Corporate governance in the United Kingdom: 
changes to the regulatory template and 
company practice from 1998-2002

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Corporate governance in the United Kingdom: changes to the regulatory template and company practice from 1998-2002

Bruce A. Rayton* and Suwina Cheng

Abstract
There was a radical change in corporate governance innovations in UK companies between the end of the 1980s and the early 1990s (Conyon, 1994). However, there have been few continuous analyses carried out for subsequent years to assess the permanence of these changes, and to identify subsequent changes to corporate governance structures.

This paper measures the extent to which the corporate governance structures in UK quoted companies changed between 1998–2002, and uses this evidence to assess the long-term impact of corporate governance recommendations in the UK since 1993. Our results show increased implementation of the recommendations included in the Cadbury Report since the early 1990s, as well as progressive implementation of the recommendations of subsequent governance reports. Key evidence of this process includes:

(1) Eighty-eight percent of the quoted companies separated the role of chief executive officer and chairman in 2002 compared to a figure of 80 percent in 1998. The analogous figure for 1993 is 77 percent (Conyon, 1994);

(2) On average, main boards have contained an in-built majority of non-executive directors since 2000 even though the Combined Code (1998) suggests that the proportion of non-executive directors on the board should be at least one third;

(3) Almost all quoted companies operated a remuneration committee and an audit committee in 2002;

(4) Of those companies with remuneration committees in 2002, only 2 percent appointed the CEO as a committee member compared to the 40 percent reported by Conyon for 1993;

(5) The number of companies using a nomination committee has doubled between 1993 and 2002.

This evidence is consistent with the ongoing evolution of the governance structures of UK public companies, and suggests that the voluntary compliance approach of the UK has proven quite effective at generating real changes in the governance structures of UK companies.

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1 Introduction

There has been a resurgence of discussion of the role and nature of corporate governance by the public, academics and regulators since the corporate scandals in the United States in 2001 and 2002 (Enron, WorldCom). These failures revealed the latent managerialism in certain companies and aroused public concern over the integrity and fidelity of the agents. Officials in the United Kingdom (UK) responded to the growing anxiety in 2002 by setting up two study groups to examine the effectiveness of non-executive directors and audit committees. The recommendations of the Higgs Committee and the Smith Committee (January 2003) are reflected in the revised Combined Code, issued on July 23, 2003.

Good corporate governance practice is supposed to minimize agency costs, improve meritocracy in boardrooms, reduce the risk of fraud, and safeguard the wealth of stakeholders. Reforms designed to capture such gains were initiated in the UK with the Cadbury Committee Report in 1992, and this was the beginning of a decade of reviews and recommendations. The Rutteman Report (1994), the Greenbury Report (1995), the Hampel Report (1998), the Turnbull Report (1999), the Higgs Report (2003) and the Smith Report (2003) all followed in the footsteps of Cadbury. Table 1 illustrates this chronology.

Much has been written about corporate governance since the Cadbury Report, and much of this work has examined the extent to which governance structures, corporate performance and top management remuneration are linked. A comparatively limited number of studies have systematically investigated the practical implementation of governance devices in UK firms over the past decade. Conyon (1994), Dedman (2000 & 2003) and Dahya et al. (2002) all confirm a massive reorganization in the governance structures of UK companies in 1993, 1995 and 1996 respectively. These changes were sufficiently evident in 1997 that Sir Ronald Hampel, the chairman of Hampel Committee, said he saw no need for a
revolution in corporate governance in the UK.\textsuperscript{1} Hampel seemed to think that the development of the national corporate governance framework was on the right track at this point. However, Hampel also said that it was still “too soon to reach a considered assessment of the long-term impact of the Cadbury Code” and, “It is even more difficult to reach a definitive conclusion on Greenbury”.\textsuperscript{2} Only now do we have an entire decade of information on which to base conclusions about whether UK companies have refined their boardroom structures to fully embrace the recommendations stemming from the Cadbury Report and its progeny.

The purpose of this paper is to review the development of the UK corporate governance framework in the decade following the Cadbury Report. Specifically, this paper assesses whether the extant corporate governance structure has kept pace with the contemporary regulatory template. Each new report (see Table 1) has extended the recommendations of the previous reports, particularly concerning the creation of important governance committees and the role of non-executive directors on these committees. Our results provide some practical details about the long-term impacts of the Reports and Codes on UK quoted companies. Our data allows us to look in detail at the effects of the main recommendations of the Hampel Report enshrined in the Combined Code (1998).

<<Insert Table 1 about here>>

Examination of the UK corporate governance environment is particularly interesting for a number of reasons. The first of these is that the UK is the home of the Cadbury Report, and as such is the wellspring of many of the recent corporate governance reforms around the

\begin{itemize}
  \item \textsuperscript{1} PIRC Intelligence, July/August 1997, p.1.
  \item \textsuperscript{2} The Hampel Report, paragraphs 1.8 and 1.9.
\end{itemize}
world. Secondly, the examination of the UK voluntary approach provides a contrast to the regulation-based approach taken in the United States. The advent of the Sarbanes-Oxley legislation in 2002 is just the latest event in a history of legislative and regulatory efforts to improve corporate governance in the United States. Sarbanes-Oxley represents firm legislation with regulations written by the likes of the Securities and Exchange Commission (SEC) and the New York Stock Exchange. 4 By contrast, the New Combined Code is a set of recommendations for UK public companies, and firms are required only to disclose either their compliance with the guidelines or to give reasons for non-compliance. This difference in approach is particularly interesting when examining the rates of compliance. For example, Carcello, et al (2002) report that US stock exchanges require all audit committee members to be independent. They also report that the SEC requires the proxy to state whether all audit committee members are independent (based on the standards of the stock exchange on which the company is listed). These requirements mirror recommendations from the New Combined Code in the UK, so the chief difference would appear to be in the decision to make adherence mandatory in the United States. That said, Carcello, et al (2002) examine disclosures from a sample of 150 proxy statements filed in the Spring of 2001, and they find that only 85 percent of the firms in their sample have completely independent audit committees. 5 Clearly regulation does not guarantee full compliance. If we examine the UK in 2001, we find that 95.17 percent of audit committees are made up of only non-executive members. 6 While we are unsure whether all of these members are independent, current estimates suggest that 91 percent of UK non-executive directors fit this description. 7 At the minimum, this suggests

5 See p. 295-296 for details.
6 See the description of our data and methods in section 3 for further information.
7 SpencerStuart UK Board Index 2003.
that the UK approach is approximately as effective as the regulatory approach at generating independent audit committees. This intriguing result illustrates the importance of understanding how the changes in UK governance guidelines have been translated into real changes in the governance structures of UK public companies.

We investigate UK based non-financial companies that are also listed on the London Stock Exchange in 2002. Our analysis of data from corporate reports and commercial data sources shows that there has been continuous development in UK corporate governance practice since 1998. We choose 1998 because this was the final year before the adoption of the Combined Code in the UK. The developments we observe follow on from the rapid and massive changes between 1988 and 1993 documented by Conyon (1994). We examine our data for consistency with the recommendations of the Cadbury Committee, as well as the Greenbury Committee (1995) and the Hampel Committee (1998). We pay particularly close attention to the existence and composition of the principal committees identified in these reports. Our examination of annual reports, rather than relying on retrospective single-respondent survey data, allows us to improve both the quality and quantity of data available for analysis. Our approach also enables us to gather greater detail on the composition of the key governance committees than has previously been available in the UK.

Section two of this paper discusses some of the relevant literature on corporate governance changes in the UK. Section three describes our research methodology, and section four presents our results. We draw some conclusions in section five. All of this material relies on a fairly detailed understanding of the chronological development of the UK corporate governance system. We include a review of this institutional detail as an appendix.

2 Previous Literature

Good corporate governance mechanisms are presumed to tie managerial interests to the interests of shareholders. The major changes suggested since the Cadbury Report include the
separation of the duties of chairperson and CEO, the inclusion of a sufficient number of outside directors on boards, and the establishment of various functional board committees. Several researchers in the 1990s measured compliance with these recommendations. We review this literature below as a means of framing our discussion of subsequent developments in corporate governance practice in UK public companies.

2.1 Division of Roles of CEO and Chairperson

Previous research shows that most UK public companies already separated the role of chairman and CEO prior to the Cadbury Report, and that this practice rose to a clear majority by 1999. The evidence of this comes from several sources.

The Cadbury Committee surveyed the compliance with its Code of Best Practice between 1993 and 1994. They reported that over 80 percent of the 500 UK largest companies (in terms of market capitalization) had divided the roles of CEO and chairman as of December 1994.

Conyon (1994) carried out a retrospective postal survey in April and July 1993 to examine the adoption of the Cadbury innovations by approximately 400 large public companies in the 1988 and 1993. Conyon found that 57 percent of the listed firms in the sample separated the roles of chief executive officer and chairman in 1988. This figure increased to 77 percent in 1993.

Dahya et al. (2002) investigated the impact of the key Cadbury recommendations on the quality of board oversight in UK firms over the period 1989 through 1996. They examined a random sample of 460 public companies. Prior to Cadbury, 64 percent of this sample split the roles of CEO and chairman. This figure increased to 85 percent by 1996.

Dedman (2003) examined the influence of Cadbury recommendations on the turnover of executives in UK firms. The sample was based on FTSE All Share Index firms present from 1990 to 1995. The final sample comprised 2110 firm years. Dedman observed that
about 70 percent (median) of the firms split the roles in 1989/90 and it grew to 82 percent (median) in 1994/5.

The Pensions Investment Research Consultants (PIRC) also conducted a survey of compliance with the Combined Code in 1999. This survey covered 468 companies of the FTSE All Share Index with year-ends between December 31, 1998 and June 30, 1999. The report indicated that 89 percent of companies separated the roles of chairman and chief executive in 1999 compared to 83 percent in 1996.

2.2 Number and Fraction of Outside Directors

The UK corporate governance system is operated under the notion of self-regulation. The power and responsibilities for monitoring are largely-vested with non-executive directors. These outside directors are regarded as watchdogs for the shareholders. The Cadbury Report (1992) suggested that at least three members on the board should be outsiders. Six years later, the Hampel Report (1998) recommended that one-third of the seats should be reserved for the non-executive directors. The Higgs Report (2003) then required that at least half the members of the board, excluding the chairman, should be independent non-executive directors. These changes suggest that the influence of non-executive directors, in terms of their number and proportion on the board, has been reinforced in the past decade.

In the Cadbury Survey (1995), a positive relationship between corporate size and compliance with the Code was found. Indeed, nearly all of the largest 100 firms had at least three outside directors. Conyon (1994) reported that the number of non-executive directors was rising. He found that the average number of non-executive directors in his sample of quoted companies was 3.51 in 1998 and 3.86 by 1993. Moreover, the proportion of non-executive members increased from 38 percent to 44 percent during the same period. Both the means of number and proportion in 1993 are significantly different from those in 1988.
Dedman (2003) noted that 37 percent of the board members were outsiders, pre-Cadbury, and that the ratio increased to 41 percent thereafter. Dahya et al. (2002) also examined the percentage of outside directors. They found that there was only 35 percent during 1989 to 1992 and up to 46 percent between 1993 and 1996. The PIRC survey reported an improvement as well: 95 percent of companies comply with the requirement that a third of their board is non-executive in 1999, up from 90 percent in 1996. Together these findings provide evidence that the structure of UK corporate boards have changed considerably in the 1990s.

2.3 Board Committees

Existing evidence suggests that the roles and accountability of non-executive directors have been strengthened since the Cadbury recommendations. Boards are required to set up different committees to undertake a variety of important functions in accordance with the Code of Best Practice (1992). The major committees include audit, remuneration and nomination. The audit committee has been the focus of recent attention due to the Enron crisis. An ad hoc study group, the Smith Committee, was set up by the Government in 2002 to review the function of audit committees in UK companies.

The Cadbury Survey (1995) reported that 83 percent of the 500 listed firms in their sample had an audit committee. Conyon (1994) observed that the number of companies using an audit committee increased from 35 percent in 1988 to 90 percent in 1993. Vafeas and Theodorou (1998) assessed the relationship between board structure and firm performance. They analyzed the boards of directors of 250 publicly traded firms incorporated in the UK in 1994 by examining the importance of the board characteristics including director affiliation, ownership, chairman affiliation and committee composition. Although Vafeas and Theodorou failed to find linkages between board committees and firm performance, or linkages between pay levels and the number of non-executive directors, they did confirm that 85 percent of
firms had an audit committee, and that 74 percent of these audit committee members were non-executive directors.

A remuneration committee sets the compensation strategy and policy for senior management, and the existence of such a committee is generally included in managerial compensation and performance studies. Conyon and Peck (1998) employed panel data on large listed UK companies to examine the role of board control and remuneration committees in determining management compensation. They found that approximately three-quarters of the sample had established a remuneration committee by 1991. By 1994 almost all of the firms (99 percent) had a remuneration committee. The average proportion of outsiders on these committees in 1991 was 87 percent, compared to 91 percent in 1994, and the average number of non-executives on them was approximately four. Conyon (1994) reported that 54 percent of the quoted British companies operated a remuneration committee in 1988 and it increased to 94 percent in 1993. Average number of non-executive directors on the committee was 2.75 in 1993. Vafeas and Theodorou (1998) noticed that 86 percent of their sample of 250 UK firms had a remuneration committee in 1994, and on average 68 percent of the members were non-executive directors.

A nomination (or appointment) committee was also encouraged by the Cadbury Committee. Similar to the remuneration committee, the Cadbury Report (1992) suggested that the majority of the committee should be non-executive directors. However, the Hampel Report (1998) granted an exemption to small boards. The Higgs Committee (2003) proposed that the transparency in the director nomination and appointment processes should increase and the chairman should not chair the nomination Committee at all. This particular recommendation implied a lack of confidence in the chairman, and was denounced by practitioners. Consequently, the proposal was only partially embedded in the New Code.
Conyon (1994) examined the incidence of nomination committees. Conyon found that only 10 percent of his sample ran such a committee in 1988. This figure increased to 39 percent by 1993. Vafeas and Theodorou (1998) reported that 28 percent of their sample had a nomination committee, and that 86 percent of nomination committee members were non-executives in 1994. Conyon and Peck (1998) identified nomination committees in only 12 percent of their sample of publicly traded UK firms in 1991. This soared to 72 percent in 1994. The PIRC survey (1999) also identified a continuing change after 1995: 98 percent of companies had a nomination committee in 1999, up from 72 percent in 1996.

2.4 Summary
The changes suggested since the Cadbury Report include the separation of the duties of chairperson and CEO, the inclusion of a sufficient number of outside directors on boards, and the establishment of various functional board committees. Previously published research has demonstrated substantial changes to board structure in UK firms since the late 1980s.

Our study seeks to extend this literature by assessing whether the changes initiated by the Cadbury Report (1992) and its successors continue to shape the governance structure of UK public companies. We provide the first systematic analysis of governance structures in the UK that extends into the post-millennium bear market, and we compare these structures to the contemporaneous regulatory framework.

3 Data and Method
Our study focuses on the nature of corporate governance structures in UK companies since the publication of the Hampel Report and the Combined Code in 1998. The period under our investigation covers five years commencing from 1998. We include 1998 in our sample frame as a benchmark for comparison with the years following the publication of the Hampel Report and the adoption of the Combined Code. Data used in this study comes primarily from annual corporate reports.
There are two major advantages in scrutinizing companies’ annual reports for the data about the implementation of corporate governance innovations. First, annual accounts and reports are accredited documents that proclaim a company’s financial situation and corporate information. The data gathered from annual reports is therefore supposed to be authoritative and credible. In this way we avoid the well-documented problems associated with single-respondent survey data.\(^8\) The second advantage of relying on the annual reports is that all public companies are required to file these reports. By going to the reports themselves instead of using a survey methodology we generate a sample with far more responses, and one that is far more representative than the samples used by Conyon (1994) and in other research.

Our data collection efforts focused around 402 companies, and they result in a balanced panel of 331 firms in the window from 1998-2002. We can supplement this data with and additional 248 firm-years of data from 54 companies for whom we do not have a full set of valid data. This means that we have useable data from approximately 95 percent of the targeted firm-years.\(^9\)

Relying on annual reports means that the published data might be incomplete, as there is no legal requirement for firms to publish certain data. However, this concern has gradually diminished since the introduction of the Code of Best Practice in 1993. Companies listed in the UK are required to state in their reports and accounts whether they comply with the Code, and to give reasons for any non-compliance.\(^10\) Voluntary disclosure has continuously proliferated in subsequent years, and it has accelerated as a result of the repeated reinforcement provided by the Hampel Report (1998) and the Combined Code (1998). Our

\(^{8}\) See Gerhart et al (2000) for an accessible link into the literature on survey methods and single rater bias.

\(^{9}\) For the sake of comparison it is worth noting that Conyon (1994) carried out a retrospective postal survey in 1993 to gather data for 1988 and 1993. He reports a response rate of 40 percent.

\(^{10}\) The Cadbury Report, paragraph 3.7.
data show that by 1998 over 90 percent of UK companies had chosen to fully disclose their governance arrangements.

We placed our sampling frame around UK-based non-financial companies which were quoted on the London Stock Exchange as of October 2002. In this paper we consider only firms with yearly total sales of at least 75 million pounds to facilitate comparison of our results with those published in Conyon (1994).\(^{11}\) The information on total sales is drawn from the Datastream database. All other information, including information about board structure, the roles of top management and key committee membership are taken from the corporate reports.

Examination of the annual reports allows us to observe board structure, the composition of key committees and the co-location of the duties of CEO and chairman in each year after 1998. We then compare summary statistics for 1998 and 2002 to determine whether any significant differences exist. This approach is deliberately similar to that taken by Conyon (1994) in order to facilitate the comparison of our results.

We extend Conyon’s work not only through the examination of a different time period, but we also examine the data for the interim years, as this data provides the opportunity to examine the process through which the 2002 position was reached. We also extend Conyon’s work by exploiting the full disclosure of the principal committees by most companies. This detailed information on the size and composition of audit, remuneration and nomination committees allows us to study the structures of individual committees in depth.

4 Corporate Governance in UK Companies

This section presents the results of our study. First we examine the separation of the roles of CEO and chairman. Second we examine the structure of the main board. In the third section

\(^{11}\) Conyon surveyed large public companies.
we examine the incidence of the principle board committees, and follow this with a more detailed examination of the structure of these committees.

Throughout these sections we refer to our data in ‘panels.’ Panel A refers to results published in Conyon (1994). We are reticent to use statistical tests to aid comparison of our results with these results as we do not have access to the data: only the summary statistics. Still, we include these figures as a useful reference to behavior in 1993. Panel B refers to our full set of data. Thus Panel B is an unbalanced panel containing 1,803 firm-years of data from 385 firms. We use this panel whenever we wish to compare average behavior across time periods. Panel C refers to our balanced panel of 331 firms. We use this panel when we are specifically addressing the propensity of individual firms to change their behavior through the sample frame.

4.1 The Chief Executive Officer and Chairman

Companies usually disclose the roles of individual directors in their corporate annual reports. This means we can tell whether the duties of the chief executive officer and the chairman of the board of directors are given to the same person. Table 2 details the incidence of the separation of the roles of chairman and chief executive beginning in 1993.

Panel A represents a partial recapitulation of the results published in Conyon (1994), where he found that approximately 77 percent of 301 quoted companies separated the role of chairman and chief executive in 1993. Panel B shows the incidence of separation from 1998 through 2002. In 1998 approximately 81 percent of our 339 sample companies separated the role of chief executive and chairman. By 2002 this figure had risen to 88 percent of 370 companies with a division of the roles of chief executive officer and chairman. The null hypothesis of the equality the means in the 1998 and 2002 samples can be rejected at conventional significance levels ($t = 2.475$ with 707 degrees of freedom). Though we are unable to test the mean difference between 1993 and 1998 or 1993 and 2002, the discrepancy
in means between the two studies is noticeable. An inspection of the yearly frequencies from Panel B also provides evidence that the changes leading to 2002 represent a continuation of the trend towards separation identified by Conyon between 1988 and 1993.

Panel C examines the behavior of the 331 companies for which we have data throughout the five years 1998–2002. The summary of this data in Table 3 demonstrates that 80 percent of these firms separated the roles of chairman and CEO throughout the period. Approximately 12 percent of the firms divided the roles during our sample window, and only 7 percent of the firms continued to combine the roles of CEO and chairman in 2002. We observe no firms who choose to combine the roles of chairman and CEO during the sample period.

4.2 The Structure of the Main Board
Non-executive directors occupy a crucial role in the UK corporate governance system. The presence of an adequate number and proportion of non-executive members on the main board is one of the key recommendations of the Cadbury Report (1992), the Hampel Report (1998) and the Higgs Report (2003). Table 4 illustrates the composition of main boards in UK companies since 1993. We use Panel B to present the proportion of outside directors sitting on the board from 1998 to 2002. These can be compared with the results from Panel A.

The average proportion of non-executive directors on the main board was approximately 53 percent in 2002. This represents a significant increase over the analogous
figure of 47 percent for 1998 (t = 5.559 with 709 degrees of freedom). Examination of the individual years demonstrates that this proportion has been gradually increasing over the sample period. Conyon (1994) reports that the proportion of non-executives on the main board was only 43.54 percent in 1993. The average proportion of membership of main boards filled by non-executive directors reached 50 percent in 2000. The data indicates that the appointment of non-executive directors to the main board has continued to increase both in number and in proportion since 1993.

Conyon (1994) also examined whether the proportion of non-executive membership varied with the size of the board, and we do the same. These results are interesting because the appointment of non-executive members to at least one third of the places on the main board has been expected only since the Combined Code of 1998, and non-executive majorities on main boards were not expected until the implementation of the New Combined Code in 2003. The evidence from Panel B indicates a significant increase in the fraction of non-executive directors for all board sizes except for the extremely small boards (0-6 members) and the extremely large boards (13 or more members).

<<Table 4 about here>>

Table 4 also illustrates the average size of main boards and the number of non-executive directors for firms in our sample. Panel A reveals that the average number of members on board of directors was approximately nine in 1993. Panel B demonstrates that

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12 Paragraph A.3.1.

13 Looking at the lower quartile (or similar) might be interesting here. It would demonstrate that the vast majority of firms meet the guidelines. Indeed, we could track this percentile score for the 1/3 and 1/2 benchmarks.

the average size of the main board varies between eight and nine between 1998 and 2002. Though the average board size has declined over the period, these differences are insignificant. Conversely, we see strong evidence that the number of non-executive directors has increased over the same period. The average number of non-executive directors in 1993 was 3.86, but inspection of Panel B indicates that the analogous mean was 3.98 in 1998 and that it rose to 4.45 in 2002. The null hypothesis that the mean number of non-executive directors in 1998 and 2002 are equal is rejected at conventional significance levels.

The difference between the mean levels of non-executive directors reveals acceleration in the shift towards non-executive directors after the publication of the Hampel Report. The recommendations of the Hampel Report were put into practice in June of 1998, and we observe an increase in the average number of non-executive directors of 0.47 between the last pre-Hampel date and the end of our sample in 2002. This increase is nearly four times the size of the 0.12 increase in the average number of non-executive directors observed after the Cadbury Report (1993 – 1998). Given the static nature of board size, these results clearly illustrate that both the proportion and number of non-executive directors on the main board increased after the Cadbury Report (1992) and that the rate of change increased substantially after the Hampel Report (1998).

4.3 The Incidence and Composition of Principle Board Committees

The Reports and Codes that provide the structure of UK corporate governance encourage the main board to delegate its major tasks to various subcommittees, and the UK Stock Exchange issued the Combined Code and amended the Listing Rules in 1998 to reflect the recommendations contained in these governance reports. Quoted companies in the UK are

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15 The t-statistic is only 0.397, and is insignificant at all conventional levels.

16 The t-statistic for this test is 3.466, and is evaluated with 709 degrees of freedom.
required to follow the provisions in the Code, and they are required to publish corporate governance information in their annual reports. Most listed companies fully disclose the incidence and composition of remuneration, audit and nomination committees.

The duties of these committees are described in the Reports and Codes. A remuneration committee is to determine on behalf of the board of directors and shareholders the company’s policy on executive remuneration and specific remuneration packages for each of the executive directors.\(^{17}\) An audit committee is assumed to monitor and review the company’s internal financial control system and internal audit function.\(^{18}\) A nomination committee makes recommendations to the board on all new board appointments.\(^{19}\) The purpose for this division of responsibilities is to avoid any potential conflict of interest, as well as to promote independence and effectiveness. Therefore, the structure of the key committees is one of the major concerns in each governance report.

The Cadbury (1992) and Greenbury (1995) codes suggested that there should be a minimum of three members on both the audit and remuneration committees and that the membership of these committees should be confined to the non-executive directors.\(^{20}\) The New Combined Code (2003) suggested that a majority of members of the nomination committee should be independent non-executive directors.\(^{21}\)

In order to gain a clear picture of various subcommittees in UK companies, we examine both the existence and the composition of the remuneration, audit and nomination committees. In examining our data from company reports, we adopt a methodology adapted from Main and Johnson (1993). We deem a company to have a committee in the year only if

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\(^{17}\) The Greenbury Report, paragraph A1.

\(^{18}\) The Smith Report, paragraph 2.1.

\(^{19}\) The Higgs Report, paragraph 10.3.

\(^{20}\) The Cadbury Report, paragraph 4.35b and The Greenbury Report, paragraphs 4.8 and 4.11.

\(^{21}\) The New Combined Code, paragraph 4.1.
its existence is mentioned in the company’s annual report. This strategy introduces a downward bias in our measurements of these committees. However, we think this bias is small because of the increasing number of companies choosing to comprehensively disclose their governance information.

We begin with a presentation of the incidence of the three principal committees (remuneration, audit and nomination). We then discuss the composition of the membership of each of these committees in turn.

### 4.3.1 The Incidence of Principle Board Committees

Table 5 delineates the incidence of the three principal committees since 1993. Panel A again displays summary information from Conyon (1994), and Panel B presents our results for the years 1998 through 2002. Conyon reported that 94 percent of quoted companies used remuneration committees in 1993. Approximately 98.5 percent of the firms in our 1998 sample claim the existence of a remuneration committee in their annual reports. This fraction rises to 98.86 percent in 1999, and stays at this high level in the rest of the period. There is no significant difference between the proportions in Panel B. The changes between 1993 and 1998 might represent a significant change, but we are unable to compare these results in a meaningful way. The evidence at our disposal suggests near-universal use of remuneration committees by listed UK companies. The movement to this position appears to have happened somewhere between 1993 and 1998.

<<Table 5 about here>>

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22 See Conyon (1994) for further discussion.
Changes in the incidence of an audit committee are somewhat more pronounced. We see near-universal use of an audit committee by the end of Panel B. Panel B shows that an average 99 percent of the companies in our sample claimed that they operated an audit committee in 2002 compared to a figure of 97 percent in 1998. This difference is significant at the 10 percent level, but this represents only weak evidence for a difference between these proportions (t = 1.789 with 705 degrees of freedom). Only 90 percent of the listed companies used an audit committee in 1993. Again, the hypothesis of a change in the incidence of audit committees between 1993 and 1998 is not testable in a meaningful way, but the evidence suggests a move to near-universal use of an audit committee sometime between 1993 and 1998.

Our sample window appears to have missed many of the final moves toward universal use of remuneration and audit committees, but we can see significant changes in the use of nomination committees. Table 5 reveals the implementation of this extent since 1993. The average incidence of nomination committee was only 39 percent in 1993, but had risen to 64 percent by 1998. The increases during the period of Panel B were equally impressive. There was a leap of 13 percent in the year following the publication of Hampel Report and the Combined Code. This improvement appears to have been caused by the emphasis placed on nomination committees in the Hampel Report and Combined Code.²³ The proportion of listed companies using a nomination committee reached twice its 1993 level by the close of 2000, and still continued to increase. The proportion of companies using a nomination committee was approximately 84 percent in 2002. A t-test of the null hypothesis that the proportion of

²³ “Unless the board is small, a nomination committee should be established to make recommendations to the board on all new board appointments.” The Hampel Report, paragraph 3.19 and The Combined Code, paragraph A.5.1.
companies using a nomination committee was unchanged between 1998 and 2002 can be rejected at any sensible significance level ($t = 6.466$ with 705 degrees of freedom).

### 4.3.2 The Composition of Principal Board Committees

Analysis of the structure of the principal committees of main boards reveals more interesting developments in the structure of the UK corporate governance system. We examine each of the principal committees in turn, and we focus on the size of the committee, the number and proportion of these members who are non-executive directors, and whether or not the CEO is a member of the committee. Table 6 presents our results from the analysis of Panel B (1998-2002).

| Table 6 about here |

#### 4.3.2.1 Remuneration Committee

Table 6 reports the structure of remuneration committee for the years 1998–2002. The average size of the committees and number of non-executive directors on the committee was between three and four over the period under our investigation. We can see that that 98.74 percent of remuneration committee members were non-executives in 2002 compared to the figure of 96.64 percent in 1998. Although both of these proportions are very high, a test of the null hypothesis that these proportions are statistically equivalent is rejected at conventional levels ($t = 3.067$ with 697 degrees of freedom).

Much of the perceived value of remuneration committees comes from concerns about senior managers setting their own pay. As such, we examine whether the chief executive officer is appointed to the committee. The proportion of companies who have placed their CEO on the remuneration committee was 5 percent in 1998, 3 percent in 1999, and...
approximately 2 percent in 2000, 2001 and 2002. The proportions presented in Panel B are quite low, and there is little variation between 2000 and 2002. Even so, a test of the null hypothesis that these proportions are the same in 1998 and 2002 is rejected at conventional significance levels ($t = 2.295$ with 706 degrees of freedom). This indicates significant changes post-Hampel Report. A comparison of our results to those published in Conyon (1994) indicates that the most striking changes occurred between 1993 and 1998. Conyon (1994) reported that 40 percent of the CEOs in his sample had membership on the remuneration committee in 1993.

The changes seen since 1993 are consistent with the timing of the recommendations made by the Greenbury Committee in 1995, which emphasized the integrity and independence of the remuneration committee: “Remuneration committees should consist exclusively of Non-Executive Directors with no personal financial interest other than as shareholders in the matters to be decided.”

4.3.2.2 Audit Committee

Table 6 also displays the composition of audit committees between 1998 and 2002. The average size of an audit committee was 3.45 in 1998, and remained largely unchanged throughout the sample period. The number of non-executive members was 3.36 in 1998 and rose to 3.48 in 2002. This increase is significant at conventional levels. Given these two results, it is not surprising that we also identify a significant change in the proportion of non-executive directors on committees. The incidence of CEO membership on audit committees is under one percent in every year except 1998. The evidence indicates that the vast majority

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25 The t-statistic for the comparison of these means is 2.242.

26 The t-statistic for the comparison of these means is 2.586, with 691 degrees of freedom.
of the companies in our sample follow the governance recommendation confining the membership of audit committees to non-executive directors.

4.3.2.3 Nomination Committee

Table 6 also examines the structure of nomination committees between 1998 and 2002. The average nomination committee had 2.75 members in 1998. This number rose to 3.60 members in 2002. This difference is significant at conventional levels. The average number of non-executive members on the nomination committee was 2.20 in 1998. This rose to 2.97 in 2002. The proportion of non-executive directors remained largely unchanged throughout the sample period. In 2002 the proportion of non-executives on the committee was 82.64 percent compared to a figure of 80.13 percent in 1998. There is only weak statistical support for the significance of this difference. Chief Executive Officers have had a visible role on nomination committees throughout the sample period. There are no significant differences across the years, but the proportion of CEOs with membership on the nomination committee averages 42.51 percent throughout the sample period.

The membership of the nomination committee appears to be more directly influenced by the executives of the firm than the other committees, but these committees still are constructed (on average) with a majority of non-executive directors. Perhaps this is not surprising as The New Combined Code (2003) encourages all companies to establish a nomination committee, but it does not confine the membership to non-executive directors. Indeed, average behavior seems precisely in line with the recommendations of the New

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27 The t-statistic for the comparison of these means is 5.129, with 705 degrees of freedom.

28 This increase is significant at conventional levels. The t-statistic for the comparison of these means is 5.511.

29 The t-statistic for the comparison of these proportions is 1.676 with 525 degrees of freedom. This could be rejected at the 10 percent level, but the sample size is sufficiently large that the acceptance of this result would be questionable.
Combined Code, which states, “A majority of members of the nomination committee should be independent non-executive directors.”

4.4 Summary

The analysis of the composition of various committees provides us with a detailed picture of the role of non-executive directors in the governance of public companies. Our results show that the size of each committee is between three and four on average. Consistent with the regulatory recommendations governing UK firms, the remuneration and audit committees are more independent than the nomination committee: based both on the proportion of non-executive directors and based on the committee membership of chief executive officers. The use of remuneration and audit committees appears to have reached saturation by 1998. Conversely, the time series variation of the incidence of a nomination committee between 1998 and 2002 was remarkable. The incidence of these committees doubled between 1993 and 2000, and the incidence of nomination committees had risen to 84 percent by 2002.

5 Conclusion

The role, nature and development of the UK corporate governance system have been the subject of a great deal of attention from practitioners, authorities, academics and members of the public. The efforts of the Cadbury, Greenbury, Hampel, Turnbull, Higgs and Smith Committees have gradually tightened the governance system since the early 1990s. The recommendations from these Reports and the subsequent Codes have had a far-reaching influence on the contemporary managerial practice. Listed companies on the UK Stock Exchange are required to adhere to the New Combined Code, and to report details of their compliance in their corporate reports.

Conyon (1994) published a comprehensive survey of the nature of the UK corporate governance structure. Conyon examined the division of the roles of chief executive officer and chairman, the composition of the main board and the incidences of principal board committees for the years of 1988 and 1993 respectively. Conyon’s results revealed striking corporate governance innovations after the publication of Cadbury Report (1992), and our results indicate that the Cadbury Report has had a long-term impact on UK governance structures.

Our results also demonstrate that more recent changes in the nature of the UK corporate governance system are coincident with changes in the corporate governance framework in the UK between 1998 and 2002. Of particular note are the recommendations of the Hampel Committee, and the adoption of the Combined Code after 1998. The UK governance guidelines changed at this point: asking for an increase in the proportion of non-executive membership on the main board; suggesting the existence of a nomination committee with a non-executive majority; and suggesting that the roles of CEO and chairman should only be combined by exception. Our results demonstrate that since 1998 there has been a clear increase in the number and proportion of non-executive directors on the main board as well as an increase in the incidence of nomination committees, and a decrease in the combination of the roles of chairman and CEO. The ‘comply or explain’ approach to corporate governance reform is still working in the UK.

The changes observed in the corporate governance frameworks of UK firms are remarkable. Our study demonstrates several important changes to the UK corporate governance system that occurred by 2002:

(1) Firms were much more likely to split the role of chairman and chief executive officer.

(2) On average, at least half of directors on the main boards of the sample were non-executive directors after 1999.
(3) Nearly all listed companies had both a remuneration committee and an audit committee.

(4) Only two percent of remuneration committees had the chief executive officer as a member in 2002 as compared to 40 percent in 1993.

(5) The incidence of nomination committees more than doubled between 1993 and 2002.

The above findings are clear evidence that the Cadbury Report (1992) and its siblings have had a significant influence on shaping the corporate governance structures of UK listed corporations. Our study also shows that the remuneration and audit committee are highly independent in terms of proportion of non-executive directors and the lack of participation by the chief executive officers. In both cases, approximately 99 percent of the committee members were non-executive members in 2002.

We find a stronger, though still minority, role for executive members (especially the CEO) on nomination committees. The nomination committee effectively acts as a gatekeeper for the membership of the main board, and thus the potential members of the principle committees. The relatively high representation of CEOs and other executive directors on these committees may present challenges to the independence of the main board and the key committees. For example, a CEO may nominate people with whom he has personal relationships or common interests. If these individuals are appointed as non-executive directors, and if they sit on the principal committees the CEO may have substantial influence on apparently independent committees. Though a transparent procedure for the nomination of new directors to the board is emphasized in the Codes,31 these documents are less proscriptive for the composition of nomination committees than they are for remuneration and audit committees.

Our results reflect a continuing increase in the scale and scope of the duties expected of non-executive directors. UK guidelines have called for larger numbers of independent, 

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skilled individuals who should devote larger amounts of their time to control potential management indiscretion. These increasing demands are mirror movements in the United States, and around the world. The expansion of the already-important role of non-executive directors places an even greater premium on the recruitment, selection and remuneration of these individuals that ever before.

In conclusion, the results of this study suggest the existence of a long-term impact resulting from over a decade of committees and reports. The recommendations have been implemented through the efforts of related groups and authorities. The result has been the development of a detailed corporate governance framework, and real changes in the governance structures of UK quoted companies.
6 Appendix: A Review of UK Corporate Governance

This appendix describes the chronological development of the UK corporate governance system in some detail. This institutional detail provides important context to the research questions pursued in this paper. An understanding of the timing of the various recommendations described below is important when discussing the pattern of adoption observed in UK public companies.

A series of unexpected corporate failures in the late 1980s and early 1990s (e.g., Polly Peck and Maxwell Communication Group) were attributed to poor management practice, and this led to substantial discussions about the UK corporate governance system. Public and media joined officials in querying the supervising and monitoring ability of management and the reliability of financial reports. The Financial Reporting Council, the London Stock Exchange and accounting professional bodies responded to these failures by appointing the Cadbury Committee, thus beginning a process of policy review and change that continues today. This section describes this process in some detail.

6.1 The Cadbury Committee

The Cadbury Committee was charged to study the financial aspects of corporate governance in May 1991. This was in response to growing concerns over, “the perceived low level of confidence both in financial reporting and in the ability of auditors to provide the safeguards which the users of company reports sought and expected”. The Committee’s remit was: to study the structure and responsibilities of the board of directors; to review the effectiveness audits; and to consider the relationship between shareholders, directors and auditors. The final report and the resulting Code of Best Practice were published in December 1992. The Committee’s recommendations and the nineteen points of code described a primary

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32 The Cadbury Report, paragraph 2.1.
framework of corporate governance. In reply to the Report, the London Stock Exchange amended its listing rules accordingly in April 1993. The essential governance changes recommended by Cadbury that have been comprehensively adopted by UK listed companies include:

(1) Division of Responsibilities between Chairperson and CEO

In order to prevent any individual from abusing unfettered power in a company, the Committee suggested the separation of the surveillance and execution duties between the chairperson of the board of directors and the chief executive officer.

“There should be a clearly accepted division of responsibility at the head of a company, which will ensure a balance of power and authority.”33

(2) Strengthen the Role of Outside Directors

The committee also suggested that non-executive directors should exercise independent judgment on corporate issues. To meet the recommendation on the composition of sub-committees, the Committee required at least three non-executives directors were on the board.

“We recommend that the calibre and number of non-executive directors on a board should be such that their views will carry significant weight in the board’s decisions.”34

(3) Adoption of Key Committees

The Cadbury Report suggested that companies should have an audit committee,35 a remuneration committee36 and a nomination committee.37 The Cadbury Report suggested that the audit committee should have a minimum of three non-executive members, and that the

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33 Code of Best Practice, paragraph 1.2.
34 The Cadbury Report, paragraph 4.11.
35 Paragraph 4.35.
36 Paragraph 4.42.
37 Paragraph 4.30.
composition of the remuneration and nomination committees should be mainly non-executive directors.

The Cadbury Committee contended that the delegation of power to the sub-committees would reinforce accountability, improve managerial performance, and retrieve public confidence in the governance system.

The Cadbury Committee Report has exercised far-reaching influence on the development of corporate governance. It has become the foundation of corporate governance systems worldwide. Corporations in the UK, the US and other developed regions that adopt the unitary board system follow the key Cadbury recommendations when structuring their boards.38

The Cadbury Committee’s final advice was that the Code should be kept up to date in order to keep up with evolving board practice. Consequently, a working group was formed by the Institute of Chartered Accountants in England and Wales, and by the Institute of Chartered Accounts of Scotland to perform a study of internal control in UK listed companies in 1994. This group spawned the Rutteman Report.

6.2 The Rutteman Report

The working group led by Sir Simon Rutteman issued its report in December 1994. The Rutteman guidelines were applicable to accounting periods beginning on or after January 1, 1995, and were operative until they were superseded by the Turnbull Report in 1999. The Rutteman guidelines were developed from the United States’ COSO report entitled, “Internal Control – Integrated Framework,” and emphasized that the internal control statement should be embedded in the corporate governance statement, and that this statement should contain:

1. A declaration from the directors of a listed company that they are responsible for the company’s system of internal control;

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2. A description of the internal control procedures that have been established by the directors, as well as an assessment of their effectiveness;

3. A clear statement that such a system can provide only reasonable and not absolute assurance against material misstatement or loss; and

4. Confirmation that the directors have reviewed the effectiveness of the internal control system.

6.3 The Greenbury Committee

In response to public and shareholder concerns about large increases in pay and other remuneration received by the directors in the newly privatized utility industries, the Confederation of British Industry initiated a study group, chaired by Sir Richard Greenbury, centered on directors’ remuneration in January 1995. The terms of reference of the Committee were “To identify good practice in determining Directors’ remuneration and prepare a Code of such practice for use by UK PLCs.”

The report was released in July 1995, and it made definite recommendations about pay-for-performance, and also affirmed the important governing role of non-executive directors in the pay system.

The report and the resulting Code of Best Practice were based on the principles of accountability, transparency, and linkage of reward to performance. The report also indicated a need, “to delegate responsibility for determining executive remuneration to a group of people with a good knowledge of the company and responsive to shareholders’ interests, but with no personal financial interest in the remuneration decisions they are taking.”

The report also made specific recommendations about the structure of the remuneration committee. Namely, that the remuneration committee should “consist of at least three Non-Executive Directors (at least two in the case of small companies),” and “consist exclusively

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39 The Greenbury Report, paragraph 1.2.


41 The Greenbury Report, paragraph 4.11.
of Non-Executive Directors”. These recommendations were reflected in new listing rules for the London Stock Exchange in October 1995.

6.4 The Hampel Committee

The Cadbury Committee proposed that, “The Committee’s sponsors, convened by the Financial Reporting council, should appoint a new Committee by the end of June 1995 to examine how far compliance with the Code has progressed, how far our other recommendations have been implemented, and whether the Code needs updating.” Following similar recommendations from the Greenbury Committee, a new committee was set up to review the implementation of their findings. The Hampel Committee started work in November 1995.

The Hampel Committee was initiated by the Chairman of the Financial Reporting Council. It was sponsored by the London Stock Exchange, the Confederation of British Industry, the Institute of Directors, the Consultative Committee of Accountancy Bodies, the National Association of Pension Funds, and the Association of British Insurers. The Hampel Committee was asked to “promote high standards of corporate governance in the interests of investor protection and in order to preserve and enhance the standing of companies listed on the Stock Exchange.”

The Hampel Committee reviewed the content and implementation of the Cadbury and Greenbury Codes, and engaged in a wide-ranging study of corporate governance on listed companies. The Hampel Committee Report was published in January 1998, and it broadly reaffirmed the recommendations of its predecessors. The Hampel Committee suggested that no big changes would be needed, but it asserted that at least a third of the board positions

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42 The Code, A.4.

43 The Cadbury Report, paragraph 3.12.

44 The Hampel Report, p.66.
(rather than at least three members), should be filled by non-executive directors. The significant differences between the Hampel recommendations and the recommendations of its predecessors were:

(a) to emphasize the importance of business performance rather than accountability; and

(b) to encourage a flexible governance practice in a given particular circumstance and fully disclosure and explanation for any departure from the guidelines.

Instead of proposing some prescriptive provisions for good practice, the Hampel Committee outlined a set of ‘Principles of Corporate Governance’ in four sections: the role of directors; directors’ remuneration; the role of shareholders; and accountability and audit. As a consequence, the Committee suggested that a ‘Combined Code’ embracing the work of Cadbury, Greenbury and Hampel Committees should be produced by the Stock Exchange so that it could sit alongside the listing rules.

6.5 The Combined Code on Corporate Governance

The London Stock Exchange issued the Combined Code on Corporate Governance in June, 1998. The Combined Code represented a consolidation of the work of the Cadbury, Greenbury and Hampel committees, and it contained both principles and detailed code provisions. The Combined Code integrated the essence of the previous studies and delineated an articulate and modern corporate governance framework.

The Combined Code was composed of 17 principles and 48 provisions and was annexed to the listing rules. The provisions covered five domains: directors; directors’ remuneration; relations with shareholders; accountability and audit; and institutional investors. Listed companies in the UK are required to report how they have applied the principles in the Combined Code, and confirm whether they have complied with the Code provisions and provide reasons for any non-compliance.
The Combined Code says, “The board should maintain a sound system of internal control to safeguard shareholders’ investment and the company’s assets.”\textsuperscript{45} However, there are no details or guidelines defining a sound internal control system in the Combined Code. This gap would be addressed by the Turnbull Report.

6.6 The Turnbull Report

In order to “…provide guidance to assist listed companies to implement the requirements in the Code relating to internal control,”\textsuperscript{46} the Institute of Chartered Accountants in England & Wales published the guidance “Internal Control: Guidance for Directors on the Combined Code” (i.e. The Turnbull Report) in September 1999.

The study group was chaired by Nigel Turnbull, and its major tasks were to examine internal control practice in UK companies and provide relevant guidance to help the directors of listed companies to set up a sound internal control system to manage significant risks facing companies. The guidance emphasized risk management, and addressed four key issues: the types of risks that should be controlled; what the control system should include; measures for updating the control system; and the responsibilities of the board of directors. The Turnbull Report superseded the guidance from the Rutteman Report. Listed companies were required to be fully compliant with the Turnbull Report for fiscal years ending after December 22, 2000.

6.7 The Smith Committee and the Higgs Committee

Corporate failures in the US in late 2001 revealed some loopholes in corporate governance systems in the United States, and these scandals created concerns over the governance system in the UK. The UK response involved the creation of The Higgs Committee and the Smith

\textsuperscript{45} Combined Code, D.2.

\textsuperscript{46} The Turnbull Report, paragraph 1.
Committee in 2002. The Smith Committee was charged with examining the roles and effectiveness of audit committees. The Higgs Committee was established to study the roles and the effectiveness of non-executive directors.

The Smith Committee was formed at the request of the Co-ordinating Group on Accounting and Audit. The Co-ordinating Group was set up by the UK government to oversee the UK response to the issues raised by the major corporate failures in the United States in 2001. The Committee was chaired by Sir Robert Smith and its remit was “to assist company boards in making suitable arrangements for their audit committees, and to assist directors serving on audit committees in carrying out their role.”^47^ The Smith Report was published in January 2003. The key recommendation was that the audit committee should be populated by no less than three independent non-executive directors, and at least one of these members should possess recent and relevant financial experience.

The Higgs Committee was formed in April 2002 by the Secretary of State for Trade and Industry and the Chancellor of the Exchequer with the nomination of Derek Higgs to lead an independent review into the role and effectiveness of non-executive directors. The review focused mainly on the efficacy of outside directors in promoting company performance and accountability.

The Higgs Report was published at the same time as the Smith Report. Its recommendations aimed to increase rigor and transparency in the director nomination and appointment processes, and to encourage meritocracy and spread multi-experience in the boardrooms in the UK. The Higgs Report also included guidance for non-executive directors and chairmen. Some aspects of the Higgs Report were widely criticized. The focus of the criticism was around three main recommendations of the Higgs Report:

^47^ The Smith Report, paragraph 1.1.
1. The recommendation that the chairman of the company should not be the chairman of the nomination committee;

2. The assignment of responsibility to the senior independent directors rather than the chairman; and

3. The proposed ban on the Chief Executive becoming the Chairman.

Both the Higgs and Smith Reports suggested that the fundamentals of the UK corporate governance system are sound. However, they proposed a revision to the existing Combined Code to strengthen the best practice. Both reports spelled out a resolute and realistic agenda for change based on the existing framework of UK corporate governance. The Financial Reporting Council that is responsible for the Combined Code set up a working group to revise the extant version in 2003.

6.8 *The New Combined Code*

The New Combined Code, published on July 23, 2003 included many recommendations from the Higgs and Smith Reports. The core principles of the Combined Code (1998) remained unchanged in the revised Code, with only a new addition relating to board performance evaluation. Some of these core principles have been expanded and supplemented by “supporting principles.” The section on the disclosure of directors’ remuneration has been superseded by a UK statutory requirement to publish a directors’ remuneration report, and, therefore, is excluded. The New Code superseded the 1998 Combined Code and was effective for all listed companies for fiscal years beginning on or after November 1, 2003. The key changes introduced in the New Combined Code are:

1. Chairman should on appointment be independent;\(^\text{48}\)

2. A chief executive should not go on to be chairman of the same company. However, if, exceptionally, a board decides that a chief executive should become chairman, the board should consult major shareholders in advance and should set out its reason to

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\(^{48}\) The Code, A.2.2.
shareholders at the time of the appointment and in the next annual report;\textsuperscript{49}

3. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board;\textsuperscript{50}

4. The proportion of independent non-executives on the board, excluding the chairman, should be at least one half, except for smaller companies which should have at least two independent non-executive directors;\textsuperscript{51}

5. The board should undertake formal and rigorous evaluation of its own performance and that of its committees and individual directors and state in the annual report how the evaluation has been conducted.\textsuperscript{52}

6.9 Summary

Regulators and policy makers have been striving for a balance between shareholder protection and managerial autonomy for the last decade, and the seven committees and working groups described above have driven the course of corporate governance development in the UK during that period. These continuous efforts have built a substantial framework on Cadbury’s foundation that is in line with accepted ideas of good governance practice. Indeed, some of these efforts have helped define these accepted ideas.

The resulting framework makes efforts to safeguard company property from expropriation, while also allowing agents to act with discretion in a fast changing and competitive environment. The latest recommendations and guidelines are based on the notion of self-regulation, and advance on three dimensions:

1. The recommendations consolidate board structure by relying heavily on the non-executive directors. Emphasis is placed on their monitoring and governing roles, as evidenced by their suggested

\textsuperscript{49} The Code, A.2.2.

\textsuperscript{50} The Code, A.2.1.

\textsuperscript{51} The Code, A.3.2.

\textsuperscript{52} The Code, A.6 and A.6.1.
proportion on the board of directors, individual competence and experience, their independence and their accountability

2. The recommendations try to stimulate performance by suggesting appropriate reward systems for management.

3. The recommendations increase the degree of transparency. They encourage full disclosure in an attempt to raise investors’ awareness of company affairs.

This description of the development of the UK corporate governance system, while lengthy, provides important context to the research questions pursued in this paper. We will attempt to examine the timing and extent of the adoption of these recommendations by UK public companies. Our concentration on the implementation of these suggestions allows us to see the extent to which the well-meaning recommendations developed over more than a decade have actually been put into practice.
References


Organization for Economic Co-operation and Development (OECD), 1999, Corporate governance – improving competitiveness and access to global capital markets, Corporate Governance, 7 (2), 198-206.


Table 1: Chronological development of the UK corporate governance framework

<table>
<thead>
<tr>
<th>Date</th>
<th>Event</th>
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<tbody>
<tr>
<td>1991 May</td>
<td>Establishment of the Cadbury Committee</td>
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<td>1993 April</td>
<td>UK Stock Exchange amended the Listing Rules to reflect the recommendations in the Cadbury Report</td>
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<tr>
<td>1995 October</td>
<td>UK Stock Exchange amended the Listing Rules to reflect the recommendations in Greenbury Report</td>
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<td>1995 November</td>
<td>Establishment of the Hampel Committee</td>
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<td>1998 January</td>
<td>Publication of the Hampel Report on Corporate Governance</td>
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<tr>
<td>1998 June</td>
<td>UK Stock Exchange issued the Hampel Combined Code on Corporate Governance</td>
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<td>1998 December</td>
<td>Establishment of the Turnbull Committee</td>
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<td>1999 September</td>
<td>Publication of the Turnbull Report on internal control</td>
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<tr>
<td>2002 February</td>
<td>Establishment of the Higgs Committee</td>
</tr>
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<td>2002 September</td>
<td>Establishment of the Smith Committee</td>
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<tr>
<td>2003 January</td>
<td>Publication of the Higgs Report on review of the role and effectiveness of non-executive directors</td>
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<tr>
<td>2003 January</td>
<td>Publication of the Smith Report on Audit Committee</td>
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<td>2003 July</td>
<td>Publication of the New Combined Code</td>
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Table 2: The separation of the role of Chairman and Chief Executive Officer (1993, 1998 – 2002)

<table>
<thead>
<tr>
<th>Total number of board directors</th>
<th>Panel A Conyon (1994)</th>
<th>Panel B All companies in the sample</th>
<th>T Test (Means different in 1998 and 2002)</th>
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<td></td>
<td>1993</td>
<td>1998</td>
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<td>301</td>
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Table 3: Chronology of the separation of the roles of the Chief Executive Officer and Chairman

Table 4: Proportion of the main board who are non-executive directors (1993, 1998 – 2002)

<table>
<thead>
<tr>
<th>Total number of board directors</th>
<th>Panel A Conyon (1994)</th>
<th>Panel B All companies in the sample</th>
<th>T Test (Means different in 1998 and 2002)</th>
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<th>Panel B All companies in the sample of this study</th>
<th>T Test (Means different in 1998 and 2002)</th>
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Table 6: The composition of principal committees (1998 – 2002)

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