

Institutional investors, the political economy of corporate disclosure, and the market for corporate social responsibility: implications from the UK Companies Act (2006)

- Gordon L Clark <gordon.clark@ouce.ox.ac.uk>
Centre for Employment, Work and Finance
Oxford University Centre for the Environment
South Parks Rd.
Oxford OX1 3QY, UK

and

Labor and Worklife Program
Harvard Law School
Cambridge MA 02138, USA

- Eric R Knight
Centre for Employment, Work and Finance
Oxford University Centre for the Environment
South Parks Rd.
Oxford OX1 3QY, UK

Institutional investors, the political economy of corporate disclosure, and the market for corporate social responsibility: implications from the UK Companies Act (2006)

Gordon L Clark* and Eric R Knight. Centre for Employment, Work and Finance, Oxford University Centre for the Environment, South Parks Rd., Oxford OX1 3QY, UK and *Labor and Worklife Program, Harvard Law School, Cambridge MA 02138, USA

Contact. gordon.clark@ouce.ox.ac.uk

Abstract. Shareholder scrutiny of reported income and stock price appreciation, non-governmental organisations, activists, and the public-at-large hold large firms accountable on many issues including their environmental footprints and the social standards of their suppliers around the world. For those coming from European social democratic traditions, stakeholders have a legitimate voice in the affairs of the corporation especially in two-tiered governance regimes that separate supervision from management. Notwithstanding attempts to re-write their proper roles and responsibilities, the Anglo-American corporation is widely believed to be the medium for the accumulation of shareholder value. Recently, however, a counter-argument has emerged suggesting that the UK Companies Act of 2006 broke with this tradition to embrace the European model if not wholly then at least in terms of giving legitimate voice to social and environmental issues. We note that the UK Companies Act owes much to the EU Modernisation Directive but argue that the disclosure of social and environmental factors relevant to understanding the risks faced by the corporation owes more to the interests of institutional investors than community activism. We also suggest that there remains deep-seated divisions amongst institutional investors (especially different types of pension funds) that may have long-term consequences for UK disclosure policy and the power of markets to affect corporate social and environmental responsibility.

Keywords. Disclosure, institutional investors, UK company policy, social and environmental standards

JEL Codes. D23, G18, G23

Acknowledgements. This paper was prepared for presentation to the Sloan Industry Conference, Boston MA (May 2008) and is based upon the first-named author's Nanovic Lecture on European Studies at Notre Dame University (September 2007). It bears the imprint of continuing dialogue on the power of institutional investors with Emiko Caerlewy-Smith, Teresa Ghilarducci, Tessa Hebb and Cindy Williams. Thanks go to Notre Dame for the invitation to present the Nanovic Lecture, to Adam Dixon for research assistance on the themes developed herein, and to Tessa Hebb and Ashby Monk for comments on a first draft of this paper. None of the above should be held responsible for any errors or omissions.

Introduction

Much is expected of the modern corporation. For shareholders seeking to maximise their return on investment, close attention is paid to reported earnings and stock price appreciation (Graham et al. 2005); unanticipated negative movements in these variables can give rise to shareholder agitation amplified by hedge funds and activist pension funds (Hebb 2008). If characteristic of the Anglo-American 'market for corporate control' (Hopt et al. 1998), it is apparent that these types of pressures have been brought to bear on large continental European companies even if nation-state rules and regulations governing stakeholders' relationships have been slow to embrace shareholder rights (see Bauer et al. 2008). It is significant that the European Union (EU) has sought to 'modernise' member state corporate law responding, in part, to the reliance of member states on domiciled companies for long-term economic growth in the face of heightened global competition for market position and the integration of financial markets.

Shareholders' interest in the rate of return aside, it should be acknowledged that community activists and some types of institutional investors have encouraged traded firms to respond to larger challenges such as climate change and the welfare of employees and service providers in distant lands (Clark and Hebb 2005). For many activists, these issues are about ethics and moral responsibility given the enormous power of large corporations when compared to the majority of national governments. For some institutional investors, especially those with legal obligations as regards the long-term welfare of beneficiaries, short-term shareholder value is balanced against the long-term growth and development of whole economies (Richardson 2007). In these cases, fiduciaries are self-conscious about the time horizon over which they reap value from investment; if not intended, the largest of institutional investors have a stake in the long-term structure and performance of global markets (see Hawley and Williams 2000 on fiduciary capitalism).

Whether corporations have any obligation other than making a profit, the limit of corporate social responsibility associated with Milton Friedman's dictum proclaimed at the height of the cold-war, is subject to considerable debate (Clark et al. 2008). For much of continental Europe, the corporation is foremost a social institution and is

treated as such in corporate law. In many jurisdictions, the formal purpose of the corporation references the ‘social good’ albeit in a variety of guises, often stating an explicit commitment to community welfare and economic value. Even in the Anglo-American world, companies seeking social respectability often proclaim their commitment to community norms and expectations; managing public expectations goes well-beyond investor expectations, a fact-of-life recognised as such by non-governmental organisations (NGOs) and community groups at the interface between media and markets (Bansal and Clelland 2004). Mobilizing public confidence in corporate responsibility while remaining duty-bound by statutory obligations to shareholder value is a challenging task (McBarnet 2007).

The issue of corporate responsibility has four distinct dimensions: social expectations, investor expectations (short-term and long-term), governmental expectations (statute and regulations), and theoretical-cum-academic expectations. We should take care not to discount the significance of any of these expectations, least of which are the theoretical or ‘in-principle’ expectations of the academic community (Parker 2007). These expectations can be important given debate about the relative value of national models of corporate governance in global financial markets (Gordon and Roe 2004), with far-reaching consequences for the nature and scope of standards adopted by supra-national legislative entities such as the EU and the International Accounting Standards Board (IASB). The genesis of the UK Companies Act (2006) owes a great deal to the EU Modernisation Directive as well as deeply-entrenched theoretical conceptions of the proper roles and responsibilities of corporate officers. Understanding corporate responsibility as embedded in the UK Companies Act requires an appreciation of the interests of those stakeholders who sought to influence the conception and implementation of the Act.

Our paper has four goals. First, we show that the UK Companies Act (2006) is, in part, an expression of the EU modernisation project, adopted by the British government to further the status of the UK as a global standard-setting jurisdiction. Second, we suggest that the UK Companies Act (2006) can be seen as an expression of conventional microeconomic theoretical expectations as regards the proper roles and responsibilities of corporate officers (referencing Jensen 2000). Third, we argue that the disclosure requirements of the Act are entirely consistent with Anglo-

American investor expectations as regards the premium on the free-flow of market-sensitive data. While disclosure requirements seem to match the expectations of many social activists, especially regarding firms' long-term environmental liabilities, the motivating logic of such disclosure has more to do with the market pricing of corporate value than an expansion of corporate social responsibility. Fourth, whatever the nature and scope of disclosure, care should be taken not to exaggerate the commitment of institutional investors to these issues. In conclusion, we distinguish between the demand and supply of disclosure and the interests of public and private pension funds.

In these ways, we challenge those who argue the UK Companies Act (2006) is a major step forward in defining the nature and scope of corporate responsibility. We concede that it is important, but argue that its importance is to be found in its commitment to improving information disclosure relevant to market pricing. By our assessment, the UK government was able to marry-together otherwise competing expectations of social activists and investors in a model of disclosure that is quite conventional (if judged against information-dependent theories of financial market performance; see Wilhelm and Downing 2001). Equally, the UK government was able to use this template to tame more radical amendments for disclosure on environmental foot-prints and supplier-network conditions. Whether the modest form of disclosure on these issues will be effective depends, in part, on the degree to which institutional investors are willing to act on the information. Some may. But it is suggested that many of the largest private pension funds will not because of conflicts of interest inherent in these types of institutions.

To sustain these arguments, we rely upon textual analysis and 'close dialogue' with some of the principal players in the NGO, investor, and political communities. Being a qualitative method of information-gathering and assessment, close dialogue places a premium on accessing and synthesizing 'inside' information. This is important for developing knowledge of the governance practices and conflicts of interest embedded in different types of institutional investors. In this respect, we follow the lead of O'Barr and Conley (1992) and Clark (1998).

Modern capitalism

In his treatment of post-war economic structure and performance, Shonfield (1965) marvelled at the rate of growth in UK employment and income over the previous twenty years. By his account, the chronic instability and poor performance of the UK economy through the inter-war years had been solved by “the existence of in-built economic stabilisers” and Keynesian “control over the business cycle” (pp. 17 & 64). Some forty years ago, Shonfield argued that the conflict over consumption and investment, which had bedevilled the first half of the twentieth century, could be resolved through the judicious use of national planning (especially as regards education and training), economic management, the welfare state, and the regulation of the large enterprises that dominated the economy. As for long-term growth, Shonfield suggested that many enterprises were of sufficient economic size to mobilize internal resources necessary to invest in the next wave of innovation.

Shonfield’s treatise was matched in the US by Galbraith’s (1967) The New Industrial State. Both writers were transfixed by the emerging ‘partnership’ between the nation-state and the modern corporation, suggesting that the bureaucratic management of markets and incomes were to their mutual advantage. Elsewhere, Clark (2005) develops these claims about the symbiosis between the nation-state and the corporation for Anglo-American economies in the years leading up to about 1973 emphasizing their implications for the management of labour resources and the consequent growth of private pension systems. The ‘golden era of growth’ was dominated by large industrial corporations, relatively high levels of unionization, and growing real incomes (Chandler 1990). It was also an era in which corporations held their assets as physical plant and equipment, market incumbency being the basis for generating further investment. Shonfield (1965, 376-77) concluded that the “modern private enterprise” viewed itself as a “*permanent* institution”.

As the record shows, Shonfield and Galbraith wrote of a mode of accumulation at its peak. Through the 1970s, the UK experienced high levels of unemployment, slowing growth in real income, and rapid de-industrialization as private institutions faced the full force of international competition for market share. While US industry was not to face these competitive pressures until the 1980s, by the early 1990s Jensen (1993) argued that the US industrial corporation had proven unable to respond effectively to

growing market competition because of management entrenchment and an imperfect market for corporate control. Coming out of the 1980s, the UK economy had entered a new phase of accumulation where real incomes were now driven by employment in service industries and the pivotal place of London in the emerging global financial industry (Clark 2003). By the end of the 1990s, the US economy had also been transformed albeit with greater income disparity and the remarkable persistence of a number of enormous industrial firms that had refused to die (Monk 2008).

Our point in rehearsing the recent history of the UK and the US is to stress that, not so long ago the modern corporation was a power in the land. It dominated domestic markets, it controlled its financial destiny, and it was an equal partner with the nation-state in fostering the growth and development of its home-market. The modern corporation and its associated unions could negotiate their shares of revenue (retained earnings and wages) to their mutual benefit leaving the residual to be paid as dividends to shareholders.

Three forces conspired to undercut the power of the modern corporation (see also Zingales 2000). First, the liberalisation of product markets through the European Economic Community and then the EU effectively pitted UK industry, characterised by poor productivity growth and low rates of research and innovation, against robust European national champions. British firms resisted competition, turning slow rates of change into profound economic crisis. These types of competitive forces, found in the momentum associated with twenty-first century economic globalization, now threaten continental Europe (Clark et al. 2004). Second, as UK industry failed under the weight of resistance, the nation-state came to realise that the post-war 'partnership' could no longer be relied upon to deliver employment and rising living standards. This political calculus effectively shattered hide-bound class alliances, replacing the partnership with a more distant relationship such that the corporation is now seen as a means to an end (Campbell and Vick 2007). The nation-state has sought to affect the market for corporate control so as to sustain the growth of national income (if not the interests of corporate-elites).

Fuelling the transformation of British industry was the fledgling financial services industry. Underpinned by the reserves of established banks and insurance companies,

the assets of public and private funded pension systems created in the aftermath of the Second World War flooded into London. Thatcher's 'big bang' liberalised London's markets, providing domestic savings a global platform for portfolio investment around the world. Intended or not, the 'big bang' combined with burgeoning market liquidity gave the London market a significant 'first-mover' advantage over continental rivals, reinforced by the in-flow from American investment houses and then by the acceleration of global financial integration from about 1995 until the pause imposed by the sub-prime credit crisis. Pension funds and institutional investors swamped the internal resources of corporations driving a wedge between the generation and distribution of earned income *and* the financing of corporate strategy and investment. As foreign banks came to London for a global and European location, the cosy alliances of the past were fractured.

Unlike much of continental Europe, the Anglo-American financial sector has grown separately from industry and the state (Hopt et al. 1998). Because of the trust institution, the application of fiduciary duty as the governing ethic, and the legal separation of asset management from pension plan sponsors' treasuries it is arguable that plan sponsors being the origin of pension assets are also, paradoxically, the object of financial institutions' investment strategies (Clark and Hebb 2004). Given the goal of maximising the portfolio risk-adjusted rate of return, the average traded firm has been forced into a corner: being just one stock in large diversified portfolios, it is neither held nor traded on its particular merits nor is its management necessarily held to account for poor performance. It's all about the short-term pricing of stock given the flow of information about actual and expected earnings and market capitalisation. Automated trading systems cued to changes in stock market pricing and linked to stock market indices dominate daily trading volume (Davis and Steil 2001).

The modern corporation has become the traded object of global financial markets and, in some cases, deliberately so (see Clark and Wójcik 2007 on the 'demand' for cross-listing). Not surprisingly, the demand for information on its structure and performance has come to dominate debate over the proper substance of company law pitting national traditions against the argued inexorable logic of global financial market integration (Strange 1997).

Institutional investors, markets, and disclosure

We have suggested that the growth of retirement savings in institutions at arms-length from the immediate interests of sponsoring companies profoundly altered the balance-of-power in financial markets in favour of third-party investors. Elsewhere, the nature and significance of this transformation for the structure of Anglo-American financial markets is described in detail (see Clark 2000; Davis and Steil 2001), and is referred to by Clark and Hebb (2004) as the “fifth stage of capitalism” (developing Robert Clark’s 1981 account of the historical evolution of management theories over two centuries). As pension and retirement savings accumulated over the second half of the twentieth century, a revolution was taking place in the investment of those assets, accentuating the growing separation between traded companies and institutional investors and their market intermediaries (see Clowes 2000). This revolution was conceptual and analytical and has, arguably, remade the structure and performance of global financial markets in its image (MacKenzie 2006).

As is well-appreciated, the vast majority of pension funds, mutual funds insurance companies, and endowments abide by the principles of modern portfolio theory (MPT) (Campbell and Viceira 2002). In brief, these principles are as follows: (1) there is a correlation between risk and return such that particular investments can be assessed in accordance with their expected risk-adjusted rates of return; (2) investment strategy is about managing portfolio risk such that any particular investment and its associated risk and return characteristics should be judged against investors’ overall objectives; and (3) markets are so efficient that active investment—picking winning stocks over losing stocks—is not a viable long-term investment strategy. In combination, MPT provides a rationale for holding large swaths of whole markets, treating particular stocks as components in a comprehensive strategy of investment management. Given the costs of active management and the unlikely prospect of being able to formulate a consistent winning strategy, passive portfolio investment is the operative strategy (Litterman 2003).¹

¹/ This is not, of course, the full story. Recent research in the UK and the US on the persistence of ‘winning’ traders suggests that a small set of market players are able to produce out-performance in a systematic manner by virtue of their buying (stock selection) but not selling strategies. This is apparently the case for individuals as well as institutions (although the latter are likely to dominate the former); it is also widely believed that out-performance may decline as the net inflow of assets to ‘winning’ mutual funds dampens the capacity of those entities to sustain their distinctive strategies (see, for example, Keswani and Stolin 2008).

Accompanying the revolution in financial markets has been the systematic outsourcing of investment management from all but the largest of pensions funds (note: mutual funds and insurance companies have, by their very nature, tended to internally manage pension and retirement savings). There are significant economies of scale in managing the flow of assets from contributors to funds to managers and in return to funds and their beneficiaries (witness the market dominance of custodial firms like State Street Bank of Boston). Likewise, there are economies of scale in executing planned trading strategies that vary by asset class and market segment. Just as importantly, while many investment banks offer a full range of investment management services, these firms can often claim a stronger reputation in one asset class over others (eg. PIMCO in bonds but not in equities). Specialised knowledge and expertise are a continuing source of competitive advantage notwithstanding the claims made by bulge-bracket firms for the cost-advantages of cross-over services and complementary products (Clark 2003; ch. 8).

Just as importantly, the accumulated size, complexity, and time-sensitivity of global financial markets have effectively disenfranchised pension fund trustees from direct operational responsibility for investment management (Ambachtsheer 2007). Recognising this fact of life, pension fund trustees have been left with the responsibility for overall investment strategy informed, of course, by modern portfolio theory (Clark and Urwin 2008). Only rarely, and mostly in public pension funds, do trustees seek to influence the trajectory of particular stocks (Hebb 2008).

This story about the structure and control of investment management has been told a number of times (as noted above). In recent years, it has been complicated by a loss of confidence in the efficient markets hypothesis, the rise of hedge funds and alternative asset classes like infrastructure, and the search for alpha (a premium on active investment) over beta (the performance of whole markets). The subprime credit crisis has also undercut the credibility of less-than-transparent risk transfer devices such as collateralised debt obligations (eg. mortgages). It is apparent that only the best-governed funds and institutions, focused on risk management and return volatility, have been effective investors in these arenas. For all the publicity garnered by endowments' high compound annual rates of return, the average public and private

pension fund has not engaged the frontiers of financial innovation nor has it been able to systematically out-perform asset-specific benchmarks (Lerner et al. 2007).

What should be emphasised at this juncture is the degree to which institutional investors rely upon the veracity of market prices and the response of financial agents to those prices—the efficient pricing of stocks and bonds, let alone the more exotic financial instruments such as collateralised debt obligations, is at the very heart of MPT. Even if the efficient markets hypothesis is not a full account of the anomalies and biases in market pricing and human behaviour, it serves as a normative claim on the proper value of quoted prices (Huberman 2003). As such, it is not surprising that there is enormous attention paid by institutional investors (acting on behalf of their pension fund clients) and governments (acting on behalf of the welfare of many millions of beneficiaries) to the informational content of market prices. In the end, the mis-pricing and systematic distortion of asset values represents a significant welfare cost to society and, more immediately, a constraint on the performance of investment managers (as apparent in the subprime credit crisis). In this respect, the scope of “disclosure” by traded companies and related entities of market-relevant information has become the litmus test of financial regulation (Hebb 2006).

As the record shows, however, no country has an unblemished record in these matters, particularly in relation to the auditing of declared corporate assets and liabilities (witness the Enron and WorldCom scandals in the USA) and the treatment of insider and outsider shareholders as regards the timely disclosure of market information (as in much of continental Europe) (see respectively Coffee 2005 and Clark and Wójcik 2007). La Porta et al. (1997) demonstrate the existence of very different national traditions and policies as regards corporate disclosure policies and the variable significance attributed to global portfolio investors over entrenched domestic interests.² Apparent differences between countries’ disclosure regimes have prompted some of the world’s largest pension funds to agitate for ‘reform’ either directly through the lobbying of governments or through the leverage applied by the

²/. While the problems of management entrenchment and the influence of insiders over outsiders are often discussed with reference to continental Europe, it is apparent that some analysts of corporate governance would dispute the presumption in favour of US standards of corporate governance. See, for example, Bebchuk (2005) on the costs of management entrenchment in the US and the improper limits imposed on institutional investors in exercising their ‘ownership’ rights.

differential investment of their own assets by company and country (Hebb and Wójcik 2005). As such, some of the world's largest pension funds have been identified as important innovators in their own right, assuming the responsibilities and obligations that Hawley and Williams (2005) attribute to "universal owners".

In this context, the election of the UK Labour Government in 1997 and booming securities markets in the run-up to 9/11 seemed to offer a chance for social activists to mobilize the power of institutional investors. Being part of a larger debate over the prospects for a UK stakeholder society and the lessons to be learnt about corporate social responsibility from continental European social democracies (Hutton 1997), the Labour government was lobbied to make good on the promise to affect socially responsible investment. In 1999 the UK government issued changes in regulations—the Occupational Pension Schemes (Investment, and Assignment, Forfeiture, Bankruptcy etc) Amendment Regulations—under the Pensions Act 1995 wherein trustees of occupational (and thereafter local government pension funds) were required to disclose in a written statement of investment principles the following: "(a) the extent (if at all) to which social, environmental or ethical considerations are taken into account in the selection, retention and realisation of investments; and (b) their policy (if any) in relation to the exercise of the rights (including voting rights) attaching to investments" (cl 2(4)).

For all the critical comment that has accompanied this policy (see Conley and Williams 2005), there are three reasons why its impact has proven rather limited. Most obviously, the change in regulation pre-supposed corporate disclosure on these issues whereas the nature and scope of corporate disclosure was not directly affected. In any event, though hardly recognised at the time, the effects of the change in regulation were to fall largely on fund managers rather than on pension funds. Fund managers are very reluctant to engage with the issues unless directly required by their clients.³ In this respect, the regulation did not require institutional investors to take social, environmental or ethical considerations into account in their investment decisions. The UK government also rejected a proposal by the UK Social Investment

³/. The lack of responsiveness of the global finance industry to social concerns, indeed social welfare, is one of the topics explored by Bogle (2005).

Forum for amendment to the Financial Services and Market Act (2000) to include the provision of environmental investment and related lending products within the Financial Services Authority's mandate.⁴

The EU Modernisation Directive

Having emphasized the significance of financial actors and markets for the modern corporation, we now turn to the recent EU and UK initiatives on corporate disclosure and reporting. The EU Modernisation Directive was a product of the Lisbon Strategy of 2000 which sought to build competitive and efficient European financial markets. The Strategy set 2005 as the deadline by which the European Commission's Financial Services Action Plan (FSAP) of 1999 would be implemented. The motivating purpose of the FSAP was to "enhance the comparability of financial statements prepared by Community companies whose securities are admitted to trading on a regulated market" (EU Modernisation Directive, Recitals clause 1). Policies which emerged from the FSAP included Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 which introduced the requirement that European listed companies prepare consolidated accounts in accordance with International Accounting Standards (from 2005). The EU Modernisation Directive sought to ensure that annual and consolidated reporting for EU companies was in line with best practice, including the reporting of financial and non-financial information.

The EU Modernisation Directive was ambitious in its scope, amending both annual reporting under Directive 78/660/EC and consolidated annual reporting under Directive 83/349/EEC. It instituted a system of reporting whereby companies must provide "at least a fair review of the development and performance of the company's business ...together with the principal risks and uncertainties that it faces." Although this did not explicitly refer to environmental, social or governance factors of firms, the Directive provided that "where appropriate, non-financial key performance indicators relevant to the particular business, including information relating to

⁴/. If limited in scope, the UK 'reform' did spark legislative initiatives in continental Europe and Australia for fund managers to actively consider social, environmental and ethical concerns in their investment decisions. Sweden introduced the toughest provisions regarding social and environmental disclosure. Regulatory reforms in January 2001 required Sweden's five largest state-run pensions, to incorporate environmental and ethical considerations in their investment strategies as well as report to the Government on the implementation of this policy: "investments activities shall take environmental and ethical considerations into account without lowering the overall objective of a high return".

environmental and employee matters” shall be reported (EU Modernisation Directive, articles 1.14, and 2.10).

The EU strategic plan subsequent to the Lisbon Strategy, the Action Plan on *Modernising Company Law and Enhancing Corporate Governance in the European Union* (hereafter, Action Plan) launched by the European Commission in May 2003, was one of the points of reference for the UK’s 2004 White Paper on Company Law Reform (hereafter, White Paper). The White Paper was framed around four strategic objectives. These were to enhance shareholder engagement and a long-term investment culture, ensure better company regulation and a “think small first” approach, make it easier to set-up and run a company in the UK, and provide greater flexibility for corporate reforms in the future (Rickford 2004). The White Paper described disclosure reforms as “a further major step forward in improving company reporting and transparency and in promoting effective dialogue on the drivers of long-term performance” (p.12). Heightened disclosure standards were driven by a commitment to a more efficient market pricing of traded companies, implying that stock prices ought to be determined by long-term ‘value’.

Unresolved was whether non-financial disclosure had separate status or was dependent upon a demonstrable link to stock market pricing. The initial legislative effect of the EU Modernisation Directive and the UK White Paper as regards greater disclosure of financial and non-financial information came through in the UK in the 2005 amendments to the UK Companies Act (1985). Among the items considered, these amendments established the requirement for an Operating and Financial Review (hereafter, OFR) for quoted companies. The principal motivation behind these amendments was the incorporation into UK law of the new accounting requirements introduced under the EU Modernisation Directive. However, there were other considerations in the UK’s purpose and intended effects of these reforms.

The UK Government noted that there was a need for a sophisticated financial disclosure regime to encourage capital market activity. It was argued that where market asymmetries of information were overcome, investors would be more able to invest with reduced adverse selection and therefore lower liquidity risks. Improved transparency through greater access to data on quoted companies would place

shareholders in a better position to effectively protect their interests and control directors' overreach (Bauer et al. 2008). The "fair review" standard in the EU Modernisation Directive would lead to "reporting on performance on financial and non-financial matters" (Department of Trade and Industry, "Final Regulatory Impact Assessment on the Operating and Financial Review and Directors' Report Regulations" (OFR Impact Assessment) at paragraph 13). Environmental disclosures were to be elements of non-financial "matters", acknowledging the increasing pressure on businesses "to exercise social responsibilities, contributing more to the wellbeing of their employees, their customers, and their communities" (OFR Impact Assessment at paragraph 18). It was also acknowledged that business is increasingly reliant upon intangible assets such as brand image and reputation (OFR Impact Assessment at paragraph 18).⁵ Assuming that the underlying purpose of the firm is to maximise shareholder value, disclosures were to provide shareholders with better information about firms' liabilities and prospects.

The OFR provided for broad disclosure of non-financial information including, where appropriate, corporate environmental and social responsibility (CESR). Although the reasons for these amendments were grounded in conventional theories of the firm (compare Jensen 2000), they also satisfied NGO interests in corporate social responsibility. These provisions directly incorporated the requirements for "fair review" reporting of a company's development, performance, or position as set out in the EU Modernisation Directive. However, they went further by requiring companies to report on "the future trends and factors underlying the development, performance and position" of the company in the next financial year (OFR Regulations 2005, s 1(d)). Additionally, OFR provisions gave substance to the EU Modernisation Directive's requirement for non-financial reporting on "environmental and employee matters" (OFR Regulations 2005, s 6(1)). Companies were to be required to include information about the environment including analysing the impact of the company on the environment (OFR Regulations 2005, s 4(1)(a)). As well, companies were

⁵/. The significance of intangible assets for the modern corporation clearly varies by sector, and the history of a corporation. Methods of discriminating between corporations as regards their sensitivity to reputation have been developed, in part, based upon proprietary databases (see, for example, Clark and Salo 2008).

required to provide “information about social and community issues” (OFR Regulations 2005, s 4 (1)(c)).

In November 2005, however, the UK Chancellor abandoned the new OFR provisions less than 6 months after they were introduced without consultation with the Department of Trade and Industry, other Ministries, or relevant stakeholders.⁶ The publicly stated reason for abandoning these provisions was the administrative costs associated with reporting. The then Chancellor (and now Prime Minister) Gordon Brown said "I understand the concerns about the extra administrative cost of the gold-plated regulatory requirement that from April next year all quoted companies must publish an operating and financial review" (BBC News Website on 28 November 2005) .

The policy reversal was not met with universal acclaim by the business community, suggesting that business saw the disclosure regime as, perhaps, valuable to the market rather than simply an additional burden. As we note below, these provisions reappeared in a weaker form in the Company Law Reform Bill (hereafter Reform Bill) which was debated in the House of Lords and the House of Commons through 2006 before its passage as the UK Companies Act (2006). Lord Sharman during the Second Reading on the Reform Bill in the House of Lords assessed the political and business communities’ positions on disclosure in the following terms: “the Chancellor’s statement abolishing the OFR simply did not earn him the brownie points from the business community that he anticipated....investing bodies like the notion of an OFR and the issues that have given rise to concern did not involve whether there should be an OFR, but involved some of the data that were to be required” (Hansard, House of Lords SR on 11 January 2006 at 194).

Passage of the UK Companies Act 2006

In the Reform Bill, the obligation on companies to report on non-financial information as per the OFR was replaced by an obligation on company directors to produce an annual business review (Reform Bill, s 390(2)). The Bill abandoned

⁶/. For example, in anticipation of the adoption of the OPR, the UK Accounting Standards Board had published an Exposure Draft in 2005 canvassing the likely scope of expected disclosure as well as various measures needed to implement the policy.

substantial provisions which had appeared in the OFR. First, the Reform Bill dropped the requirement for forward-looking reporting on the main trends and factors likely to affect the company's future. Second, although the business review would be required to include information on environmental and employee matters where appropriate, "social and community" issues were omitted (Reform Bill, s 390 (4)(b)). Furthermore, environmental matters no longer explicitly included the impact of the business of the company on the environment and the requirement to disclose policies on these issues and the success of their implementation was abandoned. Finally, whereas the OFR and the EU Modernisation Directive required businesses to report in a manner consistent with their size and complexity, the Reform Bill exempted businesses qualifying as "medium-sized" from reporting non-financial information (Reform Bill, s 390 (7)).

In debate through the House of Commons and House of Lords, however, the Government was pressured to reinstate many of the OFR provisions which had been replaced in the business review section of the Reform Bill. Although there was lobbying from both the NGO and business communities, the key reforms which made it into the Bill were based on mainstream microeconomic theories of the firm and efficient markets *vis-a-vis* information disclosure (Jensen 2000), rather than a radically model of new social responsibility for the UK corporation.

Disclosure was deemed necessary in order to give effect to the newly codified directors' duty to act in a way which is "most likely to promote the success of the company for the benefit of its members as a whole" (Companies Act 2006, s 172). This question was raised early in the Grand Committee stage in the House of Lords and continued to be debated throughout the passage of the Bill. At issue was whether the duty to promote the success of the company was a new duty which therefore required a change in implementation arrangements to support this duty or whether it simply made no difference. Lord Sharman's view was that a new duty would be formed to push the Anglo-Saxon model of corporate endeavour "to a more not quite pluralist society but rather a northern European model where a group of stakeholders are involved" (Hansard, House of Lords GC on 1 March 2006 at 169). This was contested by Lord Hodgson who argued that the Bill simply codified common law duties and therefore made no substantive difference to the existing legal position.

Lord Sainsbury, Under-Secretary of State (Department of Trade and Industry), sought to clarify the Government's position. Although he acknowledged that the Bill would helpfully codify common law duties, he contended that it would make a substantive difference by identifying specific factors which are relevant to the success of the company (Hansard, House of Lords GC on 1 March 2006 at 170).

In the House of Commons, a company's environmental and ethical performance was interpreted as a financial value issue by the Conservatives, rather than as a purely environmental issue. Justine Greening MP argued that "at the heart of any successful company is an in-depth understanding of what its customers want and value. Perhaps more than at any time in the past, customers place a value not just on what they are purchasing from companies, but on the way in which companies have carried out their business in order to provide those products or services. Companies can therefore be at the forefront of the push to tackle environmental and ethical issues" (Hansard, House of Commons Debate on 18 Oct 2006 at 889). She distinguished this financial value-based argument from a purely environmental-based case for the disclosure regime saying "as the Minister said, company law is not the best vehicle for addressing wider social and environmental concerns. We can address those objectives, as some Government Members have said, through domestic legislation, health and safety measures and environmental protection, on which progress has been made." (Hansard, House of Commons Debate on 18 Oct 2006 at 890)

A second issue debated was the need for an auditor's report to verify the validity of reported information. Baroness Thornton in the Grand Committee stage of the House of Lords identified quality assurance of the information as an issue which was raised from public consultations on the OFR regulations but which was not addressed in the Reform Bill (Hansard, House of Lords GC on 1 March 2006 at 166). Her concern was that un-audited information would result in the provisions becoming a "marketing bandwagon" for companies to promote their alleged "ethical", "sustainable", or "fair trade" products and services (Baroness Miller, Hansard, House of Lords GC on 1 March 2006 at 167). This concern was echoed later in the House of Commons where it was argued that much of the information presented by companies on environmental and social responsibility is public relations (or "green-wash"). The auditing of corporate reports was therefore central to making the information relevant to actual

business performance rather than simply another avenue for marketing (see generally Blair et al 2007).

In the final version of the Companies Act, the provisions regarding the auditing of disclosed information remained weak. The only explicit obligation on the auditor is with respect to the directors' report more generally, which includes the business review. At section 496 of the Companies Act (2006), the auditor "must state in his report on the company's annual accounts whether in his opinion the information given in the directors' report for the financial year for which the accounts are prepared is consistent with those accounts." There is no requirement to verify the validity of the non-financial information itself. This reflects the Government's eagerness to avoid a "prescriptive" or rules-based approach to reporting. The provisions which do apply to the quality of reporting hold directors liable for loss to the company suffered as a result of any untrue or misleading statements in the directors' report (Companies Act (2006) s 463). Personal liability also attaches to directors if they fail to disclose relevant information to the company's auditor or if they fail to take all relevant steps to do so (Companies Act (2006) s 418).

A related issue which attracted attention in the House of Lords was a late amendment to the Bill suggested by the House of Commons on 18 October 2006 to require disclosure of "information about persons with whom the company has contractual or other arrangements which are essential to the business of the company" (Companies Act (2006) s 417 (5) (c)). This is particularly relevant to companies' supply chains. There were two substantive objections to this amendment debated by the House of Lords. First, it was thought that disclosure of this information would be detrimental to business because of its commercially sensitive nature (Hansard, House of Lords Consideration of Commons Amendments on 3 November 2006, Baroness Cohen). Second, there was a concern that the obligation would be too onerous, since it was unclear how much detail companies would need to provide so as to comply with the provision (Hansard, House of Lords Consideration of Commons Amendments on 3 November 2006, Baroness Noakes). The Government made two clarifications in response to these concerns. The first was to provide an exception to reporting on supply chain issues where "disclosure would, in the opinion of the directors, be seriously prejudicial to that person and contrary to the public interest" (Hansard,

House of Lords Consideration of Commons Amendments on 3 November 2006, Lord Sainsbury of Turville). Secondly, the Government did not intend disclosure to be particularly detailed, but to be sufficiently high-levelled so as to give an impression of the principal risks and opportunities facing the company.

While these clarifications were sufficient to win support for the amendment, they also highlighted a weakness with the reforms: the absence of rules and regulations which could serve as benchmarks for the quality and quantity of required disclosure. The omission of such standards reflected the Government's concern not to impose costly reporting obligations on companies, and to leave much of the nature of reporting to directors' discretion. But as Lord Razzall commented, in the final Consideration of Commons Amendments in the House of Lords on November 2006, "we support the NGOs in believing that the Government...ought to give some indication of what the standard reporting practice should be, which they have the power to do by regulation. The whole purpose of this is not only to obtain the disclosure of information itself, but also to provide a measure by which a number of ethical investors, or those who wish to invest within an ethical framework, can obtain comparisons between different companies. It would be difficult for those ethical comparisons to be made without some element of standard reporting practice which I feel can come only from the Government".⁷

Ultimately, the disclosure regime promulgated under the amended Companies Act 2006 incorporated elements of the EU Modernisation Directive. Nonetheless, there were significant differences in form and substance. In section 417(2) of the Act directors, not the company, are required to compile a business review "to inform members of the company and help assess how the directors have performed their duty under section 172 (duty to promote the success of the company)". The content for the business review is as follows: "the business review must, to the extent necessary for the understanding of the development, performance or position of the company's business, include (a) the main trends and factors likely to affect the future development, performance and position of the company's business; and (b)

⁷/ This echoed the principal purpose of the EU Modernisation Directive which was to generate a common reporting standard so as to allow comparison between European traded companies on financial and non-financial measures.

information about (i) environmental matters (including the impact of the company's business on the environment), (ii) the company's employees, and (iii) social and community issues, including information about any policies of the company in relation to those matters and the effectiveness of those policies; and (c) subject to subsection (11), information about persons with whom the company has contractual or other arrangements which are essential to the business of the company" (Companies Act (2006) section 417 (5)).

Disclosure standards and financial intermediation

As is the case in many areas of European policy making, member states are required to adhere to EU Directives unless there are previously agreed exceptions specific to a member state (as for the UK in selected areas of policy making). While the EU does lead the UK in a variety of policy areas, especially as regards employment rights and conditions and environmental policy, it is arguable that the roots of the EU Modernisation Directive in the Lisbon Strategy (2000) and the commitment to pan-European integration of financial markets reflected the interest of the UK government in a growing market for financial services as well as the unfettered flow of portfolio investment to Europe's largest traded companies. In fact, the EU Modernisation Directive came to a UK policy arena already committed to reinforcing UK global advantages in corporate governance and the 'principles' approach over the 'rules and regulation' approach to securities regulation (Ford 2008). In this context, both the EU Modernisation project and the UK Companies Act can be seen as elements of a concerted campaign by the UK Government to reinforce the dominance of London in European financial markets, and the advantages enjoyed by London over New York in international financial market transactions (Coffee 2002).⁸

⁸/. Competition between financial centres for global position is a vital ingredient in debate over nation-state financial regulation (Wójcik 2007). In their assessments of the declining significance of Wall Street in relation to London both the Committee on Capital Markets Regulation (2007) and the Bloomberg and Schumer (2007) report suggested that one cause of this decline was to be found in the costs of US securities regulation and especially the US preference for detailed rules and regulations over principles. This issue has re-emerged with the debate over the proper US regulatory response to the sub-prime credit crisis; for some, the crisis was the result of banks and financial institutions circumventing the rules as regards capital adequacy and the like. By some accounts a principles approach would have dampened such behaviour putting the onus on the institutions to show that their investment practices were consistent with the intentions of regulators.

Even so, as noted above, the UK Companies Act (2006) left company directors responsible for disclosing relevant information for business reviews of the long-term prospects of their firms. The Act referenced the crucial issues to be considered, as noted above, but did not provide explicit definition of the nature and scope of proper reporting on those issues. For some commentators, Parliament had neither the time nor the expertise to define the nature and scope of the implied reporting ‘standards’ introduced through the legislation. Observers of the legislative campaign in the House of Lords suggest that the Commons’ deliberations on the Bill were at best perfunctory, at worst uninformed.⁹ Equally, the Chancellor’s political sensitivity to claims about the costs of ‘over-burdening corporate reporting’ narrowed the nature and scope of mandated reporting. As a consequence, and notwithstanding attention to the environment and employee circumstances in debate over passage of the Reform Bill, company directors are deemed responsible for determining the weight and significance (if any) to be attributed to these issues.

As a consequence, firms specialising in legal services, accounting and audit functions, and directors’ training and compliance have entered the market to provide advice on reporting according to the Act and its provisions. Service companies have relied, in part, upon professional bodies to supply guidelines on compliance in the absence of detailed government rules and regulations and legal precedents that might provide authoritative interpretations. Similarly, a range of NGOs have come to the burgeoning market for corporate advice and third-party certification, moving from public opinion with respect to the proper scope of CESR to providing fee-based advisory services. Not surprisingly, the larger advisory companies have employed CESR specialists from the NGO sector and universities just as many of the larger FTSE-listed corporations have come to employ in-house CESR specialists with responsibility to build the information databases consistent with director’s new found disclosure obligations. Armed with CESR information, disclosure has become, amongst other things, an important element of corporations’ reputation management programmes in the media and elsewhere (Clark and Hebb 2005).

⁹/. There is a certain irony in the capacity and willingness of the House of Lords to engage in the substantive issues of legislation (compared to their colleagues in the Commons). Since being elected in 1997, the Labour Government has sought to establish the primacy of the lower House by reforming the Lords. However, by excluding hereditary peers and by the appointment process, the Lords has become a chamber more than able to challenge the government of the day. See King (2007) on the recent history of British constitutional life.

Notwithstanding the boost to fee-based advisory services brought by the disclosure requirements of the Companies Act (2006), it would seem that directors' compliance with the Act may remain specific to each company until 'best-practice' standards of reporting are established. By contrast, institutional investors demand standardised disclosure of market-sensitive information such that data are comparable between companies (especially those in the same industries and countries), consistent in definition and measurement over time, and comprehensive in nature and scope. Further, with the importance of real-time data providers such as Bloomberg, Reuters, and Thomson it is also apparent that institutional investors demand immediate access to this type of data directly from trading desks. Data-mining and the stress-testing of causal relationships as regards corporate characteristics and stock-price movements have become essential to investment practice whatever the past significance attributed to the efficient markets hypothesis (Clark et al. 2007). See, for example, the success of the Gompers et al. (2003) test and its variants of the significance of companies' quality of corporate governance for stock value.

Absent UK government rules and regulations governing the disclosure of market-sensitive data on the long-term prospects of companies, market intermediaries have sought to supply standards and data. Whereas one of the most important providers of disclosure standards with respect to corporate balance sheets, if not the related data that flows through global financial markets, is the London-based International Accounting Standards Board (IASB), the IASB has lagged EU and UK legislation on these types of issues. Independent of government and based upon expertise as opposed to partisan politics, the IASB is responsible for formulating and articulating corporate reporting standards consistent with the effective flow of market-sensitive information to global financial markets. In contrast to the principled approach of the UK Companies Act (2006), if the IASB were to introduce related standards it would neither allow directors discretion as to the significance attributed to such standards, nor would it allow directors the option to select 'relevant' data or information. The IASB, like other accounting standard boards around the world, mandates both the use of promulgated standards and the nature and scope of information to be disclosed (Godfrey and Chalmers 2007).

In the space provided by the UK Companies Act (2006), and the lack of engagement on these issues by the accounting standards boards, intermediaries have come to market with their own ‘standards’ and products to match.¹⁰ As such, the absence of standard-setting by the Government on this issue is arguably a deliberate experiment in market-volunteerism. It is an attempt to let market agents digest the large volume of financial and non-financial information entering the marketplace so that it might pre-empt what CESR issues is regards as important drivers for long-term sustainable economic growth. It would subsequently fall to governments to crystallize these market-based models in more traditional regulatory standards.¹¹

Historically, of course, agencies like Standard & Poor’s, Moody’s, and Fitch have provided company-specific single-score alphanumeric credit ratings to the market allowing investors to evaluate in a comparable, consistent and comprehensive manner the market value of proffered debt. These companies use similar methods of assessment to come to their scores, matched by some of the more recent market entrants that offer specialised ratings on, for example, the nature and quality of corporate governance. As is well-appreciated, however, the mainstream ratings companies have not fared well in the aftermath of the 1990s tech-bubble and the more recent subprime global credit crisis. Their methods of assessment and calibration of underlying credit risks have been subject to harsh criticism (TUAC 2007). Mainstream rating companies have remained aloof from the calibration of CESR related issues preferring, perhaps, to monitor the development of standards and data in this area before acquiring (some time in the future) the market innovators.

We can distinguish between two generic approaches taken by intermediaries in the development of CESR standards and performance data. There are, as noted above, firms that begin with a comprehensive array of variables designed to capture the

¹⁰/. Note, however, that the UK Accounting Standards Board (2006) has sought to influence the reporting of items subject to the “business review” sections of the Companies Act with a set of recommendations reflecting what they contend to be “best-practice”. Lacking statutory force, as was to be the case through the OFR, these recommendations have not set industry standards.

¹¹/. Presumably the Government will introduce such a standard once the metrics are clearer, and the private sector has ‘test-run’ what the standard needs to include (so that investment companies can build their metrics in common agreement). See, for example, recent debate (early 2008) in the Lords over the Climate Change Bill where a proposed amendment would provide “guidance” on company reporting as to greenhouse emissions.

crucial issues relevant to CCSR factors. Beginning with company annual reports and websites, these firms interview companies to augment their initial assessments. From there they develop qualitative scores to indicate corporate responsiveness to the issues as well as their actual performance benchmarked against industry and country averages. The resulting scores across a number of indicators relevant to institutional investors rely upon directors' disclosure and the evaluation of collected data. In effect, these types of intermediaries seek to capture current performance against relevant standards and supply to the market their assessments of companies' likely future performance. For example, when assessing companies' environmental performance, ratings firms must determine the relevant issues, the indicator variables, and the extent to which the assessed companies could be said to be above or below the relevant benchmark (Salo 2008).

Instead of relying upon corporate disclosure and the willingness of corporations to be interviewed and assessed, a new generation of intermediaries have sought to develop quantitative estimates of corporate CCSR 'liability' over a range of crucial variables relevant to corporations' long-term financial performance. Here, the intention is plain: to avoid the complications and costs involved in site-visits and qualitative ratings by building comprehensive and consistent databases on individual firms benchmarked against industry averages. Intermediaries rely heavily upon the public disclosure by corporations of their liabilities, augmented by stylised models of whole industries. In effect, these models seek to map the nature and scope of industry-specific systems of production and distribution being a means of referencing firms according to their relative performance. Based on this procedure, industry analysts can build stories of likely long-term environmental performance, innovation, and technological change. Analysts can identify firms that might be included, for example, in 'best-in-class' sectorally-diverse investment portfolios.

Reference to corporate CCSR 'liabilities' here should be qualified by the fact that, in most cases, these quantitative metrics are measuring a company's exposure to financial costs *in the event* that regulation is implemented to price CCSR externalities, rather than existing regulated liabilities or costs. In the context of emerging legal regimes to price carbon and other environmental outputs from industry, these quantitative metrics are helpful in anticipating what that firm's future cash flow risks

might be if that firm continues on its current emissions trajectory. However, since these projections are long-term, there are inevitably subject to uncertainty about both the future regulatory landscape as well as the future CCSR performance of the firm.

Nevertheless, these quantitative estimates of companies' actual and disclosed liabilities, and their expected rates of change over time, can be very important for analysts seeking to build predictive models of stock price movements. Equally, quantitative estimates allow for rapid and systematic data sorting and comparison. For example, a single carbon-estimate may be sufficient for investment analysts to rank-order traded firms by industry, by country, and by market indices. By stripping out the judgement associated with qualitative scores, as well as the problems sometimes encountered when attempting to understand assessors' judgements and benchmarks, these types of intermediaries supply to the market data in much the same form that analysts encounter in their day-to-day trading.¹² These intermediaries are also clearly distinct from social activists whose agenda is differently focussed on the roles and responsibilities of the firm.

Implications and Conclusions

The premise of this paper is that the modern corporation is both the object of investment for the global financial sector and the source of value for society. As the object of investment, the modern corporation is subject to the theories and practices of the investment industry being, more often than not, just one element amongst many in market-based portfolios. Its 'value', in this respect, is relative: that is, it is priced against market information concerning its expected value relying upon common metrics and comparative market performance. As such, the modern corporation has no intrinsic value—whether investors hold or do not hold a corporation in their stock portfolios depends upon their overall desired risk-adjusted rate of return. We recognise, of course, that this is characteristic of Anglo-American economies wherein the financial sector has become virtually autonomous from the so-called 'real' economy (Allen and Gale 2007). But it is increasingly the case for continental

¹²/ See, for example, the assessment methodology of Trucost one of the most important intermediaries in the London market for environmental accounting; www.trucost.com

European economies, and especially their largest traded corporations that seek the benefits of global financial markets (Bauer et al. 2008).

At another level, the modern corporation is the principal source of value for society. Obviously, it provides employment and earned income as well as tax revenue for governments. In many countries, its share of national income has grown dramatically over the past fifty years so much so that the 'partnership' between the state and the corporation, so important for post-war politics and policy has been heavily discounted. The corporation is now the most important driver of social welfare. For many, this is the 'normal' state of affairs. But this has meant that the modern corporation carries two rather different sets of expectations; as the means of generating income for distribution through society and as the medium through which social expectations are to be, in part, realised. We noted the tension between these expectations, arguing that the UK Companies Act (2006) was conceived to enhance the global competitiveness of UK-listed corporations given EU and domestic debate over the proper purpose of the corporation with respect to social and environmental standards. When pressed to explain its preference, the UK Labour government favoured the former over the latter.

Nonetheless, it is apparent that the government, market analysts, and social activists have joined together in an uneasy alliance to promote greater disclosure of information to a broad array of constituents. At one level, the disclosure movement has been driven by financial market agents concerned to better price, on a comparative basis, one company over others. This claim for the disclosure of market-sensitive information has proven extremely powerful, buttressed by theories of market efficiency and related notions of market equitability wherein 'insiders' and 'outsiders' are declined to deserve much the same access to information (see Wilhelm and Downing 2001). If it appears as an unassailable economic good, the disclosure movement is also a means to an end wherein the autonomy of corporate executives is brought to account on the assumption that disclosure can discipline hubris and a penchant for empire-building (Bauer et al. 2008). For continental Europe, of course, the disclosure movement is part of a larger process whereby hitherto sheltered national champions have been integrated into the global financial community (Clark and Wójcik 2007).

For the EU, concerned about the social responsibility of the modern corporation, the interest of financial agents in disclosure has been an opportunity to articulate a broad range of items for disclosure while advocating standards by which the quantity and quality of information are to be judged. The EU Modernisation Directive sought to combine both in a way that would meet the interests of the social partners or stakeholders in an expansive definition of corporate responsibility. Recognising the underlying logic of the Directive, the UK embraced the opportunity to re-write UK company law but with a particular flavour (captured in our recounting of the parliamentary debate over its passage through the House of Lords). Here, the Labour government accepted the principle that company directors ought to disclosure market-relevant information on the long-term prospects of the firm, including *where relevant* reference to social and environmental matters. But, as we noted, this was hardly a ringing endorsement of corporate social responsibility; as the withdrawal of the previously mooted OFR indicated, the government sought at every opportunity to narrow the scope of such a requirement to that which would be appropriate for market valuation of company prospects.

In effect, the Labour government passed on the opportunity to embrace continental European social democracy. In doing so, it reinforced its apparent commitment to the competitiveness of UK financial markets and especially London's place in the global competition for incorporation, cross-listing, and international financial transactions. Whether intended or not, the government's reluctance to require reporting on certain matters including social and environmental issues as well as its unwillingness to set standards of disclosure on these matters has prompted rapid growth in market-based solutions to these questions. We have argued that, to the extent that financial agents require consistent, comparative and comprehensive metrics for assessing corporate value, in the absence of government reporting standards financial intermediaries have sought to provide these types of measures. There has been a remarkable burst of private investment in metric-making, some of which rely upon qualitative judgement others of which are entirely quantitative in the manner made popular by the real-time data streams that flow across the trading desks of major financial institutions. Once again, metric-making has advantaged London as one of just a few truly global centres of financial innovation (Clark 2003).

Not surprisingly, metric-making has brought into being remarkable coalitions of interest and institutions linking the NGO community with banks, venture capital partnerships and pension funds. If stymied in the framing and passage of the Companies Act (2006), the NGO community have found a willing audience in some segments of the financial industry (if not always the corporate sector). But at this juncture we emphasized that metric-making is a supply-side activity—it is all about articulating standards and measures of measurement for the investment industry on the assumption that the demand for such metrics will follow the lead provided by the relevant sections of the Companies Act (2006). Whether this will actually occur remains to be seen. The Government has embarked on a remarkable experiment in market-volunteerism eschewing political leadership in the hope that the social expectations of activists will be taken up through the interests of financial agents in pricing the value of major companies.

There is, no doubt, genuine interest in these issues found especially in some types of pension funds and institutional investors. We noted, though, that the UK Government's 1999 disclosure 'policy' on 'ethical' pension fund investment was still-born; it failed at a rudimentary level to encourage pension funds and their service providers to engage in the issues. By contrast, the relevant provisions of the Companies Act (2006) concerning the long-term prospects of firms are likely to have far more important affects than the change in regulations to the Pensions Act (1995). In any event, recent research has indicated that many pension funds and their trustees have not made real efforts to match their investment policies to community expectations as regards social and environmental matters (Caerlewy-Smith et al. 2007). In part, reluctance to engage CCSR issues can be explained by a narrow interpretation of fiduciary duty that excludes reference to anything other than the risk-adjusted rate of return. Equally, we have also shown that many trustees, especially those that are experienced, recognise the complex nature of the issues involved and the lack of widely-accepted decision-metrics relevant to investment strategy. Too often, CCSR issues considered are event-specific, undercutting the strong interest of pension fund trustees in a well-governed investment strategy (Clark and Urwin 2008).

In any event, many private sector pension funds are opposed to these types of interventions in all but the most obvious cases. This is for two reasons. First, private

sector pension fund boards typically include senior executives whose principal concerns are their own status and promotion in the company (most important) and the solvency of the fund in relation to corporate revenue and growth (very important). In the UK, it is also the case that many funds are staffed by ‘secretaries’ that are company employees; deliberation over investment strategy is often truncated and reliant upon consultants. In effect, private pension funds have neither the interest nor the capacity to engage with the issues. At best, pension fund boards are likely to follow the lead on social and environmental matters provided by highly reputable investment houses whose investment products integrate these matters into the expected pricing of offered portfolios. At the margin, a demonstrated link between risk and return and environmental liabilities and management capacity may attract the interest of boards; at the margin, unless held by government to account for such decisions, pension boards may simply ignore the issues.

By our interpretation, the UK Companies Act (2006) provides a political recipe for reconciling two competing interests in the value of the modern corporation. Where the Government might have required certain reporting standards and where it might have introduced mandatory disclosure on significant social and environmental concerns, the Government sought to enhance the competitiveness of London’s financial markets in relation to Frankfurt and Wall Street. In this respect, the Government underwrote the prospects for market-intermediation rather than directly regulate corporate social and environmental responsibility.

Bibliography

Accounting Standards Board. 2006. *Reporting Statement: Operating and Financial Review*. London

Allen, F. and Gale, D. 2007. *Understanding Financial Crises*. Oxford: Oxford University Press.

Ambachtsheer, K. 2007. *Pension Revolution: A Solution to the Pensions Crisis*. New York: J. Wiley.

Bansal, P. and Clelland, I. 2004. ‘Talking trash: legitimacy, impression management, and unsystematic risk in the context of the natural environment.’ *Academy of Management Journal* 47:93-103.

Bauer, R., Braun, R., and Clark, G. L. 2008. 'The emerging market for European corporate governance: the relationship between governance and capital expenditures, 1997-2005' *Journal of Economic Geography* (forthcoming).

BBC News Website 28/11/2005 < <http://news.bbc.co.uk/1/hi/business/4477516.stm>> (checked 10 April 2008).

Bebchuk, L. 2005. 'The case for increasing shareholder power', *Harvard Law Review*, 118:833-914.

— and Roe, M. J. 1999. 'A theory of path dependence in corporate ownership and governance'. *Stanford Law Review*, 52: 127-70.

Blair, M., Williams, C. and Lin, L-W. 2008. 'The new role for assurance services in global commerce.' *The Journal of Corporation Law* (forthcoming).

Bloomberg, M. and Schumer, C. 2007. *Sustaining New York's and the US' Global Financial Leadership*. New York.

Bogle, J. 2005. *The Battle for the Soul of Capitalism*. New Haven: Yale University Press.

Caerlewy-Smith, E., Clark, G. L. and Marshall, J. C. 2007. 'How to value the future? Or Agitation, resistance, and reconciliation with respect to socially responsible investment: the attitudes of UK pension trustees and Oxford undergraduates.' *Environment and Planning A* 38:1585-89.

Campbell, J. Y. and Viceira, L. M. 2002. *Strategic Asset Allocation: Portfolio Choice for Long-Term Investors*. Oxford: Clarendon Press.

Campbell, K. and Vick, D. 2007. 'Disclosure law and the market for corporate control.' In *The New Corporate Accountability: Corporate Social Responsibility and the Law* edited D. McBarnet, A. Voiculescu and T. Campbell. Cambridge: Cambridge University Press, 241-77.

Chandler, A. D. 1990. *Scale and Scope: The Dynamics of Industrial Capitalism*. Cambridge MA: Harvard University Press

Clark, G. L. 1998. 'Stylised facts and close dialogue: methodology in economic geography.' *Annals, Association of American Geographers* 88:73-87.

— 2000. *Pension Fund Capitalism*. Oxford: Oxford University Press.

— 2003. *European Pensions & Global Finance*. Oxford: Oxford University Press.

— 2005. Re-writing pension fund capitalism 1: the modern corporation and pension benefit systems in a world of perpetual motion. WPG05-05. Oxford: Oxford University Centre for the Environment.

- and Hebb, T. 2004. 'Pension fund corporate engagement: the fifth stage of capitalism'. *Relations Industrielles/Industrial Relations* 59:142-71.
- and Hebb, T. 2005. 'Why they should care: institutional investors and corporate global standards'. *Environment and Planning A*.
- , Hebb, T. and Wojcik, D. 2007. 'Institutional investors and the language of finance.' In *Globalization of Accounting Standards* edited by J. M. Godfrey and K. Chalmers. Cheltenham: Edward Elgar, 15-33.
- , Palaskas, T., Tracey, P. and Tsampra, M. 2004. 'Globalization and competitive strategy in Europe's vulnerable regions: firm, industry and country effects in labour-intensive industries.' *Regional Studies* 38:1085-100.
- and Salo, J. 2008. 'Corporate governance and environmental risk management: a quantitative analysis of 'new paradigm' firms.' In *Pensions at Work* edited by J. Quarter. Toronto: University of Toronto Press (forthcoming).
- , Salo, J. and Hebb, T. 2008. 'Social and environmental shareholder activism in the public spotlight: US corporate annual meetings, campaign strategies, and environmental performance, 2001–04.' *Environment and Planning A* advance online publication, doi:10.1068/a39198 (forthcoming).
- and Urwin, R. 2008. 'Best-practice pension fund governance.' *Journal of Asset Management* (forthcoming).
- and Wójcik, D. 2007. *The Geography of Finance*. Oxford: Oxford University Press.
- Clark, R. C. 1981. 'The four stages of capitalism: reflections on investment management treatises.' *Harvard Law Review* 94: 561-82.
- Clowes, M. J. 2000. *The Money Flood: How Pension Funds Revolutionized Investing*. New York: Wiley.
- Coffee, J.C. 2002. 'Racing towards the top? The impact of cross-listing and stock market competition on international corporate governance. *Columbia Law Review* 102:1757-1831.
- 2005. 'A Theory of corporate scandals: why the US and Europe differ.' *Oxford Review of Economic Policy* 21(2):198-211.
- Committee on Capital Markets Regulation. 2007. *The Competitive Position of the US Public Equity Market*. New York.
- Conley, J. M. and Williams, C. 2005. Engage, embed, and embellish: theory versus practice in the corporate social responsibility movement. *The Journal of Corporation Law* 31.

- Davis, E. P. and Steil, B. 2001. *Institutional Investors*. Cambridge MA: MIT Press.
- Dore, R. 2000. *Stock Market Capitalism: Welfare Capitalism. Japan and Germany Versus the Anglo-Saxons*. Oxford: Oxford University Press.
- European Commission, Action Plan on *Modernising Company Law and Enhancing Corporate Governance in the EU* of 21 May 2003, available at: http://ec.europa.eu/internal_market/company/modern/index_en.htm (checked 10 April 2008)
- European Commission, *Financial Services: Implementing the Framework for Financial Markets: Action Plan* COM (1999) 232 (11 May 1999) (FSAP), available at: http://ec.europa.eu/internal_market/finances/docs/actionplan/index/action_en.pdf (checked 10 April 2008)
- Ford, C. L. 2008. 'New governance, compliance, and principles-based securities regulation.' *American Business Law Journal* (forthcoming).
- Galbraith, J. K. 1967. *The New Industrial State* (2nd edn). London: Andre Deutsch.
- Garrido Garcia, J-M., Hopt, K., Ricjford, J., Rossi, G., Schaus Christensen, J. and Simon, J. 2002. *Report of the High Level Group of Company Law Experts on a Modern Regulatory Framework for Company Law in Europe*. Brussels.
- Gompers, P. A., Ishii, J. L. and Metrick, A. 2003. 'Corporate governance and equity prices.' *Quarterly Journal of Economics* 118:107-55.
- Godfrey, J. and Chalmers, K. (Eds.) 2007. *Globalization of Accounting Standards*. Cheltenham: Ed Elgar.
- Gordon, J. N. and Roe, M. J. (Eds.) 2004. *Convergence and Persistence in Corporate Governance*. Cambridge: Cambridge University Press.
- Graham, J. R., Harvey, C. R. and Rajgopal, S. 2005. 'The economic implications of corporate financial reporting.' *Journal of Accounting and Economics* 40:3-73.
- 2006. 'Value destruction and financial reporting decisions.' Available at SSRN: <<http://ssrn.com/abstract=871215>> (Checked April 10 2008).
- Hansard, House of Commons Debate on 18 Oct 2006.
- Hansard, House of Lords Consideration of Commons Amendments on 3 November 2006.
- Hansard, House of Lords Grand Committee on 1 March 2006.
- Hansard, House of Lords Second Reading on 11 January 2006.

Hawley, J. P. and Williams, A. T. 2000. *The Rise of Fiduciary Capitalism: How Institutional Investors Can Make Corporate America More Democratic*. Philadelphia: University of Pennsylvania Press.

— 2005. 'Shifting ground: global corporate governance standards and the rise of fiduciary capitalism.' *Environment and Planning A* 37:1995-2013.

Hebb, T. 2006. 'The economic inefficiency of secrecy: pension fund investors' corporate transparency concerns.' *Journal of Business Ethics* 63:385-405.

— 2008. *No Small Change: Pension Funds and Corporate Engagement*. Ithaca NY: Cornell University Press.

— and Wójcik, D. 2005. 'Global standards and emerging markets: the institutional investment value chain and CalPERS' investment strategy.' *Environment and Planning A* 37:1955-74.

Hill, J. 2007. 'Evolving 'rules of the game' in corporate governance reform'. Available at ssrn.com/abstract=1000085.

Hopt, K. J., Kanda, H., Roe, M. J., Wymeersch, E. and Prigge, S. Eds. 1998. *Comparative Corporate Governance: The State of the Art and Emerging Research*. Oxford: Oxford University Press.

Huberman, G. 2003. 'Behavioural finance and markets.' In *Cognitive Processes and Economic Behaviour* edited by N. Dimitri, M. Basili, and I. Gilboa. London: Routledge, 1-14.

Hutton, W. 1997. *The State We're In*. London: Jonathan Cape.

Jensen, M. 1993. 'The modern industrial revolution, exit, and the failure of internal control systems'. *Journal of Finance* 48: 831-80.

— 2000. *A Theory of the Firm: Governance, Residual Claims, and Organizational Forms*. Cambridge MA: Harvard University Press.

Keswani, A. and Stolin, D. 2008. 'Which money is smart? Mutual fund buys and sells of individuals and institutions.' *Journal of Finance* 63:85-118.

King, A. 2007. *The British Constitution*. Oxford: Oxford University Press.

La Porta, R., Lopez-de-Silanes, F., Shleifer, A., and Vishny, R. 1997. 'Legal determinants of external finance.' *Journal of Finance* 52:1131-50.

Lerner, J., Schoar, A., and Wongsunwai, W. 2007. 'Smart institutions, foolish choices: the limited partner performance puzzle.' *Journal of Finance* 62: 731-64.

Lisbon European Council of 23-24 March 2000 (Lisbon Strategy).

Litterman, B. et al. 2003. *Modern Investment Management: An Equilibrium Approach*. Wiley: New York.

Lowenstein, L. 1996. 'Financial transparency and corporate governance: you manage what you measure.' *Columbia Law Review* 96: 1335-62.

MacKenzie, D. 2006. *An Engine, Not a Camera: How Financial Models Shape Markets*. Cambridge MA: MIT Press.

McBarnet, D. 2007. 'Corporate social responsibility beyond law, through law, for law: the new corporate accountability.' In *The New Corporate Accountability: Corporate Social Responsibility and the Law* edited D. McBarnet, A. Voiculescu and T. Campbell. Cambridge: Cambridge University Press, 9-56.

Monk, A.H. 2008. 'The knot of contracts: the corporate geography of legacy costs.' *Economic Geography* (forthcoming).

Parker, C. 2007. 'Meta-regulation: legal accountability for corporate social responsibility.' In *The New Corporate Accountability: Corporate Social Responsibility and the Law* edited D. McBarnet, A. Voiculescu and T. Campbell. Cambridge: Cambridge University Press, 207-37.

Patel, S., Balic, A., Bwakira, L., Bradley, N and Dallas, G. 2003. Transparency and disclosure study: Europe. London: Standard & Poor's.

Reisberg, A. 2008. 'Derivative claims under the Companies Act 2006: much ado about nothing?' In *Rationality in Company Law: Essays in Honour of D D Prentice* edited by J. Amour and J. Payne. Oxford: Hart Publishing (forthcoming).

Richardson, B. J. 2007. 'Do the fiduciary duties of pension funds hinder socially responsible investment?' *Banking & Finance Law Review* 22:145-201.

Rickford, J. 2004. 'Fundamentals, developments and trends in British company law-some wider reflections-first part: overview and the British approach.' *European Corporate Governance Law Review* 1(4).

Roberts, J. 2004. *The Modern Firm: Organizational Design for Performance and Growth*. Oxford: Oxford University Press.

Roe, M. J. 1994. *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance*. Princeton: Princeton University Press.

Salo, J. 2008. 'Corporate governance and environmental performance.' *Competition and Change* (forthcoming).

Shonfield, A. 1965. *Modern Capitalism: The Changing Balance of Public and Private Power*. Oxford: Oxford University Press.

Strange, S. 1997. 'The future of global capitalism; or, will divergence persist forever?' *Political Economy of Modern Capitalism: Mapping Convergence and Divergence* In edited by C. Crouch and W. Streeck. (London: Sage, pp. 182-91.

Strebel, P. 2004. 'The case for contingent governance.' *MIT Sloan Management Review* 45(2):59-66.

Trade Union Advisory Committee (TUAC). 2007. 'Financialisation and the sub-prime financial crisis-issues for future regulation. Paris: 15, rue La Pérouse

UK Department of Trade and Industry, "Final Regulatory Impact Assessment on the Operating and Financial Review and Directors' Report Regulations", available at: <http://www.berr.gov.uk/files/file21361.pdf> (checked 10 April 2008).

UK Department of Trade and Industry, "White Paper on Company Law Reform" of 17 March 2005, available at: <http://www.berr.gov.uk/bbf/co-act-2006/white-paper/page22800.html> (checked 10 April 2008).

Wilhelm, W. J. and Downing, J. D. 2001. *Information Markets*. Boston MA: Harvard Business School Press.

Wójcik, D. 2007. 'Geography and the future of stock exchanges: between real and virtual space'. *Growth and Change* 38:200-23.

Zingales, L. 2000. 'In search of new foundations.' *Journal of Finance* 55: 1623-53.

Regulation References

Directive 2003/51/EC of the European Parliament and of the Council of 18 June 2003 (EU Modernisation Directive).

Fourth Council Directive 78/660/ECC of 25 July 1978 on the annual accounts of certain types of companies.

Occupational Pension Schemes (Investment, and Assignment, Forfeiture, Bankruptcy etc.), Amendment Regulations 1999, enacted pursuant to Pensions Act 1995, s.35(3)(f).

Seventh Council Directive 83/349/ECC of 13 June 1983 on consolidated accounts.

UK Companies Act 1985 (Operating and Financial Review and Directors' Report etc.) Regulations 2005, Schedule 7ZA (OFR Regulations 2005).

UK Companies Act (2006).

UK Company Law Reform Bill (House of Lords), as on 1 November 2005, available at <http://www.publications.parliament.uk/pa/ld200506/ldbills/034/2006034.htm> (checked 10 April 2008).

UK Financial Services and Market Act (2000).

