

Corporate Governance that ‘Works for Everyone’: Promoting Public Policies through Corporate Governance Mechanisms

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Abstract: Corporate governance mechanisms are traditionally seen as devices for reducing agency costs between shareholders and managers in the context of private ordering. More recently, however, the UK and other governments have embraced regulations in the field of corporate governance as tools through which to impose public responsibilities on corporations. Among others, corporate governance mechanisms have been relied on to equalise wealth distribution, promote equality in the labour force, and pursue environmental goals. This article assesses the justification, utility, and efficacy of using corporate governance to promote public aims. It finds that while it may be appropriate for corporate governance mechanisms to include public goals, it also concludes that the current overreliance on disclosure requirements and on indirect regulation to address societal issues is misguided. Instead, the article suggests that governments should view corporate governance mechanisms with public policy goals as complementary strategies, and not as substitutes, to direct external regulation.

Keywords: Corporate governance, regulation, public policy, executive remuneration, non-financial disclosure, board diversity, corporate purpose

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“We will make Britain a country that works for everyone: An economy that works for everyone, so we don’t just maintain economic confidence ... but we make sure that everyone can share in the country’s wealth.”

THERESA MAY¹

“The best way to achieve better work is not national regulation but responsible corporate governance”

THE TAYLOR REVIEW OF MODERN WORKING PRACTICES

1. Introduction

On June 23, 2016, in a historic vote known as ‘Brexit’, the UK voted to leave the EU. The surprising result set into motion a series of events that culminated in the appointment of Theresa May as the UK’s new prime minister. Shortly after her appointment, May outlined her new vision for the country. Recognizing that the Brexit vote was in part precipitated by feelings of marginalization by “ordinary, working people”, she vowed to reform the UK’s economy to ensure that it would work “not for a privileged few but for every one of us”.² Her vision seemed focused on the idea that all people should be able to share in the country’s wealth.³ An integral part of May’s vision centred on the corporation’s role in helping to better allocate wealth distribution. In her speech, she emphasised the need for corporations to be accountable and responsible and outlined several reforms to corporate governance as ways to have the economy adapt to her vision for society.⁴ Indeed, then and later it became apparent that May views corporations and their managers as being responsible for ensuring a ‘fairer

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¹ Theresa May, ‘We can make Britain a country that works for everyone’ (11 July 2016), <<http://press.conservatives.com/post/147947450370/we-can-make-britain-a-country-that-works-for>> accessed 4 April 2016.

² The Independent Staff, ‘Theresa May’s Tory Leadership Launch Statement: Full Text’ The Independent (London, 30 June 2016).

³ May (n 1).

⁴ *ibid.*

economy’ and that corporate governance mechanisms are the tools by which these responsibilities should be imposed.

In October 2016, Theresa May commissioned an independent review of the impact of new forms of work – including in particular those often referred to as the ‘gig economy’ – on workers’ and employers’ rights and responsibilities. More specifically, the purpose of the review was to explore reasons for low paid workers’ anxieties stemming from insecure jobs and ‘how new forms of work might undermine the effectiveness of policies such as the minimum wage, maternity and paternity rights, pensions auto-enrolment, sick pay, and holiday pay’.⁵ The resulting report, the so-called Taylor Review,⁶ was unveiled in July 2017. While the Review suggested clarifications and updates to existing primary and secondary legislation, it also found that regulation is not the key to improve working conditions. Instead, and in line with Theresa May’s earlier speech on the role of business in achieving a fair economy, the Review stated as part of its main conclusions that not regulation, but rather “responsible corporate governance, good management and strong employment relations within the organisation” are best suited to achieve future improvements in work practices.⁷

The May government is not alone in its views on the utility of corporate governance mechanisms. While corporate governance mechanisms were initially used primarily to reduce agency costs between shareholders and corporate managers, they have especially in recent times been embraced as a tool through which public responsibilities can be imposed on corporations.⁸ In particular, corporate governance mechanisms have been relied on to help better equalise wealth distribution, promote equality in the labour force and promote social goals. Nevertheless, while corporate governance mechanisms with a public focus are not in and of themselves problematic, the current approaches entail three problems. First, that the measures may unduly promote public interests at the expense of shareholder interests; second, that there is an inordinate focus on disclosure mechanisms; and third, that the

⁵ Rowena Mason, ‘Theresa May hires former Blair policy boss to review workers’ rights’ *The Guardian* (London, 1 Oct 2016).

⁶ Matthew Taylor, *Good Work: The Taylor Review of Modern Working Practices* (2017), available at <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/627671/good-work-taylor-review-modern-working-practices-rg.pdf> accessed 18 July 2017.

⁷ *ibid* 9.

⁸ The idea of pursuing non-shareholder oriented goals through corporate law is not new. For example, the British and American chartering system (in place until roughly the mid-nineteenth century) normally required that companies pursue public functions. Another example is the German co-determination system (later adopted by several other jurisdictions), which introduced employee representation on boards already in the 1950s. This article will however focus on recent initiatives.

prevailing indirect regulatory approach may not be warranted given the failures to achieve the desired public policy objectives.

Drawing from three examples of corporate governance mechanisms that are being used to further public interests, this article assesses the justification, utility and efficacy of these mechanisms. Specifically, it examines executive remuneration mechanisms as a method of reducing wealth inequality; diversity on board measures as a means of promoting equality; and non-financial disclosure mechanisms as a method of promoting various social goals. These examples illustrate the increasing role for corporations in furthering public interests as well as the failure, in many instances, of these mechanisms to substantially improve public interests. Based on our assessment of the proper corporate purpose, which we find lies on an axis between purely shareholder wealth maximization, other stakeholders' interests, and public interests, we conclude that it is appropriate for corporate governance policies to include public goals as long as they do not unduly advance one constituency's interests over another's. However, we also find that the current preference for corporate governance mechanisms with public goals to rely heavily on disclosure is misguided. Indeed, we suggest that reliance on disclosure is reflective of a more fundamental issue, namely the preference for using indirect regulation over direct regulation in this area. Governments should therefore in our view use corporate governance mechanisms with public policy goals as complementary strategies and not as a substitute for tackling the root causes of problematic areas through direct and external (non-corporate governance) regulatory measures.

This article is structured into five parts. In Part 2, it examines the theoretical justifications that support the idea of corporate governance mechanisms with a public purpose. Examining shareholder wealth maximization and stakeholder theory, this part assesses where on the spectrum between these two competing positions the true corporate purpose lies and whether this accords with a view of public purpose-oriented corporate governance mechanisms. In Part 3, it examines three examples of corporate governance mechanisms that are designed, at least in part, to achieve a public purpose: executive remuneration mechanisms, diversity on board measures, and non-financial disclosure measures. The examples serve to illustrate the reach of corporate governance mechanisms beyond shareholder interests. In Part 4, the article turns to evaluate the corporate governance mechanisms examined in Part 3, finding that they contain three principal flaws, and suggests ways forward. Part 5 concludes.

2. The Fundamental Question of the Corporate Purpose

Traditionally, corporate governance mechanisms have been instituted to reduce agency costs. Governance of corporations is thought to be improved by ensuring that managers pursue the interests of shareholders rather than their own self-interests.⁹ In part, the focus on agency cost reduction in corporate governance mechanisms has followed naturally from the traditional view of the purpose of corporations, which is to maximise, or at least enhance in the long term, the monetary value of the enterprise – usually measured by the price of shares – for the benefit of its shareholders.¹⁰ However, there is a growing recognition that the corporate purpose may be broader than shareholder wealth maximization, thereby supporting corporate governance mechanisms with a function beyond agency cost reduction. The next section introduces shareholder wealth maximization as the most prevalent corporate purpose before canvassing alternate views.

A. Shareholder Wealth Maximization

The idea of shareholder wealth maximization flows from the nexus of contracts theory. This theory describes the corporation as a bundle of formal and informal ‘contractual’ relationships between various constituencies acting together to produce goods and services and thus form a ‘firm’.¹¹ The nexus of contracts view emphasises the private nature of corporations and, consequently, regulations that affect these entities. It sees corporate law primarily as a set of non-mandatory rules that facilitate ‘contracting’ between involved parties by providing a set of cost-saving default provisions, which the parties are still able to change as needed.¹² The nexus of contracts theory has become the dominant approach by which to conceptualise corporations under US law.¹³

⁹ Michael C. Jensen and William H. Meckling, ‘Theory of the Firm: Managerial Behavior, Agency Costs and Capital Structure’ (1976) 3 J. of Financial Economics 305.

¹⁰ John Armour et al., ‘Shareholder Primacy and the Trajectory of UK Corporate Governance’ (2003) 41 British J. of Industrial Relations 531; Henry H. Hansmann and Reinier H. Kraakman, ‘The End of History for Corporate Law’ (2001) 110 Georgetown Law Journal 387.

¹¹ Frank H. Easterbrook and Daniel R. Fischel, *The Economic Structure of Corporate Law* (Harvard University Press 1991), 14-15, 36; Stephen M. Bainbridge, ‘Director Primacy: The Means and Ends of Corporate Governance’ (2003) 97 Nw. U. L. Rev. 547, 552-61.

¹² Easterbrook and Fischel (n 11) 36; Bainbridge (n 11) 577.

¹³ See Lorraine Talbot, *Progressive Corporate Law for the 21st Century* (Routledge, 2013), 153–56; for supporting views by (present and past) members of the Delaware judiciary see also Leo E. Strine, Jr., ‘Conservative Collision Course: The Tension between Conservative Corporate Law Theory and

The nexus of contracts theory normally coincides with the belief that the corporate purpose is exclusively to maximise shareholder wealth. Two basic justifications are put forward in support of this claim. First, proponents of the theory argue that corporations are incapable of bearing societal or moral duties. Contractarians assert that this inability to bear social or moral duties is a result of the corporation's nature as a 'contractual nexus', making it a purely fictional legal device and lacking the actual human consciousness that would enable it to bear such duties.¹⁴ As a result, the nexus of contracts theory concludes that the corporate purpose is solely geared towards shareholders' financial interests, whereas considerations of extraneous interests are either non-existent or subordinated as matters that should be regulated through non-corporate laws. Second, and more prominently, the nexus of contracts theory also stands for the proposition that directors and officers have 'fiduciary obligations to maximise shareholder wealth' because they are 'contractual agents of the shareholders'.¹⁵ Accordingly, shareholders (unless they decide otherwise as a group and instruct managers accordingly) retain a privileged position among the various contracting parties that make up the corporation whereas the interests of non-shareholder constituencies remain subordinated.¹⁶ Contractarians argue that shareholders, as residual risk bearers, would have demanded primacy in corporate decision-making¹⁷ and that profit maximization as the corporation's goal is the 'bargained for right' under which shareholders have implicitly contracted with the corporation.¹⁸ Consequently, shareholders as the individuals who have

Citizens United' (2015) 100 Cornell L. Rev. 335, 390; William T. Allen, 'Contracts and Communities in Corporation Law' (1993) 50 Wash. & Lee L. Rev. 1395, 1399. A detailed outline of the nexus of contracts theory can be found in Easterbrook and Fischel (n 11).

¹⁴ Daniel R. Fischel, 'The Corporate Governance Movement' (1982) 35 Vanderbilt LR 1259, 1273. See also Stephen M. Bainbridge, 'Interpreting Nonshareholder Constituency Statutes' (1992) 19 Pepperdine Law Review 971, 971 n. 1; Michael C. Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Capital Structure' (1976) 3 Journal of Financial Economics 305, 311 (all arguing against the 'personalization' of the firm).

¹⁵ Bainbridge (n 11) 548; Easterbrook and Fischel (n 11) 36–39, 92–3. As an exception, the team production model of the firm is grounded in contractarian thought but nevertheless promotes the view that the firm should take non-shareholder interests into account. See Margaret M. Blair and Lynn A. Stout, 'A Team Production Theory of Corporate Law' (1999) 85 Va. L. Rev. 247.

¹⁶ See, e.g., Bainbridge (n 11) 548.

¹⁷ Easterbrook and Fischel (n 11) 36-39, 92-93; Bainbridge (n 11) 577-87.

¹⁸ Easterbrook and Fischel (n 11) 36; Bainbridge (n 11) 579. This account raises the question why other parties to the virtual corporate contract should agree to shareholder primacy and profit maximization. As Bainbridge posits, non-shareholders will do so for two reasons. First, they receive superior protection from contracts and welfare legislation. Second, shareholders as the greatest risk-bearers will place the highest higher value on being the beneficiaries of director fiduciary duties.

provided the business capital that is at risk should be rewarded and re-assured by the directors' duty to prioritise the enhancement of shareholders' invested capital/wealth. Finally, contractarians also view profit maximization as integral to reducing agency costs.¹⁹ Profit maximization as a singular goal, it is argued, limits managers' discretion to further their self-interests and provides clear aims for them to pursue, eliminating the distraction of having to resolve issues of conflicting interests and goals.²⁰ This point is frequently cited by shareholder wealth maximization proponents.²¹

In the UK, various corporate governance reviews have equally stressed the alleged difficulty associated with deviations from shareholder wealth maximization. Although the reviews and other UK corporate governance sources do not rely on a specific corporate theory, they generally operate on the basis of the assumptions of contractarian 'agency costs' thinking.²² The 2009 Walker Review of corporate governance in financial institutions, for instance, offered a strong defence of shareholder value as the sole focal point for boards. The report cautioned that diluting the primacy of the directors' duty to shareholders would both introduce uncertainty for shareholders in terms of the value of their holdings and distract the board from focusing on important strategic matters.²³ Similarly, the Hampel Report found that boards should be solely accountable to shareholders because to do otherwise would risk directors not being accountable to anyone due to a lack of a 'clear yardstick for judging their performance'.²⁴ In line with these views, the UK Corporate Governance Code, in an older version, once explicitly stated that good governance should enable management to deliver

Because of this, a bargain would be struck in which shareholders and other constituencies agree on shareholder primacy and wealth maximization as the chosen norm.

¹⁹ Jensen and Meckling (n 9).

²⁰ Michael C. Jensen 'Value Maximization, Stakeholder Theory, and the Corporate Objective Function' (2001) 14(3) *J. of Applied Corp. Finance* 8; Mark J. Roe, 'The Shareholder Wealth Maximization Norm and Industrial Organization' (2001) 149 *U. Pennsylvania Law Review* 2063, 2065.

²¹ See, for example, Henry N. Butler and Fred S. McChesney, 'Why They Give at the Office: Shareholder Welfare and Corporate Philanthropy in the Contractual Theory of the Corporation' (1999) 84 *Cornell Law Review* 1995, 1225; Frank H. Easterbrook & Daniel R. Fischel, 'The Proper Role of a Target's Management in Responding to a Tender Offer' (1981) 94 *Harvard Law Review* 1161, 1191–1192; Jonathan R. Macey, 'An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties' (1991) 21 *Stetson Law Review* 23, 32; Stephen M. Bainbridge 'The Bishops and the Corporate Stakeholder Debate' (2002) 4 *Villanova Journal of Law and Investment Management* 3, 11; note 24 below and accompanying text.

²² Talbot (n 13) 153–156.

²³ Sir David Walker, 'A Review of Corporate Governance in Banks and Other Financial Industry Entities: Final Recommendations' (26 November 2009), Annex 3.

²⁴ Committee on Corporate Governance, Final Report ('The Hampel Report') (January 1998), s. 1.17.

shareholder value.²⁵ In its most recent form, the Code still continues to embody shareholder wealth maximization thinking, albeit now in the tweaked form of ‘enlightened shareholder value’.²⁶ While the FRC has observed that the Code views corporate governance as a device for improving ‘the board’s ability to manage the company effectively to deliver long-term success as well as provide accountability to shareholders’,²⁷ the latter’s financial interests must remain the focal point for UK companies.

The UK Companies Act, Listing Rules, Takeover Code, and the Stewardship Code are also all underpinned by the aim to promote shareholder wealth maximization.²⁸ Notably, the introduction of section 172 in the Companies Act 2006 did not change the corporate purpose. This section does not entail stakeholder responsibilities other than the soft obligation for directors to ‘consider’ various non-shareholder interests, in effect leaving shareholder wealth maximization as the legislatively prescribed principle. Although the wording of section 172 may appear to suggest that there is room for interpretation, the ultimate aim of the provision remains shareholder value generation,²⁹ unless the purpose of a specific company consists of or includes purposes other than the benefit of its members.³⁰ This understanding of the ‘benefit of members as a whole’ is in line with case law and preparatory legislative work, the latter of which did not intend to deviate from the shareholder wealth maximization principle.³¹ Consequently, UK law, perhaps surprisingly, has gone farther in entrenching the shareholder wealth maximization principle than US law, which does not contain an analogous provision to section 172 and remains ambivalent or even agnostic – and

²⁵ UK Combined Code (2008), Preface.

²⁶ The Companies Act (2006) promotes an enlightened shareholder value model, which is also reflected in the Corporate Governance Code. As the FRC explains, the model’s application ‘means that boards must ensure that the business is sustainable and take account of long-term consequences in setting its business model and strategies’. Financial Reporting Council, ‘The UK Approach to Corporate Governance’ (October 2010) 6.

²⁷ *ibid.*

²⁸ See Talbot (n 13) chapter 5.

²⁹ Lorraine Talbot, ‘Trying to Change the World with Company Law? Some Problems’ (2016) 36 *Legal Studies* 513, 515, 529.

³⁰ Companies Act (2006), section 172(2).

³¹ See Andrew Keay and Hao Zhang, ‘An Analysis of Enlightened Shareholder Value in Light of Ex Post Opportunism and Incomplete Law’ (2011) *European Company and Financial Law Review* 1, 6–10; Thomas Clarke, ‘The Long Road to Reformulating the Understanding of Directors’ Duties: Legalizing Team Production Theory?’ (2015) 38 *Seattle University Law Review* 433, 458–467; 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, 500; Robert Goddard, ‘Modernising Company Law: The Government’s White Paper’ (2003) 66(3) *Modern Law Review* 402, 405. See also Explanatory Notes to Companies Act (2006), section 172, para. 325.

thus more flexible – when it comes to interpreting the corporate purpose and the question of shareholder wealth maximization.³²

B. Alternative Views – Responsibilities Towards Non-Shareholders

Despite its dominance the shareholder wealth maximization paradigm has not gone unchallenged. At various points in time, and since the beginning of the industrialist era, commentators have with varying degrees of intensity argued against the idea of profit as the main corporate purpose.³³ Now, once more, alternative views to shareholder wealth maximization are gaining traction. Triggered initially by corporate scandals around the turn of the millennium and, more recently, by the 2008-09 financial crisis, various scholars and policy-makers have expressed concern that the principle may lead to short-termism and negative effects on the economy and society.³⁴ As Margaret Blair has observed, even a number of previously strong shareholder value advocates have backed away from the commitment to shareholder wealth maximization as the exclusive corporate goal,³⁵ potentially marking a new dawn for alternative approaches to the corporate purpose.

In contrast to shareholder wealth maximization, stakeholder oriented models, corporate social responsibility (CSR) thinking³⁶ and similar theories focus on the idea that companies have responsibilities not only to shareholders, but also to a variety of other constituents. These constituents – such as employees, communities, or governments – are regarded as additional stakeholders whose resources and ‘investments’ in the corporation,

³² On this, see for example William T. Allen, ‘Our Schizophrenic Conception of the Business Corporation’ (1992) 14 *Cardozo Law Review* 261; Christopher M. Bruner, ‘The Enduring Ambivalence of Corporate Law’ (2008) 59 *Alabama Law Review* 1385; David Millon, ‘Two Models of Corporate Social Responsibility, (2011) 46 *Wake Forest Law Review* 523. Compare, however, Delaware Supreme Court Chief Justice Leo Strine’s forceful defense of the proposition that Delaware law demands shareholder wealth maximization. Leo E. Strine, ‘The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law’ (2015) 50 *Wake Forest Law Review* 761.

³³ See Andrew R. Keay, ‘Stakeholder Theory in Corporate Law: Has It Got What It Takes?’ (2010) 9(3) *Richmond J. of Global Law & Business* 249,253–254. See also Part 2 of this article for further background.

³⁴ Marc T. Moore, *Corporate Governance in the Shadow of the State* (Hart, 2013), 6.

³⁵ Margaret M. Blair, ‘Corporate Law and the Team Production Problem’ (2012) *Vanderbilt Law & Econ. Research Paper No. 12-12, 2* <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2037240> accessed 4 Apr 2017.

³⁶ See e.g., John M. Conley and Cynthia A. Williams, ‘Engage, Embed, and Embellish: Theory Versus Practice in the Corporate Social Responsibility Movement’ (2005) 31 *J. of Corporation Law* 1; Millon (n 32).

financial or non-financial in nature, deserve protection and consideration to the same extent as shareholder interests. The corporate purpose, in what can be broadly referred to as ‘pluralist theories’, is thus widened and the strict focus on shareholder interests relaxed or abandoned. The responsibilities of corporations, according to these views, relate to shareholders and non-shareholders, even if that necessitates corporate decisions or actions that run against shareholder value interests. The bases for such alternative positions that emphasise public responsibilities of corporations are varied. Possible justifications for corporations’ need to consider stakeholder interests include: viewing corporations as social or public institutions;³⁷ the need to maximise social welfare;³⁸ and as a result of the externalities companies can impose on stakeholders.³⁹

Building upon pluralist ideas, recent years have seen various efforts to provide fresh impulses and advance the corporate purpose debate. Commentators have put forward models that reduce shareholder influence over directors and corporate decision-making and increase duties by directors to all stakeholders;⁴⁰ advocated in favour of sustainable, long-term value instead of shareholder wealth enhancement⁴¹ and proposed the establishment of ‘trust firms’, in which only long-term committed shareholders can vote.⁴² Indeed, these alternate views are partly reminiscent of earlier periods during which corporate entities were thought to serve the public good⁴³ as well as earlier arguments against shareholders’ dominant status.⁴⁴

Notably, alternative views of the corporate purpose are not solely academic in nature. International recognition of stakeholder approaches by policy makers and international

³⁷ Adolf A. Berle, Jr. and Gardiner C. Means, *The Modern Corporation and Private Property* (Harcourt, Brace & World, Inc., 2nd ed. 1968), 46; Thomas L. Hazen, ‘The Corporate Persona, Contract (And Market) Failure, and Moral Value’ (1991) 69 *North Carolina Law Review* 273, 309; Moore (n 34).

³⁸ Kent Greenfield, ‘Defending Stakeholder Governance’ (2008) 58 *Case Western Reserve LR* 1043, 1055.

³⁹ Ronald M. Green, ‘Shareholders as Stakeholders, Changing Metaphors of Corporate Governance’ (1993) 50 *Washington and Lee LR* 1409, 1417.

⁴⁰ See, e.g., Talbot (n 29).

⁴¹ Andrew R. Keay, ‘Board Accountability and the Entity Maximization and Sustainability Approach’ in Barnali Choudhury and Martin Petrin (eds), *Understanding the Modern Company* (Cambridge University Press 2017); Andrew R. Keay, *The Corporate Objective* (Edward Elgar Publishing 2011).

⁴² Colin Mayer, *Firm Commitment: Why the Corporation is Failing us and How to Restore Trust in it* (Oxford University Press 2013).

⁴³ See, e.g. Lyman Johnson, ‘Law and Legal Theory in the History of Corporate Responsibility: Corporate Personhood’ (2012) 35 *Seattle University LR* 1135, 1144–45; Paddy Ireland et al., ‘The Conceptual Foundations of Modern Company Law’ (1987) 14(1) *J. of Law and Society* 149.

⁴⁴ Berle and Means (n 37) 312.

organizations is also growing. Views such as those expressed in the OECD Guidelines for Multinational Enterprises and the OECD Corporate Governance Principles support the idea of corporations taking into account non-shareholder interests.⁴⁵ The work of the OECD in this area is reflective of the growing global recognition of the links between corporate activities and social impacts. The role of business is even highlighted in the UN's new sustainable development goals, which directly identify business as being a key player in the achievement of these goals.⁴⁶ Corporate law, in the broader sense, is moving along a similar path, in an effort to redefine and broaden the corporate purpose, albeit in a piecemeal approach. Corporations, themselves, have also not remained unaffected by these changing perceptions. Major US retailer Walmart has, for instance, raised its employees' starting wage to almost a quarter above the required minimum level⁴⁷ while elite entrepreneur Elon Musk, driven by repeatedly stated environmental concerns, has decided to pursue a carbon-free future as the main goal for Tesla and SolarCity, two of his companies.⁴⁸

C. Towards a New Corporate (Public) Purpose

As the two contrasting views of the corporate purpose outlined above indicate, the corporate purpose – at least from a normative standpoint – is not settled. In ideal scenarios, the question of a corporation's purpose will not matter. This is the case when non-shareholder interests converge with profit enhancement goals, ensuring that both shareholder wealth maximization and stakeholder interests are realised. However, in less than ideal scenarios, trade-offs will need to be made necessitating a choice between the two major schools of thought.

Nevertheless, both approaches can lead to problematic results. An overly narrow focus on shareholder interests and profitability may, through increased risk-taking and neglect of non-financial impacts of corporate activities, lead or contribute to negative corporate externalities. Yet, defining the corporate purpose too widely may impair innovation and economic growth if it substantially reduces capital investment and results in costs that are

⁴⁵ OECD Guidelines for Multinational Enterprises (2011); G20/OECD Principles of Corporate Governance (2015).

⁴⁶ See, e.g., OECD, Development Co-operation Report 2016 – The Sustainable Development Goals as Business Opportunities (OECD Publishing 2016).

⁴⁷ Benn Steil and Dinah Walker, 'Why Did Walmart Raise Its Wages?' *Forbes* (Jersey City, 2 Apr 2015).

⁴⁸ Elon Musk, 'Master Plan, Part Deux' (Tesla.com Blog, 21 July 2016), <https://www.tesla.com/en_GB/blog/master-plan-part-deux > accessed 4 April 2016.

difficult for businesses to absorb. Moreover, an important but often overlooked factor is the dependence of pension funds – and ultimately pensioners – on steady corporate earnings that translate into dividends.⁴⁹ A large part of the workforce are, via public and private pension plans, indirectly major shareholders themselves.⁵⁰ Thus, their interests need to be taken into account in defining corporate aims.

Still, it is arguably the shareholder wealth maximization principle – which reflects the status quo – that should be most severely questioned. While it is unknown how the full-fledged adoption of stakeholderism or pluralist approaches would play out in practice, the last decades have seen devastating financial crises, mass torts, human rights violations, and environmental disasters that occurred while many corporations' main focus was on maximizing their shareholders' wealth. In particular, the 2008 financial crisis contributed to increased doubts as to the shareholder wealth maximization objective's justifiability as a guiding corporate law principle. Moreover, the basic foundations of shareholder wealth maximization also raise questions.

Principally, the efficacy of contractarian propositions on how stakeholders other than shareholders should protect their interests under a shareholder wealth maximization norm are called into question. It is unrealistic to assume that these stakeholders can actually bargain and adjust the price of their 'contract' with corporations to account for the fact that managers will give primacy to shareholder interests.⁵¹ This proposition appears to assume perfect market conditions – free from information asymmetries, inequalities in bargaining power, etc. – under which bargaining between the firm and non-shareholder constituencies takes place.⁵²

Yet, it is often a stretch to contend that constituencies such as communities affected by corporate activities have, even in a looser sense of the word, 'bargained' with the corporation and thus had a chance to negotiate the terms of their contracts.⁵³ These

⁴⁹ On this, see Martin Gelter, 'The Pension System and the Rise of Shareholder Primacy' (2013) 43 *Seton Hall Law Review* 909; Markus Roth, 'Labor and Comparative Corporate Governance in Times of Pension Capitalism – Independent Directors, Shareholder Empowerment and Long-Termism: The Transatlantic Perspective' (2013) 18 *Fordham Journal of Corporate & Financial Law* 751.

⁵⁰ Although this situation is more prevalent in the US than the UK.

⁵¹ Stephen M. Bainbridge, 'In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green' (1993) 50 *Washington and Lee Law Review* 1423, 1443-44.

⁵² Barnali Choudhury, 'Aligning Corporate and Community Interests: From Abominable to Symbiotic' (2014) 2014 *Brigham Young University LR* 257; Michael Galanis, 'Vicious Spirals in Corporate Governance: Mandatory Rules for Systemic (Re)Balancing?' (2011) 31 *OJLS* 327.

⁵³ Choudhury (n 52) 270; Greenfield (n 38) 1059–62.

weaknesses could be overcome or could be irrelevant if non-corporate laws and regulations effectively protected third parties affected by corporations, which the standard contractarian account seems to assume when it leaves it up to tort, criminal, constitutional, and other laws to deal with corporate externalities.⁵⁴ While protection is of course provided for to a certain extent through external regulation, these potential protections may well be ‘narrow in scope, limited by jurisdiction, and often captured by corporate interests’.⁵⁵ In particular, this is true for jurisdictions with lower levels of regulations, enforcement, or weaker access to justice. Third party exposure to harm in general also trumps another contractarian argument, the corporation’s inability to assume societal responsibilities due to its fictional nature. Such arguments have been shown to be unhelpful in defining either corporate rights or duties.⁵⁶

Shareholder wealth maximization proponents argue that even in the face of social costs incurred by stakeholders, utilitarian justifications for this goal arise from an interest in strong capital markets and distributional efficiency.⁵⁷ In the long run, the costs occasioned by reduced incentives for investment if profit maximization were not a corporation’s sole goal, would allegedly greatly exceed any negative effects on the public.⁵⁸ Moreover, as already mentioned above, corporate managers have been said to be both distracted and invited to serve their self-interests in the absence of a singular overarching, profit oriented goal. For these reasons, shareholder wealth maximization proponents argue, the pursuit of aggregate social welfare is best served through a singular focus on profits.⁵⁹

However, neither utilitarianism nor an aggregate social welfare philosophy points definitively in favour of a *singular* focus on profits. For example, utility theories, which link profit maximization to the existence of strong capital markets, tend to presume that without shareholder primacy equity investors would be less inclined to invest, diminishing economic growth.⁶⁰ Ultimately, utilitarian theorists assume that shareholders’ utility is solely dependent on the corporation’s ability to create shareholder wealth. Yet, this presumption does not

⁵⁴ Hansmann and Kraakman (n 10) 440–41.

⁵⁵ Kent Greenfield, ‘The Disaster at Bhopal: Lessons for Corporate Law?’ (2008) 42 *New England LR* 755, 758–59.

⁵⁶ Martin Petrin, ‘From Nature to Function: Reconceptualizing the Theory of the Firm’ (2013) 118 *Penn State Law Review* 1.

⁵⁷ Roe (n 20) 2065; William T. Allen et al., ‘The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide’ (2002) 69 *U. Chi. L. Rev.* 1067, 1089.

⁵⁸ Allen et al. (n 57) 1089.

⁵⁹ Hansmann and Kraakman (n 10) 441.

⁶⁰ Allen et al., (n 57) 1089.

account for the increasing numbers of investors whose investments are guided by some concern for social responsibility.⁶¹ Even the most self-interested shareholders will likely have some moral and non-financial interests that will limit the extent to which they want the corporation to pursue unconditional profit goals.⁶² Thus, it can no longer be assumed that the rational shareholders' utility is maximised exclusively by profit considerations.

More fundamentally, a goal of profit maximization does not necessarily translate into the pursuit of aggregate social welfare. A corporation that maximises profits for its shareholders does not automatically create benefits for its non-shareholder constituents or for society. Without effective distributional mechanisms to allocate corporate gains to stakeholders, the 'trickle-down' effect (in which increased shareholder profits result in benefits for other stakeholders and society in general) cannot be presumed.⁶³ Relatedly, in some instances, corporate profit may not even result not from productive wealth creation but from a transfer of wealth from stakeholders to shareholders, for example in cases where a corporation pays substandard wages, engages in environmentally damaging acts, or increases profits through activities related to financial engineering and tax avoidance.⁶⁴

In short, the various negative external effects of shareholder wealth maximization and the weaknesses in its underlying theoretical explanations suggest that the way forward for corporations ought to be along a different path. This does not mean, however, that profit should become meaningless or that shareholders' financial concerns are not important. The

⁶¹ Arthur Small and Joshua G. Zivin, 'A Modigliani-Miller Theory of Altruistic Corporate Social Responsibility' (2005) 5:1 *Topics in Economic Analysis & Policy* 1, 5-6; Henry T.C. Hu, 'Buffett, Corporate Objectives, and the Nature of Sheep' (1997) 19 *Cardozo LR* 379,391-92.

⁶² Small and Zivin (n 61) 19; Einer Elhauge, 'Sacrificing Corporate Profits in the Public Interest' (2005) 80 *N.Y.U. Law Review* 733, 783; Robert J. Rhee, 'Corporate Ethics, Agency and the Theory of the Firm' (2008) *J. of Business and Technology* 1101, 1111. Indeed, even the important class of institutional shareholders has in more recent times been shown to value and actively seek out investments in firms with socially responsible corporate practices. See, for example, I.J. Alexander Dyck et al., 'Do Institutional Investors Drive Corporate Social Responsibility? International Evidence' (11 October 2017), Rotman School of Management Working Paper No. 2708589 <<https://ssrn.com/abstract=2708589>>; Henry L. Pedersen and Harrie Vredenburg, 'Morals or Economics? Institutional Investor Preferences for Corporate Social Responsibility' (2009) 90 *Journal of Business Ethics* 1.

⁶³ Kent Greenfield, 'Proposition: Saving the World With Corporate Law' (2008) 57(4) *Emory LJ* 948, 967; but cf. George W. Dent, Jr., 'Academics in Wonderland: The Team Production and Director Primacy Models of Corporate Governance' (2008) 44 *Houston LR* 1213, 1273 (arguing that profit maximization inevitably benefits society). Perhaps the most prominent redistribution mechanism is taxation, on which see for instance Louis Kaplow and Steven Shavell, 'Why the Legal System is Less Efficient than the Income Tax in Redistributing Income' (1994) 23(2) *Journal of Legal Studies* 667.

⁶⁴ See Talbot (n 29) 19–20; Greenfield (n 63) 967.

importance of the corporation as a creator of shareholder wealth cannot and should not be ignored. However, at the same time, a singular and unconstrained focus on shareholder wealth maximization is unjustified. The true corporate purpose must therefore lie somewhere on an axis between the two competing positions. Thus, the notion that the corporate purpose – and, flowing from this, the regulation of corporate governance – includes aspects of public policies (and goes beyond the reduction of agency costs) is a theoretically justifiable position. Still, the question to which extent the corporate purpose should be directed towards public goals as well as how such goals should be achieved require further examination. The remaining sections will focus on these questions.

3. Examples of Corporate Governance Mechanisms with a Public Policy Focus

In light of the theoretic justifications for promulgating corporate governance mechanisms that focus on public policy objectives, this section examines three examples of such mechanisms. These include corporate governance mechanisms focusing on executive remuneration, board diversity, and non-financial reporting. While each of these mechanisms were initially justified by the government in terms of promoting shareholder interests, a closer examination reveals both veiled – and at times explicit – efforts to use the mechanisms to promote public policy issues.

A. Executive Remuneration

(i) Background

One area in which the responsibilities of corporations to promote public issues has been increasing is executive remuneration. This is hardly surprising, since executives of large public companies undoubtedly receive substantial and continuously increasing remuneration packages, which have often attracted public scrutiny. Between 1998 and 2010 the average total pay of FTSE 100 Chief Executive Officers rose 13.6% per year from an average of £1 million to £4.2 million. This rise in pay far exceeded the 1.7% average annual increase in the FTSE 100 index as well as the average remuneration levels for other employees for the same

period.⁶⁵ More recently, in 2014, the average UK CEO remuneration was estimated to be 125 times more than the average earnings of an employee.⁶⁶

The apparent excesses of executive remuneration are symptomatic of a number of underlying problems. At its root, the problem is often viewed as an agency cost⁶⁷ between shareholders who delegate managerial duties to corporate managers and managers who may be inclined to act in their own self-interest by setting excessive pay rates for themselves.⁶⁸ Compounded with agency cost issues, remuneration of corporate managers may not align with firm performance, resulting in what shareholders perceive as ‘excessive’ or inefficiently high rewards relative to performance.⁶⁹ Yet, the problems with executive remuneration extend well past the interests of shareholders. The large differences between CEO to worker pay ratios have been characterised as examples of a capture of wealth by a small, elite class, triggering suggestions to aim for redistribution.⁷⁰ Excessive levels of pay at the executive level naturally remove wealth from both shareholders and employees, although this may be relatively small in relation to a business’s overall financial position. More importantly, it seems, both the absolute size and differences in relative increases of executive remuneration versus non-executive remuneration emphasise class divisions, frustrate those with lower salaries, and imperil the political economy that gave rise to the corporation’s wealth in the first place⁷¹ – as the aftermath of the Brexit vote and the Prime Minister’s speech on new policies for the country seemed to demonstrate. Measures that are intended to address excessive executive remuneration⁷² are therefore, in part, an attempt to impose responsibility on corporations for reducing income inequality.

⁶⁵ BIS, ‘Executive remuneration discussion paper’ (2011), 11.

⁶⁶ Paul Marsland, ‘Pay Ratios: Just Do It’ (Nov. 2015) High Pay Centre Publication, 17 <<http://highpaycentre.org/pubs/pay-ratios-just-do-it>> accessed 4 Apr 2017.

⁶⁷ Jensen and Meckling (n 9).

⁶⁸ Martin Petrin, ‘Executive Compensation in the United Kingdom - Past, Present, and Future’ (2015) 36 *The Company Lawyer* 195,196–197.

⁶⁹ Lucian Bebchuk and Jesse Fried, *Pay Without Performance: The Unfulfilled Promise of Executive Compensation* (Harvard University Press 2006).

⁷⁰ See generally Charlotte Villiers, ‘Executive pay: a socially-oriented distributive justice framework’ (2016) 37(5) *Company Lawyer* 139.

⁷¹ David O. Friedrichs, ‘Exorbitant CEO Compensation: Just Reward or Grand Theft?’ (2009) 51 *Crime, Law & Social Change* 45, 58; Charlotte Villiers, ‘Controlling Executive Pay: Institutional Investors or Distributive Justice?’ (2010) 10 *J. of Corp. L. Studies* 309, 336.

⁷² See below, section 3.A(ii).

Indeed, although executive remuneration corporate governance mechanisms are principally characterised as tools by which agency costs can be reduced, they are also seen as tools to promote distributive justice or fairness.⁷³ According to this view, excessive executive salaries can impede the equality of society which, in turn, can promote social and political crises.⁷⁴ Indeed, remuneration policies based on distributive fairness concerns can help incentivise low-wage workers and increase the productivity of businesses.⁷⁵ Following this line of reasoning, some governments and organizations have been quite explicit in the underlying need to address executive remuneration problems as part of an effort to address inequality in society. Britain's High Pay Centre observed, for example, that "so much wealth has been channelled to [executives] at the very top ... that Britain now has a gap between rich and poor that rivals that in some developing nations ..."⁷⁶ Similarly, the Labour party suggested that measures curbing executive pay would 'create an economy based on mutual obligations ... between employers and employees.'⁷⁷ Even today, the recognition of these links between executive pay and fairness continues. Theresa May observed that a fairer economy would entail changes to executive pay "because there is an irrational, unhealthy and growing gap between what ... companies pay their workers and what they pay their bosses" while the House of Commons Business, Energy and Industrial Strategy Committee's 2017 report on Corporate Governance stated that "we agree with the Prime Minister that [the regulation of executive remuneration] is an issue which needs to be addressed for the benefits of society as a whole and in line with her vision of an economy that works for everyone".⁷⁸

Apart from addressing inequality, excessive executive remuneration may also represent a deeper seated problem in the way corporations are being managed. Financial crises have been, at least partially, attributed to managerial short-termism, or the myopic

⁷³ See, e.g., Villiers (n 71); William Lazonick, 'Why Executive Pay Matters to Innovation and Inequality' in Cynthia A. Williams and Peer Zumbansen (eds), *The Embedded Firm: Corporate Governance, Labor, and Finance Capitalism* (Cambridge University Press 2011) 413.

⁷⁴ Villiers (n 71) 313.

⁷⁵ Marc T. Moore, 'Corporate Governance, Pay Equity, and the Limitations of Agency Theory' (2015) 68:1 *Current Legal Problems* 431.

⁷⁶ High Pay Commission, 'Cheques With Balances: Why Tackling High Pay Is In The National Interest' (2012), 7 <http://highpaycentre.org/files/Cheques_with_Balances.pdf> accessed 4 Apr 2017.

⁷⁷ Labour Party, 'Britain can be better: The Labour Party Manifesto 2015' (2015), 21 <http://b.3cdn.net/labouruk/e1d45da42456423b8c_vwm6brbvb.pdf> accessed 4 Apr 2017.

⁷⁸ May (n 1); House of Commons Business, Energy and Industrial Strategy Committee, 'Corporate Governance – Third Report of Session 2016-17' (5 April 2017) 3.

focus by corporate managers on short-term results.⁷⁹ Given the links between short-termism, engaging in excessively risky behaviour and executive remuneration, remuneration issues can exacerbate these problems.⁸⁰ Curbing executive remuneration may therefore also promote the idea of corporations being responsible for managing their operations with a view to long-term sustainability, not only for their own benefit, but for the benefit of the economy and society as a whole.

(ii) Executive Remuneration Governance Mechanisms

As mentioned above, corporate governance mechanisms designed to address executive remuneration issues have traditionally been designed to reduce agency costs between management and shareholders. Thus, early efforts in the UK focused on addressing rising executive pay through the recommendation of measures such as the use of remuneration committees, disclosure requirements for pay policies, and the use of shareholder approval of remuneration policies.⁸¹ Similarly, when these measures were found not to be effective and the government introduced the Directors Remuneration Report Regulations in 2002, which elevated directors' remuneration provisions to statutory level, the new measures still focused on agency cost reductions.⁸² However, propelled by the near collapse of the financial industry during the last financial crisis and subsequent corporate governance reports that suggested a connection between the crisis, risk-taking, and executive pay practices, the newest set of executive remuneration regulations introduced in 2013 took a broader approach.⁸³

⁷⁹ CFA Center For Financial Integrity & Business Roundtable Institute for Corporate Ethics, 'Breaking the Short-Term Cycle: Discussion and Recommendations On How Corporate Leaders, Asset Managers, Investors And Analysts Can Refocus On Long-Term Value' (2006), 3 <http://www.corporate-ethics.org/pdf/Short-termism_Report.pdf> accessed 4 Apr 2017.

⁸⁰ FSA, 'A Regulatory Response to the Global Banking Crisis' (March 2009) Discussion Paper 09/02, para 10.2; Michael Faulkender et al., 'Executive Compensation: An Overview of Research on Corporate Practices and Proposed Reforms' (2010) 22 *J. of Applied Corporate Finance* 107; BIS, 'Kay Review of UK Equity Markets and Long-Term Decision-Making' (July 2012).

⁸¹ Richard Greenbury, 'Directors' Remuneration: Report of a Study Group chaired by Sir Richard Greenbury' (17 July 1995), ss. C, D, B 2 and paras 5.3–5.12; 5.28–5.32.

⁸² Directors' Remuneration Report Regulations 2002 (SI 2002/1986) ('2002 Regulations'), amending the Companies Act 1985.

⁸³ See Walker (n 23).

While the new framework articulated the aim of empowering shareholders to hold companies accountable for executive pay matters⁸⁴ – seemingly suggesting a focus on shareholder interests once again – there were clear signs that the regulations encompassed larger goals. For instance, in a consultation document, the BIS (as it was known then) explained that executive remuneration has been a matter of interest and concern, and has had an impact on, stakeholders and the wider public.⁸⁵ In addition, both former deputy Prime Minister Nick Clegg and former Opposition Leader Ed Milliband spoke about the need for executive remuneration to be reformed for equality reasons just prior to the reforms being announced.⁸⁶ Even then Prime Minister David Cameron suggested that the need for executive remuneration reforms was because ‘big rewards ... make people’s blood boil’.⁸⁷

The substance of the new regulations still addressed shareholder interests, requiring both a tri-annual binding shareholder vote on a corporation’s general policy for annual directorial remuneration as well as an annual, non-binding shareholder advisory vote on the implementation of the director’s remuneration policy.⁸⁸ In addition, the reforms introduced greater precision into the directors’ remuneration report, although again this was mainly directed at shareholder interests.⁸⁹ Companies are thus required to provide information on the major decisions and changes made to directors’ remuneration,⁹⁰ provide information on how the directors’ remuneration policy has been implemented and provide a single total remuneration figure for every director.⁹¹ In addition, they must prepare the directors’ remuneration policy, which sets out the policy for making directorial remuneration payments as well as includes a statement on how pay and employment conditions of employees were taken into account in setting the policy for directors’ remuneration.⁹² However, the focus on shareholders was not exclusive. The regulations attended to a wider set of interests by

⁸⁴ BIS, ‘Directors’ Pay: Consultation on revised remuneration reporting regulations’ (June 2012), 5.

⁸⁵ *ibid* 10.

⁸⁶ ‘Ed Miliband: The Speech in full’, *The Telegraph* (London, 2 Oct 2012); ‘Transcript of Nick Clegg Interview on the Andrew Marr Show’ (4 Dec. 2011) <http://news.bbc.co.uk/2/hi/programmes/andrew_marr_show/9654782.stm> accessed 4 Apr 2017.

⁸⁷ Robert Winnett, ‘David Cameron: Give Shareholders Vote to Rein in Executive Pay’ *The Telegraph* (London, 8 Jan 2012).

⁸⁸ Enterprise and Regulatory Reform Act 2013, s 79(4) and s. 79(3).

⁸⁹ The directors’ remuneration policy may be omitted from the overall directors’ remuneration report if the company does not intend and is not required to seek approval for it in a given financial year. See Companies Act 2006, s 439A (as amended).

⁹⁰ 2013 Regulations (n 88) Schedule 8, s 3.

⁹¹ *ibid* ss. 4-13.

⁹² *ibid* ss. 25-36, 38-40.

requiring companies to provide a single remuneration figure for each director – which would allow both shareholders and the public – to be able to compare directorial pay between companies as well as require companies to state how they had taken into account the pay and employment conditions of employees in setting director remuneration, presumably in hopes that this consideration would reduce stark disparities between the two. Additionally, the political and legislative backdrop to the regulations evidenced that the regulations were seen as serving partially public goals.

More recently, in its latest efforts to address executive remuneration issues, the government once again focused on shareholder concerns but also introduced public policy goals into its proposals. In the 2016 Green Paper on Corporate Governance Reform, the BEIS stated its aim was to update the corporate governance framework by increasing shareholder influence on executive pay.⁹³ However, in offering a background to the issue, the Green Paper observed, at the outset, that executive pay is ‘an area of significant public concern’ and ‘a key factor in public dissatisfaction with large businesses’,⁹⁴ suggesting that reforms to executive pay were being driven at least in part by public policy concerns. Moreover, while many of the options for reform in the Green Paper focused on increasing shareholder influence, two reform options appeared to focus at least as much on the public policy aspects of executive compensation as shareholder concerns. The first was the idea of having companies set upper limits for executive pay⁹⁵ while the second was the notion of companies disclosing pay ratios between executives and employees.⁹⁶ Both of these options are directly addressed at reducing wealth inequality, rather than simply reducing agency costs, reinforcing the underlying public purpose aims of these proposals.

In August 2017, the government went on to release the latest reform plans for executive remuneration.⁹⁷ Pointing to wider societal concerns over high levels of executive remuneration and ‘a widespread perception that boardroom remuneration is increasingly

⁹³ BIS, Corporate Governance Reform: Green Paper (Nov 2016)
<https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/584013/corporate-governance-reform-green-paper.pdf> accessed 4 Apr 2017.

⁹⁴ *ibid* 16.

⁹⁵ *ibid* 23.

⁹⁶ *ibid* 29.

⁹⁷ BEIS, ‘Corporate Governance Reform: The Government response to the green paper consultation’ (Aug 2017)
<https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/640631/corporate-governance-reform-government-response.pdf> accessed 3 Nov 2017.

disconnected from the pay of ordinary working people’,⁹⁸ the government indicated that it would (among other measures) introduce legislation requiring listed companies to report on the ratio of CEO pay to the average pay of their UK workforce, along with a narrative explaining changes to that ratio from year to year and setting the ratio in the context of pay and conditions across the wider workforce.⁹⁹ In addition, remuneration committees would be required “to engage with the wider workforce to explain how executive remuneration aligns with wider company pay policy”, using pay ratios where appropriate.¹⁰⁰ Confirming and perhaps even going beyond the thrust of previous regulatory interventions, these reforms – with their focus on “driv[ing] greater alignment between pay at the top and across the rest of the company”¹⁰¹ – focus more on addressing wealth inequality rather than reducing agency costs, exemplifying once again the current public objective nature of executive remuneration (and other intended measures) outlined or already implemented by the UK government.

B. Diversity on Boards

(i) Background

A second example of corporate governance mechanisms focusing on public policy issues can be found in relation to diversity on corporate boards. The idea of diversity has gained currency, in part, because in contrast to boards today’s labour force represents a wide range of workers. In the UK, for instance, roughly half of the labour force is comprised of women, 12 percent of workers are of a different ethnic origin and just under half of all workers are aged between 25 and 49.¹⁰² Yet this varied mix of labour market participants is not reflected in the governance of corporations. Instead, the predominant characteristics of a typical

⁹⁸ *ibid* 8.

⁹⁹ *ibid* 3.

¹⁰⁰ *ibid*.

¹⁰¹ *ibid* 8.

¹⁰² EMP01 SA: Full-Time, Part-Time And Temporary Workers (Seasonally Adjusted) (July 2016) <<http://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/datasets/fulltimeparttimeandtemporaryworkersseasonallyadjustedemp01sa>> accessed 4 Apr 2017; 2011 Census Analysis: Ethnicity and the Labour Market, England and Wales (Nov. 2014), <<http://www.ons.gov.uk/peoplepopulationandcommunity/culturalidentity/ethnicity/articles/ethnicityandthelabourmarket2011censusenglandandwales/2014-11-13>> accessed 4 Apr 2017.

member of a board of directors have been described as ‘pale, stale, and male’.¹⁰³ The dominance of boards by older white men has prompted governments to seek methods by which to diversify corporate boards.

The justification for this inclusion of a wider set of individuals at board level has been couched primarily in two different rationales. Typically, governments have sought to justify measures designed to increase board diversity in utilitarian terms by emphasizing the use of or the consequences that a diverse board can bestow.¹⁰⁴ The most relied upon utilitarian argument has traditionally been in terms of the links between a diverse board and increased firm profitability. However, as studies surveying these links have been equivocal in their findings,¹⁰⁵ governments and policy makers have looked more generally to the positive contributions that a diverse group of individuals can bring to a board. As the preface to the UK Corporate Governance Code observes, one method by which constructive debate among board members can be encouraged is by having a diverse board.¹⁰⁶

Yet apart from utilitarian arguments, promoting diversity on boards undoubtedly also promotes equality. Diversity on boards can help equalise power and opportunities between the majority and the minority particularly at the upper levels of leadership in companies.¹⁰⁷ Indeed, in some ways, justifying diversity measures on boards in terms of equality is even more important than utilitarian arguments because an equality rationale promotes diversity on boards as a desired value in and of itself. In short, promoting diversity on boards imposes responsibilities on corporations to help aid governmental efforts to create a more equitable society.

¹⁰³ Bloomberg, ‘Pale, Stale and Male: In Search of Board Diversity’ (New York, Apr. 30, 2015) <<https://www.bloomberg.com/news/videos/2015-04-30/pale-stale-and-male-in-search-of-board-diversity>> accessed 4 Apr 2017.

¹⁰⁴ Mari Teigen, ‘The Affirmative Action Controversy’ (2000) 8:2 NORA – Nordic J. of Fem. and Gender 63, 64.

¹⁰⁵ See, for example, the studies cited in Barnali Choudhury, ‘New Rationales for Women on Boards’ (2014) 34:1 OJLS 1, 3.

¹⁰⁶ Financial Reporting Council, ‘The UK Corporate Governance Code’ (2014), para. 3.

¹⁰⁷ T. Giske, Member of Parliament, as quoted in Hilde Bjørkhaug and Siri O. Sørensen, ‘Feminism without Gender? Arguments for Gender Quotas on Corporate Boards in Norway’ in Fredrik Engelstad and Mari Teigen (eds), *Firms, Boards and Gender Quotas: Comparative Perspectives* (Emerald Group Publishing Limited 2012) 198.

(ii) Examples of Board Diversity Initiatives

Efforts to increase one specific aspect of diversity, female board representation, have been prioritised in the UK in the last couple of years. As early as 2003, Derek Higgs, in his review of the role and effectiveness of non-executive directors, observed that the low number of female directors was ‘striking’.¹⁰⁸ Accordingly, he recommended that boards draw directorships from pools of qualified women,¹⁰⁹ a recommendation that was also echoed by the Tyson Report.¹¹⁰

In 2011, renewed efforts to promote women on board were advocated by Lord Davies of Abersoch in a government-backed report,¹¹¹ which promoted gender equality on boards as part of an effort to build ‘a fairer society’.¹¹² Nevertheless, Lord Davies’ report justified the need for more women on board entirely in utilitarian terms, noting that the ‘business case for increasing the number of women on corporate boards is clear’ and that ‘when women are so under-represented on corporate boards, companies are missing out’.¹¹³ Lord Davies went on to recommend that boards of FTSE 100 companies should voluntarily aim to achieve a minimum of 25 per cent female representation on boards by 2015. Listed companies were further recommended to, among others, establish boardroom diversity policies; disclose the number of women both on the company’s board and in senior positions; and consider women for board appointments whose experience is garnered outside the corporate mainstream.¹¹⁴

In the wake of these recommendations, the UK Corporate Governance Code was amended and now provides that search for and appointment of board candidates should be conducted ‘with due regard for the benefits of diversity on the board, including gender’, that the annual report should contain a description of the board’s policy on diversity, and that the board’s annual evaluation should include a review of its diversity.¹¹⁵ In addition, following

¹⁰⁸ Derek Higgs, ‘Review of the Role and Effectiveness of Non-Executive Directors’ (DTI 2003), para. 10.22.

¹⁰⁹ *ibid* para. 10.25.

¹¹⁰ Laura Tyson, ‘The Tyson Report on the Recruitment and Development of Non-Executive Directors’ (2003).

¹¹¹ Lord Davies of Abersoch, ‘Women on Boards – February 2011’ (Department of Business Innovation & Skills 2011).

¹¹² Cabinet Office, *The Coalition: Our Programme for Government* (2010), 18 <https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/83820/coalition_programme_for_government.pdf> accessed 4 Apr 2017.

¹¹³ Lord Davies (n 111) 3.

¹¹⁴ *ibid* 18-22.

¹¹⁵ UK Corporate Governance Code (n 106), Principle B.2. - Provision B.2.4, Principle B.6.

recent amendments influenced by EU requirements, boards of companies are further required to disclose information on female representation on the board and at other hierarchical levels within the company.¹¹⁶

In 2015, Lord Davies reviewed the efforts that had been made since his initial report in 2011.¹¹⁷ His report noted that the target of 25 per cent of women on boards of FTSE 100 companies had been achieved, but that further progress was needed. Interestingly, the report was prefaced by comments from the Ministers for Women and Equalities and for BIS, observing that work in this area must continue to develop ‘powerful role models’ and to ensure ‘women play a full part throughout their place of work’.¹¹⁸ The preface also featured a large, bolded quote noting the existence of societal interconnections as evidence that “the success of women in one strata can reinforce success of women in another, creating a virtuous cycle”.¹¹⁹ This seemed to indicate a clear departure from the utilitarian only justifications for promoting women on boards permeating the 2011 Davies report.

Given the success of the earlier recommendations, Lord Davies put forward a new set of recommendations. These included, among others, a new voluntary target of 33 per cent of female representation on boards of FTSE 350 companies by 2020 and increasing the numbers of female appointments to the roles of Chair, Senior Independent Director and into Executive Director positions on Boards of FTSE 350 companies.¹²⁰

Success with the women on boards initiative has also spurred governmental efforts to define diversity on boards in wider terms. In November 2016, government appointee Sir John Parker released a draft report, *A Report into the Ethnic Diversity of UK Boards*, which noted the need to increase ethnic diversity on boards ‘in order for corporate Britain to reflect the progress that is being made in diversity, equality and inclusion generally’, to reflect the ‘ethical aspects of ensuring [that] the composition of [corporate] boards reflects the make-up of society’ as well as other business case reasons for doing so.¹²¹ It thus recommended that each FTSE 100 Board have at least one director of colour by 2021, that Nomination

¹¹⁶ See The Companies Act 2006 (Strategic Report and Directors’ Report) Regulations 2014, inserting a new section 414C in the Companies Act 2006.

¹¹⁷ Lord Davies of Abersoch, ‘Improving the Gender Balance on British Boards – Women On Boards Davies Review Five Year Summary’ (October 2015).

¹¹⁸ *ibid* 4.

¹¹⁹ *ibid* 5.

¹²⁰ *ibid* 7.

¹²¹ Sir John Parker, ‘A Report into the Ethnic Diversity of UK Boards (Nov 2016), 5-6.

Committees require their search firms to identify and present qualified people of colour to be considered for Board appointment when vacancies occur, develop mechanisms to identify, develop and promote people of colour within their organisations and that the board disclose its diversity policy and efforts to increase diversity generally in its annual report.¹²² Although the UK Corporate Governance Code had included race as an example of diversity in its preface heralding the benefits of board diversity since 2014,¹²³ the Parker review's recommendations reflect the first substantial effort at interpreting the term diversity more widely than gender. Nevertheless, beyond gender and ethnicity, diversity continues to be interpreted rather narrowly as diversity in terms of age, disability, sexual orientation or other personal characteristics is not part of the discussion. Yet, what is clear today is that regulations addressing board diversity have moved beyond solely economic or shareholder-oriented justifications to include broader equality and societal goals as well.

C. Non-Financial Disclosure

(i) Background

A third area in which corporations are being increasingly tasked with responsibility for public interest issues relates to non-financial disclosure. Governments are relying on disclosure rules to promote myriad public policy goals from curbing greenhouse gas emissions to curtailing energy usage to promoting humanitarian aid. This burgeoning interest in relying on non-financial disclosure mechanisms to promote broader public policy goals is a departure from the traditional role of disclosure obligations, which has mainly focused on reducing information asymmetries and instilling confidence in capital markets.¹²⁴ Non-financial disclosure obligations are gradually being focused on another function: the promotion of social policy goals, a clear indication of the blending of public and private goals.

In part, designing non-financial disclosure obligations to target social issues is not *per se* problematic and can easily be justified when the disclosure obligations result in private benefits for corporations as well as public benefits for society. A good example of this are

¹²² *ibid* 8-9.

¹²³ See, e.g., UK Corporate Governance Code (n 106) 2.

¹²⁴ Gaetane Schaecken Willemaers, *The EU Issuer-Disclosure Regime: Objectives and Proposals for Reform* (Kluwer Law International 2011) 21; London Stock Exchange, 'Admission and Disclosure Standards' (2013), 15.

disclosure obligations targeted at reducing energy efficiency, which can result in both cost savings for corporations as well as protection of the environment.¹²⁵ However, the blending of public and private goals becomes more difficult to justify when the link between private and public benefits is less discernible.

(ii) Examples of Non-Financial Disclosure Obligations

The UK has implemented a number of non-financial disclosure requirements promoting public policy goals. Large corporations must disclose information on environmental and employee matters¹²⁶ and listed corporations must disclose information on environmental, employee, and social and community matters as well as information on human rights issues.¹²⁷ Moreover, as part of the government's efforts to increase the number of women on boards, listed corporations are additionally required to disclose the number of female directors, senior managers, and employees of the corporation.¹²⁸ Further, there are disclosure requirements pertaining to corporations' greenhouse gas emissions if it is practical to obtain that information.¹²⁹

The various disclosure requirements seemingly are addressed at furthering both corporate (private) goals alongside public policy goals. As the Ministerial Forward in the draft report enacting these provisions argued, this type of disclosure information is necessary to help shareholders hold corporations to account, which when they fail to do, leads to effects that can be 'widely felt' – a seemingly implicit reference to the public at large.¹³⁰ Many of the non-financial disclosure obligations implemented in the UK are derived from a 2014 EU directive that equally reflects public goals. The directive, which was introduced, in part, 'for companies to deliver better results' and 'to enhance the trust citizens have in business and in

¹²⁵ Carbon Trust, 'The Business of Energy Efficiency' (Dec. 2010) <<https://www.carbontrust.com/resources/reports/advice/the-business-of-energy-efficiency>> accessed 4 Apr 2017; D. Zenghelis, 'How much will it cost to cut global greenhouse gas emissions?' (27 Oct 2014) <<http://www.lse.ac.uk/GranthamInstitute/faqs/how-much-will-it-cost-to-cut-global-greenhouse-gas-emissions/>> accessed 4 Apr 2017.

¹²⁶ The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, SI 2013/1970, s. 414A.

¹²⁷ *ibid* s. 414C(7)(b).

¹²⁸ *ibid* s. 414C(8).

¹²⁹ *ibid* s. 15-20.

¹³⁰ Jo Swinson, 'Ministerial Foreword' in BIS, 'The Future of Narrative Reporting' (Oct. 2012), 3.

markets'¹³¹, required the disclosure of information on environmental matters; social and employee-related issues and respect for human rights, and anti-corruption and bribery issues.¹³² Thus, these disclosure obligations also address private and public goals.

In contrast to the dual furthering of private and public interests approach seen in the UK and EU, some countries rely on disclosure requirements *primarily* to further public goals. For example, since 2012 Indian corporations are required to spend at least two per cent of their average net profits from the preceding three years on CSR activities.¹³³ Listed corporations are further required to disclose environmental and social measures taken by the business as part of their business responsibility reports.¹³⁴ In introducing these requirements, India's Securities and Exchange Board observed that these obligations were introduced to enable corporations – as 'critical components of the social system' – to be accountable to the public at large.¹³⁵ Similarly, in China, the Shenzhen Stock Exchange prefaces its non-financial disclosure obligations by noting that these rules have been implemented for the purpose of 'building social harmony' and 'accelerating sustainable economic and social development.'¹³⁶ Pursuant to this notion, the Shenzhen Stock Exchange rules require corporations to establish a social responsibility mechanism and to disclose social responsibility matters.¹³⁷

Compared to other countries, the US has embarked on a unique approach to adopting disclosure rules. In some instances, the government has elected to promote both public and private goals in its disclosure rules, while in others the rules promote only public goals. For

¹³¹ EU Commission, 'Impact Assessment Accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of nonfinancial and diversity information by certain large companies and groups' (16 April 2013) SWD(2013) 127 final, para. 3

¹³² Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups (2014). Corporations are also required to disclose information on diversity policies relating to administrative, management, and supervisory bodies. See also article 6 of the Transparency Directive 2004/109/EC (as amended by Directive 2013/50/EU), which requires certain companies involved in the extractive industries or the logging of primary forests to disclose payments of EUR 100,000 or more made to governments.

¹³³ The Companies Bill, 2012, No. 121-C, 2012, s. 135(5).

¹³⁴ Securities and Exchange Board of India, 'Circular – Business Responsibility Reports' (2012) <http://www.sebi.gov.in/cms/sebi_data/attachdocs/1344915990072.pdf> accessed 4 Apr 2017.

¹³⁵ *ibid* 1.

¹³⁶ Shenzhen Stock Exchange, 'Shenzhen Stock Exchange Social Responsibility Instructions to Listed Companies' (25 Sept 2006), art. 1.

¹³⁷ *ibid* art. 35-36.

instance, under SEC rules, corporations must, among other requirements, disclose climate change-related matters¹³⁸ as well as details on how they consider diversity in identifying nominees for directorships.¹³⁹ Both of these disclosure requirements arguably promote both investor (private) as well as public interests.

However, recent efforts at enacting disclosure obligations have aligned almost exclusively with the promotion of public goals. Thus, in enacting the *Conflict Minerals* rule,¹⁴⁰ which requires corporations to disclose measures taken to exercise due diligence on the source and chain of custody of conflict minerals,¹⁴¹ the SEC cited the purposes of the rule as being to help end the human rights abuses in the Democratic Republic of Congo, to promote peace and security, to increase public awareness of the source of corporations' conflict minerals, and 'to promote the exercise of due diligence on conflict mineral supply chains'.¹⁴² Similarly, enactment of the *Resource Extraction Payment* rule – which requires disclosure of payments made by corporations to governments for the commercial development of oil, natural gas, or minerals¹⁴³ – was prefaced by the SEC's observation that the rule's purpose was to increase the transparency of payments in an effort 'to combat global corruption and empower citizens of resource-rich countries to hold their governments accountable for the wealth generated by those resources'.¹⁴⁴

Business opposition to these non-financial disclosure obligations and their broader societal goals was made apparent in court challenges to the rules.¹⁴⁵ The courts struck down

¹³⁸ Securities and Exchange Commission, 'Commission Guidance Regarding Disclosure Related to Climate Change' (8 Feb 2010) 75 Fed. Reg. 6290.

¹³⁹ Corporate Governance (2015) 17 C.F.R. § 229.407(c)(2)(vi).

¹⁴⁰ Conflict Minerals, 77 Fed. Reg. 56274, 56275 (Sept. 12, 2012) (codified at 17 C.F.R. pt. 240, 249b).

¹⁴¹ The Conflict Minerals rule requires corporations that use conflict minerals to determine whether any of the minerals originated in the Congo or bordering countries and to disclose the details of this process. If the corporation determines that the minerals originated in a conflict country, they must file a report detailing the measures taken to exercise due diligence on the source and chain of custody of those conflict minerals.

¹⁴² Conflict Minerals Rule (n 140).

¹⁴³ Disclosure of Payments by Resource Extraction Issuers, 77 Fed. Reg. 56365 (Sept. 12, 2012) (codified at 17 C.F.R. pt. 240, 249).

¹⁴⁴ *ibid* 56366.

¹⁴⁵ The Resource Extraction Payment rule was challenged in two lawsuits: *American Petroleum Institute v. SEC* (2013) 953 F. Supp. 2d 5 and *American Petroleum Institute v. SEC* (2013) 714 F.3d 1329 and struck down in the first case. The Conflicts Mineral rule was challenged in *National Association of Manufacturers v. SEC* (2014) 748 F.3d 359, wherein parts of it were struck down and this was affirmed in *National Association of Manufacturers, et al. v. Securities and Exchange Commission, et al.* (2015) 800 F.3d 518.

both rules, at least in part,¹⁴⁶ leaving the Conflict Minerals rule still largely intact while the SEC recently revised the *Resource Extraction Payment* rule.¹⁴⁷

4. Assessing Corporate Governance Mechanisms with Public Aims

As the previous sections' examples illustrate, corporate governance mechanisms are increasingly being used to involve corporations as vehicles for addressing a variety of public policy issues. However, these examples also indicate that the various measures are not without shortcomings. For one, while they may simultaneously further shareholders' and other corporate stakeholders' (such as employees') interests alongside broader public interests, the measures may also lead to scenarios where corporations are required to pursue or further public policy objectives at the expense of other objectives. Second, the examples indicate that governments prefer to couch corporate governance mechanisms with public policy aims predominantly in disclosure requirements rather than rely on other or additional regulatory approaches. This raises questions about the efficacy of such an approach. Finally, there is concern that in aiming to further public policy aims through corporate governance, the mechanisms are failing to achieve their goals altogether, suggesting that an exclusive focus on indirect regulation is misplaced. The following examines these shortcomings.

A. Corporate Responsibility through Corporate Governance?

As we have previously concluded, given that the corporate purpose lies somewhere between exclusive shareholder wealth maximization and the pursuance of public interests, governmentally imposed corporate governance mechanisms may justifiably include public goals. Yet, we argue that such mechanisms must similarly reflect a balanced corporate purpose and promote governance in line with multi-faceted corporate aims. A balanced corporate purpose does not negate the role of shareholders. Rather, shareholder wealth forms part of the financial and non-financial interests of its various stakeholders that corporations should take into account. Consequently, then, if corporate governance mechanisms are reflective of a more balanced corporate purpose (as compared to exclusive shareholder wealth

¹⁴⁶ *ibid.*

¹⁴⁷ Securities and Exchange Commission 'SEC Adopts Rules for Resource Extraction Issuers under Dodd-Frank Act', SEC Press Release 2016-132 (27 Jun 2016).

maximization), their ambit should also include both shareholder *and* public interests. This is not to say that corporate governance mechanisms with a public interest focus must necessarily promote public and shareholder interests equally, but rather that the overall effects of a particular governance mechanism should be balanced and insofar as possible directed at benefitting the full range of corporate stakeholders. This also suggests that caution should be exercised when using corporate governance mechanisms in addressing societal issues in order to prevent public interests being unduly privileged over shareholder interests and vice versa as the aim remains to benefit the corporation in a holistic manner.

An example of corporate governance mechanisms that advance both shareholder and public interests are provided in the field of executive remuneration mechanisms. Regulations in this area offer shareholders a binding vote on directors' remuneration packages. This not only helps reduce agency costs but it also signals attempts at reducing wealth inequality – a public interest. Similarly, measures that advance diversity on corporate boards have the potential to promote both public interests, by promoting equality in leadership, as well as a corporation's financial interests through improved decision-making at the board level. Similarly, some non-financial disclosure obligations also promote dual aims by improving not only the public interest that the particular disclosure obligation covers but also the corporation's ability to identify and manage risk, such as community disruptions or protests of corporate projects leading to project delays, lawsuits by stakeholders aimed at the corporation, and reputational damage.¹⁴⁸

In some instances, however, corporate governance mechanisms have been set up only to further the interests of one set of stakeholders. This practice is not per se problematic, but becomes so if the privileging of one set of stakeholders comes at the cost of others. Certain non-financial disclosure requirements can fall into this category. A good example in this regard is the US's Conflict Minerals Rule. As the SEC observed when promulgating it, the Rule is intended to provide humanitarian aid in the Congo – a decidedly public interest. However, advancing humanitarian aid in the Congo comes at significant financial cost to corporations. Initial compliance costs of the Rule are estimated at between \$3 and \$4 billion

¹⁴⁸ Amy K. Lehr and Gare A. Smith, *Implementing a Corporate Free, Prior, and Informed Consent Policy: Benefits and Challenges* (Foley Hoag 2010), 21; Paul Kapelus, 'Mining, Corporate Social Responsibility and the "Community": The Case of Rio Tinto, Richards Bay Minerals and the Mbonambi' (2002) 39 *J. of Business Ethics* 275, 285.

and ongoing compliance costs are estimated at between \$207 and \$609 million.¹⁴⁹ While costs, in of themselves, should not prevent the use of corporations to promote a public policy such as the one pursued via the Conflict Minerals Rule, there is reason to be cautious. Corporate governance mechanisms with a public policy focus may be ineffective (particularly when they are designed as disclosure obligations, as we will explore in more detail below). They may also inadvertently privilege one type of stakeholder over another. Thus, for instance, when diversity is specified only in terms of gender, female stakeholder interests may be privileged over those of ethnic minorities. Finally, it is important to note that the costs of compliance with disclosure obligations rules can lead to the diversion of funds away from other productive opportunities and result in a loss of allocative efficiency.¹⁵⁰ In other words, the costs of compliance with a disclosure rule such as the Conflict Minerals Rule negatively affects shareholders financial interests by forcing businesses to divert capital (in the form of investments or wages) away from other business opportunities as well as areas that further other stakeholder interests, such as employees or the community.

By giving heed to a more balanced corporate purpose, the use of corporate governance mechanisms to further public aims can generally be justified. However, when corporate governance mechanisms are designed in a manner that privileges a particular stakeholder at the expense of other stakeholder interests and without producing mutual benefits, the measures may fail to benefit the corporation as a whole. In these instances, the furthering of one stakeholder group's interest risks hampering the long-term interests of the corporation and may result in many of the same problems associated with a shareholder wealth maximization norm; that is, by impinging or even harming competing stakeholder interests. Corporate governance mechanisms that only advance one constituent group's interests also deviate from the core idea of the balanced corporate purpose outlined above. Regulations with such effects should thus not be introduced through corporate governance instruments but rather through other, more traditional means of legislative action.

B. The Weaknesses of Disclosure Obligations

A second common issue that runs through the three examples examined above is governmental preference for disclosure mechanisms to effect corporate governance measures

¹⁴⁹ Conflict Minerals Rule (n 140) 56351.

¹⁵⁰ *ibid* 56350.

that target public policy. Whether it is measures to address executive pay, board diversity or climate change, governments seem to turn first to disclosure requirements. Even the recent Taylor Review is suggesting that disclosure mechanisms are key to addressing poor working conditions.¹⁵¹

Requiring corporations to disclose certain prescribed information is a meta-regulatory approach that focuses on regulating the process of regulation, rather than regulating the issues directly (more on direct/indirect regulation will follow in the next section).¹⁵² The idea behind it is that corporations, which possess superior information as to which internal rules and procedures are needed to address issues, should be encouraged to reorient their internal workings to address problems identified by the regulators. This gives corporations the flexibility to solve the problems they create.¹⁵³ Yet, using a less favourable characterization, disclosure can also be seen as a ‘weaker’ compromise between the absence of any measures to regulate certain issues and direct measures, the latter of which may lead to strong political and interest group resistance. Disclosure, for this reason, has therefore been referred to as ‘therapeutic’ in nature, implying that they are only window-dressing.¹⁵⁴

Nevertheless, disclosure is part of the arsenal of self-regulation that forms the corpus of modern corporate governance. In part, this is because the regulatory culture in many countries, including the UK, seeks to outsource regulatory functions to corporations due to a longstanding ‘wariness’ towards state interference.¹⁵⁵ Still, it may be misguided to rely on disclosure based mechanisms to advance important public policy issues given that their efficacy is questionable.

A useful example is executive remuneration. Despite moving to a heavily disclosure-based regime in this area, executive remuneration has continued to rise. For instance, a recent study examining the UK’s disclosure based-regime for executive remuneration has found that

¹⁵¹ See Taylor Review (n 6) 55 (suggesting various new corporate disclosures and stating that “[i]n thinking about corporate governance more generally”, the government should “develop proposals to require companies to be much more transparent about their workforce structure.”).

¹⁵² Bronwen Morgan, *Social Citizenship in the Shadow of Competition: The Bureaucratic Politics of Regulatory Justification* (Ashgate 2003) 2.

¹⁵³ Cary Coglianese and Eva Mendelson, ‘Meta-Regulation and Self-Regulation’ in Robert Baldwin et al. (eds.), *The Oxford Handbook of Regulation* (Oxford University Press 2010) 149.

¹⁵⁴ Stephen M. Bainbridge, *Corporate Governance after the Financial Crisis* (Oxford University Press 2011) 34.

¹⁵⁵ David Kershaw, ‘Corporate Law and Self-Regulation’ (2015) LSE Law, Society and Economy Working Papers 5/2015, 8 <https://www.lse.ac.uk/collections/law/wps/WPS2015-05_Kershaw.pdf> accessed 4 Apr 2017.

the regime is largely ineffective. The study found that the enhanced disclosure reforms neither narrow the pay gap between CEOs and employees nor improve the relationship between executive remuneration and firm performance.¹⁵⁶

Disclosure requirements directed at diversity on boards have not fared much better. Thus, even though gender parity has increased on UK boards of directors in the last five years, the result is attributed to a multitude of factors other than disclosure, including the use of thought leaders, changing practices of executive search firms, and the development of ‘an industry aimed at supporting senior women through their career progression’.¹⁵⁷ While disclosure rules may have also contributed to increasing female representation on boards, since they were introduced only in the last two years of the five year period in question, their independent impact is uncertain. It is therefore questionable whether the newly introduced ethnicity on board initiatives – which seem to lack the additional factors the women on board initiative was able to benefit from – will achieve their targeted results.

Conversely, non-financial disclosure rules have seemingly had at least limited or partial success. For example, a large-scale study of mandatory sustainability reporting found that disclosure obligations increase corporate priorities for employee training and implementation of ethical practices¹⁵⁸ and disclosure obligations related to toxic chemicals improved firms’ environmental performance.¹⁵⁹ Nevertheless, several other studies found disclosure obligations to be less effective. Thus, one study failed to find ‘a statistically reliable effect of mandatory disclosure on the prioritization of sustainable development by

¹⁵⁶ A. Gupta et al., ‘Form over substance? An investigation of recent remuneration disclosure changes in the UK’ (21 June 2016) at p. 25 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2798001>. See also Stephen A. Bank et al., ‘Executive Pay: What Worked?’ (2016) UCLA School of Law-Law-Econ Research Paper No. 16-11 <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2812349> accessed 4 Apr 2017.

¹⁵⁷ Women on Boards – Davies Review Annual Report 2014 (2014) 5-6.

¹⁵⁸ Ioannis Ioannou and George Serafeim, ‘The Consequences of Mandatory Corporate Sustainability Reporting: Evidence from Four Countries’ (2011) Harvard Business School Working Paper No. 11-100, 4 <http://www.hbs.edu/faculty/Publication%20Files/11-100_7f383b79-8dad-462d-90df-324e298acb49.pdf> accessed 4 Apr 2017.

¹⁵⁹ See, e.g., Shameek Konar and Mark A. Cohen, ‘Information as Regulation: The Effect of Community Right to Know Laws on Toxic Emissions’ (1997) 32 *J. of Environmental Economics and Management* 109; Dara O’Rourke and Eungkyoon Lee, ‘Mandatory Planning for Environmental Innovation: Evaluating Regulatory Mechanisms for Toxics Use Reduction’ (2004) 47 *J. of Environmental Planning and Management* 181; Bradley C. Karkkainen, ‘Information as Environmental Regulation: Tri and Performance Benchmarking, Precursor to a New Paradigm?’ (2001) 89 *Georgetown L. J.* 257.

firms',¹⁶⁰ while another found that disclosure on environmental issues did not lead to significant organizational changes in firms.¹⁶¹

The shortcomings of disclosure are likely for three reasons. One possibility may be that corporations are either failing to comply with disclosure obligations – as they are often enforced on a comply-or-explain basis – or they are doing so in a 'tick-the-box' method without embracing their 'spirit'. Studies have found, for instance, that compliance with disclosure rules has been haphazard or consisting of only brief or generic information.¹⁶² A second possibility is that corporate managers are disclosing information in a selective manner wherein they only disclose information that shows the corporation in a favourable light.¹⁶³ Even where negative information is disclosed, the disclosed information is marginalised or abstracted in such a way that the focus is on altering stakeholders' perceptions rather than changing corporate behaviour.¹⁶⁴ Corporate managers may thus be using disclosure obligations as a 'public relations tool rather than as an opportunity for candid performance analysis'.¹⁶⁵ Third, and relatedly, disclosure is only effective if it induces corporate managers – on their own volition or via external pressures – to substantially change corporate behaviour. This seems to have mostly failed thus far.

In sum, corporate governance mechanisms with public policy aims that are couched in disclosure obligations appear to be, by themselves and without any complementary measures, largely ineffective. At times, disclosure requirements may even result in

¹⁶⁰ Ioannou and Serafeim (n 158) 22.

¹⁶¹ Carlos Larrinaga-González et al., 'The Role of Environmental Accounting in Organizational Change: An Exploration of Spanish Companies' (2013) 14 *Accounting, Auditing and Accountability J.* 213.

¹⁶² Ceres, 'Cool Response: The SEC and Corporate Climate Change Reporting - SEC Climate Guidance and S&P 500 Reporting—2010 to 2013' (2014) 5; P. Bennett, *Australia's Female-Less Boardrooms* (2012) BlackRock Australia; Deloitte, 'Annual Reports Insights 2013: A New Beginning' (2013), 33-34.

¹⁶³ Niamh M. Brennan and Doris M. Merkl-Davies, 'Accounting Narratives and Impression Management' in Lisa Jack et al. (eds), *The Routledge Companion to Communication in Accounting* (Routledge 2013) 109,112; Reggy Hooghiemstra, 'Corporate Communication and Impression Management – New Perspectives Why Companies Engage in Corporate Social Reporting' (2000) 27 *J. Bus. Ethics* 55; Rüdiger Hahn and Regina Lülfs, 'Legitimizing Negative Aspects in GRI-Oriented Sustainability Reporting: A Qualitative Analysis of Corporate Disclosure Strategies' (2013) 123 *J. of Business Ethics* 401.

¹⁶⁴ Hahn & Lülfs (n 163); Hooghiemstra, (n 163) 60-61.

¹⁶⁵ Olajo Aiyegbayo and Charlotte Villiers, 'The Enhanced Business Review: Has It Made Corporate Governance More Effective?' (2011) 2011 *J. of Business L.* 699, 703.

unintended consequences – such as in the case of the Conflict Mineral Rule¹⁶⁶ – and in the worst case exacerbate public policy problems. While disclosure obligations may bring value by promoting awareness of particular public policy issues in the corporate governance context and even achieve limited changes in some specific areas, because of their general lack of direct efficacy, they do not seem to result in any meaningful broader improvement to the public policy issue in question. Their utility thus appears to be limited to acting as a signalling device for societal values.

C. Indirect versus Direct Regulation of Corporate Responsibility

Likely the biggest shortcoming of the three examples of corporate governance mechanisms directed at public policy issues examined above is that they are reflective of governmental efforts to focus *primarily* on indirect modes of regulating corporate conduct. While indirect regulatory efforts can be an effective element of a multifaceted regulatory approach, an exclusive or extensive focus on indirect regulation can lead to failures in achieving regulatory aims and may prevent governments from addressing a problem's root issues.

Modern regulation consists of both direct and indirect regulation, each of which may be usefully employed (or not used at all) depending on the specific area and behaviour that is being addressed. Direct regulation directs an object – that is, it tells it how to behave and threatens punishment if not achieved – while indirect regulation changes a constraint of behaviour;¹⁶⁷ namely norms, the market, or the architecture.¹⁶⁸ As Lessig observes, each type of regulation has its benefits and costs and it is only by weighing these costs and benefits that the regulator can determine which combination most efficiently achieves its aim.¹⁶⁹ For public-oriented corporate governance mechanisms, the governmental preference has clearly been to rely heavily on indirect rather than direct regulation. Thus, as we have shown, executive remuneration mechanisms direct shareholders to provide non-binding votes on pay

¹⁶⁶ See The Unintended Consequences of Dodd-Frank's Conflict Minerals Provision Before the Subcomm. on Monetary Policy & Trade of the H. Comm. on Fin. Servs. (2013) 130th Cong. 3-6; Laura E. Seay, 'What's Wrong with Dodd-Frank 1502? – Conflict Minerals, Civilian Livelihoods, and the Unintended Consequences of Western Advocacy' (2012) Center for Global Development Working Paper No. 284 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2009350> accessed 4 Apr 2017.

¹⁶⁷ Lawrence Lessig, 'The New Chicago School' (1998) 27 J. Legal Studies 661, 666 and 662.

¹⁶⁸ *ibid* 662. Architecture, for Lessig, is 'the world as I find it, understanding that as I find it, much of this world has been made). *ibid* 663.

¹⁶⁹ *ibid* 668.

levels, instead of limiting executive pay; boards are encouraged, rather than required, to appoint diverse members; and disclosure mechanisms require corporations to report on energy usage rather than capping such usage. In part, this may be reminiscent of the wariness of state intervention discussed above. Using Lessig's framework, we could say that public oriented corporate governance mechanisms seem designed to address corporate managers' norms as well as the market in which companies operate, presumably through reliance on the effects of enhanced investor and public awareness. To a lesser extent these mechanisms may also represent efforts to change the architecture, which could in the present context be seen as the corporate law regulatory framework within which companies operate – for instance by requiring shareholder (non-binding) approval on executive remuneration, although this is again also related to the norm-shaping function of indirect regulation.

As regulation experts, Braithwaite and Ayres, argue, reliance on indirect regulation is an appropriate compromise between those that view over-regulation as inefficient and those that view under-regulation as ineffective. However, as they go on to note, indirect regulation is not always feasible or preferable over its direct counterpart. Reliance on indirect regulation is only effective if underwritten or 'reinforced by traditional forms of regulatory fiat' if such regulatory delegation fails.¹⁷⁰ This appears to be precisely the situation in the corporate governance context. Empirical studies have found that public-oriented corporate governance mechanism – in which case the delegation that Braithwaite and Ayres reference entails corporate managers as the delegees – have failed to meet their regulatory aims in several areas.¹⁷¹ Given these failures, it seems prudent to at least complement indirect approaches with traditional direct regulation as well.

For instance, if executive remuneration mechanisms are at least partially designed to task corporations with the role of promoting wealth distribution and equality, then

¹⁷⁰ Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (OUP 1994) 158.

¹⁷¹ See e.g., Aditi Gupta et al., 'Form over substance? An investigation of recent remuneration disclosure changes in the UK' (21 June 2016) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2798001> accessed 1 Nov 2017; Michael Mitchell et al., 'Can Triple Bottom Line Reporting Become A Cycle for "Double Loop" Learning and Radical Change?' (2010) 25 *Accounting, Auditing & Accountability J.* 1048; Carlos Larrinaga-Gonzalez et al., 'The Role of Environmental Accounting in Organizational Change: An Exploration of Spanish Companies' (2013) 14 *Accounting, Auditing & Accountability J.* 213; Jędrzej G. Frynas, 'Corporate Social Responsibility or Government Regulation? Evidence on Oil Spill Prevention' (2012) 17(4) *Ecology & Soc.* 4.

governments pursuing this goal should, alongside current indirect approaches, address the issues more directly. For instance, the government could cap the upper limits of executive pay (rather than suggest companies set their own upper limits), establish acceptable pay ratio requirements between the lowest paid employee and the CEO (rather than simply requiring disclosure of pay ratios) or tax remuneration packages above certain thresholds as certain countries including France and Sweden have already done. Requiring corporations to pay executives a specified ratio over a lowly paid employee leads to a very different result than requiring a business to disclose the ratio by which an executive is paid vis-à-vis an employee: the latter is designed to shame or nudge the company into a particular course of action whereas the former specifies the required outcome. Similarly, governments interested in curbing corporations' greenhouse gas emissions, prohibiting their use of conflict minerals or having them refrain from bribery, may be better off prescribing the desired conduct rather than nudging them in a direction, which they may not be interested in heading towards, by relying on non-financial disclosure obligations.

Indeed, in relation to ethnic diversity on board initiatives, the government-backed report was adamant in rejecting direct regulatory approaches such as quotas or even the use of mandated short-lists due to possible business resistance.¹⁷² While it is certainly possible that business-led initiatives – that is, initiatives in which the government does not mandate regulation – can enjoy success, it is equally possible that such an approach will not effect any meaningful change. As evidence from the business-led women on boards initiative indicates, although female representation on boards has increased to just over 25%, including through a series of measures other than disclosure requirements, progress on further increases has stalled, in part due to a lack of continued governmental support.¹⁷³ The ethnic diversity initiative, which does not enjoy the same level of government support as the women on boards initiative, thus seems – without a more interventionist regulatory approach – doomed to failure.

In short, if governments are truly seeking to regulate and change corporate conduct towards public policy issues, they must complement current approaches with more direct approaches. Thus, in relation to wealth inequality, governments could additionally require

¹⁷² Parker Report (n 121) 35.

¹⁷³ Sarah Gordon, 'Only the government can ensure women get on to boards' *Financial Times* (London, 4 Aug 2016).

corporations to pay their employees a living wage, limit zero hours contracts or cap the prices of essential necessities for consumers, among other possibilities. Moreover, if they want more diverse boards they could mandate short-lists for nominating committees to consider diverse candidates or require board observers from diverse backgrounds.¹⁷⁴ Similarly, if their desire is to protect the environment, they could limit greenhouse gas or carbon emissions or mandate that corporations maintain compensation funds to be able to pay for environmental calamities. While these suggestions are clearly more interventionist in their approach, and we do not necessarily advocate their use, they seem to be more prudent tools for addressing public goals rather than relying exclusively on the shaming and nudging techniques of indirect regulation. Indeed, without expressing an opinion on the wisdom of these or similar measures, the point here is to highlight that there may be more effective approaches to achieving public policy goals rather than relying only on corporations to do the government's work for them through indirect regulation.

By relying primarily on an indirect regulatory approach, governments risk the possibility that corporate conduct will not be changed at all. A review of the history of developments in executive remuneration-related corporate governance mechanisms shows that both advisory votes on remuneration and an increasing disclosure regime have not made any difference to wealth inequality over the years. Similarly, indirectly regulating board diversity or sustainability goals through the use of non-financial disclosure obligations have also had limited or, in some cases, no effects at all. Yet, despite their apparent lack of success, governments are increasing indirect regulations in these areas, rather than employing other regulatory approaches to address corporate conduct in these areas.¹⁷⁵ It thus appears that governments are more focused on giving the *appearance* that these types of problems are being addressed rather than working to eradicate the problem's root causes.

Finally, an indirect approach to regulating corporations' relationship with public policy issues, may, additionally, represent a false sense that this type of regulatory approach is sufficient to handle a specific problem. For example, when the Conflict Minerals Rule was

¹⁷⁴ The 30% Club already runs a voluntary scheme enabling women to act as observers on boards of other businesses. See 30% Club, 'The Future Boards Scheme' <<https://30percentclub.org/initiatives/the-future-boards-scheme>> accessed 4 Apr 2017.

¹⁷⁵ A notable exception is the UK government's approach to increasing the number of women on boards which has tackled the problem through multiple approaches including by using thought leaders, business-led initiatives, and guidelines for executive recruitment firms.

introduced to indirectly regulate corporations' treatment of conflict minerals stemming out of the Congo, a member of Congress asked whether passage of this law could lead to a sense that the problem was taken care of and therefore the government could 'walk away'.¹⁷⁶ In other words, promulgation of these types of indirect regulations may give governments the sense that they have acted and are relieved of subsequent obligations relating to the issue.

5. Conclusion

The interest in corporate governance mechanisms as a means of addressing public policy objectives has apparently become the new norm. As one of the government's latest corporate governance reform project notes, corporate governance mechanisms are 'part of wider work to enhance public trust in business as a force for good' and this has seemingly become the justification for introducing even more corporate governance public policy-oriented mechanisms.¹⁷⁷ Yet because theoretical justification for the corporate purpose lies somewhere between shareholder and broader public concerns, corporate governance mechanisms must similarly occupy middle positions in the policies they seek to address. Principally, corporate governance mechanisms should be used to promote public policy issues as long as they aim to benefit a multitude of corporate stakeholders and do not unduly privilege one particular set of stakeholders at the expense of others. This makes it imperative for governments to design such mechanisms to reflect a balance of stakeholder interests, including shareholders.

Still, such corporate governance mechanisms should clearly be viewed as supplemental or complementary regulatory strategies. Increasing reliance on these indirect regulatory tools risks minimal or, even worse, a complete failure to alter corporate conduct in relation to these public policy issues. In particular, governments should recognise the limited effects of increasing disclosure obligations, namely their limited efficacy in achieving regulatory aims due to insufficient enforcement of such obligations. While it is unnecessary to completely abandon reliance on these types of regulations, drafting of disclosure obligations should reflect the fact that they are tools with limits and cannot, unless used in conjunction with other measures, redirect corporate misconduct.

¹⁷⁶ The Unintended Consequences of Dodd-Frank's Conflict Minerals Provision, Before the Subcomm. on Monetary Policy & Trade of the H. Comm. on Fin. Servs., 130th Cong. 31 (2013) (statement of Rep. Huizenga).

¹⁷⁷ Corporate Governance Reform: Green Paper (n 93).

If governments begin to view most corporate governance mechanisms directed at furthering public policy issues as only complementary strategies, there may also be an increased willingness to tackle the root causes of these issues through other regulatory approaches. A good example is the multifaceted approach the UK government initially used to increase gender parity on corporate boards. Rather than rely simply on disclosure obligations, the government used thought leaders, a voluntary code of conduct for executive search firms and annual governmental reviews of progress, among other initiatives, to increase the number of women on boards. This enabled the government to address many of the root causes for the lack of women on boards, namely business' scepticism of the value of women in leadership positions as well as concerns about the lack of supply of qualified women. Thus, governments should not rely exclusively or primarily on corporate governance mechanisms with public policy aims. Instead, these mechanisms should be used strategically and form part of a concerted, multifaceted effort to address the genesis of the public policy issue. Most importantly, though, governments should recognise that corporate governance mechanisms with a public policy objective are not an opportunity to completely outsource governance of these important issues. Governments should prudently remember that these tools are not, and cannot, act as substitute for direct regulation.