Corporate Governance after Hampel
The Accountant 1997

Bob Tricker[*]

The preliminary report of the Hampel Committee reflects the conventional wisdom in the majority of UK boardrooms, despite the misgivings of some professional bodies and institutional investors that the unequivocal recommendations of the Cadbury Report have been diluted. The final report, due next year, will combine revisions to the preliminary report with a consolidated version of the earlier Cadbury and Greenbury codes of best practice in corporate governance. Many hope that this will be the definitive pronouncement on corporate governance in Britain for the foreseeable future.

Is this a reasonable expectation? In the short term, probably yes. Corporate governance is, above all else, about the exercise of power: power over some of the most significant entities in the modern world. Most boards of directors of listed companies in the UK see no need for greater accountability, more performance monitoring, or further regulation, whether by self-regulation or legislation. They are confident of their ability to perform effectively without more inquiries from analysts, lobbying from institutional investors, or the threat of regulation or litigation.

In the longer term, however, Hampel is unlikely to provide the definitive last word on corporate governance. The pressures for change in corporate governance practices no longer originate in the UK. Just as business and finance have become global, so has the influence of corporate governance. The convergence of international accounting standards and the search for common listing standards by stock exchanges throughout the world, working through IOSCO, are straws blowing in the winds of such change.

The evolution of corporate governance

Before reviewing pressures for change in corporate governance around the world, it is worth recalling how we reached the present position. Corporate governance thinking did not start with Cadbury (1992). The first book to use the title *Corporate Governance* was published in the UK in 1984. Since then the topic has come centre stage, largely as a response to the corporate collapses, dominant chief executives and perceived board level excesses of the later part of the 80s. The Cadbury Report, after all, was about *the financial aspects* of corporate governance.

Perhaps the most surprising thing about corporate governance is that the subject took so long to mature. Over fifty years ago the work of Berle and Means' in the United States raised the question, still vital today, of the separation of power between increasingly diverse and remote shareholders and management - and led to the creation of the Securities and Exchange Commission. In the 1970s the original fifth draft directive of the European Community, calling for two tier boards which totally separated responsibilities for running the business from its monitoring and oversight (together with co-determination ideas of joint shareholder and employee participation in supervision) led to the UK Bullock Committee's proposal for a unitary board with worker representation.

Also in the 1970s came the stakeholder debates on both sides of the Atlantic, producing in the process *The Corporate Report* from the Accounting Standards Steering Committee (1975). This seminal paper called for all economic entities to report publicly and accept accountability to all those whose interests were affected by the directors' decisions: a report whose political implications for the erosion of managerial power soon consigned it to the top shelf.

---

[*] Dr. R. I. (Bob) Tricker is author of the *Economist Pocket Director* and editor of the journal *Corporate Governance - an international review*

The classical concept of the company in the UK stems from Companies Acts in the mid-nineteenth century. The notion was elegantly simple and superbly successful, enabling the subsequent creation of untold industrial growth, employment and wealth. This was one of the finest systems man has ever designed - incorporate a legal entity separate from the owners, whose liability for the company's debts is limited to their investment, but with ownership remaining the basis of power. Superb - but unfortunately this model now bears about as much relationship to reality as a hang-glider does to a fleet of jumbo-jets.

In recent years there have been numerous reports from around the world calling for improvements in corporate governance processes [for example, the Viénot Report (1995) from France, the King Report (1995) from South Africa, and the Report of the Hong Kong Society of Accountants (1996)]

Calls for change around the world
As with the Cadbury Committee Report (1992), many of these reports reflected concerns about the potential for abuse of corporate power that had been shown in the excesses of the 1980s. Similarly many of them called for greater conformance and compliance at board level, recommending the use of audit committees as a bridge between board and external auditor, the wider use of independent outside, non-executive directors, and the separation of the role of chairman of the board from chief executive. More checks and balances to avoid executive domination of decision-making was the theme.

However, in 1993 an Australian Committee on corporate governance, chaired by Professor Fred Hilmer of the Australian Graduate School of Management, advanced a different view. Governance is about performance as well as conformance, the report argued:

> "the board's key role is to ensure that corporate management is continuously and effectively striving for above-average performance, taking account of risk." Adding, almost as an after thought "this is not to deny the board's additional role with respect to shareholder protection."

They gave their report the splendid title *Strictly Boardroom* - after the film 'Strictly Ballroom', which portrays the world of competitive ball dancing, in which originality, creativity and innovation had been sacrificed to inflexible and inhibiting rules and regulations. This is the danger facing current governance practices, argued Hilmer, with conformance and compliance overshadowing improved corporate performance.

Interestingly, contemporary scholarship is also discovering that not only does increasing governance conformance and compliance not add to corporate performance - it actually detracts. Colleagues of Hilmer's - Lex Donaldson and Melinda Muth - have challenged the shibboleths of agency theory, which underpin conventional assumptions about the benefits of checks and balances. Boards with well connected, executive directors perform better than those that meet the paradigms of conventional governance thinking, they found.

Trends in corporate governance around the world
So what are the emerging trends in corporate governance around the world that might affect UK companies in the future? Three broad areas emerge - a move towards more pro-active corporate governance, the growing power and influence of institutional investors, and calls for wider corporate transparency, responsibility and accountability.

Pro-active corporate governance
The nineteenth century saw the foundations laid for modern corporations: this was the century of the entrepreneurs. The twentieth century has become the century of management: the phenomenal growth of management theories, management consultants and the business schools all reflect the preoccupation with management. But the twenty-first century promises to be the century of governance - when the focus swings to the legitimacy and effectiveness of power over vast, global corporate empires.

The lead is being taken already by those companies that see the advantage of being pro-active in corporate governance, rather than waiting for the dictates of self-regulatory or legislative regimes.

A classic example is seen in the board guidelines developed [and published openly*] by General Motors in the United States. These guidelines describe board policies on matters such as meetings of outside directors with their own chairman, the assignment and rotation of members of board committees, the content and timing of board information, board access to senior management, the definition of independence for outside directors, whether former executive directors should become non-executive directors on retirement, criteria for board membership, the size and balance of the board, retirement age, and the formal evaluation of the chief executive officer. How many British boards even consider such matters, except in crisis, let alone publish their policies formally?

Other examples arise in communication with investors. The annual report and accounts and the annual general meeting of shareholders is increasingly recognised as an inefficient and largely ineffective way of liaising with a diverse and widely-spread portfolio of investors. Corporate performance needs to be reported regularly in financial and non-financial performance measures. The internet offers new opportunities - not just to carry electronic copies of the published accounts - but to provide an avenue of communication with individual members, giving them access to relevant files of information, taking them on virtual tours of the plants, products and processes of the company, and providing an inter-active, question and answer facility to meet the information needs of present and potential investors.

Growing power and influence of institutional investors

The growing power of institutional investors lies in companies' needs to tap the ever-increasing pension funding and savings around the world. Starting in the United States, this has been reflected in growing expectations of institutional investors for performance improvement, associated with specific corporate governance practices. The directors of American Express, General Motors and IBM all had cause to regret the power of institutional fund managers to vote their shares against incumbent members of boards they considered to be performing badly. Now the trend has spread to Britain and is appearing in Continental Europe, Japan and elsewhere Asia Pacific, as global funds seek to exercise their rights. The Californian State Employees pension fund (CalPers) has been particularly active, producing Global Principles for Corporate Governance, which they intend to use to benchmark corporate governance practices in companies in their portfolio around the world.

Meanwhile, in a counter development, others have been questioning the accountability of institutional investors, whose investment objectives, as banks, unit trusts and insurance funds, may not be homogeneous.

Societal calls for corporate transparency, responsibility and accountability

In the original concept of the company, power was vested in shareholder democracy. Directors were responsible to shareholders; and with one share one vote members exercised their rights on crucial issues before the members' meeting. Today questions are being asked about the validity of shareholder democracy in companies with many thousands of individual investors but *de facto* domination by a handful of institutional investors with direct access to top management. This ability of major institutional investors to carry on a dialogue directly with companies has also produced a reaction from individual shareholders for more disclosure. Other ideas have been proposed that would give each investor, not each share, a vote.

The Hampel Committee's dismissal of stakeholder notions - " directors are responsible for relations with stakeholders, but are accountable to the shareholders" - undoubtedly reflects the conventional wisdom in British boardrooms. Despite the thinking of the group which produced the report *Tomorrow's Company,* Britain is not ready for a rehearsal of the 1970s notions of a wider responsibility and accountability to stakeholders such as suppliers, customers and employees. But the issue has not been resolved. Stakeholder theory continues to attract in a society in which expectations of companies are changing with growing demands for better consumer, environmental and societal behaviour. Expect wider and more penetrating demands in future. Investigative journalism is becoming ever more intrusive and the media ever more inquisitive. The recent focus on directors' remuneration and the so-called 'fat-cats' issue is a case in point. The inexorable rise of the litigious society is set to continue and to accelerate.

---

* For the full text see *The Economist Pocket Director,* Profile Books, London, 1997

The complex reality of modern corporate networks

But perhaps the most telling driver of change in corporate governance is the dynamic, flexible new corporate structures that are now replacing the stable corporate groups of the post-war years - massively complex networks of subsidiary companies and strategic alliances with cross-holdings of shares, cross-directorships, chains of leveraged (and often public) funding, dynamic and ever changing operational and financial linkages throughout the added-value chain. Networks that operate in multiple jurisdictions, cultures and currencies; groupings with voracious appetites for growth. Top management of major corporations around the world now wield enormous power. Whilst claiming to reflect owners' interests, directors pursue their own agendas and expect huge rewards - privileges reserved in earlier generations for aristocrats and kings.

Just as corporate governance thinking did not start with Cadbury, it will not end with Hampel. The truly effective board in the future will have directors and professional advisers who are in touch with global trends, prepared to influence them, and capable of leading, rather than following, corporate governance change.