



ADAM SMITH  
INSTITUTE

# Mind Your Own Business!

## Establishing a market for corporate control

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### Introduction

Once again, government regulation of corporate affairs is being demanded, this time in response to furore over high pay. Such demands for greater government intervention are always deeply misguided. They presuppose that levels of executive remuneration – or any matters of corporate governance – are the business of anyone but the corporation's owners, its shareholders. And they mistakenly assume that there is some specific structure – of remuneration, or management or direction – that can be appropriately imposed on all organisations. The right structure for any particular company, however, like any matter of corporate governance, is the one wanted by its shareholders. It is the shareholders' prerogative to determine the objectives and the structures of the corporations that they own, and the degree and methods of accountability that they wish to enforce.

As I argued in *Competition in Corporate Control*,

*Demands for government action to improve corporate governance are... based on a dual mistake. They wrongly presuppose that the problems have been caused by a lack of sufficient regulation, and they erroneously assume that government regulation can make things better.<sup>1</sup>*

To the extent that there are genuine problems impeding good corporate governance, they are typically ones that have been promoted by government action. The only way that governments can improve corporate governance is by removing the obstacles to shareholder action that they themselves have created. All other government interventions in corporate affairs, even measures that ostensibly promote shareholder power, are at best counterproductive.

### Government Intervention is Unjustified

#### No Market Failure

Advocates of increased government regulation of corporations often claim that it is needed in order to correct market failure. That is the justification offered for regulating shareholders' rights:

*Why is government intervention necessary? The [European] Commission has identified a market failure in the exercise of cross border voting rights in EU listed companies.<sup>2</sup>*

The diagnosis is also central to the 2011 report by the High Pay Commission. It asserts that '...top pay is a symptom of market failure...'.<sup>3</sup> The same allegation underlies major policy recommendations made by Vince Cable, the Secretary of State for Business, Innovation and Skills.<sup>4</sup>

But the failure that such market critics identify, is simply the failure of market outcomes to correspond with their own preferences; they have not demonstrated any inability of markets to allocate resources efficiently. Unequal outcomes, even when immense, are not an indication of market failure. The market is a dynamic information system that translates the preferences of myriad unrelated individuals into price signals. Remuneration levels reflect the operation of supply and demand for people's services. To the extent that the market is one in which the purchasers and vendors are not dealing at arm's length, and/or the payers are not the purchasers, outcomes will be distorted. But reciprocal back-scratching and upward ratcheting, capture of remuneration consultancies and the current structure of collective investment schemes are not necessary features of market operations. Nor are they incapable of being corrected by market mechanisms.

Neither is the free-rider problem evidence of market

failure; it poses no insuperable barrier to market ordering of corporate governance. An investor acting independently would unilaterally incur the costs of action from which all shareholders would benefit. But if the costs of the corporate governance action were for the account of the corporation, they would automatically be shared by all shareholders, in proportion to their shareholdings.<sup>5</sup> Market solutions are possible.

### **Inappropriate Allegations of Unfairness**

The diagnosis of market failure and presumed need for regulation are given no support by allegations of unfairness. The envious may resent high remuneration received by others, but the notions of fairness that are invoked are typically irrelevant.

Moral evaluation properly applies only to allocations made by moral agents – persons. Distributions that result from natural forces are not sensibly the subject of moral assessment: it is not unfair that Switzerland has more mountains than Swindon. Similarly unsuitable for moral evaluation are those distributions, like the ones resulting from the operations of free markets, that reflect the spontaneous orderings of human interactions. Such orderings and their outcomes result from human activity, but they are not the product of human design. Unequal market levels of remuneration could only be deemed unfair if (counterfactually) it were also unfair for London's population to be larger than Leicester's. There is no 'fair pay' by reference to which general remuneration levels can be assessed.<sup>6</sup>

Remuneration levels within organisations, in contrast, are the result of human allocations, and so are appropriately the subject of moral evaluation. Within a particular corporation, remuneration is fair if it reflects contributions made to the corporate objective.<sup>7</sup> Accordingly, it is not unfair for payouts to be unequal – even massively so – when they reward correspondingly unequal contributions. It need not even be unfair for executives to get immense bonuses while other employees suffer pay cuts or are made redundant. The same technological advances that render the services of unskilled workers less valuable to the corporation, may increase the worth to it of expert executives: managing change and increasing productivity are key managerial responsibilities. Specific pay awards that are 'loser friendly' will be unfair. But it is the shareholders' responsibility to insist that corporate rewards fairly reflect the corporate objective.

### **Erroneous Explanations of 'Excessive' Payouts**

Why, then, don't shareholders constrain high payouts? The High Pay Commission attributes shareholders' failure to curb 'unfair' high pay to 'flaws in remuneration

committees, the extent of management power and the challenges inherent in placing all control in the hands of an increasingly disparate range of owners.'<sup>8</sup> According to the High Pay Commission, corporations have the wrong sort of shareholders... ones who are too speculative, foreign or uninvolved.<sup>9</sup> This is a particularly ironic diagnosis, considering the Commission's otherwise enthusiastic endorsement of diversity.<sup>10</sup>

It is also misguided. There is no obligation for shareholders to be long-term, domestic or engaged. Even if (counterfactually) such an obligation made sense, the evidence offered by the High Pay Commission fails to support its conclusions. High average share turnover levels need not translate into lack of interest in corporate governance, or even into short holding periods:

*The use of share turnover data as a proxy for average holding periods of shares is inappropriate as this metric accounts for all shares that trade, but does not represent change of beneficial ownership in a company's share register. Many registers remain reasonably fixed and stable, and only a small proportion turns over quite quickly. For example, [as of 31 March 2011] 60 per cent of the London Stock Exchange Group's share register is owned by shareholders who have consistently held their shares for longer than three years - despite the LSE having a share turnover that in the last financial year peaked at 135 per cent (suggesting an average holding period of nine months).<sup>11</sup>*

Indeed, the High Pay Commission itself acknowledges that shares are commonly held by long term holders for 10 years.<sup>12</sup> Moreover, even short holding periods are not necessarily associated with diminished interest in achieving corporate objectives.<sup>13</sup> Nor is foreign ownership.<sup>14</sup>

### **Government Promotes the Problems**

There must be some better explanation than shareholder laxity to account for high payouts. A likely factor is previous government regulation. Intervention that is intended to improve corporate governance typically has consequences that are unintended and damaging. It may, for example, be valuable for audit committee members to have 'recent and relevant financial experience'.<sup>15</sup> But requiring that they do so limits the available supply of eligible candidates while simultaneously increasing the demand; it raises the price. The problem is likely to get worse when more stringent regulatory requirements for 'diversity' go into effect from 1 October 2012.<sup>16</sup> Higher payouts may also be needed to compensate executives for the greater official scrutiny and resultant job insecurity they experience following

successive waves of official regulation. Remuneration increases may even result from the legal requirement that directors take into account the interests of employees as well as shareholders: executives, even most directors, are themselves employees.<sup>17</sup>

Another possible explanation of high payouts is that shareholders don't share the visceral aversion to them exhibited by the High Pay Commission and the media.<sup>18</sup> That, indeed, is what is suggested by the government's official consultation on executive pay.<sup>19</sup> Remuneration is typically only a tiny fraction of total company costs, and may well be less important for investor outcomes than attracting and keeping expert executives. It might also be that the ultimate payers, the beneficial owners of the corporations whose executives are 'overpaid', do not get their preferences properly registered, because of administrative and regulatory barriers that impede their transmission through pension plans and collective investment schemes. What needs reduction by government is not executive pay, but government-imposed barriers to free markets and genuine owner control.

## The Meaning of Corporate Governance

Calls for government intervention in corporate governance typically rely on confused notions of what corporations are, and of what corporate governance is.<sup>20</sup> Corporations are not creatures of government, available to be used for serving officially appointed social ends.<sup>21</sup> *Contra* the High Pay Commission, for example, and the avowedly collectivist agenda of Compass, its pressure group creator, the purpose of corporations is not to promote an egalitarian society.<sup>22</sup> Corporations are private property: they belong to their shareholders in aggregate, and properly serve the ends designated by their owners.

The concept of 'corporate governance' is similarly subject to common misuse. Too often, it is loosely applied to anything from the state of the economy, to the regulation of organisations that are not even corporations. Strictly understood, however, corporate governance refers to:

*ways of ensuring that corporate actions, agents and assets are directed at the constitutional objectives of the corporation, those set by the corporation's owners, the shareholders.*<sup>23</sup>

It should therefore be up to the shareholders of each corporation to determine the rights, responsibilities and remuneration of all their corporate agents, and also to specify the kinds, degrees and methods of accountability they require. Corporate governance systems or mechanisms are good insofar as they enable shareholders to establish

their corporations' objectives, and help shareholders to ensure that corporate actions, agents and assets are directed at them.

## The Importance of the Corporate Objective

The corporate objective is, accordingly, a crucial element of corporate governance. Historically, one of the advantages of the corporate form is that it has been usable for a wide variety of purposes – personal, educational and charitable as well as commercial. Contrary to popular belief, not all corporations are businesses, and most businesses are not corporations.<sup>24</sup> In the United Kingdom, for example, only about a quarter of businesses are corporate in form.<sup>25</sup> Far fewer still are the sorts of corporations presupposed by most commentators: a mere 2/10 of 1% of corporations – and thus a substantially tinier percentage of businesses – have shares listed on the Stock Exchange.<sup>26</sup> Conversely, more than half of the companies listed at Companies House are not businesses.<sup>27</sup>

If the corporate purpose is not necessarily business, what is it? Though the personal and institutional objectives of shareholders can be as diverse as they are, the corporate purpose is easy to identify: it is that which is set out in the corporation's Memorandum of Association or comparable constitutional document.<sup>28</sup>

It may be objected that such official corporate purposes are now largely irrelevant. The UK government's White Paper on Company Law Reform claimed that company objects had no 'useful purpose'<sup>29</sup>; the 'Objects' clause was removed from the UK's new model corporate constitution.<sup>30</sup> Even when corporations do still designate objects, most are so broad as to permit them to do almost anything. And in any case, most corporations do much else besides pursue their official objectives; they are, for example, obliged to act as unpaid tax collectors.

The official corporate objective remains important, however, because it creates expectations and establishes limits. A corporation that solicits stakeholder participation on the basis of being a business, creates legitimate expectations that it will be run as a business, and not as a charity or a managerial fiefdom. The corporate objective demarcates the bounds of legitimate action for people acting in their corporate capacities. When ownership is detached from control, corporate agents may be disposed to act so as to serve their own ends rather than the owners'. Mechanisms are needed, therefore, to make sure that it is the shareholders' ends, defined by reference to the corporate objective, that govern the corporation and all its actions and agents. Ensuring adherence to the corporate objective is the essence of corporate governance. Accordingly, a major way of improving corporate governance could be to

specify corporate purposes more precisely.

The corporate purpose is actually crucial for defining the 'success of the company' that directors are obliged by UK law to promote. The Companies Act 2006 assumes that success consists of 'the benefit of the members', its owners.<sup>31</sup> But what constitutes the benefit all the diverse individual and institutional members? For owners of a business, it will be maximising the financial value of their investment; for a disaster relief charity, it will be ameliorating conditions in stricken territories. The benefit of the members, and the success of the company, consists in achievement of the corporate objective.

## Objections to Shareholders: Overcome

Objections to shareholders' governing their own corporations often reflect basic confusions about the meaning of corporate governance.<sup>32</sup> Contrary to critics' claims, shareholders don't need the skills to be managers or directors: different qualities are required, because the roles are very different. Shareholders provide equity, and establish the company's internal 'rules of the game', the basic aim and structure of their corporation. Directors set and oversee the strategy for achieving that aim; managers execute the designated strategy. In motoring terms, the shareholders specify the destination, the directors choose the route, and the managers drive the car.

Fears that shareholders might use their powers in the wrong ways are fundamentally unjustified. They presuppose either that the corporate purpose should be something other than that which the shareholders want, or that shareholders should be protected from acting counterproductively.<sup>33</sup> But in a free society, people may choose their own aims... and rightly bear the consequences of their choices of ends and of means. When executives and directors perceive shareholder activism as interference, and claim that it jeopardises efficient corporate functioning, it may be because they are pursuing their own objectives rather than the owners'. If they are, then interference is right and proper.

A genuine problem would exist if corporations' legitimate activities were hindered by shareholder attempts to monitor them. Since the purpose of corporate governance is to promote achievement of the corporate objective, the amount and type of monitoring must be consistent with that purpose; monitoring that undermines achievement of the corporate purpose is self-defeating. When that happens, however, the culprit is bad judgement. The way to prevent it is not government regulation of shareholder action, but better understanding of the corporate objective and corporate governance.

## Objections to Regulation: Sustained

Government regulation of corporate governance constitutes a much more intractable problem. It is counterproductive by its very nature, insofar as it interferes with shareholders organising their own corporations in their own ways. Even reforms that would otherwise be sensible are inappropriate when prescribed, because they ignore the prerogatives of shareholders as owners. In addition, regulation necessarily ignores the different characteristics and circumstances of particular companies; features that are appropriate for many companies will not be so for all. The degree and sort of accountability wanted, and the mechanisms most suited for achieving that accountability, will appropriately reflect each corporation's distinctive objectives, history, size, activity, jurisdiction and shareholder composition. One size will emphatically not fit all.

When shareholders are free to act for themselves, regulation typically does more to impede good governance than to promote it. Regulation is necessarily inflexible, and imposes substantial costs, in terms of both funds and freedoms: even disclosure is not costless. Regulations frequently have consequences that are unintended, damaging and difficult to correct; regulation is indeed often positively self-defeating.<sup>34</sup> And laws made in response to perceived crises and hard cases are notoriously defective.

Examples of regulation producing more harm than good are regrettably commonplace. In particular, regulation intended to make markets safer routinely handicaps corporate governance. UK insider trading regulation encourages investors to refrain from acquiring information about their investments, lest they become contaminated and unable to trade. The Takeover Code discourages investors from acquiring a large enough stake to exercise effective company control. And by creating a false sense of security, authorising collective investment schemes constitutes an inherent moral hazard: it provides a perverse incentive for investors to be less diligent and less vigilant.

Unfortunately, despite repeated reviews, and promises that government regulation would be curtailed, it has instead increased dramatically, in part reflecting the influence of the European Union. Since the Cadbury Report was published in 1992, the strictures on corporate governance have multiplied, especially for financial institutions.<sup>35</sup> According to the Institute of Chartered Accountants in England and Wales, the Companies Act 2006 is 'the longest act in history'.<sup>36</sup>

The government programme presented in Vince Cable's 23 January 2012 speech would make things still worse.<sup>37</sup> Misguidedly embodying most of the recommendations of

the High Pay Commission, it proposed further constraints on the ability of shareholders to govern their own corporations. It would require companies to provide specified information in specified formats about how executives are rewarded, how benchmarks are chosen and how they reflect employee differentials, how pay consultants are used and remunerated, how employees have been consulted and how their views have been taken into account. It would require all public companies to have claw-back provisions, and binding votes both on severance packages of greater than one year's salary and on directors' notice periods of more than one year. It would oblige companies to include on their boards people from 'different backgrounds', with at least two preferably lacking any previous board experience.... Some of the new requirements, such as statements explaining how pay policies reflect and support company strategy, might be ones that shareholders would endorse. But others are ones that have already been rejected by a majority of respondents to the government's Executive Remuneration Discussion Paper. They expressed 'scepticism that more regulation was needed when greater clarity and good shareholder and company practice would be most effective.'<sup>38</sup>

The least damaging sorts of regulations are those which increase the powers of shareholders to choose and implement their own corporate governance mechanisms. Reforms that *empower* shareholders to nominate and directly elect directors, or to vote on matters of basic corporate policy, are more worthy of serious consideration than those which *require* them to do so. Similarly, regulation that describes general principles or default positions, but allows shareholders to opt out, is better than that which provides no alternatives. But although the 'comply or explain' regime of the UK Corporate Governance Code and the Stewardship Code is less damaging than more coercive regulation, even it is contrary to the essence of good corporate governance. In a genuinely free market, the powers of shareholders are conferred by contract, not by government.

## What Government Can Do

Is there any role for government action? Definitely: reforms that would free corporate governance from government-imposed burdens<sup>39</sup> and obstacles would be welcome.<sup>40</sup> One way government could act to improve corporate governance would be to reverse its progressive undermining of the common law doctrine of *ultra vires*. Historically, any contract entered into that involved matters that did not fall under the corporate objects was *ultra vires* the company.<sup>41</sup> Being outside the company's capacity, such contracts were deemed not to have existed; complaints alleging *ultra vires* action could be made by creditors as well as by company

members. Since the 1985 and 1989 Companies Acts, however, and even more since the 2006 Companies Act came into force, the doctrine has been effectively nullified. According to Article 39 of the 2006 Act, '(1) The validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's constitution...'. Shareholders' retained rights to sue directors are thus of reduced utility. Elimination of what could be a major component of shareholder power and corporate governance should be reversed.

## The Way Forward: A Genuine Market for Corporate Control

Most modifications, however, that are needed to improve corporate governance do not involve any government action. They can and should be provided by the marketplace itself. The best way to bring about beneficial changes would be to encourage experimentation, and to allow different forms of corporate governance to compete for the support of investors.

The 'market for corporate control' conventionally refers to the use of takeovers to transfer corporate ownership through the securities market. But it can be used more broadly, to refer to the market in which companies compete for shareholders, and investment managers compete for funds, in part on the degree and kinds of accountability they afford to owners and investors.<sup>42</sup>

One form of market for corporate control has long existed in the United States. There, individual states compete to be sites of company incorporation on the basis of the protection they afford to managements. The need now is for comparable competition to protect the interests of owners. Subjects of such competition might include, for example, the nature and breadth of the constitutional corporate objectives, the extent to which strategic and operational matters require shareholder approval, company election procedures, the kinds and amounts of shareholder support paid for by the corporation, the independence and quality of directors, the extent and quality of performance-related remuneration, and the types of disclosure and audits.

These are, however, just a few of the very many different ways in which companies might compete in respect of corporate governance. One of the most significant advantages of free markets, is that they elicit innovative solutions to problems as they arise in all their real-life variety and complexity. Markets also effectively test those solutions and efficiently disseminate best practice.

The best way to ensure good corporate governance – and superior performance – is for shareholders to



have the greatest possible freedom to govern their own corporations.<sup>43</sup>

## Notes and References

1. Elaine Sternberg, *Competition in Corporate Control: A Shareholder-Driven Alternative to the Higgs Proposals on Non-Executive Directors* (henceforth 'CCC'). London: Adam Smith Institute, 2003. p.3.

2. *Explanatory Memorandum to the Companies (Shareholders' Rights) Regulations 2009* No. 1632. [http://www.legislation.gov.uk/uksi/2009/1632/pdfs/uksiem\\_20091632\\_en.pdf](http://www.legislation.gov.uk/uksi/2009/1632/pdfs/uksiem_20091632_en.pdf).

3. The High Pay Commission, *Cheques With Balances: why tackling high pay is in the national interest* (henceforth 'HPC'), Final report of the High Pay Commission; 2011, p.11; see also p.20. It is noteworthy that despite its claims to the contrary, the Commission had no business members, and consisted entirely of representatives of the media, politics, trades unions and investment managers.

4. *Hansard*, 23 January 2012, Column 23ff (henceforth 'Cable'). <http://www.publications.parliament.uk/pa/cm201212/cmhansrd/cm120123/debtext/120123.0001.htm#12012313000002>.

5. Such an equitable association of costs and benefits would result if, for example, the corporation hired the services of specialists who were accountable to the shareholders. Consider auditors, for example, and proxy advisory firms. E.g., the (US) Corporate Monitoring Project, Institutional Shareholder Services, Proxy Monitor, and Investor Responsibility Research Center.

6. Even if there were, it would not necessarily support judgements that executives were overpaid. A recent survey by Obermatt that measured executive pay across organisations concluded that many of the highest earners were paid too little. 'Underpaid bosses', *The Economist* print edition, 12 February 2012. <http://www.economist.com/node/21547292>.

7. For a definition and discussion of fairness and distributive justice, see Elaine Sternberg, *Just Business: Business Ethics in Action* (2nd ed.; Oxford University Press, 2000; henceforth 'JB2'), especially Chapter 3. For a full discussion of ethical remuneration, hiring and firing, see Chapter 6.

8. *HPC*, *op.cit.* note 3 above, p.20.

9. *Ibid.*, p.54.

10. In, e.g., remuneration committees (p.14) and more generally in the board of directors (p.61).

11. *LSEG Response to the European Commission's Green Paper on the corporate governance framework in the EU*, 22 July 2011, pp.1-2; <http://www.londonstockexchange.com/about-the-exchange/regulatory/lsegresponsetocommissiononcorporategovernancejuly2011.pdf>

12. *Ibid.*

13. Dent, George W., 'The Essential Unity of Shareholders and the Myth of Investor Short Termism'. *Delaware Journal of Corporate Law*, Vol. 35, No. 1, 2010; Case Legal Studies Research Paper No. 2010 11. <http://ssrn.com/abstract=1557356>.

14. *Ibid.*

15. Financial Reporting Council, *Guidance on audit committees*, December 2010 Para 2.16, <http://www.frc.org.uk/images/uploaded/documents/Guidance%20on%20Audit%20Committees%202010%20final1.pdf>. Also October 2008, para 2.3.

16. Financial Reporting Council, *Developments in Corporate Governance 2011: the impact and implementation of the UK Corporate Governance and Stewardship Codes*, December 2011, p.4. <http://www.frc.org.uk/images/uploaded/documents/Developments%20in%20Corporate%20Governance%2020116.pdf>.

17. Companies Act 2006 (henceforth 'CA06') Article 172(1)(b). <http://www.legislation.gov.uk/ukpga/2006/46/contents>.

18. *Op.cit.*, note 3 above, p.10.

19. Department of Business, Innovation & Skills, *Executive remuneration discussion paper: summary of responses*, January 2012, URN 12/564, especially p.7.: <http://www.bis.gov.uk/assets/biscore/business-law/docs/e/12-564-executive-remuneration-discussion-paper-summary-responses.pdf>.

20. Much in this section and the following ones draws heavily on CCC, *op.cit.*, note 1 above.

21. Although historically, corporations were established through government charters, all essential corporate features -- including limited liability for shareholders -- could be established through private contracting.

22. Despite its official sounding name, the High Pay Commission is not an official government body. It is, rather, the creation of Compass, which describes itself as an 'ideas and action based pressure group' providing 'direction for the democratic left' (<http://www.compassonline.org.uk>). Its aims include, *inter alia*, 'restructuring the economy for greater equality with more emphasis on public goods instead of just individualistic consumerism.' Neal Lawson and Howard Reed, eds., *Plan B: a good economy for a good society*, London: Compass, Oct, 2011. Introduction, p.7.

23. And set out in the Memorandum of Association or comparable constitutional document. Sternberg, Elaine, *Corporate Governance: Accountability in the Marketplace* ('CGAIM'). 2nd edition; Institute of Economic Affairs, Hobart Paper 147, 2004, p.28, italics in text. Chapter 1 offers a justification, explanation and exploration of this concept of corporate governance.

24. 'Corporation' designates a particular organisational structure. 'Business' designates a particular objective (and derivatively the activity of pursuing it, and those organisations (of whatever structural form)) that have the business objective of maximising long-term owner value by selling goods or services as their sole or defining purpose. For a detailed justification and explanation of this characterisation of business, see *JB2*, *op.cit.* note 7 above, especially Chapter 2.

25. According to the most recent statistics available February 2012, at the start of 2011 the total number of UK private sector businesses (including public corporations and nationalized bodies) was 4,542,765, of which 27.7% (1,258,345) were companies. The others were partnerships and sole proprietorships. (Department for Business Innovation and Skills, Business Population Estimates 2011. [http://www.bis.gov.uk/assets/biscore/statistics/docs/b/bpe\\_2011\\_stats\\_release.pdf](http://www.bis.gov.uk/assets/biscore/statistics/docs/b/bpe_2011_stats_release.pdf).)

26. According to the most recent statistics available February 2012 (those for January 2012), the total number of UK companies (including those with no equity) listed on the Main Market of the London Stock Exchange was only 2,573. (Source: <http://www.londonstockexchange.com/en-gb/about/statistics/factsheets/>).

27. According to the most recent figures available from Companies House at February 2012, as of 29 January 2012 there were 2,618,456 companies in the UK of which 8,478 were public companies. Companies House, *Monthly Statistics — Register/Compliance/Liquidations and Dissolutions*, January 12. <http://www.companieshouse.gov.uk/about/busRegArchive/businessRegisterStatisticsJan2012.pdf>. Subtracting the 1,258,345 business companies (see note 13 above) from that total leaves 1,360,111 companies (51.94%) that were not businesses.

28. Unless otherwise specified, all references here to 'official' corporate purposes or objectives, and to 'shareholders' purposes or objectives' refer to this constitutional purpose; references to 'shareholders' interests' refer to their interests in having the constitutional purpose achieved.

29. Department of Trade and Industry, *Modernising Company Law*, CM 5553-I, 16 July 2002, Volume I, Part II, p.17, para 2.2. This reflected its endorsement of the stakeholder doctrine, in which the only legitimate organisational purpose is that of 'balanced stakeholder benefits'. *CGAIM*, *op.cit.*, note 23 above.

30. 'Any new companies formed on or after 1 October 2009 will not be required to list objects for the company as these will be unrestricted from that point forward, unless the company chooses specifically to restrict them.' Department for Business, Innovation & Skills, *Companies Act 2006 final implementation -- changes to constitutional documents, including model articles: a summary of what the new approach means*, Article 1.18. <http://webarchive.nationalarchives.gov.uk/+http://www.bis.gov.uk/files/file53041.pdf>, accessed 9 Feb 12.

31. According to the Companies Act 2006 (see note 17 above) Article 31(1), 'Unless a company's articles specifically restrict the objects of the company, its objects are unrestricted.' Article 172 states:

(2) Where or to the extent that the purposes of the company consist of or include purposes other than the benefit of its members, subsection (1) [director's duty to promote the success of the company] has effect as if the reference to promoting the success of the company for the benefit of its members were to achieving those purposes.

32. For a discussion of some of the issues, see, e.g., Bebchuk, Lucian A., 'Letting Shareholders Set the Rules'. *Harvard Law Review*, Vol. 119, pp. 1784 1813, 2006. SSRN: <http://ssrn.com/abstract=891823>.

33. See, for example, Bratton, William W. and Wachter, Michael L., 'The Case Against Shareholder Empowerment'. *University of Pennsylvania Law Review*, Vol. 158, p. 653, 2010. <http://ssrn.com/abstract=1480290>.

34. For a summary of six ways in which they are, see Sunstein, Cass R., *Free Markets and Social Justice*, Oxford University Press, 1997, pp.271-289. Reprinted as 'Paradoxes of the Regulatory State' in Heath, Eugene, *Morality and the Market: Ethics and Virtue in the Conduct of Business*, McGraw-Hill, 2002, pp.116-25.

35. Cadbury Committee *Report on the Financial Aspects of Corporate Governance*, London: Gee Publishing, 1992.

36. '...running to 1,300 sections'. The Institute of Chartered Accountants in England and Wales website, Modernising UK Company Law; accessed 22 February 2012. [http://www.icaew.com/en/technical/legal\\_and\\_regulatory/modernising\\_uk\\_company\\_law](http://www.icaew.com/en/technical/legal_and_regulatory/modernising_uk_company_law).

37. Cable, *op.cit.*, note 4 above, column 24.

38. *Op.cit.*, note 19 above, p.6.

39. Including most anti-discrimination, welfare and health and safety regulation....

40. In the US, for example, perverse incentives should be removed from the tax code. Crucially, SEC restrictions that inhibit shareholders from nominating directors should be eliminated. Shareholders should also not be prevented by law from making proposals that are binding on the board, or from proposing resolutions about corporate elections or the 'conduct of the ordinary business of the corporation'. Directors' duty of care and loyalty should be restored, by rejecting the 'business judgement' rule, and by states' repealing laws that limit directors' liability. Laws requiring long and staggered terms for directors should also be abolished. When such laws apply, only some of the directors can be replaced at any election; even takeovers can have little effect.

41. *Ashbury Railway Carriage & Iron Co v Riche* (1875) LR 7 HL 653.

42. Such a market is recognised by the OECD: 'A market for governance arrangements should be permitted so that those arrangements that can attract investors and other resource contributors -- and support competitive corporations -- flourish.' OECD Business Sector Advisory Group on Corporate Governance, *Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets*, Organisation for Economic Co-operation and Development, April 1988, p.34, para 54.

43. See, for example, note 32 above. Also Gompers, Paul, Joy Ishii, and Andrew Metrick, *Corporate Governance and Equity Prices*, NBER Working Paper No. 8449, August 2001. Bebchuk, Lucian A., Cohen, Alma and Ferrell, Allen, 'What Matters in Corporate Governance?' (September 1, 2004). *Review of Financial Studies*, Vol. 22, No. 2, pp. 783 827, February

2009; <http://ssrn.com/abstract=593423> or <http://dx.doi.org/10.2139/ssrn.593423>. Brown, Lawrence D. and Caylor, Marcus L., 'Corporate Governance and Firm Performance' (December 7, 2004). <http://ssrn.com/abstract=586423>. Brown, Lawrence D. and Caylor, Marcus L., 'Corporate Governance and Firm Valuation'. *Journal of Accounting and Public Policy*, Vol. 25, No. 4, 2006. <http://ssrn.com/abstract=754484>. Spellman, G. Kevin and Watson, Robert, 'Corporate Governance Ratings and Corporate Performance: An Analysis of Governance Metrics International (GMI) ratings of US Firms, 2003 to 2008' (January 1, 2009). <http://ssrn.com/abstract=1392313>.

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