

Corporate Culture, Corporate Law and Financial Regulation

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Corporate Culture

‘a general constellation of beliefs, mores, value systems, behavioural norms and ways of doing business that are unique to each corporation’ Turnstall (1983)

When something goes wrong it may not always be possible to identify individual wrong-doing.

It is possible for wrong-doing to be caused or facilitated by toxic corporate culture.

Examples: Space Shuttle Columbia Disaster (1986)



Tom Hayes - UBS and Citigroup (2015)



Kweku Adoboli - UBS (2012)



Toxic corporate culture

Michel L Ehrenhard and Timo L Fiorito, 'Corporate values in the 25 largest European banks: Exploring the ambiguous link with corporate scandals' (2018) 18 Journal of Public Affairs 1

<https://onlinelibrary.wiley.com/doi/epdf/10.1002/pa.1700>

Joel Suess, David Bholat, Alex Gillespie and Tom Reader, Organisational Culture and Bank Risk, Bank of England Staff Working Paper No 912 (5 March 2021) [https://www.bankofengland.co.uk/working-](https://www.bankofengland.co.uk/working-paper/2021/organisational-culture-and-bank-risk)

[paper/2021/organisational-culture-and-bank-risk](https://www.bankofengland.co.uk/working-paper/2021/organisational-culture-and-bank-risk): robust evidence that poor culture leads to substantially higher risk, demonstrating the importance of bank culture for prudential outcomes

The Role of Corporate Culture

Individual wrong-doing may not have happened in a different cultural environment.

contributing factor facilitating individual wrong-doing

Manifestations of corporate culture:

- remuneration decisions
- promotion decisions
- extreme pressure to minimise cost
- extreme pressure to maximise return
- culture of over-working
- impossibility to have relationships outside of work
- normalising unethical and unlawful behaviour
- loss of moral compass
- dispersed governance: trades in the UK, managers in US, risk management in India

Conceptualising corporate culture in economic and legal terms



The Nexus of Contracts

Theory of the Firm



Agency Theory

Neoclassical Economics

Bilateral relationships

The firm is as another form of a market place.

Conflict between two rational actors, who each maximise their respective return in monetary terms.

Agents affect the well-being of principals.

Directors are agents of shareholders.

Assumption of rational actors

This helps to 'mathematicise' problems.

Agency Theory

helps economics to engage with law

gives law an inroad into economic concepts

spill over into the legal discourse

focus only on the incentives of individual actors

performance related pay as a normative recommendation

established in the 'greed is good' climate of the 1980s

Corporate law and regulation is now largely constructed against this background.

The approach relies on an unrealistic conception of human action.

It also ignores corporate culture

Organisations as autonomous actors

Natural action: humans can act rationally but do so rarely.

Humans act differently in different social contexts.

When human beings work together habits, routines, process, procedures, tacit knowledge, culture form.

These are sometimes referred to as 'social structure'.

Group loyalty and group think disengage individual judgement.

Impact of organisational context on human action can be measured empirically through experiments.

There also exists human agency.

Human agency can ignore 'structure' and modify it.

But modification takes time and effort.

Organisations are autonomous actors

They are more than the sum of the contributions by their participants.

There exists an autonomous structure (a glue) in the form of procedures, processes and culture.

We need to focus on this glue as well as on individual incentives.

How to influence corporate culture

Financial Reporting Council, Creating Positive Culture, Opportunities and Challenges (December 2021)

role-modelling and behaviour of the board

language and communications

culture on the agenda

evaluating performance

HR decisions

middle management

induction and training

(https://www.frc.org.uk/getattachment/bed9e8e2-0d24-448a-a530-ed3c71fdf9a7/FRC-Creating-Positive-Culture_2021-December.pdf)

Role of the law and of regulation

Focus on identifying and punishing individual wrong-doers counter productive

Christopher Hodges, Science-Based Regulation in Financial Services (SSRN)

Safety of air travel

- Fines for failure to disclose
- No fines for mistakes

Failure to prevent model

- Bribery Act 2010, s 7
- Criminal Finances Act 2017, s 44 and 45