



University of
Salford
MANCHESTER

Exploring the rationale of enlightened shareholder value in the realm of UK company law – the path dependence perspective

Wen, S and Zhao, J

Title	Exploring the rationale of enlightened shareholder value in the realm of UK company law – the path dependence perspective
Authors	Wen, S and Zhao, J
Publication title	International Trade and Business Law Review
Publisher	Murdoch Law School
Type	Article
USIR URL	This version is available at: http://usir.salford.ac.uk/id/eprint/15818/
Published Date	2011

USIR is a digital collection of the research output of the University of Salford. Where copyright permits, full text material held in the repository is made freely available online and can be read, downloaded and copied for non-commercial private study or research purposes. Please check the manuscript for any further copyright restrictions.

For more information, including our policy and submission procedure, please contact the Repository Team at: library-research@salford.ac.uk.

EXPLORING THE RATIONALE OF ENLIGHTENED SHAREHOLDER VALUE IN THE REALM OF UK COMPANY LAW – THE PATH DEPENDENCE PERSPECTIVE

SHUANGGE WEN* AND JINGCHEN ZHAO**

Abstract

Despite conventional beliefs in the predominance of shareholder value, a broader agenda of stakeholder consideration has been advocated in the UK by the recently-introduced ESV principle – the overriding corporate objective in the new company law regime. In this paper, the efficiency of this principle in terms of stakeholder enhancement is challenged through an interdisciplinary analysis. Through a critical review of the ESV principle, it is discovered that stakeholder enhancement practices in the context of the 2006 company law regime are still for the fundamental goal of shareholder value maximisation, and that their enlightened impact has been fairly limited in practice. Furthermore, by revisiting the interrelationships between UK economic, political and cultural factors with the predominance objective of shareholder value maximisation in the *Companies Act 2006*, it is discovered that the enlightened effect of this new approach in the company law regime is in fact impeded by strong, persistent forces deriving from shareholder-oriented particulars. Providing insight into the future direction of corporate governance practice, the paper concludes the rationale behind the shareholder-oriented ESV principle, and further suggests the continuing predominance of shareholder value in UK corporate governance.

I INTRODUCTION

In 2006, based on recommendations from the Company Law Review Steering Group (CLRSG), The UK *Companies Act 2006* acquired Royal Assent and become the cornerstone of the new company law regime. The newly-defined objective of the company – the Enlightened Shareholder Value (ESV) approach, has been set out in this new *Companies Act*, intending to become a significant expansion to the scope of the UK traditional shareholder value paradigm.¹

So far, the enlightened effect of s 172(1) has been keenly debated in a large body of corporate governance literature. Scholars represented by Williams and Conley present the argument that the shift to this long-term ESV approach effectively enhances stakeholder concerns and directs the UK towards a ‘third way’ that merges elements of both shareholder and stakeholder-oriented practice.² In contrast, scholars including Birds and Keay, hold the countervailing view that this new statutory directors’ duty offers little to non-shareholder interest groups in practice, and the UK shareholder-centred perspective remains intact under this new ESV approach.³

Based on path dependence and the complementarity argument, this paper will attempt to explain the rationale behind the ESV principle in the UK context. It starts by critically evaluating the effect of the ESV principle in enhancing stakeholder consideration. It will be seen that the ESV approach in the new company law regime is merely a means to achieve the fundamental corporate objective of shareholder wealth maximisation. It does not deliver any significant change to the existing UK shareholder-oriented corporate governance culture. In the next part, potential explanation will be sought for such strong persistence of shareholder value in UK corporate governance. By revisiting the interrelationships between UK economic, political and cultural factors with the predominant objective of shareholder value maximisation in the legal context, the concrete ideology of shareholder value as the predominant corporate objective in the UK will be entrenched theoretically. It will be seen that those factors are influential in shaping the dynamic properties of UK shareholder-oriented corporate governance. Though the stakeholder-oriented approach has been tried and tested in other

* Shuangge Wen, (LLB, LLM, PhD), Lecturer in Law, School of Law, The University of Liverpool, UK.

** Jingchen Zhao, (LLB, LLM, PhD), Lecturer in Law, School of Law, The University of Salford, UK.

¹ For the purpose of this article, the shareholder value paradigm is regarded as primarily referring to the welfare priority in corporate governance, i.e., the maximisation of shareholder wealth. It embraces the idea that shareholders’ interests should be regarded as the ultimate interests of the company and the company should pursue the objective of maximizing shareholders’ interests.

² Cynthia Williams and John Conley, ‘An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct’ (2005) 38 *Cornell International Law Journal* 493, 496.

³ John Birds, ‘The Companies Act 2006: Revolution or Evolution?’ (2007) 49 *Managerial Law* 13; Andrew Keay, ‘Tackling the Issue of the Corporate Objective: An Analysis of the United Kingdom’s ‘Enlightened Shareholder Value Approach’’ (2007) 29 *Sydney Law Review* 577.

jurisdictions,⁴ it is not applicable in the UK because it does not integrate with existing institutional arrangements and historical traditions which are strongly shareholder-oriented. The rationale behind the ESV approach in UK corporate governance, despite its inefficiency in stakeholder consideration, is therefore sufficiently justified.

II AN OVERVIEW OF THE ESV APPROACH

Regarded as one of the most important and radical changes in the UK 2006 company law regime, the ESV approach enshrined in the *Companies Act* purports to introduce a new corporate objective for UK directors to aim for in corporate governance. Significantly, the new codified expression of directors' 'good faith' fiduciary duty in s 172(1) 'captures a cultural change in which companies conduct their business'⁵ by introducing the concept of ESV into the UK corporate governance.

It is stated in *Companies Act 2006* s 172(1) that:

(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 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 between the members of the company.

This provision embraces two significant elements concerning the way directors should operate the company. Firstly, it is recognised that directors have to have regard to the non-shareholder groups' interests if they are to discharge their general duty in ss 172(1)(a)-(f). For the first time in UK law, the significance of paying attention to a wider range of interests additional to shareholders', particularly in respect to the long-term well-being of the corporation and benefit of the shareholders, is statutorily recognised. This approach is deemed as a legal response to modern business operations, in which business interests and the wider community are closely interconnected in many aspects.⁶ Secondly, it is clearly stated that the stakeholder consideration and the long-term concern required in s 172(1) are all for the aim of maximising shareholders' benefits, or, in the words of s 172(1), 'promote the success of the company for the benefit of its members as a whole'. So far, the most authorised view interprets the meaning of the 'success of the company' as what the members collectively want the company to achieve. For a commercial company, success will usually mean long-term increase in value...the principle does not change that those who establish the company will start off by setting out what they hope to achieve. For most people who invest in companies, there is never any doubt about it – money.⁷

The explicit recognition in s 172(1) of non-shareholder groups' interests is therefore still instrumental, i.e., for the ultimate objective of maximising shareholder wealth. The necessity of such instrumental purpose lies in that, 'businesses normally best generate wealth where participants operate harmoniously as teams and that managers should recognise the wider interests of the community in their activities.'⁸

III THE PRACTICAL EFFECT OF THE ESV APPROACH IN STAKEHOLDER ENHANCEMENT

A *The Continuing Predominance of Shareholder Value*

In a broader sense, it is expected by the Government that the implementation of s 172(1) will help create a long-term corporate culture in the UK and eliminate the 'undue focus on the short term and the narrow interest of members at the expense of what is in a broader and a longer term sense the best interest of the enterprise'.⁹ This provision was initially drafted in Cl B3(3) of the Government White Paper *Company Law Reform*¹⁰ as requiring a director to take into account 'the likely consequences (short and long term) of the actions open to the director'. In s 172(1), rather than emphasising both

⁴ Deryn Fisher, 'The Enlightened Shareholder – Leaving Stakeholders in the Dark: Will Section 172 (1) of the Companies Act 2006 Make Directors Consider the Impact of Their Decisions on Third Parties?' (2009) *International Company and Commercial Law Review* 10, 12.

⁵ Margaret Hodge, *Companies Act 2006: Duties of Company Directors – Ministerial Statements* (2007) 2.

⁶ *Ibid.*

⁷ *Ibid* 7.

⁸ CLRS, *Modern Company Law for a Competitive Economy: The Strategic Framework*, URN 99/654, (1999) 5.1.9.

⁹ *Ibid* 5.1.17.

¹⁰ Department of Trade and Industry (DTI), *Company Law Reform – White Paper* (2005).

short-term and long-term interests of the company, durable company development has been explicitly highlighted for directors to have regard to, which indicates the Government's attitude that it is the long-term that is more important.¹¹

Despite the Government's expectations in stakeholder enhancement, the practical perspective of this stipulation is not satisfactory: the predominance of shareholder value orientation has been entirely preserved under the ESV approach by the stipulation that stakeholder concerns are for the benefit of company members. In s 172(1), different expressions of 'act in the way' and 'have regard to' are respectively used in addressing directors' regard to shareholders' interests and stakeholders' interests. The phrase 'have regard to' indicates that the consideration of stakeholders' interests is purely at directors' discretion and exercised only when such action would be beneficial to the paramount interests of shareholders.¹² According to s 172(1), directors would be obliged to act for the interests of shareholders, but not bound to act for stakeholders' interests as all they are required is to take those interests into account in good faith. If stakeholder consideration is in conflict with the consideration of the interests of shareholders, certainly the latter will supersede. Most of the UK shareholder-oriented factors constituting the 1985 company law structure, including fundamentals of directors' duty to act for shareholder's interests and shareholders' ultimate controlling rights, therefore continue to be preserved as the centre of the new company law framework.¹³

B Practical Difficulties of ESV in Terms of Stakeholder Consideration

In addition to the continuing predominance of the shareholder value paradigm, it is discovered that a number of obstacles effectively obstruct the enlightened impact of the ESV principle. This approach in the new company law statute offers little more than established common law principles in relation to stakeholder enhancement and would hardly make any practical difference.

C The Strong Influence of Shareholder-Oriented Common Law and Equity Principles on Statutory Duties

Traditionally, directors' duties in the United Kingdom have been in a fragmented state, embodied in case law, statute law, codes and statements of best practice.¹⁴ To eliminate the considerable overlapping and duplications in this field, directors' duties have been codified and provided in the *Companies Act 2006* ss 171-177.

Nevertheless, considering the fact that the statutory duty of directors in the new company law regime is not an exhaustive list, the UK Government holds the view that despite the enactment of the statutory statement, the continuity between the common law and the statute should not be lost and common law rules and equitable principles may well continue to develop outside company law.¹⁵ It is provided in the *Companies Act 2006* s 170(3) and s 170(4) that the common law rules and equitable principles would remain important in the sense that new codified duties, when applied in practice, shall be interpreted by judges' discretion in the manner of the long-established common law rules and equity principles. As regards the interpretation of s 172(1), it is further provided in the Explanatory Note to the *Companies Act 2006* that this duty is not applied in the area 'where the statutory statement departs from current law'.¹⁶ Therefore, common law and equity principles regarding the traditional *good faith* fiduciary duty of directors, which were developed before the ESV approach, would shed significant light upon the interpretation of the ESV duty under s 172(1).

[The codified duties are] intended to enable the courts to continue to have regard to development in the common law rules and equitable principles applying to these other types of fiduciary relationships. The

¹¹ Derek French, Stephn Mayson and Christopher Ryan, *Mayson, French and Ryan on Company Law*, (Oxford: Oxford University Press, 24th ed, 2007) 457.

¹² Andrew Keay, 'Section 172 (1) of the Companies Act 2006: An Interpretation and Assessment' (2007) 28 *Company Lawyer* 106, 108.

¹³ The Company Law Review did not agree on the statement that the current company law regime encourages a short-term view of directors' functions. The undue focus of corporate management and the narrow interests of company members in practice is explained as the established corporate law has not been well recognised or understood. See CLRSO, *Modern Company Law for a Competitive Economy – The Strategic Framework* (1999) 40: '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.'

¹⁴ Saleem Sheikh, 'Company Law for the 21st Century: Part 2: Corporate Governance' (2002) 13 *International Company and Commercial Law Review* 88.

¹⁵ DTI, *Companies Act 2006: Explanatory Notes* (29 May 2009) <http://www.opsi.gov.uk/acts/acts2006/en/ukpgaen_20060046_en.pdf> 305; Paul Omar, 'In the Wake of the Companies Act 2006: An Assessment of the Potential Impact of Reforms to Company Law' (2009) *International Company and Commercial Law Review* 44, 48.

¹⁶ *Ibid* 298-302.

advantage of that is it will enable the statutory duties to develop in line with relevant developments in the law as it applies elsewhere.¹⁷

Given that there is no judicial precedent for the implementation of s 172(1), the interpretation of all open margins would be left as future work for the courts.¹⁸ It is well anticipated that under the strong influence of existing common law in support of the shareholder value paradigm, the extent to which directors can take into consideration stakeholders' interests under s 172(1) would be strictly constrained by the courts' interpretation.

In addition, it has been found that long before the ESV approach was introduced in the UK, similar principles had already been established in common law in the context of *ultra vires*, under which directors had been granted powers to take into consideration various stakeholders' interests and conduct appropriate action for their interests, provided that such managerial decision was capable of producing a return for shareholders in the future.¹⁹ The most famous judicial statement underlying this principle was from the judgment of Bowen, LJ in *Hutton v West Cork Railway Co*,²⁰ 'the law does not say that there are to be no cakes and ale, but that there are to be no cakes and ale except such as are required for the benefit of the company.' The general doctrine embodied in the judgment is that directors can conduct business for the interests of non-shareholder groups, but only insofar as that will in the end, albeit indirectly, be for the benefit of shareholders. Considering the ESV principle in s 172(1) which states that '(directors act) to promote the success of the company for the benefit of its members as a whole, and in doing so must have regard to (other interests)' it is not difficult to find that the ESV principle does not practically extend the scope of this general doctrine in *Hutton*: the ultimate goal of directors prescribed by ESV is still the maximisation of benefits to shareholders and directors' consideration of constituencies' interests is still regarded as a means to achieve this ultimate objective. The establishment of the ESV approach in the 2006 company law regime certainly could not qualify as rapid progress towards the Continental stakeholder model, as the principle it advocates has already been acknowledged in English common law for more than a century.

D Effect of the Business Judgement Principle in Assessing s 172(1)

It has been long established in common law that directors' fiduciary duty to act for the benefit of the company is governed by the business judgment principle, i.e., when assessing whether directors had breached this duty, the court will consider, in the opinion of directors rather than in the courts' own opinion, if the directors had acted bona fide in the interests of the company.²¹ According to Lord Greene MR in *Re Smith and Fawcett Ltd*,²² '[Directors of a company must act] bona fide in what they consider – not what a court may consider – is in the interests of the company, and not for any collateral purpose. In *Regentcrest plc v Cohen*, this subjective test was further interpreted in detail:

The question is not whether, viewed objectively by the court, the particular act or omission which is challenged was in fact in the interests of the company; still less is the question whether the court, had it been in the position of the director at the relevant time, might have acted differently. Rather, the question is whether the director honestly believed that his act or omission was in the interests of the company. The issue is as to the directors' state of mind. No doubt, where it is clear that the act or omission under challenge resulted in substantial detriment to the company, the director will have a harder task persuading the court that he honestly believed it to be in the company's interests; but that does not detract from the subjective nature of the test.²³

For decades this subjective standard has been the prevalent principle used for the UK and other Anglo-American jurisdictions, including UK courts, to assess directors' managerial decisions. As the central provision of the new Companies Act, s 172(1) has codified directors' fiduciary duty, requiring 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'. This statutory statement,

¹⁷ Lord Goldsmith, *Companies Act 2006: Duties of Company Directors --- Ministerial Statements* (2007) 5-6.

¹⁸ Paul Omar, 'In the Wake of the Companies Act 2006: An Assessment of the Potential Impact of Reforms to Company Law' (2009) *International Company and Commercial Law Review* 44, 51; Bill Perry and Lynne Gregory, 'The European Panorama: Directors' Economic and Social Responsibilities' (2009) *International Company and Commercial Law Review* 25, 30; Luca Cerioni, 'The Success of the Company in s. 172(1) of the UK Companies Act 2006: Towards an 'Enlightened Directors' Primacy?' (2008) 4 *Original Law Review* 8, 24.

¹⁹ Andrew Johnson, 'After the OFR: Can UK Shareholder Value Still Be Enlightened?' (2006) 7 *European Business Organisation Law Review* 817, 825.

²⁰ (1883) 23 Ch D 654.

²¹ John Birds et al, *Boyle and Birds' Company Law* (Jordan Publishing Ltd, 2007) 615; Derek French, Stephn Mayson and Christopher Ryan, *Mayson, French and Ryan on Company Law* (Oxford University Press, 2007) 455.

²² [1942] Ch 304.

²³ [2001] 2 BCLC 80.

nevertheless, provides neither procedural requirement nor practical criteria to assess directors' behaviour as regards what directors should achieve in order to fulfil the requirement of 'having regard to 'stakeholders' interest'.²⁴ The main requirement in s 172 appears to be 'good faith', which is explained by the Company Law Reform Bill Guidance as 'the decision as to what will promote success [of the company], and what constitutes such success, is *one for the directors' good faith judgment*. This ensures that business decisions on, for example, strategy and tactics are for the directors, and not subject to decision by the courts, subject to good faith.'²⁵ It therefore appears that the business judgment rule will continue to apply to assess if a director is in breach of s 172(1), and 'unequivocally refers to a subjective test only'²⁶: the court will see, in the way a director but not the court considers, if the director's act would be to promote the success of the company for the benefit of its members.

A major downside with this subjective standard is that it runs the risk of granting directors 'unfettered discretion'²⁷ and facilitating them to escape from their stakeholder consideration duty presented in ss 172(b)-(e).²⁸ It would be entirely up to directors' discretion to determine the proper extent of stakeholder consideration for the promotion of shareholders' interests. As long as the UK directors can prove they acted in good faith for the benefits of shareholders, it is unlikely that they would be held liable under s 172(1) for not considering stakeholders' interests. Coupled with the fact that shareholders are now statutorily entitled to derivative proceedings,²⁹ predictably, directors would be more willing to risk a technical breach of stakeholder consideration in practice than fail to promote the ultimate interests of shareholders.³⁰

E The Lack of Remedy Support for Stakeholders under s 172(1)

So far, most of the opposing voices challenging the enlightened impact of s 172(1) have arisen with respect to the *enforceability* of stakeholders' interests. Remedy methods stakeholders could rely on are mainly provided outside the scope of company law. There is no direct remedy support for stakeholders in the *Companies Act 2006* when directors fail to consider their interests listed out in ss 172(1)(a)-(f). As criticised, 'a right without a remedy is worthless'.³¹ In practice, there is a great chance that non-shareholder constituencies prescribed in s 172(1) will not be informed of directors' behaviour properly or in a timely manner as they are not participating in the corporate decision-making process. Even if they have found out that directors have breached s 172(1) by failing to take proper consideration of their interests, there would be no appropriate legal action available for them to take against the directors. In the *Companies Act 2006*, the remedy for breach of duties is either exercised by the company itself, or by shareholders who are the only constituency group entitled to bring legal action against directors.³² Obviously, it is impractical and highly impossible for shareholders to bear the time and cost of bringing litigation in the interests of other constituencies.

One could envisage them doing so if directors have failed to act so as to promote the success of the company for the benefit of the members or fail to have regard for the need to act fairly as between members (s 172 (1) (f)), but this is not so likely to occur, if at all, in circumstances where the directors fail to have regard for the other interests incorporated in s 172 (1), especially when one takes into account the fact that there is likely to be a cost element in any derivative claim.³³

²⁴ Parliamentary Joint Committee on Corporations and Financial Services, Commonwealth of Australia, *Corporate Responsibility: Managing Risk and Creating Value*, (29 May 2009) <http://www.aph.gov.au/SENATE/committee/corporations_ctte/completed_inquiries/2004-07/corporate_responsibility/index.htm> 55.

²⁵ DTI, *Guidance on Key Clauses to the Company Law Reform Bill* (2005) 64.

²⁶ Andrew Keay, 'Section 172(1) of the Companies Act 2006: an Interpretation and Assessment' (2007) 28 *Company Lawyer* 106, 108.

²⁷ CLRS, *Modern Company Law for a Competitive Economy: Developing the Framework*, (2000) 2.11.

²⁸ Deryn Fisher, 'The Enlightened Shareholder –Leasing Stakeholders in the Dark: Will Section 172(1) of the Companies Act 2006 Make Directors Consider the Impact of Their Decision on Third Parties?' (2009) *International Company and Commercial Law Review* 10, 15.

²⁹ *Companies Act 2006* s 260(1).

³⁰ Deryn Fisher, 'The Enlightened Shareholder –Leasing Stakeholders in the Dark: Will Section 172(1) of the Companies Act 2006 Make Directors Consider the Impact of Their Decision on Third Parties?' (2009) *International Company and Commercial Law Review* 10, 16.

³¹ Morey McDaniel, 'Bondholders and Stockholders' (1988) 13 *Journal of Corporation Law* 205, 209.

³² It is provided in s260(3) that a derivative claim may be brought by a member of the company (subject to court approval) in respect of a cause of action arising from an actual or proposed act or omission involving breach of duty by a director of the company; *Companies Act 2006* s260(1).

³³ Andrew Keay, 'Section 172 (1) of the Companies Act 2006: An Interpretation and Assessment', (2007) 28 *Company Lawyer* 106, 109.

The fact that only the company, via its shareholders, has the capacity to enforce this duty of stakeholder consideration therefore seriously challenges the practical effectiveness of this 'enlightened approach'.³⁴

IV LIMITED IMPACT OF THE BUSINESS REVIEW

In addition to s 172(1), it is designated in the new company law regime that the ESV principle should also be embraced in the context of corporate disclosure. In s 417, it is required that the directors' report must contain a business review, including relevant information regarding stakeholder matters and social and environmental concerns, to the extent necessary for an understanding of the development, performance or position of the business of the company.

This Business Review provision was formulated on the basis of the preceding Operating and Financial Review (OFR) regime recommended by the CLRSG.³⁵ Given that corporate disclosure has long been regarded as an important means of enhancing directors' accountability and improving corporate transparency,³⁶ the OFR requirement, which significantly embraced disclosure on stakeholder issues, was regarded as a key mechanism for reinforcing the ESV principle.³⁷ The disclosure practice suggested by the OFR Scheme also gained wide practical support of most large and quoted British firms even before it was mandatorily introduced. In a report issued by the Accounting Standards Board (ASB) in 1993, it was discovered that the relevant OFR disclosure requirement was complied with by more than 60 percent of listed companies at that time, though with wide variations in content and consistency within the statement.³⁸ Yet only a few months after its introduction,³⁹ this OFR measure was dramatically withdrawn as a piece of unnecessary 'red tape'⁴⁰ on the grounds that it might result in unnecessary burdens for directors and companies. The act of replacing the statutory OFR with the Business Review represents a backwards step in the corporate sector's commitment to the social and environmental agenda.⁴¹

In general, the OFR report was expected to work as a central strategy to help investors gain greater insight into the long-term development and position of the company, and to subsequently relieve directors from short-term profit maximisation pressures. Therefore, it had a focus on the disclosure of strategic and forward-looking information. Under the OFR requirement, directors are required to disclose the business objectives and strategies, available resources, capital structure, trade policies, as well as main trends and factors underlying the development, performance and position of the company during the financial year. In contrast, in the new Business Review provision, the disclosure requirement is far less detailed regarding information for stakeholder groups and relevant corporate policies.⁴² Most importantly, under s 417, quoted companies are only expected to disclose environmental, employee, and social issues in the Business Review to the extent that they consider necessary for the understanding of the prospects of the company. Societal and stakeholder

³⁴ John Birds et al, *Boyle and Birds' Company Law* (Jordans, 6th ed, 2007) 405.

³⁵ OFR was recommended by the CLRSG in their report. See CLRSG, *Modern Company Law for a Competitive Economy – Developing the Framework* (2000) 180.

³⁶ For instance, see James Guthrie and Lee Parker, 'Corporate Social Reporting: A Rebuttal of Legitimacy Theory' (1989) 19 *Accounting and Business Research* 343; Trevor Wilmshurst and Geoffrey Frost, 'Corporate Environmental Reporting: A Test of Legitimacy Theory' (2000) 13 *Accounting, Auditing and Accountability Journal* 10.

³⁷ Cynthia Williams and John Conley, 'An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct' (2005) 38 *Cornell International Law Journal* 493, 516.

³⁸ Charles Tiley, 'A Lost Opportunity on Reporting Rules' (2005) *Financial Times*, 29 November 2005; DTI, *Guidance on the OFR and Changes to the Directors' Report* (2005).

³⁹ On 22 March 2005 the Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005 (No 1011) finally came into force, statutorily requiring companies to produce an OFR for the financial year beginning on or after 1 April 2005 alongside the directors' report.

⁴⁰ On 28 November 2005, the Chancellor of the Exchequer announced in a speech to the Confederation of British Industry (CBI) that the OFR was to be withdrawn. See News Room and Speeches, *Speech by the Rt. Hon. Gordon Brown MP, Chancellor of the Exchequer, at the CBI Annual Conference in London*, The National Archive (29 May 2009) <http://www.hm-treasury.gov.uk/speech_chex_281105.htm>.

⁴¹ Timothy Copnell and Julian Oram, *The End of the OFR – and Corporate Responsibility?* Accountant Age (29 May 2009) <<http://www.accountancyage.com/accountancyage/comment/2148650/adequate-replacement>>. For examples of criticism to the abolishment of OFR, see Andrew Johnson, 'After the OFR: Can UK Shareholder Value Still Be Enlightened?' (2006) 7 *European Business Organisation Law Review* 817; John Birds et al, *Boyle and Birds' Company Law*, (Jodrans, 6th ed, 2007) 405.

⁴² Department of Business Enterprise and Regulatory Reform, *Table comparing the requirements of the Business Review and the Operating and Financial Review* (29 May 2009) The National Archives <<http://www.berr.gov.uk/bbf/corp-gov-research/page21369.html>>: A table has been produced by the Department for Business Enterprise and Regulatory Reform, which contains major comparisons of the main requirements of the Business Review and the Operating and Financial Review, principally from the amendments to the *Companies Act* 1985, inserted by SI 2005, No 1011.

disclosure is no longer mandatory and directors can freely decide whether or not to disclose such information.⁴³ In addition, qualitative information disclosure is no longer mandatory after the OFR has been abolished, and (the disclosure of qualitative information) 'is just fog if it is not reported regularly and collected in a consistent and sensible way'⁴⁴. The reason that the Business Review provision is far less detailed and weakly-focused in enhancing both the long-term strategy and stakeholder-related information disclosure, as claimed by the Government, is to 'keep regulatory burdens to a minimum'.⁴⁵ Meanwhile, it also indicates that the enlightened impact expected of s 417 is going to be at a minimum level.

In terms of practical effect, it is also argued that the practical influence of the Business Review provision would not be as powerful as the OFR. The OFR standard was based on a detailed reporting standard published by the Accounting Standards Board in 1993, which provided a disclosure framework to help reporting companies define the content and scope of their OFRs.⁴⁶ In contrast, there is no relevant supporting standard for the implementation of the Business Review. The lack of statutory standard support and heavily diluted auditing requirements of the Business Review requirement seriously undermine its practical effectiveness.⁴⁷ The introduction of the Business Review therefore must be considered as a regressive movement away from enforcing the enlightened approach in corporate governance.⁴⁸ The less satisfactory enlightened impact of the Business Review provision, nevertheless, indicates the unwillingness of the British Government to incur any change which would possibly disturb its traditional shareholder value regime. In Gordon Brown's speech in which the decision to repeal the OFR requirement was announced, the reluctance of the British Government to adjust its shareholder-oriented corporate governance practice to the pan-European convergence practice has been sufficiently revealed:

I've been concerned about what is called the gold-plating of European regulation, where in the process of translation, into the UK, we end up with additional and unnecessary burdens. ... So we will abolish this (OFR) requirement and will reduce the burden placed on you.⁴⁹

V PATH DEPENDENCE AND COMPLEMENTARITY CONCERNS IN UK CORPORATE GOVERNANCE: THE PERSISTENCE OF SHAREHOLDER VALUE ORIENTATION

Further to previous discussions, it is presented in this section that path dependence theory, together with the paradigm of complementarity, effectively explains the rationale of systematic persistence of shareholder value orientation in the realm of UK corporate governance. According to these two theories, a corporate governance system is deeply embedded into its domestic environment through both its historical evolution and its coherence with interrelated national forces, involving political forces, legal influences and cultural backgrounds. Internal arrangements of the corporate governance system, for instance shareholder powers and labour relations, are therefore shaped by and complementary to local economic, social and legal contexts, which consequently leads to the persistence of the shareholder value paradigm in the UK.

VI PATH DEPENDENCE THEORY AND THE COMPLEMENTARITY ARGUMENT

As a fairly new concept originated in the 1980s, the first well-known use of the term 'path dependence' in referring to the feature of persistence was by David in his article 'Clio and the Economics of QWERTY'.⁵⁰ In this article, the continuing use of standard keyboard 'QWERTY' was applied as an example to illustrate the stability of path dependence concerns: because of the influence of a number of 'historical accidents', a relatively ineffective technology or approach could be 'locked in' and survive in practice for a long period, regardless of the available choice of more efficient technologies.⁵¹ The

⁴³ *Companies Act 2006* s417(5).

⁴⁴ Margaret Blair and Steven Wallman, *Unseen Wealth: Report of the Brookings Task Force on Intangibles* (2001) 59-60; Andrew Johnson, 'After the OFR: Can UK Shareholder Value Still Be Enlightened?' (2006) 7 *European Business Organisation Law Review* 817, 840.

⁴⁵ John Birds et al, *Boyle and Birds' Company Law* (Jordans, 6th ed, 2007) 405.

⁴⁶ Radley Yeldar's Seminar Guidance, *Goodbye OFR, Hello Business Review* (29 May 2009) <http://www.ry.com/files/publication/1146/all_change.pdf>.

⁴⁷ David Williamson and Gary Lynch-Wood, 'Social and Environmental Reporting in UK Company Law and the Issue of Legitimacy' (2008) 8 *Corporate Governance* 128, 137.

⁴⁸ Andrew Johnson, 'After the OFR: Can UK Shareholder Value Still Be Enlightened?' (2006) 7 *European Business Organisation Law Review* 817, 840.

⁴⁹ Gordon Brown, *Full Speech by the RT Hon Gordon Brown MP to the CBI Interactive Conference* (29 May 2009) Confederation of British Industry <<http://www.cbi.org.uk/ndbs/press.nsf/0363c1f07c6ca12a8025671c00381cc7/ee59d1c32ce4ec12802570c70041152c?OpenDocument>>.

⁵⁰ Paul David, 'Clio and the Economics of QWERTY' (1985) 75 *American Economic Review* 332.

⁵¹ Reinhard Schmidt and Gerald Sprindler, 'Path Dependence, Corporate Governance and Complementarity' (2002) 5 *International Finance* 311.

path dependence theory has been further simplified by recent scholarship as 'history matters',⁵² and has been widely applied to explain various economic and legal phenomena, for instance, the long-term stability of economic institutions regardless of their competency,⁵³ the evolution process of the common law system,⁵⁴ and the 'lock in' factors under legal circumstances.⁵⁵

The theory of path dependence was initially applied by Bebchuk and Roe in the realm of corporate governance to suggest that corporate governance systems of current major capitalist economies are unlikely to converge towards a single system based on 'best practice'.⁵⁶ As argued, being part of the domestic framework, a corporate governance system has significant sources of path dependence, which include historical accidents, economic and political particulars of the domestic system.⁵⁷ Recent scholarship further expands the scope of domestic path dependence concerns to involve cultural and legal elements,⁵⁸ and institutional complementarities.⁵⁹ The persistence of those sources significantly contributes to the stability of the domestic corporate governance system in the local socio-economic environment and the likelihood of continuing divergence of corporate ownership and governance practices among major economies.⁶⁰ In particular, the combined employment of path dependence theory and the complementarity argument effectively explain the likely persistence of national-specific features in domestic corporate governance: fundamental changes cannot fully occur in a nation's system in the absence of changes of relevant traditions and complementary factors.

VII IDENTIFYING THE ELEMENTS CONTRIBUTING TO UK SHAREHOLDER VALUE PERSISTENCE

A Historical and Economic Influence

By examining the rich diversity of corporate ownership and governance among advanced economies, Bebchuk and Roe discovered the impact of historical evolution of governance structures in preserving domestic diversity. It is argued that the initial ownership and governance structure of an economy has overwhelming influence upon subsequent structure choices, through both its direct structural dependence and the accompanying corporate rules under which the subsequent structures are chosen.⁶¹

By investigating the interdependence between corporate governance systems and matching economic structures, the conventional wisdom that growing competition in the business world would result in convergence in best practice in corporate governance⁶² is further effectively disputed. Elements of a national economic system, for example, the role of capital markets and banking sectors, and the extent of stock market capitalisation, play a crucial role in shaping features of

⁵² Stephen Margolis and Stan Liebowitz, 'Path Dependence, Lock-In, and History' (1995) 11 *Journal of Law, Economics and Organisation* 205; Klaus Heine and Wolfgang Kerber, 'European Corporate Laws, Regulatory Competition and Path Dependence' (2002) 13 *European Journal of Law and Economics* 47.

⁵³ Douglass North, *Institutions, Institutional Change and Economic Performance* (Cambridge University Press, 1990).

⁵⁴ Oona Hathaway, 'Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System' (2001) 86 *Iowa Law Review* 601.

⁵⁵ Clayton Gillette, 'Lock-in Effects in Law and Norms' (1998) 78 *Boston University Law Review* 813.

⁵⁶ Lucian Bebchuk and Mark Roe, 'A Theory of Path Dependence in Corporate Governance and Ownership' (2000) 52 *Stanford Law Review* 127.

⁵⁷ *Ibid.*

⁵⁸ For the path dependence influence of the domestic cultural factor, see Sidney Gray, 'Towards a Theory of Cultural Influence on the Development of Accounting Systems Internationally' (1988) 24 *Abacus* 1; Amir Licht, 'The Mother of All Path Dependencies: Towards a Cross-Cultural Theory of Corporate Governance Systems' (2001) 26 *Delaware Journal of Corporate Law* 147. For the influence of the legal factor, see Rafael La Porta, et al, 'Legal Determinants of External Finance' (1997) 52 *Journal of Finance* 1131; Rafael La Porta et al, 'Law and Finance' (1998) 106 *Journal of Political Economy* 1113; John Coffee, 'The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications' (1999) 93 *Northwestern University Law Review* 642.

⁵⁹ Complementarity refers to the situation where some key corporate institutions are built on one another and take enough of their value from their interaction so that changing one without changing the others is hard. Jeffrey Gordon and Mark Roe, *Convergence and Persistence in Corporate Governance* (2004) 5; Reinhard Schmidt and Gerald Sprindler, 'Path Dependence, Corporate Governance and Complementarity' (2002) 5 *International Finance* 311.

⁶⁰ Lucian Bebchuk and Mark Roe, 'A Theory of Path Dependence in Corporate Governance and Ownership' (2000) 52 *Stanford Law Review* 127.

⁶¹ Lucian Bebchuk and Mark J Roe, 'A Theory of Path Dependence in Corporate Governance and Ownership' (2000) 52 *Stanford Law Review* 127.

⁶² Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 *Georgetown Law Journal* 439; Michael Jensen, *A Theory of the Firm: Governance, Residual Claims, and Organisational Forms* (Harvard University Press, 2000).

the domestic corporate governance system, integrating it into the local environment and potentially obstructing it from taking on changes. 'Differences in the nature of firms and markets ... might have all impeded, and might well continue to impede, convergence of corporate structures'.⁶³ In related empirical research, it has been discovered that the form of governance largely depends upon the country's timing of entry into industrialisation and the extent of institutionalisation.⁶⁴ The strong path dependence influence of both historical evolution and economic arrangements upon corporate governance has therefore been empirically asserted.

B Political Influences

In the light of the emergence of the political theory in the early 1990s, the effect of a nation's political and social arrangements on the continuity of domestic corporate governance features, in particular, the prevailing ownership and governance structure at the firm level, has been sufficiently addressed.⁶⁵

The political theory advocates that a corporate governance system fits into its national political structure and subsequently becomes one consistent 'package of ownership structures and political orientation'.⁶⁶ Determinants in the political field, as argued, has a direct effect on the coherent features of the corporate governance system and act as an impeding force on its further reform. Without a substantial transformation of those political determinants, major reforms in the corporate governance field might generate negative returns due to the incompatibility between the new governance structure and the deep-rooted political framework. The traditional wisdom of economic efficiency being the driver of convergence, as argued, is only a relatively weak source of influence in politically constrained environments.⁶⁷ Exemplifying the political theory, it is found that traditional American policies restraining the development of concentrated powers and ownership of financial institutions have had significant impact upon the formation of its dispersed ownership structure and further shaped its fundamental corporate governance feature - the separation of ownership and control.⁶⁸

C Cultural Diversity

'An essential feature of social systems is the inclusion of a system of societal norms, consisting of the value systems shared by major groups within a nation'.⁶⁹ While the last few decades have seen a significant amount of literature analysing the converging and persisting prospects of national differences in corporate governance, most of the research merely focuses on the divergence among corporate governance and economic systems,⁷⁰ and leaves the cultural diversity among different nations, 'the mother of all path dependencies',⁷¹ ignored.⁷²

⁶³ Lucian Bebchuk and Mark Roe, 'A Theory of Path Dependence in Corporate Governance and Ownership' (2000) 52 *Stanford Law Review* 127, 132.

⁶⁴ Neil Fligstein and Robert Freeland, 'Theoretical and Comparative Perspectives on Corporate Governance' (1995) 21 *Annual Review of Sociology* 21.

⁶⁵ Mark Roe, 'A Political Theory of American Corporate Finance' (1991) 91 *Columbia Law Review* 10; Mark Roe, *Strong Managers, Weak Owners: the Political Roots of American Corporate Finance*, (Princeton University Press, 1994); Mark Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (Oxford University Press, 2002); John Pound, 'The Rise of the Political Model of Corporate Governance and Corporate Control' (1993) 68 *New York University Law Review* 103.

⁶⁶ Mark Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact*, (Oxford University Press, 2002) vii.

⁶⁷ John Coffee, 'The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications' (1999) 93 *Northwestern University Law Review* 642, 646.

⁶⁸ Mark Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact*, (Oxford University, 2002); T Clarke, *International Corporate governance* (2007), 256.

⁶⁹ Sidney Gray, 'Towards a Theory of Cultural Influence on the Development of Accounting Systems Internationally' (1988) 24 *Abacus* 1, 4.

⁷⁰ Douglass North, 'Economic Performance through Time' (1994) 84 *The American Economic Review* 359; Michael Rubach and Terrence Sebor, 'Comparative Corporate Governance: Competitive Implications of an Emerging Convergence' (1998) 33 *Journal of World Business* 167; LG Thomas III and Geoffrey Waring, 'Competing Capitalisms: Capital Investment in American, German, and Japanese Firms' (1999) 20 *Strategic Management Journal* 729.

⁷¹ Amir Licht, 'The Mother of All Path Dependencies: Towards a Cross-Cultural Theory of Corporate Governance Systems' (2001) 26 *Delaware Journal of Corporate Law* 147, 149.

⁷² Douglas Branson, 'The Very Uncertain Prospects of 'Global' Convergence in Corporate Governance' (2001) 34 *Cornell International Law Journal* 321, 325; Andrew West, 'Corporate Governance Convergence and Moral Relativism' (2009) 17 *Corporate Governance: An International Review* 107, 109.

A nation's culture, a system of societal or collectively held values,⁷³ is of great significance in underpinning the configurations of major economic and legal structures, on which the national corporate governance system is based. In the search for explanations of distinct corporate governance types within particular national contexts, path dependence advocates demonstrate that the diversity of domestic socio-cultural settings has given rise to the variety of corporate governance models.⁷⁴ '... A nation's culture might be more persistent than other factors believed to induce path dependence. Substantively, a nation's unique set of cultural values might indeed affect – in a chain of causality – the development of that nation's laws in general and its corporate governance system in particular.'⁷⁵ The convergence argument that different corporate governance types will be generalised into a superior corporate governance model has been refuted on the grounds that each model has developed on the basis of, and has comparative advantages in, its domestic setting. 'As societal values develop so those exercising power and influence over companies will adopt policies and attitudes which reflect these developments.'⁷⁶

The complementarity effect of domestic cultural factors upon corporate governance also refutes the doubt cast on the rationale of path dependence theory. Roe's path dependence theory, in particular, the political dependence argument, was challenged by Cheffins on the grounds that it could not offer a convincing explanation for the formation of Berle-Means shareholder-centred corporations in the UK.⁷⁷ It was discovered that unlike the situation in America, financial regulations in the UK did not prevent banks or insurance companies from owning companies' shares or taking an active part in corporation business.⁷⁸ Nevertheless, taking into consideration the relevance of national culture, it could be found that what really prevented UK financial institutions from taking on responsibility for companies' daily operations was the strong influence of the profit-seeking and liquid business culture, which was sufficiently demonstrated in their industry policies.⁷⁹ This sufficiently proves the influence of cultural input in determining the types of corporate governance structures, and asserts the rationale of path dependence and complementarity in maintaining the salient features of domestic corporate governance.

D The Legal Influence

In addition to Roe's political theory which attributes the formation of American dispersed share ownership to its political determinants, an alternative explanation has recently been developed by La Porta et al, arguing that the dispersed ownership structure and liquid markets in America were actually based on its strong legal tradition of minority shareholder protection.⁸⁰

It was argued by Coffee that though the political theory advocated by Roe and the legal theory suggested by La Porta et al have some synthesis in common, they lead to contradictory perspectives in terms of corporate governance convergence: the political theory was pessimistic about the likelihood of convergence by arguing that the persisting forces of political determinants are unlikely to be overcome, while the legal hypothesis holds positive views regarding convergence towards the Anglo-American end by arguing that a legal regime that protects public shareholders has important long-term competitive advantages and will attract corporate migrants.⁸¹

⁷³ Sidney Gray, 'Towards a Theory of Cultural Influence on the Development of Accounting Systems Internationally' (1988) 24 *Abacus* 1, 4.

⁷⁴ Amir Licht, 'The Mother of All Path Dependencies: Towards a Cross-Cultural Theory of Corporate Governance Systems' (2001) 26 *Delaware Journal of Corporate Law* 147, 149; Douglas Branson, 'The Very Uncertain Prospects of 'Global' Convergence in Corporate Governance' (2001) 34 *Cornell International Law Journal* 321, 325; Andrew West, 'Corporate Governance Convergence and Moral Relativism' (2009) 17 *Corporate Governance: An International Review* 107, 109.

⁷⁵ Amir Licht, 'The Mother of All Path Dependencies: Towards a Cross-Cultural Theory of Corporate Governance Systems' (2001) 26 *Delaware Journal of Corporate Law* 147, 149.

⁷⁶ CLRSG, *Modern Company Law for a Competitive Economy: the Strategic Framework* (1999) 5.1.3.

⁷⁷ Brian Cheffins, 'Putting Britain on the Roe Map: The Emergence of the Berle-Means Corporation in the United Kingdom' as cited in Joseph McCahery et al., *Corporate Governance Regimes, Convergence and Diversity* (Oxford University Press, 2002) 147.

⁷⁸ For more information, see Herbert Jacobs, *Grant on the Law Relating to Bankers and Banking Companies* (Butterworths, 1923) 579; Mark Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (Princeton University Press, 1994) 201.

⁷⁹ Michael Collins, *Banks and Industrial Finance in Britain 1800-1939* (Macmillan Education, 1991) 36, 41, 49, 69-71; David Kynaston, *The City of London, Volume II: Golden Years* (Oxford University Press, 1991) 455.

⁸⁰ Rafael La Porta et al, 'Legal Determinants of External Finance' (1997) 52 *Journal of Finance* 1131; Rafael La Porta et al, 'Law and Finance' (1998) 106 *Journal of Political Economy* 1113; Rafael La Porta, F Lopez-de-Silanes and A Shleifer, 'Corporate Ownership Around the World' (1999) 54 *The Journal of Finance* 471.

⁸¹ John Coffee, 'The Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications' (1999) 93 *Northwestern University Law Review* 642, 705.

From the authors' point of view, both of these two theories are correct as regards the path dependence effect of political and legal factors, but also partially biased in terms of the convergence/divergence perspective owing to the fact that each of them only represents the complementary effect of one social element on the whole corporate governance system. The dispersed ownership regime in Anglo-American countries was actually formed on the basis of a wide range of mixed factors. Other than the political influence and the legal regime of minority shareholder protection emphasised by political and legal theorists, other complementary concerns also shed light upon the formation of the dispersed ownership structure, for instance, the liberal cultural tradition and liquid market mechanisms in America. The formation and development of a regime is based on the mutual effects of a collection of domestic elements, which all need to be taken into account.

E *Institutional Complementarities*

Furthering path dependence theory, complementarity theory considerably strengthens the legitimacy of national persistence of governance structures by discussing the significance of the complementary consistency of elements within a given system.⁸² Those complementary elements in the realm of corporate governance include the distribution of ownership and residual decision rights; the distribution of residual claims and shareholdings; the board structure and the composition of the supervisory board; the objective of the firm to which management is bound; the general structure of corporate law; the quality of accounting information for shareholders; the role and function of the stock market; access to capital markets; the role of takeovers; and the role of employees in corporate decision making.⁸³ Given the fact that partial changes to individual elements will not fit together well with the rest of the complementary elements, the reformed system would not be as efficient as the old system unless fundamental alterations can be made to 'the different elements of an economic, social and legal system in which governance is embedded'.⁸⁴ The likelihood of persistence of existing elements among corporate governance systems therefore is significantly increased.

Recent empirical research further asserts the rationale of path dependence and complementarity and indicates the continuing persistence of national divergence in corporate governance. In Wojcik's recent research, data of nearly 300 of the largest European companies was collected and analysed to discover the state of firms' corporate governance in 2000 and 2003 and changes between 2000 and 2003 across countries, groups of countries and industries.⁸⁵ It was discovered that the European corporate governance landscape is still diverse despite some marginal evidence of convergence, and differences among countries are significantly overwhelming differences among industries.⁸⁶ This effectively proves that the unique inputs of each country have contributed to diversified structures in the field of corporate governance, and these distinguishing features of corporate governance are likely to be preserved in various domestic contexts as an integrated part of national patterns of governance.

VIII PATH DEPENDENCE EFFECT IN UK CORPORATE GOVERNANCE: FACTORS CONTRIBUTING TO THE PERSEVERANCE OF SHAREHOLDER VALUE ORIENTATION

The interconnections between a nation's corporate governance system and its domestic elements practically ensure the comparative advantage of the given corporate governance system within its local environment and further prevents this system from transforming to other patterns. As stated, 'corporate governance consists not simply of elements but of

⁸² For further discussion on institutional complementarity, see Reinhard Schmidt and Gerald Sprindler, 'Path Dependence, Corporate Governance and Complementarity' (2002) 5 *International Finance* 311; Bruno Amable, 'Institutional Complementarity and Diversity of Social Systems of Innovation and Production' (2000) 7 *Review of International Political Economy* 645; Richard Deeg, 'Path Dependency, Institutional Complementarity, and Change in National Business Systems' as cited in Glenn Morgan and Eli Moen, *Changing Capitalisms? Internationalisation, Institutionalisation and Systems of Economic Organisation* (Oxford University Press, 2006) 21.

⁸³ Reinhard Schmidt and Gerald Sprindler, 'Path Dependence, Corporate Governance and Complementarity' (2002) 5 *International Finance* 311, 321-322.

⁸⁴ Reinhard Schmidt and Gerald Sprindler, 'Path Dependence, Corporate Governance and Complementarity' (2002) 5 *International Finance* 311, 327.

⁸⁵ Dariusz Wojcik, *Convergence in Corporate Governance: Empirical Evidence from Europe 2000-2003* (2004) Social Science Research Network <<http://ssrn.com/abstract=559424>>.

⁸⁶ *Ibid* 1. There has also been indication of the interrelationship between industry differences and diversified structures in corporate governance in recent research. It will not be discussed in detail as this article primarily focuses on the comparative differences among national corporate governance systems. For the significance of industry differences in shaping the diversity of corporate governance structures, see Clas Bergstrom and Kristian Rydqvist, 'The Determinants of Corporate Ownership' (1990) 14 *Journal of Banking and Finance* 137; Øyvind Bøhren and Bernt Ødegaard, *The Ownership Structure of Norwegian Firms: Characteristics of an Outlier* (2000).

systems ... Transplanting some of the formal elements without regard for the institutional complements may lead to serious problems later, and these problems may impede, or reverse, convergence.⁸⁷ In the case of the UK, it is found that the persistence of shareholder value orientation in corporate governance could be attributed to a number of significant concerns of path dependence and complementarity, involving historical, political and cultural arrangements of the UK national model.⁸⁸

A Historical and Economic Dependence

A major driver of the predominance of shareholder value in the UK is its mature market systems, which constitute a salient feature of its market-based economy. In the UK, equity markets are the primary source of capital with most stocks relatively dispersed among shareholders.⁸⁹ Corporate control is often fulfilled by outside market factors and shareholders mainly exercise their influence by buying or selling shares on liquid equity markets that reward performing companies with higher share prices.⁹⁰ Under increasing market forces for corporate control, particularly hostile takeovers, the shareholder-centred governance objective has been significantly reinforced in UK practice,⁹¹ and corporations are under high pressures to provide a high degree of transparency and accountability to markets and capital providers – shareholders.⁹²

The early development and high degree of industrialisation of the UK economy have also facilitated the predominance of shareholder value orientation in practice.⁹³ Compared to Germany, France and other Continental European countries, the UK's industrialisation took place in a much earlier period and in a more thorough way. It brought technology innovation, increasing productivity, the division of labour, and most importantly, the development of trade and business which largely facilitated UK market liquidity and shareholder orientation. By 1890, the UK had almost completed its transformation from an agrarian economy to an industrial one and become the world's first industrial nation.⁹⁴ At the same time, Continental European countries were still characterised by agricultural economies and the industrialisation progress was much slower. Just before World War I, agriculture in France continued to provide employment for up to 41 percent of the total labour force and 35 percent of the overall national income.⁹⁵ In contrast, Britain in the same period had only 8 percent of the workforce dedicated to the land, and agriculture accounted for only 5 percent of total domestic production.⁹⁶

The political and legal environments at that given time in the UK were very supportive of its industrialised economy, which further contributed to the development of shareholder value orientation. In terms of political support, the UK feudal system at that time which focused on estates and property rights was not as influential and persistent as its counterparts in France and other Continental countries. In terms of legal support, there had been few legal restrictions upon the right to trade in land, which facilitated land trade at a really early stage.⁹⁷ All these historical concerns essentially contributed to

⁸⁷ Jeffrey Gordon and Mark Roe, *Convergence and Persistence in Corporate Governance* (2004) 6.

⁸⁸ For the definition of a national model, see Bruno Amable, 'Institutional Complementarity and Diversity of Social Systems of Innovation and Production' (2000) 7 *Review of International Political Economy* 645, 667: 'The 'coherence' of a given system – a 'national' model for instance, defined as the set of interrelated national institutions – is then the expression of the complementarity between specific institutional arrangements and the outcome in terms of economic performance.'

⁸⁹ Marco Becht and Ailsa Röell, 'Blockholdings in Europe: An International Comparison' (1999) 43 *European Economic Review* 1049; John Coffee, 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control' (2001) 111 *Yale Law Journal* 1.

⁹⁰ Thomas Clarke, *International Corporate Governance: A Comparative Approach*, (Routledge, 2007), 94.

⁹¹ Anant Sundaram and Andrew Inkpen, 'The Corporate Objective Revisited' (2004) 15 *Organisation Science* 350.

⁹² Dirk Matten and Jeremy Moon, 'Implicit' and 'Explicit' CSR: A Conceptual Framework for a Comparative Understanding of Corporate Social Responsibility' (2008) 33 *Academy of Management Review* 404, 407.

⁹³ For support on the interconnection between industrialisation and the corporate objective, see footnote 64 and relevant text.

⁹⁴ Alfred Chandler, *Scale and Scope: The Dynamics of Industrial Capitalism* (Harvard University Press, 1990) 251.

⁹⁵ Patrick O'Brien, 'Path Dependency, or Why Britain Became an Industrialized and Urbanized Economy Long Before France' (1996) 49 *The Economy History Review* 213, 214; also see Maurice Lévy-Leboyer and Francois Bourguignon, translated by Jesse Bryant and Virginia Perotin, *The French Economy in the Nineteenth Century* (Cambridge University Press, 1990) 294.

⁹⁶ Roderick Floud, 'Britain 1860-1914' as cited in Roderick Floud and Donald McCloskey (ed), *The Economic History of Britain since 1700 II: 1860-1939* (Cambridge University Press, 1994) 1, 18; Phyllis Deane and William Cole, *British Economic Growth, 1688-1959* (Cambridge University Press, 1967) 166.

⁹⁷ In contrast, in the most parts of France, legal and other customary codes restricted the possibility of land trade, which enhanced the agricultural economy and restricted the development of industrialised economy. For more details see Alan Macfarlane, *The Origins of English Individualism, The Family, Property and Social Transition* (Oxford University Press, 1978); Gordon Mingay, *The Gentry: The Rise and Fall of a Ruling Class* (Longman, 1976); Peter Roebuck, *Yorkshire Baronets, 1640-1760* (Oxford University Press, 1980); Joan Thirsk, 'The European Debate on Customs of Inheritance, 1500-

the growth of market liquidity, the rapid industrial/commercial development and the predominance of shareholder value orientation in the UK.

B Political Influence

The influence of the political realm, despite its complexity, has shed significant light upon features of British securities markets, governance structures and other economic elements. In particular, the interrelationship between political determinants and the development of shareholder-oriented corporate governance arrangements adequately asserts the rationale of political theory.

For decades, the political policy in Britain has swung back and forth between social democracy and conservative liberty, which were respectively advocated by the Labour Party and the Conservative Party. The Labour Party was in command of politics in 17 years out of the half-century after World War II, while after 1979 the Conservative Party saw its liberal attitude dominate in Britain until near the end of the 20th century. The policy divergence between liberalism and socialism has provided diverse influences on the development of British corporate governance. Although the Labour Party advocated planning on the growth of the economy,⁹⁸ its main political theme before 1979 was social democracy. The significance of employees and the representation of labour unions on company boards⁹⁹ had been the focus of corporate governance practice emphasised by the Labour Party during this period. While after 1979, the ascendance of the right-wing policies advocated by the Conservative Party contributed to the rapid growth of the UK market economy and its shareholder-centred corporate governance. In particular, Margaret Thatcher's overturning of socialism after 1979 largely accelerated the diffusion of share ownership. By the mid-1980s, a major decline in the percentage of family ownership of companies was witnessed, and many of the families have even disappeared from blockholder lists of the largest British companies.¹⁰⁰

It is interesting to note that since the late 1990s when the Labour Party regained power, the economic policy has been remaining close to the preceding Conservative policy and further contributing to the continuing development of shareholder value. 'Labour's close relationship with business has mirrored that of the previous Conservative governments, placing a limit on the freedom to initiate policies that may alienate the government from its business linkages, such as larger spending on the social sphere, and increased labour protection.'¹⁰¹ The Labour Party's current policy has been commented as 'less of a socialist party',¹⁰² or 'ameliorations of Thatcherism, but no reversal'.¹⁰³ The Government's enthusiasm for liberal economic policies and reduced focus on societal issues, inevitably, leads to the continuing perseverance of a shareholder-oriented corporate governance regime in the UK.

The historical path dependence of both political and economic elements manage to explain this seemingly controversial phenomenon that even when the left-wing Labour Party was in control, the UK's economic policy somehow still moved rightward and this was even more evident after the Blair government came in power. First of all, the social democracy policy advocated by the Labour Party has been somehow influenced by the structures left by the Conservative Party and was not as strong as its counterparts in other Continental European countries. For instance, a distinctive feature of social democratic policy is the nationalisation of private firms, while in the UK the Labour Party never intended to change all the private corporate structures. It only nationalised those firms whose structures it felt needed to be changed and left the rest

1700' as cited in Jack Goody, Joan Thirsk and Edward Thompson, *Family and Inheritance: Rural Society in Europe, 1200-1800* (Cambridge University Press, 1976) 177. In addition, Continental European countries featuring agricultural economy turned out to have been far more dependent than Britain upon labour inputs in order to raise and maintain the growth of agricultural output above the rate of population growth. See Patrick O'Brien, 'Path Dependency, or Why Britain Became an Industrialized and Urbanized Economy Long Before France' (1996) 49 *The Economy History Review* 213, 218.

⁹⁸ Peter Hall, 'The State and Economic Decline' as cited in Bernard Elbaum and William Lazonick, *The Decline of the British Economy* (Clarendon Press, 1986) 276.

⁹⁹ For instance, Committee of Inquiry on Industrial Democracy, *Report of the Committee of Inquiry on Industrial Democracy* (1977) (the Bullock Report).

¹⁰⁰ John Scott, 'Corporate Control and Corporate Rules: Britain in an International Perspective' (1990) 41 *The British Journal of Sociology* 351, 366-367.

¹⁰¹ Leo McCann, Aris Solomon and Jill Solomon, 'Explaining the Growth in UK Socially Responsible Investment' (2003) 28 *Journal of General Management* 15, 22.

¹⁰² Mark Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (Oxford University Press, 2003) 101.

¹⁰³ Andrew Sullivan, 'The End of Britain', *New York Times* (New York) 21 February 1999, 39, 54: '[Blair] had long since lost faith in the sclerotic European social-democratic model ... [He] made some ... Clintonite changes...'

intact with their private regimes.¹⁰⁴ The rightward social democratic policy of the Labour Party suggests the huge influence of the previous political structure left by the Conservative Party and strong path dependence in the political domain.

Secondly, historical dependence also casts light on the continuing growth of the British market-based economy during the social democracy period. The development of security markets had commenced long before the social democracy policy started its way in the UK, and had had far-reaching influence in the establishment of the financial regime.¹⁰⁵ If the Labour Party had intended to pursue policies advocating social democracy, it would have had to take into account possible outcomes if the established financial regime had been affected or demised: the UK would have lost a considerable amount of earnings from abroad, and the long established trading order beneficial to its financial development would have been severely diminished.¹⁰⁶ Such historical dependence of financial dynamics also influenced the Labour Party to adopt a soft approach in adjusting policy. The historical path dependence of political and economic concerns hereby effectively explains the persistence of shareholder value orientation and liberal market-based economy in Britain and additionally suggests the strong prospect of its further continuation.

C Legal Determinants

The legal factor also plays a vital role in the development of the UK's shareholder-oriented economy. It is discovered that the deep-rooted self-regulation legal culture in the UK has been providing sufficient autonomy for the rapid growth of market activities, and thus accelerating the prosperity of the market-based economy and the primacy of shareholders' interests. In particular, as a self-regulatory body, the London Stock Exchange has been playing a significant role in consolidating the UK market-based economy. Ever since its establishment, the Stock Exchange has been taking the lead as a controller of the equity markets and working much on its own initiative as a private association with no direct association with the Government.¹⁰⁷ Rules developed by the Stock Exchange are far more rigorous than their statutory counterparts and compliance with those rules has been substantive in corporate practice.¹⁰⁸

The governance of takeover activities also demonstrates the importance of UK self-regulatory tradition in terms of promoting market-based shareholder value orientation in corporate governance. Before the implementation of the Takeover Directive in the UK, the Code developed by the Takeover Panel took the primary role in controlling takeover activities. Notwithstanding the fact that the panel had no statutory powers and its orders were not legally binding, its measures were proved effective and its self-regulation standards were found much higher than statutory legislation both in terms of corporate disclosure and hostile takeovers.¹⁰⁹ After the Takeover Directive (Directive 2004/25/EC of 21/04/2004 on Takeover Bids) was introduced in the UK, the rules set out in the Code were required to have a statutory basis to comply with relevant requirements in the Directive.¹¹⁰ At first glance, it seems to undermine the UK self-regulatory tradition in the field of takeovers. But after close scrutiny, it is found that there is no intention in the new UK company law of making takeover activities subject to more legally-binding rules. There are few changes of substance to either the Code or the functions of the Panel.¹¹¹ The main aim of takeover regulation and the Panel being on a statutory footing is to legally underpin all the Panel's activities.¹¹² The Panel remains the entity giving rulings on the interpretation,

¹⁰⁴ Mark Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact*, (Oxford University Press, 2003) 99. Also see Ben Clift, Andrew Gamble and Mike Harris, 'The Labour Party and the Company' as cited in John Parkinson, Andrew Gamble and Gavin Kelly, *The Political Economy of the Company* (Hart Publishing, 2000) 51, 81: 'In the 1940s, [reconstructing the private, non-nationalized corporation] never registered as a significant [Labour Party] priority; in the 1970s, when it did, the Party was too divided internally and too politically weak to find a way to implement it.'

¹⁰⁵ A pivotal feature of the UK finance regime is the international financial centre – the City of London. For more information, see Mark Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact*, (Oxford University Press, 2003) 102.

¹⁰⁶ Mark Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact*, (Oxford University Press, 2003) 102.

¹⁰⁷ For further comment, see Brian Cheffins, 'Does Law Matter? The Separation of Ownership and Control' (2001) 30 *Journal of Legal Studies* 459, 474-476; Ranald Michie, *The London Stock Exchange: A History* (Oxford University Press, 2001).

¹⁰⁸ Ranald Michie, *The London Stock Exchange: A History* (Oxford University Press, 2001) 567; James Fishman, *The Transformation of Threadneedle Street: The Deregulation and Reregulation of Britain's Financial Services* (Carolina Academic Press, 1993) 24-26.

¹⁰⁹ Brian Cheffins, 'Does Law Matter? The Separation of Ownership and Control in the United Kingdom' (2001) 30 *The Journal of Legal Studies* 459, 480-481.

¹¹⁰ Provisions regarding takeovers (*Companies Act 2006* ss 942-992) have been implemented in UK since 6 April 2007.

¹¹¹ Freshfields, *UK Implementation of the EU Takeover Directive* (29 May 2009) <<http://www.freshfields.com/publications/pdfs/practices/TakeoverDirectiveUKImplement.pdf>>.

¹¹² *Ibid*.

application or the effect of rules, and its independence and considerable freedom to decide its internal structures and operational framework are completely preserved.¹¹³ Considering the long-standing non-statutory state of the Panel (it has been a non-statutory body independent of the Exchange and the UK Listing Authority since 1968), it is not difficult to reach the conclusion that takeover activities in UK will, to the largest extent, remain self-regulated.

IX PATH DEPENDENCE ATTRIBUTES: THE RATIONALE OF ESV IN THE UK AND FUTURE TRENDS IN CORPORATE GOVERNANCE

Path dependence theory and the complementarity argument offer effective explanations for the continuing predominance of shareholder value orientation in the UK in light of the ESV approach. As regarded, shareholder value orientation has been historically deeply embodied in the UK. The main configurations of the UK corporate governance system, including the dispersed ownership and ultimate shareholder decision rights, the one-tier board structure, the external monitoring system, the liquid market and the dynamic market activities are all determined by and complementary to the ultimate objective of shareholder value maximisation. External socio-economic institutional elements, as presented in the previous section, including the historical recognition of a corporation as a shareholder value maximisation economic entity, the role of the law in promoting trade freedom, discipline forced by the political policy to enhance competition and the market for corporate control, have all solidified the shareholder value maximisation ideology.¹¹⁴ 'The fundamental reason is that shareholder sovereignty is not an efficient arrangement, but rather a power relationship, that is a particular (societal) way to design a corporation ...'.¹¹⁵ The preference for shareholder value orientation in the UK, therefore, is not because of its inherent superiority over the stakeholder approach, but because of its inseparable systemic links with UK domestic socio-economic frameworks.

The UK Government's preference for the ESV principle over the pluralist approach further asserts the effect of existing corporate governance configurations in preventing systematic changes. 'A shift in emphasis away from profit maximisation and towards a stakeholder theory of the company could have serious repercussions throughout company law and necessitate a fundamental reassessment of the principles on which it is based.'¹¹⁶ According to the Company Law Review, the adoption of ESV in the UK is mainly because its preservation of the long-established corporate objective (i.e., shareholder wealth maximisation) would not entail fundamental changes to existing shareholder-oriented corporate governance configurations, including shareholders' rights and directors' duties.¹¹⁷ In contrast, the implementation of a pluralist approach would require an 'extensive reform' of directors' duties and shareholders' control over the company, which 'would represent a very radical change to British corporate culture and would be unlikely to command wide support'.¹¹⁸ The path dependence concern that the ESV approach would be compatible with the main elements of its existing corporate governance system therefore is the major factor determining the UK's choice of ESV in its new company law regime.

The UK's resistance to the 'Europeanisation' process further indicates continuing preservation of its existing shareholder-oriented corporate governance regime.¹¹⁹ The UK Government holds the view that the current UK regulatory framework should not be subject to too many European pressures. 'In striking the balance between dynamism and social standards, our position is that no change to European regulations, like the Working Time Directive, should risk British job creation.'¹²⁰ In addition, it is emphasised that the impact of the British social and economic frameworks should be exported to the Continent whenever possible, because 'flexibility at a UK level should be matched by flexibility in Europe.'¹²¹ Though the significance of long-term development and stakeholder considerations has been increasingly recognised both in UK's new corporate law and its business practice, a substantial movement toward the stakeholder model is not anticipated due to the incompatibility with the UK socio-economic setting. Rather, societal practice without threatening the predominance of shareholder value, for instance, voluntary CSR and SRI activities and the development of

¹¹³ For instance, it is provided in s944(1) that the Takeover Panel has its own authority in developing different forms of rules which grants the right of choice to players. See DTI, *Implementation of the EU Directive on Takeover Bids Guidance on Changes to the Rules on Company Takeovers* (2006), 3.

¹¹⁴ Anant Sundaram and Andrew Inkpen, 'The Corporate Objective Revisited' (2004) 15 *Organisation Science* 350, 352.

¹¹⁵ Antoine Reberrioux, 'European Style of Corporate Governance at the Cross Roads: The Role of Worker Involvement' (2002) 40 *Journal of Common Market Studies* 111, 119.

¹¹⁶ Eilis Ferran, *Company Law and Corporate Finance* (Oxford University Press), 136.

¹¹⁷ CLRS, *Modern Company Law for a Competitive Economy: the Strategic Framework* (1999) 5.1.17.

¹¹⁸ *Ibid* 5.1.25–5.1.32.

¹¹⁹ Catherine Barnard, Simon Deakin and Richard Hobbs, '“Fog in the Channel, Continent Isolated”: Britain as a Model for EU Social and Economic Policy?' (2003) 34 *Industrial Relations Journal* 461, 461.

¹²⁰ Gordon Brown, *Budget Report 2003: Building a Britain of Economic Strength and Social Justice* (29 May 2009) National Archives <http://www.hm-treasury.gov.uk/budget/bud_bud03/budget_report/bud_bud03_repindex.cfm> 277.

¹²¹ *Ibid*.

self-regulated codes of practice encouraging corporations' voluntary stakeholder considerations, will continually act as a major UK corporate governance approach accelerating stakeholder interests.¹²²

X Conclusion

Through interdisciplinary analyses in the economic, political and legal contexts, the point is therefore reached that the predominance of shareholder value is likely to continue to be preserved in the UK context at least in the near future. Though the ESV doctrine in the *Companies Act 2006* does not offer any further right or substantive protection to corporate stakeholders, its rationale in terms of shareholder value predominance has been justified in light of strong path dependence and complementarity concerns, and its mild approach in terms of stakeholder consideration turns out to be the appropriate choice for the UK shareholder-oriented environment.

¹²² Similar view to stakeholder consideration has also been perceived in Australia, another country featuring the Anglo-American model. In the Australian Joint Parliamentary Inquiry and a report of the Australian Corporations and Markets Advisory Committee, a conclusion is jointly reached that a change in the directors' duty to statutorily require the managerial act for stakeholders is neither necessary nor desirable, and it is sufficient that stakeholders' interests are currently voluntarily pursued by management in the form of CSR. See Corporations and Markets Advisory Committee, *The Social Responsibility of Corporations Report* (2006); Peter Waring, 'Rethinking Directors' Duties in Changing Global Markets' (2008) 8 *Corporate Governance* 153, 157.