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Contextualizing Corporate Social Responsibility: A Theoretical Approach

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Abstract

Several safeguards which are aimed at bolstering the objective of ensuring that the agent's objectives and actions are closely monitored, as well as aligned with firm investors' desires, encompass and relate to the encouragement of longer term firm economic performance, increasing shareholder voting power, and the implementation of legislative tools and financial reporting standards as means of determining how effectively executives and management are to be compensated. This paper is therefore also aimed at exploring how these safeguards could be applied, particularly within the context of insider trading and the rationale behind several jurisdictions to adopt or not to adopt insider trading regulations. Furthermore, it will seek to provide a better understanding of how corporate governance structures can assist businesses.

Keywords: Corporate social responsibility, self-regulation, economic responsibility, corporate governance, legal regulations

Introduction

Through the Enforced Self-Regulation model, the role played by government in the direct monitoring of firms is highlighted. In incorporating the Co-operative and Competitive Enforced Self-Regulation model, it attempts to draw attention to the fact that the absence of effective enforcement mechanisms will restrict the maximization potential of such a model. As well as accentuating how corporate responsibility and accountability could be fostered through monitoring and the involvement of governments in the regulation of firms, this book aims to further consolidate on, as well as explain how corporate governance structures which operate in various systems function (and attempt) to address gaps which may arise as a result of lack of adequate mechanisms of accountability. Where self-dealing or self-serving interests are not involved, and where devastating consequences to the economy – which also adversely impact stakeholders, need to be averted, then there is clear argument for the supremacy of economic responsibilities over legal and ethical responsibilities.

This however, still provides loopholes and lee ways for directors and management to evade legal and ethical responsibilities. Ideally, legal and ethical responsibilities should serve as safeguards in the facilitation of economic responsibilities. However what is regarded by many as constituting safeguards may also be

considered by some to restrict revenue generating capacity. Whilst standards and codes of ethics are to be regarded as facilitators of vital corporate governance mechanisms, regulations are sometimes viewed as burdensome and a waste of resources - particularly in terms of compliance and monitoring costs - an argument for the pyramid of regulatory strategies which was put forward by Ayres and Braithwaite.

Research design:

Through an interdisciplinary approach which consolidates on previous research on the topic, as well as previous research by the author - hence aiming to contribute to existing and previous literature on the topic - as well as address gaps in the present literature on corporate governance and self-regulation, this research is aimed at ultimately generating useful recommendations and suggestions for future research.

It will also aim to address how the question of how corporate governance structures can assist businesses and regain trust in the operating systems of these businesses, can be achieving - through the incorporation of research questions and objectives into solutions.

Interactions between States and Markets

Legal regulation

According to Lange, the occurrence of interactions between states and markets does not take place in a vacuum.[1] Such interactions, in her opinion, not only determine the position assumed by legal regulation - the characterization of different types of law has occurred on the basis of reference to the "location in space".[2] Legal pluralism, which is generally perceived to be a prominent form in globalization, refers to "geographical or metaphorical notions of space in its conception of law" and in her opinion, a consideration of legal regulation as state-market interactions simply does not generate analytical questions which relate to the nature of these interactions, but also prescriptive questions, namely, the degree of state intervention and market ordering required for the facilitation of effective regulation.[3]

Figures of several researches clearly indicate that audit firms have placed economic responsibilities above their legal responsibilities and it is also quite understandable why safeguards aimed at ensuring that audit independence and objectivity are complied with, will be compromised. Such ethical codes relating to objectivity, independence are more likely to be compromised where excessive reliance is placed on revenue generated from other non-audit incomes relative to that generated from audit income.

Changes in state-market relationships are highlighted as being reflected through: Gradually blurred lines between states and markets, which are attributed to the privatization of states and the dominance of markets by powerful corporate actors.[4] It is added further, that in response to changing state-market relationships, modern forms of legal regulation have developed.[5] The privilege of the inclusion of state-economy interactions in considering legal regulation derives from the definition of legal regulation, which can be defined as the regulation of economic activities.[6]

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[1] B Lange 'Regulatory Spaces and Interactions: An Introduction' Sage Publications (2003)12 (4) 413

[2] *ibid*

[3] See ibid at pages 414 and 416

[4] See B Lange 'Regulatory Spaces and Interactions: An Introduction' Sage Publications (2003) 12 (4) 413

[5] ibid

[6] See S Picciotto 'Introduction: Reconceptualising Regulation in the Era of Globalization' in D Campbell and S Picciotto (eds) 'New Directions in Regulatory Theory', special issue of the Journal of Law and Society 29(1) 1-11

Hence does the flexibility provided to directors and management to override legal and ethical responsibilities, serve as justifiable means of attaining economic responsibilities - as well as an effective deterrent to certain culpable corporate actions?

The importance of due diligence and observation of codes of ethics, legal responsibilities, statutes and directives, where the objective of investor protection is concerned - as opposed to the goal of profit maximization.

> - The Strategic Plan appropriately continues to emphasize the Board's statutory investor protection mission. It is important for us to keep the statutory directive in mind and to continually remind the auditing profession that its primary client is the investor community.

This statement not only underlines the overarching goal of investor protection, but also the watchdog function of the profession in ensuring that rules and codes are not over-ridden in a bid to mask the true and correct financial position of an entity's state of affairs.

Such function of the audit profession also underlines the central role now assumed by the audit profession in ensuring that greater accountability is fostered in regulation.

"Decentring regulation" is used by Black to express the notion that governments should not and do not have a monopoly on regulation and that regulation is now being carried out by other actors namely: large organizations, collective associations, professions, technical committees etc without government's involvement or even formal approval.[7] Decentring is also considered to refer to changes occurring within government and administration: the internal fragmentation of the tasks of policy formation and implementation.[8] Self-regulation fits into this analysis because it is a form of 'decentred' regulation as it is not state regulation.[9]

Enforced Self-Regulation

The responsive approach (to regulation) proposed by Ayres and Braithwaite involves a process whereby regulators proceed with compliance based strategies and then resort to more punitive "deterrents" where the desired level of compliance is not achieved.[10] In their opinion, this is a more preferable option to the positions supported either by those who believe that "gentle persuasion works in securing business compliance with the law"[11] and those who only consider that corporations would only comply with the law where tough sanctions were applied. Greater regulatory challenges, in their view, were to be found, not at the apex of the pyramid of regulatory strategies, nor at the base of the pyramid, but at the intermediate levels of the pyramid of regulatory strategies and such intermediate sections, thus, were in greatest need of regulatory innovation.[12]

Further, responsive regulation, as argued by Ayres and Braithwaite, considers the role of non-government organizations as regulators to be so fundamentally important, in the same way that businesses play a vital role as regulators – as well as regulatees. With the responsive approach, it is assumed that regulation would always commence at the base of the pyramid.

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[7] J Black, 'Decentring Regulation: Understanding the Role of Regulation and Self-Regulation in a 'Post – Regulatory' World (2001) in M. Freeman (ed.) 103

[8] Ibid p 104

[9] Ibid p 113

[10] I Ayres and J Braithwaite, Responsive Regulation: Transcending the Deregulation Debate (1995) Oxford: Social Legal Studies at page 101

[11] ibid at page 20

[12] ibid at page 101. "A range of certified punitive strategies exist at the apex of the pyramid whilst experience of the successes and failures of the free market and of self-regulation (aimed at protecting consumers) can be found at the base of the pyramid", ibid

Distinguishing Between the Principal Agent Theory and the Stakeholder Theory

To the effect that corporate and firm goals are not merely restricted to the goal of profit maximization - as evident under the traditional principal agent theory model, but that such goals embrace the goals of stakeholder protection and the realization of responsibilities owed towards such broader stakeholders, economic responsibilities should be accorded less pre-eminence under the stakeholder theory than is the case under the traditional principal agent theory whilst legal and ethical responsibilities should be accorded nearly the same status with economic responsibilities – in order of priority and importance, under the stakeholder theory and concept of corporate social responsibility.

Furthermore, a model of Corporate Social Responsibility - one which requires and compels directors and management to comply with legal and ethical responsibilities whilst executing economic objectives, would not only serve as a more effective mechanism in terms of facilitating greater compliance, but also one which deters them from engaging in self-dealing and serving inclined activities - whilst facilitating the ultimate goal to wider stakeholders as well as philanthropic responsibilities.

Achieving Greater Compliance under the Pyramid of Regulatory Strategies

Although the 'pyramid of regulatory strategies' is directed at individual regulated firms, a parallel approach is applied by Ayres and Braithwaite to entire industries.[13]

Enforced self-regulation was not only proposed as a means of striking a balance between the advocates of "gentle persuasion" works best and those who favor tougher measures, but also considered to be of greatest need at the intermediate levels of the pyramid of regulatory strategies.[14] In striking this balance between compliance and enforcement measures, Ayres and Braithwaite contribute to resolving regulatory difficulties faced by regulators, of when best to apply either compliance or punitive measures, and in situations where the use of excessive punitive deterrent measures could conceal harsh treatment of less significant regulatees.

According to Baldwin and Black, Ayres and Braithwaite acknowledge the possible difficulties of moving down the regulatory pyramid since relationships between regulators and regulatees, which are foundations for less punitive strategies, could be influenced through the application of overly punitive sanctions.[15] Furthermore, 'voluntary' compliance at the base of the pyramid could be rendered extremely difficult as a result of constant threat of punitive measures at the top.[16]

Further criticisms directed at the pyramid approach, as highlighted by Baldwin and Black, in addition to the above mentioned criticism, can be classified into three groups, namely, "the policy" or "conceptual", "the practical" and "the constitutional".[17] Legal problems which exist in applying a responsive approach, it is further added, may arise from the fact some legislatures may have stipulated deterrence procedures which may leave little scope for the enforcement agency in adopting such an approach.[18] Furthermore, responsive regulation would be difficult to implement in corrupt societies since it encourages situations whereby discretion is given to bureaucrats who may exploit such discretion for purposes aimed at promoting their own interests.

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[13] R Baldwin and J Black, 'Really Responsive Regulation' LSE Law, Society and Economy Working Papers 15/2007 at page 5

[14] I Ayres and J Braithwaite, Transcending the Deregulation Debate (1995) Oxford: Social Legal Studies at page 101

[15] R Baldwin and J Black, 'Really Responsive Regulation' LSE Law, Society and Economy Working Papers 15/2007 at page 6

[16] *ibid*

[17] R Baldwin and J Black, 'Really Responsive Regulation' LSE Law, Society and Economy Working Papers 15/2007 at page 6 and for further criticisms, see ibid.

[18] *ibid* at page 9

The incentive structures which exist within a firm become[19] very crucial in issues involving voluntary or involuntary compliance. Whilst it has been observed by some[20] that good regulatory practice should focus on outcomes of regulatory objectives, rather than compliance with prescriptive rules, the concern relating to whether compliance is 'voluntary' or 'involuntary appears to be of irrelevance as long as compliance is ultimately achieved. Nevertheless, compliance is vital, hence the need for direct monitoring by the State or government. Three fundamental elements exist in implementing responsive regulation.[21] The first of these consists of disapproval which is systematic, fairly directed and explained in its entirety. The second element combines such disapproval with a respect for regulatees, whilst the third consists of increased intensification of regulatory response in situations where the regulator has tried considerably, but without success, to meet those standards which are required.

Traditional Regulation

Advantages of Traditional Regulation

Although command and control regulation has been criticized for its rigidity, such rigidity having contributed to economic inefficiency, Latin suggests that this approach has advantages.[22] Furthermore, these advantages extend beyond those advantages identified with more tailored and flexible instruments.[23]

> - ……"decreased information collection and evaluation costs, greater consistency and predictability of results, greater accessibility of decisions to public scrutiny and participation, increased likelihood that regulations will withstand judicial review, reduced opportunities for manipulative behavior by agencies in response to political or bureaucratic pressures, reduced opportunities for obstructive behavior by regulated parties, and decreased likelihood of social dislocation and "forum shopping" resulting from competitive disadvantages between geographical regions or between firms in regulated industries".[24]

As argued by Gunningham and Grabosky, the ability to define the expected behavior of regulatees with immense clarity, constitutes the major strength of command and control regulation. Further, not only does this enable breaches of the legal[25] standard and legal enforcement to be identified in a relatively straight forward manner, it defines limits of regulators' operations which enables the firms to have a clearer understanding of their regulatory obligations.[26]

Addressing the Deficiencies of Traditional Regulation

"Responsive regulation is distinguished (from other strategies of market governance) both in what triggers a regulatory response and what the regulatory response will be".[27]

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[19] See J Braithwaite, 'Responsive Regulation and Developing Economies' (2006) World Development Volume 34 No 5 at page 896

[20] See F Haines and D Gurney 'Regulatory Compliance: The Problems and Possibilities in Generic Models of Regulation' in 'Regulation: Enforcement and Compliance' R Johnstone and R Sarre (eds) (2004) Research and Public Policy Series No 57 at page 19; P May and R Burby 'Making Sense Out of Regulatory Enforcement' Law and Policy 20 (2) 157-182, J Black 'Rules and Regulators' Journal of Law and Society 26 (2) 215-239 (1997) Oxford: Clarendon Press

[21] See R Baldwin and J Black, 'Really Responsive Regulation' LSE Law, Society and Economy Working Papers 15/2007 at page 6 , and also J Braithwaite, Responsive Regulation and Restorative Justice (2002) Oxford: Oxford University Press

[22] N Gunningham and P Grabosky Smart Regulation: Designing Environmental Policy (1998) Oxford : Clarendon Press at page 42

[23] ibid; also see H Latin 'Ideal versus Real Regulatory Efficiency: Implementation of Uniform Standards and "Fine Tuning" Reforms' (1985) 37 Stanford Law Review at page 1271

[24] *ibid*

[25] N Gunningham and P Grabosky Smart Regulation: Designing Environmental Policy (1998) Oxford : Clarendon Press at page 42

[26] *ibid* at page 41

[27] Ayres and Braithwaite, Responsive Regulation p 4

Ayres and Braithwaite also propose that regulation be responsive to industry structure – since different structures will be conducive to different degrees and forms of regulation.[28] According to Baldwin and Black,[29] in order to be "really responsive", regulators are required to be responsive - not only to the level of compliance of the regulatee, but also to the frameworks within the firms – both operating and cognitive, to the environment which encompasses the regulatory regime, which is broader and institutional, to the different ways whereby regulatory tools and strategies operate, to the performance of the regime and ultimately, to changes which exist within each of the mentioned elements. Regulation, it is argued, is responsive when it knows its regulatees and its environments, when it is capable of coherently organizing different and new regulatory modes of reasoning, when it is sensitive to performance and when it recognizes what its changing challenges are.[30] Baldwin and Black's opinion of what is really responsive would have to take into consideration the growing impact of risk.[31]

Gunningham advances the argument that the deployment of a range of regulatory actors to implement combinations of "policy instruments", which are tailored to individual goals and circumstances, will generate more effective and efficient policy outcomes and that this approach should reduce the regulatory burden on government, thereby liberating scarce resources for apportionment to those areas which are in greatest need of government intervention.[32] Greater focus is also placed on the ability of second and third parties - be it business, commercial or non-commercial third parties- to act as quasi regulators who would complement or act as substitutes for government regulation in particular situations. Proposals are advanced[33] whereby a set of principles and policy prescriptions can be designed to achieve a "regulatory mix".[34]

Self-regulation, co regulation and Meta regulation Self-regulation and Co regulation

The exercise of control, by a group of firms or individuals, over its membership and their behavior can be considered as self-regulation.[35] Variables of self-regulation consist of the governmental nature of self-regulation, the level of involvement of self-regulators and the extent of the binding legal force which is connected to self-regulatory rules.[36] Claims in favor of self-regulation or the incorporation of components of self-regulation into governmental regulation are based on arguments related to expertise and efficiency.[37]

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[28] *ibid*

[29] R Baldwin and J Black, 'Really Responsive Regulation' LSE Law, Society and Economy Working Papers 15/2007 at pages 3 and 4

[30] ibid

[31] See M Ojo 'The Growing Importance of Risk in Regulation' Journal of Risk Finance Vol. 11, Issue-3 http://www.emeraldinsight.com/doi/abs/10.1108/15265941011043639

[32] N Gunningham and P Grabosky Smart Regulation: Designing Environmental Policy (1998) Oxford : Clarendon Press at page 15

[33] *ibid*

[34] See ibid at page 19

[35] See R Baldwin and M Cave, Understanding Regulation: Theory, Strategy and Practice (1999) Oxford University Press at page 125

[36] ibid at pages 125 and 126

[37] ibid at page 126; In relation to expertise, it is usually advanced that self-regulatory bodies possess greater expertise than is the case with independent regulation. Efficiency is also a ground put forward by proponents of self-regulation in that self-regulation emphasizes the ability of self-regulation to generate controls in an efficient manner – since there is greater accessibility to those being controlled. Furthermore, self-regulators are able to acquire information at lower costs, incur low monitoring and enforcement costs and can easily adapt their regimes to changing industrial conditions; ibid at page 127.

"Co regulation, as distinct from enforced self-regulation, is usually taken to mean industry association self-regulation with some oversight and/or ratification by government."[38] It is distinguished from enforced self-regulation in that with enforced self-regulation, negotiations which are aimed at establishing regulations that are tailor made to each firm, take place between the state and individual firms.[39]

Meta regulation why Meta regulation could be the most responsive form of regulation

Regulation may be regarded as a response to risk[40] and the control of risks can be considered to be the main concern of regulation.[41] "The regulatory state is becoming a risk management state". Ulrich Beck argues that whilst the standard way of risk regulation[42] in modern societies was well suited for such societies, it is not responsive enough to our "post-modern" societies.

Risk is, as a result, inefficiently controlled at too high a cost. Recent years have witnessed growing acceptance of the fact that the efficiency of regulation will be enhanced where collaboration with private control systems exists. By utilizing activities which relate to private internal control systems for purposes which are of public regulatory nature, regulators are not only able to relieve themselves of the cumbersome work which derives from rule making, but are also able to concentrate on the oversight of the functioning and design of local systems.[43] 'Enforced self-regulation', 'regulated self-regulation' and 'meta regulation' are various forms which a responsive model may assume and such a model assigns a central role to internal control systems.[44]

Basel II bank regulation reforms constitute an example of Meta regulation. Meta regulation is referred to as the regulation of self-regulation[45] whilst Meta risk management implies the risk management of risk management. Traditionally risk management, to a large extent, has focused on complying with current rules.[46] It has great potential especially in situations where risks are volatile and where the regulator is not in a position to comprehend such risks.[47] However maximum realization of such potential can only occur only where such risks are within the control of an enterprise where the regulator holds an influential position.[48] As was mentioned in the above paragraph, over the years, there has been a trend towards greater regulation of business management processes and strategies of regulated firms through regulatory tools which address the role of senior managements of firms and directly regulate individuals within firms.[49]

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[38] P Grabosky and J Braithwaite,. Of Manners Gentle; Enforcement Strategies of Australian Business Regulatory Agencies, (1986) Oxford University Press, Melbourne at page 83

[39] S ee also I Ayres and J Braithwaite, Responsive Regulation: Transcending the Deregulation Debate (1995) Oxford: Social Legal Studies at page 101 and R Baldwin and M Cave, Understanding Regulation: Theory, Strategy and Practice (1999) Oxford University Press at pages 125-127

[40] U Beck, Risk Society: Towards a New Modernity (1992) London: Sage Publications ; also see C Hood, H Rothstein and R Baldwin The Government of Risk: Understanding Risk (2001) Oxford University Press

[41] R Baldwin and M Cave, Understanding Regulation: Theory, Strategy and Practice (1999) Oxford University Press at page 138

[42] M Power, The Risk Management of Everything: Rethinking the Politics of Uncertainty 2004 Demos at page 23 and also see B Fischoff, SR Watson and C Hope ' Defining Risk' Policy Sciences 17 (1984)

[43] ibid

[44] ibid; Also see E Rosa, 'Meta Theoretical Foundations For Post Normal Risk' Journal of Risk Research 1 (1998)

[45] See the penultimate chapter of Christine Parker's book, C Parker The Open Corporation: Effective Self-Regulation and Democracy. 2002 Cambridge: Cambridge University Press

[46] M Lassagne and B Munier, 'The Move Towards Risk-Based Regulation and Its Impact on Operational and Strategic Management' see http://www.cireq.umontreal.ca/activites/050930/papers/munier.pdf (last visited 16th May 2015)

[47] J Braithwaite, Meta Risk Management and Responsive Governance Paper to Risk Regulation, Accountability and Development Conference, University of Manchester, 26-27 June 2003 at page 1

[48] *ibid*

[49] J Gray and J Hamilton, Implementing Financial Regulation (John Wiley and Sons Ltd 2006 at page 2

According to Fiona Haynes,[50] meta regulation "with its collaborative approach to rule generation", could controversially be considered to be the approach with greatest evolvement when considered in relation to other approaches such as co-regulation, enforced self-regulation and process or management-based regulation. Meta regulation is a method which is capable of managing "self-regulatory capacity" within those sites being regulated whilst exercising governmental discretion in stipulating the goals and levels of risk reduction to be achieved in regulation.[51] Processes and procedures for risk management are developed, not only by key stakeholders, but also by personnel within these organizations.[52] This takes place whilst ensuring that "pro-compliance motivational postures" are generated within the site being regulated such that the goal of the regulator, that is, risk reduction, is achieved.[53] The success of the implementation of meta regulation is based on the regulator and regulated organization's understanding of risk priorities in the same manner.[54]

Meta regulation is advantageous particularly where there are complex causes of harm, which also require constant monitoring.[55] However, problems related to enforcement exist. Legal and General Assurance Society v FSA highlighted how the more holistic focus which Meta regulation has on systemic failures on the part of firms, rather than their specific acts or omissions, is starting to influence the ways of approaching issues of causation in the framework of regulatory responsibility. The increasing popularity of internal control systems has been an express feature of risk management.[56] Primary or real risks[57] are translated by internal control systems into systems risks such as early warning mechanisms and compliance violation alerts.[58] As a result, many risks are capable of being and are being "operationalized" as organizational processes of control. Such transformation is a prerequisite for the feasibility[59] of risk based regulation – which will be discussed in the final section of this article.[60] Enforced Self-Regulation envisions that in particular situations, it will be more efficacious for the regulated firms to take on some or all of the legislative, executive and judicial regulatory functions.[61] Ayres and Braithwaite however stress that whatever particular regulatory functions should be "sub contracted" to the regulated firms would be dependent on the industry's structure and historical performance and that delegation of legislative functions need not imply delegation of executive functions.

The issue of monitoring is crucial in the model of Enforced Self-Regulation. In achieving the right mix of regulatory strategies, the right reallocation of regulatory resources would be important.[62] Direct government monitoring would still be necessary for firms too small to afford their own compliance groups. State involvement would not stop at monitoring as violations of the privately written and publicly ratified rules would be punishable by law.[63] Ayres and Braithwaite demonstrate that Enforced Self-Regulation might produce simple specific rules that would make possible both more efficient, comparable

[50] F Haines, 'Regulatory Failures and Regulatory Solutions: A Characteristic Analysis of the Aftermath of Disaster', Law and Social Inquiry (2009) 39 at page 3

[51] *ibid* at page 1

[52] *ibid* at page 3; Also see C Parker The Open Corporation: Effective Self- Regulation and Democracy. 2002 Cambridge: Cambridge University Press

[53] *ibid*

[54] F Haines, 'Regulatory Failures and Regulatory Solutions: A Characteristic Analysis of the Aftermath of Disaster', Law and Social Inquiry (2009) 39 at page 17

[55] ibid at page 1

[56] M Power, The Risk Management of Everything: Rethinking the Politics of Uncertainty 2004 Demos at page 24

[57] Primary risks, for example financial loss are distinguished from secondary risk (reputational risk) see ibid at page 32

[58] *ibid* at page 24

[59] *ibid*

[60] *ibid*

[61] Ayres and Braithwaite, Responsive Regulation p 103

[62] I Ayres and J Braithwaite Responsive Regulation: Transcending the Deregulation Debate (New York: Oxford Union Press 1992) at page 129

[63] *ibid*

accounting and easier conviction of violators.[64] Good regulatory policy could therefore be said to constitute an acceptance of the inevitability of some sort of symbiosis between state regulation and self-regulation.[65]

According to Rose – Ackerman (1988),[66] good regulatory policy should be a combination of self – regulation and state regulation. Issue relates to what proportion of self-regulation or state regulation should make up a good regulatory policy. This is of vital importance as proper delegation of a certain percentage of responsibilities to the state and individual institutions would reduce many of the disadvantages of the Enforced Self-Regulation Model.

Ayres and Braithwaite also argue[67] that good policy analysis is neither about choosing between the free market and government regulation nor deciding what the law should prescribe. They suggest that an understanding of private regulation, its interdependence with state regulation is required to achieve the mix of private and public regulation. Achieving the right mix of private and public regulation is one of the greatest challenges in designing a good regulatory policy.

Ayres and Braithwaite[68] contend that there is no such thing as an optimal regulatory strategy and that there are just different strategies that have a mix of strengths and weaknesses. They go on to say that the appropriateness of a particular strategy depends on the legal, constitutional and cultural context and history of its invocation. Gunningham and Sinclair[69] propose two vital components of a successful regulatory design namely, regulatory design principles[70] and instrument mixes.[71] Regulatory processes are classified into four namely:[72] Identification of the desired policy goal(s) and tradeoffs necessary to achieve it, identification of the unique characteristics of problem being addressed, identification of the range of potential regulatory participants and policy instruments and identification of opportunities for consultation and public participation.

Regulatory principles are classified into five namely:[73] Prefer policy mixes incorporating a broader range of instruments and institutions, prefer less interventionist measures which include the principle of low interventionism, ascending a dynamic instrument pyramid to the level required to achieve policy goals – including building in regulatory responsiveness, empowering participants which are best placed to act as quasi regulators – including the application of the principle of empowerment and maximizing opportunities for win-win outcomes – including the consideration of whether firms will voluntarily go beyond compliance. Instrument mixes[74] are broadly classified into those which involve inherently complementary activities,[75] inherently counterproductive instrument combinations, sequencing

[64] C Hadjiemmanuil, 'Institutional Structure of Financial Regulation: A Trend Towards Mega regulators, United Kingdom: Full Consolidation as a Response to the Inefficiencies of Fragmentation' p 109

[65] I Ayres and J Braithwaite, Responsive Regulation : Transcending the Deregulation Debate (Oxford Union Press 1992) at page 3

[66] ibid

[67] ibid

[68] Ibid at p 101

[69] See concluding chapter 'Designing Environmental Policy' by N Cunningham and D Sinclair in N Gunningham and P Grabosky Smart Regulation: Designing Environmental Policy (1998) Oxford : Clarendon Press

[70] ibid at pages 387-419

[71] ibid at pages 422- 448

[72] see ibid at pages 378-385

[73] See N. Gunningham, & P. Grabosky, (1998). Smart Regulation. Designing Environmental Policy. New York: Oxford University Press. and N. Gunningham, & D. Sinclair, (1999). Designing Smart Regulation. http://www.oecd.org/dataoecd/18/39/33947759.pdf

[74] *ibid*

[75] These include voluntarism and command and control regulation, self-regulation and command and control, command and control regulation (or self-regulation) and supply side incentives, command and control (or self regulation) and broad based economic instruments (which target different aspects of a common problem), liability rules and command and control (or self-regulation)

instrument combinations,[76] combinations where outcome will be context specific and multi instrument mixes.

Conclusion

The transformation of internal control into risk management can be attributed to an increasingly volatile financial environment and the emergence of complex financial products (for example, derivatives). Whilst such factors necessitate the need for risk management, several consequences emanate from an excessive operation of risk management, namely:[77] Reliance on internal controls may increase risk if it leads to an undermining of the knowledge of risk in other areas; despite the benefits of risk management, concerns are generated due to the fact that secondary risk management has become an accepted "organizational common sense"[78] - reflecting the society's loss in faith in its professions and public organizations.[79]

According to Baldwin and Cave, the first regulatory challenge faced by regulators consists in the identification of risks that need to be reduced – not only on the basis of priority, but also in a way which would be approved by the public.[80] Secondly, regulators are confronted with the challenge of managing and regulating risks in a way which is both effective and acceptable.

Furthermore, the design of institutions and techniques for managing risk, the choice of the appropriate regulatory technique, issues relating to whether risk management or regulation should be "blame oriented" and the contentious topic of reliance by risk managers on qualitative risk evaluations in contrast to more quantitative methods of assessments constitute additional challenges.[81] In spite of the above mentioned consequences and challenges, the ability of responsive regulation to address such a complex factor as risk, its flexibility and responsiveness to regulatees and its environment among other advantages, make it a more desirable regulatory tool than traditional regulation or risk based regulation. Whilst direct monitoring by the State would be required, the involvement of third parties such as non-government organizations would also be crucial to ensuring that a situation, whereby the State could be captured, is avoided. Furthermore the possibilities available in achieving the right "regulatory mix" make it a promising regulatory tool. Even though the contested nature of risk contributes to the difficulty of relying on risk as a regulatory tool, its presence and ever growing significance cannot be ignored – hence the need for a form of regulation which is able to manage risk more effectively and which would best suit an evolving regulatory environment.

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[76] These include self-regulation and sequential command and control, self-regulation and sequential broad based economic instruments

[77] R Baldwin and J Black, 'Really Responsive Regulation' LSE Law, Society and Economy Working Papers 15/2007 at pages 50- 58; "Soft management systems" which are able to address uncertainties need to be designed and a balance should be struck between the role of calculative methods and other softer forms such as images and normative.

[78] See also D Marquand, The Decline of the Public Cambridge: Polity Press 2004

[79] The close association between organizational governance and risk management exacerbates this position. Furthermore, Power argues that to move beyond such "risk management driven privatization of the public sphere", a new idea of risk which incorporates types of leadership at state, regulatory and corporate levels, and which is able to develop a language of risk, understood by the public and which expressly allows for the possibility of failure without this being understood as a way of "passing the buck", will be required, see M Power, The Risk Management of Everything: Rethinking the Politics of Uncertainty 2004 Demos at pages 57 and 58

[80] R Baldwin and M Cave, Understanding Regulation: Theory, Strategy and Practice (1999) Oxford University Press at pages 142 and 143

[81] *ibid* at 144

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