The Cadbury Code and Recurrent Crisis

"A fascinating book, tracing the development of the UK Corporate Governance Code and highlighting its continuity through successive crises. It identifies areas of controversy and challenge, intriguingly suggesting that 'defeated logics' are merely suspended, perhaps poised to return. Essential interdisciplinary reading for all those interested in the UK's corporate governance system."

—Andrew Johnston, *Professor of Company Law and Corporate Governance, School of Law, University of Warwick*

"The importance of the Cadbury Committee and the codes of corporate governance that followed in shaping the current form and scope of possibility for corporate governance in the UK can hardly be underestimated. Nordberg's fascinating account of the process by which these have been shaped by individuals and institutions is a welcome examination of how the code developed over time, what it achieved, and what it left undone. Those who care about how boards of directors work and how that work is guided by policy can learn much from this study."

—Dr. Jeroen Veldman, *Associate Professor, Nyenrode Business University, The Netherlands*

"Professor Nordberg provides a timely and thoughtful discussion on a topic which, if anything, is even more important than it was some three decades ago. Recurrent corporate governance crises indeed indicate that the current paradigmatic approach to good corporate governance, with its focus on internal control, risk management, audit, overseen by a board, and increasingly dependent on the contribution of the independent director, may provide limited assurance as to its ability to prevent further cases of governance failures. Since the early 1990s we have seen increasingly damaging examples of governance failures which must give rise to the question whether the various corporate governance codes, guides, laws and formal reviews address the core problem of governance, how to prevent those entrusted with the assets of others from abusing their position, to a satisfactory degree. This is not purely an academic concern. Gross failures of governance can touch upon the livelihoods of entire nations and increasingly impact on the global community through the concept of ecological governance which aims at incorporating issues of biodiversity and species extinction into the heart of the governance model. The late Sir Adrian Cadbury created an admirable and world leading guide to best governance practice, setting in motion a process of continuously reviewing, refining, and updating a Code which endured the test of time and is adopted across many jurisdictions. Nordberg's book strongly contributes to the debate on how to address an age-old problem in a rapidly changing environment. By reflecting on current insights, urging to learn from past mistakes, emphasising a broad discussion, and most of all, keeping an open mind to potential future solutions, Nordberg continues the great tradition of asking critical questions without necessarily providing predetermined answers."

—Oliver Marnet *is Associate Professor in Accounting at the Southampton Business School, who has written extensively on corporate governance and external audit, and has provided written evidence to BEIS, CMA, ICSA, ICAEW, PIRC, the European Commission, and the FRC's Guidance on Board Effectiveness*

Donald Nordberg

The Cadbury Code and Recurrent Crisis

A Model for Corporate Governance?

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Acknowledgements

The ideas in this book grew from the observations of many scholars and practitioners I have known or whose work I have found stimulating. At the time of the Cadbury deliberations, I was an editorial executive for the news agency Reuters, then based in New York. There we were preoccupied by the collapse of the Soviet Union and an emerging economic order based on triumphant capitalism. As journalists, however, we could not escape the concern for colleagues when Robert Maxwell's two UK-listed corporations—Mirror Group Newspapers and Maxwell Communication—collapsed. Also, Maxwell had sat as non-executive director on the Reuters board as it listed on the London Stock Exchange and rapidly moved into the FTSE100 index, serving alongside his arch-rival Rupert Murdoch.

But there was more. The demise of Maxwell's companies was foreshadowed by fraudulent use of their pension funds to prop up his faltering share prices. Those who lost their retirement savings included reporters and editors at the New York *Daily News*, which Maxwell owned. For journalists, this governance failure was personal. When I returned to London a few years later, I discovered that a strange term—'corporate governance'—had entered the everyday discourse, not just of investors and corporate directors, but of journalists as well.

By the time 'Cadbury' morphed into the 'Combined Code', I was involved in shareholder relations and met Bernard Taylor at Henley Management College, who convened an annual conference on board effectiveness. There I got to know the famous US activist investor and author Robert A.G. Monks. Through Tomorrow's Company—a project of the Royal Society of the Arts—I joined debates about reforming company law. I also met the governance academics at the Business School at City University of London, among them Georges Selim and Rob Melville. They introduced me to Terry McNulty from the University of Liverpool, who had led a research project for the 2003 Higgs Review. He supervised my doctoral studies, which commenced just as the global financial crisis began. This book revisits themes from that study and includes sections adapted from an article in *Economics and Business Review* for a special issue on corporate governance co-edited by my colleague at Bournemouth University, Steve Letza, and used here with permission.

Other helpful suggestions came from Kevin Tennant, Suzanne Konzelmann, Jeroen Veldman, David Gindis, Dionysia Katelouzou, Gerhard Schnyder, and Lez Rayman-Bacchus. They all listened to aspects of the research that led to this volume and provided insights and encouragement. Any mistakes, however, are my own.

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Prologue

Since 1992, corporate governance in the UK and much of the world has been articulated in codes of conduct, rather than formal law and regulations or even less formal social arrangements. Moreover, despite their gradual revision over the years, their core tenets survived despite repeated and arguably growing shocks to the system they were meant to protect. That suggests the problems they sought to address have not been solved. Britain—in particular its banks—was perhaps the worst hit by the global financial crisis, at a cost to the state that continues more than a decade later. How did various revisions fail to undertake fresh approaches to the recurring crises?

This book explores how corporate governance in Britain came to be codified, what key disputes took place during its major revisions, and how it institutionalised a way of viewing what corporate governance should be. This study also suggests that the while the flexibility that was built into the code's compliance regime allowed for variations, few companies took the opportunities provided to experiment with other ways of organisation the work of boards of directors. The code is much admired, with good reason. And it has achieved wide legitimacy. But is it the model for corporate governance?

The Cadbury Code and Report was the starting point for this new direction. It combined a set of principles of good governance that served as a how to guide for listed companies. It established a regulatory framework that guided equity capital markets and proposed ways that shareholders—principally institutional investors—should relate to the companies in which they invest. This framework was loose because of a central plank of the code: it was to be voluntary, subject the requirement that companies explain why they decided not to comply. Although the Cadbury Code did not use the phrase, this idea quickly attracted the label 'comply-or-explain'.

Moreover, the influence of this domestic exercise was vast. The code's ideas were copied in countries around the world, from France to South Africa to Germany, then to much of Africa and South America, and to Russia and Japan. One of its core tenets even found its way into the listing requirements of the New York Stock Exchange and Nasdaq, despite wide criticism from American CEOs: the provision concerning the separation of roles of the company chair and the chief executive officer (CEO), to prevent one person having 'unfettered' boardroom control. There, too, 'comply-or-explain' applied.

The code's influence grew even larger. Its principles informed other codes, often written by professional bodies for a wide range of organisation types far removed from the world of capital markets, investment portfolios, and even shareholders.

The UK code of corporate governance is widely admired and imitated, but it has not prevented the types of emergency that led to its creation—recurring failures of large corporations because of the lack of oversight and internal control. The biggest case was the financial crisis of 2007–2009, in which the UK suffered disproportionate damage, as we shall see.

Were we expecting too much of a code of conduct? Why did the framers of the code not recommend something stronger than a voluntary code of conduct?

This study examines those questions through analysis of the debates that led up to the drafting of the original Cadbury Code and then the major revisions undertaken in 2003 and 2010 in response to renewed crises. It does so through a critical discourse analysis of contributions to the consultations that informed the drafting, undertaken against the economic and political context that shaped the code and was then shaped by it.

It shows, historically, how the process engaged actors from all parts of the chain of investment, and how that process embedded power in the hands of central actors. Theoretically, it shows how the logics employed in the debate became institutionalised, but also how the form of their institutionalisation provided opportunities for change, leaving rejected logics suspended not defeated, so they could resurface later, which enhanced the legitimacy of the process. Practically, it demonstrates how the code's flexibility forestalled more radical action and won acceptance even among those whose views it rejected.

The crisis in corporate governance is one MacAvoy and Millstein call 'recurrent'. 'The turnaround began taking place in the mid-1990s … The die was cast for effective governance through board structure and process and we could move on … but the new form was not universally and instantaneously followed by changes in conduct' (2003, pp. 2–3). They were writing just as US financial markets had just been rocked by failures of very large corporations, the collapse of the market in new technology companies, and the implosion of one of the five global accountancy and audit firms. They expressed their concern that the responses, in regulation and corporate behaviour would prove disappointing. There was some change in US practice, which included translating some aspects of UK corporate governance into US listing requirements. Yet before the decade was out, both countries would experience an even more serious corporate governance crisis.

This study examines how the UK reforms, enacted in the 1990s and repeatedly revised, kept options for different responses open to debate but nonetheless left them unexplored in practice. It questions what might have happened if the roads not taken had been followed, perhaps as experiments rather than policy, and if in practice the code had been followed with the degrees of freedom that its language of explanation proposed. Instead of striving for formal compliance, and thus escape enforcement via investors and the proxy voting agencies they employed, corporate boards might have adopted a more thoughtful approach. They might have adapted code recommendations and innovated in board design and process to suit the peculiar circumstances of the company, rather than shaping the board and its processes to fit the code. What sort of ethos might then have developed?

Reference

MacAvoy, P., & Millstein, I. (2003). *The recurrent crisis: in corporate governance*. Basingstoke: Palgrave Macmillan.

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About the Author

Donald Nordberg is Associate Professor at Bournemouth University in the UK and author of *Corporate Governance: Principles and Issues* (Sage, 2011). His research has been published in many journals, including *Corporate Governance: An International Review, Business History, Leadership, Journal of Financial Regulation and Compliance, European Management Journal*, and *Philosophy of Management*. He is also a governance practitioner: chair of a major UK social care provider and non-executive director of a company in the performing arts. Earlier he was a correspondent and editorial executive at Reuters, based in London, Frankfurt, Zurich, and New York. A native of Chicago, he was educated in the US at Reed College in Portland, Oregon, and the University of Illinois at Urbana-Champaign, and in Britain at the Universities of Warwick and Liverpool.

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