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PROGRESSIVE CORPORATE GOVERNANCE FOR THE 21ST CENTURY

ORRAINE TALBOT

ITH A FOREWORD BY LAWRENCE E. MITCHELL

Progressive
Governance
21st Centur

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Routledge
Taylor & Francis Group
LONDON AND NEW YORK

First published 2013
by Routledge
2 Park Square, Milton Park, Abingdon, Oxon OX14 4RN

Simultaneously published in the USA and Canada
by Routledge
711 Third Avenue, New York, NY 10017

Routledge is an imprint of the Taylor & Francis Group, an informa business

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library

Library of Congress Cataloging in Publication Data
A catalog record for this book has been requested

ISBN 978-0-415-56382-6 (hbk)
ISBN 978-0-203-10096-7 (ebk)

Typeset in Garamond
by RefineCatch Limited, Bungay, Suffolk

MIX
Paper from responsible sources
FSC www.fsc.org FSC® C004839

Printed and bound in Great Britain by
CPI Group (UK) Ltd, Croydon, CR0 4YY

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Acknowledgements

In the preparation of this book I am indebted to the following people. To Lawrence Mitchell for his generosity in writing the foreword to this book. The staff at Routledge for their professionalism and patience, my two sterling research assistants, Rahul Worah and Jamal Tuhin, for their work on the footnotes, and to Jamal for his work on the corporate governance codes and index. I am also indebted to my colleagues at Warwick for their contributions to a vibrant research culture, and particularly to Julio Faundez for his wisdom and guidance at Warwick. On a more personal level I am indebted to my talented mother for the beautiful picture on the front cover, to both my parents for being so nice and to my children Jasmine, Jago and Felix for being simply glorious. Most of all, though, I am indebted to my husband Richard, who has commented extensively on early drafts of the book, cheerfully engaged in discussions about the book and looked after our children so I could write the book. This book is dedicated to his unwavering love and support.

Foreword

Lawrence E. Mitchell

Dean of Cape Western Reserve University and
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"Neoliberalism kills." Thus concludes Lorraine Talbot in this bold and provocative book. Yet this is not, on its face, a book about politics or revolution. It is, rather, a book on the seemingly prosaic topic of corporate and financial governance. More particularly, it is a book detailing and analyzing the fall and rise of the dominant mode of that governance, shareholder-centrism. That mode, according to Talbot, is grounded in the neoliberalism of the late 20th century, and thus reveals a political as much as an economic theory. The power of Talbot's statement reflects the importance of the subject.

The governance of corporations and financial markets has, at least in the so-called developed world, been a topic of debate for over a century. Participants in that debate, from Thorstein Veblen to Adolph Berle to contemporary commentators, all have realized that much is at stake. First, and most obviously, corporate and financial governance are essential to the sustainability of national and world economies, for corporations have become and are likely long to remain the principal instruments for the concentration of wealth in service of the production of goods and services and the distribution and transmittal of that wealth from generation to generation. Governance determines who is in control, whose interests are served, and, ultimately, the output of production and the distribution of wealth. In light of the relatively small proportion of the world's population that invests in financial products, one might see the debate as important, but still one among relatively well-to-do people and institutions.

Talbot, as the quotation above suggests, casts the debate in an entirely different light. Important as the debate might be in the developed world, the transmission of neo-liberal principals to former command and control economies has brought in its wake wealth for the very few and increased poverty and disadvantage for the many in a manner that communism and socialism never achieved. In Talbot's understanding, neoliberalism is a world-wide epidemic.

These symptoms reveal the underlying cause, the relentless disregard of labor by corporate governance rules and norms. Perhaps the greatest peculiarity of the set of rules designed for the governance of our largest institutions is that they pay no regard whatsoever to the greater segment of society that make those institutions run. The interests of workers are, unaccountably, unaccounted for in governance codes, but for occasional lip-service that, in practice, is drowned out by the power of shareholders and financial markets.

Unlike disease, however, neoliberalism is not part of the natural order of things, no matter how much modern economic theory attempts to replicate scientific method with high-level calculus and convincing proofs. It is the product of political choice, choice that reinforces and even accelerates the strength of the status quo of unequal and arguably unjust economic distribution. The neoclassical economics that is at the heart of neoliberal corporate governance is constructed on assumptions, not empirical proofs, about the behavior of humans, individually and in society.

Grounding these assumptions is a single *telos*, wealth creation, drawn from an assumption about human motivation. While that *telos* is not normatively evil, and in fact is essential to social welfare, while the assumption does of course capture a portion of human behavior, the combination of assumptions and ends leaves the means as amoral and technical tools to achieve the ends most efficiently. Here, though, even efficiency has a limited meaning. Efficiency, like equality, is by itself an empty term, for one must always ask of efficiency, as of equality: Efficiency of what? One answer to this question, an answer given by Veblen and progressives down to Talbot, is the efficiency of producing goods and providing services. The neoliberal answer is the efficiency of creating wealth for stockholders.

These two notions of efficiency need not necessarily be at cross-purposes. It might be possible that the efficient creation of shareholder wealth results in the most efficient methods of production. But, as Talbot explores, the overlay of modern financial markets, and the narrow demands of financial actors, make this an unlikely concordance. Financial markets are notoriously short-term in their behavior and, were any evidence needed, the panic of 2008 and its aftermath seems proof enough.

Short-term market behavior, as I, and others previously have written, develops a particular set of incentives in corporate managers, the ultimate objects of corporate governance. Simply put, the combined incentives of market actors, along with modern executive compensation in the form of stock options, create almost irresistible pressure to manage for stock price in the short-term. Short-term gains, at least consistently achieved, almost certainly result in short-term management. Short-term management results in the externalization of all of the cost of short-term gain onto stakeholders, like labour, other than stockholders. The gains are reaped and retained by the latter.

Short-term gains come at the expense of long-term profit. In the U.S. and, I suspect, in the U.K. those gains are the result not only of anticipated profits that might never be earned, but also of underpaid (or laid-off) workers, environmental harm, short-cutting product quality, and underinvestment in research and development, among other things. This harms those directly affected, but it also tends to strip the corporation of the capacity to weather hard times and to develop sustainable and healthy businesses. One consequence of the 2008 panic in the U.S. has been a deep and lingering recession, caused at least in significant part by the unavailability of credit to finance corporate productivity following the panic. Had long-term management been the corporate focus, businesses would have had substantial retained earnings to continue productivity. Instead, the search for short-term gains left treasuries depleted, and no funds in sight to sustain businesses

A large part of the success of the neoliberal program is its claim to describing nature. Talbot demonstrates that this argument historically is false by describing in detail the political choices made over the course of almost two centuries, choices that have, at times, privileged neoliberalism and, at others, what she describes as a progressive agenda (one, that is, that favors the broad interests of society for which labour is a proxy). From an American perspective (which Talbot understands quite nicely), the New Deal reversed a shareholder-based (neoliberal) agenda and created the American Century, the period from approximately 1940 through the early 1990s, the period in modern American history producing not only great productivity and profit but also the most economic equality America has experienced. As she also shows, the U.K. followed a similar pattern. Not nature, but design, created the overall prosperity of this era. Not nature, but design, restored the neoliberalism that has, in the late 20th and early 21st century, produced at least in the American economy by far the greatest economic inequality that American society ever has experienced.

Talbot is, unapologetically, a regulator, for it is only through regulation that political choice can be expressed. The growth of the neoliberal corporate economy is founded on the notion of self-regulation, a modality that is pronounced in the United States, and the U.K. as well. But self-regulation itself is a mirage. As Talbot is quick to point out, neither the U.S. nor the U.K. ever has had self-regulating financial markets. Indeed those markets are rather heavily regulated and are so in a manner that is most protective of the financial actors and institutions that are the primary beneficiaries of neoliberalism. This notion of self-regulation was sold to nations emerging from socialist economies and, as Talbot illustrates, to disastrous results. Those results are perhaps less apparent to the casual Western eye because they exist in economies that had previously known little prosperity. But those economies had known greater equality, an equality that permitted a higher standard of living for most of the populations of those countries than has neoliberalism. For at some point, standard of living is more dependent upon relative individual wealth than it is absolute individual wealth. To whatever degree that point had been reached in the East, it clearly has been destroyed by neoliberalism.

State intervention – regulation – is essential to restore the economic balance of industrialized societies, and to ensure a more equitable distribution of corporate wealth. The alternative is growing inequality, increasing dire poverty, perhaps the eventual collapse of the corporate capitalist system and, at the extreme, revolution. Those who do not have must be deeply concerned with the issues explored by Talbot. But those who have achieved their prosperity under neoliberalism must as well. For history teaches the end of societies in which radical inequality and injustice pass beyond the point of public tolerance. Corporate governance cannot fix all evils. But in light of its role in causing fundamental social problems, it can certainly go some significant way towards rectifying them.

Introduction

Progressive corporate governance: what it is and what it isn't

Overview

Society has political choices that it can make about the underlying dynamics of a market economy. How companies are governed is one of those choices. This book is concerned with the choices that have been made in the context of the historical emergence of the market economy in England and America; in the current market economy; and in transition economies. It is also concerned to illustrate that, although political choices are made in a particular national and international context – including levels of economic development, cultural and social norms – this context *informs* but should not *determine* these choices. Historically, context did not determine political choices. When the market economy was emerging in late 18th century England, the dominant interpretation of the economy – what economists thought – was based on Smith's labour theory of value. It remained so until the late 19th century. This interpretation, which posited labour as the source of value, did not correlate into a normative position – that is, one which facilitated labour's entitlement to the wealth it created. On the contrary, the normative position of this period, supported by Smith and other proponents of labour value theory, was one which overtly oppressed labour. Political choices were made to reward capitalists, in the form of law which enabled the interests of control groups such as majority shareholders to prevail.

Similarly in the early capitalist period in the United States, political egalitarianism together with the labour theory of value did not translate into the elevation of labour against capital. And, although the picture here is complicated by state jurisdictions and state economies, political choices were made in favour of capital and expressed in corporate law. In both countries the emergence of large companies with high levels of dispersed ownership was a direct result of political choices made to benefit substantial investors. This finding is in stark contrast to the prevailing neoliberal claim that the success of this model of ownership is a *natural* result of its inherent efficiencies, and should therefore be the model pursued globally.

The later history discussed in this book also illustrates that political choices were made in post-Wall Street crash United States and post-war

United Kingdom to meet social necessity and to promote the interests of labour. Academic thought and policy-makers acknowledged the emergence of large corporations with dispersed shareholding but did not see this development as determining their options. Instead, this development was welcomed as an opportunity for political leaders to promote a radical reform programme, unimpeded by the demands of shareholders. The post-crash, post-war period illustrated, inter alia, that the size of companies does not mean that political goals must be enthralled to the market but conversely that their size means that corporate governance can be shaped to harness these organisations for socially progressive ends. In contrast, in the current period, large commercial organisations deemed 'too big to fail' are seen as fettering political leaders' ability to effect social change.

Unlike the earlier periods, since the late 1970s, academic thought and national and global institutions have embraced neoliberal economic theory (a contemporary form of neoclassical economics) and translated it wholesale into normative and political positions.[1] The notion of political choice seems to have been abandoned. Indeed, the state of the global economy is presented as something which negates choice. Neoliberalism must be applied because the size of global institutions makes them somehow reform resistant. Similarly, the transition of command economies post 1989 followed neoliberal proscriptions because all other possible ways of organising society had, apparently, failed. There is no historical precedent for the power of economists to define reality since the late 1970s and it is an unwelcome development.

However, political choices can have unintended consequences. In the post-crash, post-war period political choices were made to bolster the economic and social power of institutions. Institutional economics, institutional sociology and managerialism recognised the power of institutions to order economic and social life. Most (but not all) thought that this power could be harnessed to promote the interests of the community and social progress. To that end companies, as institutions, were encouraged to prioritise stability by retaining earnings and promoting the interests of employees. At the same time, policies were adopted to bolster the economic strength of financial institutions and diminish the strength of private investors. In the United Kingdom these included favourable tax policies, which encouraged pension funds to grow and invest in company equities and policies to enable mergers and takeovers. The

1 Neoliberalism rejects government intervention in the market, believing that it disturbs the inherent efficiency of unregulated markets. Financial markets are efficient because the information upon which they operate and which informs investment is the optimum available (the efficient market hypothesis). More generally, neoliberalism embraces the neoclassical assumptions that people and business organsiations are rational market actors, that they act to maximise their interests in a quantifiable way and that they are fully informed when they act. Neoliberalism evangelised these assumptions promoting liberalised trade, open markets and privatisation. This short definition of neoliberalism is further developed in the proceeding chapters of this book.

unintended consequences of these policies was that they become the 'gravediggers' of post-war progressivism. As neoliberal politics became ascendant in the 1980s, the accumulated assets in companies from retained earnings became available for plunder by financiers qua shareholders. Institutional shareholders became the dominant shareholders, replaced dispersed private shareholders and claimed corporate governance in their own interest. The vast wealth enjoyed through hostile takeover activity and the re-emergence of significant shareholders meant that the focus of corporate governance could return to shareholder value. Problematically for the progressive project, corporate governance law was never the modality for progressivism and was overlooked.

Neoliberalism provided the intellectual framework that justified these activities and promoted the value of shareholder primacy, to the point of making any alternative almost unthinkable. Shareholder primacy was more efficient, hostile takeovers created an efficiency-enhancing market in corporate control and the company delivered to its rightful owners. Riding high on the rapid wealth increases to shareholders and facing no alternative world views, neoliberalism set about defining the world so that, unlike in previous periods, neoliberals saw economic theory as necessitating specific normative values. In this book, this is illustrated in a number of chapters with reference to United Kingdom company law, United Kingdom takeover regulation, national and international corporate governance codes and in the prescription for the transition of ex-command economies.

Neoliberalism's influence on corporate governance may be seen in both substance and process. In substance it promotes shareholder value over any other social or community concerns. In process, through the form of the corporate governance codes, neoliberal norms have been globalised. In the ex-command economies transition to capitalism was pursued on a neoliberal agenda, with the result that economic wealth has been transferred according to political positioning.

A model for progressive corporate governance

The centrality of labour

Throughout the historical and contextual study of corporate governance in this book I attempt to distil what is progressive in any given period and to arrive at some assessment as to what would be progressive in this period. In so doing I define progressiveness as that which promotes the interests of people as a whole, as that which puts labour at the centre of corporate governance and as that which enhances substantive social equality, enabling all to share in economic progress. I see the progressive approach as the replacement of shareholder primacy with labour primacy and progressive corporate governance as a humanist project.

A strong form of the assertion of labour centrality is the classical labour theory of value. Classical economists recognised labour as being the only true