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# Governors and directors: Competing models of corporate governance

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## Abstract

Why do we use the term 'corporate *governance*' rather than 'corporate *direction*'? Early British joint stock companies were normally managed by a single 'governor'. The 'court of governors' or 'board of directors' emerged slowly as the ruling body for companies. By the nineteenth century, however, companies were typically run by directors while not-for-profit entities such as hospitals, schools and charitable bodies had governors. The nineteenth century saw steady refinement of the roles of company directors, often in response to corporate scandals, with a gradual change from the notion of the director as a 'representative shareholder' to the directors being seen collectively as 'representatives of the shareholders'. Governors in not-for-profit entities, however, were regarded as having broader responsibilities. The term 'governance' itself suggests that corporate boards should be studied as 'political' entities rather than merely through economic lenses such as agency theory.



## Keywords

Corporate governance, corporate scandals, directors, governors, joint stock companies, representatives of the shareholders, not-for-profit entities

# Governors or Directors: Competing models of corporate governance

## Introduction

Why do we use the term 'corporate *governance*' rather than 'corporate *direction*'? After all, companies are run by boards of directors not courts of governors. Our aim in this paper is to examine corporate governance in historical perspective in order to understand how the term 'corporate governance' came to dominate modern discourse. We achieve our aim first of all by using both dictionaries and the Google Books corpus of English language publications to identify early usages of the word 'governance'. We then draw on a range of previous studies in the accounting, business and legal history literatures to identify significant early examples of governance structures and practices in both commercial and public interest organisations (such as charities, hospitals, and schools). Relevant contributions were analysed for evidence of governance, although we acknowledge that this word was rarely used in the context we examined. Nonetheless, various studies of how organisations were governed could be identified (though we do not claim that we provide a complete review of all entities that have been studied historically – in particular, our review examines governance largely in a British context).

Our work contributes to the increasing awareness that simplistic versions of popular theories of governance, such as agency theory, do not provide a full understanding of the observed phenomena, particularly in a historical perspective. We draw on two models of corporate governance developed by Napier (1998) to illustrate this point. We find that early business organisations in Britain were usually headed by a 'Governor', who combined many of the characteristics of a modern chairman of the board of directors and chief executive officer, but who, unlike the modern board chairman, was elected directly by the members of the organisation. On the other hand, the title of 'governor' in public interest organisations was often granted to anyone who had made a significant contribution to the organisation's funds, so that some entities could have several hundred governors. The term 'director' for a member of a corporate board emerged in the late 17$^{th}$ century, but the adoption of 'corporate governance' as a general expression in the 1970s probably reflected a desire on the part of early adopters of the term to emphasise what they saw as the 'political' nature of the management of organisations.

In the next section of the paper, we examine the emergence of 'governance' as a word used in literary and legal sources. We then review some of the earliest corporate entities in Britain and observe how their governance structures, while certainly precursors, differed from modern models. This section looks at both commercial and public interest entities. We go on to consider how the roles and responsibilities of directors of the modern limited company in Britain developed in the nineteenth and early twentieth centuries, and the effect of this on governance structures. We conclude with a tentative answer to our initial question.

## The emergence of governance

The nineteenth-century English novelist Anthony Trollope gained a reputation for reflecting current social phenomena in his fiction, and thus providing insights into life in the mid to late nineteenth century.[1] Trollope's fourth novel, but the first to gain a lasting reputation (Glendinning, 1992: 215), was *The Warden*, published in 1855 . This novel tells the story of the Rev. Septimus Harding, the Warden of Hiram's Hospital, a charitable almshouse in the fictional cathedral city of Barchester. Harding enjoys an enviable lifestyle because the Warden of Hiram's Hospital is entitled to all of the charity's substantial income after covering the modest living expenses of the twelve residents of the almshouse. After a press campaign for reform, Harding feels he has no alternative but to resign as Warden. As Trollope himself notes, and as Chadwick (1995: xiv) explains in his introduction to a recent edition of *The Warden*, the case of Hiram's Hospital is based on a contemporary scandal in the early 1850s, that of the Hospital of St Cross in Winchester. The Master of the Hospital was in receipt of an annual income of over £2,000, out of which he paid less than £200 to support a small number of residents of the Hospital and to provide a salary for a resident chaplain. The Hospital of St Cross was seen as a particularly blatant case of abuse of an ancient charitable foundation, particularly as the Master at the time had been appointed by the Bishop of Winchester, who just happened to be the Master's father.

Trollope's next novel, published in 1857, was a sequel to *The Warden*, and established his reputation as a major author. This novel was *Barchester Towers*. The details of this novel are not important for the present study, but Trollope begins by recapitulating the plot of *The Warden*. In doing so, he refers to 'A political pamphleteer' who 'had produced a few dozen pages [...] intended to give an infallible rule for the *governance* of all such establishments' (Trollope, 1857/1995: 11, emphasis added). This quotation is one of the few sentences in the corpus of

English literature up to the mid-twentieth century to contain the word 'governance'.[2] Miller and Napier (1993: 639) have warned against reading modern meanings of terms (or indeed modern terminology itself) back into the past, noting that: 'Genealogies of calculation put much more emphasis than do traditional approaches on the contemporaneous existence of a particular language or vocabulary'. In studying governance in a historical perspective, therefore, care needs to be taken to be sensitive to historical usages of the word 'governance' as well as to guard against the temptation to assess historical practices uncritically against what would be considered 'good governance' today. The word 'governance' itself has shifted in sense from referring to 'the office, function, or power of governing', through 'conduct of life or business', to 'controlling, directing, or regulating influence; control, mastery'.[3]

Moreover, the context in which the word 'governance' is most frequently used has changed dramatically through time. An examination of the Google Books corpus of English language publications[4] shows that 'governance' tended to be used more frequently than average in periods where there were debates about how England (later Britain) should be governed. The word appears most often in the 1580s; the 1640s and 1650s, during the English Civil War and Commonwealth periods; the 1680s, during the 'Glorious Revolution'; and the 1710s and 1740s, during Jacobite challenges to Hanoverian rule. These were all periods when the role of the monarch in government faced challenges. This political usage of 'governance' was to be echoed in the 1970s by the recently retired British prime minister, Harold Wilson, who published a book called *The Governance of Britain* (Wilson, 1976). This book claimed to discuss how Britain was actually governed and how government should be carried out. At the time, Wilson's use of the word 'governance' in his title was considered unusual, even pretentious, with reviewers describing the word as 'pompous' and Wilson's approach as 'emanat[ing] a certain smugness' (Stansky, 1977: 1260).

However, three decades later, Wilson's title was to be recycled by another British prime minister, Gordon Brown, for an official UK Government discussion document on the British constitution (United Kingdom Government, 2007). The use of the word 'governance' was no longer considered pretentious in a political context. This is not surprising to political scientists. Pollitt and Hupe (2011) consider that 'governance' along with 'accountability' and 'networks' have become what they call 'magic concepts'. According to Pollitt and Hupe (2011: 643), magic concepts exhibit four characteristics: *broadness* ('they cover huge domains, have multiple, overlapping, sometimes conflicting definitions'), *normative attractiveness* ('they have an overwhelmingly positive connotation; it is hard to be "against" them'), *implication of consensus* ('they dilute [...] traditional social science concerns with conflicting interests'), and *global marketability* ('they are known by and used by many practitioners and academics – that is, they are fashionable'). These concepts may be valuable more for their rhetorical connotations than their practical applications. The fact that they are notoriously difficult to define allows them to be used to achieve a variety of agendas, and Pollitt and Hupe (2011: 646) observe, 'the term "good governance" has spread pandemically through the community of international organizations concerned with public administration.'

From this discussion of governance in the political science literature, and Trollope's reference to governance of charities, we can conclude that governance was originally a term used in the context of how nations are governed, and its ambit became extended to local government and to 'public interest' entities such as almshouses, schools and hospitals. The term 'corporate governance' is a much more recent creation. A search for the expression 'corporate governance' in publications from 1600 to 1960 indexed on Google Scholar[5] produced an initially promising 248 citations, but virtually all of these have been misdated by Google Scholar, and refer to much more recent publications. A paper that is widely cited as the earliest scholarly reference to 'corporate governance' is 'The close corporation and the law' (Israels, 1948) but this uses the expression only once, without providing any definition or explanation.Ocasio and Joseph (2005) see the term 'corporate governance' as emerging in the USA in the early 1970s, in the context of growing concerns that large multinationals were abusing their economic strength. This stimulated attempts by consumer advocates, most notably Ralph Nader, to appeal to political notions of governance in order to enhance the accountability of corporations to broad constituencies (Nader et al., 1976).

However, Ocasio and Joseph (2005) document how this early linking of corporate governance to what would now be referred to as 'stakeholder democracy' (see, for example,Turnbull, 1994; O'Dwyer, 2005) became overtaken by a positioning of 'corporate governance' as an aspect of finance. Ocasio and Joseph (2005: 171) show that: 'The vocabulary of shareholder rights replaces the vocabulary of democratic political economy'. In his own history of corporate governance, Cheffins (2013) shows how, by the early 1980s, scholars in the neoclassical economics-based 'law and economics' movement had 'captured' corporate governance from political reformers using the recently formulated agency theory approach of Jensen and Meckling (1976) and Fama (1980). This spelled out that what mattered in corporate governance was the relationship between the corporate board (as the representative of the owners of a company) and the company's management, particularly the chief executive officer (CEO), and that problems within this relationship could be minimised through clever drafting of contracts rather than requiring external regulation. Ocasio and Joseph (2005: 167) ascribe to Richard M. Cyert, the co-author (with James G. March) of the seminal contribution to the management literature, *A Behavioral Theory of the Firm* (Cyert and March, 1963), the view that defined corporate governance 'in terms of the more narrow conception of board relationships with the CEO and the shareholders'.

This narrowing of the understanding of corporate governance has had an unfortunate effect, as it tends to take for granted that the central issue of governance is the board of directors. This includes how the board relates to owners in particular and broader stakeholders in general, how members of the board relate to each other, and how the board relates to management (Gevurtz, 2004). Yet the modern corporate board stands at the end of a long history of what, despite the possible anachronism of the expression, is conveniently termed 'corporate governance'. Different governance structures have existed at different times and in different places, and even key terms such as 'board' and 'director' have emerged at specific junctures.

## Governance in early British organisations

### Chartered companies

In his magisterial survey of all the British and Irish joint stock companies up to the time of the South Sea Bubble in 1720, Scott (1912a, b, c) provides details of how these companies were governed and managed (in particular Scott, 1912c: 461-481). Some of the earliest of the companies examined by Scott provided coordination and regulation for English merchants trading overseas. For example, the company with the long name 'The Mysterie and Companie of the Marchants Adventurers for the discoverie of regions, dominions and places unknown' (later to become in turn the Muscovy Company and the Russia Company), first mentioned in 1553, was organised with a governor, four consuls, and 24 assistants. These officials were elected from the members (referred to as the 'fellowship') of the company on an annual basis. The company was managed through a 'governor's court', where at least half of the officials needed to be present to constitute a quorum. The main activity of the governor's court was regulating disputes among members – there were originally 240 merchants with shares in the company (Scott, 1912c: 462-463).

This early example of a joint stock company exhibits various features that would be common in subsequent companies. First, the most senior person is called the 'governor'. In many cases, the senior person was referred to in the formal name of the entity – we can still see, on English banknotes, reference to 'The Governor and Company of the Bank of England', the formal name of the bank since its establishment by royal charter in 1694. Occasionally, the senior person had a different title: so we have 'The Treasurer and Company of Adventurers and Planters of the City of London for the First Colony in Virginia', chartered in 1606 (Scott, 1912c: 466-467), which established 'The Society of Particular Adventurers for Traffique with them of Virginia in a Joint-Stock', with a director and five committees.[6] The governing body was frequently referred to as a 'court' or 'council', rarely as a 'board'. The elected officials would be active in the business of the company – there does not appear to be any equivalent to the 'non-executive director' that is such a feature of modern corporate governance (Solomon, 2013: 81-95).

The governor was elected to this role by the general membership rather than being chosen by the governing body from among its number. This is one way in which the governor of a chartered company was unlike the chairman of the board of a modern company. Another difference is that the modern chairman is regarded as having a crucial role in securing good corporate governance (Tricker, 2015: 346, citing Cadbury Committee, 1992).. The governor of these early companies would likely be responsible for all executive decisions, subject to some oversight from the company members through regular general meetings, and therefore was closer to the modern chief executive officer than to the modern chairman. Most companies would have at least one deputy governor, empowered to act on behalf of the governor in his absence.

The general use of the word 'governor' for the senior official is significant. Corporate governance textbooks often provide an etymology for this word, showing how it ultimately derives from the classical Latin word *gubernator*, originally meaning a steersman or pilot, controlling the direction of a ship, and later coming to have a more general sense of someone who directs or controls.[7] An implication of this etymology is that the 'governor' should be in sole command – ships are not steered by committees. The other officials, in such a governance model, would have both executive and advisory roles, but ultimately the governor would be responsible for making decisions and ensuring that they were put into effect. This model of governance may still operate in practice in many corporate organisations, particularly those in emerging economies and traded on secondary markets such as London's Alternative Investment Market (Shah, 2014), where it is often the case that the company's chairman of the board is the original founder. In such situations, other directors defer to the chairman's decisions rather than seeing their role as challenging them.[8]

Two of the original trading companies have been studied in detail in the accounting history literature. These are the English East India Company (originally 'The Governor and Company of Merchants of London trading into the East Indies') and the Hudson's Bay Company (originally 'The Governor and Company of Adventurers of England trading into Hudson's Bay'). Baladouni (1983) describes the governance structure of the East India Company (EIC). The members of the company (sometimes referred to as 'adventurers': there were originally 198 of these in 1601 but over 1,000 by the end of the century – Scott, 1912c: 464-465) met twice a year as the general court, but the management of the company was in the hands of a governor (who had a deputy) and 24 committees. These individuals were persons of financial substance – the qualification to be a committee was holding £1,000 of stock in the company. Collectively, the committees had executive roles, they would 'perform various tasks for the execution of the trade – preparations of the outward voyage, the discharge and unloading of goods from the incoming ships, the organization of the sales of the Company's commodities' (Baladouni, 1983: 65). Baladouni points out that there was frequent tension between the committees and the general members of the company, particularly over the provision of accounting information. In 1634, for example, a member proposed the establishment of a special committee of 12 members to examine the company's accounts, but this was 'rejected with contempt by the governing body' (Baladouni, 1983: 68). Because of the substantial shareholding required to be elected as a committee, it is likely that the court of committees consisted of the principal investors in the company.

The governor and committees of the East India Company do not appear to have been paid regular salaries fixed in advance, but there is evidence that the members would from time to time vote to reward them with honoraria. For example, in 1615, '£1000 was granted to the twenty-four committees, on account of the growth of the business, which required their attendance every day' (Scott, 1912a: 163). In 1615, members voted by show of hands. From 1629, votes were made by secret ballot, which allowed members to resist pressure from King Charles I to elect the King's chosen nominee (Scott, 1912a: 228). There is little further evidence relating to how the governor and committees of the East India Company were selected – there is certainly no trace of anything like a modern nomination committee.

One important feature of joint stock companies of the period is the sheer size of the governing bodies. It is common for the governing bodies to consist of 12 members, divided among the governor and his deputy and various assistants, or even for there to be 24 assistants or committees. We have seen that the Russia Company had 24 assistants and the East India Company had 24 committees. These governing bodies are large by modern standards, but may reflect the involvement of active merchants and traders in the companies. Several of these would likely be absent at any one time carrying on trading ventures on their own account or for the company, making it difficult to obtain a quorum at meetings unless the pool of potential attendees was large. The reason for using multiples of 12 members for the governing body is unclear – perhaps there is a distant echo of Christ's 12 disciples, while juries in England traditionally have 12 members.[9]

However, the Hudson's Bay Company, chartered in 1668, had, in addition to the typical governor and deputy-governor, only seven committees. This relatively small number may reflect the pool of investors from which they would be drawn: by 1672, there were only 32 shareholders in the company (Scott, 1912b: 230). Also, as Spraakman (2006: 108) observes: 'From London, the governor and committee could control the business by reconciling outgoing trade good[s] and supplies with incoming furs', so a company with such a simple business model would not require complex and extensive governance. Spraakman and Wilkie (2000: 61) point out that this was still the structure of the central governing body 150 years later, with on-the-spot management in North America being delegated to two 'inland governors', reporting to the committee back in London. Yet joint stock companies continued to have governing bodies consisting of many members. Both the Bank of England, established by royal charter and act of parliament in 1694 (Scott, 1912c: 476-477), and the Bank of Scotland, set up by an act of the Scottish parliament in 1695 (Scott, 1912c: 478-479), have, in addition to the standard governor and deputy-governor, governing bodies of 24 members. However, for the first time, these members are called 'directors', and this name quickly catches on, with the so-called United East India Company (1709),[10] the Royal Exchange Assurance Company (1717) and the London Assurance Company (1719) all being established with boards or courts of 24 directors, and the South Sea Company (1711) having 30 directors (Scott, 1912c: 480-481).

The early British joint stock companies show a model of corporate governance rather different from what would be regarded as 'good governance' today. Generally, directors, whether called this or some other term (for example, assistants or committees), worked actively in the companies. The notion of a non-executive director would have made little sense to those in the seventeenth and early eighteenth centuries. Secondly, companies were led by governors who combined the modern roles of chairman of the board and chief executive officer. The idea of 'splitting the role of chairman and chief executive' (Solomon, 2013: 79) would not have seemed reasonable at a time when a joint stock company's governor often acted autonomously to resolve, in a quasi-judicial manner, trading disputes among members of the company. This model of corporate governance was autocratic rather than democratic. The move to designate those who ran companies as 'directors' may reflect a movement towards greater democracy from the late seventeenth century, in parallel with broader political changes from the 'Glorious Revolution' of 1688 to the increasing strength of the British parliament with the accession of the Hanoverian kings in 1714.

**Public interest organisations**

As the *Oxford English Dictionary* points out, the word 'governor' is 'sometimes applied only to the head of an institution (as in the Bank of England), sometimes to every member of a governing body (as in many schools, charities, etc.)'.[11] In England, 'maintained' schools (those schools under the control of local authorities) are subject to the *School Governance (Constitution) (England) Regulations 2012*,[12] which set out the structure, powers and responsibilities of school governing bodies (Department for Education, 2017: 3). The regulations specify who should be governors of schools and how they should be elected or appointed. The tradition that schools in England are under the direction of a body of governors is longstanding. However, what was involved in being a governor of a school could vary considerably.

One long-established school is Christ's Hospital (sometimes known as the Bluecoat School after the distinctive clothes worn by students), founded by King Edward VI in 1552. From the 1670s, new governors would be elected by the court of governors after making a donation, originally £200, but rising gradually to £500 in 1841. Governors had the right to nominate ('present') children for admission to the school, and the duty to visit the school to make sure that standards were being maintained.[13] A pamphlet published around 1816, 'compiled chiefly for the convenience of persons who are desirous of getting Children into Christ's Hospital' (Anonymous, c.1816: iii), lists a president and 24 governors (Anonymous, c.1816: 77), nominated by the Common Council of the City of London and forming a management committee, and then a further 330 or so 'benefaction governors' (Anonymous, c.1816: 78-98), who, with the nominees of the Common Council, formed the court of governors. As the pamphlet notes:

> [T]he more immediate government is vested in the Treasurer (who is Chairman of all Committees) and a Committee, chosen from the whole body of Governors. This

Committee has the whole superintendence of the Hospital, and reports to the General Court from time to time upon the state of the foundation. (Anonymous, c.1816: 23)

Before the word 'hospital' came to refer to a place where the sick and injured are treated, it had the sense of a charitable institution for maintaining the old or destitute, or for caring for and educating needy children and young people.[14] As in the case of Christ's Hospital, other similar institutions often had a large number of governors, whose main qualification was making a donation. An example is the Foundling Hospital in London, established by Royal Charter in 1739 (Miley and Read, 2016: 168) under the name 'The Corporation of the Governors and Guardians of the Hospital for the Maintenance and Education of Exposed and Deserted Young Children'. The original governors qualified by making a donation and would normally hold that position for life. Because there were several hundred such governors, it was necessary to establish a smaller managing body, which was known as the daily committee (Miley and Read, 2016: 169).

Similar organisational structures can be found in medical hospitals of this period. The Newcastle Infirmary, founded in 1751 (Holden et al., 2009: 533), had as its principal governing body a board of governors. To be eligible for appointment as a governor, an individual needed to be a subscriber of two guineas or more a year: donating £20 would entitle the donor to be a governor for life. The statutes of government of the Infirmary 'required a House Committee of Governors consisting of 36 governors, 12 each from the governors representing the three counties of Durham, Northumberland and Newcastle' (Holden et al., 2009: 538) – it is interesting to note that the use of multiples of 12, common in trading companies in the seventeenth century, reappears here. Later, by the nineteenth century, even a committee of 36 governors was considered too unwieldly, and a house sub-committee, meeting every week, had only 12 members (Holden et al., 2009: 539).

One common participant in modern governance structures has not been mentioned so far – this is the auditor. At the Newcastle Infirmary, two honorary auditors were appointed from among the governors, and Holden et al. (2009: 539) note that the auditors 'needed to be men of impeccable social standing [...] "gentlemen".' By the end of the nineteenth century, the role of 'house governor' had been established to undertake day-to-day management. This position was rewarded with a salary that was generous for the time of £300 per annum. In some hospitals, the senior salaried manager was referred to as the 'secretary'. In many not-for-profit organisations, therefore, the governance structure involved a very large court of governors, consisting of donors (either on an annual basis or giving a one-off payment), which met infrequently, a committee, which met monthly or even weekly, and a senior salaried manager. Where the organisation had been established by a single donor, however, the court of governors might be much smaller. Royal Holloway College, founded as a higher education institution for women in 1883, was entirely financed by Thomas Holloway. The College had a court of around 15 governors, all members of 'the great and the good' – eminent individuals such as the Archbishop of Canterbury and Prince Christian of Schleswig-Holstein (Queen Victoria's son-in-law) as well as bankers, financiers, politicians and other public figures. The existing members chose the new members of the court of governors, so the court was self-perpetuating. A salaried secretary undertook day-to-day management of the college, but he was not a governor, nor was the college's principal, who was in charge of educational matters. Indeed, the principal, who was required by the college's deed of foundation to be a woman, did not attend the meetings of the all-male court of governors (Giovannoni and Napier, 2017).

Many of the significant public interest organisations formed in the seventeenth and eighteenth centuries had the legal status of a 'corporation', defined as: 'A body corporate legally authorised to act as a single individual; an artificial person created by royal charter, prescription, or act of the legislature, and having authority to preserve certain rights in perpetual succession.'[15] In England, the earliest corporations were town and city councils and religious institutions such as cathedrals and abbeys, which had corporate personality conferred upon them by a charter from the Crown or were deemed by prescription to have received such a grant (Davies, 1997: 18). Towns were usually governed by councils, with a senior individual (mayor, lord mayor or alderman) acting as chair of the council, and other members (councillors or burgesses) either elected by citizens or appointed by the existing council to fill vacancies. The size of town councils was often based on multiples of 12: for example, in the mid-thirteenth century, Leicester's town council had 24 members and Ipswich's town council had 12 members (Gevurtz, 2004: 146). Medieval guilds merchant, responsible for regulating local trade, often had the same governance structure, and in some cases, membership of the local merchant guild and the local town council was identical.

Medieval guilds and town councils had a social as well as an organisational side. They held regular 'feasts and convivial meetings' (Scott, 1912a:4), which meant that members had the opportunity of gaining personal knowledge of each other. This meant that the members who were elected to governing bodies were often a consensus choice. These regular meetings would often involve a review of the financial affairs of the organization. Scott (1912a:5) describes this as 'the audit of accounts', but this process was more like a 'hearing' by the governing body of the accounts than a report from a designated auditor. These regular meetings of members foreshadowed the modern annual general meeting, while, as Gevurtz (2004: 144) suggests, the structure of town councils was a major influence on the form of early corporate boards.

## British corporate boards in the nineteenth century

The *Joint Stock Companies Act 1844* allowed companies in Britain to be incorporated by simple registration, rather than requiring a royal charter or specific act of parliament. Nonetheless, large entities such as railway companies still needed an individual act of parliament, which usually stated the size of the board of directors. The *Companies Clauses Consolidation Act 1845*, which applied to such 'statutory' companies, provided that: 'The directors shall have the management and superintendence of the affairs of the company' (sect. 90), required the directors to elect a chairman (sect. 93), and allowed for committees of directors (sect. 95). The directors themselves were elected by the members of the company at annual general meetings. It is worth noting that the chairman was chosen by the elected directors from among their number, rather than being voted on by the members.

Some early railway companies reflected assumptions as to ideal board structures carried over from previous centuries. For example, the Great Western Railway was originally established in 1833 with a 24-member board of directors, made up of two 12-member committees, the 'London Committee' and the 'Bristol Committee', reflecting the two cities that the railway was intended to link. The company was run on a day-to-day basis by two secretaries, one in London and the other in Bristol. The London secretary, Charles A. Saunders, had remarkable longevity, because as late as 1861 he was the railway's sole secretary and chief superintendent (the equivalent of a modern chief operating officer), though he was not one of the 15 directors of the company.[16]

The Great Western Railway's governance structure, like that of other statutory companies and indeed most companies registered under the *Joint Stock Companies Act 1844* and its successors, follows what Napier (1998: 113) has labelled the *collectivity model* of corporate governance. This reflects the legal view that a company literally *is* the members (in a commercial concern these would be shareholders because the company's capital would consist of shares), acting as a group. Ultimate power lies with the company's members at the company's general meetings. The members elect a board of directors to manage and supervise the company on their behalf. The directors are not involved in the day-to-day management of the company (here the collectivity model differs from the model of governance in early chartered companies, where the governor and assistants or committees would be active in the company's business). Instead, the directors hire managers to undertake the operations of the business. The directors are *officers* of the company, but not employees, and are remunerated in the form of fees rather than salaries.

Originally, managers might *attend* board meetings, but would not be *members* of the board. However, British company law began to recognise the status of 'managing director', where it would be convenient for the full-time salaried manager of the company to be a member of the board. In some cases, the founder of a business would continue as managing director (often also as chairman of the board of directors) after the flotation of the company on a stock exchange. One advantage of being a managing director was that companies could specify, in their articles of association, that a managing director was not subject to periodic election by the shareholders (Davies, 1997: 181). The rationale for this was that the managing director was an employee of the business, and hence was subject to dismissal by the board of directors. However, in practice, particularly where the managing director was the founder of the business, this provision would entrench the founder on the board of directors.

Within the collectivity model, as well as appointing directors, the shareholders would appoint auditors, who would themselves be members of the company. Before the emergence of professional auditors, these individuals would be 'representative shareholders' in the same way as the company directors. Both the board of directors and the auditors would monitor the actions of the managers, in different ways – the board would likely undertake monitoring on a regular and ongoing basis while the auditors would normally simply review the financial statements prepared by the managers on a periodic basis. However, sometimes the auditors would be asked to carry out special investigations, especially where the managers were suspected of misconduct or poor commercial decisions. The managers would report to the directors, and in some cases so would the auditors, particularly if they had undertaken a special investigation. Finally, both the directors and the auditors would report, through the general meeting, to the shareholders. A schematic diagram of the collectivity model is shown in figure 1 below.

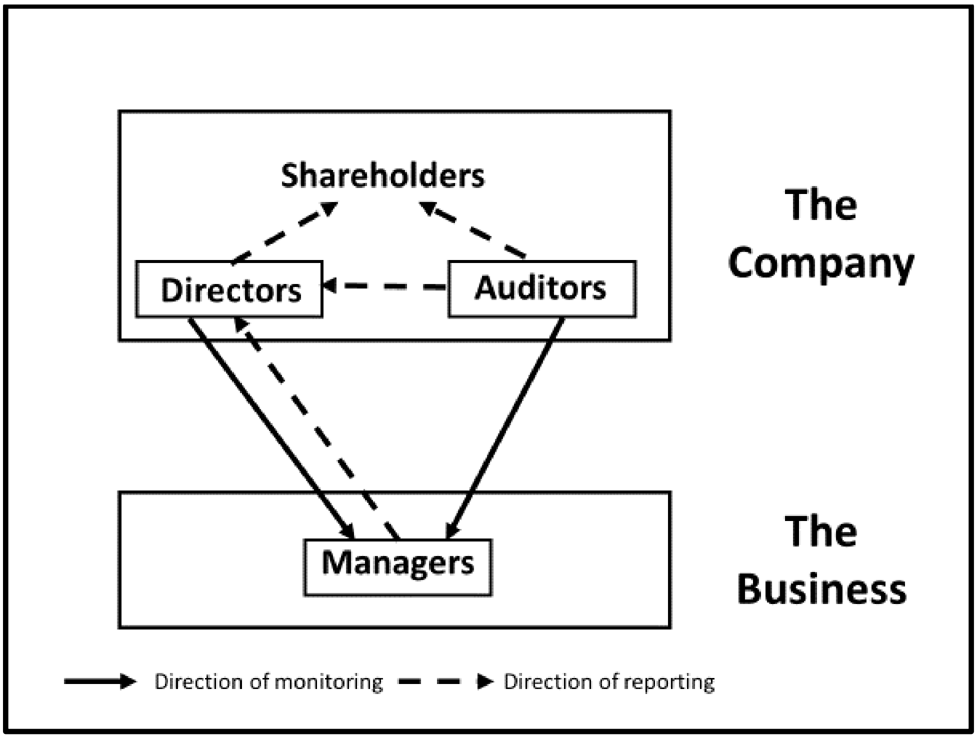


**Figure 1**. Collectivity model of corporate governance
Source: Napier, 1998: 114

In the collectivity model, there is a clear separation between the board of directors and the managers. However, as more managers are appointed as directors, the collectivity model begins to mutate. Directors have less of a role in monitoring management if they actually *are* the managers. The auditors become the main monitors, but shareholder auditors do not have the skills to undertake this responsibility effectively, so are gradually replaced by professional auditors. Instead of regarding the ownership of shares in the company as a necessary requirement to have the interest to act as an auditor, professional auditors see ownership of shares as a potential threat to their independence, and so professional auditors are no longer 'representative shareholders' but rather 'representatives of the shareholders' in monitoring the managers of the business. Napier (1998) named the governance structure that developed with the convergence of directors and managers the *business company model*, and a simplified version of this is set out in figure 2 below:

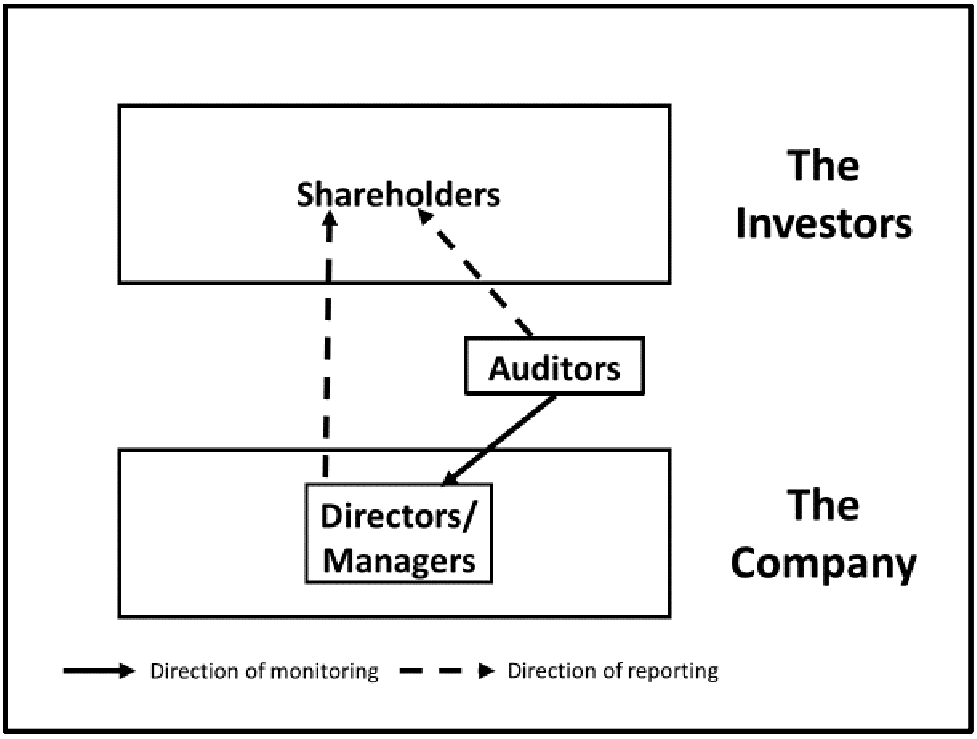


**Figure 2**. The business company model of corporate governance
Source: Napier, 1998: 115, adapted

The relationships involving shareholders, directors, managers and auditors that are shown in figures 1 and 2 have been analysed extensively at a theoretical level, using various approaches. Stewardship theory, for example, suggests that shareholders nominate and elect directors to protect their interests, while directors accept a fiduciary duty to be stewards of those interests (Tricker, 2015:66). On the other hand, agency theory sees the owners of the business employing managers, who may act in ways detrimental to the owners' interests (Tricker, 2015:62). Under agency theory, the main role of the auditor is to monitor the actions of the management. The two models bring out the ambiguous position of the board of directors: do they act as the shareholders' representatives in opposition to managers, or are they basically the same as the managers? The historical approach taken in this study suggests that there is no single model of corporate governance that applies across time.

The version of the business company model shown in figure 2 assumes that all the members of the board of directors are employed as managers in the company. There is a subtle change in nomenclature in that 'the company' is no longer considered to be essentially the same as the members acting as a group but now is identified as the business itself. In practice, particularly for companies with a large number of shareholders and with stock exchange listings, boards would consist of some directors working actively in the day-to-day management of the company and other directors whose involvement with the company was simply to serve on the board. Nowadays, we would distinguish between executive and non-executive directors, but this terminology emerged only recently, and British company law made no distinction between the different types of director. Company promoters found that they could achieve greater success in floating the securities of a company on a stock exchange if at least some of the directors were regarded by investors as 'safe pairs of hands'. This provided opportunities for a small group of individuals to earn good livings as 'directors of companies', more insultingly known as 'guinea pigs',[17] because directors' fees were usually expressed in guineas (an archaic English coin worth £1 1s. or £1.05), and board meetings often finished with generous refreshments.

The wide variation in the quality of 'guinea pigs' can be seen by examining members of the British aristocracy who held multiple directorships. According to information provided by Cannadine (1990: 407) about a quarter of the entire nobility in 1896 held at least one company directorship. Some of these were directors of companies linked to their lands (for example, local railway and canal companies and mining companies), others were recently ennobled industrialists, but there was a group of peers who held multiple directorships. Two individuals stand out: the Marquess of Tweeddale, with 19 directorships, and the Earl of Donoughmore, with 11. William Montagu Hay, the 10th Marquess of Tweeddale, was born a younger son, and so had to make his way in the world. He worked in the Indian Civil Service, and on his return to Britain in the 1860s he became a Liberal member of parliament and also became involved on the boards of several companies. He was caricatured in the periodical *Vanity Fair* in 1874, with the title 'The Director', indicating the number of directorships he held at that time. He succeeded to the title in 1878 and continued to hold directorships (in 1896 he was director of 19 companies, including Chairman of the North British Railway – Cannadine, 1990: 717). At the same time, Tweeddale owned a vast estate in Scotland producing an annual income of over £25,000 (equivalent to roughly £5 million today).

If Tweeddale was an example of a highly respected 'director of companies', John Hely-Hutchinson, 5th Earl of Donoughmore, can only be regarded as a 'guinea pig'. In 1896, Donoughmore was the director of 11 companies (Cannadine, 1990: 717), although he had no particular commercial talent. Donoughmore had extensive estates in Ireland, but in the late nineteenth century such estates were often unprofitable, so Donoughmore would have needed the additional income provided by his directors' fees to support what, from his caricature in *Vanity Fair* in 1879, appears to have been a comfortable, indeed, sybaritic lifestyle. Certain company promoters were notorious for their lists of potential 'guinea pigs', though other promoters tried to avoid them – Cannadine (1990: 410) quotes promoter William Weston:

> Sir George Deadbroke, Bart., Lord Arthur Pauper, Viscount Damphule . . ., and others of that ilk, are always ready to lend the charm of their great names to these enterprises and attend board meetings, for moderate consideration of one guinea per meeting.[18]

A particularly egregious case described by Cannadine (1990: 411) involved Cecil Rhodes and the British South Africa Company, which had been established to exploit lands in southern Africa, including what is now Zimbabwe (Power, 2017). Rhodes had been advised that the existing board of the company (mainly businessmen operating in South Africa) would not inspire confidence among British investors. Following this advice, Rhodes secured as directors such aristocrats as the Duke of Abercorn (an impoverished Irish landowner) as chairman, at an annual salary of £2,000, and the Duke of Fife (who was married to the daughter of the Prince of Wales) as vice-chairman. These directors were later to be described as 'worse than useless, for they gave a sheen of respectability to a company over which they had no control' (quoted in Cannadine, 1990: 412).

By the opening years of the twentieth century, therefore, many of the problems that would subsequently be subsumed under the heading of 'corporate governance' were already in existence. Neither the collectivity model nor the business company model of governance represented a guarantee of sound management. This was also the case, of course, in public interest organisations, where good management was usually the result of the professionalism of salaried managers as much as the work of governing bodies. However, in public interest organisations, there was often more likelihood of problems emerging quickly, because of the active involvement of governors with a mission to advance the objects of the organisation rather than their personal interests. Organisations such as Christ's Hospital, the Foundling Hospital and the Newcastle Infirmary had too many governors for issues to be concealed for long. However, particularly in the business company model, shareholders often found it difficult to gain detailed information about the companies in which they invested. They had to rely on a regular pattern of dividends to indicate financial soundness (and current dividends could be paid by less scrupulous corporate managers at the expense of future dividend-paying capacity) and on the names and reputations of the board of directors to indicate quality of management.

Because so many company directors came from upper echelons of society and were essentially amateurs, the requirements imposed on directors by company law were not onerous. In his seminal account of corporate governance, Tricker (1984: 40) summarises the three basic principles for directors' responsibilities, which had been set out in the case *Re City Equitable Fire Insurance Company Limited* (1925 Ch 407):

> (a) A Subjective Test of Skill: A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience.
>
> (b) Periodical Attendance: He is not bound to give continuous attention to the affairs of the company. His duties are of an intermittent nature to be performed at periodical board meetings. He is not bound to attend all such meetings though he ought to whenever he reasonably can.
>
> (c) Delegation to Executives: He is entitled to trust an official to perform such duties as can properly be entrusted to him in accordance with the Articles.

Not much was expected from the nineteenth and early twentieth century company directors, and this was reflected in generally permissive attitudes towards corporate practice. Taylor (2013), in his study of how corporate fraud was treated (or often disregarded) by nineteenth century criminal law, argues that the British criminal courts were 'soft' on company directors who had carried out what would now be regarded as fraudulent practices, such as appropriating corporate funds that had been committed to the directors as persons in positions of trust and authority. Criminal prosecutions were considered unnecessary because the loss of reputation or status suffered by directors involved in corporate collapses was regarded as sufficient punishment (Taylor, 2005). Shareholders preferred civil actions against directors, which offered the potential of financial recoveries, to criminal proceedings, where any financial penalties would accrue to the state. The conviction of directors of the City of Glasgow Bank in 1879 (Walker, 1998) appeared to usher in new ethical standards for company management, but judges in subsequent litigation downplayed this case as a potential precedent. Taylor shows that the impact of greater regulation, such as the establishment of the role of Director of Public Prosecutions in 1880 (Taylor, 2013: 191) and the *Winding Up Act 1892* (p. 80), was not fully observed until the twentieth century.

One unhappy story was that of Gerard Lee Bevan, the chairman of the City Equitable Fire Insurance Company. Despite the company's large and distinguished board, Bevan dominated the company's policies and practices. Bevan was tried in 1922 (Vander Weyer, 2011: 217) under the *Larceny Act 1861*,[19] which made it an offence for a director of a public company to issue any statement in writing that was materially false with intention to deceive or defraud the investors. He was convicted for issuing false balance sheets and prospectuses (Taylor, 2013: 259-260).

However, the other directors were not prosecuted, and in civil litigation against the directors and the company's auditors, the courts set the requirements for directors at the rather low level quoted above.

The *Larceny Act* continued to underpin prosecutions in the twentieth century and was interpreted more expansively in the case of Lord Kylsant, the chairman of the Royal Mail Steam Packet Company, who was convicted for issuing a prospectus that was considered false because of what it omitted – that the company's reported profits were the result of dividends received from subsidiaries and the release of tax provisions rather than successful trading – rather than what it explicitly stated (again, the other directors of the company did not face criminal prosecution). Taylor (2013: 262) asserts that the prosecutions in the twentieth century followed a path set by their nineteenth century predecessors. However, the reluctance to prosecute 'respectable' British businessmen under the *Larceny Act*, noted by Taylor (2013), which provided little deterrence to those in control of companies, is reflected in modern models of corporate governance, which see governance as predominantly a private matter between directors and investors rather than a public concern justifying the use of the criminal law. In other countries, such as the USA, there is perhaps less reluctance to prosecute directors and senior managers of failing companies, though Fuerman (2004) cautions us against generalising from exceptional cases such as Enron.

## Conclusions

In this paper, we have examined some of the precursors of modern corporate governance, in a period when that term was unknown, and even the word 'governance' was used infrequently and in limited contexts. Much of the modern debate over good governance in the corporate sector homes in on board structures, and it is interesting to note how corporate boards were originally based on structures developed in public interest settings, such as town councils and merchant guilds. In early chartered companies, the most senior individual was usually known as the governor, who was supported by assistants, and who had considerable power. The members of the body that ran a company were not referred to as directors until the late seventeenth century, but this rapidly became the standard nomenclature. In charitable corporations, the governors were often those who had given a certain financial contribution, and different structures developed to achieve effective day-to-day management, usually involving the employment of a salaried secretary or superintendent. By the nineteenth century, the 'collectivity model' of corporate governance, deriving from seventeenth and eighteenth century practices, became common, and arguably (Napier, 1998) was the default structure assumed by British company law. However, by the end of the nineteenth century, corporate boards of companies with stock market quotations often consisted of various 'managing directors', employed by the company and not subject to periodic re-election, together with what would now be called non-executive directors, often put on boards because of the cachet of their names rather than because of their personal abilities.

Why should these changes have taken place, particularly in Britain during the 19th century? Classic historical studies of business organisation have suggested several factors: Chandler (1990) emphasises the increasing complexity of business, which required sophisticated management structures relying on professional managers, while Cottrell (1980) notes the growth of the stock exchange as a source of finance for expanding businesses, with wider shareholding and the separation of ownership from control leading to changes in expectations surrounding the role and duties of directors. Sometimes, specific corporate scandals brought out weaknesses in how companies were directed and managed: reference has already been made to the scandals involving Gerard Lee Bevan and Lord Kylsant in the 1920s/30s, but earlier examples would include the South Sea Bubble in the early 1720s (Dale, 2004) and the 'great railway swindle' in the 1840s (Bryer, 1991), where boards of directors often acted to advance their personal interests at the expense of those of 'the company' (that is, the shareholders collectively). Attempting to tease out the precise factors that led to particular changes in attitudes to corporate governance in different periods is a matter that would merit further research.

At the beginning of this paper, we proposed a question: 'Why do we use the term "corporate *governance*" rather than "corporate *direction*"?' We suggest that 'corporate governance' was intended to emphasise the 'political' nature of running companies. The view of companies as 'little republics', proposed by the mid-Victorian British politician Robert Lowe (see for example Loftus, 2009: 96), is consistent with the notion that directing and managing companies is a political process as much as, if not more than, a process of rational organisation, and hence should be considered through the originally 'political' notion of governance. This aspect of governance has arguably become lost in more recent considerations of corporate direction and management, which is normally seen through the theoretical economic lens of agency theory (and to a lesser extent other theories such as stewardship). By attending to the historical emergence of governance structures in business and not-for-profit organisations (even before this term was applied to companies), we can observe how the Governor of the early joint stock company gradually mutated into the Chairman of the Board of the modern business corporation. Further research, using business archives as well as past accounting records, is likely to provide further insights into how the past illuminates the present and helps to guide us towards the future.

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## Notes

1. In the accounting history literature, for example, Rutterford and Maltby (2006) have used Trollope's novels as sources for information about the involvement of women in the ownership and management of property in the nineteenth century. Napier (2017) has reviewed the use of literary sources by accounting historians.
2. The *Oxford English Dictionary* uses this sentence of Trollope's as an illustration of the usage of the word 'governance', in the sense 'the manner in which something is governed or regulated; method of management; system of regulation' (http://www.oed.com/view/Entry/80307, accessed 18 August 2017).
3. Quotations from the *Oxford English Dictionary*, see reference in note 2 above.
4. See https://books.google.com/ngrams/graph?content=governance&year_start=1400&year_end=2000&corpus=15&smoothing=3&share=&direct_url=t1%3B%2Cgovernance%3B%2Cc0 (accessed 18 August 2017).
5. Search undertaken on 18 August 2017.
6. The stress is on the final syllable.
7. The *Oxford English Dictionary* confirms this etymology in its entry for 'governor', pointing out very similar words in many other European languages (http://www.oed.com/view/Entry/80323, (accessed 18 August 2017).
8. Almulhim et al. (2016) note that this phenomenon occurs in several listed Saudi Arabian companies, where, even if boards discuss issues carefully, directors are reluctant to vote against the wishes of the chairman. It has been suggested that this behaviour is consistent with the Islamic concept of *shura* or consultation, and that the governance models of Islamic financial institutions should include a *shura* council including representatives of shareholders, creditors, the public, the board of directors, and the Sharia Supervisory Board (Asri and Fahmi, 2004; cited in Safieddine, 2009: 145).
9. The religious influence of the number 12 or multiples of 12 is observed more widely, for example, Spellman (1962) recounts the tale of the Indian Jain saint Bhadrabahu, who predicted a famine lasting for 12 years, and led an exodus of 12,000 Jains, accompanied by King Chandragupta, who survived 12 years after the death of the saint.
10. This combined the original (or 'Old') East India Company with a rival concern set up in 1698 and known as the English (or 'New') East India Company (Scott, 1912b: 189).
11. http://www.oed.com/view/Entry/80323 (accessed 17 August 2017).
12. http://www.legislation.gov.uk/uksi/2012/1034/pdfs/uksi_20121034_en.pdf (accessed 27 October 2017).
13. Information from Christ's Hospital website at http://www.chmuseum.org.uk/authenticated/browse.aspx?BrowseID=2192&tableName=b_Browse (accessed 18 August 2017).
14. See entry for 'hospital' in the *Oxford English Dictionary* (http://www.oed.com/view/Entry/88724, accessed 18 August 2017).
15 Third meaning for 'corporation' in the *Oxford English Dictionary* (http://www.oed.com/view/Entry/41833, accessed 18 August 2017).
16. The list of the original directors of the Great Western Railway is available at https://www.gracesguide.co.uk/Great_Western_Railway:_1833_Committees, and the 1861 list is at https://www.gracesguide.co.uk/Great_Western_Railway:_1861_Directors_and_Officers. Saunders was 64 in 1861 and soon afterwards he retired, to be succeeded by his nephew Frederick George Saunders (https://www.gracesguide.co.uk/Charles_Alexander_Saunders - all accessed 18 August 2017).
17. This term was widely used in the late nineteenth century. For example, Thomas Gilbert, who founded a mining company, Gold Queen, in 1888, was described in contemporary sources as filling the company's board with 'compliant 'guinea-pig' directors', including a deaf vice-admiral who later admitted that he could not hear what was said at board meetings (see Taylor, 2013: 216).
18. In practice, directors' fees might be considerably more than this, and 'guinea pig' directors were often granted other benefits such as opportunities for insider trading.
19. The *Larceny Act* continued to be the basis for prosecutions until its supersession by the *Theft Act 1968*.