Corporate Governance Reform and Corporate Failure in the UK

Edwin Mujih*

Abstract

This paper examines the incidents of recent high-profile corporate failure in the UK in the light of corporate governance reforms focussing on three areas of corporate governance, i.e. board failure, inaccurate accounting and directors' remuneration.

Introduction

The rate of corporate failure in the UK has been increasing at an alarming rate in recent years with one in every 213 companies falling into liquidation in 2017[1]. Official figures released recently by the Insolvency Service in the fourth quarter of 2019 show that there were 17,196 underlying company insolvencies in 2019, a 6.8% increase on 2018 and the highest level of underlying insolvencies since 2013[2], although this represents a 1.8% decrease in the last quarter of 2019 after a rise in the three consecutive quarters between 2018 and 2019[3]. The Insolvency Service attributes this rapid increase to an increase in underlying creditors' voluntary

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*Dr Edwin Mujih, Senior Lecturer in Law, London Metropolitan University, London.
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[1] Lucy Burton, 'Number of British Businesses Going Bust Hits Four-year High' (*The Telegraph*, 26 January 2018), https://www.telegraph.co.uk/business/2018/01/26/number-british-businesses-going-bust-hits-four-year-high/. Accessed 13 August 2018

[2] The Insolvency Service, *Company insolvency statistics, Q4 October to December 2019*, Released 30 January 2020, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/861187/Commentary_-_Company_Insolvency_Statistics_Q4_2019.pdf p. 7. Assessed 25 April 2020. See also, http://www.gov.uk/government/collections/insolvency-service-official-statistics; and https://www.telegraph.co.uk/business/2018/01/26/number-british-businesses-going-bust-hits-four-year-high/. Accessed 13 August 2018.

[3] *Company insolvency statistics, Q4 October to December 2019*, Ibid, p. 8.

liquidations.[4] In the past few years, there have been reports of high-profile corporate failures every year. In fact, such failures now appear to be a common feature of the corporate world in the UK.

The collapse of Carillion in January 2018 is said to be the biggest corporate collapse in the country for a decade. It sent shockwaves in the corporate world which reverberated across many sectors in the UK and also abroad, given that the company had operations in many industries in the UK and abroad. The collapse of Carillion came on the heels of other high-profile corporate failures such as BHS. And, hot on the heels of Carillion were other high-profile corporate failures such as British Steel in May 2019 and Thomas Cook, the British travel firm, in September 2019. And, the current coronavirus pandemic is likely to lead to more corporate failures. But the impact of the pandemic on corporate governance is not the subject of this paper. Perhaps what is worrying is that in many cases, these failures are usually preceded by the publication of good accounting records for the company giving it a clean bill of health. This alone should raise questions about the state of corporate governance or the effectiveness of corporate governance reform in the country.

At the same time, there has been regular corporate governance reform in the country since the first review of corporate governance issues, the Cadbury Report, was published in 1992. It is well-known that the Cadbury Report led the way for corporate governance reform not only in the UK but in other countries around the world. Many countries have chosen to model their corporate governance codes on the UK Corporate Governance Code, with some variations to take into account local realities. The Cadbury Report, which laid the foundation for corporate governance reform in the UK, was incorporated with subsequent reports into a Combined Code on Corporate Governance published in 1998. The Combined Code has been revised several times and has been known as the UK Corporate Governance Code since

[4] The Insolvency Service, *Company insolvency statistics, Q4 October to December 2019,* https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/861187/Commentary_-_Company_Insolvency_Statistics_Q4_2019.pdf, p. 3. Assessed 25 April 2020.

2009[5]. Since then, the Code has been updated virtually every two years. The Code supplements statutory rules such as those contained in the Companies Act 2006.

It is a matter of curiosity that these corporate failures come against the background of such regular reforms. It is well-known that the UK has been at the forefront of corporate governance reform in the world since the publication of the Cadbury Report in 1992, which encourages listed companies to comply with the principles of the Code or explain why they are not complying – known as "comply or explain|". And, the number of companies supposedly complying with the Code has been increasing since it was first published. Writing in 2018, Lowe revealed that sixty-six percent of the FTSE 350 complied with the Code then, compared to 36% in 2002, when the first FTSE 350 Corporate Governance Review was launched.[6] So why are companies failing despite corporate governance reforms? Or is it the case that companies will always fail and therefore no amount of corporate governance reform could ever, even remotely, impact on the number of corporate failures however effective such reforms might be? This paper examines the reasons for corporate failure vis-à-vis regulatory changes with the view to determining the effectiveness of corporate governance reform in the UK. It is proposed to begin with a brief history of corporate governance in the UK.

1. A Brief History of UK Corporate Governance: From Cadbury to the UKCG Code 2016

A history of UK corporate governance is necessary here in order to provide a background for the ensuing discussion. However, it is proposed to be brief as readers will presumably be all too familiar with the subject.

Following a series of high-profile corporate failures in the UK in the late 1980s and early 1990s, the private sector initiated a series of reforms to improve transparency and accountability in corporate governance. The first was the Cadbury

[5] Independent Review of the Financial Reporting Council, December 2018, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf

[6] Simon Lowe, 'How will the Revised UK Corporate Governance Code affect you?' (*Grant Thornton*, 25 July 2018); https://www.grantthornton.co.uk/insights/how-will-the-revised-uk-corporate-governance-Code-affect-you/. Accessed 13 August 2018.

Committee on the Financial Aspects of Corporate Governance set up by the London Stock Exchange, the Financial Reporting Council and accountancy professions to report on financial aspects of corporate governance. The Committee published a Report in 1992 that came to be known as the 'Cadbury Report' The Report recommended, among other things, a Code of best practice to be complied with by the board of listed companies as a condition of continued listing.[7] The Cadbury Report formed the basis for future corporate governance reform in the UK and influenced the development of many corporate governance Codes around the world. Some of the reports published after Cadbury focused on specific aspects of corporate governance, all with the overall objective of improving accountability and transparency in corporate governance. For example, the Greenbury Report 1995 focused on directors' remuneration and their disclosure; the Hampel Report 1998 reviewed the implementation of the Cadbury and Greenbury recommendations focusing on directors' remuneration, the role of both executive and non-executive directors as well as the role of shareholders and auditors in corporate governance; the Combined Code 1998 drew together the recommendations of the Cadbury, Greenbury and Hampel Reports. The Turnbull Report 1999 provided guidance on the implementation of the internal control requirements of the Combine Code.[8] The Higgs Review 2003 reported on the role and effectiveness of non-executive directors; the Smith Review 2003, clarified the important role of the audit committee. The revised Combined Code 2003 replaced the Combined Code issued by Hampel in 1998.[9] The Code incorporated the substance of the Higgs and Smith Reviews.[10] The Combine Code was updated in 2006 and again in 2008 following an extensive review by the Financial Reporting Council (FRC).[11] The 2008 Code introduced two changes to the 2006 Code which had itself introduced three main changes to the 2003 Code. The Code, now known as the UK Corporate Governance Code, was further revised in 2010 and has been updated every two years to ensure it stays

[7] *Report of the Committee on The Financial Aspects of Corporate Governance*, 1 December 1992, https://ecgi.global/sites/default/files/codes/documents/cadbury.pdf, para. 1.3; See also, Stephen Griffin, *Company Law: Fundamental Principles* (4th ed. Pearson Education Ltd, 2006), p. 365. Hereinafter cited as Griffin.
[8] Christine Mallin, *Corporate Governance*, (5th ed. OUP, 2016), p. 31. Hereinafter cited as 'Mallin'
[9] Griffin, p. 368.
[10] Mallin, p. 33.
[11] The FRC is responsible for setting the UK's Corporate Governance and Stewardship Codes and also for regulating auditors, accountants and actuaries.

relevant.[12] The most recent one is the UK Corporate Governance Code 2018 – the focus of this paper. The UK Corporate Governance Code has served as a benchmark for international best practice.

2. Reasons for Corporate Failings

As noted at the beginning of this paper, there has been a series of high-profile corporate collapses in the UK in recent years, despite a regular review of the Corporate Governance Code. In fact, corporate governance reforms are largely a response to these corporate failings going back to the Cadbury Code. Commonly cited reasons for corporate failure include: fraud,[13] mismanagement, accounting irregularities, failure of the board to anticipate or address the risks facing the company,[14] economic distress[15] and excessive remuneration of corporate executives. These reasons can be classified under the five main principles of the Corporate Governance Code – suggesting a correlation between breach of the principles and corporate failure and raising questions about the level of compliance with the Code. It is proposed to continue by examining three of the above reasons, with the aid of empirical data, insofar as they are covered by the principles of the Code. They are: board failure, accountability, and directors' remuneration. It is worth noting that these corporate governance principles are also supplemented by legislation such as the Companies Act 2006. For example, directors' general duties is covered in part 10 chapter 2. This is in addition to directors' specific duties which pervades much of the Act. Accounts and reports is covered in part 15, while part 15

[12] Mallin, p. 28 & 35.

[13] Nash Riggins reveals that a US Senate investigation into the role of Enron's board in its collapse in 2001 found that the directors were inexperienced and the board riddled with conflicts of interest and breach of fiduciary duties. Nash Riggins "10 Reasons for Corporate Failure" (Financial Director, 29 March 2019) https://www.financialdirector.co.uk/2019/03/29/10-reasons-for-corporate-failure/ accessed 3 July 19.

[14] Brenda Hannigan: "Board Failure in the Financial Crisis – Tinkering with Codes and the need for wider Corporate Governance Reforms: Part 1" (2011) 32 *Company Lawyer*, 12, 363, 364.
Paul Hopkins reveals that a research commissioned after the global financial crisis 2008 found that corporate failures are usually the result of poor risk management by boards of directors. Paul Hopkin, "Understanding the Causes of Corporate Failure" (FM 1 February 2012) https://www.fm-magazine.com/issues/2012/feb/understanding-causes-of-corporate-failure.html. Accessed 3 July 19.

[15] "Corporate Failure" (Business Jargons) https://businessjargons.com/corporate-failure.html. Accessed 19/8/19.

chapter 6 of the Act imposes a duty on directors of quoted and traded companies to prepare a directors' remuneration report, a breach of which is a criminal offence.

2.1. Board Failure

The Board of directors plays an important role in the governance of the company. It can be described as the nerve-centre of the company. Among other things, it oversees the overall functioning of and provides direction for the company in virtually every area of corporate life.[16] It is perhaps for this reason that the Code pays more attention to the board than to other areas of corporate governance. In fact, the Board is charged with the responsibility of applying all the five principles of the Code ranging from leadership to remuneration in the case of the 2018 Code and leadership to relations with shareholders in the case of the 2016 Code. Unsurprisingly, when things go wrong for the company, the board is often to blame.

Board failure has often been identified as a major reason not only for corporate collapses such as Enron and Carillion,[17] but also for failings in the banking sector. For example, Hannigan reveals that following the financial crisis in 2008, Her Majesty's Treasury concluded that failure by the board to probe and understand their firms' risk management processes, poor management decisions, among others contributed to the crisis. Similarly, the European Commission observed that board failure to ultimately control "the risks to which their financial institutions were exposed lay at the heart of the origins of the crisis".[18] More recently, a report by the business, energy and industrial strategy (BEIS) and work and pension on the collapse of Carillion, blamed "greed among the company's board members and a rotten

[16] For example, in a 62 page Report published in 2016 entitled "Corporate Culture and the Role of Boards: Report of Observations", the FRC elaborated on the importance of the role played by the board in influencing and shaping the corporate culture. In the Report, the FRC stated that strategy to achieve a company's purpose should reflect the values and culture of the company and should not be developed in isolation. It charged the board with the responsibility of overseeing this strategy. FRC: Corporate Culture and the Role of Boards – Report of Observations, July 2016, https://www.frc.org.uk/getattachment/d246eacb-5774-4912-98e1-c03f1c8f692f/Corporate-Culture-and-the-Role-of-Boards-Report-of-Observations-tagged.pdf, p. 3.

[17] Nash Riggins "Top Corporate Scandals in 2018" (https://.financialdirector.co.uk/author/nashriggins) – (https://www.financialdirector.co.uk/2019/03/19/top-corporate-scandals-in-2018/ - 19 March 2019. Accessed 1 July 19.

[18] Brenda Hannigan "Board failures in the financial crisis - tinkering with Codes and the need for wider corporate governance reforms: Part 1" (2011) 32 *Comp. Law*. 12, 363.

corporate culture."[19] The collapse of Carillion led to claims that the board failed to adequately manage the company's risk by allowing it to take high debts while trading on low margins and that the board also failed to grasp the company's contract risk management.[20]

The UK Corporate Governance Code emphasises the importance of the company being governed by an effective board of directors that is responsible for the long-term success of the company. This principle, like many corporate governance principles, has its roots in the Cadbury Report which recommended that the board be split between executive directors and non-executive directors to make it more effective and that the non-executive directors (NEDs) be appointed by the board rather than senior management in order to ensure their independence. The role of executive directors and NEDs was reviewed by the Greenbury Committee and emphasised in the subsequent Codes. For example, the Main Principles of Section A1 (which defines the role of the board) of the 2012, 2014 and 2016 Codes provides that "every company should be headed by an effective board which is collectively responsible for the long-term success of the company". The Main Principle of section A.4, which deals with the role of NEDs, encourages them to effectively challenge and help develop proposals on strategy.

It is clear that board effectiveness and accountability are important principles in the Corporate Governance Code. Principle C2 of the 2016 Code which is replicated as Principle O of the 2018 Code requires the board to maintain sound risk management and internal control systems. Following the collapse of Carillion, the head of governance at the institute of directors said "effective governance was lacking at Carillion."[21]

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[19] Caitlin Morrison, "MPs blast Carillion bosses and Big Four accountancy firms for part in outsourcer's collapse" (*Independent*, 16 May 2018) https://www.independent.co.uk/news/business/news/carillion-collapse-latest-big-four-pwc-ey-kpmg-deloitte-a8352886.html; News: Construction Europe, October 2018.

[20] Nash Riggins "Top Ten Corporate Scandals in 2018" https://www.financialdirector.co.uk/2019/03/19/top-corporate-scandals-in-2018/. Accessed 17/7/19.

[21] Josie Cox, "Carillion collapse - as it happened: Government and unions react as major NHS contractor enters liquidation" (*Independent*, 15 January 2018); https://www.independent.co.uk/news/business/news/carillion-liquidation-live-updates-latest-updates-hs2-nhs-contractor-high-speed-2-construction-a8159411.html

2.1.1. An Empirical Analysis of Board Failure: Surface Compliance to conceal In-depth Defiance?

It is a matter of curiosity that board failure or the lack of board effectiveness should be a major reason for corporate collapse, when generally speaking, the corporate world has always been receptive to corporate governance reform in the UK and seem to be complying with the provisions of the Corporate Governance Code as seen above. Following the financial crisis in 2008, Hannigan observed that "on paper, looking at the domestic United Kingdom banking defaulters and failures, such as Northern Rock, HBOS, and Royal Bank of Scotland, all had boards with the obligatory mix of executive and non-executive directors, all had remuneration, audit and nomination committees, all operated in compliance with respected Codes of corporate governance, as their annual reports confirmed. But the reality, as HM Treasury concluded, "was widespread corporate governance failures by these boards, particularly in understanding and probing their firms' risk management processes."[22] The European Commission considered that the failure of boards to identify, understand and ultimately control the risks to which their financial institutions were exposed lay at the heart of the origins of the crisis.

On paper, these organisations had complied with the provisions of the Corporate Governance Code, the Stewardship Code and other regulatory instruments largely by ticking the boxes. However, the reality was different. In many cases, companies went into insolvency after the publication of glowing reports about their performance. For example, in its 2016 annual report Carillion noted that the evaluation had "confirmed that the board, each of its committees and the directors continue to be highly effective."[23] One year after the publication, the company collapsed with board failure at least partly to blame despite its experience[24]. This raises the question of why companies that are said to have complied with the Principles of the Code are found to have compliance issues after they collapse.

[22] Brenda Hannigan, "Board Failure in the Financial Crisis – Tinkering with Codes and the need for wider Corporate Governance Reforms: Part 1" (2011) 32 *Company Lawyer* (12) 363, 363.

[23] Sacha Sadan, "Carillion's collapse exposes deep corporate governance failings" (*Financial Times*, 14/2/18) www.ft.com/content/1958fb80-0fe6-11e8-940e-08320fc2a277. Accessed 13/8/18.

[24] Kate Burgess, "Carillion's Board: Misguided or Incompetent?" (Financial Times 17/1/2018) https://www.ft.com/content/2095beca-fb8b-11e7-a492-2c9be7f3120a. Accessed 5 May 2020.

As is well-known, the Code offers flexibility in implementation and operates on a comply or explain basis. Comply or explain means that listed companies may either comply with the principles and guidelines of the Code or explain why they have not complied. The flexibility offered in the implementation of the Code means that in many cases, companies choose to comply with the Principles by ticking the box. But box-ticking has its problems. The paradox is that box-ticking which focuses on complying with the letter of the Code is an offshoot of the much-vaunted flexibility offered by the FRC[25] to companies as a way of applying the spirit of the Principles. In other words, the FRC believed that flexibility would enable companies to comply with the spirit of the Principles. However, flexibility had the opposite effect of enabling companies to adopt the box-ticking approach and comply with the letter of the Principles only. Paradoxically, this is a realisation of Cadbury's fears, when expressing his preference for a voluntary code, that statutory measures would impose a minimum standard and there would be a greater risk of boards complying with the letter rather than the spirit of their requirements.[26] As argued elsewhere, box-ticking amounts to surface compliance as the company is only concerned with applying the letter of the Code, whereas compliance is in-depth when the company applies the spirit of the Code.[27] It is significant that in the 2018 Code, the FRC advocated the use of high-quality reporting on the Provisions of the Code in the application of the Principles, cautioned companies against box-ticking and again reiterated the importance of applying the spirit of the Code. This shows an awareness of the prevailing corporate practice of box-ticking and compliance with the letter rather than the spirit of the Code.

A robust monitoring mechanism to ensure real compliance with the Code might have prevented this situation where companies inaccurately reported compliance with the provisions of the Code. This reflects the failure by companies to implement the spirit of the Code despite ostensibly welcoming corporate governance reforms.

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[25] FRC, The UK Corporate Governance Code, July 2018, https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf, p. 1.

[26] Report of the Committee o the Financial Aspects of Corporate Governance, https://www.frc.org.uk/getattachment/9c19ea6f-bcc7-434c-b481-f2e29c1c271a/The-Financial-Aspects-of-Corporate-Governance-(the-Cadbury-Code).pdf, December 1992, para. 1.10.

[27] Edwin Mujih "Do not Simply Tick the Box: The Effectiveness of the Corporate Governance Code 2018 in the Absence of an Implementation Mechanism" *Company Lawyer*, forthcoming.

2.2. Inaccurate Accounting

Accounting is an important element in the Corporate Governance Code. It has featured prominently as one of the main corporate governance principles going back to the Cadbury report. One of the recommendations of Cadbury was that directors should make a statement in the report and accounts on the effectiveness of their system of internal control and that the auditors should report thereon.[28] As mentioned earlier, the Code complements and in many instances reinforces existing statutory duties imposed on directors. For example, Cadbury reiterates the need for directors to maintain a system of internal control over the financial management of the company in order to meet their responsibilities under part 15, chapter 2 of the Companies Act 2006.[29]

2.2.1. An Empirical Analysis of Inaccurate Accounting

Unfortunately, inaccurate accounting, lack of internal controls and misleading audit caused by a limited remit of auditors have often been cited as major reasons for the collapse of many companies. This suggests that the provisions of the Code in relation to accounting are not fully complied with. For example, the failure of a company to adequately manage its risk and handle annual reporting and accounts could be said to be a breach of section C of the 2016 Code which contains three main principles of accountability. The main principle for section C.1 requires the board to present a fair, balanced and understandable assessment of the company's position and prospects. Section C is reproduced in an abridged form as section 4 of the 2018 Code entitled "Audit, Risk and internal Control". The three main principles for section C.1 are listed as principles M, N, and O in the 2018 Code. The main principle for C.1 is reproduced as principle N, while principle O requires the board to establish procedures to manage risks, among others in other to achieve the company's long-term strategic objective.

[28] Cadbury Report, paragraph 4.32.
[29] Cadbury Report para 4.31.

Of the reasons cited for the corporate failure, misleading audit appears to play a lead role as an accurate audit will pick up deficiencies in accounting and internal control systems. At a launch of a new inquiry examining the future of audit in November 2018, the Chair of the Business, Energy and Industrial Service Committee, Honourable Rachel Reeves said the audit market is broken. She said:

> Misleading audits have been at the heart of corporate failures over recent decades. Recent accounting scandals at BHS, Carillion, and at Patisserie Valerie have shown accounts bearing closer resemblance to works of fiction than an accurate reflection of the true financial performance of the business. Repeated accounting failures have contributed to the collapse of major businesses and undermined public and investor confidence.[30]

A common example of accounting failures is where the company's account is signed off prior to it going into insolvency. EY, the new auditors for Thomas Cook, signed off the company's last set of account for 2018 prior to it becoming insolvent in September 2019.[31] Such practices commonly arise where the company uses the same firm of auditors for many years. In addition to giving rise to feelings of loyalty, this practice can gradually compromise the independence and objectivity of the firm and could eventually lead to the auditors being found complicit with the failed company. Such was the case with Carillion, which bears a striking similarity with the case of the failed USA company, Enron, and its firm of accountants Author Anderson both of which collapsed at the turn of the millennium. The same accusation of auditors' complicity in Thomas Cook's downfall was levied against PwC, auditors of Thomas Cook and EY the firm which replaced PwC in 2017. A Parliamentary inquiry into the collapse of the company found that Thomas Cook paid PwC up to £21m in consultancy fee between 2007 and 2016.[32]

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[30] "BEIS Committee Examine the Future of Audit", (Parliament, 12/11/2018), https://www.parliament.uk/business/committees/committees-a-z/commons-select/business-energy-industrial-strategy/news-parliament-2017/future-of-audit-inquiry-launch-17-19/. Accessed 25 November 2019. See also; Nash Riggins "Top Corporate Scandals in 2018", https://www.financialdirector.co.uk/2019/03/19/top-corporate-scandals-in-2018/ , 19 March 2019.

[31] Wale Azeez, "Auditors 'Complicit' in UK Corporate Failures" (Sky News, 23 October 2019), https://news.sky.com/story/auditors-complicit-in-uk-corporate-failures-mps-say-11842171

[32] Wale Azeez, "Auditors 'Complicit' in UK Corporate Failures" 23 October 2019, https://news.sky.com/story/auditors-complicit-in-uk-corporate-failures-mps-say-11842171 , accessed 27/11/19.

According to another Parliamentary report[33] on the collapse of Carillion, the Financial Reporting Council first raised concerns about the company's future in 2015 while conducting a regular review of the company's account.[34] "The FRC highlighted 12 potential problems with Carillion's books, ranging from a lack of clarity in goodwill assumptions to a non-existent explanation on the major decline in Carillion's book-to-bill ratio" and gave warnings of a potential profit shortfall.[35] Yet the company's account continued to be signed off until March 2017, when Carillion itself issued profits warnings.[36] The company went into liquidation less than a year later in January 2018 with debts of £1.5bn. The Board's insufficient handling of annual reporting and accounts was seen as a major reason for the company's collapse. The Parliamentary Report raised questions about the independence and objectivity of KPMG, Carillion's auditor, given that they were the company's auditors for all 19 years of its existence from 1999, although it noted that this was within the 20 year statutory maximum period within which companies must change their auditors.[37] In a critical statement, the Report stated that:

> KPMG audited Carillion for 19 years, pocketing £29 million in the process. Not once during that time did they qualify their audit opinion on the financial statements, instead signing off the figures put in front of them by the company's directors. Yet, had KPMG been prepared to challenge management, the warning signs were there in highly questionable assumptions about construction contract revenue and the intangible asset of goodwill accumulated in historic acquisitions. These assumptions were fundamental to the picture of corporate health presented in audited annual accounts. In failing to exercise and voice professional scepticism towards Carillion's aggressive accounting judgements, KPMG was complicit in them.[38]

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[33] Parliament, https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/769/76906.htm#_idTextAnchor110. Accessed 17/7/19.

[34] Nash Riggins, "Top Corporate Scandals in 2018" 19 March 2019, https://www.financialdirector.co.uk/2019/03/19/top-corporate-scandals-in-2018/. Accessed 17/7/19.

[35] https://www.financialdirector.co.uk/2019/03/19/top-corporate-scandals-in-2018/

[36] https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/769/76906.htm#_idTextAnchor110; See also, Nash Riggins, https://www.financialdirector.co.uk/2019/03/19/top-corporate-scandals-in-2018/

[37] Parliament, https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/769/76906.htm#_idTextAnchor110 accessed 24/11/19.

[38] https://publications.parliament.uk/pa/cm201719/cmselect/cmworpen/769/76906.htm#_idTextAnchor110

It is clear that accounting failures contribute to corporate failures. Perhaps it is in recognition of this link and its importance that measures are being introduced to improve the quality of accounting and auditing. For example in July 2019, the FRC proposed to issue new, revised ethical standards with effect from 15 December 2019. This follows a consultation on revisions to ethical and auditing standards which was issued in July 2019.[39] In December 2018, the government appointed Sir Donald Brydon to conduct a review into the quality and effectiveness of audits.[40] The Brydon Report was submitted in December 2019.

Accurate accounting requires transparency in financial records, which was absent in Carillion's case. Inaccurate accounting could result from negligence or corruption and in either case the company directors should be held accountable. As observed by Schipani, accountability is an obligation of corporate directors and officers to be held responsible for their actions, and is inherently related to transparency measures.[41] But to meet this obligation, there must be mechanisms fostering transparency and disclosure.[42] Indeed, the FRC concluded in its audit quality review inspection reports for 2018/19 that 25% of assessed audits fall below acceptable standards. Findings of the Report include the possible factors responsible for audit teams failing to challenge company management sufficiently.[43] However, things are likely to change with the proposed replacement of the FRC with a new body, the Audit, Reporting and Governance Authority, (ARGA) which will introduce a new sanction regime of auditors and directors.

2.3. Directors' Remuneration

39 "Corporate Governance in the UK" (SpencerStuart, November 2019), https://www.spencerstuart.com/research-and-insight/corporate-governance-in-the-uk, accessed 25/11/19.

40 "Gov't takes next step in improving Standard of UK Audit Market with new Independent Review into Audit Standards" 18 December 2018, https://www.gov.uk/government/news/government-takes-next-step-in-improving-standards-of-uk-audit-market-with-new-independent-review-into-audit-standards, accessed 25/11/19. See also https://www.spencerstuart.com/research-and-insight/corporate-governance-in-the-uk.

41 Cindy Schipani, "The role of Corporate Governance in promoting integrity and addressing corruption", (2014) 35 *Comp. Law.* (5), 1332-37

42 Schipani, Ibid.

43 *Company Lawyer*, 2019, 40(10), 327.

Directors' remuneration has been one of the most controversial corporate governance issues in the past three decades. Regulators have sought to resolve this thorny issue by introducing more disclosure requirements through corporate governance rules and company law with the effect of giving shareholders a role on directors' remuneration. Shareholders in the UK have been entitled to an advisory vote on directors' remuneration since 2002.[44] This is intended to enable them to influence directors' remuneration and give them a role in corporate governance. The question will be examined later as to whether shareholders have exercised this right and if so whether this has had an impact on the thorny issue of directors' remuneration. The Corporate Governance Code provides clear guidelines on directors' remuneration. Principle P of the 2018 Code requires remuneration policies to promote long-term sustainable success and directors' remuneration to be clearly linked to the successful delivery of the company's long-term strategy. Principle R requires directors to take account of the company and individual performance as well as wider circumstances when authorising remuneration outcome. Provision 40 of the Code recommends that the remuneration committee should engage with shareholders and the workforce when determining executive director remuneration policy. The 2018 Code echoes earlier codes such as the Greenbury Report which recommended that remuneration should be linked explicitly to performance.

As with accounting rules, the Code's provisions on directors' remuneration complements statutory rules. For example, the Principle P requirement to promote the long-term success of the company replicates the duty of directors under section 172 of the Companies Act 2006. The Provision 40 recommendation to engage with shareholders mirrors further provisions of the 2006 Act. For example, section 420 of the Act imposes a duty on directors' of quoted companies to prepare a directors' remuneration report. Under section 423, a copy of the annual accounts and report must be circulated to shareholders and other stakeholders.[45] Over the years, the government has introduced additional reporting requirements to encourage

[44] Department for Business Innovation and Skills, Executive Remuneration Discussion Paper, September 2011, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31660/11-1287-executive-remuneration-discussion-paper.pdf

[45] Cadbury reinforces this statutory duty of disclosure by providing at paragraph 4.40 that shareholders are entitled to a full and clear statement of directors' present and future benefits and of how they have been determined. The role the Code provides to shareholders in directors' remuneration goes beyond disclosure. Cadbury provides in paragraph 4.44 that shareholders require that the remuneration of directors should both be fair and competitive.

companies to be more transparent about directors' remuneration. Examples include the Directors' Remuneration Reporting Regulations 2013 which brought in new rules giving shareholders a binding vote on directors' remuneration.[46] A more recent example is the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008[47], which have been amended recently by the Companies (Directors' Remuneration Policy and Directors Remuneration Report) Regulation 2019 to extend the scope of remuneration reporting to unquoted traded companies and to introduce new requirements in respect of directors' remuneration policy and remuneration report.[48] The Regulations implement Articles 9a and 9b of the European Directive 2017/82/EC, commonly known as the Revised Shareholder Rights Directive.[49] They apply to company reporting on financial years starting on or after 10 June 2019.

These provisions give shareholders rights over directors' remuneration. As seen below, shareholders have recently been exercising these rights as corporate failures have brought corporate governance issues such as directors' remuneration to the limelight. These instruments have heightened disclosure requirements by, inter alia, removing the board's former discretion in respect of holding a vote and giving shareholders a voice on directors' remuneration.[50] In short, the rules require companies to put their remuneration policies to a binding shareholder vote at their AGM.[51] However, the question as to whether statutory rules have succeeded in aligning directors' remuneration and corporate performance has, generally, been answered in the negative.[52] In fact, some commentators take the view that disclosure

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[46] Christine Mallin, *Corporate Governance*, 6th ed. OUP, 2019, p. 241.

[47] BIS, Department for Business Innovation and Skills, Executive Remuneration, Discussion Paper, Sept. 2011, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31660/11-1287-executive-remuneration-discussion-paper.pdf, p. 10

[48] "Government Publishes Draft Legislation amending Directors' Remuneration Requirement", 15 April 2019; https://www.iasplus.com/en-gb/news/2019/04/government-publishes-draft-legislation-amending-directors-remuneration-requirements accessed 19/11/19.

[49] Department for Business, Energy and Industry Strategy, Corporate Governance: The Companies (Directors Remuneration Policy and Directors Remuneration Report) Regulations 2019 – Frequently Asked Questions, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/808993/corporate-governance-directors-renumeration-policy-renumeration-report.pdf. Accessed 14/11/19.

[50] Martin Petrin, "Executive Compensation in the United Kingdom – Past, Present and Future" (2015) 36 *The Company Lawyer* 195, 196–97. Also available at: https://discovery.ucl.ac.uk/id/eprint/1453284/1/Petrin,%20M.%20Executive%20Compensation%20.pdf, p. 11.

[51] CIPD "Total FTSE 100 Chief Executive pay has fallen by 13%" (21 August 2019) https://www.cipd.co.uk/about/media/press/ftse-ceo-pay-falls,

[52] Petrin, supra note 74.

has had the opposite effect of raising the level of directors' remuneration. According to Howard, Greenbury's disclosure requirements helped raise average pay by revealing peer earnings, and companies were not presenting pay reports to shareholders for approval.[53]

2.3. 1. An Empirical Analysis of Directors' Remuneration: Link with Performance

Empirical data suggest that the requirement that directors' remuneration should be linked to performance has not always been observed in the corporate world and examples abound where directors receive excessive pay rises or huge bonuses when their companies are in financial crises and sometimes laying off employees. A recent example makes the point. In November 2019, shareholders of Kier Group plc, a leading UK construction and infrastructure services company, revolted over the company's plan to pay its CEO more than £1m in bonuses despite disastrous profit warnings and a plunging share price.[54] Kier is reported to have paid its board a total of £2.1m in the year to June 2019, when the company reported losses of £245m. Although the £2.1m payment was a significant drop from the £5.5m paid the year before, as the company did not pay any bonuses in 2018-19, it came against a 90% drop in shares reflecting a fall in its market value from £1bn to £200m during the same period.[55] At the same time, the company also planned to lay off 1,200 employees by June 2020, that is over 6% of its workforce. The current developments at Kier are a chilling echo of the events that heralded the collapse of Carillion. They are a familiar tale of many public companies that have gone into liquidation in the UK and carry the tell-tale signs of a company heading in the Carillion direction.

The link (or lack of a link) between pay and performance has fuelled the controversy surrounding directors' remuneration. In 2004, the Chair of Treasury Select Committee criticised the CEO of large insurance companies following an executive pay increase of 45-70% after a period of a decline in profitability, 50% drop in share prices, 25% loss of endowments saying: "the industry is going down like a

[53] Howard, A. Supra n. 24.

[54] Gill Plimmer, "Kier's Investors Rebel over Chief's Potential £1m Bonus" *Financial Times*, (15 November 2019), https://www.ft.com/content/015a526e-07be-11ea-9afa-d9e2401fa7ca, accessed 26/11/19.

[55] Ibid.

slalom skier … why do you think you are worth so much?"[56] The increase has continued over the years. In a discussion paper on Executive Remuneration published in September 2011, the Department for Business Innovation and Skills, now the Department for Business, Energy and Industrial Strategy (BEIS) revealed that the average total pay of FTSE 100 CEOs for the period from 1998-2010 rose 13.6% year from an average of £1 million to £4.2 million.[57] 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. During the same period, UK employee pay only grew by 4.7%, lifting the multiple of CEO pay from 47 times average worker pay to a multiple of 120.[58] And, in 2014, the average UK CEO remuneration was estimated to be 125 times more than the average earnings of an employee.[59]

Jenkins observes that while there was an astronomical 330% increase in executive pay between 1998 and 2015, average wages, worth £28,000 in 2015 rose only about 12% in real terms during the same period.[60] As mentioned earlier, the 2018 Code now requires, in provision 33, that the remuneration committee reviews workforce remuneration and take it into account when setting the policy for executive directors' remuneration. Furthermore, the Companies Regulation 2019 now also

[56] The Times, 28 January 2004. A discussion of other jurisdictions is outside the ambit of this paper as it is limited to the UK only. However, an example in the USA will suffice. In 2010 a Goldman Sachs CEO received $9 million in share bonus just 2yrs after the company had been bailed out by the US in the 2007-08 subprime mortgage crisis. See Times Online, 2010; Stephanie Sy, "Bonus Shock: Goldman CEO Gets Just $9M" (ABC News, 6 February 2010) https://abcnews.go.com/WN/goldman-sachs-ceo-blankfein-9m-bonus-stock/story?id=9768161.

[57] BIS, Department for Business Innovation and Skills, Executive Remuneration, Discussion Paper, Sept. 2011, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31660/11-1287-executive-remuneration-discussion-paper.pdf, page 6. See also; Barnali Choudhury, and Martin Petrin, "Corporate governance that 'works for everyone': promoting public policies through corporate governance mechanisms" (Oct 2018) 18 *Journal of Corporate Law Studies*, Issue 2, 381, 395; Martin Petrin, "Executive Compensation in the United Kingdom – Past, Present and Future" (2015) 36 *The Company Lawyer* 195, 196–97. Also at: https://discovery.ucl.ac.uk/id/eprint/1453284/1/Petrin,%20M.%20Executive%20Compensation%20.pdf. Accessed 13/11/19.

[58] BIS, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31660/11-1287-executive-remuneration-discussion-paper.pdf; Petrin, ibid, p. 4.

[59] Barnali Choudhury and Martin Petrin, [2018] 18 *Journal of Corporate Law Studies*, Issue 2, 381-415. "Corporate governance that 'works for everyone': promoting public policies through corporate governance mechanisms"

[60] Patrick Jenkins, "How Paying Chief Executives Less can help Corporate Performance" 13/02/2017 https://www.ft.com/content/10952312-ee30-11e6-930f-061b01e23655

requires a comparison of the annual change of each director's pay to the annual change in average employee pay over a five year period in traded companies.[61]

The former Department for Business Innovation and Skills observed that while CEO remuneration rose rapidly in the period above, the link between pay and performance was hard to discern.[62] One reason is that the complexity of reports means that in some cases, the symmetry between remuneration, shareholder return and the long-term objectives of the company is lost.[63] Research reveals that only around a third of the remuneration reports of the FTSE 150 companies clearly disclosed how remuneration is dependent on performance.[64]

2.3. 2. Shareholder Activism over Directors' Remuneration

The problem of directors' excessive remuneration has led to an increase in shareholder activism in recent years, apparently to enforce the rights provided to them in regulatory instruments such as those examined above. There has been a resurgence of shareholder interest in the corporate decision-making process relating in particular to director's remuneration. This renewed interest has revitalised

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[61] BEIS, Corporate Governance, The Companies (Directors' Remuneration Policy and Directors' Remuneration Report) Regulations 2019 – Frequently Asked Questions, June 2019, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/808993/corporate-governance-directors-renumeration-policy-renumeration-report.pdf, p. 6.

[62] Jenkins, Ibid. See also, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31660/11-1287-executive-remuneration-discussion-paper.pdf , p. 10. For studies on the link between remuneration and performance, see; Godfred Adjapong Afrifa; Venancio Tauringana, "Corporate governance and performance of UK listed small and medium enterprises", [2015] 15 *Corporate Governance: The International Journal of Effective Board Performance*. Issue 5, 719-733. This articles focuses on small and medium size enterprises. Brian G.M. Main, Alistair Bruce and Trevor Buck (1996), "Total board remuneration and company performance", (1996) 106 *The Economic Journal,* no. 439, pp. 1627-1644; Ivan E. Brick, Oded Palmon and John K. Wald, "CEO compensation, director compensation, and firm performance: evidence of cronyism?", (2006) 12 *Journal of Corporate Finance*, no. 3, pp. 403-423; Neslihan Ozkan, "CEO Compensation and Firm Performance: An Empirical Investigation of UK Panel Data", University of Bristol, School of Economics, Finance and Management, Bristol, [2011] 17 *European Financial Management* 2, 260-285 , also available at https://research-information.bris.ac.uk/en/publications/ceo-compensation-and-firm-performance-an-empirical-investigation-of-uk-panel-data(89d842e2-6b62-4b02-bb05-dde303258188).html.

[63] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31660/11-1287-executive-remuneration-discussion-paper.pdf, p. 17.

[64] PwC, Insight or Fatigue? FTSE 350 Reporting, 2010. Available at http://www.pwcwebcast.co.uk/cr_ftse350.pdf, via https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31660/11-1287-executive-remuneration-discussion-paper.pdf, p. 17.

corporate democracy. In July 2018, Institutional Shareholder Services and Glass Lewis, the world's largest and most influential proxy advisers advised shareholders of Royal Mail to reject its plan to pay its new CEO a higher salary than that of his predecessor.[65] In May 2019, investors protests over huge remuneration packages and pension contributions led to a pay cut of the CEO of Standard Chartered and the resignation of the CEO of Smith & Nephew.[66] Similarly, in the same month, in one of the biggest rebellions at a FTSE 100 company hitherto, 42% of shareholders at Standard Life Aberdeen, the £546 bn UK asset manager, protested against the pay of a senior executive and voted against the fund house's remuneration report.[67] This is even below the 53.9% of Kier Group shareholders who rejected the pay report of the company's directors a few months later in November 2019.[68] The rejection came despite the fact that the total pay was down to £2.1m from £5.5m the year before.[69] Still in November 2019, Britain's most influential investor group, The Investor Association, warned the country's biggest companies to address excessive and opaque executive pay deals or face shareholder scrutiny during the 2020 AGM season.[70] Investors would like to see a greater alignment of pay with long-term company strategy in 2020, a recommendation of the Code. Protesting investors have generally expressed similar concerns that remuneration is geared at short rather than long-term performance and that it exceeded UK market norms.

2.3.3. The Impact of Shareholder Activism on Directors' Remuneration

The question that arises is whether recent shareholder activism over directors' remuneration is having an impact. Reports indicate that despite the increase in shareholder rebellion, there has been a trend of increased remuneration of non-

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65 Attracta Mooney and Michael Pooler "Royal Mail Faces Shareholder Pay Revolt" 10 July 2018, https://www.ft.com/content/d5b61604-8391-11e8-96dd-fa565ec55929

66 Matthew Vincent; "Executive Pay: Shareholders Ensure the Days of Excess are Over" 21 Oct 2019, https://www.ft.com/content/975fb9fa-f401-11e9-a79c-bc9acae3b654

67 Siobahn Riding, "Standard Life Aberdeen Suffers Heavy Revolt over CFO Pay" 14 May 2019; https://www.ft.com/content/666dfe44-7664-11e9-be7d-6d846537acab

68 Gill Plimer "Kier investors rebel over chief's potential £1m bonus", (FT, 15 /11/2019), https://www.ft.com/content/015a526e-07be-11ea-9afa-d9e2401fa7ca, op cit.

69 Mooney and Pooler, op cit; https://www.ft.com/content/d5b61604-8391-11e8-96dd-fa565ec55929

70 Owen Walker, "Shareholder Warn over UK plc Opaque Executive Pay Deals" 5 November 2019, https://www.ft.com/content/59529be6-ffd7-11e9-b7bc-f3fa4e77dd47

executive directors and chair in 2019.[71] And, executive pay is even higher.[72] The average pay of chairmen of UK's largest companies is said to have risen by almost a third to more than £400,000 since the end of the financial crisis. According to the Spencer Stuart Board Index, which analyses the boardrooms for the largest companies with a premium listing on the London Stock Exchange, a major reason for the increased remuneration is that boards have become more professional in the last decade.[73] However, as pointed out by what was formerly the Department for Business Innovation and Skills, research on the reasons for the growth in pay has reached different conclusions, with many studies pointing to the difficulty of identifying causal effects. "As a result, no single, clear reason has emerged and the trend is likely to be a combination of factors"[74].

Despite the recent incidents of shareholder activism described above, it is worth noting that incidents of shareholder activism are still very negligible and, overall, remuneration reports receive shareholder approval. It has been seen above that companies are legally required to put their remuneration policy to the vote in the AGM. In its recent report, the Chartered Institute for Professional Development (CIPD) observed that between 2014 and 2018 every single FTSE 100 remuneration policy put to the vote at an AGM was approved by shareholders.[75] According to the analysis, most remuneration packages received more than 90% vote and despite the reported incidents of shareholder protests, no remuneration reports were defeated in 2019 and only six pay packages were defeated between 2014 and 2018.[76] Recently,

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[71] Daniel Thomas, "UK Chairmen's Average Pay Rises by 30% since Crises" 11 November 2019; https://www.ft.com/content/14221c7c-0220-11ea-be59-e49b2a136b8d. See also https://www.spencerstuart.com/research-and-insight/us-board-index.

[72] However, according to a recent report, total FTSE 100 CEO pay has fallen by 13. Nevertheless, the report estimates that it would still take 117 years for a worker to earn a CEO's annual salary. This fuels questions over fairness, performance and governance. https://www.cipd.co.uk/about/media/press/ftse-ceo-pay-falls, published 21 August 2019. First accessed 14 October 2019. The claim that pay is falling can be supported by the Kier Group example. As seen above the total pay of £2.2m was a significant drop from the £5.5m paid the year before and in the year 2018/19, the company did not pay any bonuses.

[73] Ibid.

[74] BIS, op cit, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31660/11-1287-executive-remuneration-discussion-paper.pdf p. 8.

[75] https://www.cipd.co.uk/about/media/press/ftse-ceo-pay-falls.

[76] https://www.cipd.co.uk/about/media/press/ftse-ceo-pay-falls. However, such reports must be treated with caution because the Kier Group, Standard Chartered and Standard Life Aberdeen cases are only a few examples of pay packages that have been defeated in AGMs in 2019 alone.

a review carried out by Sir John Kingman[77] on the FRC noted that investors are not as engaged, particularly in audit and accounting issues, as they should be.[78] The conclusion that can be drawn so far is that although shareholders' right in respect of directors' remuneration have been strengthened by regulatory framework and there have been incidents of shareholder activism recently, shareholder apathy is still a major issue overall.

2.3.4. An Agency Theory Justification of Directors' Remuneration

So far, we have analysed the seemingly perennial issue of directors' remuneration with the aid of regulatory instruments and empirical data. However, the analysis would be incomplete without a brief reference to corporate legal theory. In fact, the controversy surrounding directors' remuneration makes such a reference not only appealing but compelling, perhaps the most compelling corporate governance issue. Nevertheless, a detail discussion of corporate law theory is beyond the scope of this article and it is certainly not intended to revisit the Berle and Means thesis on the separation of ownership and control which sparked the Berle and Dodd debate of the 1930s. The discussion of directors' remuneration reveals a conflict between the interests of shareholders who personify ownership of the company and directors who personify management of the company. This conflict arises from an agency relationship which Jensen and Meckling define as a form of contract between shareholders and directors.[79] The conflict is a practical reflection of the agency theory of the firm, a theory which deals with the relationship between the shareholders and the directors. A corollary of the agency theory is the agency cost theory, that is, the cost that shareholders incur by having managers run the company on their behalf. The requirement that executive pay should be linked with performance is significant in this regard. Where pay is linked with performance, this

[77] See below for details of the Review.
[78] Independent Review of the Financial Reporting Council, December 2018; https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf. P. 8
[79] Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behaviour, Agency Cost and Ownership Structure" *Journal of Financial Economics*, vol. 3, issue 4, (1976), pages 305-360. Also available at https://www2.bc.edu/thomas-chemmanur/phdfincorp/MF891%20papers/Jensen%20and%20Meckling%201976.pdf.

can be seen as a justifiable agency cost that shareholders incur by having directors run the company on their behalf.

The friction between directors and shareholders as revealed in the analysis above is a reflection of the intricacies of the theory. And, agency theory is based on the view that the corporate governance system as seen in the regulatory frameworks examined above, (which essentially require directors to promote the success of the company for the benefit of the members as whole) is designed to minimize the agency problem[80] and reduce agency cost. But problems arise where directors, as agents, take decisions which are perceived not to be for the benefit of the shareholders, as principals. Indeed, much mistrust on the reliability or trustworthiness of agents such as directors has been expressed in the literature. According to Williamson, agents are 'opportunistic actors given to self-interest seeking with guile'.[81] Some commentators have proposed the introduction of an effective mechanism in the governance system needed to align the agent's interest with those of the principal otherwise directors will have no incentive to maximise the interests of shareholders.[82] According to Coffee improved accountability "improves the behaviour of most individuals".[83] It seems that no other corporate governance issue epitomises this conflict more than directors' excessive remuneration. This is more so where the remuneration is perceived not to be linked with performance. Excessive remuneration could come under one of many forms of what La Porta et al describe as "expropriation of minority shareholders and creditors by the controlling shareholders"[84]. This is a corollary of the agency problem described by Jensen and Meckling, and means that insiders use the profits of the firm to benefit themselves

[80] Agency problem is often seen as the problem that arises from the fact that power in the company is placed in the hands of people who are not the owners of the company. According to Keay and Loughrey, the agency theory of the company requires board accountability in order to deal with the agency problem. However, they bemoan the lack of clarity on the meaning of accountability in the field of corporate governance despite the widespread use of the term. They argue that one effect of this is that it blurs the debate about board accountability. Andrew Keay and Joan Loughrey "The Framework for Accountability in Corporate Governance" [2015] 35 *Legal Studies*, 2, 252-289.

[81] O Williamson, *Mechanisms of Governance* (Oxford: Oxford University Press, 1996) p 253. Quoted in Keay and Loughrey, op cit pages 258-9.

[82] M. Dooley 'Two models of corporate governance' (1992) 47 *Bus Law* 461 at 468; J Roberts 'Trust and control in Anglo-American systems of corporate governance: the individualizing and socializing effects of processes of accountability'(2001) 54 *Hum Rel* 1547 at 1548. Quoted in Keay and Loughrey, op cit.

[83] JC Coffee 'New myths and old realities: the American Law Institute faces the derivative action' (1993) 48 Bus Law 1407 at 1425. Quoted in Keay and Loughrey, op cit.

[84] Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny, "Investor Protection and Corporate Governance" (2000) 58 *Journal of Financial Economics*, 3-27, at p. 4

rather than return the money to the outside investors. According to La Porta et al who take a cynical view of insider motives, when the legal system provides good protection for investors, one of the few options that insiders can resort to is to overpay themselves.[85]

On reflection, empirical evidence on directors' remuneration bear the hallmarks of the agency theory more than any other corporate theory. As the preceding analysis reveals, despite regulatory reform both in the form of soft law and hard law to ultimately reduce agency costs, directors' remuneration has continued to rise, overall, and shareholders have continued to approve remuneration packages in the AGM. The surprising approval by shareholders of directors' remuneration packages in the midst of controversies over directors' pay underlines the fact that whatever hype directors' remuneration may cause, the subject is a contractual one to be determined ultimately by the parties to the contract in pursuit of their respective interests. External regulation has a limited intrusive force. It can only provide a framework within which the parties to the agency contract can exercise their contractual rights in pursuit of their respective interests, but ultimately the decision is theirs. And, in this contract, shareholders as principals, almost invariably exercise their contractual and statutory rights to vote in favour of the remuneration packages presented to them in the AGMs by their agents, the directors. What then is the fuss – one might ask?

The FRC itself acknowledges that despite increasing regulation to improve transparency and accountability, the inconsistent alignment between executive remuneration and performance and between the remuneration of senior executives and employees has continued unabated.[86] This acknowledgement underscores the agency theory basis of directors' remuneration and the limited effect that external regulation can have in this area of corporate governance.

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[85] Ibid, p. 6.

[86] FRC, Corporate Culture and the Role of Boards: Report of Observations, July 2016; https://www.frc.org.uk/getattachment/d246eacb-5774-4912-98e1-c03f1c8f692f/Corporate-Culture-and-the-Role-of-Boards-Report-of-Observations-tagged.pdf, p. 23.

Conclusion

Corporate governance issues are perennial and they will remain so for as long as companies continue to fail. And, companies will sometimes fail as admitted by the Kingman Review.[87] Corporate failure cannot therefore, be interpreted as a sign of corporate governance failure. What is certain, however, is that corporate failure provokes corporate governance reform. Most of the corporate governance reforms in the UK, both in the form of soft law and hard law, have been in response to these corporate failures. If anything, this paper has revealed that the UK corporate world is hardly a dull or an idle place. It is a vibrant beehive that is reverberating with a near-incessant flurry of corporate governance reforms matched equally by corporate failures and the concomitant fallouts. In fact, some of the reforms and corporate activities discussed in this paper took place while the paper was being written. One might be tempted to ask if the reforms are working, but that is another subject. The following passionate statement made by Rachel Reeves MP, to a session of auditors facing the Commons Business, Energy and Industry Strategy (BEIS) Committee in October 2019 captures the theme:

> How many more company failures, how many more egregious cases of accounting do we need? We've had BHS, Carillion and Patisserie Valerie, and now we've had Thomas Cook. How many more do we need before your industry opens its eyes and recognises that you're complicit in all of this and you need to reform? I think the conclusion policy makers will take from today is that we can't rely on you to do the right thing and legislation is needed to have a tougher regulator. We need tougher regulation because your industry is not willing to make the changes needed.[88]

A question that is worth asking is if the above statement and the replacement of the FRC with ARGA is an admission that industry self-regulation has failed and if this gives credence to the argument that industry cannot be trusted to self-regulate. This too, is another subject.

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[87] Independent Review of the Financial Reporting Council, December 2018; https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/767387/frc-independent-review-final-report.pdf,

[88] Wale Azeez, op cit, n. 31, https://news.sky.com/story/auditors-complicit-in-uk-corporate-failures-mps-say-11842171

The three corporate governance issues examine in this paper underpin the fact that by virtue of its inter-disciplinary nature, corporate governance intersects various subject areas including law (both soft law and hard law) and corporate legal theory, all supported by empirical data. It was seen above that the problem of directors' remuneration is best explained by the agency theory. However, it can be surmised from the analysis in this paper that, overall, corporate governance is a nexus of contracts involving an intense interplay between the various stakeholders involved in this giant, invisible and amorphous entity called the company. As seen earlier, the agency theory provides a suitable theoretical home for the issue of directors' remuneration which essentially involves a contract between the directors and shareholders. This contract is a part of the bigger nexus of contracts upon which the company is thought to be based.[89] The above speech by Honourable Reeves to the session of auditors at the Commons Committee is an indictment on auditors that they have failed to perform their role in the contract between them and the company – a contract which is yet another part of the bigger nexus of contract. It follows that corporate governance reform often involves separate regulatory instruments dealing with these separate contractual relationships which weaved together provide an effective system of governance. For example, as seen earlier, the Companies (Directors' Remuneration Policy and Directors Remuneration Report) Regulation 2019 deals with directors' remuneration which concerns the agency relationship between shareholders and directors. The Statutory Auditors, Third Country Auditors and International Accounting Standards (Amendment) (EU Exit) Regulations 2019 deal with auditors, which concerns the agency contract between the company and the auditors. Only occasionally is there a single regulatory framework such as the Code or the Companies Act 2006, which deals with all or most of the parties in this nexus of contract and the issues involved. And even then, a perusal of the instruments would reveal that they carry the hallmarks of the nexus of contract theory. For example, the main principles of the Code deal with different contracts,

[89] For a discussion of the nexus of contract theory, see Jensen and Meckling. Jensen and Meckling, op cit, n. 79. Jensen and Meckling's network of contract theory has been expanded on by Easterbrrok and Fischel. See Frank H. Easterbrook & Daniel R. Fischel, The Corporate Contract, 89 *Colum. L. Rev*. 1416, 1426 (1989). It should be noted that the theory is not without its opponents, many of whom see the company as a creation of the state. See Grant M. Hayden and Matthew T. Bodie "The Uncorporation and the Unravelling of 'Nexus of 'Nexus of Contracts' Theory" [2011] Issue 6 Michigan Law rev. vol. 109, pp. 1127-1144. Available at https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1156&context=mlr.

such as the contract between the shareholder and the directors, the contract with the auditors, etc.