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# The Framework for Board Accountability in Corporate Governance

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## 1. Introduction

‘Accountability’ is a word that is frequently used in many different parts of society, perhaps most often in the realm of government and politics. As a result a significant literature has grown up in relation to the study of accountability in various disciplines, such as public administration and politics, and its application to certain offices and posts. The word has also been employed increasingly in the field of corporate governance, and perhaps this is commensurate with the rise in the importance and greater use of the expression ‘corporate governance.’ In the wake of the financial crisis there has been much discussion about whether boards (particularly of banks, but also more generally) are sufficiently accountable. A key government policy is to make companies more accountable to shareholders and the public.<sup>1</sup> Nevertheless, while we see a large number of references to accountability in the titles to books<sup>2</sup> and journal articles,<sup>3</sup> in abstracts to,

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<sup>1</sup> Department for Business Innovation and Skills and HM Treasury, Making Companies More Accountable to Shareholders and the Public (updated 9 December 2013) available at <https://www.gov.uk/government/policies/making-companies-more-accountable-to-shareholders-and-the-public> (accessed 12 December 2013).

<sup>2</sup> For instance, see R Monks and N Minnow Power and Accountability (New York: Harper Collins 1991); S Demirag Corporate Governance, Accountability and Pressure to Perform: An International Study (Stamford, CT:

and keywords for, scholarly papers,<sup>4</sup> in official consultation papers,<sup>5</sup> government guidance papers<sup>6</sup> and position papers formulated by a broad cross-section of bodies,<sup>7</sup> and actually in the text of a large range of publications,<sup>8</sup> there is neither an articulation of the essence of the concept

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JAI Press 1998); D Bavly *Corporate Governance and Accountability: What Role for the Regulator, Director and Auditor?* (Westport: Quorum Books 1999); R Warren *Corporate Governance and Accountability* (Liverpool: Liverpool Academic Press 2000); J Solomon *Corporate Governance and Accountability* (Chichester: John Wiley, 3rd edn, 2010).

<sup>3</sup> For instance, see L Spira, 'Enterprise and Accountability: Striking a Balance' (2001) 39 *Management Decision* 739; A Pye 'Corporate Boards, Investors and their Relationships: Accounts of Accountability and Corporate Governance in Action' (2001) 9 *Corporate Governance: An International Review* 186; R Aguilera 'Corporate Governance and Director Accountability: An Institutional Comparative Perspective' (2005) 16 *British Journal of Management* S39; R Jones 'Law, Norms and the Breakdown of the Board: Promoting Accountability in Corporate Governance' 92 *Iowa L Rev* 105 (2006); A Reberioux 'Does Shareholder Primacy Lead to a Decline in Managerial Accountability?' (2007) 31 *Cambridge J Econ* 507; N Brennan and J Solomon 'Corporate Governance, Accountability and Mechanisms of Accountability: An Overview' (2008) 21 *Accounting Auditing and Accountability Journal* 885.

<sup>4</sup> For instance, see J Roberts, T McNulty and P Stiles 'Beyond Agency Conceptions of the Work of the Non-Executive Director: Creating Accountability in the Boardroom' (2005) 16 *British Journal of Management* S5; P Koh, S Laplante and Y Tong 'Accountability and Value Enhancement Roles of Corporate Governance' (2007) 47 *Accounting and Finance* 305.

<sup>5</sup> For instance, see Financial Reporting Council 'Consultation on the Revised UK Corporate Governance Code' (December 2009) 17 available at <http://www.frc.org.uk/images/uploaded/documents/Consultation%20on%20the%20Revised%20Corporate%20Governance%20Code1.pdf> (accessed 2 December 2011).

<sup>6</sup> For instance, see Financial Reporting Council 'Effective Corporate Governance' (July 2011) available at <http://www.frc.org.uk/FRC-Documents/FRC/FRC-Effective-Corporate-Governance.aspx> (accessed 27 August 2013).

<sup>7</sup> For instance, see Corporations and Markets Advisory Committee 'Guidance for Directors' (Canberra April 2010) 13-15 available at [http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2010/\\$file/Guidance\\_for\\_directors\\_Report\\_April2010.pdf](http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFFinal+Reports+2010/$file/Guidance_for_directors_Report_April2010.pdf) (accessed 2 December 2011); OECD 'Corporate Governance: Accountability and Transparency: A Guide for State Ownership' (10 February 2010).

<sup>8</sup> For instance, see Monks and Minnow above n 1, pp 11, 12, 15, 16; H Hutchison 'Director Primacy and Corporate Governance: Shareholder Voting Rights Captured by the Accountability/Authority Paradigm' 36 *Loy U Chi LJ* 1111, 1112 (2005); E Banks *Corporate Governance: Financial Responsibility, Controls and Ethics* (Hampshire: Palgrave Macmillan 2004) 22.

nor substantial explanation of the meaning that is sought to be conveyed by the word in relation to corporate governance. In fact it is a word that is frequently tossed around in articles on corporate governance with apparent abandon without much thought for what it actually entails. This is problematic, because without a clear idea of what accountability is, it is not possible to assess whether it is actually present, and what steps might be needed to institute it. This article seeks to address this gap by identifying the key ingredients for accountability in the corporate governance context.

Clearly accountability is, in the main, seen as something that is good and commendable to consider. In fact it has been said that ‘accountability’ has become such an icon of good governance and has universal appeal that it is applied casually, perhaps to the point of thoughtlessness.<sup>9</sup> The word even features in some definitions of corporate governance. For instance, Demirag defined corporate governance as: ‘[T]he systems by which companies are controlled, directed and made accountable to shareholders and other stakeholders...’<sup>10</sup>

The Report of the Committee on the Financial Aspects of Corporate Governance (commonly known as ‘the Cadbury Report’) said that the principles on which its Code of Best Practice was based are those of openness, integrity and accountability.<sup>11</sup> The Report then essentially defined ‘openness’ and ‘integrity’ but refrained from doing the same for ‘accountability.’<sup>12</sup> The Hampel Report,<sup>13</sup> a subsequently published report on corporate

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<sup>9</sup> M Dubnick and K Yang ‘The Pursuit of Accountability: Promise, Problems, and Prospects’ (2010) p 20 available at <http://ssrn.com/abstract=1548922> (accessed 19 March 2012).

<sup>10</sup> ‘Short Termism, Financial Systems and Corporate Governance’ in Demirag above n 2, p 20.

<sup>11</sup> Report of the Committee on the Financial Aspects of Corporate Governance under the chairmanship of Sir Adrian Cadbury (hereafter referred to as the Cadbury Report) (London: Gee Publishing, December 1992) [3.2].

<sup>12</sup> Ibid [3.2]-[3.4].

<sup>13</sup> Final Report of the Committee on Corporate Governance (London: Gee Publishing, January 1998) (hereafter referred to as the Hampel Report).

governance, contained, as have later codes of corporate governance,<sup>14</sup> a whole section titled ‘Accountability’ in its ‘Principles of Corporate Governance’ but did not in any way allude to what it saw as the meaning behind accountability in the context of corporate governance.<sup>15</sup> Similarly, in a wide-ranging report by Weil, Gotshal and Manges on behalf of the European Commission, and titled, ‘Comparative Study of Corporate Governance Codes Relevant to the European Union and its Member States’, a whole section of the report was headed ‘The Accountability of Supervisory and Managerial Bodies’ yet the material gathered under that heading does not provide clear guidance as to what accountability entails, either in general or in the context of the report’s discussion.<sup>16</sup> If one were to trace the approach of the reports addressing corporate governance and the various iterations of the UK’s Combined Code on Corporate Governance concerning the issue of accountability one finds that accountability is often mentioned, and one is given the impression that it is exceedingly important, but it is never defined or explained.

All of this is surprising, as the concept of accountability is clearly regarded by many scholars as of critical importance to corporate governance.<sup>17</sup> It has been said that accountability

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<sup>14</sup> For instance Financial Reporting Council ‘The UK Corporate Governance Code’ (September 2012) Main Principles Section C available at <http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-September-2012.aspx> (accessed 5 August 2013).

<sup>15</sup> Above n 13, Section D [2.18]-[2.22].

<sup>16</sup> European Union Internal Market Directorate General (Brussels 2002) 46 available at [http://ec.europa.eu/internal\\_market/company/docs/corpgov/corp-gov-codes-rpt-part1\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/corpgov/corp-gov-codes-rpt-part1_en.pdf) (accessed 15 March 2012).

<sup>17</sup> For instance, see A Young ‘Frameworks in Regulating Company Directors: Rethinking the Philosophical Foundations to Enhance Accountability’ (2009) 30 *Company Lawyer* 355, 355, 356.

of the board can be linked to value creation.<sup>18</sup> Also accountability is referred to in several definitions of ‘corporate governance.’ One was mentioned above. In another, the UK’s Department for Business Innovation and Skills defines corporate governance as:

the system by which companies are directed and controlled. It deals largely with the relationship between the constituent parts of a company - the directors, the board (and its sub-committees) and the shareholders. Transparency and accountability are the most important elements of good corporate governance.<sup>19</sup> (our emphasis)

In fact the Financial Reporting Council recently stated that corporate governance could be defined as: ‘a means to establish a system of control between the board and management as well as accountability from the board to the shareholders.’<sup>20</sup> This accords with what the Cadbury Report said many years ago, namely: ‘The issue for corporate governance is how to strengthen the accountability of boards of directors to shareholders.’<sup>21</sup>

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<sup>18</sup> B Taylor ‘From Corporate Governance to Corporate Entrepreneurship’ (2001) 2 J of Change Management 128; M Huse ‘Accountability and Creating Accountability: A Framework for Exploring Behavioural Perspectives of Corporate Governance’ (2005) 16 British Journal of Management S65.

<sup>19</sup> The definition originally appeared at <http://www.berr.gov.uk/bbf/corp-governance/page15267.html> and has been superseded by the following address : <http://webarchive.nationalarchives.gov.uk/20090902193559/berr.gov.uk/whatwedo/businesslaw/corp-governance/page15267.html> (accessed 6 October 2011).

<sup>20</sup> Financial Reporting Council ‘Response to the European Commission Green Paper on the EU Corporate Governance Framework’ (2011) p. 26 available at <http://www.frc.org.uk/images/uploaded/documents/FRC%20response%20to%20the%20Green%20Paper%20on%20the%20EU%20corporate%20governance%20framework%20July%202011.pdf> (accessed 15 March 2012).

<sup>21</sup> Above n 11, [6.1].

The academic corporate governance literature, corporate governance codes, government reports and other publications either opt not to explain what is meant by the concept of accountability or appear to presume that readers understand what it is.<sup>22</sup> But at a time when society is questioning the role of directors and certainly their remuneration and the way that they operate companies, particularly in relation to banks and other large public companies, not least because of the Global Financial Crisis of 2007-2008, it causes us to ask: why is there a failure to explain accountability considering that it appears to be regarded as an important issue? One reason might be that accountability is a notoriously difficult concept to articulate. The fact is that accountability, as it is discussed in many different contexts, and not just in the corporate governance context, is a complicated and elusive concept.<sup>23</sup> A sense of what accountability actually involves in a precise way is, therefore, lacking.<sup>24</sup> It might be something that one knows when one sees it, but it is difficult to define precisely.<sup>25</sup>

Nevertheless the failure to identify what precisely is meant by accountability creates several problems. Without a clearer idea of this concept, debates about accountability may be at

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<sup>22</sup> For example, S Bottomley *The Constitutional Corporation* (Aldershot: Ashgate, 2007) p 80. In an excellent and recent book, *Corporate Governance in the Shadow of the State* (Oxford: Hart Publishing, 2013), Marc Moore does endeavour to analyse the concept of accountability although the learned author does not go into detail in defining the concept. He is more concerned with seeing how it fits in corporate governance.

<sup>23</sup> R Behn *Rethinking Democratic Accountability* (Washington, DC: Brookings Institution Press, 2001) p 221; A Sinclair 'The Chameleon of Accountability: Forms and Discourses' (1995) 20 *Accounting, Organizations and Society* 219, 221; I Demirag, M Dubnick and M Khadaroo 'Exploring the Relationship Between Accountability and Performance in the UK's Private Initiative (PFI)' 7: paper presented at the 'Conference on Governing the Corporation: Mapping the Loci of Power in Corporate Governance Design,' at Queen's University, Belfast, 20-21 September 2004 (on file with authors); M Bovens 'Analysing and Assessing Accountability: A Conceptual Framework' (2007) 13 *European Law Journal* 447, 448, 449.

<sup>24</sup> Dubnick and Yang, above n 9, 14.

<sup>25</sup> See A Licht 'Accountability and Corporate Governance' (September 2002) 1 available at <http://ssrn.com/abstract=328401> (accessed 19 March 2012).

cross-purposes. The absence of a clear conception of accountability makes it difficult to assess whether particular corporate governance mechanisms promote accountability, and if not, why not. This lack of clarity can also mask accountability deficits which, in turn, is significant because, as we explore in Part 2, there are a number of reasons why accountability is important, and so it is necessary to be able to identify its absence. A lack of clarity can also result in poorly designed accountability mechanisms. This article aims to address these issues, by exploring the meaning of the concept of accountability and providing a framework to assess whether accountability is present in the corporate governance context, and it does so while focussing on board accountability. The article does not and cannot address the way that accountability plays out in the governance of companies. What the article does is to provide a general framework within which to important issues related to accountability can be considered such as to whom and for what boards are accountable, and what mechanisms can be employed to ensure that accountability exists.<sup>26</sup> The article deals with issues, such as the meaning of accountability, that must be addressed before one can move on to a consideration of the role and nature of the accountability of boards, and the adequacy of measures which might ensure that boards are in fact accountable.

The article focuses on large public companies, listed or non-listed and does not seek to encompass all types of companies as different issues might be applicable, particularly to small private companies. Within this context the need for accountability can be directed at several actors. Accountability can be a reference to the accountability of the company to society or other stakeholders or the accountability of managers to boards. However as we have seen the main concern in corporate governance is the accountability of the company's board of directors to

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<sup>26</sup> There are many mechanisms that presently exist that might be regarded as seeking to enhance accountability.



shareholders. Repeating what the Cadbury Report stated: ‘The issue for corporate governance is how to strengthen the accountability of boards of directors to shareholders.’<sup>27</sup>

The article develops as follows. First, it examines why accountability is important in order to contribute to establishing why the issue we have identified for consideration in this article is worthy of study. Next it articulates why it is important to identify a shared definition of accountability. It then sets out a framework for assessing whether accountability is present in corporate governance. In order to do this it will consider what accountability has been taken to comprise both without and within the field of corporate governance. Finally, there are some concluding remarks.

## **2. The Importance of Accountability in Corporate Governance**

In legal terms companies governed by Anglo-American corporate law are governed by both the general meeting of shareholders and the board of directors but typically, today, the company’s articles of association will vest the board of directors with very broad general management powers.<sup>28</sup> In some jurisdictions, such as the UK, where directors have been given wide-ranging powers, they alone can exercise them, and the only action that the members can take is to pass a special resolution to amend the articles; the shareholders cannot interfere in the exercise of the management power except in very limited circumstances.<sup>29</sup> Elsewhere, such as the US, not even

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<sup>27</sup> Above n 11, [6.1].

<sup>28</sup> For example, see in the UK, The Companies (Tables A-F) Regulations 1985, SI 1985/805 Table A art 70 and The Companies (Model Articles) Regulations 2008, SI 2008/3229 reg 2 and Sch 1, art 5(private companies); reg 4 and Sch 3, art 5 (public companies). In the US see Delaware General Corporation Law §141(a) (2009) and Model Business Corporation Act §8.01 (2008).

<sup>29</sup> John Shaw & Sons (Salford) Ltd v Shaw [1935] 2 KB 113.

a unanimous vote of shareholders can control the directors.<sup>30</sup> Public companies, particularly in jurisdictions applying Anglo-American corporate law, are characterised by ownership being separated from control, that is, the shareholders, who are loosely referred to as the owners of a company, do not control the company; that role falls to the board of directors.<sup>31</sup> So, the shareholders rely on the board to manage in an appropriate manner. The board itself relies on executive directors and managers to manage the company on a day-to-day basis and in an efficient way. Thus the management of a business by the managers is generally totally in their discretion provided that they do not steal or commit outright fraud.<sup>32</sup> In turn the board has very broad power in relation to making decisions and devising strategy.<sup>33</sup> Because reliance is placed on the board of directors which has exceedingly wide discretion and power vested in it, the law imposes certain obligations on the board members, such as the requirement to discharge fiduciary duties, which are duties requiring loyalty and honesty. According to many, the fact that power is placed in the hands of people other than the shareholders causes something known as an agency problem.

Agency problems are probably the most well-rehearsed rationale for accountability, certainly in the past 30 years or so. Where principals delegate power to agents, agents are liable to account to their principals for the manner in which that power is exercised. It is said that

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<sup>30</sup> S Bainbridge *The New Corporate Governance* (New York: OUP, 2008) p 34.

<sup>31</sup> This article is neutral on the contested concept of whether shareholders are owners of the company. Contractarians, for example, reject the ownership analysis: F. Easterbrook and D.R. Fischel, *The Economic Structure of Corporate Law* (Cambridge, Mass: Harvard University Press, 1996), pp.38, 68–70. See also J. Kay and A. Silberston, “Corporate Governance” in F. Patfield (ed.), *Perspectives on Company Law Volume 2* (London: Kluwer, 1997), p.49; R. Grantham, “*The Doctrinal Basis of the Rights of Company Shareholders*” (1998) 57 *C.L.J.* 554, p.562; P. Ireland, “*Company Law and the Myth of Shareholder Ownership*” [1999] 62 *M.L.R.* 32; ; S. Worthington, “Shares and Shareholders: Property, Power and Entitlement” Part 1 (2001) 22 *Company Lawyer* 258 and Part 2 (2001) 22 *Company Lawyer* 307. See also the review and critique of the literature in D.C. Donald, “Shareholder Voice and its Opponents”(2005) 5 *Journal of Corporate Law Studies* 305 at pp.308–316.

<sup>32</sup> M Gelter ‘The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance’ 50 *Harv Int'l LJ* 129,146 (2009).

<sup>33</sup> Bottomley, above n 22, p 68; Bainbridge, above n 29, p 34.

accountability guards against the risk that agents will shirk or will exercise the power in their own interests rather than in the interests of their principals.<sup>34</sup> Concern over self-dealing and shirking has been described as the ‘standard working assumption underlying corporate governance systems around the world’.<sup>35</sup> board accountability is required in corporate governance to address this concern.

This explanation for requiring board accountability fits well with the agency theory of the company,<sup>36</sup> supported heavily by neo-classical economics and law and economics scholars, which provides inter alia that the shareholders are regarded as the true owners of the company and they are the principals of the directors (the board) who act as their agents in running the company’s affairs.<sup>37</sup> Consequently, so the theory goes, there is a need to introduce into the governance system some mechanisms that will ensure that the interests of the agents are aligned with those of the principals.<sup>38</sup> If this is not achieved, directors, as they are rational actors and

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<sup>34</sup> Licht, above n 25, 20; C Harlow and R Rawlings ‘Promoting Accountability in Multilevel Governance: A Network Approach’ (2007) 13 *European Law Journal* 542, 547. See C Scott ‘Accountability in the Regulatory State’ (2000) *J Law & Soc* 27, 39: problems of accountability arise as a result of delegated authority.

<sup>35</sup> Licht, above n 25, 3.

<sup>36</sup> The theory was pioneered by A Alchian and H Demsetz in ‘Production, Information Costs, and Economic Organization’ (1972) 62 *Amer Econ Review* 777 and M Jensen and W Meckling ‘Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure’ (1976) 3 *J Fin Econ* 305 and employed by many scholars in various disciplines since.

<sup>37</sup> R Pilon ‘Capitalism and Rights: An Essay Toward Fine Tuning the Moral Foundations of the Free Society’ (1982) *Journal of Business Ethics* 29, 31 and following; A Keay ‘Shareholder Primacy in Corporate Law: Can It Survive? Should It Survive?’ (2010) 7 *European Company and Financial Law Review* 369, 393. Many dispute the fact that the shareholders are the owners of the company: see literature at n 31 above. The following cases might be cited to support the latter view : *Bligh v Brent* (1837) 2 *Y & C Ex* 268, *Salomon v Salomon and Co Ltd* [1897] *AC* 22 and *Short v Treasury Commissioners* [1948] 1 *KB* 116.

<sup>38</sup> As far back as 1797 Jeremy Bentham was talking in terms of managers having responsibilities to their principals: *J Bentham Pauper Management Improved: Particularly by Means of an Application of the Panopticon Principle of Construction* (Young's *Annals of Agriculture*, 1797), pp 51-52 and referred to in S Gallhofer and J

cannot be trusted,<sup>39</sup> will engage in self-dealing and/or shirking; they will have no incentive to maximise the interests of the shareholders.<sup>40</sup> Williamson regarded agents as ‘opportunistic actors given to self-interest seeking with guile.’<sup>41</sup> These sentiments clearly underlie many corporate governance systems.<sup>42</sup> So, accountability is needed to ensure directors act properly. As Coffee has said: ‘the knowledge that one is being watched and that one must justify one’s actions improves the behaviour of most individuals.’<sup>43</sup> Any accountability-based corporate governance provision is going to strive to identify contradictions, and thus, actual or potential conflicts of interests which may exist amongst board members.<sup>44</sup> It has also been asserted that corporate governance is actually based on the premise that company officers operate optimally when they are under an obligation to account for what they do.<sup>45</sup>

Some disagree with the thrust of the agency approach on the basis that it portrays directors, like all rational actors, as selfish, and is a wrong view of humans in general, and directors in particular. Elements of this dissentient group will argue that directors can be regarded as stewards of the company’s affairs who can be trusted to do a good, professional job.

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Haslam ‘Approaching Corporate Accountability: Fragments from the Past’ (1993) 23 Accounting and Business Research 320, 322.

<sup>39</sup> J Roberts ‘Trust and Control in Anglo-American Systems of Corporate Governance: The Individualizing and Socializing Effects of Processes of Accountability’ (2001) 54 Human Relations 1547, 1548.

<sup>40</sup> M Dooley ‘Two Models of Corporate Governance’ 47 Bus Law 461, 468 (1992).

<sup>41</sup> O. Williamson *Mechanisms of Governance* (Oxford: OUP, 1996) p 253.

<sup>42</sup> Licht, above n 25, 3. Also see S Lindenberg ‘Myopic Opportunism and Joint Production: A Relational Approach to Corporate Governance’ in A Grandori (ed) *Corporate Governance and Firm Organization* (Oxford: OUP, 2004) p 212.

<sup>43</sup> JC Coffee ‘New Myths and Old Realities: The American Institute Faces the Derivative Action’ 48 Bus Law 1407, 1425 (1993). This same view was stated by Jeremy Bentham: see Gallhofer and Haslam, above n 36, 320.

<sup>44</sup> A Licht ‘Adaptive Accountability: Towards a Culturally Compatible Model of Corporate Governance for East Asia’ paper delivered at the BCLBE Conference on Corporate Governance in East Asia UC Berkeley, 4-5 May 2006 available at <http://www.law.berkeley.edu/files/Licht-AdaptiveAccountability.pdf> (accessed 14 March 2013).

<sup>45</sup> Bavly, above n 2, p 7.

As professionals they can be trusted to make some degree of personal sacrifice and act honestly and diligently and this is not to be seen as quirky behaviour.<sup>46</sup>

However, even if agency theory is not accepted as a basis for accountability, accountability can be grounded on other rationales. Accountability is said to be necessary when actors' conduct impacts upon the rights or interests of others. This second rationale supplements the agency explanation, and while it could result in accountability to a broader range of persons, actors will only be accountable when they are capable of causing harm to, or breach, another's rights.<sup>47</sup> In contrast, accountability on the first basis arises regardless of harm, when agents fail to act in accordance with their principals' preferences, as is the case with fiduciary liability for example.<sup>48</sup>

Many explanations for accountability also emphasise its link with power.<sup>49</sup> An essential precept in relation to political power is that the power must be partnered with a system of accountability.<sup>50</sup> Licht has said that accountability is able to be seen as a norm of governance determining modes of wielding power and of responses to power.<sup>51</sup> However, there are two distinct, though often overlapping, senses of the term 'power.' The first refers to a power or the

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<sup>46</sup> M Blair and L Stout 'Director Accountability and the Mediating Role of the Corporate Board' 79 Wash U LQ 403, 440 (2001). The approach that is mentioned is often seen as the basis for stewardship theory. For a consideration of stewardship theory, see J Davis, F Schoorman and L Donaldson 'Towards a Stewardship Theory of Management' (1997) 22 Academy of Management Review 20.

<sup>47</sup> R Mulgan  *Holding Power to Account: Accountability in Modern Democracies* (Basingstoke: Palgrave MacMillan, 2003) pp 12-14. D Curtin and L Senden 'Public Accountability of Transnational Private Regulation: Chimera or Reality?' (2011) 38 J Law & Soc 163, 169.

<sup>48</sup> Mulgan, *ibid.*

<sup>49</sup> In the corporate governance context see Licht, above n 25, 17-22.

<sup>50</sup> D Thompson  *Restoring Responsibility: Ethics in Government, Business and Healthcare* (Cambridge: CUP, 2005) p 3.

<sup>51</sup> Licht, above n 25, 17.

power to do something.<sup>52</sup> This is power in the Hohfeldian sense, referring to a power to affect another's legal relations, common examples being the power of an agent or a trustee.<sup>53</sup> The power-holders are not necessarily more powerful than those whose legal relations they can affect and to whom they owe an account as a result of the delegation of the power.<sup>54</sup> Power in this sense is linked to the agency explanation for accountability.

The second sense of the word 'power' means power over, implying might and domination or being powerful.<sup>55</sup> It is almost a given now in democratic societies that anyone who is granted significant power is accountable for what he or she does with it. The more power that an actor exercises, the more pressing the demands for accountability. Holding power to account is perceived to be an essential safeguard against tyranny because it guards against power being exercised in an oppressive and abusive manner.<sup>56</sup> Hence, it is designed to protect certain people or groups; in this context, the shareholders.

The board has power in both senses. The shareholders effectively delegate power to the board and as a result the latter should be held to account for its use.<sup>57</sup> As in many fields, accountability in corporate governance is something that is required as an exchange for the grant

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<sup>52</sup> See J Roberts and R Scapens 'Accounting Systems and Systems of Accountability-Understanding Accounting Practices in their Organisational Contexts' (1985) 10 Accounting Organizations and Society 443, 449 citing A Giddens Central Problems in Social Theory (London: Macmillan, 1979) p 57.

<sup>53</sup> W Hohfeld 'Fundamental Legal Conceptions as Applied in Judicial Reasoning' 26 Yale LJ 710, 756-757 (1917).

<sup>54</sup> Agents for example are not necessarily more powerful than their principals: see comments of Lawton LJ in Alpha Trading Ltd v Dunshaw-Patten Ltd [1981] QB 290, 307.

<sup>55</sup> Roberts and Scapens, above n 50.

<sup>56</sup> J March and J Olsen Democratic Governance (New York: The Free Press, 1995) p 152; Licht, n 25 above, 17.

<sup>57</sup> M Koenig-Archibugi 'Transnational Corporations and Public Accountability' (2004) Government and Opposition 235, 236.

of authority.<sup>58</sup> Boards also have considerable power over, and control of, the affairs of the company. The board deals with the capital that the shareholders have provided, as well as any profits that it produces, and board members may have no direct pecuniary interest in the company's profitability. Meanwhile, in medium-large companies, which are the primary focus of this article, the shareholders are limited in the monitoring that they can exert over board activity, and non-executive directors, whose function is partly to monitor management for the shareholders, might have been 'captured' by the executive directors, that is, relying overly on the executive directors and other managers for information and depending solely on their explanations.

The amount of discretion a power-holder possesses is also significant in determining the necessary degree of accountability. In exercising their power directors of public companies enjoy 'a remarkable degree of freedom from shareholder command and control.'<sup>59</sup> The fact is that the shareholders in a large company are at a disadvantage when compared with the board. For example, the former lack any or all of the information that is available to the board and which they need in order to assess the directors' performance and/or to know how well the company is doing. This is a classic information asymmetry situation, and making the board accountable remedies that to a certain extent; it at least potentially reduces the level of asymmetry. In addition it is arguable that shareholders cannot protect themselves by way of contracts, for any attempt to write a contract between the shareholders and the board would be otiose as it would be so incomplete, given the various decisions which the board and the managers have to make in the

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<sup>58</sup> Sinclair, n 23 above, 221. See Canadian Democracy and Corporate Accountability Commission 'Canadian Democracy and Corporate Accountability: An Overview of Issues' (2001) 10.

<sup>59</sup> Blair and Stout, n 44 above, 406.

course of managing the company, that it would not be worth making.<sup>60</sup> It is true that the shareholders in the UK and other jurisdictions have the power to remove a director provided that a majority vote is obtained.<sup>61</sup> But to secure removal is difficult. A meeting to vote on a motion to remove can only be called if at least those members representing five per cent of such of the paid up capital of the company as carries the right of voting at general meetings request a meeting. It takes a lot of organization and influence to obtain sufficient requests and then to get a majority vote in favour of removal, and in large companies small shareholders are too disorganised and powerless to impose their will.<sup>62</sup> Sometimes large shareholders, such as institutional investors are able to negotiate with the board for the removal of one or more directors, and this is often seen as a preferable way to proceed. Instead of going through the removal process shareholders might determine that it is much easier to sell their shares.<sup>63</sup>

Accountability is necessary because shareholders are not effective monitors of boards.<sup>64</sup> As we discuss later, accountability can be seen as a much richer concept than monitoring, involving a number of stages. The fact is that shareholders, and this includes many institutional investors like pension funds, tend not to be motivated monitors of boards.<sup>65</sup> The European Commission appeared to acknowledge there was a problem in getting institutional investors to

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<sup>60</sup> F Tung 'The New Death of Contract: Creeping Corporate Fiduciary Duties for Creditors' 57 Emory LJ 809, 813 (2008).

<sup>61</sup> See Companies Act 2006, s168 (the Act).

<sup>62</sup> M Bennedsen and D Wolfenzon 'The Balance of Power in Closely Held Corporations' (2000) 58 J Fin Econ 113, 114.

<sup>63</sup> Often referred to as 'doing the Wall Street Walk.'

<sup>64</sup> Dooley, n 38 above, 525.

<sup>65</sup> For example, see S Bainbridge 'Shareholder Activism and Institutional Investors' (September 2005) available at <http://ssrn.com/abstract=796227> (accessed 13 April 2012); S Bainbridge 'Director Primacy: The Means and Ends of Corporate Governance' 97 Nw U L Rev 547, 571 (2003); B Cheffins *Corporate Ownership and Control: British Business Transformed* (Oxford: OUP, 2008) pp 385-386.



monitor appropriately as it made it a medium-term objective in its Action Plan of 2003 to require such investors to disclose their exercise of voting rights and how they have used these rights so as to enhance participation of these investors in the affairs of companies.<sup>66</sup> The formulation of the Stewardship Code in the UK might also be seen as recognition by the Financial Reporting Council that institutional investors do not monitor adequately.<sup>67</sup>

Furthermore, shareholders can be substantially affected by the actions of the board.<sup>68</sup> As a consequence, the shareholders who contribute the capital to these companies, and indirectly empower the directors, might be said to have reasonable expectations, when investing, that the board will be accountable for what it does as part of the bestowal of power and authority on the board. The requirement to meet expectations can be said to be founded on a degree of moral responsibility that the board has to shareholders. We could assume that shareholders would not be too happy if boards were able to make decisions and take any action without the possibility of what they do being subject to consideration and possible challenge.

However, as already indicated, boards need flexibility to run businesses, so, in the corporate governance context there needs to be a balance between power/authority/discretion that is granted to the board, on the one hand, and the accountability of the board, on the other, as

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<sup>66</sup> Communication from the Commission to the Council and the European Parliament, 'Modernising Company Law and Enhancing Corporate Governance in the European Union – A Plan to Move Forward' (COM 21 May 2003) 284 originally accessible at <http://eur-lex.europa.eu/LexUrlServ/LexUrlServ.do?url=COM:2003:0284:FIN:EN:pdf> and referred to in RiskMetrics Group, 'Study on Monitoring and Enforcement Practices in Corporate Governance in the Member States' (EU 23 September 2009) 187 at n 320 available at [http://ec.europa.eu/internal\\_market/company/docs/ecgforum/studies/comply-or-explain-090923\\_en.pdf](http://ec.europa.eu/internal_market/company/docs/ecgforum/studies/comply-or-explain-090923_en.pdf) (accessed 27 April 2012).

<sup>67</sup> Financial Reporting Council, 'UK Stewardship Code' (September 2012) available at <https://www.frc.org.uk/getattachment/e2db042e-120b-4e4e-bdc7-d540923533a6/UK-Stewardship-Code-September-2012.aspx> (accessed 10 May 2013).

<sup>68</sup> Koenig-Archibugi, above n 55, 236.

the shareholders are at the mercy of the board whose members can be moved by self-interest. Accountability is there to correct errors but what it must not do so, according to some commentators, is operate so as ‘to destroy the genuine values of authority.’<sup>69</sup> There has been significant consideration of the need for this balance in corporate governance,<sup>70</sup> and probably the central issue in this field is establishing the correct blend of power and accountability.<sup>71</sup> At the time of the Cadbury Report it was thought that there needed to be a greater emphasis on accountability,<sup>72</sup> primarily fuelled by the collapse of some large companies like Polly Peck and Maxwell Communications, but by the time the Hampel Committee was convened, things had changed and it was felt that there needed to be greater focus on enterprise which implied giving directors greater discretion and power to be able to pursue their strategies.<sup>73</sup> Nevertheless, there are clear calls from bodies such as the OECD that corporate governance frameworks should include a sufficient amount of accountability.<sup>74</sup>

It is also important to the board and to the company as a whole that the board is seen to possess the quality of accountability. Accountability has been described as being critical to legitimacy<sup>75</sup> and actors often seek to be perceived as accountable in order to acquire

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<sup>69</sup> K Arrow *The Limits of Organization* (New York: WW Norton, 1974) p 78.

<sup>70</sup> Bainbridge, above n 29; Hutchison, above n 8; Spira, above n 3.

<sup>71</sup> Hutchison, *ibid* 1116.

<sup>72</sup> Above n 11, [1.2].

<sup>73</sup> Above n 13, 7. This view has continued amongst some. For example, see Taylor, above n 18, 127. This was because accountability had obscured business prosperity, although it has been said that there does not appear to be sufficient evidence to support that conclusion: Spira, above n 3, 739.

<sup>74</sup> OECD ‘Principles of Corporate Governance’ (2004); OECD, above n 7.

<sup>75</sup> E Fisher ‘The European Union in the Age of Accountability’ (2004) 24 OJLS 495, 500; J Black ‘Constructing and Contesting Legitimacy in Polycentric Regulatory Regimes’ LSE Law, Society and Economy Working Papers 2/2008 24, 23 available at [http://eprints.lse.ac.uk/23040/1/WPS2008-02\\_Black.pdf](http://eprints.lse.ac.uk/23040/1/WPS2008-02_Black.pdf) (27 August 2013); M Moore *Corporate Governance in the Shadow of the State* (Oxford: Hart Publishing, 2013) pp 6-7.

legitimacy.<sup>76</sup> Legitimacy refers to ‘a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norm, values, beliefs and definitions’.<sup>77</sup> It is important because its presence positively affects how people act towards and perceive an organization.<sup>78</sup> Thus Bovens has argued, in the context of powerful public organizations, that being seen as accountable provides them with legitimacy because transparent, responsive and responsible behaviour shores up the public’s confidence in such organizations and means that the public is more likely to trust them with power.<sup>79</sup> It also decreases the costs of persuading the public that they can be trusted.<sup>80</sup>

Any body or group in society needs to be regarded as legitimate so as to be trusted, and for most this requires the presence of accountability mechanisms.<sup>81</sup> The board is no different, within the limited parameters of the life of a company. If there is accountability then the board will be regarded as legitimately holding power and be able to continue to employ it with the express or implicit acquiescence of the shareholders.<sup>82</sup> Conversely if there were no accounting provided by the board then shareholders and others might be suspicious of nearly everything that the board decided to do. As one commentator has said: ‘It would not matter whether the actual

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<sup>76</sup> See, for example, I Castello and J Lozano ‘Searching for New Forms of Legitimacy Through Corporate Responsibility Rhetoric’ (2011) 100 *Journal of Business Ethics* 11, 19, 23, who between 2006-2008 traced an increase in claims by firms that they were engaging in voluntary actions and formal mechanisms to make themselves accountable, which the authors attributed to the firms seeking legitimacy.

<sup>77</sup> M Suchman ‘Managing Legitimacy: Strategic and Institutional Approaches’ (1995) 20 *Academy of Management Review* 571, 574.

<sup>78</sup> *Ibid* 575; Castello and Lozano, above n 75, 12.

<sup>79</sup> M Bovens ‘Two Concepts of Accountability: Accountability as a Virtue and as a Mechanism’ (2010) 33 *West European Politics* 946, 954. See also F Contini and R Mohr ‘Reconciling Independence and Accountability in Judicial Systems’ (2007) 3 *Utrecht L Rev* 26, 28.

<sup>80</sup> Frankel, above n 57, 31.

<sup>81</sup> Bovens, above n 78, 954.

<sup>82</sup> Moore, above n 74, p 41.

decisions being made in a corporation were proper or improper; the fact that they were beyond challenge would make them all suspect.<sup>83</sup> Therefore, if accountability were not required it would not be healthy for the company and it could well mean that its fortunes would be severely compromised, for investors might be unwilling to trust the board and give it support and invest further capital. Where there are accountability mechanisms the shareholders can have a degree of confidence that directors will take action knowing that they will be accountable for what they do, and any impropriety will be exposed. Besides producing existing shareholder confidence it can produce a wider effect by ensuring more market confidence.

In sum there are a range of reasons why board accountability is important in corporate governance. The next section considers why it is also important that there is a shared understanding of what is meant by accountability.

### **3. The Importance of Identifying A Framework For Accountability**

One of the key reasons for identifying what accountability means in corporate governance is that no other issues which interest corporate governance scholars, such as to whom should a board be accountable and how accountability is to be secured, can be considered without first getting to grips with this. The lack of a common definition of accountability creates the risk that debates about accountability may be at cross-purposes: because accountability is a concept that is difficult to pin down, discussions about accountability may in fact be focused on different things. There is the danger that parties who are engaged in devising and assessing corporate measures

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<sup>83</sup> Bottomley, above n 22, p 73.

will have different views as to what mechanisms should be implemented based on their view of what accountability entails.

A further concern is that a failure to identify precisely what is meant by accountability may lead to assumptions that accountability is present, even when it is not, thus masking accountability deficits and undermining policy initiatives aimed at promoting accountability. Thus, as we will see, in the UK and elsewhere, it has been assumed that by promoting board transparency as a corporate governance mechanism, board accountability will also be promoted. But this understanding of accountability is incomplete: transparency alone cannot produce accountability.<sup>84</sup>

Furthermore, while it is generally assumed that accountability is a good thing, it has potential drawbacks. Initiatives that are aimed at promoting accountability, but are hazy about what exactly this entails, can lead to actors being subject to multiple accountability mechanisms incorporating different norms or objectives. These are not necessarily interchangeable: thus an actor who is sufficiently accountable through audit for financial probity, may be insufficiently accountable in other respects, such as legal accountability for errors.<sup>85</sup> Multiple accountability can make it less likely that the actor will act in a desired manner by creating uncertainty regarding what behaviour is required to satisfy different mechanisms with different goals.<sup>86</sup> It can lead to one accountability goal being inappropriately prioritised over another, resulting in a focus on information relevant to the former whilst more important information relevant to the

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<sup>84</sup> See text to ns 167-168 below.

<sup>85</sup> Black, above n 74, 28.

<sup>86</sup> See D Beu and M Buckley 'The Hypothesized Relationship Between Accountability and Ethical Behaviour' (2001) 34 *Journal of Business Ethics* 57, 63, 66; Licht, above n 25, 37; J Koppell 'Pathologies of Accountability: ICANN and the Challenge of "Multiple Accountabilities Disorder"' (2005) 65 *Public Administration Review* 94, 95; B Luke 'Examining Accountability in State-Owned Enterprises' (2010) 26 *Financial Accountability and Management* 134, 157-158; Dubnick and Yang, above n 9, 13.

latter is ignored, sometimes with disastrous results.<sup>87</sup> Poorly designed initiatives can also create a bias towards immediately accessible quantitative data which can be produced and measured to demonstrate compliance with performance measures, to the neglect of difficult to measure, but important, values.<sup>88</sup> It creates a gap between ‘what one knows to be important about one’s work and what others pay attention to’.<sup>89</sup> This can encourage short-termism particularly if the audience has a short-term horizon.<sup>90</sup> In the corporate governance context it has been argued that quarterly reporting of a company’s financial performance and a focus on earnings targets increases short-termism and leads to the neglect by directors of long-term actions such as investment in research and development.<sup>91</sup> From an accountability perspective it is relevant that measuring the success of the latter is uncertain and difficult, since it may involve estimates about future performance and because factors other than management action can affect a company’s performance.<sup>92</sup>

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<sup>87</sup> See for example B Romzek and M Dubnick ‘Accountability in the Public Sector: Lessons from the Challenger Tragedy’ (1987) 47 Public Admin Rev 223.

<sup>88</sup> March and Olsen, above n 54, p 151; P Jos and M Tompkins ‘The Accountability Paradox in an Age of Reinvention: The Perennial Problem of Preserving Character and Judgment’ (2004) 36 Administration and Society 255, 272.

<sup>89</sup> Jos and Tompkins *ibid*.

<sup>90</sup> March and Olsen, above n 54, p 151.

<sup>91</sup> A Rappaport ‘The Economics of Short-term Performance Obsession’ (2005) 61 Financial Analysts Journal 65, 65. Also, see M Tonello ‘Revisiting Stock Market Short-Termism’ (2006), 8 available at <http://ssrn.com/abstract=938466> (accessed 17 June 2013); L Dallas ‘Short-Termism, the Financial Crisis, and Corporate Governance’ 37 J Corp L 265, 268 (2012); D Millon ‘Shareholder Social Responsibility’ 36 Seattle U L Rev 911, 911-917 (2013).

<sup>92</sup> Although the need to develop metrics that value long term performance is recognised: see for example, R Dobbs and T Koller ‘Measuring Long-term Performance’ (2005) The McKinsey Quarterly 17.

Even accountability mechanisms that share common values may strive for different outcomes.<sup>93</sup> They may aim to alter behaviour by causing actors to internalise relevant norms so that the actors voluntarily comply with those norms, or they may seek to alter behaviour by deterring conduct through sanctioning. They may aim to encourage individual actors to engage in more deliberative and critically reflective decision-making<sup>94</sup> or may seek to address defective organizational decision-making processes<sup>95</sup> or to induce proper standards of conduct by monitoring and controlling power.<sup>96</sup> Given this variety of goals, a lack of clarity over what precisely is entailed in promoting accountability can lead to one form of accountability undermining another, without an assessment being made of which form might best promote effective corporate governance. For example Roberts, McNulty and Stiles argue in their study of how non-executive directors promote the accountability of executives, that accountability mechanisms that emphasise the need to control directors' conduct can impede effective dialogue between a principal (meaning the shareholders represented by the non-executive directors), and the agent, (meaning management), discourage debate, and prevent the non-executive directors from obtaining relevant information from management. This in turn would reduce the opportunity for principals to provide more informed feedback and for agents to learn from

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<sup>93</sup> For an overview of the different goals and methods of accountability systems see: Dubnick and Yang, above n 9. See also M Bovens, T Schillemans and P T'Hart 'Does Public Accountability Work? An Assessment Tool' (2008) 86 Public Administration 225, 230-232.

<sup>94</sup> J Lerner and P Tetlock 'Accounting for the Effects of Accountability' (1999) 125 Psychological Bulletin 255, 257.

<sup>95</sup> K Bamberger 'Regulation as Delegation: Private Firms, Decision-making, and Accountability in the Administrative State' 56 Duke L J 377, 418-421 (2006). On decision making biases within organizations see also D Langevoort 'Organized Illusion: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (And Cause Other Social Harms)' 146 U Pa L Rev 101 120-126,131-136 (1997).

<sup>96</sup> R Mulgan "'Accountability': An Ever Expanding Concept?" (2000) 78 Public Administration 555, 563-566; Bovens, Schillemans and T'Hart, above n 93, 225.

mistakes and improve their performance.<sup>97</sup> In order to maximise the beneficial effects of accountability and minimise its harmful effects, measures taken to promote accountability must be carefully designed, and conflicts between such measures avoided. However, this will not be possible without a clear, shared concept of what a framework for accountability looks like and it is to this that the next section turns.

#### **4. Defining Accountability**

To recapitulate, it has been asserted frequently that accountability is a matter of great importance in corporate governance. This is not to say that accountability stands alone as the only central concept of corporate governance. While clearly important in its own right, accountability in corporate governance is related to other matters. These are ‘delegation, responsibility, disclosure, autonomy, authority, power and legitimacy,’<sup>98</sup> some of which have been referred to already and others will be referred to in the ensuing discussion.

Accountability is widely accepted to be an elusive concept the meaning of which often depends on context.<sup>99</sup> While this creates challenges for discussing accountability at a general level, more embedded discussions are also problematic because they can reflect the preoccupations of the particular discipline in question, and at the risk of neglecting important aspects of accountability. It is therefore worthwhile stepping back to examine accountability at a more general level. While much of the literature has considered accountability in the public

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<sup>97</sup> Roberts, McNulty and Stiles, above n 4, S15-S19. See also Sinclair, above n 23, 233 criticising performance evaluation for having the same effect.

<sup>98</sup> K Chansa ‘Accountability: A Case Study of ZSIC’ (2006) referred to in ‘Accountability in Corporate Governance’ Economy Building (8 March 2011) available at <http://economybuilding.wordpress.com/2011/03/08/accountability-in-corporate-governance/> (accessed 2 December 2011).

<sup>99</sup> Sinclair, above n 23, 221 arguing that the more we try to define the concept the murkier it becomes.



sphere and involving political power, it has been suggested that private law, which obviously includes company law, also involves the need for consideration of the meaning and operation of accountability.<sup>100</sup> So, clearly what is said in other contexts can be highly relevant, in broad terms, in determining the meaning and application of accountability in corporate governance, as well as in other areas of private law.

Bovens has argued that part of the difficulty with accountability is that it is used to refer to two different concepts. The first is normative, and refers to accountability as a positive quality or virtue possessed by organizations. Accountability in this sense is a quantifiable 'product'-an entity can be more or less accountable<sup>101</sup> and often is ascribed to organizations that demonstrate appropriate standards of governance.<sup>102</sup> One of the difficulties with this concept of accountability is the lack of consensus regarding what standards of conduct or qualities organizations must exhibit before they will be deemed to possess it. It has been suggested that organizations that behave transparently, responsibly, courteously and fairly, or that deliver services to a high standard, may be accountable in this sense.<sup>103</sup>

The second concept of accountability describes a process involving several stages. It is generally agreed that this sense comprises a number of core elements.<sup>104</sup> First a person or entity

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<sup>100</sup> H Kelsen *Introduction to the Problems of Legal Theory* (trans B L Paulson, S L. Paulson) (Oxford, Clarendon Press 2002) pp 95-96.

<sup>101</sup> L O'Connell 'Program Accountability as an Emergent Property: The Role of Stakeholders in a Program's Field' (2005) 65 *Public Administration Review* 85, 85.

<sup>102</sup> Bovens, above n 78, 957.

<sup>103</sup> L Dicke 'Ensuring Accountability in Human Services Contracting: Can Stewardship Theory Fit the Bill?' (2002) 32 *The American Review of Public Administration* 455, 462; Koppell, above n 85. See also literature cited in Bovens, *ibid*, 950.

<sup>104</sup> Mulgan, above n 96, 555; Bovens, Schillemans and T'Hart, above n 93. Not everyone agrees that all the elements outlined need be present, for example see J Kaler 'Responsibility, Accountability and Governance' (2002) 11 *Business Ethics: A European Review* 327, 329-330.

(actor) must be called to account, that is, obliged to recount or report his or her conduct to a third party (the audience). This involves the provision of information to the audience and has been referred to as ‘accounting for verification,’<sup>105</sup> or ‘informative accountability.’<sup>106</sup>

The next stage in the process has been referred to as explanatory accountability.<sup>107</sup> Alongside providing information actors must explain and justify their conduct against a set of externally set values or standards. This highlights the essentially normative nature of accountability which has been described as ‘those methods, procedures, and forces that determine what values will be reflected in ...decisions’ (emphasis added).<sup>108</sup> It reflects a moral order and communicates ‘ideals of accepted behaviour’.<sup>109</sup> This stage is key to the idea that accountability includes the notion of being answerable. Of course, the justification might include excuses for what has been or has not been done. It is probably correct to say that explanation involves the actor saying what has been done and how it has been done, and justification involves a statement as to why it has been done. Justification includes the actor being able to persuade the audience concerning the correctness and appropriateness of what has been done, and this might then have a profound effect on the next stage of accountability.

The third stage is that the audience can ask questions and debate the actor’s conduct before passing judgment. This questioning stage, together with perhaps the next part, fulfils what is often meant by holding someone accountable.<sup>110</sup>

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<sup>105</sup> J Uhr ‘Redesigning Accountability: From Muddles to Maps’ (1993) 65 Australian Quarterly 1, 4.

<sup>106</sup> Kaler, above n 104, 328.

<sup>107</sup> Uhr, above n 105.

<sup>108</sup> H Simon, D Smithburg and V Thompson Public Administration (New York: Knopf, 1950) p 513.

<sup>109</sup> Roberts and Scapens, above n 50, 448.

<sup>110</sup> A Allen ‘2003 Daniel J. Meador Lecture: Privacy Isn’t Everything: Accountability as a Personal and Social Good’ 54 Al L Rev 1375, 1382 (2003).

Finally, there must be the possibility of consequences being visited upon the actor.<sup>111</sup> It is the prospect of consequences rather than their actual imposition that matters and that ‘makes the difference between the non-committal provision of information and being held to account’.<sup>112</sup> Some approaches have suggested that an accountability regime requires negative consequences being imposed on ones who are accounting if they fail to account adequately, or at all, or the accounting of their actions does not comply with the requirements demanded of them. Others describe this last stage as the punishment event, but punishment is not necessarily an element.<sup>113</sup> While consequences may have a negative flavour and may comprise formal or informal sanctions,<sup>114</sup> sanctions are not an essential element and consequences may instead include a requirement to make reparation, or may be positive in effect, comprising promotions and rewards.<sup>115</sup> Kaler describes this stage as the coercive element of accountability, emphasising that one purpose of imposing consequences is to control behaviour.<sup>116</sup>

In discussing the process of accountability the following key questions are usually posed: who is accountable, to whom, for what, through what mechanisms and by what standards is conduct to be judged, what consequences follow and what goals are sought by the imposition of accountability? However many definitions of accountability are directed at providing the answers to the first three questions: who, what and to whom.

Thus Mulgan has identified collective, individual and role accountability which are primarily ways of describing who is accountable and for whose actions. The first refers to the

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<sup>111</sup> Mulgan, above n 96, 555; Bovens, Schillemans and T’Hart, above n 93, 225.

<sup>112</sup> Bovens, above n 23, 451.

<sup>113</sup> Behn, above n 23,1; Kaler, above n 104, 329; Koenig-Archibugi, above n 55, 238.

<sup>114</sup> Lerner and Tetlock, above n 94, 256.

<sup>115</sup> Harlow and Rawlings, above n 32, 545 who do not agree that sanctions are a core aspect of accountability.

<sup>116</sup> Kaler, above n 104, 329-330. He sees the attribution of blame as a weaker version of coercive accountability and punishment as the stronger version: *ibid* 330.

accountability of an organization for conduct carried out on its behalf by its agents and employees. The second refers to an individual's accountability for his or her own conduct. Role accountability refers to individuals' accountability for matters falling within their role though others within their organization are individually responsible for what has occurred. A person such as a corporate officer may have role accountability for certain tasks or areas of work and will also have individual responsibility for the manner in which he or she discharges his or her office.<sup>117</sup>

Meanwhile professional, managerial, political and legal accountability all give different answers to the questions of to whom and for what. So, professional accountability refers to accountability to a professional body or other peers, measured against a set of professional norms and usually arises where actors exercise a high degree of discretion in discharging their obligations.<sup>118</sup> Political accountability refers to judgment by political actors, or possibly by the media, against a set of societal/political norms. Legal accountability refers to accountability to legal institutions such as courts or regulators for compliance with legal norms. Managerial accountability describes accountability to organizational superiors for matters such as efficiency and cost control, and is associated with a high degree of control over the actor.<sup>119</sup>

Compliance-based and performance-based accountability address 'for what' the actor is accountable, with the former judging the actor's conduct against externally defined rules and procedures<sup>120</sup> whilst the latter measures it against a set of outcomes.<sup>121</sup> March and Olsen identify

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<sup>117</sup> Mulgan, above n 45, p 193.

<sup>118</sup> Romzek and Dubnick, n 87 above, 229.

<sup>119</sup> Romzek and Dubnick *ibid* 228-229; Contini and Mohr, above n 78, 30.

<sup>120</sup> Jos and Tompkins, above n 88, 257.

similar categories, contrasting accountability for outcomes, which holds actors accountable when things turn out badly, with accountability for behaviour which allows actors to escape liability for poor consequences provided that they have followed proper processes and acted with dedication and integrity.<sup>122</sup> Scott meanwhile places the answers to ‘for what’ into three categories, namely accountability for economic values such as financial probity and performance, for social and procedural values such as fairness, equality and legality and for security values such as safety.<sup>123</sup>

Accountability can also be classified ‘spatially’, that is, upwards (reporting to superiors in a hierarchy), horizontal (reporting to others on roughly the same level) and downwards (accountability to those over whom the actor wields authority).<sup>124</sup> The last sometimes refers to accountability to consumers and the market<sup>125</sup> but there is disagreement over whether these are strictly accountability mechanisms. Mashaw argues that since, for example, in product markets producers are ‘responsible’ to consumers for the quality or price of their products and are assessed against standards constituted by consumer preferences with consequences in terms of consumers’ willingness to buy the product, accountability is present.<sup>126</sup> Mulgan, in contrast,

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<sup>121</sup> Ibid, 259. Terminology varies: for example Sinclair defines performance based accountability as managerial accountability which she distinguishes from administrative accountability which is concerned with monitoring processes: Sinclair, above n 23, 227.

<sup>122</sup> March and Olsen, above n 54, pp 154-155.

<sup>123</sup> Scott, above n 32, 42.

<sup>124</sup> Mulgan, above n 45, pp 27-28

<sup>125</sup> Scott, above n 32, 42, 48-49.

<sup>126</sup> J Mashaw ‘Accountability and Institutional Design: Some Thoughts on the Grammar of Governance’ in M Dowdle (ed), *Public Accountability: Designs, Dilemmas and Experience* (Cambridge: CUP, 2006) pp 115, 122. See also Scott, above n 32, 49.

considers this to be a form of responsiveness,<sup>127</sup> referring to an actor's propensity to anticipate and pursue the wishes or needs of others,<sup>128</sup> which can be a product of accountability, but can also arise in its absence.<sup>129</sup> Accepting Mashaw's point that formal accountability mechanisms and market-based mechanisms 'blend into each other and provide alternative paths to a similar overall goal, that of promoting publicly responsible behavior,'<sup>130</sup> they are nevertheless distinct. The latter do not oblige actors to explain and justify their actions and, as Mulgan argues, extending accountability in this fashion obscures the distinction between voice (represented by accountability) and exit (market choice).<sup>131</sup> On the other hand, Mulgan does accept that the stock market is a key accountability mechanism for listed companies on the basis that they are obliged to provide accounts and reports and possibly because disclosure does not necessarily lead to investors exiting but could result in the exercise of voice.<sup>132</sup>

Another source of disagreement is whether accountability only operates ex post or whether it includes ex ante 'checks on decision-making',<sup>133</sup> designed to shape the content of particular decisions.<sup>134</sup> Ex ante mechanisms such as consultation and participation obligations have important prophylactic effects<sup>135</sup> but it has been argued that they usually lack the elements

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<sup>127</sup> R Mulgan 'Contracting Out and Accountability' (1997) 56 Australian Journal of Public Administration 106, 115. See also Black, above n 74 at fn 103.

<sup>128</sup> M O'Loughlin, 'What is Bureaucratic Accountability and How Can We Measure It?' (1990) 22 Administration and Society 275, 283.

<sup>129</sup> Mulgan, above n 96, 567.

<sup>130</sup> Mashaw, above n 126, 123.

<sup>131</sup> Mulgan, above n 45, p 21. However Mashaw argues that mechanisms that Mulgan would recognise as accountability mechanism may in practice operate very much like market mechanisms where control is exercised through influence rather than a formal calling to account: Mashaw *ibid* 124.

<sup>132</sup> *Ibid* 122.

<sup>133</sup> J Freeman 'The Private Role in Public Governance' 75 NYUL Rev 543, 664-665 (2000).

<sup>134</sup> As argued Frankel, above n 57, 32.

<sup>135</sup> Mashaw, above n 126, 132.

of justification, judgment and consequences<sup>136</sup> and probably cannot act as a substitute for ex post accountability, the functions of which include, but can go beyond, behaviour alteration and control to include reparation and retribution. However, where actors are being held to account for the results of their conduct, but it is difficult to evaluate those results, because of their complexity or because the results may appear a long time after the conduct in question, then ex ante mechanisms may be the only effective means to ensure that actors explain their decisions and take account of their audience's preferences.<sup>137</sup>

Accountability as a quality and as a process are closely linked, with the latter promoting the former. However it is unclear whether, for the former to be present, an actor must be subject to the process of accountability. For example if a company responds to consumer pressure by becoming more transparent, or by producing higher quality goods at lower prices, or by dealing more courteously with complaints, would it possess the quality of accountability even if it was not subject to an accountability process? One response is that actors will not exhibit these qualities without such a process. But even if actors were voluntarily compliant it is unclear whether it would be correct to describe them as possessing accountability in the absence of an obligation to account and to face consequences.<sup>138</sup> The presence of the quality of accountability may depend not just practically but also theoretically on the existence of an accountability process.

## **5. Defining Accountability in Corporate Governance**

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<sup>136</sup> Bovens, above n 23, 453; see also Mulgan, above n 45, pp 19-20.

<sup>137</sup> Frankel, above n 57, 32-35.

<sup>138</sup> For example Koppell lists transparency and exposure to liability as essential components of accountability, but not explicitly the obligation to provide an account: Koppell, above n 85, 96-97.

In the light of the elements of accountability canvassed above, this section turns to what must be taken into consideration when discussing board accountability in corporate governance. It does not seek to identify what forms of accountability are desirable, or to map out and assess the effectiveness of all the ways in which directors may be accountable. Rather it addresses the a priori issue of what kinds of questions must be posed and answered when assessing whether accountability is present, effective and desirable.

Bottomley has said that: ‘Corporate lawyers have long been alert to the problems of promoting and ensuring accountability’.<sup>139</sup> However, as mentioned at the outset, the term ‘accountability’ tends to get thrown around cavalierly. The presence or absence of accountability seems to be assumed without an account of what it might mean to make such claims. Nevertheless in most, if not all, occasions when it is mentioned, the sense in which it seems to be used is accountability as a process and this is the sense that we will adopt.<sup>140</sup> Given this, the key questions that must be answered are to whom directors are accountable, for what and how. These are complex issues and it is beyond the scope of this article to discuss the matters in detail, or to provide definitive answers to these questions but we must broach them in passing in order to put some flesh on our discussion.

The answers to the first and second questions may be found in the shareholder value theory which is generally perceived to apply to Anglo-American company law.<sup>141</sup> This provides that the directors are to do that which will ultimately benefit the shareholders of the company. In the

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<sup>139</sup> Bottomley, above n 22, p 69.

<sup>140</sup> See for example Blair and Stout, above n 44 (discussing to whom and how directors should be accountable; Bainbridge ‘Director Primacy’, above n 64, 603 (discussing accountability to shareholders and accountability ‘mechanisms’); Jones, above n 3 (discussing liability rules as a means of promoting accountability).



UK this theory is, arguably, codified in s 172(1) of the Companies Act 2006 ('the Act'), albeit with a slightly different tag namely, according to the Company Law Review Steering Group, 'enlightened shareholder value,' which states, inter alia, that directors are to promote the success of the company for the benefit of the members as a whole.<sup>142</sup> Consequently, it can be said that the directors are accountable to maximising 'the utility of the pool of shareholders.'<sup>143</sup> Thus, in the context of shareholder value, one commentator defined accountability as 'the process of supervision and control intended to ensure that the company's management acts in accordance with the interests of the shareholders.'<sup>144</sup> This is consistent with what the Cadbury Committee stated, namely:

Boards of directors are accountable to their shareholders and both have to play their part in making that accountability effective. Boards of directors need to do so through the quality of the information which they provide to shareholders, and the shareholders through their willingness to exercise their responsibilities as owners.<sup>145</sup>

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<sup>142</sup> Company Law Review 'Modern Company Law for a Competitive Economy: Strategic Framework' (DTI 1999) at [5.1.19]. The Review Group was established by the DTI to examine UK company law and formulate principles for its reform. For a discussion of enlightened shareholder value, see A Keay *Enlightened Shareholder Value and Corporate Governance* (Oxford: Routledge, 2013). This book argues that s 172(1) effectively enshrines a form of shareholder value in UK law. The form of shareholder value is one that accepts that in acting in the best interests of the shareholders it is necessary for directors to take into account the interests of stakeholders. See also Brenda Hannigan, *Board failures in the Financial Crisis: Tinkering with Codes and the Need for Wider Corporate Governance Reforms: Part 2* (2012) *COMPANY LAWYER* 35, 39-40

<sup>143</sup> Reberioux, above n 3, 509.

<sup>144</sup> J Parkinson *Corporate Power and Responsibility* (Oxford: Oxford University Press, 1994) and quoted in J Solomon, *Corporate Governance and Accountability* (Chichester: John Wiley, 2nd edn, 2007) p 13.

<sup>145</sup> Above n 11, [3.2], [3.3], [3.4]. Many commentators, principally those adhering to agency theory and/or shareholder primacy, refer to the shareholders as owners of companies (e.g. R Hessen, 'A New Concept of Corporations : A Contractual and Private Property Model' (1979) 30 *Hastings Law Journal* 1327 at 1330; E

One of the benefits of a shareholder value approach is said to be that it simplifies things as far as determining whether the directors have done their job properly. They only have one group to whom they must account, and so they can take their lead as to how they are to act and the decisions they make from what would benefit the shareholders.<sup>146</sup> As we saw, studies on the effects of accountability support this approach as they demonstrate that when people are accountable to more than one audience and in more than one way this can lead to poor outcomes. But the insights from the accountability literature highlight that the problem created by multiple accountability is not just that it renders directors unaccountable and enables them to shirk more easily which is a common criticism of stakeholder theory,<sup>147</sup> Rather directors will remain accountable to third parties but will prioritise one set of goals against which they can be held accountable over another, for reasons unrelated to good corporate governance and the long term interests of the company. This may occur because the consequences contingent on non-performance against one set of goals may be more easily measurable or felt more immediately than the consequences contingent on the other, thus encouraging a more short-term perspective.<sup>148</sup> For example measuring quarterly financial performance is likely to be easier than measuring whether having regard to the impact of the company's operations on the community

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Steinberg, 'The Responsible Shareholder' (1992) 1 *Business Ethics : A European Review* 192 at 192; M van der Weide, 'Against Fiduciary Duties to Corporate Stakeholders' (1996) 21 *Delaware Journal of Corporate Law* 27 at 77). But many others would disagree –see literature at n 31 above, and some would point to cases such as *Bligh v Brent* (1837) 2 Y & C Ex 268, *Salomon v Salomon and Co Ltd* [1897] AC 22 and *Short v Treasury Commissioners* [1948] 1 KB 116 in support.

<sup>146</sup> The Committee on Corporate Law 'Other Constituency Statutes: Potential for Confusion' 45 *Bus Law* 2253, 2269 (1990); Keay, above n 35, pp 383, 385.

<sup>147</sup> E Sternberg 'The Defects of Stakeholder Theory' (1997) 5 *Corporate Governance* 3, 5.

<sup>148</sup> See text above to n 85 and following.

and the environment under s. 172 (1)(d) promotes the success of the company for the benefit of its members as a whole. Accountability mechanisms that required directors to pay attention to the latter may be ineffective insofar as they co-exist with accountability mechanisms that encourage attention to the former.

There has been extensive criticism of the shareholder value approach,<sup>149</sup> but it is not intended to examine these criticisms in the context of this article as the issues are complex and would require greater space than can be devoted to it here. As indicated earlier, our aim is to provide a framework that can be used for consideration of accountability of boards which importantly can be applied to whatever approach might be embraced. For the sake of exposition this article assumes that the shareholder value approach accurately encapsulates the legal position in the UK. We do note that given the fact that accountability is said to be necessary where persons are affected by another's conduct arguably directors should be accountable to a broader range of stakeholders.<sup>150</sup> Again, while it is not possible to resolve this dispute within the confines of the present discussion, nor is that its aim, this disagreement highlights that in order to promote accountability for tangible results, decisions must first be taken about relevant goals and priorities. Arguing that directors should be accountable for promoting shareholder interests constitutes a normative judgment about the proper role of the company and how to weigh the

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<sup>149</sup> For example, see D G Smith, 'The Shareholder Primacy Norm' (1998) 23 *Journal of Corporation Law* 277; M Blair and L Stout, 'Director Accountability and the Mediating Role of the Corporate Board' (2001) 79 *Wash U L Q* 403; L Stout, "Bad and Not-So-Bad Arguments for Shareholder Primacy" (2002) 75 *Southern California Law Review* 1189; P Ireland, 'Shareholder Primacy and the Distribution of Wealth' (2005) 68 *MLR* 49; Keay, above n 36.

<sup>150</sup> See, for example, Institute of Directors in Southern Africa 'King Code of Governance for South Africa 2009, Code of Governance Principles' which requires accountability to stakeholders, available at <http://www.ecgi.org/codes/documents/king3.pdf> (accessed on 23 December 2013).

claims of its various stakeholders. Claims that directors should be more or less accountable to others incorporate similar normative judgments either explicitly or implicitly.

Turning to how directors are accountable, it will be recalled that accountability as a process requires actors to provide an account to a third party audience that can ask questions and pass judgment, with the possibility of consequences following. An absence of any of these features will mean that full accountability is not present.

Taking the requirement to provide an account first, directors have to provide accurate information concerning their decisions and actions, because shareholders need to be informed as to what has been done. An element of this part is transparency, which involves disclosing and reporting, and certainly candid reporting is an essential element.<sup>151</sup> A possible obstacle is the fact that companies guard their knowledge resources, including information about their internal operations, business practices, and decision procedures, and they only disclose what they must.<sup>152</sup>

The provision of information could be the result of a statutory or other requirement which demands a regular delivery, or it could be the result of legal proceedings and the demand for information emanating from a court hearing, following on from the initiation of derivative proceedings. Disclosure takes place through a variety of mechanisms including the reports of the various committees of the board, such as the audit committee,<sup>153</sup> the financial reports,<sup>154</sup> the

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<sup>151</sup> Licht, above n 25, 29.

<sup>152</sup> E Gorga and M Halberstam 'Knowledge Inputs, Legal Institutions, and Firm Structure' 101 Nw U L Rev 1123 (2007); M Siebecker 'Trust & Transparency: Promoting Efficient Corporate Disclosure Through Fiduciary-Based Discourse' 87 Wash U L Rev 115, 117 (2009); E Gorga and M Halberstam, 'Litigation Discovery and Corporate Governance: The Missing Story About the "Genius of American Corporate Law"' (28 March 2013) available at <http://ssrn.com/abstract=2239322> (accessed 1 May 2013).

<sup>153</sup> FRC, above n 14, C.3.8.

Directors' Report<sup>155</sup> and the Strategic Report that large companies have to prepare and file pursuant to s414A of the Act.<sup>156</sup> Section 414C(1) states that the purpose of the Strategic Report is to inform shareholders so as to permit them to assess how the directors have performed their duty under s172(1),<sup>157</sup> namely to act so as to promote the success of the company for the benefit of the members. It involves a form of narrative reporting and is intended to provide shareholders with a wide array of information<sup>158</sup> such as a fair review of the company's business, a description of the principal risks and uncertainties facing the business,<sup>159</sup> the main trends and factors likely to affect the future development, performance and position of the company's business, information about environmental matters, the company's employees, and social and community issues, and including information relating to the policies of the company concerning the last mentioned issues.<sup>160</sup>

The provision of information and disclosure addresses the problem of information asymmetry, and is probably one of the principal benefits of transparency.<sup>161</sup> Transparency is

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<sup>154</sup> Generally regarded as part of the accountability process: Koh, Laplante and Tong, above n 4. Financial reporting has been regarded this way for many years, and certainly since the time of Jeremy Bentham in the early 19<sup>th</sup> century : Gallhofer and Haslam, above n 36, 321-322.

<sup>155</sup> Required by the Act, s 416.

<sup>156</sup> This effectively replaced the Business Review from 1 October 2013: The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013, SI 2013/1970.

<sup>157</sup> The Act, s 414C(1).

<sup>158</sup> Query whether this actually occurs. Empirical studies suggested that the Business Review often gave little away (P Taylor 'Enlightened Shareholder Value and the Companies Act 2006' (PhD thesis, Birkbeck College, University of London 2010) 186; O Aiyegbayo and C Villiers 'The Enhanced Business Review: Has it Made Corporate Governance More Effective?' [2011] JBL 699, 715-716) and the same shortcoming might well be innate in the Strategic Report.

<sup>159</sup> The Act, s 414C(2).

<sup>160</sup> The Act, s 414C(7).

<sup>161</sup> B Hermalin and M Weisbach 'Transparency and Corporate Governance' (21 January 2007) 1 available at <http://ssrn.com/abstract=958628> (accessed 1 May 2013).

regarded in different ways in corporate governance. It is viewed as separate from accountability,<sup>162</sup> as a mechanism of accountability<sup>163</sup> or, problematically, as synonymous with accountability.<sup>164</sup> The Cadbury Report came close to this last position when it stated that: ‘Boards of directors are accountable to their shareholders...[they]need to do so through the quality of the information which they provide to shareholders...’<sup>165</sup> It later stated: ‘The most direct method of ensuring that companies are accountable for their actions is through open disclosure by boards.’<sup>166</sup> Accountability is also used in this sense by the UK Corporate Governance Code.<sup>167</sup> This highlights part of the problem that this article seeks to address: that an absence of a clear conception of what is entailed by accountability may lead to an assumption that accountability is present when in fact it may not be. The voluntary system that operates in the UK under this Code purports to have some focus on accountability, without explaining what that is, when really its focus has been on disclosure. In fact Essamel and Watson refer to the UK’s system as ‘an accountability through disclosure system.’<sup>168</sup> This is evident from some of the statements and provisions in the reports that have considered the issue of corporate governance in the UK, and the various iterations of the Combined Code and the UK Corporate

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<sup>162</sup> Department of Business, Innovation and Skills ‘Corporate Governance’ available at <http://webarchive.nationalarchives.gov.uk/20090902193559/berr.gov.uk/whatwedo/businesslaw/corp-governance/page15267.html> (accessed, 29 April 2013).

<sup>163</sup> Hampel Report, above n 13, [1.2]; J Roberts ‘No One is Perfect: The Limits of Transparency and an Ethic for ‘Intelligent’ Accountability’ (2009) 34 *Accounting, Organizations and Society* 957, 966.

<sup>164</sup> Licht, above n 25, 29; J Sarra ‘New Governance, Old Norms and the Potential for Corporate Governance Reform’ (2011) 33 *Law and Policy* 576, 576.

<sup>165</sup> Above n 11, [3.4].

<sup>166</sup> *Ibid*, [5.2].

<sup>167</sup> FRC, above n 14.

<sup>168</sup> ‘Wearing Two Hats: The Conflicting Control and Management Roles of Non-Executive Directors’ in K Keasey, S Thompson and M Wright (eds) *Corporate Governance: Economic, Management and Financial Issues* (Oxford: OUP, 1997) p 56.

Governance Code that have been brought into existence. An example is where the latter Code provides that a separate section of the Annual Report should describe the work of the nomination committee.<sup>169</sup> The reporting merely requires that the work of the committee is to be described. The UK Corporate Governance Code seems to see disclosure as accountability, but it is only one, although important, aspect of the whole process of accountability. While actions such as disclosing, which contribute to transparency, are necessary in the process of accounting, an accounting process must involve more than simply revealing facts or processes, or reporting what has been done. Accountability requires active inquiry such as asking questions, passing judgment and the possibility of consequences.<sup>170</sup> Again the board must not only disclose but also explain and justify its actions, omissions, risks, and dependencies for which it is responsible.<sup>171</sup> As part of the process of explanation the board should set out the background to its actions, provide a clear rationale for them with, perhaps, reference to any mitigating actions taken to address any particular issues and risks. The element of justification acts as a check on the decision-making of the board, and acts in such a way as to move the balance between director accountability and director power somewhat towards the former.

The Strategic Report that must be prepared by all companies save those that come within the small company exemption,<sup>172</sup> provides one example of this aspect of accountability. It aims to provide readers, who are primarily going to be the shareholders, with an analysis and explanation of the business of the company as an operational and commercial entity as seen by

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<sup>169</sup> FRC, above n 14, [B.2.4].

<sup>170</sup> Roberts, above n 160, 957.

<sup>171</sup> AccountAbility 'AA1000 Framework Standards for Social and Ethical Accounting, Auditing and Reporting' (November 1999) 8 available at <http://www.accountability.org/images/content/0/7/076/AA1000%20Overview.pdf> (accessed 27 August 2013).

<sup>172</sup> The Act, s 414B.

the managers.<sup>173</sup> One would therefore expect the document to include some explanation and justification by the board for what has been done and this seems to be assumed by parts of s 414C of the Act. For example, s 414C(3) provides that the Review should provide a balanced and comprehensive analysis of the development and performance of the company's business during the financial year, and the position of the company's business at the end of that year, consistent with the size and complexity of the business. This suggests that there is a need to explain and justify what the board has done. If this is done, it would line up with the purpose of s 414C, which is to provide a greater degree of transparency and accountability as far as the work of the directors goes.<sup>174</sup>

Disclosure and justification of actions are necessary, but they are just the starting point. For accountability to be effective, there must be a dialogue.<sup>175</sup> The next stage of the process of accountability requires therefore, that following their explanations and justifications, there must be an opportunity for directors to be questioned about their decisions and judged on their responses. One of the ways that transparency facilitates accountability is that it allows for such dialogue and evaluation.<sup>176</sup> Shareholders' questions might, of course, precipitate further explanation and justification from the board. For example, recently, in response to questions raised by an activist shareholder in the Swiss bank UBS, concerning explanations about UBS's

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<sup>173</sup> Aiyegbayo and Villiers, above n 155, 705.

<sup>174</sup> See Keay, above n 141, 157 as far as the precursor to the Strategic Report, the Business Review, was concerned.

<sup>175</sup> S Zadek 'Balancing Performance, Ethics and Accountability' (1998) 17 *Journal of Business Ethics* 1421, 1428.

<sup>176</sup> Bamberger, above n 95, 407.



investment arm, the board of UBS stated that it would effectively explain and justify their views at the following annual general meeting.<sup>177</sup>

The reporting and explaining that boards are to engage in, followed by questioning, permits the shareholders to better understand how the company is progressing, which enables them to conduct better monitoring. The questioning element, which might lead to the exculpation of the board or the attribution of blame, can be regarded as critical.<sup>178</sup> Questioning could occur at annual or other general meetings of shareholders, in informal meetings between the board and shareholders (usually this would be substantial shareholders, such as institutional investors<sup>179</sup>) or in court hearings held pursuant to shareholders' derivative actions,<sup>180</sup> where questions are asked by counsel for a shareholder(s) and, possibly, by the judge.

Essentially, in the corporate governance context the process of accounting will usually operate ex post rather than ex ante. The problem with this is that it could be too late either for the accountability process influencing what the board decides to do or for the shareholders to prevent something being done that contravenes the law or does not meet with their approval. Ex ante accounting may therefore be sometimes desirable. It could also benefit the board as it might

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<sup>177</sup> N Goodway 'Activist Shareholder Knight Vinke Urges UBS to Split Up Investment Bank' *The Independent* (London, 3 May 2013).

<sup>178</sup> Kaler, above n 104, 330. Kaler sees punishment as the step after the attribution of blame, and it is to that matter we refer next.

<sup>179</sup> For example, see H Short and K Keasey 'Institutional Shareholders and Corporate Governance in the United Kingdom' in Keasey, Thompson and Wright, above n 165, p 32; B Black and J Coffee 'Hail Britannia? Institutional Investor Behavior Under Limited Regulation' 92 *Mich. L. R.* 1999 (1994); A Keay 'Company Directors Behaving Poorly: Disciplinary Options for Shareholders' [2007] *JBL* 656; J McCahery, Z Sautner and L Starks 'Behind the Scenes: The Corporate Governance Preferences of Institutional Investors' (December 2010) available at <http://ssrn.com/abstract=1571046> (accessed 29 April 2012).

<sup>180</sup> Under Part 11 of the Act. These actions are brought by shareholders effectively on behalf of the company and against directors and others.

enable the board to secure feedback for what it intended to do, and it might provide comfort to the board in that it knows that it has the support of the shareholders before engaging in a particular course of action. In addition, ex ante accounting may be necessary where the quality of the directors' decisions are not easily assessed ex post and so it is not easy to hold them adequately to account.<sup>181</sup> There are some formal ex ante mechanisms in place but they are exceptions.<sup>182</sup> An informal instance of ex ante accounting is where a board holds talks with some shareholders, usually institutional investors, before taking any specific action to gauge the reactions of the latter. On the other hand there is always the danger that ex ante accounting could involve the board endeavouring to shift the burden of responsibility. This could well attenuate the authority and responsibility of the board and that could be deleterious for decision-making.

In any event, if the possibility of ex post sanctions or even other consequences are sufficiently likely, and the nature of consequences could be severe, this is probably going to deter ex ante deviation of boards from not doing their jobs properly.<sup>183</sup> Certainly for full accountability to be present there must, at least, be some possibility of consequences for the one who accounts, flowing from what they have done or not done.<sup>184</sup> Thus Bavly states that directors must accept blame for bad choices.<sup>185</sup> This does not necessarily mean that directors will be held legally liable for what they have done as in the UK and other jurisdictions directors have a wide discretion and are not usually held liable for honest mistakes. But this does not mean that they should not be required to explain what they have done and to justify it to the members. Accepting blame in this context might simply entail accepting that they were responsible for what was done, without any legal

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<sup>181</sup> See text to n 137 above.

<sup>182</sup> For example the need to obtain a shareholder vote on remuneration policy: The Act, s 439A and s 226B.

<sup>183</sup> Bamberger, above n 95, 393.

<sup>184</sup> Bovens above n 23, 450; Bovens, Schillemans and T'Hart, above n 93, 234.

<sup>185</sup> Bavly above n 2, p 8.

liability attaching to their actions. Moreover, as this article demonstrates, accountability is not to be equated with legal accountability, that is, liability imposed in judicial proceedings. Rather legal accountability is just one form of accountability process. If legal accountability is considered undesirable (as proponents of a business judgment rule argue<sup>186</sup>) this does not rule out directors being subject to other accountability processes.

It might be said that in corporate governance accountability is a weapon of supervision and unless there are sanctions it will not be effective, as it will not have a deterrent effect.<sup>187</sup> Insofar as shareholders exert some consequences on the board, accountability could be perceived as a disciplinary mechanism.

While Licht does not accept that accountability includes a punishment element, he accepts that an important part of accountability is righting wrongs (making amends), and if this does not occur then surely there must be some form of enforcement.<sup>188</sup> Unless there are consequences for failing to account then accountability may be viewed as pointless and meaningless.<sup>189</sup> As far back as 1978 the US Business Roundtable said in a report that the enforcement of accountability was important.<sup>190</sup>

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<sup>186</sup> See for example, Margaret M. Blair & Lynn A. Stout, Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law, U. PA. L. REV. 1735, 1789-1798 (2001); Melvin Eisenberg, The Divergence of Standards of Conduct from Standards of Review in Corporate Law, 62 FORDHAM L. REV. 437; Edward B. Rock & Michael L. Wachter, Islands of Conscious Power; Law Norms and the Self-Governing Corporation, 149 U. PA. L. REV. 1619, 1658-1659 (2001); Bayless Manning, *The Business Judgment Rule and the Director's Duty of Attention: Time for Reality*, (1984) 39 BUS. LAW. 1477, 1481-1485, 1490-1492 (1984).

<sup>187</sup> Several commentators argue that the possibility of sanctions is an element of accountability. For instance, Bovens, above n 23, 451; K Strom 'Parliamentary Democracy and Delegation' in K Strom, W Müller and T Bergman (eds) *Delegation and Accountability in Parliamentary Democracies* (Oxford: OUP, 2003) p 62; Mulgan, above n 45, 9; Bovens, Schillemans and T'Hart, above n 93, 234.

<sup>188</sup> Licht, above n 25, 5, 29.

<sup>189</sup> Thompson, above n 48, 3. Jones agrees with this in the context of corporate governance: above n 3, 146.

<sup>190</sup> Referred to in R Aguilera and A Cuervo-Cazurra 'Codes of Good Governance Worldwide: What is the Trigger?' (2004) 25 *Organization Studies* 415, 418.

Examples of the kinds of consequences that can be identified include directors being held liable by a court, on a derivative action, for a breach of their duties or for the general meeting to vote to remove a director(s) under s 168 of the Act.<sup>191</sup> Again while the board might be able to get a motion through the general meeting of shareholders, it might find that at the voting stage that there are a large number of shareholders who demur in relation to that motion. This has occurred on several occasions with motions concerning the remuneration reports of boards. For instance, in 2010, sixty per cent of Shell's shareholders voted against the board's executive pay plans.<sup>192</sup> At William Hill, the FTSE 100 gambling firm, a third of all shareholders attending the company's annual general meeting in 2011 voted against approval of the rise in pay of the CEO.<sup>193</sup> This kind of scenario can be an example of accountability not leading to any formal consequences for the board, but it does act as a 'wake-up call' for it. In the case of Shell the high shareholder vote against the remuneration packages of executives did lead to the board freezing the salaries of its top three executives for a year.<sup>194</sup> Shareholder disapproval at meetings could cause other forms of change in the conduct of the board. While WPP, the advertising company, reduced the salary of its CEO after sixty per cent of the shareholders voted against the remuneration report of the board in 2012, this vote subsequently led to the board of WPP consulting more extensively with shareholders.<sup>195</sup>

It should be noted that accountability can exist even though consequences do not follow: all that is required is that consequences are possible. Thus a general meeting of shareholders,

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<sup>191</sup> The provision gives the shareholders the right, by way of the passing of an ordinary resolution, to remove a director from office. It is employed rarely.

<sup>192</sup> R Lindsay 'Shell Freezes Top Directors' Pay After Revolt,' *The Times* (London, 16 February 2010).

<sup>193</sup> N Clark 'Executive Pay Triggers Revolt at William Hill' *The Independent* (London, 13 May 2011).

<sup>194</sup> Lindsay, above n 188.

<sup>195</sup> G Spanier 'WPP's Martin Sorrell Pockets £17m Despite Pay Cut' *The Independent* (London, 1 May 2013).

which hears from a board that duties have been breached, might decide that the board should be excused from liability, and it might even ratify what the board has done. This is clearly envisaged from consideration of the derivative action process (under Chapter 11 of the Act), where shareholders can seek permission from the courts to continue proceedings on behalf of the company against an errant director, several directors or even the whole board (and, possibly, also third parties). Permission must be refused if the company's general meeting has ratified what a director or the board has done.<sup>196</sup>

The Annual General Meeting constitutes a good example of a mechanism where all of the stages of the accountability process that we have just considered occur. The board has to report to this meeting, members of it may be asked to explain and justify all, or aspects of, the report provided, the members can ask questions and then make a judgment concerning what has been said, and then take action to do various things. Admittedly in the UK, as with most Anglo-American jurisdictions, the AGM is relatively impotent when it comes to consequences. The shareholders tend to be limited to refusing to re-elect a director who is presented for re-election or hoping, as with several of the cases referred to above, that their discontent with a particular matter might precipitate changes in board processes or attitudes.

In sum, therefore, we can see that UK company law does provide for various mechanisms that either fulfil one stage or all stages in the accountability process with the aim of promoting boards' accountability to shareholders for what they do. However, the discussion also illustrates that a failure to identify what exactly is meant by accountability can lead to a focus on just one or two elements of the process, such as the need for disclosure and transparency, to the neglect of other elements that are essential for full accountability to be present. Full accountability requires

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<sup>196</sup> The Act, s 263(2)(c) (for England and Wales, and Northern Ireland); s 268(1)(c) (for Scotland).

not only that the board be required to provide information, but also to explain and justify its conduct to a third party against externally set criteria, be subject to questioning and judgment, and vulnerable to consequences.

## **6. Conclusion**

We have argued that not only is accountability important in corporate governance, it is important to identify exactly what is meant by the term. To this end, drawing on discussions about accountability as a process in other disciplines, we have sought to provide a framework within which to assess whether accountability is present in the corporate governance context. For accountability to exist, there need to be mechanisms in place that require directors to provide an account, for that account to be justified and evaluated, and for there to be the possibility of consequences being imposed upon directors in the light of the account which they give. By providing this framework it should be possible to assess more accurately whether particular corporate governance mechanisms do or do not promote directors' accountability, and if they do not, facilitate a more precise understanding of why not. It provides a context for discussing the normative questions of exactly to whom the board should be accountable, for what, and how, and reduces the possibility of such debates being at cross-purposes. It should also make it easier to identify accountability deficits which might otherwise be obscured: for example, transparency and disclosure do not constitute accountability per se as seems to have been assumed, but are rather necessary steps towards achieving accountability. The upshot is that the accountability argued for here is a strong form as it includes: justification; the requirement of dealing with queries; and consequences.

Finally the framework should assist in identifying the different accountability mechanisms directors may be subject to, and thus assist in avoiding the pitfalls of multiple accountability, as well as accountability gaps. Accountability mechanisms can have different functions and these may not be mutually complementary. It can have detrimental as well as beneficial consequences and there may need to be a trade-off between these. Because of this, we need to view directors' accountability in a holistic manner, and not focus only on the effectiveness of one particular mechanism. When claiming that directors should be more or less accountable, and in determining the desirability of various accountability mechanisms, it is necessary to identify what purpose(s) we want to promote through the imposition of an accountability mechanism, and pay attention to what effect this might have on other corporate governance objectives. In order to do this there needs to be a clearer understanding and consensus about what we mean when we talk about accountability in the corporate governance context.