: participants were asked about the general outcomes from the CLR, the new framework for directors' duties that flowed from the CLR and the resultant statement about directors' duties that appeared in CA 2006. Questions 8, 9 and 10 sought views on whether the CA 2006 requirement implied that directors should maximise shareholder value (MSV) and if so, whether such an objective might contribute to unintended consequences such as excessive executive rewards, the financial crisis or ecological problems; in particular, the interviewees were asked about whether these broader issues had been raised during the CLR process.

36. The government department responsible for company law matters and whose secretariat carried out the CLR has had several manifestations and changes of name. At the time of the CLR it was known as the Department of Trade and Industry (DTI). The DTI was reorganised when the Department for Business, Enterprise and Regulatory Reform (BERR) was created in June 2007; and it, in turn, was reorganised in June 2009 when the still extant Department for Business, Innovation and Skills (BIS) was formed. The name used in this report will reflect the appropriate chronological context.

37. In addition to the interviewees listed above, an informal meeting was held with a number of officials from BIS at the start of the project. This was very helpful in giving an overview of the CLR process and the subsequent stages that culminated in CA 2006.

38. In particular, a truncated version of the questionnaire was used for interviewees B1 and B2 since their interview focused on the consequences of CA 2006 in practice and excluded issues about the CLR process.

Questions 11, 12 and 13 related to differences identified in the literature between 'varieties of capitalism'. For instance, interviewees were asked whether they regarded maximising shareholder value as a key distinguishing characteristic of Anglo-American capitalism. Question 12 then referred to evidence that, in relation to social well-being, there are systematic and statistically significant differences between the 'Anglo-American' and 'social market' economies. Interviewees were also asked to comment on the plausibility of there being a link between these characteristics and differences in corporate conduct and regulation. In question 13 interviewees were asked if these key social issues could be considered relevant to a review of the corporate legal framework. The penultimate question asked respondents whether any aspect of the CLR process and its outcomes should be revisited, while the final question sought any other comments that the respondent wished to offer. The following section of this chapter deals with the first group of questions about the CLR process.

HOW THE COMPANY LAW REVIEW OPERATED

There was a broad consensus, among those who expressed an opinion, that the CLR operated in a professional manner; in fact, there was widespread praise for the skill with which the project was directed. As one of the interviewees from the Steering Group put it, it was a 'well-mannered process…that…enabled people to share thoughts in a pretty open way'. Some interviewees also emphasised that the CLR was not rushed, so that it was possible to consider issues in depth; for example, S3 praised the 'freedom of time' that the CLR was allowed. A very positive view of the entire process was taken by W4, who found the CLR:

> *quite enriching and encouraging.* [I] *thought that it represented a reasonably long-term way of approaching the subject* [that arrived at] *an intelligent result which is looked on with respect and some admiration in other parts of the world.*

In the opinion of others, however, this was an opportunity that was not fully realised. The following view demonstrates the strength of feeling that existed, and arguably still exists, about the CLR.

> *The Steering Group played no real role in anything at all and was recruited as a rubber stamp essentially for the DTI who* [had the] *very deliberate intention not to have any meaningful discussion of the issues.* [The] *civil service view was not a commitment to any particular line so much as a desire not to open issues that would be troublesome.* (S1)

Nonetheless, this interviewee did acknowledge that 'there was more substance to [the deliberations of] the working groups'. An interviewee from a working group was not nearly so critical but was conscious that that discussion was somewhat – and perhaps inevitably – circumscribed. W1 described the process:

> *the idea was that the chairman…would steer us towards input into the main group...But, as I say, it was a rather large group was my impression....That does mean that the chairman ends up determining what questions get discussed and who discusses them almost...we used to get an agenda for the meeting and sometimes we'd get sort of a briefing on what the issues were...we didn't get steered very much...by the chairman. You get steered in the sense of* [the] *question that's put to you; it determines where you go ultimately.*

There were other more trenchant criticisms of the CLR. T1 saw it as 'one of the great missed opportunities' while S2 commented that the process was characterised by no detailed discussion of principles; instead, S2 argued that the lawyers on the committees focused on practical matters and 'were not interested in the bigger picture'. S1 'thought [it] was a waste of time', and T1 stated that: 'The question of "in whose interests are companies operated and controlled" was never seriously asked'.

One possible reason why 'the bigger picture' was not fully considered by the CLR is that, in the opinion of a sizeable number of the interviewees, the breadth of expertise and opinion involved in the CLR was relatively narrow. For example, W3 argued that:

> [the Steering Group] *wasn't very representative at all of the stakeholder perspective.* [Those included] *in this process were people who were already involved in the sort of way that the company and company law operates rather than the much wider spectrum of the kind of groups and people who are affected by it.*

Interviewee N2 supported this view and pointed out that 'the social, environmental or non-financial aspects [of corporations] were of less importance [to the CLR] than the financial or legal aspects' of these entities. N2 went on to say that the CLR membership 'certainly wasn't representative of society which [was surprising], given the role that companies play in society'. In their view:

> *one would have expected more public representation* [but the CLR] *didn't try to speak to civil society and business at the same time.* [Instead, it kept] *the stakeholder groups separate. So that in itself was a structural problem with the Review process…There was no one from civil society on the actual* [Steering Group] *and no cross-fertilisation of ideas.*

T1 argued that 'as a process, it was set up to fail' but also acknowledged that it was 'managed…with consummate skill and actually…made a lot more progress than I thought was possible'. As for the breadth of expertise and opinion among those who carried out the CLR, T1 argued that the participants 'were extraordinarily able but they were selected to provide one answer: that there should be negligible change' to company law in the UK. In the view of S1, the Steering Group 'was a reasonable cross section of people who knew something about company law, but people who know something about company law are not very representative'. S1 acknowledged the difficulty of

selecting people to undertake such a task but clearly felt that more could have been done to get a wider range of views:

> *if I was setting* [up] *a group to review these issues seriously, I'm not sure what it would be. I suspect what it would consist of, actually, is people not very different in background from the ones who were on that group but people who had that background but in wider public policy interests.*

Interviewee W2 attributed the narrow range of expertise and opinion[39] on the CLR committees to the appointment process for those involved:

> [the CLR had] *very good people indeed on the various committees. But they were all insiders or establishment* [figures] *in the sense of knowing company law or knowing companies. They weren't people who were about to think outside the box…So from a stakeholder perspective, the* [CLR group] *wasn't particularly balanced.*

W4 agreed with this perspective to some extent in acknowledging, with respect to the Steering Group, that 'there was clearly a bias towards those on the inside'. W4 thought that people were 'invited onto things like this because they were probably personally known...they're probably meeting each other at the FT drinks party…and… therefore it makes it a touch centralised and elitist'. More positively, W4 thought that this meant that people who were involved were competent to see the task through:

> *people who are just incredibly disruptive and time wasting probably didn't get asked. So I mean, some of it's defensible and some of it's not...there's always that element of sort of insiderism and elitism about the way we do things in Britain and you saw it in the Company Law Review.*

Of course, in addition to those in the Steering Group, many people took part as members of working groups, and as members of the formal consultative committee; indeed, the whole CLR process was characterised by a broad consultative approach. A number of interviewees did think that there was a wide range of views among 'the several hundred people involved' (S4). This perception was characterised by the response of W1, whose working group was 'pretty large and very diverse' with 'members who had wider perspectives'. In general, this interviewee thought that there was 'a good cross section' on the group and that they 'had some wide-ranging discussions'.

There was a similar diversity of views in answer to the question about the range of evidence considered by the CLR. While there was a generally held view that the CLR had consulted widely, some interviewees were critical of the extent to which evidence was used. Interviewee S4 conceded that the CLR had not conducted any social survey to gather evidence but pointed out that 'if you considered the range of consultees…a huge amount of evidence came in, in one form or another'. Indeed, according to S3, 'the one thing that was not lacking was evidence'. Even so, interviewee S2 thought that the CLR process was 'less a matter of evidence and more one of debate'. This point was reiterated by W2.

> *It was more a matter of analysis rather than of evidence and the evidence was mainly the views expressed by people who were part of the process…How their opinions were taken into account was a bit of a black box.*

On the issue of whether committees gathered evidence or just conducted debates, W1 responded that their working group 'debated things'. W1's view was that working group members 'were there to give evidence'. Those critical of the evidence and the scope of the issues considered by the CLR suggested that it lacked an international focus (W3), was 'biased in favour of the status quo' (N2), and did not include fundamental questions about the nature of the corporation (S1). So even though significant research studies were undertaken at the behest of the CLR,[40] some interviewees were clearly more conscious of an analytical rather than an evidence-based approach to the whole exercise. Indeed, interviewees made no reference to the role played by such studies. W3 would have welcomed more international experience as part of the CLR:

> *people who had genuine working experience of other models of corporate governance, preferably a positive experience, as a contrast to constant bashing* [of] *the German model* [which] *you get here as common currency.*

And W3 was extremely critical of the limited consideration given to international evidence in the consultation document:

> *it was terrible in terms of the international evidence and really looking at different options because you knew there's a plethora, there's not just Germany, you know, the Dutch system, the Scandinavian system, there's a lot of other options and some of which would fit much more comfortably with where we're coming from here.*

This dissatisfaction with the composition of the CLR committees and the nature of the evidence considered may go some way to explaining why a sizeable number of the interviewees were disappointed with the outcome of the CLR. For example, P1, who had been involved in the early stages, stated that:

39. For detailed discussion and empirical evidence relating to membership of the CLR and of committees that have investigated corporate governance, see Jones and Pollitt (2001).

40. Some studies, in particular, investigated a range of international approaches to company law. See, for example, Jordan 1997 and Milman 1999.

I remember, when I heard what had come out of it, feeling slightly disappointed…[I had thought] *that there was scope for something innovative to come out of the Review. I was never sure whether it didn't happen because people lost interest or because there wasn't anything revolutionary to* [emerge from the process].

Interviewee T1 believed that something revolutionary could have emerged if the government had resisted pressure from lobby groups interested in protecting the status quo.

[The CLR] *was one of the great missed opportunities of the Labour Government: an emasculation really of what was possible…It was a capitulation…A very particular view* [was dominant] *by business of what business is about. The CBI and the business lobby…achieved the lowest common denominator on regulations…there are outlier businesses and shareholder institutions who actually do take a stakeholder view…but they weren't given a voice.*

This view was reiterated by N1, who saw the CLR as a 'real wasted opportunity…[where] the government could have gone and should have gone much further'.

A number of interviewees acknowledged the improvements that the CLR had made to aspects of the legislation but were disappointed overall. For example, S1 argued that it was probably useful 'in terms of cutting through a lot of accretion', and saw it 'as a tidying up process not intended to make any fundamental change'. S2 agreed, suggesting that the CLR had been 'useful and worthy rather than radical'. W1 saw it as 'a small step in the right direction', suggesting that it did give rise to 'some simplification and there were small things that it consolidated – but they were hardly revolutionary'. Overall, W1 thought that CA 2006 was disappointing 'in relation to the amount of effort that [they] had put into the CLR' and concluded that: 'something of a mouse emerged'.

Others, by contrast, commended aspects of the CLR on the grounds that 'the consideration of the issues was important and groundbreaking' (N2). Interviewee N2 also thought that the CLR was successful in raising the question of whether a stakeholder or shareholder approach should underpin UK company law; but was, however, disappointed that it had come down on the side of the shareholder model.

At least [the CLR] *tried to broach the concept of how do you bring in stakeholder value – the fact that they considered it was enlightened. I was moderately satisfied with the outcome. I think that it went further at some points than I thought it would but it didn't go far enough…The problem with the whole company law process is that it still assumes the narrow interest of the shareholder.*

Interviewee W4 was particularly enthusiastic about the outcome of the CLR.

On the whole [I was] *satisfied, more than satisfied. I would say when the Company Law Review concluded, I thought that was great…the whole enlightened shareholder viewpoint seems to me* [to have] *won the argument. In terms of habit and culture,* [however,] *it's far from won the argument.*

W2 was less impressed than N2 by the effort expended on stakeholder interests and much less sanguine than W4 about the enlightened shareholder value concept.

It was assumed that…companies were just managed for the benefit of shareholders and the only real question was…the extent to which the benefit of shareholders was also the benefit of…other stakeholders. That…debate was regarded as open, I think, after the first main report but in the second it was completely closed down and it was enlightened shareholder value all the way from then on in… [I was] *disappointed but not surprised when the second report came out and it was enlightened shareholder value…the second report said, 'OK we've had enough of this pluralism nonsense, now let's focus on shareholders'.*

Discussions about satisfaction or otherwise with the CLR often led to comments about subsequent events that had altered its original recommendations. In particular, virtually all the interviewees gave a great deal of emphasis to the abrupt cancellation of the plans for the mandatory Operating and Financial Review (OFR). Some interviewees emphasised that the OFR and the question of directors' duties formed a complementary package. Indeed the CLR's documentation (CLSRG 2000b: 33) referred to them as 'two pillars'. W4 focused particularly on the question of culture within companies; it was clearly in the minds of some of the interviewees that the OFR could have helped in nudging corporate culture in a stakeholder direction. It should be clearly emphasised that this aspiration, on the part of those who held it, was attached to the OFR as originally envisaged, not to the version that was later scrapped. The key feature that was emphasised by some interviewees was that the OFR was intended to 'take account of the information needs' of a 'wide range of users' (CLSRG 2000a: 159) rather than just those of members.[41] For example, S4 stated:

there are a number of things that I regret the loss of [especially the OFR]. *The new performance review captures a good deal of what was going to be in the OFR but not all of the forward-looking aspects of the proposed OFR* [are currently disclosed] *and it doesn't respect the CLR's proposal* ***that the OFR should be prepared for users****.* (The bold type reflects the emphasis the interviewee gave to this point.)

41. The final version of the proposed mandatory OFR was to have been based on the information needs of members; this remains the case in respect of the 'Business Review'.

Interviewee S3 arrived at a similar conclusion. When asked whether any aspects of the CLR and its subsequent outcomes should be revisited, S3 explained that the OFR was intended to cause a shift in cultural attitudes.

> *Yes. One....What you're looking at is not the whole building, it's one half of the building. It's probably less than one half of the building if you think along the lines of 'how is this building meant to be used, how was it to impact on the corporate citizens'. It was going to impact on* [companies] *not through what's in the Act, which doesn't truly alter anything that they didn't think they did already. It would have impacted through the reporting and disclosure mechanism.*

S4 put it this way:

> *the model that we put together was that the directors operate the business and control it at that level and...the interests of shareholders....should be paramount. But when it comes to reporting and what the company makes publicly available, then the company should, if you like, account for its social* [impact] *– its licence to trade to the community as a whole. That was the idea. The OFR is a report to users...the way that you then solve the stakeholder issues is by…bringing pressure to bear on shareholders...the shareholders are themselves driven by...social and political constraints.*

It is worth pointing out that, while most of the interviewees did not allude to the potential for the OFR to shift the culture of British business in a stakeholder direction, they all were deeply critical of the decision to scrap it; and strong emotions were typically expressed on this issue. For example, W1 was 'particularly interested in the OFR and... was really annoyed' when it was dropped.

A number of interviewees thought that the new framework for directors' duties in CA 2006 was an improvement on what had gone before while others had very significant reservations. The new legislative framework requires a director to 'act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole' while directors should also 'have regard' to a range of other matters, including the interest of employees and the company's impact on the community and the environment.

Although, within section 172, the reference to stakeholders other than shareholders is now more widely drawn (only employees were mentioned before) a number of interviewees were keen to emphasise that this change should not be misinterpreted; shareholder interests were still paramount. Some emphasised this point with approval while others were clearly disappointed. Interviewee S4 was emphatically in the former group:

> *it's to my mind vitally important that people should understand that it's shareholder value that's the objective and not the listed items later in the section. The listed items later in the section are invoked to the extent that they're relevant in doing the business of making decisions on behalf of shareholders to achieve success.*

In fact S4 was concerned that a stakeholder ethos would be wrongly imputed to the new wording: 'I think a lot of people are going to…think that it's basically a stakeholder thing – you balance one thing against another, which is not the case'.

The main rationale put forward for the primacy of a single stakeholder (the shareholder), as is made clear in the CLR documentation, is that directors should have a single clear objective; otherwise, the argument runs, they would be allowed undue discretion and this might then be abused. As S4 put it, 'the important thing is that directors have this single objective and the other objectives are subordinate'. Interviewee C1 was of the view that 'it is virtually impossible to have accountability if you have more than a single objective'.

Very different opinions were held as to whether the new form of words in section 172 would focus more attention on stakeholders, which was a concern of S4. P1 saw it as 'encouraging more of a stakeholder mentality', which should get companies thinking about their corporate responsibilities towards 'their workforce…and the environment'. Others were less certain about whether the wording had in fact been a victory for those who wanted a more stakeholder-orientated approach to underpin company law. For example, N2 and W2 pointed out that section 172 prioritised the interests of shareholders over other stakeholders. Indeed, W2 argued that:

> *the statement is unsatisfactory in that stakeholders sort of get a look in* [but don't] *affect what* [the company] *will do. It is not nearly as good as a substantive requirement* [to take account] *of stakeholder interests.*

Interviewee N2 suggested that time was needed to see how the courts would interpret the new requirements. Although courts are, in principle, the ultimate arbiter of directors' actions, they have traditionally been reluctant to take a view on business decisions. In fact S1 stated that:

> *to have a kind of business judgement…principle that says it's only in grotesque circumstances that the courts will review misjudgements made in reasonable good faith – is something that almost necessarily implies a rather loose definition of directors' duties.*

Nonetheless, interviewee S1 also suggested that 'the judges would probably have adopted a more shareholder-friendly stance in 2000 than they would have in 1960'. This view is consistent with the emphasis given by S1 to the impact of shareholder value rhetoric in recent decades. This perception may also be compared with the view, expressed by a BIS official, that the CA 2006 wording for directors' duties reflected what was thought to be the common law position – ie the position that would have been upheld by the courts.

In general, the question about satisfaction with the wording in section 172 elicited the strongest negative response among all the answers provided; some 9 of the 13 interviewees expressed dissatisfaction with the wording in the Act. Interviewees W2 and N2 expressed some concern with the phrase 'having regard to', which was described as a 'woolly concept' (N2).[42] Interviewee N1 saw it 'as a huge retrenchment' from the spirit of enlightened shareholder value that had been put forward by the CLR; in N1's view '"having regard to" doesn't mean that you look after the interests [of employees and the environment]. You just see how their interests might affect you'. It is worth noting that other interviewees regarded the 'enlightened shareholder value' concept as having precisely this meaning. Interviewee W3 had wanted the phrase 'having regard to' replaced with 'to take account of' on the grounds that 'the directness of the link was stronger'. In fact, this interviewee suspected that the new form of wording in section 172 made directors' duties more shareholder-orientated.

N2 believed that, in practice, the wording of section 172 would lead directors to focus on optimising share price and, as a consequence, shareholder value.

> *Companies have to act if they think that it will harm their share price. If they don't think that it will harm their share price, they don't have to act, actually. That's a weakness in the* [wording of the] *directors' duties* [in the Companies Act].

N1 was also quite clear on the act's limitations:

> *I've heard a few people say that what we have in the UK is brilliant because it is a hybrid approach between enlightened shareholder value and a stakeholder approach…It is not…It's purely a shareholder approach. The directors' obligations are still to the shareholder.*

S2 saw the wording as 'a political fudge' which allowed the government to claim that it was making companies more responsible while at the same time having little or no effect on the actions and decisions of directors. Interviewee S1 was even more critical, seeing the wording in section 172 as a retrograde step, having 'rather liked the pre-2006 declaration of directors' duties as being to the company'. Thus, this person argued that the wording in section 172 increased the emphasis of directors' duties on short-term shareholder interests.

> *It was better beforehand. Before the CLR…the obligation of directors was to act in the interests of the* [whole] *company. My perception would be that* [section 172] *probably made it more shareholder focused. But if you ask whether directors are doing anything different after 2006, I think that the answer…you come to is 'no'.*

Implicit in this observation is the interpretation of the word 'company' as having a connotation that is wider than the interests of its members (the shareholders). This issue was discussed in some detail in Chapter 2 above and is briefly revisited in Chapter 5.

DIRECTORS' DUTIES AND MAXIMISATION OF SHAREHOLDER VALUE

Interviewees were asked their opinion about whether the new wording of directors' duties in CA 2006 positively required directors to maximise shareholder value, or whether it was consistent with that objective. Although there was a broad and largely unqualified consensus that the wording was consistent with MSV, a number of respondents clearly regarded this question as under specified. For example, interviewee S4 stated that the answer would depend on what was meant by maximising shareholder value, adding that it certainly did not equate with maximising the share price. When it was suggested that share price reflected the market's judgement of a company, the robust and succinct response from S4 was that the efficient markets hypothesis was rubbish. A similar perspective was held by W4, who believed that the basic premise of CA 2006 was that MSV was the implied objective – but not in terms of 'crude share price'. The responses of interviewees S4 and W4 were consistent with their belief in 'enlightened shareholder value' in which the interests of all stakeholders were regarded as compatible with MSV in the long term.

W1 answered 'Yes' to the question of whether directors were required to maximise shareholder value, but distinguished between short-term and long-term value. W2 and W3 also both answered 'Yes', with W2 emphasising that 'there is no way you can say that [the wording of the Companies Act] entails looking after stakeholders' interests'.

42. Interviewee N2 pointed out that during the passage of the Companies Bill in Parliament, the minister in charge – Margaret Hodge – stated that having regard to 'doesn't mean just to listen but also to act'. N2 argued, however, that this statement 'was not actually the law; it is only a statement by a minister [and] the enforcement of that is at best weak'.

Both interviewees from the NGO sector, N1 and N2, agreed that the wording about directors' duties was consistent with the MSV objective but were also clear that no absolute obligation was placed on directors: 'they don't necessarily have to [pursue MSV]'. N1 pointed out that the new wording could, in theory, give statutory backing to directors who were to 'trade-off' shareholder value in favour of other interests, but 'the law as it stands is not placed to challenge those companies who see [other interests] as not relevant'. In other words, N1 reiterated that the current wording of directors' duties does not detract at all from shareholder primacy: 'it is purely a shareholder approach'.

Interviewees S1 and S2 responded to this question about what imperative, if any, was placed on directors to maximise shareholder value, by referring to the significance of markets as opposed to the wording of the legislation. S1 attributed the shareholder primacy doctrine to the growing influence of financial markets (financialisation) since the 1980s, while S2 emphasised the takeover culture as the main driver of the focus on MSV. But neither S1 nor S2 saw any inconsistency between MSV and the new wording of directors' duties in CA 2006.

Views obtained from the boardroom, which are mainly reported in the final section of this chapter, included the following observations from B2, a current board member with wide experience as an executive and non-executive director of large quoted companies. Rather than engaging with the significance of the forms of words in CA 2006, the response was, perhaps unsurprisingly, pragmatic: 'I certainly think that maximising shareholder value overhangs everything you do…and when you define shareholder value, it's obviously share price, dividends and things like that'.

When pressed on the significance of the wording of CA 2006, B2 stated that:

> *if you said to me you've got to prioritise amongst all your shareholders, stakeholders, etc…the thing that drives us…the core driver for boards of directors...everything we do in terms of when we make investment decisions, when we look at the monthly results – we're looking at: 'What's it going to mean for shareholders?'. Shareholders are knocking on the door a lot more than ever before because the one thing that has come out of the Companies Act as well as the Code and all the other things that have happened recently, is that shareholders very much now want to be engaged.*

Interviewee B2 contrasted experience of shareholder engagement at AGMs in the early 1990s with current practice; it was noted that the numbers of shares being voted had increased from about 30% to about 80%. B2 painted a picture of directors who experienced being almost beleaguered by annual voting: 'you know, everybody's very conscious of the fact that you can get thrown out on the spot', and by potentially hostile takeovers: 'You've got guys turning up with 24% of the shares and, you know that they can cause all sorts of havoc with the whole board'.

These perceptions suggest that the perspectives of interviewees S1 and S2 chimed more with the view from the boardroom than with those who envisaged freedom for boards to pursue shareholder value, and therefore, arguably, stakeholder value, in the long term. B2 was acutely aware of the debate about short-term and long-term MSV and of the consequent need for companies to communicate, to get the message out, to shareholders. B2 also implied, however, that the market is fundamentally short-termist in outlook: 'I mean, we would all argue in companies that our share price is undervalued'. The takeover culture was also mentioned in this context: 'you can't ignore the short term…people could come and pick up [your company] for a very low price'.

Interviewees were also asked whether using MSV as the 'key performance indicator' (KPI) could distort corporate strategies and reward systems. This question could be regarded as hypothetical – in the sense that MSV may or may not be used as a KPI. Respondents tended to answer this question according to their sense of whether directors actually do focus on MSV, and in some cases there was a slightly defensive tone in relation to the wording of CA 2006. Thus interviewee S3 emphasised that KPIs had nothing to do with the CLR, while S4 pointed out that the legal wording in CA 2006 constitutes 'a very broad qualitative objective'.

The two other members of the Steering Group, S1 and S2, were both very conscious that short-termism and the self-serving behaviour of managers were exacerbated by the rhetoric and the reality associated with the pursuit of MSV as an overriding corporate objective. For example, S1 stated that 'the really big development it seems to me, particularly in the United States, since the 1980s is the…extent to which large corporations are run for the benefit of…managers'. S1 regarded MSV as lending some unwarranted legitimation to the contentious growth in executives' financial rewards: it would arguably be less easy to make the apparent case for such rewards if corporate objectives entailed balancing stakeholder interests rather than basing them solely on the

maximisation of a single metric. W4 was also very conscious that perverse outcomes could flow from specific performance measures and, while the potential for perversity turned on how MSV was measured, W4 did single out stock options as militating against a long-term perspective. W4 suggested that 'very few people would admit to driving their business by today's share price' but did admit that maximising shareholder value could comfortably fit with appropriate reward systems over an appropriate time period: 12 months to two years was suggested.

Both S2 and W3 noted that a focus on returns to equity holders could have perverse economic consequences: for S2, returns on a broader measure of capital made more sense, while W3 noted the incentive that MSV provided for undue levels of leverage and for value extraction through sizable dividends in order to keep the share price high. W2 regarded financial returns to providers of share capital as a desirable outcome from company operations but also saw companies as having a wider social purpose. Without the latter, W2 felt that there would not ultimately be a financial return and therefore saw an exclusive focus on financial return as inherently distorting.

T1 and C1 had very clear views on the potential for MSV to distort strategies and reward systems: for T1 the issue was that it could and evidently did have an adverse impact on corporate strategy and remuneration, while for C1 'the very serious problem is the compensation system'. To represent this point fully, it is worth quoting C1's view that: 'no matter what system is [constructed] the executive affected will find a way to game it'.

Interviewees were asked whether such distortions had contributed to the recent financial crisis. One interviewee (N2) immediately said: 'Of course. That's kind of – that's an easy one. Yes.' Yet few respondents saw a straight link between MSV and the crisis, even though a small number made comments consistent with a view that 'maximising profits and macho management and all this sort of stuff...' (W1) played a part in contributing to a culture in which undue risk taking flourished. P1 stated: 'Yes. I think it is part of a general climate that is...contributory'. This argument was consistent with that made by S1, who argued that shareholder-value rhetoric was used to advance the interests of managers rather than serve the actual interests of shareholders. S1 also thought that the rhetoric was connected with 'the rise of the financial services sector and broader changes in the social and political environment'.

MSV AND ECOLOGICAL SUSTAINABILITY

To build upon their answers to the previous question, the interviewees were asked to comment on the compatibility of MSV, as a corporate objective, with ecological sustainability constraints. In addition, they were asked whether this issue had been considered during the CLR. Regarding the latter part of the question, interviewee S3 stated:

> *you might say it got far too much of an airing. It's certainly impossible to say that the word environmental doesn't flash out at you from the Companies Act now. Quite obviously, environmental matters were obvious pre-qualified entrants for the list of 'must have regards'.*

Environmental issues also arose, of course, in connection with the OFR. Several interviewees thought that environmental issues would receive much more attention if the CLR were happening today.

Views on the compatibility of MSV and ecological sustainability constraints could be classified into three groups. One group argued that they could be reasonably reconciled if a sufficiently long-term view were to be taken of MSV. For example, W1 argued that: 'It's a question of time horizon and depends on what you mean by MSV – if it's long-term MSV then maybe'. W4 agreed with this sentiment, noting that 'any decent company that wants to be around to return value to its shareholders in a few years time, has got to think about these things. It is not serving the shareholder if it doesn't.'

A second group of respondents emphasised that companies should simply operate within ecological constraints (or consents) as set by legislation; in other words it should not be a matter for individual companies to assess the sustainability of their operations. C1 exemplified this perspective:

> *I expect the question of social justice to be solved as a political matter and not as a matter of corporate governance. I see corporations as being wealth creators within the rules and it's up to civil society to create rules and allocate the wealth fairly.*

W1 expressed a similar opinion, stating that ecological considerations were: 'A matter for the legal framework and the tax framework'. And S1 put it this way:

> *I'd be genuinely unhappy about that* [directors taking a view of sustainability impacts]*...my idea of the role of a corporation is actually to run a good business. By that, I mean something wider than shareholder value but narrower than, as it were, doing good things for the community. The...job of a manager of an oil company is to run a good oil company...whether there should be oil companies at all is another matter.*

The third group put forward the view that a profit-maximising ethos meant that companies would be predisposed to push against restraints in ways that would be difficult for legislation to control. In W3's view:

> *it is obviously the case that if you do put maximising shareholder value centre stage and things like environmental damage…social damage…for want of a better word are not priced…then there is clearly a tension…if you have…the framework for the priorities of companies to be knocking against those requirements* [environmental restrictions] *all the time, then you do have a recipe for conflict and for damage.*

Interviewees often referred to time horizons and, in this context of ecological constraints, W2 emphasised that:

> [MSV] *is inherently short term. I mean, depending what you mean by maximising shareholder value but if you mean it in a technical sense, I think it's got an inherent short-termist bias.*

VARIETIES OF CAPITALISM

The next question sought views about the significance of shareholder primacy as a discriminator between different 'varieties of capitalism'. Specifically, interviewees were asked whether the maximisation of shareholder value by companies is a key distinguishing characteristic of 'Anglo-American' economies relative to so called 'social market' economies. Broadly speaking this question was answered in the affirmative, and in the case of a number of interviewees by a straightforward 'Yes'. Some interviewees who agreed that shareholder primacy was a common feature of the Anglo-American system also emphasised that there were important differences between the US and UK: the relatively greater power of US executives (and its abuse) were highlighted, as was the difference between the two countries in the regulation of takeovers.

S2 argued that both the UK and the US were at one end of a spectrum but suggested that the UK is actually more extreme in one sense, arguing that takeover rules in the UK made life easier for hostile acquirers in comparison with the regime in the US, in which 'poison pills' could offer stronger defences. S4 stated that the 'dominance of shareholder interests' was an identifying characteristic of Anglo-American economies but was quick to point out that the term 'Anglo-American' was, in an important sense, a misnomer because of differences that this interviewee saw as significant. In particular, S4 mentioned the wider discretion accorded to directors in the US to consider issues other than shareholder interests. C1 emphatically commended the UK model of corporate governance above its counterpart in the US, arguing that directors were much more accountable to shareholders in the UK. This view was consistent with a point made above by S1 about the self-interested behaviour of US managers.

A number of interviewees alluded to the spread of values associated with Anglo-American capitalism; for example W3 identified MSV as a characteristic of the Anglo-American model and also noted pressure for the EU to become more like the Anglo-American system in relation to shareholder primacy. An arresting, if rather caricatured, view of an alternative approach to capitalism, was put forward by C1:

> *I think that it is a lot clearer in the Anglo-American economy that we want to maximise shareholder value…* [In Japan, directors] *aren't businessmen at all, they are senior civil servants of the Japanese government because the major trading companies are not profit maximisers in any sense of the word. They are stewards of public policy.*

This perception is reminiscent of Berle and Means' prescription for the control of large companies, that was reported in Chapter 2: they argue for a 'purely neutral technocracy' to control 'great corporations'.

VARIETIES OF CAPITALISM AND SOCIAL WELL-BEING

Social, as distinct from ecological, issues were specifically addressed in the interviews. Evidence of there being systematically different social indicators between Anglo-American countries and 'social market countries' was adduced in Chapter 2. As already discussed, these indicators are typically associated with income inequality and generally show poorer outcomes for the Anglo-American countries, which tend to have higher levels of income inequality than other developed economies. In addition, Chapter 2 discussed the broad social influences that are related to how, and for what purposes, companies are governed: the potential significance of such influences has been raised by academics and policymakers.

Given this background, interviewees' responses were sought to the question of whether there may be a connection between the Anglo-American tradition of maximising shareholder value and these countries' social indicators. Interviewees were also asked whether such issues 'should or could be considered relevant to a review of the legal framework for companies?' Interviewees were asked about these issues in the light of the specific findings on child mortality referred to in Chapter 2 and they were also informed that such data were consistent with a range of other epidemiological evidence.

Some of the interviewees were plainly astonished by the statistical evidence relating to income inequality, which reflects particularly badly on Anglo-American countries; indeed one politely expressed scepticism about its validity. Some regarded such social indicators as having nothing to do with company law or company conduct, while others accepted that the issues may be related. It was also certainly clear that no such evidence was considered during the CLR process. Although there was some

consideration of other countries' approaches to company law there was none about 'quality of life' in other countries or about possible links between the legal framework for corporate activity and the social or physical health of a country's wider society.

The views on the significance of social indicator evidence of the 10 interviewees who were directly involved in the CLR may be summarised as follows. Four accepted that social indicators and corporate legal issues could well be linked and that evidence about the former could be relevant to an evaluation of the latter. Three did not see the issues as having any meaningful association, and certainly did not agree that social indicators had any relevance to corporate law. One person suggested that both legal and social institutions, as well as outcomes, resulted from a nation's culture so that while some association might arise there was no cause and effect relationship between the two areas; this interviewee added that social indicators were far too distant from issues of company law to have any relevance. Two interviewees were by no means dismissive of such evidence and its potential relevance, but were unsure about mechanisms of causation; nonetheless, both thought that such evidence should be considered when reviewing corporate law.

In the view of S1:

> *there is a connection between these whole varieties of phenomena – to do with individuals and culture and to do with the role and nature of the financial system – at one end of which is the shareholder value rhetoric.*

This interviewee had earlier attributed 'financialisation', which has been associated with increasing inequality in the Anglo-American countries, with this rhetoric. W2 expressed a similar perspective:

> *I think that there is a social obsession with making money* [in Anglo-American countries] *which leads to both* [MSV and poor social indicators]*…It's a cultural norm…I would say that social issues would be a reason why the CLR should not have opted for enlightened shareholder value and should have stuck with the pluralist approach.*

The response from S4 expressed extreme scepticism about the underlying evidence and its significance for company law – while acknowledging a link between corporate practice and income inequality.

> *Well, income inequality is the result of unconstrained boards…and to some extent maybe unconstrained block holder shareholders….*[However] *to draw a causal connection…is to my mind heroic in the extreme…I must say I'm staggered at any such correlation…the answer to question 13* [should social indicators be considered relevant to a review of the legal framework for companies?] *is a clear no.* (S4)

C1 also found the evidence unconvincing.

> *I'm not sure I take* [this evidence] *on board because I really do feel that there is an infinite number of statistics and I'm sure we could find other statistics that prove other things but I just don't see correlation there.*

Interviewee W4 was more receptive to the idea that there was, potentially, some information content in the evidence but approached it with scientific caution:

> *what are we correlating with what? We're correlating child mortality with inequality…so we're then correlating income inequality with those countries which have essentially the Anglo-American tradition of maximising shareholder value…I'm finding it hard to draw a direct correlation between the sort of macro assumptions we make about an Anglo-American system and the micro observations I might make about how different companies…contribute.*

In contrast to W4, who speculated doubtfully on the explanation for the evidence involving individual companies, W3 was unsurprised by the evidence and linked it to two systemic factors affecting society as a whole. First, W3 suggested:

> *I think that...maximising shareholder value does lead directly into...inequality with – a whole raft of...social evils or whatever. And yeah, it does very much contribute to companies…being very much concerned with...their shareholders and having less of a sort of societal view.* [I think] *it definitely has contributed to…a massive increase in executive pay...we have with the class of super rich which are increasingly cut off, really, from the rest of society.*

Secondly:

> *there's this constant sort of rhetoric about burdens on business but, you know, basically any regulatory requirement is seen as a burden on business, you know, regardless…the sort of assumption that any legal requirement is a burden does determine a lot of the sort of framework of policymaking.*

One of the interviewees, P1, happened to be an experienced and senior policymaker, and reacted to the evidence offered as follows:

> *I think the honest answer to your question is there nothing like the awareness* [of evidence relating to social indicators] *that there should be…. But one of the things which we are conspicuously poor about is not only weighing evidence but actually knowing what evidence is…I mean, this place* [the interview took place in the House of Commons] *is awash with people who can't tell the difference between evidence and opinion…I think it's just that we're such a non-evidence-oriented society and culture.*

OTHER ISSUES

In the penultimate question, respondents were asked whether any aspects of the CLR process and its outcomes should be revisited. This evoked a range of broadly affirmative answers; some of these emphasised specific issues, including shareholder primacy, while others were more procedural. As an example of the latter, W1 was clear that company legislation should continue to develop and adapt: 'I think the whole thing will need revisiting in the future. I don't think it's revolutionary, the way the law works; it's evolutionary'. This perspective was warmly shared by S4, who very much regretted that one of the key mechanisms recommended by the CLR had ultimately been rejected.

> *We wanted to have a company law reporting council…as an overall institution in charge of the FRC…with an obligation to keep legislation under review and to make proposals for primary legislation to government.*

Apart from procedural issues, W3 expressed reservations about the extant legal framework.

> *I do think that the outcomes should be revisited...now in the context of everything that has happened since then... There is a lot more awareness of the flaws of the shareholder value model...it's not just the financial crisis.... It's also…the whole thing of private equity…and the Kraft and the Cadbury thing – there's a lot more awareness of the problem of…mergers and takeovers…being determined just by shareholders and nobody else. So it would be a good time to review and all those things come back to shareholder primacy.*

A number of interviewees were particularly concerned about the effects of a culture which focuses on shareholder returns coupled with a regulatory framework which facilitated hostile takeovers. And for many interviewees, absolute levels of directors' remuneration and their links to what many saw as spurious performance measures were a matter of great concern verging on incredulity.[43]

THE VIEW FROM THE BOARDROOM

This project has focused on the debate, and on evidence, surrounding the issue of shareholder primacy. The empirical work particularly concentrated on the views of participants in the CLR regarding the process itself and the subsequent CA 2006. In addition, the interviewees included two people with experience of boards of listed companies (in the case of B2 this was mainly as a company secretary): this section, presents their perspectives on what effect, if any, CA 2006 has had on the conduct of companies, as well as their views on other aspects of this study.

These views were supplemented by the comments of one of the members of the CLR Steering Group, who also had recent board-level experience within a large listed organisation. The responses of these participants are typified by the following statement from S1: 'if you ask, are directors doing anything different after 2006 than before, I think the answer is…no.' This opinion was based on specific personal experience:

> *was there ever any discussion of the issue of whether directors' duties had changed as a result of a change in the legal form* [of wording about directors' duties in CA2006]*?…the answer is 'No'. When one raised this… people could not understand that there might be an issue.(S1).*

The views of B1 and B2 were consistent with this position. For example, B1 stated: 'I mean, it's clearly much more clearly defined than ever it was before but I'm not sure in practical terms it has changed the way boards operate'. B2 put it this way: 'It revised the form of words but I don't think it actually changed very much'. Concerning the other stakeholders to whom the board should have regard, B2 stated that:

> *they're borne in mind. I've never been present at any discussion at a board where a decision's been made and the conversation has actually specifically gone to those other items.*

The number of board members whose opinions were canvassed is of course quite small, but one may have reasonable confidence that their views and experiences are not at all unusual for two reasons. First, there is the consistency of their substantive responses to the questions asked about directors' duties and, secondly, there is the wide range of experience that was brought to the boards of the interviewees' companies by non-executive directors. In this connection, company secretary B2 was reassured that their company practice was not remiss.

> *One of our board members is…on the board of a lot of public companies and I'm sure that had those public companies been approaching decisions in different ways or looking at taking into account other stakeholders formally in a board meeting…I think that X would have said to me, I think we ought to minute that we've taken into account these other considerations, but* [X] *hasn't…I…don't think it's made very much difference at all to the way that boards operate.*

43. Although levels of remuneration per se were not a main focus of this project, they were an issue which clearly exercised a number of interviewees, and which had been linked in the literature to the shareholder primacy culture.

On the issue of the withdrawal of the OFR, which had greatly exercised many of the interviewees, B1 and B2 showed much less concern but for different reasons. For B1, whose experience was mainly in large quoted companies, the event, though badly handled, was of little relevance because the reporting culture was strongly rooted in any case. By contrast, B2, whose experience was mainly with a smaller listed company, stated that: 'We breathed a sigh of relief when that happened' and in relation to the narrative reporting that was done, B2 candidly said: 'my task was to find the absolute minimum way of complying with the requirement'.

Regarding the significance of MSV, the views of B1 were that shareholder value maximisation was of crucial importance; in practice, this led B1's firm to focus on reportable metrics, eg share price and dividends. This was entirely the position of B2; in this case, of a smaller listed company with dominant shareholders on the board, a significant driver was the incentive of share options held by directors: 'we are very, very much maximising shareholder value wherever we can'.

This section on the 'view from the boardroom' now concludes with some perspectives about 'varieties of capitalism' from B1, who had personal experience of continental companies as well as those based in the UK. Some differences were very clear. For instance, B1 was of the opinion that:

> *the French system works better in terms of...thinking very carefully about the whole population. In the UK, you're very much more driven by shareholder value and so you're focused very much on driving sales and profits and cash and dividends.*

B1 stated that boards in France had: 'much more involvement with trade unions, they're also much more involved in environmental issues' and 'one other thing that struck me dramatically [about] being on a French board versus a UK board...is the involvement of government'.

B1 had also noticed that, in UK companies, especially over the last three or four years, some individual board members had a growing personal awareness and concern about a range of health and safety, community and environmental issues. But B1 also argued that such factors could be taken into account more readily in a non-listed company than in a listed one, where adverse implications for the share price could constrain decisions. B1 was also very conscious of a change in culture within UK companies due to increased emphasis on shareholder primacy:

> *I think back to* [X] *and the old guys that ran companies – I mean,* [Y] *for example. I mean, all the things that they did in the past for the environment, for the city, etc, etc... the Anglo-Saxon model has been much, much more involved in shareholders and returns and of course personal greed comes into it as well. You don't get any money for giving money to the local authorities and setting up a charity if it's coming off your P&L account... whereas the French are much less driven – are much less worried about that. They're much more involved in the community that they're in, etc, etc. They...feel very much more strongly that there's an external view to this. They do a lot more sponsorship of things, they do all sorts of things in the community, much more than I see happening nowadays in the UK.*

Another example of the differences between the UK and continental cultures was given by the same interviewee: it concerned Swedish companies of which B1 had personal knowledge, in which managers had rejected the offer of bonuses since 'we earn our salaries'. They had expressed a preference for the money to be used for local civic services instead. B1 was 'astonished by that' and emphasised that this seemed to be not untypical behaviour in Sweden, where people have a 'very different mindset'.

In response to the question about the potential distortion of company strategy as a result of focusing on MSV, B1 gave the following example, currently under serious examination by two companies.

> [In] *the drive to get more shareholder value, we can move the whole centre of the company outside of the UK. In other words...inversion...taking the central focal point of the company outside the UK...And that's driving shares because we're saying, hey, we can drive shareholder value because we'll reduce the tax paid by the whole company from 28% to 24%, that gives us more earnings per share, then we can pay the shareholders and suddenly you're going to close down your head office...and you go to the shareholders and they say, we don't care.*

When asked whether such a practice could be envisaged in a French company, B1 said: 'Not the one that I'm in, that's for sure'.

The interviewees gave their perspectives on a number of issues and this chapter has attempted to present a fair representation of this range of views and of the strength of emotion that was often apparent. The next, concluding, chapter offers a synthesis of the main findings of this report and sets out proposed recommendations.

5. Conclusions and recommendations

This chapter starts with a brief summary of the work included in this report. Following the introduction in Chapter 1, the literature was reviewed in Chapter 2. This provided a context for the issues examined in the report. Chapter 3 provided an overview of the CLR process and outlined the events that led up to CA 2006. Given the focus of this report and the potential of the CLR for an in-depth consideration of the shareholder/stakeholder debate, this report concentrates on whether or not such an in-depth debate had taken place. Chapter 4 reported the findings from 15 interviews: most of these were with participants in the CLR, including four members of the Steering Group. The current chapter highlights the key findings from the work and offers recommendations.

Since the main empirical component of this report is the series of interviews, this chapter will focus on the interview findings while drawing on material from other aspects of the report where appropriate.

There was a wide perception among interviewees that much of the work of the CLR had been useful as a tidying up and modernising exercise, and that it had been very ably led. This being so, one of the most striking findings was the strong doubt, by some of those involved, about the value of the exercise. Regarding its consideration of fundamental questions, the CLR was described as 'waste of time' by one Steering Group member who thought that there was never any intention to have a 'meaningful discussion of the issues'. One observer of the exercise described it as 'one of the great missed opportunities' while another Steering Group member said there was little interest in discussion of principles or 'the bigger picture'. Other participants took a different view about the nature of the process, praising the fact that plenty of time was made available to allow consideration of issues in depth. It was apparent that whether interviewees spoke positively or negatively about the CLR process was correlated with their views about the outcomes. It appeared to the researchers that those who supported the 'enlightened shareholder value' outcome were generally content about the quality of the examination that took place, while those who leaned to the pluralist view, which was rejected, were very much less so.

A number of interviewees, even some who were supportive of its outcomes, felt that the breadth of expertise and opinion represented on the CLR was rather narrow. It was characterised as being reasonably representative of those who were knowledgeable about company law, but not representative of the wider interests affected by it. The 'bias towards the inside' and a tendency towards inviting those 'personally known' was acknowledged by one CLR participant, who considered this a rather British characteristic, but one that enabled the job to be done. Another perception, in the context of its ability to consider fundamental issues seriously, was that it was set up to fail.

Participants in the CLR were asked about the evidence that was considered. The most common response, among both Steering Group and working party members, was typified by the remark that the process was 'less a matter of evidence and more one of debate'. Another opinion was that the range of views canvassed as part of the consultation process, and the knowledge and experience brought to the CLR by the participants, meant that evidence was not lacking. A strong and specific criticism was the absence of international evidence: while some mention was made of the German system it was felt that there were many other options in Europe that would have been worth examining. As noted in Chapter 4, studies were commissioned by the CLR to look at such alternatives but the interviews carried out in the present research gave no sense that these studies had informed discussions.

As noted above, the interviewees involved in the CLR, in the Steering Group and the working groups, had mixed reactions to the outcome; some were keen admirers of the 'enlightened shareholder value' position that was taken, while others were very disappointed, particularly those who thought that the issues had not been fully explored.

As might be expected from the previous point, the form of words that ultimately emerged as the expression of directors' duties (see Appendix 1) attracted mixed reactions. One member of the Steering Group preferred the previous wording, in which directors' duties were expressed as being owed to the 'company': this was because the term 'company' might be felt to have connotations of a wider responsibility than one owed only to members;[44] this individual argued that the legal wording on directors' duties had become more shareholder focused. But the new form of words was described as a 'fudge' by another of the Steering Group members, though this term was qualified as a 'very high-quality fudge' by another. In relation to views about the new form of words, there was perhaps only one point on which all the interviewees agreed. This was that shareholder primacy is the clear intention and thrust of the current law – notwithstanding the notion of 'enlightened shareholder value'. One interviewee's perspective was that the current law does not put an increased onus on directors to consider other stakeholders' interests, but gives some protection for directors against shareholders who feel that their interests have not been maximised. The more widely shared understanding was that, while the wording acts as a reminder about the interests of other stakeholders, their interests should be taken into account only in order to

44. The question of whether the interests of the company are synonymous with the interests of members, ie shareholders, is one that appears to offer room for legal rumination. Broadly speaking, the interviewees believed this to be the case although some still thought that the reference to the 'company' could engender a sense of a community of interests that was wider than that of the members.

induce them to contribute to the overriding objective, which is to maximise shareholder value. The central intention of the CLR, subsequently enshrined in CA 2006, is that the shareholder is sovereign.[45]

The central rationale for shareholder primacy that was emphasised by certain interviewees, and that figures prominently in the CLR documentation, is the scope for directors to abuse the discretion that is implicit in a pluralist regime where the interests of different stakeholders are balanced. Nonetheless, this position was clearly not accepted by several interviewees, who pointed to a number of such corporate governance regimes in other developed economies. On the subject of rationales, our own analysis of the arguments advanced in the CLR documentation for and against the 'pluralist' and 'enlightened shareholder value' positions did suggest that they were less than even-handed and implicitly favoured the status quo. This perception is consistent with the position of a number of interviewees regarding the lack of serious consideration given to alternatives to shareholder primacy: see the analysis presented in Appendix 3.[46]

The CLR envisaged greater transparency to 'take account of the information needs' of a 'wide range of users' as a key part of its original proposals. Of course the proposed means of achieving this, the OFR, was attenuated as the proposal proceeded towards legislation, first by dispensing with the needs of users other than shareholders, and then famously by dispensing completely with the OFR as a mandatory requirement. The OFR had been seen by some interviewees as a potential way of nudging business culture (subject to shareholder approval) in a pluralist direction; as Chapter 3 highlighted, its perceived importance was reflected in the term 'two pillars' (CLRSG 2000b: 33) to refer to the complementary role envisaged for the OFR and shareholder primacy. All the interviewees who had had any involvement with the CLR were critical of the cancellation of the mandatory OFR and the abrupt manner in which it occurred. But the boardroom perspectives varied; one board member, while thinking the repeal was a mistake, thought that it had made virtually no difference in practice to the imperative for, and practice of, narrative reporting that companies (larger companies at least) recognised. The other board perspective was from the company secretary of a smaller listed company, who candidly admitted relief at not having to meet the increased disclosure requirements.

An important issue that was discussed at some length with the interviewees was whether directors' duties amounted to a duty to maximise shareholder value. This prompted discussion of what the term means: for some the distinction between the long and short term was central, and a number were critical of interpretations of MSV as meaning that share price should be maximised in the short term. It was recognised that this is what the term often does mean in practice: this was held to be consistent with the legal duty but some argued that the imperative came not from the wording of the act but from the risk of hostile takeovers; and a number commented that directors' remuneration contracts also led to a focus on dividends and share price. This was certainly the view of those with current experience of listed company boardrooms. Enthusiasts for the 'enlightened shareholder value' wording thought that MSV should imply a long-term emphasis, though again the interpretation of the term was held, formally, to be solely a matter for shareholders to determine. Some interviewees questioned the importance of the legal wording on directors' duties. For example, the rhetoric of shareholder value in the US and UK was perceived as a phenomenon based on the financial markets (financialisation) rather than one caused by any legal changes. But it was agreed that a 'shareholder primacy legal framework' readily lent itself to this development. Some thought that this rhetoric, with its link to a single financial metric, was implicated in both high levels of executive remuneration and the financial crisis.

The compatibility of MSV with ecological sustainability was addressed in the interviews and views fell into three categories. Some argued that, if a long-term view were to be taken of MSV, then it was compatible with sustainability; such views are reminiscent of some corporate sustainability reports in which entity sustainability is conflated with more fundamental notions of planetary sustainability (see Milne and Gray 2007). Other interviewees commented that ecological sustainability was a matter for public policy, not for assessment at corporate level; hence, the responsibility of companies should be to operate within the permitted regulatory parameters. Another view was that a maximising ethos within companies would tend to conflict with any regulatory restraints and encourage resistance to their imposition.

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45. Of course, since it is for the shareholders alone to define what 'value' means, the wording is not incompatible with a balancing of all stakeholders' interests, rather than maximising the interests of one group and satisficing all the others.

46. The strongly expressed view, held by a number of interviewees, that no serious attempt was made to consider an alternative to shareholder primacy, led the present researchers to examine carefully the quality of the arguments for and against 'enlightened shareholder value' and 'pluralism' that were advanced in the CLR. This examination is presented in Appendix 3.

Interviewees were asked whether they regarded MSV as an identifying characteristic of Anglo-American capitalism, and the consensus view was that this was broadly the case. Some interviewees did, however, emphasise the differences between the US and UK models; in particular the relatively unrestrained power of directors, and the relative facility to obstruct hostile takeovers in the US were highlighted.

Some evidence that poorer societal well-being, linked to income inequality, is systematically associated with the Anglo-American model of capitalism was presented to interviewees for their reaction. In particular they were asked whether such evidence could be considered relevant to any review of the laws governing corporate conduct. Views about this varied a great deal. Some were highly sceptical about the significance of the evidence. Of those who were not, some expressed caution about the nature of cause and effect, while others readily linked corporate law and culture to wider questions of social well-being. Most interviewees thought that the evidence merited serious consideration in any future review of the legal framework governing companies.

One of the interviews was with an individual who had board-level experience of companies in the UK and Europe and this person's observations corroborated much of the evidence from the literature about the differences between Anglo-American and continental European corporate culture. In the latter, the impact of corporate decisions on communities and employees was given much more emphasis with correspondingly less focus on dividends and share price. While clearly one cannot claim too much from the experience of a single individual, these perceptions were certainly consistent with the stereotypes. This interviewee made two observations, in particular, about differences in the remuneration culture between the UK and mainland Europe. The interviewee had been extremely surprised by the rejection of bonuses by managers in Swedish subsidiaries, but was also aware that other continental European directors, in a company which was starting to focus more on shareholder value than it previously had, were 'getting an eye on this personal greed thing'. The self-interest of directors had been identified in the literature as one of the drivers of 'convergence' towards the Anglo-American model, by companies in social market countries.

Certain views of the interviewees resonated with insights from the literature review about the nature of the common law – which is associated with the Anglo-American model of capitalism. Berle and Means (1932) identify a central principle of the common law as defending 'men in their own', in other words, defending property rights. They contrast this with an approach to law based on setting up 'ideal schemes of government'. One Steering Group member had suggested that 'judges would have probably adopted a more shareholder friendly stance in 2000 than…in 1960'; and a view expressed to us by a BIS official was that the wording for directors' duties, which was the final outcome of CA 2006, reflected what was thought to be the common law position, ie the position that would have been upheld by the courts. Such views could suggest that protection of shareholder primacy reflects a legal attachment to the cultural and material status quo, which the common law, unlike the civil law, inherently protects. If that is so, it underlines the importance of weighing as much evidence as possible in evaluating alternative approaches to setting a legal framework for companies.

Interviewees were invited to comment on any aspects of the CLR process and its outcomes that should be revisited, and on any other issues relating to the legal framework governing companies. One member of the Steering Group gave special emphasis to two issues. One was the OFR – not only its repeal, but, prior to that, the change from 'users' to 'shareholders' as the identified parties whose information needs should be addressed. The other issue was the rejection by government of the CLR recommendation that there should be a 'Company Law and Reporting Commission', with an advisory role, 'to keep the whole of company law under review' (CLSRG 2001: 60). Given the fundamental reservations expressed by a number of interviewees about CA 2006, the potential for such a body to consider such concerns, and to monitor events and new evidence, has obvious attractions. Two other areas that received particular emphasis were the regulations governing the market for corporate control in the UK, and the level of directors' remuneration. Both these issues were related to a perceived fixation with shareholder value as measured by share price in the short term.

RECOMMENDATIONS

For academics to make direct recommendations on such a key question of legal and social policy as 'in whose interests should companies be run?' may seem presumptuous.[47] Perhaps it would be more appropriate to recommend that the question be revisited and to indicate why. The literature reviewed as part of this project, and the evidence provided by the empirical work, suggest, firstly, that the following matters justify a re-examination and, secondly, that the wider evidence reported here should be taken into account in any such examination.

A number of participants in, and close observers of, the CLR process argued very strongly that the CLR did not provide an opportunity to consider seriously the alternatives to shareholder primacy. This amounted to a very regrettable waste in the minds of a number of people because the CLR was, ostensibly, an unusual opportunity for a detailed and lengthy examination of the principles underpinning company law. Arguably, a wider lesson could also be drawn from these perceptions about the value and credibility of government consultation exercises.

The interviews with directors conducted for this research indicate that the new form of words relating to directors' duties in CA 2006 has not resulted in changes in corporate behaviour. (As reported in Chapter 3, a similar point is made in the recent evaluation of the implementation of CA 2006 undertaken by BIS (BIS 2010).)

MSV is implicated in the phenomenon of 'financialisation', which itself is implicated, in the views of many observers, in the self-serving and irresponsible pursuit of short-term financial rewards at the expense of sustainable value creation and social stability.

Shareholder primacy is an identifying characteristic of Anglo-American countries. Anglo-American countries have a 'case to answer' in regard to their consistently poor measures of social well-being relative to those of other developed economies, which typically pursue a 'stakeholder', rather than a 'shareholder', model of capitalism.

The possibility that the poor social indicators referred to in the previous paragraph are related to the objectives pursued by large companies should, at least, be seriously considered. Academics and policymakers have emphasised that both social justice and efficiency are influenced by the regulatory framework within which businesses operate. The significant evidence that income inequality is a driver of many social ills, and that income inequality is, in general, higher in Anglo-American countries, should be borne in mind when assessing these issues.

In addition to the view of a number of the interviewees that there was no serious consideration of, or debate about, alternatives to shareholder primacy, the evidence here suggests that media discussion of these fundamental issues has been rather muted. While it is a matter for the media to decide what they report, this lack of a public airing of the issues was perhaps symptomatic of a review process in which the terms of the debate and its participants were narrowly circumscribed.

In addition to the question 'in whose interests should companies be run?' a number of other matters arose in the course of the empirical research discussed in this report, and these also merit serious review.

The importance of enhanced corporate accountability should be recognised and could be achieved by explicitly addressing the information needs of a range of stakeholders, not just shareholders.

The potential benefit of a body such as a 'Company Law and Reporting Commission', which was proposed by the CLR to keep the regulatory framework of companies under review, should be recognised.

The operation of the market for corporate control in the UK is a matter of major social importance; its consequences and the accountability of its regulators should be regularly reviewed. This matter is, of course, closely related to the issue of 'shareholder primacy'.

Great concern was expressed about executive remuneration in the UK; it is not appropriate here to suggest steps that should be taken in this regard but the spontaneity and vehemence with which this issue was raised by a number of interviewees (with differing backgrounds and views about company law) was striking.

47. Although the role of academics as 'critic and conscience' (see, for example, Bridgman 2007), on the basis of their relatively independent perspective and presumed ability to assess evidence, could be grounds for suggesting otherwise. Indeed Bridgman argues that: '[being the] critic and conscience of society is a statutory obligation for universities' (Bridgman 2007: 126).

Appendix 1: Changes in the statutory statement of directors' duties

Prior to CA 2006, the wording relating to directors' duties in section 309 CA 1985 was as follows.

> *(1) The matters to which the directors of a company are to have regard in the performance of their functions include the interests of the company's employees in general, as well as the interests of its members.*
>
> *(2) Accordingly, the duty imposed by this section on the directors is owed by them to the company (and the company alone) and is enforceable in the same way as any other fiduciary duty owed to a company by its directors.*

The wording relating to directors' duties in section 172 CA 2006 is as follows.

> *(1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to –*
>
> *(a) the likely consequences of any decision in the long term,*
>
> *(b) the interests of the company's employees,*
>
> *(c) the need to foster the company's business relationships with suppliers, customers and others,*
>
> *(d) the impact of the company's operations on the community and the environment,*
>
> *(e) the desirability of the company maintaining a reputation for high standards of business conduct, and*
>
> *(f) the need to act fairly as between members of the company.*
>
> *(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.*
>
> *(3) The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company.*

Appendix 2: Research methods

Three different methods were employed when conducting this research because it was believed that no one approach would allow the research questions to be fully addressed. Thus 13 semi-structured interviews were conducted with a range of individuals involved in the CLR process, which ultimately resulted in the Companies Act 2006 (CA 2006). The interviews sought to ascertain views about how the rationale for shareholder primacy in UK company law had been considered during the CLR process, and opinions about the final outcomes. Specifically, a semi-structured interview template was developed with 15 questions that sought interviewees' views on:

- the operation and membership of the CLR process
- the evidence considered by the CLR and the emergence of the enlightened shareholder value approach, which underpinned the legal framework for directors' duties in CA 2006
- the implications of UK companies' adoption of the maximisation of shareholder value as their corporate objective, and
- the possibility that broader corporate objectives based on a range of social indicators could influence the review of the legal framework for companies.

The set of semi-structured interview questions was emailed to participants before each interview and used as a template for structuring the discussion that took place; participants did not have to stick rigidly to the order of the questions as listed, nor did the questionnaire limit the discussion that took place. Each interview lasted for about 90 minutes, on average, and was attended by two members of the research team. All but one of the interviews were taped; these tapes were then transcribed and the text analysed by at least two members of the team. Detailed notes were taken in the case of the unrecorded interview and these were discussed and agreed by the two interviewees. Responses to each question were documented and insights noted; quotes were identified to express the points being made. These points were then summarised across all the participants and findings highlighted. More details on the roles and backgrounds of the interviewees are given in the introduction to Chapter 4.

In addition to this main group of interviews, two interviews were held with a board member and with a company secretary of separate listed companies to shed light on the impact of CA 2006 on boards' procedures and decision-making processes. Furthermore, a meeting was held with a group of officials at the Department for Business Innovation and Skills (BIS) at an early stage of the research to assist the researchers in understanding the procedures, including the CLR, which had led up to the new Companies Act.

The second research method involved a summary analysis of the public submissions to the CLR. Two versions of the submissions were analysed in this part of the research: those included on the website of the CLR and summaries of the submissions that had been undertaken by the DTI.[48] The texts were scrutinised to determine whether the submissions had referred to the shareholder primacy issue or addressed the question 'in whose interests should UK companies be run?' Specifically, any discussion of the goals that UK companies might adopt was noted and any arguments about the maximisation of shareholder value as a corporate objective highlighted. These discussions and arguments were then examined to assess the range and volume of arguments advanced regarding the deliberations of the CLR and the resultant formulation of directors' duties in CA 2006.

Finally, articles in the financial press were scrutinised to investigate the nature of any coverage of the CLR during its period of operation. In particular, the Nexis database was searched and references to the CLR in all national newspapers noted for the period between 1998 and 2006; all articles containing such references were downloaded and read by the research team; this part of the analysis then focused on articles from the *Financial Times* because references to the CLR in other newspapers were scarce. Thus, the *Financial Times* pieces with references to the CLR were examined by two members of the research team and their contents analysed. This content analysis noted the number of references to the CLR, the topic of the piece, the format of the publication (eg letter, article, feature) and its average length. In addition, a spreadsheet was set up to summarise this information about each article; the spreadsheet was then analysed to examine the overall coverage of the CLR within the FT throughout the period from the beginning of the Review to the passing of the CA 2006. Further, the subset of articles that focused on the corporate objectives of UK companies and the legal duties of directors that their authors thought should be enshrined in UK law were examined in greater detail. Specifically, arguments raised about the maximisation of shareholder value as a corporate objective were documented in order to get some impression about the public debate that existed at the time, which had possibly been sparked by the CLR process. These arguments were summarised and the findings are reported in Chapter 3 of this report.

48. The government department responsible for company law matters and whose secretariat carried out the CLR has had several manifestations and changes of name. At the time of the review it was known as the Department of Trade and Industry (DTI). The DTI was disbanded when the Department for Business, Enterprise and Regulatory Reform (BERR) was created in June 2007; and it, in turn, was disbanded in June 2009 when the still extant Department for Business, Innovation and Skills (BIS) was formed. The name used in this report reflects the chronological context.

Appendix 3: A critical appraisal of the arguments made for and against shareholder primacy in the CLR documentation

The rationales for and against shareholder primacy were examined in the CLR documentation and this Appendix outlines and considers these arguments; it also uses key examples of the terminology that the CLR employed.

In DTI (1998), the launch document of the Company Law Review process, the duties of directors were raised as an important issue that the CLR would address. The fundamental question was put this way:

> [a] *wider issue for the review is whether directors' duty to act in the interests of their company should be interpreted as meaning simply that they should act in the interests of the shareholders, or whether they should also take account of other interests, such as those of employees, creditors, customers, the environment, and the wider community*. (DTI 1998)

The document expresses the DTI's desire to 'stimulate wider discussions' of these issues and to explore whether they 'just represent interesting philosophical ideas and ideals' or whether they could lead to 'concrete proposals'.

In the subsequent CLR document, *The Strategic Framework* (CLRSG 1999), the key alternatives are outlined. It is accepted as given (p. vi) that directors should 'have regard' to the interests of a range of 'interested parties' and to the 'longer term', and two competing approaches are then aired. These are the 'enlightened shareholder value' approach, which is described as being consistent with 'present principles', and the 'pluralist' approach, in which directors would be 'permitted (or required) to balance shareholders' interests with those of others committed to the company' (p. vi).

Various arguments and counter arguments are advanced in CLRSG (1999) for the two approaches (although in fact the term 'counter arguments' (CLRSG 1999: 43) was used only in relation to the pluralist approach).

The first argument advanced for enlightened shareholder value (p. 37) is that, in the view of its supporters, the ultimate objective of generating 'maximum value for shareholders' is also, in principle, the best means of securing overall prosperity and welfare. It is observed, however, that 'many who take this view' are aware that these outcomes may not be achieved if there is undue focus on the 'short-term financial bottom line'. (Although this point is described as an argument in the CLR documentation, it is merely an assertion whose empirical validity is not addressed).

The first argument advanced in favour of the pluralist approach is that non-shareholder contributors to the wealth-creating process will be more inclined to make the commitments needed for success of the company (p. 38) in the long term (such as firm-specific training on the part of employees, investment in specialist facilities by suppliers, and long-term agreements with customers) if their interests are to be balanced with, rather than secondary to, the interests of shareholders.

CLRSG (1999: 39) then notes that if directors' duties are owed to the 'company' the choice between the two systems turns on whether the company is to be equated with shareholders alone, or the shareholders plus other participants.

After making these initial points, the CLRSG (1999: 39) moves on to consider the implications of the two approaches for reform of the law. The first point made is that an enlightened shareholder value approach would not require reform to the fundamentals of directors' duties (and at that point it is also suggested that problems of short-termism could be addressed by greater disclosure, though this suggestion is deferred for later discussion in the document). There is then discussion of the extant wording of the law on directors' fiduciary duties (section 309 CA 1985) and the main message is that it needs to be clarified.

In the consideration of the pluralist approach, the previous argument about commitments is reiterated and a further argument is added as follows: 'in modern companies it is no longer necessarily the case that shareholders are the sole repositories of residual risk which cannot be diversified away' (CLRSG 1999: 43). This wording reads a little oddly for in fact, of all stakeholders – especially in large companies – shareholders are, and have for long been, the stakeholders who can most easily diversify.

CLRSG (1999) now turns to the counter arguments to 'pluralist views'. The first such counter argument (p. 43) is that a pluralist approach is not needed since an enlightened shareholder value approach has the potential to achieve the same framework for developing long-term commitments based on trust. Clearly, a precisely symmetrical and opposite 'counter argument' could be applied to the 'enlightened shareholder value' approach on the same grounds. Since this version of the argument is not made it appears that, all things being equal, maintenance of the status quo is regarded as inherently desirable, though this is not made explicit.

The second counter argument (CLRSG 1999: 44) is that it is not self-evident that normal commercial bargaining 'between suppliers and consumers of factors of production' cannot generate the necessary safeguards or incentives required to encourage long commitments. This is, of course, an argument that could be applied to all commercial relationships including that between directors and shareholders, and is one that may offer little reassurance when, for example, small suppliers are dealing with large corporations.

The third counter argument (p. 44) is that 'if there are deficiencies in this area they are best made good by changes in other areas of the law and public policy, or in best practice' rather than in company law. The possibility of 'unpredictable and damaging effects' is raised in relation to changes in company law, but not to any of the former options.

The fourth counter argument (p. 44) is that to 'change the focus of directors' from increasing 'the value of the business over time' in favour of a 'broader objective' involving a 'trade off of interests of members and others' would distract management into a 'balancing style', 'at the expense of economic growth' and 'competitiveness'.

The wording of this fourth counter argument is also curious. First, it discards, in fact it implicitly rejects without acknowledgement, the point that balancing of interests through the improved commitment of stakeholders is intended to achieve better long-term value. Secondly, the paragraph is laced with gratuitous and pejorative terms: management would not just be 'distracted', they would be 'dangerously' distracted; the 'others' who are referred to, along with the shareholders, are described as being 'in some aspects' 'adversarial' which rather misses the point of pluralism; the balancing is described as 'political', and the spectre of relative national decline is raised since 'competitiveness' is qualified as 'international competitiveness' even though our main trading partners typically have a pluralist approach to company law and practice.

These four counter arguments are followed by the observation that accepting the case for pluralism would require the 'net[49] benefit, in overall welfare terms' not only to outweigh the four possible objections just outlined but also to outweigh the 'necessary disadvantage to shareholders'. This onus of justification that is required of pluralism seems to be a rhetorical device since it is not followed up by any proposals for assessing welfare benefit. Evidence of the social-welfare performance of countries in which versions of pluralism are the norm were adduced earlier in this report, but no such evidence appeared to be considered by the CLR.

In fact, the interviews reported in Chapter 4 confirm that no such evidence figured in the CLR, though a number of interviewees were of the opinion that such evidence could and should have been considered.

A further argument against pluralism appears a little later in CLRSG (1999) and this one is subsequently given significant emphasis in CLR documentation. The argument is essentially one that was put forward by Jensen (2001) and is what CLRSG (1999: 45) calls 'a dangerously broad and unaccountable discretion', should directors be enabled to 'diverge from the enlightened shareholder value objective'. The equivalent point, as made by Jensen, is that managers need to have a single objective function in order to engage in 'purposeful behavior' since 'it is logically impossible to maximise in more than one dimension' (Jensen 2001: 297). This argument from Jensen arguably begs the question (in the sense of assuming what needs to be proved) since the maximisation of the interests of one particular group is not the point of a pluralist approach. Alternatively, Jensen is accepting, as an article of faith, that what maximises shareholder value maximises social welfare: that assumption is challenged by evidence elsewhere in this report.

As already reported, the CLR also envisaged greater transparency to a 'take account of the information needs' of a 'wide range of users' as a key part of its original proposals. Enlightened shareholder value and enhanced transparency were regarded as 'two pillars'. Of course, as a vehicle for greater disclosure, the OFR was weakened as the proposal proceeded towards legislation, by dispensing with the requirement to consider the needs of users other than shareholders. Then, as we have seen, the OFR was dispensed with altogether as a mandatory requirement.

But even if the original proposals had come through unscathed, the sovereignty of shareholders would have been undiminished notwithstanding the aspiration set out by the CLRSG (1999: 51).

> *Enhanced reporting obligations operating within a structure of enlightened shareholder value have the capacity in principle to achieve the objectives of a more pluralist approach, by ensuring that it is in the self-interest of members that such pressures should be satisfied.*

The argument turned on the supposition that publishing a company's accounts and reports 'enables the public at large to evaluate its performance and bring pressure to bear on the company as a whole, both members and directors, so as to satisfy relational and wider social interests'. The potency of such reporting was held to be at risk within a framework in which directors have 'pluralist' discretions since, 'if members' powers are correspondingly diminished the reality of any such constraint will be debatable' (CLRSG 1999: 52).

49. It may be noted that the use of the word 'net' in this context is redundant.

This example of the CLR's reasoning does emphasise first, that the possibility of achieving pluralist objectives – even assuming the existence of the second 'pillar' of wider accountability – is to be dependent on the shareholders' assessment of what constitutes a reasonable balance of interest. And, in that regard, the shareholders' normal criterion for assessing these issues was asserted, by the then Attorney General during the parliamentary stages, to be financial:

> *it is essentially for the members of a company to define the objectives they wish to achieve. …For most people who invest in companies, there is never any doubt about it—money. That is what they want.* (Goldsmith 2006: 8).

Secondly, it also reiterates the central rationale for shareholder primacy, advanced in the CLR and by some of our interviewees, namely that directors should have only one objective – and that should be to maximise shareholder value (as determined by shareholders).

That key argument, based on the difficulty of controlling the potential abuse of directors' discretion in the absence of shareholder sovereignty, was accepted as virtually unanswerable within the CLR documentation. This position was not accepted by a number of our interviewees, and is clearly open to question, as noted in Chapter 2, since such corporate governance regimes are the reality in many developed economies, as noted in this report. An elegant riposte to this particular criticism of pluralism was made by Kay (1996) when he observed that:

> *the most common answer to the stakeholder* [ie pluralist] *argument is that to pursue a multiplicity of objectives is unmanageable. In answer to this we should simply think about how we do exactly that in almost every aspect of our daily lives.* (Kay 1996: 79).

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