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# **Public Accountability and Crisis in the Banking Sector**

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**The Case of the UK**

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Doctor of Philosophy

The University of Edinburgh

2014

# Declaration Page

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## Declaration

This is to certify that that the work contained within has been composed by me and is entirely my own work. No part of this thesis has been submitted for any other degree or professional qualification.

Signed:

# Dedication

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I dedicate this thesis to the memory of Fraser Timothy Henderson, stillborn 29<sup>th</sup> March 2014.

“I loved the Boy with the utmost love of which my soul is capable, and he is taken from me – yet in the agony of my spirit in surrendering such a treasure I feel a thousand times richer than if I had never possessed it.” (Wordsworth, 1812)

# Abstract

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The marked disintegration of the UK banking system in 2008 led to significant Government ownership in two major banks: The Royal Bank of Scotland (RBS) and Lloyds Banking Group (LBG) (National Audit Office, 2009). The banks are termed 'quasi-nationalised' due to the retention of stock exchange listings alongside Government ownership. The thesis offers a documentary analysis on the public accountability of these banks. The research themes are:

- The impact of Government intervention on the accountability of the quasi-nationalised banks
- The banking crisis through the lens of financial reporting for RBS and LBG
- Newspaper reporting of the banking crisis in RBS and LBG

A multiple theory framework is utilised in the study. Property rights (Alchian, 1974; Alchian and Demsetz, 1973; Demsetz, 1967) and agency theory (Fama, 1980; Jensen and Meckling, 1976) explore the implications of Government Intervention. Impression Management and Stigma (Goffman, 1968; Goffman, 1956a) are used to critique financial reporting since the crisis. Critical Discourse Analysis assesses newspaper reporting of the banks' finances (Fairclough, 2010; Fairclough, 1995).

Summary findings for the three research themes are as follows. Quasi-nationalisation has been a positive response to the banking crisis. Banks acknowledge they must consider societal responsibilities as well as corporate profits. Yet the increased accountability mechanisms have been difficult to define and enforce. Property rights theory applauds the retention of private sector scrutiny. Agency theory, however, identifies the muted disciplinary effects of the markets in the circumstances.

The banks' financial reporting gives an alternative perspective on the banking crisis. Both banks acknowledge their role in the crisis but simultaneously distance themselves from it. RBS highlights the virtues of a 'new' bank different from the failed one. LBG explains poor results through 'market dislocation'. The statutory accounts themselves are relegated in favour of managerially defined pro forma numbers and promotional materials. In this way, the statutory numbers can be seen as part of the 'dirty work' (Goffman, 1956b) of the crisis.

Using critical discourse analysis (Fairclough, 2010; Fairclough, 1995), findings are that newspaper reporting of the banks' accounting results occurs across a broad spectrum of titles and articles. Headlines favour big numbers for impact. But constant focus on banking pay endures. The accounts provide an important counterpoint to the news context of the banks. Positively, accounting is portrayed as a neutral challenger to the public relations news process and fulfils democratic accountability. Critically, however, it is in the interests of papers to create and sustain media panics (Leach, 2006).

The thesis responds to calls for literature on the financial crisis (British Accounting Review, 2012; Journal of Accounting and Public Policy, 2011; Arnold, 2009), multi-theoretical research in the public sector (Jacobs, 2012; Kurunmäki et al., 2003), linguistic theory in accounting (Evans, 2010) and accounting in the tabloids (Jeacle, 2012) as well as interpretive research in financial reporting (London School of Economics, 2011; Brennan and Solomon, 2008; Parker, 2007).

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# List of Abbreviations

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ABS	Asset Backed Securities
APA	Asset Protection Agency
BBA	British Bankers' Association
EU	European Union
FSA	Financial Services Authority
HBOS	HBOS plc (Halifax Bank of Scotland)
HMRC	Her Majesty's Revenue and Customs
HMT	Her Majesty's Treasury
IAS	International Accounting Standard
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
ICB	Independent Commission on Banking
IFRS	International Financial Reporting Standard
LBG/ Lloyds	Lloyds Banking Group plc
NAO	National Audit Office
NPM	New Public Management
RBS	Royal Bank of Scotland Group plc
RFS	RBS, Fortis, Santander – Consortium of Bidders for ABN Amro
SOE	State Owned Enterprise
SFP	Statement of Financial Position (Balance Sheet)
SME	Small and Medium Sized Enterprises
TSC	Treasury Select Committee of the UK Parliament
UKFI	UK Financial Investments Ltd
UKLA	UK Listing Authority
WGA	Whole of Government Accounts

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## POSTSCRIPT

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# Chapter 1: Introduction

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This thesis explores the public accountability of two quasi-nationalised UK banks. In this introductory chapter, the context of the banking crisis is outlined first to locate the rationale for the research. The three main research themes are then outlined as well as the contribution to knowledge of the thesis. The structure of the thesis then follows.

The banking crisis in the UK was part of the global financial crisis which has affected the markets since 2007. The crisis itself had been building up for some time. Throughout the early 2000s, interest rates had been low and credit rules in the USA became looser. Mortgages became available to a greater number of people, including those for subprime borrowers, who had low or no income (Ackermann, 2008). Borrowing was made to these people on the belief that house prices in the country would only ever go up (*ibid*, p331). Banks were using the ‘originate and distribute’ model of funding. This meant that as mortgages were agreed, they were sold on to financial institutions who repackaged them with other mortgages and sold them on again as asset backed securities (ABS) in the wholesale money markets (Laeven and Valencia, 2008). The original idea of the ABSs was to diversify risks, rather than attract it. Yet the underlying assets in the instruments became so remote from the ABSs on the market, that it became extremely difficult to decipher what assets and risks each institution actually held (Cukierman, 2011). A loss of trust occurred in the markets, as the exposure to the US subprime housing market was impossible to determine for any counterparty to a transaction (*ibid.*). ABSs were hard to value and had to be written down on the back of credit rating agency downgrades and fair value accounting (Laeven & Valencia, 2008 p25). The first major collapse in the UK was Northern Rock, who had made extensive use of the ‘originate and distribute’ model. It experienced the first bank run in the UK for 140 years on September 15, 2007.

## **1.1 The Beginnings of the Banking Crisis: Northern Rock**

Although Northern Rock had little direct subprime exposure, the bank’s position became perilous with the collapse in wholesale markets, as only 23% of its funding came from retail bank deposits (Shin, 2009; Northern Rock plc, 2007). The Bank of England agreed to act as a lender of last resort to rectify the bank’s short term liquidity problems on 14 September 2007 (Bank of England, 2007). After a Press Leak (Peston, 2007), Northern Rock experienced a mass withdrawal of its retail deposits (Song Shin, 2009). On Monday, 17th September the Chancellor of the Exchequer, Alistair Darling, announced that the deposits of



the bank were to be covered by a Tripartite Authorities guarantee to curtail the bank run (HM Treasury, 2007b). Northern Rock was for sale, and it was made clear that its buyer would have to fulfil the principles laid down by the State: to protect taxpayers; promote financial stability; and to protect consumers (HM Treasury, 2007). No successful buyer was found and it was announced on 17<sup>th</sup> February 2008 that the bank would be taken into temporary public ownership to recuperate its failing business and liquidity problems. There would be a view to an onward private sector sale after the market's recovery (HM Treasury, 2008b). Parts of the bank were sold to Virgin Money plc in 2011 (HM Treasury, 2011). The remaining mortgage assets would be serviced as they were run down by a Government company called UK Asset Resolution Ltd (UK Asset Resolution Ltd, 2013b).

## **1.2 The Height of Crisis: September and October 2008**

The nationalisation of Northern Rock in 2008 set a recent precedent for investing in failing banks. It also was an indicator of much larger, systemic problems to come in the UK banking crisis later that year. The nature of difficulties for the two banks of interest here, RBS and HBOS, are considered briefly before outlining the nature of Government intervention.

### **1.2.1 RBS**

In October 2007, at the very precipice of the crisis, RBS was involved in a hostile takeover bid of ABN Amro. The successful purchase of ABN Amro would transform the RBS group into one of the largest banks in the world. Previously a domestic retail bank in Scotland, RBS had grown substantially through a number a of high profile acquisitions. The CEO, Sir Fred Goodwin, had been complimented on his execution of the reverse takeover of NatWest in the early 2000s (BBC, 2011; Kerr and Robinson, 2011). Eager to continue the success of acquisitive growth, RBS, in a consortium with European banking giants Santander and Fortis, led a joint takeover bid for ABN Amro. The deal captured the great confidence the bank had in the potential for its markets and businesses (Royal Bank of Scotland, 2007e). Nonetheless, the proposed takeover was complicated and based on a very little due diligence. As a result, RBS paid a large amount of cash for ABN Amro as financial markets were contracting. RBS was unprepared. It was thinly capitalised and had little liquidity as financial markets dried up (Smit, 2010; Larsen Simon Thai, 2008). When financial markets contracted entirely, RBS was unable to continue trading. It required Government intervention to meet its obligations, along with another Scottish bank: HBOS.

## **1.2.2 HBOS and Lloyds Banking Group**

HBOS was heavily exposed to the market dislocation and its impact on the property sector (HBOS, 2009). HBOS tried to raise £4bn in a rights issue in July 2008 to strengthen its capital base but this was unsuccessful (HBOS, 2008b). There continued to be widespread rumours in the market regarding HBOS' ability to trade through the crisis (Seib, 2008; Flanagan, 2008; Guardian, 2008; Croft J, 2008a; Croft J, 2008b)

The collapse of Lehman brothers on 15<sup>th</sup> September 2008 created widespread panic in the markets. HBOS' share price declined by 50% between 10<sup>th</sup> and 17<sup>th</sup> September<sup>1</sup>. On 17<sup>th</sup> September, HBOS announced it was in talks with Lloyds about a possible merger (HBOS, 2008a). On 18 September 2008, the merger was formally announced (Lloyds TSB, 2008c).

By 30 September 2008, the share price of HBOS had slid to 120p, well below the pre-merger announcement price of 147p (Lloyds Banking Group, 2013c). There was still concern in the markets generally about the worldwide economic situation. There was also an expectation that the HBOS treasury book would be written down again due to the downturn in the property market. Then, on 29 September, Bradford and Bingley, another UK banking institution was taken into full public ownership and wound up. Icesave, the Icelandic bank, was also put into administration (Lloyds TSB, 2008b). The deteriorating market conditions meant that both Lloyds TSB and HBOS would have to raise capital under Government recommendations (*ibid.*) The official merger for Lloyds TSB and HBOS occurred on 19 January 2009 (Lloyds Banking Group, 2008). From the time of the announcement in September, the HBOS and Lloyds TSB had a coordinated strategy. This was necessary due to the involvement of the UK Government just 3 weeks after.

## **1.3 Government Intervention in HBOS, Lloyds and RBS**

By the end of September 2008, the banking crisis had reached a crux. The systemic distress in the financial markets was causing an 'adverse spiral' (Bank of England, 2008). The banks were calculating losses on their toxic assets; the ability to attract wholesale funding was hampered by illiquidity in the markets; there were a number of failed institutions in Europe and the US; and the responses by nations globally were inadequate to stem market fear (Bank of England, 2008). This led the UK Government to offer the domestic banking

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<sup>1</sup> 299.75p at 10 Sept; 147.1p at 17 Sept 2008(Lloyds Banking Group, 2013c)

industry a voluntary rescue package. The Government aimed to free up liquidity in the markets, with an ultimate goal to aid the real economy by keeping credit lines open (Bank of England, 2008, p32). The most significant part of the rescue package was State ownership of banks. The participating institutions could apply to the State to receive equity capital to restore their finances. The rescue package was primarily directed towards the most distressed banks but offered across the whole industry:

“This was necessary because unless we could show that the action was being taken across the board, the risk was that the markets, satisfied, say, RBS was adequately capitalized, would turn their attention, to, say, Barclays, if it had not raised more capital. If they did not stand together they would be picked off one by one.”(Darling, 2011)

Funds would be in the form of equity capital to meet BASEL<sup>2</sup> requirements (HMT, 2008a). As it was, only RBS and LBG participated in the rescue scheme<sup>3</sup>. After the injection of equity capital, the UK Government had an economic stake in the bank of over 84% (RBS, 2009a)<sup>4</sup>. Government ownership in LBG rested at 43% (NAO, 2011). The nature of the investment was to be temporary and at arm’s length:

“The long-term future of UK banks lies in the private sector, and we will aim to sell the public share in the participating banks as soon as is feasibly possible, but our objective today is to stabilise and rebuild, and we will maintain our stake for as long as it takes to do that.” (Hansard HC, 2008)

Both banks retained London Stock Exchange Listings. With simultaneous listings and Government shareholdings, the banks became quasi-nationalised. The accountability under quasi-nationalisation is explored in this thesis.

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<sup>2</sup> The Basel II framework is an international standard on capital adequacy for banks.

<sup>3</sup> Barclays was another major contender for UK Government support. However, they financed an increase in the capital base through private markets, primarily the sovereign wealth funds of Qatar and UAE (Barclays, 2008b) .

<sup>4</sup> The Government entered a commitment not to exceed a proportion of 75% of ordinary listed shares. The investment exceeding this proportion is contained within alternative share classes and agreements, such as the Asset Protection Scheme. In total, the proportionate economic interest of the Government in the bank is thus 84%

## 1.4 Rationale for Investigation

Quasi-nationalising the banks was a major component of Government spending in 2008. The Government injected £45bn in to RBS and over £20bn in support of LBG (National Audit Office., 2012). This was half the total cash outlay during the crisis by the State (National Audit Office., 2012). Including guarantees and commitments, the peak support of the State stood at £1,162bn (*ibid*). The Government involvement affected the UK economy. The country emerged from the (first) recession in 2009 with higher public and private debt and higher unemployment (OECD Economic Survey, 2011). Growth in 2012 was flat overall. The growth since the recession of 2008 after the crisis has been the slowest post-recession recovery in output in the past 100 years (National Institute Economic Review, 2013). Public Sector net debt is expected to peak at 79.9% in 2015 (Office for Budget Responsibility, 2012). Successive UK Budgets have announced spending cuts, benefit cuts, reduced pension entitlements and public sector pay freezes to manage the large public debt (HM Treasury and Department for Business Innovation and Skills, 2012). VAT has risen, affecting all sectors of society as an unprogressive tax (HM Treasury, 2009a). It is important that this turbulent period of financial events is investigated.

As well as the impact on Government finances and economic growth, the quasi-nationalisation of RBS and LBG has implications for accounting. During times of crisis, financial accounting has been involved in corporate failure globally (Carnegie and O'Connell, 2013; Hamilton and Micklethwait, 2006; Clarke, 2004). In particular, Enron adversely affected the reputation of the accounting and auditing profession (Marnet, 2007; Benston and Wall, 2005; Cullinan, 2004; Benston and Hartgraves, 2002).

For failed and successful corporations alike, accountants and auditors are important facilitators in fulfilling corporate accountability to the public. A part of public accountability lies in financial accounting. Financial accounting is presented mainly through the annual report in the form of financial statements whose aim:

“...is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity” (IASB, 2010c)

Other parties may find the financial statements useful but the reports are not primarily directed towards them (IASB, 2010c). Determining who is the ‘owner’ then is critical in helping determine what information is produced, how it is presented, to whom and at what time. By extension, the imagined owner in the mind of management will inform the decisions made about what is produced, and to justify their choices.

Taking into consideration the financial and economic impact on the UK Government and economy, the relationship accounting itself has with corporate failure and the resultant impact on the profession's reputation, there is a clear rationale for investigating RBS and LBG in depth. The next section extends the rationale for this study by specifying the themes of the study.

## **1.5 Research Themes and Rationale**

The three research themes of the thesis centre on the public and financial accountability of the quasi-nationalised banks RBS and LBG. The themes are introduced below along with the rationale for investigation. The rationale has been based on a combination of the unique features of the quasi-nationalised banks and the academic literature which has problematized the nature of accountability.

The quasi-nationalised banks, by the virtue of their distinct ownership structure present a fascinating setting for studying accountability. The accountability of these banks goes beyond the established expectations of shareholders in the listed enterprise. Public sector enterprises face more complicated reporting lines than private corporations. Public sector accountability can be on multiple levels and shift over time (Luke, 2010). Public Sector CEOs face numerous forms of accountability from diverse bodies (Sinclair, 1995). Meeting one set of demands from a stakeholder may result in other forms of accountability being compromised (*ibid*, p231). Furthermore, the very notion of accountability is constructed and redefined in reference to managerial perception and political processes (*ibid*, p234). This ambiguity produces an additional complexity to accountability procedures, which remain dynamic, compared to regulated markets.

Information can become inherently political, and may be adapted to anticipate the needs of users (Christensen & Skærbæk, 2007). The rise of New Public Management (NPM) (Hood, 1991) has heralded the adoption of private sector accountability techniques in the public sphere to achieve best use of the limited financial resources received. This has included the wholesale adoption of IFRS by the UK Government (HM Treasury, 2007a). The UK quasi-nationalisations may create an arena for cohesion between private and public sector accountability. As a result, the scope for examining accountability in the two banks has been left deliberately wide.

There are three research themes to the thesis which consider the accountability of the quasi-nationalised banks. The first research theme examines Government ownership and the creation of new accountabilities. It considers:

1. The impact of Government intervention on the accountability of the UK quasi-nationalised banks

From the outset, quasi-nationalisation encompassed an inherent conflict in the banks. On the one hand, there was a requirement to invest Government capital to continue trading. On the other, lending commitments required the capital to be invested in customers in a challenging economic environment. The former concentrated on the stability of the bank, whilst the latter was concentrated on protecting consumers and in assisting the wider economy recover from the crisis (House of Commons - Treasury Committee, 2009a). Thus, the aims of State investment did not rest exclusively upon financial stability. The State sought to implement economic assistance to the UK through bank ownership.

The creation of new accountabilities with Government intervention was in addition to established monitoring mechanisms. Government ownership in RBS and LBG was intended to be temporary. Both banks retained London Stock Exchange Listings. The banks were to maintain the commercial orientation to their activities, allowing recovery and return to profit (HM Treasury, 2008a). This in turn would allow the Government to exit from the investment. Modelling private sector shareholder behaviour, HM Treasury created an independent agency, the UKFI, to manage its shareholdings in LBG and RBS (UKFI, 2009). Thus, the next empirical part of the thesis investigates the impact of quasi-nationalisation on the established accountability mechanisms of the annual report and accounts. The second research theme considers:

2. The banking crisis through the lens of financial reporting for RBS and LBG

The annual report is a cornerstone of financial accountability in listed companies. Even if this *mechanism* of accountability remained identical to the pre-crisis status of these banks, there remains the extensive Government influence on strategy, pay, appointments and customer service. The banks are subject to political influence which has been a feature of state owned enterprises previously (Jenkins, 2004; Ashworth, 1991; Tivey, 1966). For RBS and LBG, there is the potential for the annual report to develop in response to the economic and political context in which it operates (Merkl-Davies and Koller, 2012; Clatworthy and Jones, 2006).

Consequently, the final empirical part of the thesis considers the role of the Press in communicating financial information of the quasi-nationalised banks:

### 3. Media reporting of the banking crisis for RBS and LBG

Part of the political context of the banks is the media interest. The Government have acknowledged that the media have had considerable influence on how the banking crisis was reported to the public. The media may have no formal powers of investigation but they can exert considerable powers of influence on State owned enterprises (Mulgan, 2000) and are a powerful stakeholder in organisations (Rowley, 1997). Prior to quasi-nationalisation, the run on Northern Rock began with a press leak and exposure by a BBC journalist (Peston, 2007), who was accused of exacerbating the crisis with the exposé. The UK Parliament investigated the role of the media in the banking crisis (House of Commons - Treasury Committee, 2009b) which highlighted concerns about journalistic quality during the crisis but did not recommend any regulatory changes.

Taken together, the three research themes are designed to consider the public accountability of the quasi-nationalised banks RBS and LBG. There are a number of contributions to be made by the thesis, which are considered in the next section.

## **1.6 Contribution**

The research themes aim to address a number of gaps in the literature. First of all, they respond to the calls for research into the global financial crisis in accounting. Despite a number of calls in journals mentioning the financial crisis, to date there have been relatively few papers published. The British Accounting Review called for papers on the topic of ‘The Global Financial Crisis and Accounting’ for a future special issue (BAR, 2012). The Journal of Accounting and Public Policy call on corporate governance and accounting directly mentioned the global financial crisis as an attractive research topic (JAPP, 2011) yet resulted in no paper abstracts or titles referring to the global financial crisis being presented (London School of Economics, 2012). The Comparative International Governmental Accounting Network is also producing a conference and special issue on “Public Sector Accounting, the Financial Crisis and Austerity” (CIGAR, 2013). Moreover, the thesis contributes to the literature responding to calls for alternative methodologies for exploring the crisis (Arnold, 2009)

Secondly, it explores impression management in financial reporting in the context of Government ownership. Impression management has been considered in the context of

business performance in many studies previously (e.g. Beattie & Jones, 1992, 1999; Neu *et al* 1998; Smith & Taffler, 1992; Merkl-Davies *et al* 2011). However, quasi-nationalisation is an opportunity to consider impression management under different ownership arrangements. Moreover, there have been relatively few in depth studies on impression management in particular companies over time (Laine, 2010; White and Hanson, 2002).

Thirdly, the thesis contributes to qualitative research in financial reporting. It responds to recent calls for alternative methods, theories and approaches to financial and external reporting (Parker, 2007; Brennan & Solomon, 2008) and sits amid limited research on financial reporting from an interpretive standpoint (Laine, 2010). This has been particularly important as the global financial crisis forces scholars to ‘re-evaluate research agendas’ (Arnold, 2009). In addition, the thesis contributes to calls for further multi theoretical research in the public sector (Kurunmäki *et al*, 2003; Jacobs, 2012) as well as in financial services (Collins *et al*, 2009).

Fourthly, the thesis extends the field of analysis of research to media dissemination. It has been increasingly recognised that the media affect annual report content (Islam and Deegan, 2010; Deegan *et al.*, 2000) and share prices (Andrew, 2007; Patten, 2002). Finally, it considers how accounting is presented in the popular media (Jeacle, 2012; Smith and Jacobs, 2011; Evans, 2009), including the broadsheet and tabloid press.

## **1.7 Structure of the Thesis**

The thesis is structured as follows. Chapter 2 considers qualitative research in bank failures previously and considers the role of accounting within them. Chapter 3 investigates the political ramifications for public ownership in failed banks by considering the UK’s experience with accountability in previous State owned enterprises.

Chapter 4 outlines the theoretical frameworks used, explaining why these have been chosen and the implications of a multi-theoretical approach. Chapter 5 considers the application of the theories in prior research. Chapter 6 details the research methods adopted in investigating the thesis.

Chapters 7 – 10 make up the empirical work of the PhD, addressing in turn each research theme. Chapter 7 gives an introduction to the case histories of RBS and LBG. It also explains the basis for calling the banks quasi-nationalised and analyses the interested stakeholders under the new ownership structure. Chapter 8 assesses the impact of public sector ownership on negotiating public sector accountability for the quasi-nationalised banks.



Chapter 9 analyses the sizeable annual reports created during the crisis for RBS and LBG. Here then, it is the substance of financial accountability in established market mechanisms which provides the topic of interest.

Chapter 10 extends this analysis by researching the headline and leaders generated in newspapers by the banks' annual accounting results. Ultimately, it is in the media that the accountability of the banks can be realised through mass dissemination. Chapter 11 concludes the thesis by reflecting on the empirical work completed and promoting a further research agenda.

# Chapter 2: Crisis, the Banking System and Accounting

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The aim of this chapter is to locate the impact of accounting and auditing during banking crises via the literature. It is argued here that the State is a key user of accounting during banking crises. The State can use accounting to help expose wrongdoing, change regulation to hide or reveal financial problems, or to rely on the quasi-regulatory function of audit. The chapter is laid out as follows. The first section considers the regularity of crisis in economies and corporations in general. Accounting and auditing are part of these phenomena. Section 2.2 considers how the State uses accounting as part of its regulatory prowess to help respond to banking failures. Finally, there is an overview of the 2008 global financial crisis and the particular accounting controversies occurring then. All of these processes are relevant for the discussion of the quasi-nationalised banks and the potential impact accounting and auditing may have had on them.

## **2.1 Financial Crisis and Corporate Failure are Regular Phenomena**

Financial crisis is not unusual. Longitudinal analyses of financial crises corroborate the regularity and causes of financial distress. Since 1970, there have been broadly 124 systemic banking crises from 37 different countries around the world (Laeven and Valencia, 2008). These have transferred wealth from taxpayers to large banks (*ibid*, p4). In developed countries, there have been nearly 50 major economic bubbles and market panics since the seventeenth century (Kindleberger and Aliber, 2005) meaning that crises are a feature of markets generally:

‘The standard model of the sequence of events that leads to financial crises is that a shock leads to an economic expansion that then morphs into an economic boom; euphoria develops and then there is a pause in the increase in asset prices. Distress is likely to follow as asset prices begin to decline. The pattern is biological in its regularity.’ (*ibid*, p77)

Pro-cyclical availability of credit increases economic expansion which can lead to an economic bubble (Kindleberger and Aliber, 2005). Banks and lending institutions are eager to be involved in the good returns so risk assessments of the investments decrease and the borrowers’ own risk aversion declines. The money supply in the country or asset type therefore increases significantly (*ibid*). When the bubble implodes, panic occurs, distress

selling takes place and a crash can follow. Crashes can then reverberate in different markets and nations (*ibid.* chapter 2).

At the corporate level, crises may be explained by enduring agency and stewardship problems (Clarke, 2004). Corporate governance mechanisms bear less scrutiny during the times of substantial profit making. Crises occur when corporations seek to expand wealth rather than retain it, reflecting different attitudes to capital (Clarke, 2004). An economic downturn occurs and the frequent response to downturn is an increase in regulation. The authors argue that the appropriate defence against crisis is not regulation per se; rather, the market should be actively risk managing at all times, whatever stage of the economic cycle they are at. There will always be the opportunity to exploit others in dynamic markets (Clarke, 2004). Clarke thus expands on the analysis of bubbles that Kindleberger and Aliber (2005) discuss, by including regulation as part of the cycle.

The downturn in the economic cycle may result in the accountancy profession having to defend itself. Thus, accounting and auditing are drawn into the process of cyclical change and regulation:

“Repeated unexpected corporate collapses lead to further governance change that is intended to ensure, as far as possible, that the errors, misjudgements and negligence of past actors do not recur. Governance change typically encompasses legislative reforms relating to financial reporting or audit involving amendments to corporations/companies legislation and other pertinent laws. The reforms may also involve the issue of new or amended pronouncements by professional accounting bodies or the establishment by the profession of standard-setting agencies as well as amendments to stock exchange listing requirements or codes of governance”. (Carnegie and O’Connell, 2013)

By examining four significant periods of corporate collapse in Australia, Carnegie and O’Connell show the connections between failures through 1) misleading financial reporting; 2) lax or ineffective accounting rules; 3) lack of auditor independence and audit quality. The authors state that the reforms which have followed crises have resulted in little substantive change, either in terms of corporate ethos or the means by which audit is conducted in practice. The authors argue that more radical approaches to accounting and auditing reform, such as mandatory rotation of auditors, may assist in prevent future crises (Carnegie and O’Connell, 2013).

A feature of economic crises may be an increase in corporate failures. At the organisational level, common features have been identified when creative accounting or fraud are involved in corporate failure (Jones, 2011). Fraud and creative accounting can be viewed as parts of the same continuum. Creative accounting is usually defined as the application of particular

accounting policies which portray a picture of financial health which is in line with what directors believe investors want to see rather than what is a true and fair view of the financial position of the organisation. Fraud, in contrast, is illegal misapplication of accounting policies (Jones, 2011). Creative accounting and fraud both involve increasing income on the income statement or assets on the SFP to inflate book value. Likewise, decreasing expenses on the income statement or SFP liabilities can artificially sustain book values in the face of real life challenges (*ibid*). Incentives for undertaking fraud or creative accounting include disguising bad financial/ management performance to help keep share prices high, and also for personal benefit. It was often the case that over strong individuals allowed the creative accounting to persist whilst persuading the market all was well (*ibid*, p497). The charismatic leader, weak internal controls and the failure of the external auditors to identify fraud were persistent characteristics (*ibid*). Reducing the potential for creative accounting and fraud could occur by creating appropriate management incentives; creating and enforcing further regulation; and corporate governance. However, historical experience suggests that corporate collapse endures despite the introduction of preventative measures (Jones, 2011).

Taking a multiple case study approach, Table 2.1, adapted from Hamilton & Micklethwait (2006), documents the authors' framework which helps them to analyse 10 recent corporate failures. In every case, 2 or more causes are attributed to each 'scandal'. The authors argue that failure is rooted in poor management first, rather than creative accounting or fraud, which are mechanisms to hide unsatisfactory performance. The aspects of poor management which can lead to corporate failure are listed in the table below. These are then attributed to well-known corporate failures.

**Table 2.1: Causes of Corporate Failure: Recent Case Studies**

Reason/ Companies	Barings/ Allied Irish	Enron	World Com	Tyco	Marconi	Swissair	Royal Ahold	Parmalat
Poor strategic decisions		✓			✓	✓	✓	
Over-expansion & ill-judged acquisitions			✓	✓	✓	✓		✓
Dominant CEOs			✓			✓	✓	✓
Greed, hubris & a desire for power	✓	✓	✓	✓				✓
Failure of internal control	✓	✓	✓	✓	✓		✓	
Ineffective boards	✓	✓	✓	✓		✓	✓	✓

Adapted from Hamilton & Micklethwait, 2006

The preceding literature builds up an historic analysis of crises which have common factors. The build up to a crisis rests in the excesses of liquidity or in poor management decision making. Accounting and auditing do not rectify excessive risk taking. Yet the accounting profession is connected to corporate collapse through its use as a mechanism to disguise bad performance. After the crisis, an enduring response to corporate failure is to increase regulation. Politically, the nation State is then intervening in markets. The next section of the chapter considers the State response to the failure of banks in particular. Similar to the above, there exists a complex relationship between the State, banks and the role of accounting and auditing.

## **2.2 States Expose Corporate Failure**

This section discusses some bank failures whereby State intervention resulted in the exposure of corporate failure. It also reflects on the failure of Enron. In all the cases summarised below, the collapse of the company was down to fraud perpetrated by staff members. However, the fraud was often facilitated by the political context in which the entity operated. This may have implications for how preventative devices such as regulation are implemented in the future (Froud *et al* 2004, p885) and may not be considered if only the causes of corporate failure are the sole focus of investigations.

In Turkey, a bank called İmarbank was allowed to continue in operation for many years despite uncertainty over its financial stability (Omurgonulsen and Omurgonulsen, 2009). Regulatory systems were outdated and weak. When the Governing State party changed, the bank's license to accept deposits was revoked (*ibid.*). At the same time, the Government instigated the liquidation of the entity and guaranteed savers' deposits. The liquidation proceedings uncovered large scale fraud at the bank, sustained through accounting which had covered up illegal activities. The 'real' accounting numbers were only accessible to a select number of executives (Omurgonulsen and Omurgonulsen, 2009). The State socialised the losses by honouring guarantees (*ibid.*).

The political environment of Fiji was also costly for its National Bank (Lodhia and Burritt, 2004). This state owned entity collapsed in the mid-1990s. The introduction of New Public Management (NPM) in the public sector was an imported Western ideal whose aims conflicted with the country's corrupt Government. A feature of NPM is heightened accountability but this was eradicated under the corrupt regime, resulting in fraudulent accounting and the breakdown of the audit process (*ibid* p353). The article demonstrates that the political environment might act as a catalyst for creative accounting to cover up acting in political rather than commercial, interests (*ibid* p354).

In the United States, politics was attributed partial responsibility for the collapse of Enron (Froud et al., 2004). The authors argue that Enron bought Government approval by generous political donations and cultivating relationships with senior politicians, including the president (*ibid* pp 905 – 907). These connections helped sustained the share price and image of Enron.

The chapter to date builds up a picture which suggests that there are connections between banks, the State and the accounting of these banks which could be investigated further. The next section considers the uses of accounting in the face of banking crises.

### **2.3 Accounting Regulation Used as an Instrument to Pursue State Ends**

Accounting regulation may be used to highlight or hide problems at banks. During the US savings and loans crisis in the 1980s, regulations were altered for institutions that helped them appear solvent for longer (Young, 1995). This helped justify non-intervention by the State. To achieve this, accounting for the institutions started to diverge from US GAAP. Accounting rules were flexed so that total income on long term loans was immediately

recognised, losses could be deferred and assets could be revalued (*ibid.* p61 – 63). However, the crisis could not be averted. At this point, the role of accounting became concerned with transparency to reveal the scale of the problems (*ibid* p67).

The audit process was used to deflect blame from the State Regulator after the collapse of Canadian Commercial Bank (Wright, 1994) . The auditors in this case were caught up in a ‘chain of reliance’ over the loan portfolio valuation. The valuation was prepared by the bank itself and the auditors assessed it for reasonableness only. Although it was noted that the loan loss provisions were now considerably less prudent than in the past, the auditors did not insist on updated figures. The chain of reliance continued with the state regulator of banks relying upon the audit report to gain assurance about the financial statements as a whole and particularly the loan valuations (*ibid.* pp376 – 379). These valuations were found to be too optimistic and the bank failed.

Accounting techniques may also impact on international banking practice. The Japanese campaigned for underlying changes in the Basel regulations in the interests of its domestic financial institutions (Sawabe, 2002). Japanese banks persuaded regulators to include the ‘Latent Reserves Revaluation’ in the calculation of the capital adequacy ratio (CAR) when it was introduced (*ibid.* p413). The CAR minimum levels were set by the authorities to help rein in an economic bubble by requiring banks to have enough capital in proportion to customer borrowing. Due to the Western focus of the ratio being mooted, Japan’s banks would have relatively lower capital adequacies than banks in the US or UK. Japan therefore bargained with the regulators to include the Latent Revaluation Reserve in the calculation as part of Tier 2 capital (*ibid* p417). Latent Revaluation Reserves were not a visible part of the bank’s financial statements; rather, it was unrealised economic gains of the bank which had accrued by virtue of stock holdings or property which had increased in price. This made up a significant part of the Japanese industry’s CAR and meant that the banks were on a level playing field internationally (*ibid.* p414). However, it also meant that the ratio ultimately became pro-cyclical and allowed the expansion of loans to increase during the Japanese property bubble in the early 1990s. Japan’s property prices remain much lower today compared to the height of the bubble in the nineties.

The relationship between failure and the State was further analysed in the case of BCCI (Arnold and Sikka, 2001) . BCCI was designed to evade regulation by operating in a complex international organisational web. The diffuse operations served as a smoke screen for illegal activities such as money laundering (*ibid.* p481). After extensive treasury losses and rumours of misconduct, the Bank of England closed down BCCI UK in 1991. Thus, the

authors argue that the State still is an influential regulator of companies, despite increasing globalisation and the rise of multi-national companies. In this instance, the Bank of England was able to shut down the bank; it did not have to gain approval of any other State to achieve this. However, the closure was delayed because of the involvement of other countries in trying to recapitalise and restructure the bank before the Bank acted. The international context contributed to the cause of the scandal (*ibid*, pp483 – 484).

The case studies of the UK, Japan and the USA demonstrate that national and international regulation has an effect on both preventing failure in banks and responding to it. Accounting techniques assist for both parts. Furthermore, auditing provides a regulatory function for the markets. Audit failure can thus also have large implications in the markets when it results in unexpected corporate collapse.

Enron's unsatisfactory audits are among the best known. The Enron failure can be viewed an audit process breakdown (Cullinan, 2004). A model is developed of three stages of the audit process which is then applied to other recent corporate collapses. The 3 steps are as follows: 1) awareness of the transaction 2) recognition that the transactions results in a misstatement, 3) willingness to modify the audit opinion if the misstatement does not get rectified. Breakdowns at all audit levels are demonstrated in corporate collapse. Despite this, the Sarbanes-Oxley Act (SOX) regulation introduced in response to the Enron failure has concentrated on the audit independence issue, which only addresses level three of the model. As a result, the author argues that US regulators missed the opportunity to legislate meaningfully on other identified deficiencies in the audit process (Cullinan, 2004).

This highlights an important component of regulation, anticipating where and how to implement rules based on likely activities taking place. It recognises that auditors may not always act rationally on jobs and regulation may move beyond the sole reliance on rational choice (Marnet, 2007). It also demonstrates that everyday processes should be considered in the light of corporate failures.

Moving on from auditing to the scrutiny of accounting processes, work on Enron has also focused on fair value accounting. The increasing use of this technique was used to manipulate profits and assets by employees and ultimately led to the demise of the company (Benston, 2006). The decision not to consolidate the special purpose entities into Enron's financial statements was perhaps the most important manipulation of all (*ibid*). In addition, fair value accounting was based on spurious models which allowed inflated profits to be



realised and there was a failure to disclose all related party transactions (Benston and Hartgraves, 2002).

These case analyses above show that further knowledge can be gained from investigating the regulatory response to corporate failures. Some cover up of failure may occur as accounting is subjected to the political will of those who regulate the preparation of financial statements. But misleading financial statements can be produced under accounting rules with the best of intentions as well when fraudulent intent is uncovered (Clarke and Dean, 2007). And accounting's *capacity* to reveal the objective truth may not be questioned (Young, 1995). The regulatory process of accounting and auditing is thus an important area to consider when investigating the financial accountability in the banking industry.

In the current crisis, fair value accounting rules have been central to regulatory debate. This is discussed next.

## **2.4 Controversies in Accounting during the Global Financial Crisis: An Overview**

The global financial crisis from 2007 onwards has caused much heated debate in corporate regulation. Fair value accounting, off balance sheet finance and poor corporate governance were blamed for exacerbating the spiralling crisis (Barth & Landsman, 2010; Magnan & Markarian, 2011). Moreover, the largest shake up in the audit market regulation has also been promoted by the EU (EC, 2011) and audit market concentration was also investigated by the House of Lords and competition commission (House of Lords, 2011). Whilst auditors and accountants have been attributed far less 'blame' in the global financial crisis of 2008 than the crisis following the failure of Enron (Sikka, 2009; Humphrey *et al* 2009), there has been considerable pressure to alter accounting standards. There was an impetus to consider the impact of financial accounting on the financial stability of economies (Tweedie, 2009). Banking Regulators and the EU were concerned at the potential losses faced by banks during the crisis. As most assets would be valued at fair value following IAS 39, the collapse of the markets meant that a large proportion of assets would be impaired. Losses would directly impact the income statement as well as the balance sheet. EU leaders and ministers were particularly worried that this would give European companies a significant disadvantage to US companies who had the option of reclassifying certain instruments in rare circumstances. The EU lobbied for the IASB to consider this when examining IAS 39 in the context of the crisis (Europa, 2008). In response, the IASB updated IAS 39 permitting certain

reclassifications of financial instruments in rare circumstances (IASB, 2008)<sup>5</sup>. This meant that banks could remove instruments from being designated at measurement of fair value to one of amortised cost by reclassifying instruments as Loans and receivables or Held-To-Maturity (*ibid.*). Alternatively, the loss on fair value could be recognised through the balance sheet rather than impacting upon the income statement under the Available-for-Sale category. This could have a large impact on the reported performance of the banks.

These changes caused widespread concern about the quality of financial reporting disclosure during the crisis, including within the UK Banking Industry. The G20 attributed the financial crisis to failures of financial regulation as well as within institutions. The leaders called for an improvement in accounting standards on valuation and provisioning (G20, 2009). In response, the FSA (2009, p24) released a consultation document to discuss the transparency of banks. This culminated in a voluntary code by the British Bankers' Association (BBA) to ensure financial disclosure information remained of high quality (British Bankers' Association, 2009). Both RBS and LBG agreed to implement this for the 2009 annual report and beyond. This was updated in 2010 after further FSA evaluation of its effectiveness (British Bankers' Association, 2010). An important component of the updated disclosure code was to be in discussion with the FSA prior to the publication of the annual report (British Bankers' Association, 2010).

#### **2.4.1 The Historical Context of the 2008 Regulatory Developments**

The quick onset of developments and regulation at the height of the crisis are likely to have increased the compliance costs required in UK banks at a time when there were huge commercial challenges to overcome. Arguably, these regulations have been developing even before the UK banking crisis. Stepping back from the technicalities of the fair value debate, it has been argued that the fair value controversies are rooted in a differing ways of thinking about accounting. Financial economics as the intellectual basis for financial reporting represents a shift in the concept of reliability in accounting. The cultural authority of financial economics has helped to deal with the very real problem of derivatives accounting (Power, 2010). However, the use of fair value has shifted the use of the Balance Sheet from a legal transactions basis to an asset and liability valuation statement. As a result, the income statement carries less relevance (*ibid*, p205). Revisions to IAS 1 exemplified this shift in priorities by the change in name of the Balance Sheet to 'Statement of Financial Position'

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<sup>5</sup> Subsequently deleted from the IAS.

(IASB, 2007). Standard setting has become increasingly isolated from the rank and file accountants implementing the IASB policies who relevance is defined in the terms of the market rather than transactions (Power, 2010).

Moreover, the new ways of thinking about accounting have enabled regulatory mechanisms to improve disclosure quality in banks. Previously, UK banks' disclosures were criticised by displaying generic rather than specific content with incomplete numerical data. Moreover, the relationship between narrative and numerical data was regarded as spurious (Woods and Marginson, 2004). As financial reporting disclosure has moved on through IAS 32 (IASB, 2009b) and IFRS 7 (IASB, 2010a) and from January 2015, IFRS 9 (IASB, 2010b), there has been a general perception that disclosure quality has increased, although not uniformly across Europe (Bischof, 2009). Whilst fair value was called into question during the crisis, Barth and Landsman (2010) argue that changes in fair value measurements had a negligible impact on banks' reporting during the downturn. There were other important aspects of the crisis, including derivatives, securitisations and loan loss provisioning which, it is argued, had a greater impact on results (*ibid*). What can be taken from the arguments over fair value is the sheer complexity of disclosures necessary to banks, which can cause problems even for experienced financial statement users. In the case of an income statement movement arising on financial liabilities linked to a company's credit status – a decline in credit status results in a gain recognised in the financial statements which is a counterintuitive result. Further disclosure describing the relationship between the credit status and income statement effect has been effective (Gaynor et al., 2011) whilst overall disclosure generally has been asserted to rectify issues associated with accounting identified (Barth and Landsman, 2010; Woods and Marginson, 2004).

Regulation can also be directed at professionals rather than at disclosure. This can have mixed results. On the one hand, the FSA's powers to ratify appointments to senior positions in financial services under the approved persons regime has appeared to increase senior staff's perceptions of responsibility (Collins et al., 2009). It has been recognised that regulation may be a process of socialization with requirements internalized by the management. Yet at the same time accountants may become mere agents for the State, acting as directed by these regulatory regimes (Mitchell, 2008). The improvement of corporate governance may be alternatively achieved through increased autonomy and the expertise of the market (Mitchell, 2008). Moreover, voluntary rather than mandatory disclosure can act as a 'soft law' with voluntary take up to prevent further regulation being implemented (Richard and Xiaoli, 2010). This may also be an easy way out, with the

intended practical impact on business limited whilst the organisation benefits from the impression of responsibility created by disclosing their compliance to voluntary codes (*ibid*).

Overall regulation both shapes and is shaped by a historical and professional context. The 2008 crisis has been no exception. Fair value accounting has caused market confusion and regulators have had to refine the parameters in response to the banking industry. However, the increase in regulation has been seen as a positive outcome for financial statement users.

## **2.5 Concluding Remarks**

The controversies in the global financial crisis resonate with previous State intervention into banking crises. The use of accounting and auditing both as a cause and as a means of responding to crisis have been discussed in this chapter. Corporate failure is not an unusual phenomenon and the first part of the chapter looked at characteristics of corporate failure. The second part then considered some instances where Governments had intervened to expose corporate failure. The State response to crisis was then discussed. The literature demonstrated that the underlying basis accounting rules could be altered to correspond to domestic conditions regarding banks. Finally, the 2008 global financial crisis is discussed with regard to accounting rules. Again, these rules took on a political slant when the techniques of accounting were questioned by authorities.

The next chapter considers further the relationship between corporations and the State. The focus moves to the political relationship with business. Starting with a historical look at UK bank nationalisations, it then discusses the UK experience of other nationalised industries.

# Chapter 3: Nationalisation in the UK

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This chapter reviews the background literature on banking and nationalised industries. It begins by discussing banking. Banking has largely been a private enterprise since the first banks were set up in the 17<sup>th</sup> Century. There have been a few notable nationalisations of UK banks since then. The Bank of England was nationalized in 1946 and Johnson Matthey, a relatively small bank, was nationalised in 1984. Not all bank failures result in nationalisation. There have also been some notable bank failures in the UK, including Barings and BCCI. Nationalisation can be seen very much as a last resort for banks in response to corporate distress. In contrast, other industries - railways, coal, steel, power and airlines- have been extensively nationalised in the UK, particularly post-World War II. During the 1980s and 1990s many of these industries were privatised under Conservative Prime Minister Margaret Thatcher. These prevailing winds of privatisation may advance an understanding of why the Labour Government of 2008 may have been reluctant to nationalise RBS and LBG outright, even though it fitted well with the 'old' Labour ideology.

The chapter journeys through previous UK bank nationalisations and reviews the Labour party's position on bank nationalisation. It then turns to the actual performance of those industries which were deliberately nationalised and the rationale for reprivatizing these industries some decades later. By understanding the fate of nationalised industries further, the implications of a change to Government ownership can be analysed as part of the empirical work of this thesis.

## **3.1 Bank Failures and Bank Nationalisations**

As previously stated, there are very few banks that have been nationalised in the UK. With the exception of the Bank of England, the bank nationalisations have been in response to corporate failure. However, the Bank of England did begin life as a private enterprise and was nationalised to mutual advantage. It has been described as a process of forming in law what was already in substance the relationship between Government and Bank. The nationalisation was more of symbolic importance than actual control (Bopp, 1946). It reflected the recent experiences of the Great Depression and the Second World War. There was a political desire to increase the supply of money during and after financial crisis in England and France. However, the private banks were much less willing to ease the supply of credit (Bopp, 1946). A change of Governor in the Bank of England led to an increased recognition of the relationship with the State (Bopp, 1946). An ownership arrangement allowed State interests to be directly realised by the Bank of England in its monetary policy.

Almost forty years later in 1984, the Bank of England became the agency on behalf of the State to rescue Johnson Matthey Bank. Johnson Matthey was one of five banks trading in gold bullion. The bank had got into difficulties with two very large loans relating to Pakistani companies. These loans consisted of 76% and 39% of the bank's capital base in 1984 (Bank of England, 1985). The exposures were deliberately understated on returns to the Bank (*ibid*, p35). A poor internal control environment meant exposures were not managed sufficiently and loan loss provisioning was not adequate. It was clear after a review by independent auditors that the bank was insolvent and would be unable to continue in business (*ibid*, p37).

The Bank of England tried to find buyers for the bank but was not successful in negotiating a deal. It then bought the bank for the nominal value of £1, after the parent company of the bank, Johnson Matthey, invested £50m into its banking subsidiary. The parent company was unable to fund any more of the recapitalisation without getting in to its own difficulties. The Bank of England agreed to indemnify Johnson Matthey bank for up to £150m. Other clearing banks agreed to counter indemnify for half of such losses (Hansard HC, 2013). Nonetheless, it took the Bank of England considerable effort in getting support from the private sector (Goodhart and Schoenmaker, 1995). Significantly, it was the wider concerns on the banking system that necessitated the rescue:

The Bank's fundamental reason for rescuing JMB was a deep concern for systemic consequences if the bank was allowed to fail...London is probably the most important international gold market and is involved in placing and taking gold deposits with a large number of institutions all over the world. The members of the market also do a substantial amount of business with each other. The failure of one of the five main participants would therefore have created a situation of extreme uncertainty." (Bank of England, 1985)

A new banking supervision enquiry was announced. The ability of the auditors and their share of the market in the UK was also debated by the House of Commons when the Johnson Matthey rescue was discussed (Hansard HC, 1984). This resonates with the cycles of crisis and regulation discussed previously (Carnegie and O'Connell, 2013; Laine, 2010; Clarke, 2004).

Although the bank was taken into public ownership by virtue of the Bank of England rescue, it was distanced from the UK Parliament. Indeed, it took 10 weeks before the rescue of the bank was debated in the House of Commons, and then only in relation to a review on banking supervision (Hansard HC, 1984). Yet it too resulted in direct equity ownership, even by virtue of the £1 nominal sum paid for it (Bank of England, 1985). The differences perhaps were that the systemic failure was related to a certain part of the banking markets; and that there was no need for direct Treasury involvement. Here, the process of trading continuing was an indemnity against any losses that may have been incurred through Johnson Matthey failing to continue as a going concern. The discourse never discussed the nationalisation of Johnson Matthey Bank.

In contrast to Johnson Matthey, The Bank of Credit and Commerce International (BCCI) was not rescued by the State or the Bank of England. It managed to conceal fraud and mismanagement for a number of years due to its large international and diverse organisational structure (Arnold and Sikka, 2001). It did not identify with any one country regulator and as such regulation was disjointed (Arnold and Sikka, 2001). A secretive rescue of the bank via restructuring and guarantees by the United Arab Emirates was negotiated into the run up of its closure. There was some disagreement about whether input should be made from the banking supervisors as well (Bingham, 1992). In the interim, a statutory report was commissioned from the auditors, Price Waterhouse, which brought together all suspected fraud and misappropriations in one place (*ibid*, p41). This led to the conclusion that restructuring was not possible and at a meeting, the Bank of England on behalf of the disperse regulators told the BCCI representatives that the bank would be wound up, with assets frozen from that day (Bingham, 1992). Liquidation ended in 2012 with 90% of losses having been recovered (Croft J, 2012).

Like BCCI, the failure of Barings in 1995 in the UK also did not receive State rescue. Barings had failed due to a system of poor internal controls which allowed a trader in Singapore to build up huge losses (Leeson and Whitley, 1997). Poor internal controls at the bank meant that these trades were not identified timeously (Banking Board of Supervision, 1995). The Bank of England took the view that there was no systemic risk to the failure of Barings (Bank of England, 1997). Commenting on the reasons behind levels of supervision, the deputy governor commented:

“If the state guarantees the existence of individual banks that can create incentives which encourage irresponsible behaviour. The prize for taking excess risk may—if things go well—be excess returns (and telephone number bonuses) while, if things turn out badly, the state steps in and picks up the tab. This is known as a one-way bet” (Bank of England, 1997)

Thus, moral hazard is the rationale for declining to intervene in bank failures. Where there was systemic risk as with Johnson Matthey, the UK Government did intervene. Likewise, the Bank of England provided a public good in the form of financial stability, contributing to the strength of the UK’s financial system. Nonetheless, there has previously been considerably public appetite for the nationalisation of industry, including the banks. This is discussed next.

### **3.2 ‘Old’ Labour and Nationalisation**

A large scale nationalisation programme began in the mid 1940s. The left wing Labour party formed a Government immediately after the end of the Second World War. The economic conditions and the electoral mind-set at this time was favourable of nationalised industry (Millward, 1997). State owned industry was part of Labour Party Ideology. Clause IV of the Labour Party constitution had sought:

“To secure for the workers by hand or by brain the full fruits of their industry and the most equitable distribution thereof that may be possible upon the basis of the **common ownership**

**of the means of production, distribution and exchange,** and the best obtainable system of popular administration and control of each industry or service." (Labour Party, 1945)

Central planning was seen as the socialist ideal of efficiently managing the economy, by directing resources to the areas of greatest need. For a number of socialists nationalisation was the only way to reach economic stability and full employment (Singleton, 1995, p14). By nationalising the 'commanding heights' of the economy, including fuel, transport and even banks – these sectors could be used effectively as levers through which all areas of the economy could be controlled and regulated (*ibid*, p 16).

### **3.3 Nationalising Industry, but not Banking**

For a small contingent of the Labour party left, nationalisation of the banks was a natural and essential step to securing the Socialist State. However, it was never enthusiastically pursued by the wider Party over the long term. The far left views advocating banking nationalisation were realised for a brief period in the 1930s, when the entire Labour party officially advocated the total nationalisation of all banks. Philosophically, common ownership of the means of production included State ownership of the banks. This would further the socialist agenda of displacing the capitalist system. It would also allow central planning of prices, production and employment, as well as the direction of credit. Nationalisation was based upon greater security for depositors and to realise economies of scale. Total credit control would allow full employment to be secured. The economy had suffered greatly with the World recession in the early 1930s (Pollard, 1979).

Yet the appetite for nationalising fully the financial system diminished considerably after the mid-1930s. The Bank of England's own nationalisation in 1946 (Bank of England Act 1946) perhaps fulfilled left wing ideals. Bank nationalisation was rarely discussed in the Labour Party after 1950 (Pollard, 1979).

In contrast, nationalisation of other industries, such as steel, coal and railways, occurred from the 1940s onwards. The model for State Owned Enterprise (SOE) during this time was a public corporation and its champion was MP Herbert Morrison. The Morrisonian model envisaged a high degree of independence for the leading team of management, taking advantage of the corporate expertise to maximise efficiency and customer service (Morrison, 1933). In a bid to buffer the enterprises from any political interference in operations, the Minister concerned with the SOE was accountable to Parliament only on matters of policy, upon which they had a direct influence, rather than operations. The corporation was legislatively enacted but only the bare bones of objectives and targets were laid out in the Acts. Instead, Morrison envisaged that informal relationships would develop between the Government department and the corporation which would allow corporations to be under the successful stewardship of the State (Morrison, 1933).



### **3.4 Privatisation of SOEs**

Over the next 30 years, nationalised entities did not live up to all expectations and became perceived as inefficient, draining economic resources and providing poor customer service (Ashworth, 1991). During the 1980s and 1990s, the Conservative Government sold a number of State industries to private ownership.

Privatisation in the late twentieth century fulfilled the Conservative ideal. Economic freedom for individuals was enhanced through selling off SOEs. Wealth would be transferred back to taxpayers and workers (Lapsley, 1993; Heald and Steel, 1986). Publicly owned industry left the electorate with an implied shareholding in these businesses. If the entities were sold, the population could keep a higher proportion of their wealth and spend or use it as they chose. Privatising industries would therefore allow individuals to pursue their own goals. This was not viewed as just favouring the privileged. All employees would now be able to take part in the ownership of their own industry by the ability to buy shares in the companies in which they worked (Heald and Steel, 1986).

Publicly, it was the economic arguments that framed the backdrop for the wide scale privatisation programme by the successive Conservative Governments during the late 1970s and 1980s:

“At the end of the day, the heart of the matter is that a nationalised industry does not have to succeed in order to survive. Even if left to their own devices, the industries have no real incentive to improve their performance or to strive for great efficiency. If the Government stands behind the industries and is viewed as possessing a bottomless purse, it is no wonder inefficiencies flourish and market responsiveness does not stand very high in an industry’s scale of priorities” (Moore, 1986)

Financially, privatisation was an attractive option. The public sector borrowing requirement was large and there was a need to reduce borrowing. For the Tories, raising taxes as a means of reducing borrowing was unattractive. Asset sales provided injections of cash into the public purse. Moreover privatisation would allow national industries access to financing at need rather than consider the public sector borrowing requirement (Moore, 1983)

### **3.5 Nationalised Industries: An Assessment**

The following section considers the assessment made of the UK’s experience with SOEs in the twentieth century. The efficiency of SOE leads the discussion. Following this, the political features of SOE are reviewed, turning attention first to ideology before examining accountability at a Parliamentary and Ministerial level.

### 3.6 Efficiency of SOEs

The efficiency of SOEs has been controversial. Comparative studies using regression analysis have identified that private sector firms have been more efficient than State owned counterparts generally (Cragg and Dyck, 1999), resulting in consumer benefits such as reduced fares for airlines (Eckel and Vermaelen, 1986). Case studies present an inherently more complex story. What emerges is an acknowledgement that efficiency has been notoriously difficult to determine, with differing criteria applied resulting in markedly different analyses. For instance, efficiency is often narrowly determined on financial grounds with little regard to technical efficiency (Pryke, 1971). Pryke argues that SOEs should be assessed on technical efficiency rather than on accounting disciplines such as surplus or deficits. Technical efficiency is concerned with maximum services for the amount of finances invested. Viewed from the vantage of technical efficiency, SOEs have been an efficient organisational structure (Pryke, 1971).

Even for financial information in most SOEs, it must be considered against the economy as whole; performance is difficult to measure as inflation became very high in the 70s and there was a movement to current cost from historic cost accounting and back again (Ashworth, 1991). More recently, there has been the move to accruals accounting (Pina et al., 2012). Furthermore, the finances must be set in the context of changes in Government and Government policies, affecting the targets set for the industry and the sort of borrowing/financing requirements for each SOE (Ashworth, 1991).

In a broad based international study, the decision to buy or sell SOEs stems much more from the political ideology of the ruling Party rather than from the economic considerations of the time (Zahariadis, 1999). Domestically, there is a mixed picture. The nationalisations in the 1940s in the UK were concentrated in the fuel and transport industries. This was partly a practical response of the Labour Government to help improve both efficiency and service (Millward, 1997). A number of key industries were left alone during this period, including the banks. The later Conservative privatisation programme was part of the inherent Tory ideology (White, 1987). However, privatisation was sometimes confused with competition (Mayer, 1989). The creation of Network Rail is the 'Third Way' ideology. The third way was associated with 'New' Labour, associated with the leadership of Tony Blair (Labour Party, 2014). For Network Rail, there is no State ownership. Rather, power is concentrated into a number of board members who administer the company (Network Rail, 2013; Jupe, 2009).

Correlating performance of SOEs directly to ownership must be treated with caution, as there may be an inherently more complex relationship. Indeed it is an established critique of the Conservative privatisation programme that private sector ownership was confused with the efficiency of competition, leading to some unsuccessful privatisations which did not operate in a competitive market (Simpson, 1989).

Controls rather than ownership may be the cause of inefficiencies in SOE (Heald, 1985). The inefficiencies identified could thus be eliminated through development within the organisational structure rather than necessarily changing the ultimate owner of the enterprise (*ibid*). For British Airways it was the *anticipated* change of ownership before privatisation which created change in management style and a move to consumer orientation, rather than the privatisation itself (Balmer, Stuart & Geysler, 2009). At British Steel improvements in performance arose from the implementation of commercial management techniques, rather than a move to the private sector (Dudley, 1999).

Overall, it has been difficult to define the parameters for measuring efficiency in SOEs. Yet efficiency was not the only concern of the Government owned corporations. For staunch left wing supporters, the SOEs were also fulfilling political ideals and to attain full employment. Thus, the accountability of the SOEs was very important. The next section discusses the issues arising in accountability.

### **3.7 Public Accountability of the SOE**

The relative independence of public corporations set up under a Morrisonian model limited Parliamentary accountability of the SOEs to areas of policy which were under the remit of the relevant Minister (see, for instance, Coal Industry Nationalisation Act 1946, s 3; Bank of England 1946, s4). In an early piece of writing examining fledgling SOEs such as the BBC, it was observed that oral debate in full Parliament was infrequent and poor quality. There was just not enough time in Parliament, nor was the expertise of MPs sufficient, to examine issues through oral debate. MPs thus made extensive use of the written questions to ministers. This was also problematic as ministers would only answer on *their* limited role in the administering of the SOE policy, rather than on operations. The written questions of MPs relied greatly upon the goodwill and discretion of the minister for any responses (O'Brien, 1937). Many of the written questions were rejected for being outside the minister's remit and went unanswered.

There was recognition in the 60s and 70s that the accountability of the SOEs was particularly weak. A select committee was set up to examine and hold them to account. However, the committee was only partially successful (Kelf-Cohen, 1973). SOEs were examined on a rota every few years. However, this prevented the dominant topics of the day being examined. Furthermore, the reports scrutinising industries were often too long and delayed.

As features of NPM developed, KPIs became a tool for assessing performance. Previously, SOEs were obliged to cover costs with the subsidies or revenues earned, ‘taking one year with another’<sup>6</sup>(UK Parliament, 1947). Yet this did not cover other objectives of the SOEs (Barberis P and May T, 1993). KPIS were unable to effectively distinguish between good management on the one hand and sheer luck or the external environment on the other (Jenkins, 2004; Woodward, 1986). In departments where social, rather than financial targets were set, Day and Klein (1987) viewed KPIs as strong and constructive. The availability of numbers in addition to social objectives allowed more for the politician to observe and ask about. KPIs also shaped the behaviour of civil servants.

Accountability remains problematic for organisations even if Government ownership is implicit, rather than formal. The ‘third way’ solution to the collapse of Railtrack was to create a company limited by guarantee. Ownership is through members of the public, rather than private shareholders or the State. However, member owners do not have a financial stake in Network rail, thus weakening accountability of the executive managing staff (Jupe, 2009). Indeed, its overall structure meant that “the company is, in practice, a very expensive mechanism for channelling large amounts of public money to private companies” (Jupe, 2009). Structurally, network rail is unable to take advantage of lower interest rates available to the public sector for borrowings. However, financial risk in the company ultimately resides with the State.

The problems associated with the accountability of the SOEs revolved around the processes for Parliamentary scrutiny of operations. Nonetheless, the minister could choose to answer questions on the SOE. Investigations, however, would then be based on personal or political interests, rather than enshrined in a formal framework. Personal ministerial intervention is discussed further next.

### **3.8 Ministerial Interference**

Ministerial involvement with SOE was to be rather informally structured and left to civil servants for the day to day scrutiny of policy. As experts in the relevant industry, managerial discretion in operations was to be observed. Ad-hoc political interference in SOEs has nonetheless been observed in studies over the decades, even though the ministers were often not in place long enough to develop a deep understanding of the SOE operations and challenges (Davies, 1988; Dell, 1973). Moreover, interference carried political dangers for them. Some ministers preferred to be uninvolved in daily activities (Davies, 1989).

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<sup>6</sup> Taking one year with another was a general principle applied to nationalized industries (Peacock and Wiseman, 1961)

The intervention of ministers in SOEs occurred if there was a perceived political advantage (Davies, 1989). It was also due to personal interests of the ministers in charge (Dudley, 1994). High profile political interference embarrassed civil servants (Dell, 1973). A popular intervention concerned the price of rail tickets. Limiting price rises caused dismay in the rail industry (Ashworth, 1991). Fuel industries were also subject to intervention on their pricing policy (Jenkins, 2004). Indeed, even under regulated private ownership, utility companies still have their pricing policies scrutinised (Ofgem, 2012).

Ministerial interest also had far reaching effects on the SOE itself. The political set up of British Rail contributed to inefficiency and underinvestment in capital projects (Shaoul, 2004). Yet there may be benefits to intervention as well (Foster, 1992). Privatisation loosened the relationship between State and industry in railways and utilities, meaning less communication between the parties. As a result, the State lost its influence on industrial policy for the relevant sector and the sector also lost its access to influential Government figures.

**The chequered history of SOE provides an important context for RBS and LBG. This revolves around perceptions of accountability and efficiency, as well as the individuals involved in the Parliamentary life of these organisations. Ministerial influence may affect both policy and operations.**

### **3.9 Concluding Remarks**

This chapter has considered response to bank failures in the UK. There is a mixed precedent for allowing failure and taking banks into public ownership to stem systemic failure. In contrast, there existed political will to nationalise industries in commodities and communications. This trend was reversed in the 1980s as a privatisation agenda was carried out under the Thatcher Government.

Research on SOE demonstrates that it is the organisational and political aspects of SOEs that provide a convincing case for regarding identity of the owners as important. This is analysed further in the relationship between the quasi-nationalised banks and those to whom they are accountable. This can be approached in a number of ways and the next chapter discusses some theoretical frameworks with which to analyse them.

# Chapter 4: Theoretical Frameworks

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The purpose of this chapter is to introduce the theories used in analysing the public accountability of the quasi-nationalised UK banks. The different theories – Property Rights, Agency, Impression Management, Stigma and Critical Discourse Analysis – are used. The choices reflect their use as established explanatory tools in accounting and their power to analyse the complex events over time. The aim is to understand and explain the issues addressed through theory. The theories are used in a standalone fashion, rather than to bridge or merge them. A discussion of the five different theories and the literature discussing them are presented below. The challenges of using a multiple theory approach then follows. The potential contributions of the theories are outlined in section 4.6, which compares and contrasts the main features of the theories. The rationale for choosing these theories against other suitable theoretical frameworks is also discussed here.

## 4.1 Property Rights Theory

The rescue of RBS and LBG by the State was realised through significant equity ownership and makes a theoretically informed analysis based on ownership relevant. Whilst property rights theory considers impacts at the macro level, agency theory penetrates to the organisations and individuals concerned. In this way, a fuller analysis is provided.

Property rights are a critical factor in the creation and development of institutions and organisations within a society, establishing a context within which transactions are negotiated (Mahoney JT, 2005). Property rights' potential reach for analysis of organisations is wide, conveying normative insights as to maximising welfare through the creation and maintenance of property rights; explaining the evolution of property rights within an economic system; and providing insights into why inefficiencies in economies persist.

Property rights are attached to attributes of assets within our society. Their existence allows individuals to use and enjoy resources in a meaningful and enforceable way, thereby increasing overall social welfare (Alchian & Demsetz, 1972). The absence of property rights, as demonstrated in common property, creates inefficiencies as individuals seek to maximise their own utility without consideration for the sustainability of the resource. This 'tragedy of the commons' (Hardin, 1968) is rectified by the creation of property rights. Externalities become embodied and internalised within the property rights with the result that individuals utilise resources more efficiently. Transaction costs are reduced as property rights become enforceable with the assistance of the State and cultural backing (Alchian, 1974; Coase R, 1960).

The classical property rights literature is critical of State ownership. For property rights theory, public ownership has three negative implications. Firstly, the managers of the SOE are less efficient than those of privately owned counterparts. Managers are not incentivised to create maximum profits for the corporation as they do not get any direct benefit from their efforts (Furubotn and Pejovich, 1974; Alchian, 1974; Alchian and Demsetz, 1973; Roland, 1972). In the private sector, management may be offered share based incentives. In the public sector, profits are absorbed into the public purse for benefits of all citizens (Armen A. Alchian, 2008; O'Hara, 1981; Alchian, 1974). Management respond by expropriating resources from the firm in other ways, such as a nice office (Armen A. Alchian, 2008; Alchian, 1974). On a related matter, there is the possibility that some resources are directed towards political ends for securing or winning votes, rather than directly for the objectives of the SOE (Crain and Zardkoohi, 1978). The benefits for political firms then are concentrated in the individuals but the costs, which are not closely monitored, are a burden on all citizens (Lee, 2004; Eggertsson, 1990).

Secondly, monitoring is less rigorous. The citizen owners are unable to transfer their property rights in SOE to create specialisations for market advantage (Eggertsson et al., 1996; Eggertsson, 1990; O'Hara, 1981; Davies, 1977; Alchian and Demsetz, 1973). Any management inefficiencies in the SOE are not sought out because there is no individual incentive to do so; there are numerous other free riders to their efforts. The citizen owners do not provide sufficient monitoring compared to private corporations.

Finally, the ownership structure encourages short termism in management style. Managers cannot gain from any future prospects of the SOE which matches the possibilities in a privately owned corporation. In the private sector, an increase in share price may reflect the net present value of the future earnings of the company (Crain and Zardkoohi, 1978). Management are then rewarded for any increases in share prices through various incentive mechanisms. This is not available in SOE. Without these incentives available, management will expropriate benefits from the SOE now. A short term profit is preferred by management compared to a longer term investment perspective. This could mean that expensive projects with large gains in the future may not be conducted by the SOE manager (Clarkson, 1972). To compensate, the State is obliged to move towards ever increasing regulation of behaviour (Alchian and Demsetz, 1973; Clarkson, 1972). This leads to greater costs for organisations (Demsetz, 1967).

Ownership and property rights, whilst related, are not identical; owners of an asset do not necessarily enjoy 100% of the property rights pertaining to it and nor do property rights necessarily reside with the owner of the asset. Property rights over the same asset may be delineated many times. However, it is expensive to fully delineate the property rights in a resource, resulting in disputes and higher transaction costs. This means that when resources are exchanged, some attributes of the resource may

become part of the public domain. Individuals will try and maximise their utility through capturing the wealth entering the public domain. Inefficiencies in allocation are thus regarded as incomplete delineation of property rights and help explain the extant structures of the property rights (Barzel, 1997). A strength of property rights theory is thus its ability to consider multiple ownership of resources. It recognises that attributes of property ownership in organisations can be transferred. In an organisation, some of these rights are given up by owners of a corporation to the responsibility of managers who will manage on an owner's behalf (Foss and Foss, 2001; Barzel, 1997). In a SOE, the managers are appointed by Parliament and represent wider society.

More recent theoretical contributions to property rights theory challenge the assumption that ever increasing delineation of property rights will result in efficiency. There remain stagnant and inefficient economies (North, 1994). This is explained by the nature of institutional change which is incremental, rather than revolutionary. Institutions act as constraints on behaviour allowing structure in everyday life and may be formal or informal. Whilst formal institutions are important, they are also more easily malleable. On the other hand, informal institutions contain embodied customs and traditions which are resistant to sudden change as they represent social norms and ideology. When individuals make decisions, the basis of this rests on incomplete information including their own subjective models of customs and culture. Thus, decisions to allocated property rights are enduringly inefficient in the long term.

Eggertsson (1994) also observes inefficiency in property rights structures, which are likewise affected by time, location and technological attributes of the resources. Property rights depend on internal factors of the actor, such as investments designed to gain control, and external factors, the institutional environment. However, property rights never provide actors with full protection and full certainty. Enforcement is necessary to exclude others from using the resources and the value of owning the relevant property rights. However, it is costly to delineate property rights and their pervasiveness may be affected by a weak State or rapid institutional change.

The State is central to the enforcement of property rights. It supports the individual through contract laws and helps to lower the cost of exchange. Economies of scale make social control a more effective enforcement arrangement than reliance on private or individual control. Yet the State does not always act in a way that minimises costs or maximises value. The effect is that politically, property rights serve narrow self-interests and yet may cause substantial losses to the community as a whole, through transactions costs or free riding.

Property rights theory thus allows a consistent framework to analyse both the macro level institutions and micro-level organisations and behaviours which nationalisations affect, helping to analyse development over time, without expecting that equilibrium can be achieved even in the long term. It also emphasises the importance of 'path dependence', the term given to the incremental nature of



change in institutions. It is useful therefore to reflect on the historical experience of SOE discussed in chapter 3. This may help understanding the response of Government in quasi-nationalising the banks during the recent banking crisis.

Nonetheless, the incomplete nature of public ownership means that the banks retain features of a privately owned corporation. Corporate governance in the UK is underpinned by the logic of agency theory. Agency theory arguably is the basis for political thinking about the banks. There remains a belief in the private sector markets (Darling, 2008) and the monitoring achieved by the Government agency, the UKFI, as similar to an institutional investor (UKFI, 2009)<sup>7</sup>. Moreover, the nature of the response to the crisis was shaped by concerns over ‘moral hazard’ by the Bank of England (Bank of England, 2009).

Due to this, the empirical work also makes use of agency theory to analyse the new ownership arrangements.

## 4.2 Agency Theory

Agency theory is a well-established explanatory medium for accounting research, for which property rights theory and agency are highly congruent (Jensen & Meckling, 1976, p308). In this theory of the firm, the Agents (Directors) act on behalf of the Principals (Shareholders) to run the day to day business operations. In return, the principals receive a share of profits and the agents receive remuneration for their efforts. There are two problems associated with agency theory.

The first is that the agents are self-interested utility maximisers and will act in their own interests rather than the principal’s (Jensen & Meckling, 1976, p308). If ownership is less than 100%, any expenditure of \$1 of company resources will only dent the wealth of the owner-manager by the proportion of his own holding in the company. The owner-manager with less than 100% ownership is thus incentivised to use company resources for perks (*ibid*, p311). A larger problem is whether the agent is actually working hard to seek profit maximising opportunities (*ibid*, p313). This is termed adverse selection, as the principals are uncertain whether the agent is doing the work for which he is paid.

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<sup>7</sup> Institutional investors themselves adhere to the provisions of the UK Corporate Governance Code (2008). The UK Markets are generally accepted as part of the Anglo-American system with a diversified shareholder base, and the concept of the separation of ownership and control under agency theory is applicable to these corporations

Any prospective owner of the firm will be aware of these issues and will adjust the price they are willing to pay for a shareholding accordingly. As a result, the firm value is reduced from that of a 100% owner manager and any prospective shareholders will pay less for the firm. The difference between the value to the 100% owner and that of a part owner results in the existence of agency costs. Agency costs are borne entirely by the owner-manager (*ibid*, p319).

The model captured is one of corporate ownership structure rather than capital structure, because the agent's relative wealth and monitoring costs change as the proportion of ownership falls (*ibid*, p349). 100% ownership is not often a desirable outcome for the entrepreneur as they are risk averse and want to diversify their wealth in the face of positive bankruptcy costs (*ibid*, p349). Furthermore, agency costs arise due to information asymmetry. Agency contracts mean that agents are much more aware of all the activities of the business than the principals. In order to overcome the problem of information asymmetry, the principal requests audited financial accounts to help assess how the resources they have provided have been put to use. In addition, the principals will incentivise the agents in such a way as to align their interests, such as share payments options or in terms of profit targets (*ibid*, p323).

With disparate ownership in large corporations the owner may not have significant interest in the well-being of the corporation. Knowing this, agents may act in a way which is contrary to the best interests of the principal (Fama & Jensen, 1983, p304). The decision process is split into two to mitigate this risk. The two aspects of decision making are decision management, made by agents, and decision control, those who monitor the decisions. Decision control is often carried out at the top level by the board (*ibid*, p311). The existence of a delegated board who carry out the decision ratification process limits the power of the managers to deviate from the interests of the residual claimants (*ibid*, p309). Outside directors in the board do not collude with management as they have their own personal reputations to consider (*ibid*, p315). At lower levels, mutual monitoring occurs through managers working together and learning about their colleagues (*ibid*, p310). Furthermore, the agent will actively accept monitoring costs and restrict any 'perks' they may have otherwise enjoyed because it results in a lower dent in wealth than no monitoring costs would. The agent is also incentivised to ensure monitoring costs are as low as possible (*ibid*, p338).

There are also market mechanisms which help to control for agency costs. These could be through the openness of the stock markets, whereby unsatisfied principals can sell their shares onwards. The price may drop as a result (Fama & Jensen, 1983, p313). Moreover, the takeovers market will mop up any inefficiently performing organisations whose share price has dropped below their potential (Fama & Jensen, 1983, p313).

The takeovers market, split decision making and information asymmetry rely on robust information and communications from agents. Monitoring can be achieved through the use of financial statements

and the audit process. The next section considers the agency implications of financial monitoring before moving on to consider managerial incentives further.

#### **4.2.1 Agency Implications of Financial Monitoring**

Financial monitoring comes in two forms: the financial statements and the audit process. There is a benefit under agency theory for the credibility of financial information. Incentives between principals and agents are not aligned if the agent has complete discretion over the reported accounting numbers (Watts and Zimmerman, 1990). Financial statements are more useful if the rules under which they have been prepared are already known and can be viewed as unbiased accounts (Benston, 1985). However, agents may choose accounting standards which will increase their compensation for management of the company, thereby acting opportunistically. Increased compensation may be achieved via increasing cash bonuses or improving results with a concomitant effect on the corporation's share price (Watts and Zimmerman, 1978). Investors can anticipate that the agents will act opportunistically and will negotiate with the agents *ex ante* to minimise this. Nonetheless, it can be beneficial to give limited discretion to the managers to choose accounting policies so that subordinates may be motivated and firm value is maximised (Watts and Zimmerman, 1990). The management and shareholders voluntarily agree on the accepted accounting procedures used by the firm (*ibid*, p137).

The audit process helps to confirm that agents are in fact following contracts to limit resource divergence away from the objectives of the principals (Benston, 1985). An audit will reduce the opportunistic behaviour of the management only if the principal reasonably expects that breaches of contract will be reported by the auditor (Watts and Zimmerman, 1983). The auditors can provide this assurance at a smaller cost than alternative monitoring schemes (*ibid*). The audit helps to reassure investors that the internal controls of the company are also robust (*ibid*). The agents will also want to actively distribute the audited information to reassure other interested parties, such as creditors, as well (*ibid*, p40). From the perspective of the audit firm, the auditor is interested in maintaining a good reputation on audit performance to retain and expand on future business opportunities (Benston, 1985).

Investors may also be interested in the employment of auditors, particularly where the agents are unknown or not trusted. The auditors could help in reducing any expected losses associated with the bankruptcy of the firm or misuse of resources (Benston, 1985).

Agency theory thus places accounting and audited information as a central component of reducing information asymmetry. This has given rise to considerations of the quality of that financial accounting via credible standards and the impact of audit on adding value to financial information as

discussed in this section. In turn, financial information often influences performance related pay for management. Likewise, agency theory considers pay in further detail.

#### **4.2.2 Managerial Incentives: Pay**

Risk capital bearers can shift their investments elsewhere at relatively low transaction costs. Therefore, it is often the manager who is more interested in the success or failure of the firm, as she/he invests a greater proportion of personal wealth in the form of human capital (Fama, 1980, p291). If the firm is viewed as a nexus of contracts where the risk capital is viewed as part of the factors of production (Fama, 1980, p290) the separation of ownership and control can be viewed as an efficient structure. Management look to monitor each other, below and above them, in order to ascertain their own marginal product. This helps determine their own wages (*ibid*, p293). On the assumption that there is an efficient labour market, the manager will be paid for his own marginal product over his entire working life, smoothing out the results of his efforts, shirking and noise as his performance is assessed at each wage period (*ibid*, p301). It is the self-regulating nature of the managers and the discipline of the labour markets which form for the basis for efficiency in agency.

Political factors may also impact on agent negotiations, particularly towards pay. Media and public outrage has been noted to dampen the upper echelons of top management pay. Pay is not a private contract, but published for top executives. Other stakeholders – labour unions, consumer groups, Government, and the media may create forces which constrain top executive pay (Jensen and Murphy, 1990b).

“Since the subjective "reasonableness" of a compensation package is strongly influenced by the political process, it is natural that well-intentioned but risk-averse board members will resist innovative incentive contracts” (*ibid*).

The political processes of pay have a flattening effect on the pay-performance relationship, as poor performance is more generously rewarded than would be the case under a freer paying regime (Jensen and Murphy, 1990b). The approach then would be to allow higher pay for the top performing CEOs and lower rewards/ increased chances of dismissal for poorly performing executives (Jensen and Murphy, 1990a).

The UK banking crisis has stimulated a critical look at banking executive pay. Agency theory provides some analysis of incentives and pay with which to look at these issues. Moreover, the theory gives insight into the particular issues of the banking industry and those with block ownership structures. These are discussed next.

### **4.2.3 Agency Theory, the Banking Industry and Type II Agency Problems**

The agency framework needs to be considered in light of the particular industry which is being researched (Grove et al., 2011). In looking at the US banking industry, the special role of regulators has been identified, who may be incentivised to intervene in the banks. Moreover, depositors are also important stakeholders to whom the bank has a duty to protect as well as maximise profits for shareholders (Grove et al., 2011). This could also cause an increase in moral hazard as deposit insurance insulates management from effects of risk taking (Houston and James, 1995). Finally, banks are extremely complex, exacerbating agency problems under information asymmetries (Grove et al., 2011). Empirical research, which is discussed in the next chapter, examines the specific banking issues under agency theory.

Type II agency problems arise when there is a conflict of interest occurring between the principals – particularly controlling shareholder owners and non-controlling shareholders. Large shareholdings often arise in State ownership or in family owned firms (La Porta et al., 1999). There are a number of implications with controlling and non-controlling owners. With diverse minority shareholders, there can be a lack of incentive to monitor and engage with corporations (Bebchuk and Weisbach, 2010). In contrast, large shareholders may be more motivated to monitor performance. They may also have enough power to oust poorly performing management (Grove et al., 2011; Shleifer and Vishny, 1997). This reduces the risk of management extracting non-pecuniary benefits and leads to a better organisational performance (Shleifer and Vishny, 1986). Improved corporate performance may benefit all interested parties.

In contrast, these gains may be subject to a biased distribution. The controlling shareholder may be able to extract benefits from a corporation that minority shareholders do not receive. These include taking a disproportionate amount of the corporation's earnings or by freezing out minority shareholders. The corporation may be obliged to transact with the controlling shareholders under terms which favour the shareholder rather than the corporation. An example would be supplying goods or services to the corporation by the controlling shareholder above market prices (Gilson and Gordon, 2003). Thus large owners may oblige management to align with their own private interests, meaning minority shareholders lose out (Shleifer and Vishny, 1997).

In addition, majority shareholders are set to gain a large amount of money from the takeovers market (Shleifer and Vishny, 1986). Moreover, they can benefit by selling the block holding at a premium to non-controlling shares (Gilson and Gordon, 2003). In such circumstances, the minority shareholders can be subject to freeze out deals, where the controlling shareholder bids for the remaining shares from the minority. These bids do not take place as an arm's length transaction and result in a conflict of interests (Bates et al., 2006). So although controlling shareholders may increase monitoring and

decrease *managerial* benefits, they can create their own *private benefits* which are not in the interests of the minority shareholders (Gilson and Gordon, 2003).

The controlling shareholders' full power may not be entirely transparent. Powers may be greater than expected through the use of 'pyramid holdings' comprising of parent and subsidiaries. The protection of minority shareholders is therefore recommended through increased legal protections (La Porta et al., 1999).

Block ownership is often a feature of State owned Enterprise. State owned enterprise may comprise of 100% ownership or a controlling interest with minority shareholders. The State interest in RBS and LBG may be characterised as block ownership. Agency theory may be critical of state ownership as a result of SOEs not achieving social objectives any better than privately run firms and SOEs' 'extreme inefficiency' (Shleifer and Vishny, 1997). In fact, bureaucrats control the firms and have no associated cashflow incentives, leaving only strong political incentives to determine the management of the firm (Shleifer and Vishny, 1997).

The above discussions show the multifaceted insights agency theory has produced in areas pertinent to this thesis, ranging from information asymmetry and accounting, to pay, moral hazard and State ownership. Its applicability in the UK banking crisis is thus extensive. However, agency theory and its assumptions are also widely critiqued. Due consideration of its overall usefulness is worthwhile and is reflected upon now.

Generally, agency theory has great potential to enrich research in organisations. Its unique contribution comes from its treatment of information as a commodity (Eisenhardt, 1989, p64, Jensen, 1983, p325) and its consideration of various risks in contracting. It remains an excellent theory for empirical studies. Qualitative information will be necessary to consider the characteristics of the contracts being produced (Jensen, 1983, p332). It is particularly appropriate for research where there are substantial goal conflicts between the principal and agents or sufficient uncertainty to ensure risk considerations are utilised (Eisenhardt, 1989). Nonetheless, it remains a partial view of the world and it is well placed to be used with other theories (*ibid*, p71).

Notably, its concepts of self-interest, opportunism and congruence of economic goals between principal and agent, taken to its logical extreme, would result in higher contracting and monitoring costs within the firm. This would erode its competitive advantage and depress its share price in the markets (Wright & Mukherji, 1999, p300). On the other hand, the consideration of the loss to reputation from poor managerial behaviour means that agents may not act opportunistically even when it may otherwise be possible to do so (Donaldson, 1990, p377). Whilst this gives the theory a great deal of flexibility, it does mean it suffers from a lack of falsifiability. It also leaves no room to explain actions through positive motivations such as altruism (Donaldson, 1990, p379).

Yet altruism does not lead to the perfect agent, who will do the bidding of others (Jensen, 2004, p6). Rather, agency theory is designed to consider conflicts which arise and how these are best dealt with through incentives, whether monetary or not. In this way, everyone can share in the gains (Jensen, 2004, p15). Jensen contends that the self-interest does not equate to rationality, nor does it mean that altruism is not part of self-interest. Indeed, humans are not rational beings, and engage in behaviour which is self-harming as well as value maximising (Jensen, 2004, p11).

Agency theory offers explanations to corporate behaviour and performance based on an established and multi-layered platform. For this reason, the first research theme, which explores negotiation of accountability in the quasi-nationalised banks post crisis, utilises agency theory and property rights. Property rights theory predicts public sector management is less efficient than the private sector. Agency theory does not have a theoretical stance on the identity of owners *per se*, although there is some work on block holdings which may be pertinent to the current capital structure of the UK banks. Its continuing relevance to the business world means it is an important tool of analysis for the current study.

The chapter now turns to the second research theme which seeks to examine accounting in a different light. In contrast to agency theory's perception of accounting as an information commodity, the second research theme considers the nature of presentation. To this end, the accounts are analysed using Erving Goffman's work.

### **4.3 The Management of Impressions and Stigma Management**

The intellectual foundation for the second research theme is Goffman's *The Presentation of the Self in Everyday Life* (1973) and *Stigma: Notes on the Management of Spoiled Identity* (1968). Goffman's work has been extremely influential within the social sciences and beyond. It concentrates on social interaction 'where most of the world's work gets done' (Burns, 1992, p18). While it is often acknowledged that Goffman's works focuses on the individual, there is some consideration of groups (Goffman, 1956b p27 - 33). This thesis embodies the assertion that 'corporate self' is one facet of the 'self' that Goffman considers, as individual human nature is another (White & Hanson, 2002). This section details some aspects of Impression and Stigma Management that Goffman considers and that resonate with features of the current study. Impression management as constructed in *The Presentation of Self in Everyday Life* (1956b) is first considered. Then additional means of managing interaction identified in *Stigma* (1968) are discussed.

At its most basic, impression management involves the process of acting in such a way so as to be perceived favourably (Goffman, 1956a). Using a stage as metaphor, Goffman theorises that every individual plays a role in interactions with others which projects an impression. There are three

components to the dramaturgical metaphor described here. These are the ‘front stage’ arena where the individual projects the impressions required. On the receiving end, the audience are critical in allowing the impression to be played out by respectfully allowing the performance to take place. Finally, there exists a ‘backstage’ area where invisible processes take place, particularly in the work required to cultivate the impression being projected.

Goffman begins by acknowledging that the majority of the time, the impression being projected will be favourable to the performer, who is the person they strive to be (*ibid*, p19). Indeed, most acts will encompass accepted societal values within the performance (*ibid*, p37). Impressions remain dynamic throughout the performance, with adaptations employed as situations and audiences change. Impressions allow the performer to set the agenda of the performance and control the impressions received by the audience. In this way, the performer can define the situation of the interaction. Routine fronts may become institutionalised in terms of an abstract stereotype, in the manner of a professional vocation (*ibid*, p27). The front then becomes a ‘collective representation’ which acts as a shorthand for individuals. However, there is also difficulty within conforming to stereotypes as some situations may make a bad fit with current roles (*ibid*, p29).

At the receiving end of the impressions, the audience are requested to take seriously the impression ‘given off’ (*ibid*, p17). However, the performance is inherently fragile and can be upset by even minor mishaps (*ibid*, p66). The audience will look to less controllable aspects of a performance to assess sincerity of the performer and their authority in giving the impression performed (*ibid*, p58 – 59). They may also take a more active role, acting in concert with an individual to validate and reinforce the impression to other members of the audience (*ibid*, p76). As a result, the audience is critical in allowing impressions to be successfully managed. With that in mind, the performer is ever mindful of the audience and will necessarily anticipate audiences’ reactions when on stage. In doing this successfully, any one individual has multiple impressions that they create, and will engage in the segregation of their audiences to ensure that these are consistently presented as necessary to various groups (*ibid*, p49). If time or resources are short, some ideals may need to be compromised in the performance so that most legitimately important ideals are preserved (*ibid*, p45).

The impression that is received by onlookers is one which encompasses concealment as well as disclosures. Concealment occurs in the backstage arena where ‘dirty work’ or secrets are kept away from the eye of the audience at front stage. Thus, the impression is necessarily a finished product and may not show secret pleasures or economies in which the person is engaged (*ibid* p43). This helps add an air of mystification to the role of the performer, where society expects that they be wholly the role that they are playing and that the performer engages with (*ibid*, p74).

Good impressions are thus a constant and fragile means of everyday interaction, with concealment inbuilt into it. Whilst the focus in *The Presentation of Self* remains with projecting a good impression,



*Stigma* considers the presence of discrediting information and how this information is managed in interaction with others. This resonates with the deeply discrediting events occurring in RBS and LBG at the peak of the banking crisis.

In *Stigma*, (1968) Goffman's builds upon many of themes first identified in *The Presentation of Self in Everyday Life* (Manning, 1992, p99). Like good impressions, it is a continuous and precarious project to keep control of the stigmatising information and generated impressions (*ibid*: p100). The work is released from the dramaturgical metaphor previously employed. Here stigma refers to 'an attribute which is deeply discrediting' (1968 p3). As a result, the stigma leads to ramifications in interactions with 'normals', i.e. those without stigma. The stigmatised suffer rejection from others or receive specialised (perhaps unwanted) treatment. This leads to a number of techniques to help manage interactions. These include the correction of the stigma (*ibid*, p9) or if possible, the stigmatising attribute is concealed. Goffman terms this 'passing' (1968, p74). As individuals interact with the world around them, considerable private effort goes into considering the response of those interacting with others, even if the other has accepted them (*ibid*, p14). Thus the individual is trying to manage the discreditable by concealing their existence as much as possible. This may be done through careful management of potentially exposing situations (*ibid* p91) or complete removal from the conventional everyday existence, through moving towns or neighbourhood (*ibid*, p92). Yet these same individuals may move beyond concealing the discrediting fact into open disclosure. Here the techniques move from concealment to managing potentially awkward social situations, much in the line of a stigmatised person with a physical impairment (*ibid*, p100). Importantly, the extent of concealment can range from complete suppression if the stigma is not visible to covering/dressing up the stigma to make it less visible and thus to help make interaction easier (*ibid*, p95).

Although the primary focus of the book is on the social interaction with the stigmatised, Goffman does also consider the social systems in place to assist the stigmatised individual. They may align themselves with a group who help support each other and give advice to coping with the difficult situations (*ibid*, p108). Those who are closely associated with the stigmatised may also collude with the individual to avoid exposure occurring (*ibid*, p95).

Yet those closest to the stigmatised may suffer consequences by association. Intimates may suffer their own stigma, even if the associate does not share that particular discreditable attribute. It is called 'courtesy stigma' (*ibid*, p30). Those suffering from courtesy stigma face a double edged separation. They are outsiders to the group who directly suffer the stigma, yet may not enjoy the same rights as those unblemished with the attribute in the wider world (*ibid*, p31). It will lead to further techniques to manage the identity of both the stigmatised and those associated with them.

Whilst stigma suggests a strong discrediting attribute, such as physical impairment or a weakness of character (*ibid*, p4), Goffman concludes his writing with the observation that stigma is in fact

commonplace. It is a general feature of society, and he urges his readers to reflect that we all probably fall short of societal expectations in some capacity of our lives (*ibid*, p130). Viewed in this sense, the work on Impression Management in *The Presentation of Self* (1956b) and in managing Stigma (1968) resonate with the regular communication of between people, which can include the one way communication in the form of TV and radio (Burns, 1992), as well as financial communications from organisations. Goffman's work is suggestive that the human is but one form of self, and there is a 'corporate self' which evokes the themes that he uses in his studies of individual interaction (White & Hanson, 2002, p 290). It has been the foundation for a number of papers which look at the financial reporting process. It is very relevant for the quasi-nationalised banks that have suffered considerable reputational damage and must repair damaged relations with wider stakeholders. Thus, Goffman's work is used to analyse the banking crisis through the lens of financial reporting.

#### **4.4 Critical Discourse Analysis and the Language of Newspaper Headlines**

The third research theme considers the possible fulfilment of public accountability through the newspaper reporting of accounting results. Fairclough's critical discourse analysis is the theoretical lens used (Fairclough, 1995). Critical Discourse Analysis (CDA) sees linguistic construction as an important instrument in representing events and institutions (*ibid*, p14; Montgomery, 1995, p223), which may highlight societal values and ideologies (Thornborrow, 2006, p618) and is a tool which can highlight inequalities of power (McKay, 2006). It has become increasingly interdisciplinary in nature and considers other socio-cultural contexts alongside the consideration of media text (McKay, 2006, p598, Fairclough, p16). In this way, social construction of knowledge is profoundly impacted by language and guides our comprehension of the world around (Montgomery, 1995, p250).

The stance taken in this paper is that newspapers contribute to a construction of reality rather than just mirroring a reality (Fairclough, p18). In this way, mass media becomes a part of the event itself, rather than just reporting on it (Leitner, 1997, p187). As an important social institution holding Government bodies to account, the printed media have an important and powerful discourse within public life. The very nature of this discourse – unidirectional and delayed in time, means that the press have a very powerful role in shaping the discourse that occurs (*ibid*, p 188).

The normative proposition of CDA is to correct social wrongs in the world (Fairclough, 2010, p7). The emphasis on critique is to provide opportunities and analysis to strategies designed to improve the world (*ibid.*). The Global financial crisis provides an opportunity for CDA to critique the strategies of transforming neo-liberal capitalism into a more socially just capitalism (*ibid*, p18).

There are two levels of analysis in Fairclough's theory of CDA. These are the Communicative Event (e.g. a newspaper article or headline); and the Order of Discourse. Discourse is a key component of CDA, linking the individual texts of the study to the wider discussions and institutions about which the text refers. CDA is thus a relational study between actors and it contributes to the meaning of the world and how these meanings are made (*ibid*, p3). It is also dialectical, as it explores relations between two distinct entities.

Textual analysis is used to consider the discourse and 'genre' of the text to which it refers. Finally, it uses linguistic theory to analyse how the world is portrayed through its semiotic choices (*ibid*). For CDA, the linguistic construction of events contributes to the understanding of how that event is represented in the press:

"by studying the minute details of linguistic structure in the light of the social and historical situation of the text, to display to consciousness the patterns of belief and value which are encoded in the language – and which are below the threshold of notice for anyone who accepts the discourse as natural...any aspect of linguistic structure, whether phonological, syntactic, lexical, semantic, pragmatic or textual can carry ideological significance." (Fowler, 1991, p67).

In other words, linguistic analysis may help to excavate the ideology of the writer and to some extent, the reader. Ideology works by becoming part of 'common sense' (*ibid*, p67). Whilst lexical meanings are important, presuppositions, metaphors and coherence all are implied in texts (Fairclough, 2010). For media, this also includes sensationalism (Molek-Kozakowska, 2013). CDA embraces all these considerations by taking into account both the order of discourse and the communicative event being analysed. A full understanding of the communicative event requires an extensive knowledge of the order of discourse to which it is related. In a media setting, this includes the context of the press industry itself.

Fairclough's analytical framework draws upon the inherent tensions which are managed by media journalists between its public sources of information and its private target recipients (*ibid*, p63). The journalists must report on events which are part of public discourse and translate that to make it relevant for a domestic, individualised setting. He also notes the increasing competition for the media industry against 24 hour broadcasting news, the internet and other publications which have resulted in public information, useful for democratic purposes being increasingly turned into a mixture of information and entertainment (*ibid*, p10). Competition encourages newspapers to cater for the prejudices of their readership in order to strive for a larger part of business. This can result in bias as to what is reported in the news (Mullainathan and Shleifer, 2005).

CDA has been criticised for being overly theoretical rather than empirical (Thornborrow, 2006) and not considering the reception of readers on the discourse displayed. Yet the reader will always bring individual ideals to the construction of texts so the analysis of the actual text remains important

(Fairclough, p16). Moreover, the voice of the public is now increasingly recognised in the media output (Thornborrow, 2006, p616) as the printed press increasingly feel the pressure to entertain as well as inform in their outputs (Fairclough, 1995, p10; McKay 2006, p600). Another form of tension highlighted by Fairclough is the public/private nature from sources in the public domain to appealing to the predominantly private audience of individuals (*ibid*, p63).

Thus language has a profound effect on the way that reality is constructed by this privileged media discourse. In the discussion that follows, this study and other literature concerning newspaper headlines will be used to illuminate why and how such linguistic devices can contribute to readers' perceptions of the outside world. Various aspects of linguistics - Phonology, Syntax, Lexicon, semantics, Pragmatics and Text - are considered in turn next.

#### **4.4.1 Phonology**

Phonology in linguistics considers the speech sounds and pronunciation of a language. This occurs most obviously in speech interaction, but the internal monologue produced when reading text means that phonology plays a role in textual analyses as well. Indeed, phonological structure remains an extremely important part of the way that newspaper headlines are constructed. Arguably, phonology is particularly used in the tabloid end of the market where punning and clichés are well known. It has been argued that this is all designed to grab readers' attention and lure a purchase (Schaffer, 1995). However, punning and clichés also find their way into the broadsheet newspapers as well, despite the relatively meagre status puns are given in literary circles (Chovanec, 2005). Playing with words draws the reader in by giving the headlines a metaphorical meaning and interpersonally allows the reader to deconstruct the communicated meaning (*ibid*).

Punning and clichés can be constructed in a number of ways. A common device is homonymy—words which are spelt differently but sound the same. These can then be reinforced later in the headline by further words related to the same lexical field as the pun. Clichés can be reinforced by collocation based on cultural references (Chovanec, 2005).

#### **4.4.2 Lexical Devices**

Lexical devices relate to the vocabulary employed in speech and text. This is particularly important in a language such as English where vocabulary is diverse and can be chosen for various subtle changes in meanings. Instruments which use lexical devices include connotation rich vocabulary, which are chosen for their impact on the readers, to literary and poetic devices, such as alliteration, rhyming and assonance. In tabloids, literary techniques may serve to give warning about the potential inaccuracies of the stories that follows (Schaffer, 1995), although studies commonly highlight the similarities of linguistic approach from qualities to the tabloids (Jucker, 1992; Chovanec, 2005). Vocabulary is often hugely illuminating about the cultural attitudes of society as it allows categorisation of the news

items within (Fowler, 1991, p82). The representation of women in a sexual capacity and nuclear weaponry provide examples of lexical divergences (Montgomery, 1995).

#### **4.4.3 Syntax**

Syntactic analysis is concerned with positional make up of elements in a sentence and is not so concerned with the meanings of the phrases involved (Fowler, 1991, p77). Positions of the subjects in a passive and nominal syntax help imply responsibility on part of the agent and can reorient the subject of the story (*ibid*, p78).

Syntax has also found to be important in distinguishing different types of news stories from one another. A study into noun phrases suggested that syntactic structure contributed to flags which demarked each type of news section within papers and that this was also variable across market segments of the Press (Jucker, 1992).

#### **4.4.4 Semantics**

Semantics is a particularly important part of the linguistic creation of headlines and helps to direct the reader to the important points of the story. The study of semantics refers to the construction of meaning in a sentence, whether spoken or written. Indeed, it has been argued that the construction of the sentences rather than the lexical choices made is more illuminating as the choice of structure is less consciously chosen by the writer (Montgomery, 1995, p236). To this end, the transitivity of a verb is very important. Transitive verbs are often classified as one which takes an object, whereas intransitive verbs are ones without objects. However, there is further analysis in examining the *process* that the verbs designate, including whether they have an effect on another entity or which only affect the actor (Fowler, 1991, p 70 – 71). These may have certain connotations in reinforcing power or powerlessness in news subjects (*ibid*, p132 – 133); designating responsibility or blame (*ibid*, p79); and in reinforcing discrimination in gender (*ibid*, p96). In this way, the subtle choices in structure in a sentence can lead to quite powerful shifts in emphasis over time or from newspaper to newspaper (Montgomery, 1995, p238). This isn't just about reflecting ideologies, but in some ways contributes to these ideologies and beliefs systems held (*ibid*, p245).

Another important part of semantics is the use of nominalization, where a verb is made into a noun. This shortens the required information for a headline, which loses some of its informational value as a result but offers 'substantial ideological opportunities' (Thornborrow, 2006; Fowler, 1991). Nominalization omits participants and time out of the headline but retains its sense. This can turn an active state into a passive one (Fairclough, 1995). However, nominalizations can then act as participants in other processes; such as 'hunger' or 'crisis' and keep the actual subjects at a distance and abstracted (Fairclough, 1995). It may also add a sense of mystification or even reification for the relevant stories (Montgomery).

#### 4.4.5 Pragmatics

Pragmatics involves the study of linguistics in actual situations. Pragmatics predominantly relates to oral interaction and is less of a concern in textual analysis. However, previous empirical work on pragmatics can be illuminating in understanding the linguistic theory behind the newspaper headlines. Dor (2003) argued that the construction of the headline was a more artistic endeavour than a scientific approach. Knowledge in producing the headlines were of a practical rather than theoretical variety (*ibid*, p707). This involved having an intimate acquaintance with the readership of the publication – their thoughts, beliefs, prejudices – as well as a thorough understanding of the story being published.

All aspects of linguistic devices – phonological, lexical, semantic, grammatical and pragmatic can impact on the construction of newspaper headlines. The above discussion illustrates the reasoning behind why these items may be important in the current study. Overall, linguistics points to the creation of reality through newspaper headlines and not just reflecting, like a mirror, events that have occurred. Language is not neutral, in the same way that accounting is also not neutral. These studies demonstrate that the media reinforces cultural and institutional stereotypes perceived in the wider world, which reflect the dominant views of society (Chovanec, 2005; Leitner, 1997; Schaffer, 1995; Jucker, 1992; Fowler, 1991). However, critical discourse analysis does not reveal the ‘truth’ of a matter as semantics and syntax can be variable depending on context. Thus the researcher must have deep understanding of the context to work with the data such as newspaper headlines (Fowler, 1991, p 90).

Critical discourse analysis offers a unique perspective on accounting and its role in fulfilling accountability to the public via the medium of the Press. There is an opportunity to discern the ideologies surrounding the publication of corporate results by considering the newspaper headlines generated.

Four separate theories are being utilised in the analysis of the three research themes identified at the beginning of the thesis. Property Rights and Agency theory are used to interrogate accountability post crisis; impression management and stigma are being used for the banking crisis through the lens of financial reporting; and CDA is being used to consider newspaper headlines generated from corporate annual results. These theories are disparate. The relationship between theory and method is an essential consideration for all projects (Blaikie, 2000: 182) as differing epistemological parameters impact on the empirical focus of the work. This has implications for how the theories are handled with the data, and this is considered further below.

## 4.5 The Multiple Theory Approach

The use of multiple paradigms in organisational research has been advocated as a means of capturing the complexity and multifaceted nature of organisational life and may arrive at a more complete set of knowledge than single paradigms being employed (Gioia et al, 1990: 599). It appears that the UK banking crisis is complex and to allow a fuller version of events to be studied, multiple theories have been introduced into the thesis. However, the use of multiple paradigms remains a controversial issue, facing particular rejection from both functionalists, who favour the political influence of their own theory and postmodernists, who adopt a more flexible approach to research (Lewis & Grimes, 1999).

The thesis straddles the subjective/objective paradigms (Kakkuri-Knuuttila et al., 2008; Burrell G and Morgan G, 1979). Recent discussion in management accounting has suggested that research projects can successfully bridge this divide (Lukka, 2010; Modell, 2010; Kakkuri-Knuuttila et al., 2008). The differences between paradigms can sometimes be overemphasised without due consideration of the similarities (Kakkuri-Knuuttila et al., 2008). These include implicit hypothesis making in qualitative work (Ahrens and Chapman, 2006) and the establishment of causality in fieldwork (Lukka, 2010). This means that interpretive research has great potential:

“Interpretive researchers can do considerably more than simply describe and explore subjectively held meanings; often they can advance theoretically informed explanations”(Modell, 2010)

The researcher must decide whether the theories will sit on the boundaries of their respective paradigms, or sit at opposite ends of a spectrum. The latter allows the possibility of meta-theorising to be considered, though it poses the potential for considerable dispute if markedly different theories are chosen (Gioia et al, 1990). Even if no bridging work is built in to the design plan, the actual process of analysing data driven by the theories employed must be considered, particularly whether the two theories will inform the research sequentially or in parallel. Furthermore, how these findings then sit beside one another to form a coherent whole in the results of the study needs addressing.

The analytical process will utilise the theories separately in a sequential rather than parallel fashion. The sequential process offers the outputs of one theoretical analysis to inform the next, “allowing theorists to grasp their disparate yet complementary points” (Lewis & Grimes, 1999: 275). This potentially would allow a degree of dialogue between theories to occur and allow a more coherent thesis to develop. The price of complementary is the possible loss of distinctiveness between theories.

The sequential approach enjoys pragmatic merits as well. It allows in-depth analysis and absorption to occur with one consistent framework over a sustained period of time, reducing the risk of analytical and methodological confusion between theoretical stances. Parallel studies, with more frequent

switching of perspectives may be more open to such confusion. Secondly, findings from one perspective do not have to be fully unlearned in order to proceed with the second theory, which potentially allows a greater flexibility to occur in choice of perspectives utilised. Research findings may bring to light a particularly relevant framework which not been considered prior to the beginning of empirical work, which offer comparatively improved insights in the subject of study.

#### **4.6 Justification of Theories Selected**

The selection of theories used in the thesis was focused primarily on the identification of a problem in practice, rather than on the identifying of gaps in the theoretical literature. This gives the thesis practical relevance and prevents theory being driven forward solely because theoretical gaps exist (Corley and Gioia, 2011). This helps to contribute to the overall progress of theory in management research generally (*ibid* ) and eliminating theory from social sciences whose usefulness is questionable (Cole, 2001). Nonetheless, it is appropriate to reflect upon the theories being utilised and their appropriateness for the research context.

Therefore, this section outlines the rationale behind choosing of the theories. Each one is discussed in turn, considering the merits of the theory and their relevance to the particular research theme being pursued. In addition, rival theories which may offer explanatory potential are also briefly considered. The rationale for not using these theories is explained subsequently. A summary of the main attributes of the theories used, and other theories considered, are given in the tables 4.1 and 4.2 below.



**Table 4.1: Attributes of Theories Selected in the Thesis**

	<b>Property Rights Theory</b>	<b>Agency Theory</b>	<b>Impression Management &amp; Stigma</b>	<b>Critical Discourse Analysis: Media Discourse</b>
<b>Research Philosophy</b>	Positivism	Positivism	Phenomenology	Phenomenology
<b>Method of Analysis</b>	Predictive	Predictive	Interpretative	Interpretative
<b>Research Approach</b>	Deductive	Deductive	Abductive	Abductive
<b>Critical/Neo Liberal</b>	Neo liberal	Neo Liberal	Critical	Critical
<b>Focal Dimension</b>	Property Rights (Demsetz 1967)	Goals of principals and agents (Fama and Jensen, 1983; Fama, 1980; Jensen and Meckling, 1976)	Impressions; Stage; stigma; management of social interaction	Order of discourse and communicative events (Fairclough, 1995)
<b>Focal Dimension characteristics</b>	Ownership of attributes of property (Barzel, 1997)	Self-interest (Jensen and Meckling, 1976); Contracts (Fama and Jensen, 1983)	Performer 'gives off' best impression or to minimise social awkwardness (Goffman, 1968; , 1956a)	Semiotic make up of texts influences creation of knowledge (Fairclough, 2010)
<b>Normative Basis</b>	Common ownership encourages inefficiency (Garmin, 1960; Lee, 2006)	Goals of principals and agents can be aligned via contracts and incentives	An explanatory rather than normative theory	Critique of neo liberal capitalism (Fairclough, 2010, p3).
<b>Sources of Friction</b>	Unclearly defined property rights, externalities, transaction costs (Coase, 1960; Eggertsson, 1994)	Misalignment of goals between principals and agents (Jensen & Meckling, 1976); Conflict of interests between principals	Front stage and back stage performances; different audiences; visibility of stigma	Representation of events reinforces societal values and prejudices
<b>Role of Government</b>	Protect and enforce property rights	Enforcement of contracts	Every day interaction - no specific role identified.	Enforcer of free speech; institution who represents events.
<b>Perspective on public corporations</b>	Inefficient; restriction of individual freedoms on investment preferences (Geddes, 1997)	State ownership may not achieve social objectives any better than private enterprise (Shleifer & Vishny, 1997)	There are many facets of 'self' (Goffman); Corporations have 'selves' (White & Hanson, 2002).	News media influence perception and understanding of public corporations through language and representation

Table 4.1 shows the main features of the theories which have been utilised in this thesis. The following discussion justifies their use, based on the nature of the cases which are being studied.

#### **4.6.1 Property Rights Theory**

Property rights theory considers that public ownership of organisations leads to inefficiency in monitoring and organisation. Quasi-nationalisation allows this to be considered further as the implications of public ownership are discovered with a new ownership structure. Even though quasi-nationalisation is ostensibly a short term solution to the banking crisis with the aim of Government exit as soon as possible, this does not impact on the nature of public ownership identified by the theory itself. Despite Government intentions, the use of SOE for social or political objectives is still frequent (Kole and Mulherin, 1997). For instance, the negotiation of post crisis accountability is primarily centred on economic or political objectives, such as lending to SMEs and householders; and bankers' pay. This makes the case of the banks an excellent setting in which to consider the nature of public ownership through new accountabilities created by the Government as a major investor in the banking system.

In addition, the evidence supporting property rights theory at a detailed level remains conflicting. This suggests that there is a need to consider the applicability of the theory in more unconventional cases of public ownership, such as in the context considered here of quasi-nationalisation.

#### **4.6.2 Agency Theory**

Agency theory is one of the most influential theories used in accounting research. In this particular case, the nature of ownership has changed in terms of identity of the owners, but the overriding ownership structures have remained constant in that investment is achieved via equity ownership. Shares continue to be freely traded on the stock exchange. The banks continue to have equity ownership which influences management behaviour. Therefore, the negotiation of accountability post crisis based on economic and political objectives can be attributed to individual interests rather than the nature of the ownership per se. Agency theory offers a useful counterfoil therefore to analyse the implications of quasi-nationalisation for the banks.

Agency theory arguably is the basis for political thinking about the banks. There remains a belief in the private sector markets (Darling, 2008) and the monitoring achieved by the Government agency, the UKFI, as similar to an institutional investor (UKFI, 2009)<sup>8</sup>. Moreover, the nature of the response

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<sup>8</sup> Institutional investors themselves generally adhere to the provisions of the UK Corporate Governance Code (2008). The UK Markets are generally accepted as part of the Anglo-American system with a diversified shareholder base, and the concept of the separation of ownership and control under agency theory is applicable to these corporations

to the crisis was shaped by concerns over ‘moral hazard’ by the Bank of England (Bank of England, 2009).

### **4.6.3 Impression Management**

Impression management is associated with the financial reporting literature and its attempt to interpret disclosure. Nonetheless, there exists a gap in the research carried out to date, as described in chapter five. This centres on the means by which the theory has been deployed. In other words, it has been used to look at attributes of annual reports, such as graphs or pictures. There is potential to join up these attributes and look at the annual report as a whole. The current case studies offer the potential to examine the usefulness of this theory by applying it in a holistic manner to the annual reports of the banks.

### **4.6.4 Critical Discourse Analysis**

The analysis of the media communication in the financial reporting context is still relatively new. The empirical analysis conducted on newspaper headlines in fact extends the realm of accounting research beyond the annual report or the press releases produced by corporations. As a result, the accounting displayed in the media is not controlled by the accountants who produce these numbers. Therefore, an understanding of how media discourse is created is essential for researching the forms of accounting featured in the press.

Critical discourse analysis does not give an explanation for events as they stand. Rather CDA offers up the idea that the representation of these events contributes to our construction of knowledge. Without an explanatory context, critical discourse analysis is a useful descriptive theory for the research agenda. Further research in the future could consider the use of additional theories to help explain the phenomena considered.

Now that the rationale for using these theories have been discussed, the chapter turns briefly to some other possible theories which showed potential for being used in the analysis. These are shown in the table below. A very brief introduction to these theories is also shown, with reasons for excluding these from the analysis.

**Table 4.2: Attributes of Alternative Theories Not Used in the Thesis**

	<b>Frame Analysis</b>	<b>Corporate Decline &amp; Turnaround</b>	<b>Blame</b>	<b>Marxism</b>
<b>Research Philosophy</b>	Phenomenology	Positivist	Phenomenology	Contested; Positivism (McLennan, 2001, p50)
<b>Method of Analysis</b>	Interpretative	Predictive	Interpretative (Hood, 2010, p120 - 122)	Historical Materialism (Antonio, 1999, p9)
<b>Research Approach</b>	Abductive	Deductive	Abductive	Deductive (Bryer, 1999)
<b>Critical/Neo Liberal</b>	Critical	Neo liberal	Critical	Critical
<b>Focal Dimension</b>	Individual understanding of situations based on 'frames' (Goffman, 1974, p21)	Innovations; Risk Avoidance; business performance (McKinley <i>et al</i> , 2014)	Blame Avoidance Techniques; claiming credit; negativity bias (institutionalised in the media) Hood, 2010, p 10	Commodities; Capital Means of Production (McLennan, 2001; Antonio, 1999, p22)
<b>Focal Dimension characteristics:</b>	Frames based on prior experience which help understand present situation: keys (Goffman, 1974, p45)	Business response to decline may cause further downward spirals or may allow organisation to turn around.	Preference in politics in avoiding blame, even at the cost of claiming credit. Blame avoided through three strategies: presentational, agency & policy Hood (2010, p16)	Exploitation of the Proletariat by the bourgeoisie (Antonio, 1999, p17)
<b>Normative Basis</b>	The frames by which the individual is convinced of truth in a situation can be manipulated to a fabrication (Manning, 1992, p126)	The study of decline and turnarounds is of practical use to businesses	Blame avoidance has negative effects, but also helps to regulate behaviour (Hood, 2010, p184).	Critique of neo liberal capitalism; freedom occurs in post capitalist classless societies (McLennan, 2001, p49)
<b>Sources of Friction</b>	Keying, rekeying and fabrication	Deciding when to use innovation or risk avoidance as a turnaround strategy	Negativity bias in institutions; credit and blame	Conflicts of interests between the capitalists and labour (McLennan, 2001; Antonio, 1999, p28)
<b>Role of Government</b>	Part of social interaction; provider of 'keys'	Regulator and enforcer of markets	Blame Avoidance an important aspect in understanding Government	To help improve situation of working class (McLennan, 2001, p49)
<b>Perspective on public corporations</b>	Public corporations may help shape 'keys' e.g. military behaviour in social interaction (Manning, p134)	Public sector corporations also subject to decline and turnaround projects	Blame Avoidance is a feature of bureaucratic and political life, at all levels of the institutions (Hood, 2010, p22)	Communist system will replace capitalist economies (McLennan, 2001)

Table 4.2 above shows the attributes of some alternative theories not utilised in the thesis. A brief introduction to each of these theories is given below, along with the reasons for not using them for the empirical research of the thesis.

#### **4.6.5 Frame Analysis**

*Frame Analysis* (Goffman, 1974) can be seen as an extension of many of the principles that Goffman used in the *Presentation of Self* (1956) (Manning, 1992). The basic tenet of the theory is that 'Frames' allow individuals to define the observations of what is going on around them. Frames provide a way of organising experience (Manning, 1992). Goffman uses observations and metaphors to expound the validity of his theory: for example, otters at a zoo may fight with each other, or they may pretend to fight; understanding which is occurring depends on 'keys' (Goffman, 1974). Keys arise whenever the frames' meanings are transformed into something patterned on, but independent of, them (Manning, 1992, p123). Goffman discusses five different types of key (1974, p48) but he also identifies how keys may be wilfully deployed in order to create a fabrication for an unsuspecting individual (*ibid*, p84).

Framing has been used to understand the nature of financial reporting and auditing in the public sector (Christensen and Skærbæk, 2007; Skaerbaek, 2005). Nonetheless, impression management and stigma are more often associated with the private sector corporate reporting context and a gap in this literature will be identified, justifying its use on theoretical, as well as empirical, grounds.

#### **4.6.6 Corporate Decline and Turnaround**

The notion of corporate decline and turnaround has been increasingly adopted in the literature, which strives to explain successful corporate responses to declining organisations. Turnaround literature is used to describe and model organisations facing substantial decline and their response in order to improve performance. The descriptive model, in various iterations, has been tested against large scale studies in empirical analysis (Trahms et al., 2013).

Turnarounds may be based on innovations within the organisation. Alternatively, they may arise through risk avoidance (McKinley et al., 2014). However, the path towards increasing success is challenging, as both risk avoidance and innovation may cause a further downward spiral rather than a turnaround (*ibid*). There have been recent calls to continue the

theoretical development of turnarounds in organisations, including within the public sector (McKinley et al., 2014; Jas and Skelcher, 2005). The turnaround model may also use other theories to explain and analyse managerial responses to organisational decline (Trahms et al., 2013). These include stakeholder theory, resource management theory and agency theory (*ibid*).

The HBOS and RBS situations are well suited to giving interesting insights into the management of organisational turnaround. However, the purpose of this thesis is to consider the public accountability of the organisations, rather than focus on the operations put in place to counteract challenges. For this reason, the turnaround literature could be seen as tangential to the primary research themes in focus here.

#### **4.6.7 Blame Game**

The notion of blame and its avoidance has been advanced as a key tool for understanding Government actions and policy, which may otherwise appear as ‘baffling’ behaviour (Hood, 2010). Blame avoidance may be understood through three techniques: Presentational strategies, such as ‘spin’; agency strategies, where a person is used as a direction for blame if failures occur; and policy strategies, whereby policy is formulated so as to attract as little blame potential as possible (*ibid*, p19).

The technique of blame avoidance through presentation strategies such as media management and spin could be useful in the analysis of accounting data in the headlines. However, the blame literature is primarily focused on public organisations and their response to blame, rather than on the phenomena creating that blame in the first place. As a result, blame has not been utilised in this thesis, although it may offer potential for further research in accounting and the media.

#### **4.6.8 Marxism**

Marxism also considers the properties of ownership under the capitalist system. The problems of capitalism largely stem from the class system. The owners of capital, the bourgeoisie, exploit the working class’ labour for their own ends. Marx and Engels predicted that the capitalist system would be replaced in the long term as the proletariat were able to accumulate power. However, the collapse of the Soviet Union in the late 1980s called the accuracy of these predictions into doubt. Moreover, Marx’s concept of class was never defined (Antonio, 2003; McLennan, 2001).

Whilst the banking crisis has created a huge challenge for Western capitalism, the concept of defining class is problematical for this thesis. For instance, some of the bankers involved have accumulated high net personal worth. Moreover, they may act as both capital providers to the banks and as part of the proletariat giving up their labour. For this reason, the use of Marxism has not been used in this thesis.

#### **4. 7 Concluding Remarks**

This chapter introduced the theoretical frameworks for the thesis. These are property rights and agency theory to assess the negotiation of accountability in the quasi-nationalised banks; impression management and stigma to analyse financial reporting of the banks; and critical discourse analysis and the language of news to consider newspaper coverage of the banks' financial results. How the theories are handled has also been discussed, with a sequential process considered appropriate. Now that the theoretical frameworks have been introduced for studying the accountability of the quasi-nationalised banks has been established, previous research using them is discussed in the next chapter.

# Chapter 5: The Theoretical Frameworks and Accounting Research

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This chapter is concerned with the theoretical tools by which the quasi-nationalised banks can be analysed. The works cited employ relevant theories to this thesis. These will be used to evaluate the contemporary situation for the banking industry.

The chapter is structured as follows. The first section considers the application of property rights theory in public sector settings. In the second section, agency theory is considered, with a particular emphasis on its public sector implications. Ownership and governance structures contribute to the understanding of how financial reporting may be affected in RBS and LBG. Thus, research in Impression Management and Stigma is discussed in section three. This establishes a solid empirical base from which financial reports in the banks can be analysed. Finally, the means by which finances are reported via the media are discussed. Media coverage encompasses both the political and financial status of the banks and contributes to fulfilling the banks' public accountability.

## **5.1 Empirical Studies using Property Rights Theory**

Property Rights Theory is critical of common ownership of resources. A number of studies thus have tested the applicability of property rights by comparing private and public sector companies. However, some studies go further and consider the management motivations within the companies as well. Part of this is recognising that Government is also essential in enforcing the structure of private property rights.

Whether a private or a public corporation is more efficient has been a central concern under the remit of property rights theory. Empirical results are varied. Large scale studies tend to conclude that private corporations are more efficient than other forms of ownership (Dewenter and Malatesta, 2001; Megginson and Netter, 2001; Boardman and Vining, 1989). As a hybrid of private and public, mixed enterprises also are less efficient than singularly private corporation (Boardman and Vining, 1989). Competition helps to increase



productivity in the SOE but even controlling for this factor, the private corporations still outperform. The difference in efficiency can be dramatic (Dewenter and Malatesta, 2001).

In addition, there is evidence that the market reacts negatively to Government interference through share ownership. When private company Domtar was suddenly and secretly taken over by the Quebecois Government there were significant abnormal returns in the share price (Boardman et al., 1986). The market was anticipating socio-political objectives of the Government impacting on profitability (Boardman et al., 1986). Expenditure on political campaigns and priorities may also contribute to the expense in public corporations (Crain and Zardkoohi, 1978).

Private corporations consistently outperformed SOE and mixed ownership companies, even for controlling for factors such as size, country and regulation (Boardman and Vining, 1989). Likewise, an examination of water utilities in the US found that the companies who switched from public to private ownership increased productivity (Crain and Zardkoohi, 1978). The same study demonstrated that the public water entities have higher operating costs and a lower marginal product than the private counterparts (Crain and Zardkoohi, 1978), thus reinforcing that the privatisation process encouraged efficiency. In a comparison between two very similar airlines operating in the same market, the privately owned enterprise also fared better in terms of productivity and revenue per employee (Davies, 1977; Davies, 1971). Arctic exploration ventures were often more successful when privately funded (Karpoff, 2001). Achievements were generally greater and crew members suffered less ill health and deaths than publicly funded ventures. They were also much smaller. The findings were attributed to poor leadership, slow adaptability to new information and diverse incentives amongst expedition members and the public funders (Karpoff, 2001).

The impact of competition rather than ownership seemed to be an important factor in other studies. The Canadian Government took over several failing railroad companies and ran these competitively alongside another privately owned corporation. After the initial years, there appeared to be no discernible difference in the relative efficiency of the two corporate forms (Caves and Christensen, 1980). Likewise when the US Government was an arms-length shareholder in companies in the immediate post war period, it appears to have made little impact on efficiency compared to privately owned corporations (Kole and Mulherin, 1997). Re-privatisation did incur some initial inefficiencies but these were attributed to merger activities (Kole and Mulherin, 1997). A cross-sectional study found that increases in

former SOEs' productivity generally arrived in the three years leading up to privatisation (Dewenter and Malatesta, 2001) and did not increase largely beyond the change in ownership. The relationship between ownership and efficiency is thus still controversial, particularly when competition and change are carefully examined.

Studies using property rights theory extend to the impact on management under differing corporate ownership structures. These have found that managerial incentives are also altered by the ownership structure of the corporation. Management do not consider long term benefits from investments as the future benefits of these projects will not be represented in a present value of the firm (Crain and Zardkoohi, 1978). There will be opportunity costs as management cannot directly benefit from any increase in efficiency in the firms. To overcome this, further controls and rules are required to regulate behaviour (Clarkson, 1972). Without an overarching incentive to maximise their own wealth, workers will engage more in the pleasant aspects of the job even if these are not as valuable as other activities (Clarkson, 1972). In the hospital setting, jobs such as monitoring and credit control were less intensively carried out when there is no profit incentive (Clarkson, 1972). Collective decision making was also found to have resulted in less publication outputs in a university setting. Exam results and publications were down when faculty in the university also had managerial responsibilities (McCormick and Meiners, 1988).

The Government's role as enforcer of private property rights is also critical. Unclearly defined property rights can lead to inefficiencies and multiple negotiations in order to capture new aspects of property. Libecaps's (1978) study of mineral extraction demonstrated an increase in lobbying activity by mine owners if opportunity arose. However, this lobbying had to provide a net benefit to them. Once property rights were sufficiently delineated, lobbying and other activities were curtailed. Riker & Sened's (1991) research on airport slots demonstrated the importance of there being political incentive for the property rights to be recognised by the State. For these airport slots, the Government would benefit financially.

Thus, property rights have considered carefully the relative efficiency of public, private and mixed ownership enterprise. Overall, the large scale studies have found the private sector to be the most efficient, but particular circumstances in case studies presented alternative considerations as well. The next section considers agency theory and its relevance for studying the quasi-nationalised banks.

## 5.2 Empirical Studies in Agency Theory

Agency theory (Jensen, 1994; Fama and Jensen, 1983; Jensen, 1983; Watts and Zimmerman, 1983; Jensen and Meckling, 1976) is one of the most influential theories in accounting (Pina et al., 2012). Each facet of the theory of the firm has generated streams of pertinent literature and there is a large body of evidence confirming its applicability to organisational life (Eisenhardt, 1989). This section considers previous empirical research on agency theory, with a particular focus on the public and banking sectors. The emphasis is on the implications of agency relationships.

Empirical studies in the public sector have used agency theory to consider the accountability of organisations. The use of economic reasoning and the related postulates of agency theory are increasing in the public sector as NPM initiatives gain in popularity. Accounting becomes central to the task of holding resource users to account (Broadbent et al., 1996). However, there has been a focus on the description of agent behaviour rather than a more normative discussion on the best design of accounting control systems (Broadbent et al., 1996). Information asymmetry becomes problematic in enhancing control. Ex ante controls require the principal to have an understanding of the agents' actions prior to them being carried out. Ex post controls such as monitoring activities have reduced effectiveness as actions have already been carried out (Broadbent et al., 1996). Indeed the very application of principal-agent theory may be problematic in the public sector. The demands of principals may clash with the deep seated values of the agents, such as doctors, which undermine the professionalism of the agents (*ibid.*).

As the parties to whom the organisation are accountable become more diverse, there are consequences in agency theory analysis (Benz, 2007). Multiple agents mean that decision making becomes more problematic, as consensus and negotiation are required. Stagnation can result. Moreover, agents may selectively use the 'blame game' to allay responsibility for decisions made. Finally, information asymmetry can result in decisions being presented as inevitable. Principals are then deprived of an opportunity to reject a decision (Benz, 2007).

Problems also arise in the case of multiple principals (Benz, 2007). The interests of principals are diverse. Individual interests must be balanced with those of other principals'. Even then, these may not be compatible, increasing the difficulty of the agent in fulfilling goals. Nonetheless, agents will try and follow the demands of principals if the alternative is

to face punishment. Control of agents must be collectively achieved which may require coordinated efforts for them (*ibid*, p508). Information must thus be shared among all principals and all agents to enable transparency. Responsibilities must be decentralised as far as possible to avoid conflicting demands by principals (*ibid*).

It is well established empirically that agents engage in earnings management to demonstrate good operating performance in the private sector. In a large scale survey, earnings smoothing is the main mechanism for management by private sector executives (Graham et al., 2005). Nevertheless, positive business actions rather than accounting techniques were preferred to help with earnings management (Graham et al., 2005). It was clear that career advancement and personal reputation were significant part of agency costs in the survey (*ibid*, p27). The incentives to do so are an increase in earnings, prestige and reputation.

Public sector management may also engage in earnings management. These have distinct incentives. Earnings management may assist in demonstrating the meeting of objectives; justifying funding and to meet targets (Pina et al., 2012). Management of earnings may employ different techniques to the private sector. For example, balancing the books means that future generations of taxpayers are unencumbered with historic deficits. On the other hand, large surpluses may be avoided to ensure that taxation rates do not appear excessive (Pina et al., 2012). Empirical evidence for the UK executive agencies suggested that earnings management techniques were used to lower operating costs in service delivery (*ibid*).

In US hospitals, ownership structures provided an explanation for the response of hospitals to Government initiatives (Duggan, 2000). The study considered three types of hospitals: Government owned; private sector, for profit organisations and private sector, not for profit organisations. In the USA, incentives were aligned for the private sector hospitals, whether they were for profit or not for profit organisations. In fact, not for profit organisations sometimes had greater profits than their for profit counterparts. Their actions to changes in Government policy were similar. Government owned hospitals that did not benefit from changes in revenue funding, did not change activities in response to the new initiatives. This suggested that the distinction in behaviour was based on ownership rather than profit (Duggan, 2000).

In contrast, a search on earnings management which considered the relationship between unexpected depreciation levels and breakeven/near breakeven net earnings had no results. There was some evidence that management of depreciation was used to adjust financial performance to receive higher capital contribution (Pilcher and Van Der Zahn, 2010).

The annual report may employ a different status in the public sector. In Italy, however, the actual role of the annual report was limited. It was used primarily to fulfil internal accountability requirements. It had minimal voluntary disclosure (Steccolini, 2004). The use of the annual reports was the only means of citizen- enabled accountability. That the role of the annual report in normative terms is central:

“The annual report might represent a fundamental medium to ‘close’ the accountability cycle, by allowing stakeholders to monitor and evaluate governmental activities and results and to involve them in the definition of governmental goals” (Steccolini, 2004)

The lack of consideration in the annual report of these other stakeholders could be seen as worrying for democratic accountability. This is particularly the case if pay is related to performance.

Empirically, the relationship between pay and performance has been varied. In an early paper, the lack of sensitivity in the pay –performance relationship was noted and it was hypothesised that political incentives were dampening any attempts for high level pay (Jensen and Murphy, 1990b). Since this hypothesis was created, the pay performance link has been enhanced during the 1990s (Hall and Liebman, 1998). Stock values and stock options were the mechanisms by which pay-performance linkages were expressed (Hall and Liebman, 1998). Nonetheless, there could be improvements to the sensitivity of pay to performance (*ibid*). In banks, compensation has been found to be similar to other industries, and did not encourage excessive risk taking (Houston and James, 1995). Deregulation of the banking industry helped to increase the relationship between pay and performance (Hubbard and Palia, 1995). Whilst pay and performance of the banks has found to be significantly correlated in more recent years, the overall loan quality of the banks has declined. This helps to identify that managers made huge bonuses on the back of risky loan taking which contributed to a long term decline in banking performance (Grove et al., 2011).

### 5.3 Agency Theory and the Banking Sector

There are particular concerns in the banking sector which may arise due to agency problems. One of these is related to the use of deposit insurance, a widespread Government policy designed to help stem bank runs and dampen banking crises. Deposit insurance was regarded as a valuable public policy tool to avoid bank runs without impacting on the smooth running of the banks generally (Diamond and Dybvig, 1983). The agency theory concern is that there is an increase in moral hazard. Managers indulge in excessive risk taking as the cost of failure is decreased. Moreover, capital market discipline weakens in the knowledge that losses will be socialised.

Empirical studies have found that unlimited deposit protection insurance schemes help to dampen the effects of banking crisis (Angkinand, 2009; Dell'Ariccia et al., 2008; Hoggarth et al., 2005). However, there is a cost to this guarantee, as it makes the banking system weaker and increases the chances of a banking crisis actually occurring (Hoggarth et al., 2005). The increase in risk is pertinent as banking crises can be economically devastating, with countries losing 15 – 20% in GDP on average (Hoggarth et al., 2002). They are particularly costly for developed countries as well (*ibid.*). Nonetheless, the absence of any deposit insurance scheme at all actually *increases* moral hazard. In a crisis, the Government is pushed towards full blown guarantees. Thus the absence of insurance was not regarded as credible (Hoggarth et al., 2005).

The relative efficiency of private and public banks has not been subject to much study (Altunbas et al., 2001). In the German market, there appeared to be no decline in efficiency for publicly owned or mutual banks compared to their private sector counterparts (Altunbas et al., 2001). In contrast, another study concluded that mutually owned banks were less efficient, as managers were able to pursue their own agendas without much monitoring from the principals (O'Hara, 1981). In Belgium, a direct comparison between a private and public bank found the public bank to be the more efficient. No reasons were given as to why this would be the case (Tulkens, 2006).

Agency theory has also considered Government ownership of banks. In this regard, it resonates with property rights, as the relative efficiency of the sectors is compared. In a sample of 92 countries, who all had enduring State ownership over 20 years:

“We find that higher government ownership of banks is associated with slower subsequent development of the financial system, lower economic growth, and, in particular, lower growth of productivity. These results, and particularly the finding of low productivity growth in countries with high government ownership of banks, are broadly supportive of the political view on the effects of government interference in markets.” (La Porta et al., 2002)

Further studies have confirmed less efficient State owned banking (Lin and Zhang, 2009; Berger et al., 2009; Sapienza, 2004) . However, these all involved multi country analyses and primarily located within developing countries. A study which directly separated out the performance of Government ownership in banks between developing and industrial countries found no significant correlation between ownership and performance (Micco et al., 2007). In a more recent study, Government owned banks were associated with higher long run growth rates than privately owned banks (Andrianova et al., 2012). Nonetheless, there may be implications for the UK on performance as a result of Government pressures. A study in Italy found that State owned banks charged lower interest rates than their private counterparts and may also choose to fund non profitable loans. This was attributed to political patronage, particularly in the south of Italy (Sapienza, 2004).

Thus there are agency implications for the banking sector, as well as public sector analysis. These include the consideration of deposit insurance and moral hazard as well as the relative efficiency of Government owned banks. Public sector analysis considers the implications of the relationship between public sector agents and principals. There is extensive scope for considering the impact of Government ownership on the quasi-nationalised banks as a result.

## **5.4 Stigma and Impression Management in Accounting Research**

The second research theme considers the banking crisis through the lens of financial reporting. A means of considering attitudes to financial reporting can be found in impression management. There have been three levels of analysis in this regard. The first has looked at the impressions generated through features of the financial reporting process. These could be pictures, graphs, narrative or numbers. Goffman considers that these impressions are generally favourable of the performer (1968, p19). Likewise, the annual report has been recognised as a self-promotion document for companies (McKinstry, 1996; Lee, 1994). Secondly, there has been research which considers the audience reaction to the impressions generated. This echoes Goffman’s ideas of adaptability and flexibility of the impressions projected (1968 pp 45 – 49). Finally, there is a smaller body of work which has concentrated

on the relationship managers have with the impressions generated, seeking to tease out the contingencies of producing the report for final consumption.

#### **5.4.1 Researching the Substance of Impressions: Features of Impression Management**

The design of annual reports has been shown to be increasing concern of management and has contributed from turning the annual report into a public relations document (McKinstry, 1996). Here the annual report is to present the company in the best possible light. In its eagerness to do so, however, the promotional material may overshadow the original purpose of the annual report which is to present the audited financial statements of a company (*ibid*, p110).

Research utilising positive methods and statistical techniques have shown the applicability of Goffman's insights into many facets of financial reporting. There have been a number of studies which demonstrate that there is an emphasis on good news, whilst downplaying the negative news in the accounting documents (Neu *et al* 1998, Merkl-Davies *et al* 2011). This included the ability to predict good news in the future as well (Pava and Epstein, 1993). Football clubs provided remarkably upbeat reports on performance despite having substantial financial problems (Morrow, 2005). This bias in positivity was not just restricted to finances but extended to the environmental reporting as well (Deegan and Gordon, 1996).

The emphasis wasn't just on positive aspects of company performance. Impression management has also been considered with regard to readability (Courtis, 1998; 2004; Linsely & Lawrence, 2007). Technical language may help to distance management from poor performance, and thus made negative disclosures less easy to read. Failed companies were significantly correlated with less readable documents (Smith & Taffler, 1992). Poorly performing companies looked to focus on the future rather than past results (Clatworthy and Jones, 2006). Moreover, results were blamed on external factors, such as the economic environment (Clatworthy and Jones, 2003).

Images have also been considered using computer assisted research techniques. Graphs have been demonstrably adjusted so that they emphasise positive trends (Beattie & Jones, 1992, 1999, 2002, Godfrey *et al* 2003). This may include selectivity of what information is shown in graphs as well as measurement distortion (Jones, 2011).



The legacy of this literature provides a strong evidence base that impression management by means of emphasising positive features of company performance and results and the minimising repercussions of negative features impacts in a plethora of ways on the overall presentation of results by companies. As a result of this, the readability of the annual report has been found to be very difficult (Courtis, 1998; 2004; Linsely & Lawrence, 2007). Consistent replacement of the performance measures produced by State bodies rendered it near impossible to establish trends or assess achievements against targets. This in turn led to less, rather than more, effective accountability (Carlin, 2004).

More recently, annual results press releases have been found to be improved by strong corporate governance mechanisms to reduce self-interested disclosures by managers, seeking to emphasise good performance and minimise the repercussions of bad news (García Osma, & Guillamón-Saorín, 2011). This may be reinforced verbally in analyst meetings (Westphal and Graebner, 2010).

Turning to photography, Preston *et al* (1996) introduce ways of seeing images in annual reports through a number of perspectives. This introduces the plethora of techniques for giving messages in the annual report. These include the projection of an intended corporate message, not only of the strengths of a company, but also in acknowledging poor performance and of responsible management in responding to it (*ibid*, p118). It may also serve to refute or diminish negative perceptions of a company, such as one which causes environmental damage (*ibid*, p119). Images nonetheless can be more critically perceived, particularly as they may overwhelm the more substantive depth of the reports by their accessibility. Images may also produce multiple meanings depending on the viewer's background (*ibid*, p122), including through items absent as well as present within them (*ibid*, p123). Finally, they may constitute as well as replicate social and institutional structures (*ibid*, p130).

Davison (2009) tracks the use of the Bowler Hat as part of Bradford & Bingley's branding through the 60s right to the present time when it has failed and held in Government ownership. The brand images are connected to and shaped by the changing business mix of the bank as well as reflecting greater societal changes within the UK. The images also inform and analyze the lack of internal brands allowed to be captured through accounting regulations. In so doing, the presence of the internal brand is emphasized yet not captured in the substantial financial statements provided in the annual report as well.

Impression management has thus allowed great insight into the financial reporting process by providing a framework of analysis for annual reports. This next subsection considers impression management in light of the audience receiving the information from the corporations thereby extending the impact of Goffman's ideas.

### **5.4.2 Managing Audiences**

In depth case study research reveals that corporations engage in a variety of impression management techniques which adapt to different audiences over time. The 'self' is adapted to individual values and circumstances. In so doing, it is both 'situational and multiple'; thus it is more practical to review corporate reputation in the multiple rather than in the singular (White and Hansen, 2002, p299). By recognising multiple audiences and their concerns, the company expresses principal ideal aims which are flexible and rely on tacit background knowledge (*ibid*, p293). The company also requires the audience to invoke their tact. In the case analysed by White and Hanson, invoking tact allowed the company to be subdued in information about a European venture failure and so maintain poise (*ibid*, p297). Furthermore, stigmatising attributes are first of all met with silence, but when they are uncovered, the company responds by covering dirty work and couches the polluting effects of its businesses into a strength of the company (*ibid* p298).

For Neu *et al* (1998), considering who are the relevant publics interested in these disclosures within the annual report and the differing communication strategies that may be used is an important aspect of analysis (*ibid*, p268). In the environmental field, the relevant publics include not only financial stakeholders, but regulators and environmentalists, the latter of whom may be critical of firm activity. These divergent interests result in ambiguity about the message that is sent in the annual report. The strategy involves addressing supportive publics and dismissing claims made by critics. This leads to an acknowledgement of the partiality of disclosures (*ibid*, p272) which can accurately portray aspects of performance but also serve to obfuscate. As a result interpretation of disclosures can be difficult. Communication strategies help to address the relevant publics in 3 ways. These include highlighting positive organisational activities; re-framing actions made visible by powerful constituents, so that attention is diverted elsewhere or to a particular aspect of these actions; and finally by ignoring actions made by less powerful parties (*ibid*, p274). These strategies are designed to influence the way that interested publics feel or know about the corporation.

Longitudinal research has pointed to the changing discourses employed by companies in areas of public concern. Management do appear to respond to an increase in societal concern with the environment with increased disclosure although critical publics shut this process down. In reviewing environmental disclosures in a selection of Finnish companies, the discourse turned from polyphony of environmental ideals to one which is more integrated with the dominant ideologies as they develop over time (Laine, 2010, p269).

### **5.4.3 The Relationship between Management and the Impressions Generated**

Impression management has also stimulated research into the relationship between management of companies and the reporting of corporate performance. Impression management can be used to reinforce management priorities, such as board or structural changes. It may also assist in understanding management responses to crisis. Furthermore, financial reporting may help management understand corporate events. Merkl-Davies et al (2011) focus on the more social aspects of impression management. Managerial behaviour in corporate reporting can be analysed by an accountability framework where annual reporting can be a process to react to others. With regard to the chairman's report, there is empirical evidence in enhancing positive outcomes in the companies and some degree of retrospective sensemaking. There is no evidence found for reporting which is at odds with management internal perceptions of the way the organisation is performing.

A change in CEO leadership was found to lead to impression management in the presentation of graphs, particularly within larger firms and in a positive manner in the year following the change. (Godfrey et al, 2003). In addition, CEOs will engage in verbal impression management. CEOs align the corporation with societal norms regarding, for example, corporate governance best practice. For the authors, the verbal reinforcement of financial market wisdom allows the legitimacy of the corporation to be increased without substantive change to corporate governance practices or procedures within the company (Westphal and Graebner, 2010).

Hospitals have also utilised impression management techniques to assist in justifying and introducing structural innovations to other stakeholders (Arndt & Bigelow, 2000). Impression management helps the authors explain how such changes are communicated in a way that stakeholders can relinquish the hospitals from a taken-for-granted structure to one

which is designed to better fit their needs. This was done by emphasising the essential nature of the changes induced by external pressures, into a new, carefully thought out structure where the pioneering nature of the changes were downplayed to increase acceptance (*ibid*, p511). Thus, the reforms become increasingly accepted by the audience through these techniques.

Top management and their approach to impression management to reinforce the corporate image are critical when entities face a period of great change or the stigma of bankruptcy. Goffman's stigma management was a useful framework to consider the actions of CEO's in computer companies in the US after filing for bankruptcy. The company suffered a loss of reputation which led to denigration and disengagement from customers, suppliers and competitors (Sutton & Callahan, 1987). Moreover, the CEOs suffered considerable personal loss to their reputations, which was also experienced by their families in a form of courtesy stigma (*ibid.*) Four means of managing the stigma of the bankruptcy filing are identified. The first and most common means was to conceal the news of the chapter 11 for as long as possible, to avoid jeopardising business relationships (*ibid*, p422). If this was not possible, then companies chose to either define the filing as a thing happening to everyone or denying responsibility – by suggesting that the filing had been forced upon them through extraneous events (*ibid*, p427). These all had the option of backfiring if the audience were not inclined to be sympathetic to the companies and if this involved misrepresentative behaviour could suggest that other events the company related could not be trusted. Accepting responsibility, on the other hand, was a more functional approach as it allowed sympathy to be gathered from the audience. Despite this, it was often not utilised by CEOs (*ibid*, p429). Finally, some CEOs chose to withdraw from the situation either on a temporary basis or permanently, although this only had the effect of confirming the validity of the stigma.

Neu & Wright (Neu and Wright, 1992) use Goffman's stigma management to explain the response of the audit profession to the failure of Canadian Commercial Bank in the late 1980s. Despite the popular blame being aimed at the individual auditors responsible for the clean opinion prior to the bank's collapse, the professional bodies chose to get involved and respond to the enquiry as well. This was to help safeguard the reputation of the auditing profession. However, the strategies of managing stigma such as scapegoating the chastised members or re-educating the public were not present in this situation. It was the power of

the auditors in the limelight and their consistent stories on professional standards which meant that the auditors retained professional membership.

In the public sector, annual reports may take on a different nature. They may be seen as an administrative communication between agencies, hidden away from the intended reader, the citizen (Christensen and Skærbæk, 2007). In this study, the financial reporting over time became increasingly distant from its intended purpose, which was to inform citizens. Instead, preparers anticipated that the reports would instead be used as part of the cost cutting agenda of central Government. To prevent calls for investment in certain areas, results were published without interpretation or context. Thus, assessing performance can be hindered not only by the hiding of information from the public eye but also by the nature of information produced. Accounting is thus used to obfuscate as well as inform. It can be used passively, fulfilling regulatory requirements and its status as a dispassionate neutral account, presenting as tedious reading to parties (Skaerbaek, 2005). Transparency is not always positive in this regard. The requirement to disclose the Northern Rock support from the Bank of England as Lender of Last Resort is one example of the ill effects of transparency (Roberts, 2009).

Overall, impression management has cultivated many different perspectives on management actions and impressions created via the financial reporting process. A particular issue for the thesis is the impact of an ownership change. Previous literature has suggested that ownership may affect the company's impression management in two distinct ways. On the one hand, the ownership of the company is expected to exert a degree of control on the output and design of communications even if there is separation to control and management by agents (Garcia Osma and Guillamion-Saoron, 2011). Simultaneously, ownership may change the sphere of interested audiences in corporate communication and the approach taken to responding to this new pool of engaged readers (Preston *et al*, 1996; Neu *et al*, 1998).

By considering ownership change in reports, this thesis contributes to the impression management literature in explicitly acknowledging Government intervention and its effect on impressions fostered. In contrast to business performance, the profound change in ownership means that impressions must be managed for an implicit agenda beyond organisational boundaries, as well as responding to changes in financial results.

In financial reporting terms, the mass communication is taken on by a different performer – that of the media. The next section considers how the mass media may shape the financial reporting process.

## **5.5 Research into Financial Reporting and the Media**

The use of critical discourse analysis is relatively new in accounting research. Yet it offers the ability to analyse accounting documents in more depth and systematically (Merkl-Davies and Koller, 2012). Thus obfuscation can be analysed in accounting texts not only in its presence but how it is achieved (*ibid.*). This contributes to a wider discourse that linguistics offers worthy analytical frameworks in which to study accounting (Evans, 2010). Using critical discourse analysis helped establish the media's role in contributing to the glamour of hedge fund managers and their lives (Eshraghi and Taffler, 2012). The media contributed to a feeling of excitement and glamour about hedge funds, thereby decreasing perceptions of risk (*ibid.*).

The media is a source which allows the idea of legitimacy to be operationalized in corporate reporting (Baum & Powell, 1995, p530). In this vein, environmental disclosures in corporate reports have been assessed with a media-borne legitimacy measure. The legitimacy measure contributed to a long term legitimacy score which was then reassessed at critical points (Aerts & Cormier, 2009). The findings were that a broad family of communications in terms of press releases and annual reports were used strategically to promote the corporations' legitimacy (Aerts & Cormier, 2009). Annual report disclosures for the long term effects of the company and press releases were more useful in managing short term legitimacy threats (*ibid.*, p27). In the case of annual reports, the soft, subjective-based information did not affect media legitimacy whereas the hard, economic based information did (*ibid.*, p17)

Yet Fairclough (2010) contends that the media do much more than confer legitimacy, by constructing knowledge through representation of events. There was an increase in positive environmental disclosures when there had been negative media coverage on that corporation's environmental practices during the year (Brown & Deegan, 1998), suggesting that organisation will react to media coverage. There was not a general correlation between disclosure and media coverage generally (positive and negative) and part of this may be attributed to the time lag between news stories being printed and the environmental annual

reports being published (*ibid*, p33). The article did not discuss the prominence of the articles, associated photos or consider the impact of each article; each article was weighted equally (*ibid*, p34). A further study confirmed the correlation between news coverage and social disclosure, which could be local, or global (Islam & Deegan, 2010).

This can be demonstrated through the choice of journalists about which stories to run. Corporate press releases would need to 'fit' with the news stories that the particular media output is concerned with. For instance, proactive, promotional press releases on corporate environmental disclosures did not gain much media coverage whereas the reactive press releases did (Islam & Deegan, 2010). Self-promoting language and stories in earnings press releases were reviewed with apparent mistrust by professional journalists (Maat, 2007). The press releases were certainly used in in the stories, but they routinely rectified or toned down the statements therein (*ibid*. p91).

CDA and media study may be relatively new in accounting research, but in wider scholarship, there has been increasing attention on the role of the media in organisational life. The media, it is argued, fulfils a corporate governance role for upholding norms of what is socially acceptable (Jansson, 2013). They help to reduce information asymmetry but also shape information received based on social legitimacy (*ibid*). For Jansson (2013), in the case of Swedish scandals, the media helped to consider the importance of ownership. The identity of the 'real owner' as opposed to mere investor was important. Shareholders were not all equal for it was the 'real' or active owner who takes care of property and therefore would be attributed with responsibility. In fact, being unable to identify the real owner was where the blame for the scandals landed (*ibid*).

The media can have different effects on the corporate governance mechanisms depending on what system of governance is prevailing in countries. In Russia, for example, the exposing of corporate governance failures had little effect on the Russian language papers whose readership was identified to be more relaxed about these. However, the exposure in Russia's English language press, whose readers were more concerned about stringent corporate governance, made a huge impact (Dyck et al., 2008). This resonates with the media's response to events and readership.

As well as reducing information asymmetry, the media confer legitimacy on organisations. Media disseminate information according to societal values (Bednar, 2012). The media was

found to have an influence on CEO dismissal and remuneration, and the make up of board of directors. However, the approval of the media was formulated through agency theory logics. Thus, there was an emphasis on the formal independence of the boards, but a lack of consideration of social familiarity of the independent non-executive directors (*ibid.*). Media scrutiny and analysis was thus limited. This in itself could have implications for the representation of corporate performance via mass dissemination.

Media also conduct an important sense making function for organisations undergoing dramatic strategic change (Kjaergaard et al., 2011). In one case, a Danish company invited the media into the organisation to discuss their new *modus operandi*. Initially this met with tension by employees because these were aspirations rather than reality. However, after some time, these aspirations became the organisational reality and the positive media coverage made employees feel good about their association with the company. Later on when the organisation underwent management changes, the media story did not reflect these new organisational values, creating tension once again with members of the organisation:

“...articles seemed to cling to past identity referents – unique and distinctive labels, personalities, structures, values, etc. – over which the celebrity of the organization had been built, regardless of their current veracity” (Kjaergaard et al., 2011)

Thus, there could be a time lag between the organisation portrayed in the media and that which is the organisational reality of the corporation.

Media reporting affects other stakeholders in an organisation apart from employees. The media has a crucial role to play in the working of the financial markets. The media can alleviate informational frictions and affect security pricing even without genuine news (Fang & Peress, 2009). Yet this may come at a cost. There is empirical evidence that stocks that have no media coverage earn higher returns than stocks with extensive media coverage, suggesting that the breadth of information dissemination can affect earnings (Fang & Peress, 2009). Investors are prone to buying attention grabbing stocks, including ones in the news (Barber & Odean, 2008) but the stocks which are bought in this way may underperform.

Media could act as the identifiers of accounting fraud in the United States (Miller, 2006). Some press outlets relied upon accusations from other trusted sources. The business press were also found to rely on in house journalistic analysis. However, there was a bias towards the more visible firms in the press and those with manager misappropriation. This fulfilled the criteria to attract readers' attention and attract a larger readership (Miller, 2006).



There has been an increasing amount of content in earnings press releases and a greater market reaction to the information contained within (Francis *et al*, 2002). Non-GAAP or 'Pro Forma' numbers given in the earnings press releases are frequent and have been given higher pertinence in the earnings press releases where the GAAP results have been less attractive (Marques, 2010). Firms with greater media coverage are also more likely to emphasise their unregulated pro forma earnings and less likely to emphasise GAAP earnings (Bowen *et al*, 2005).

The studies discussed above demonstrate that the relationship between corporate communications and the media is intricately complex. There is an established two way influence between financial reporting by the organisation reacting to media coverage and the media coverage a corporation receives. This then influences market activity. One important aspect of newspaper reporting particularly is the use of headlines. Headlines themselves have unique linguistic constructions. The following section considers the study of headlines and organisations.

### **5.5.1 Representing Organisations through Headlines**

Headlines are an important part of the news story. This is the part that attracts the reader's attention and may well drive an idea as well as indicate the subject of the story. Readers spend time scanning the headlines, but may not read the whole story (Dor, 2003). Headlines are also a common feature across the news mediums, whether it is the printed press, the internet or TV broadcasts. They act the reference point of choice about whether further attention is paid by the consumer to that particular news feature. It is natural then that the headlines in an annual earnings announcement would emphasise the positives and eliminate the negative aspects of the corporate story (Guillamon-Saorin *et al*, 2012). This study found that profitability drove the headlines if this was positive. In contrast, if a loss had been incurred, sales figures were headlined to portray a positive 'good news' story (*ibid*, p162).

Metaphor is also employed in headlines. Metaphorical analyses have focused on established metaphors such as war. It has been argued that these are predominantly masculine metaphors. Women are excluded through the reification of male attributes and reflects the disposition of the (male) business press readers (Koller, 2004). A change in metaphor has been advocated. Moreover, fresh metaphors would increase the entertainment of the news, drawing further readers in (*ibid*, p178).

Metaphors were used by the CEOs during the Parliamentary Inquiry into the banking crisis to deflect responsibility for the failures themselves (Tourish and Hargie, 2012). Using metaphors, the CEOs variously described themselves as victims of the wisdom of the crowds and at other times, observers in the unfolding events. They also characterise themselves as victims of the crisis as well as willing to learn from their mistakes. The implications are that the bankers have lost an opportunity for deep learning following the crisis and what went wrong

It is very hard to consider the impact of news media on the audiences concerned. Readers are not ‘cultural dopes’ and may not accept the meanings and interpretations presented in the media products (Gamson et al, 1992). Personal experiences and popular wisdom, as well as discussions with friends and family can alter and negotiate the construction of reality that readers of media formulate (*ibid*, p391). The understanding of how this is formulated is not well understood. However, it has been understood that the media do act as an ‘agenda-setting’ function, drawing attention to certain issues which may be of concern to the public (McCoombs & Shaw, 1972). This is particularly the case for unobtrusive issues, such as politics, where individuals do not participate daily in the activities (*ibid*, p182) but rely on the media for their information source about what is going in this arena. The same could be said for the financial health of companies.

Part of the narrative in newspaper articles (and thus picked up on in headlines) is the personal aspect of stories (Fairclough, 1995). Journalists often attribute the success or failure of a company to the individual at the top (Hayward et al., 2004). Personalising a story helps to achieve a story amid pressures to “process large amounts of information in short periods of time and present their reports in a manner that is credible, appealing and simple” (*ibid*, p650). Yet the personal aspect is an illusion (Fowler, 1991). The world is presented as cultural categories rather than unique individuals. These lead to stereotypes (*ibid*).

The use of individual characteristics leading to a stereotype is not just restricted to articles. Journalistic accounts of corporate failure have opted to steer away from the technical vagaries of accounting and auditing. Instead, they have focused on the characteristics of the accountant; honesty, integrity and professionalism (Carnegie and Napier, 2010).

The impact of the media on markets and corporations is thus established by previous empirical research. Yet there is relatively little considering the impact on the financial

reporting process. There is an increasing recognition that the financial reporting process is important in both press releases and analyst meetings. Yet the actual follow through to the media remains underexplored. This will be an important part of considering the accountability of the quasi-nationalised banks.

## **5.6 Concluding Remarks**

Overall, the empirical works cited here help utilise a body of theories commonly associated with financial accountability and financial reporting. The pedigree of the theories has been demonstrated with a discussion of a selection of literature which has employed these perspectives.

Empirical research in property rights presents diverse evidence on the merits of private ownership compared to public ownership. Agency theory research demonstrates that the particular circumstances of the public sector result in several incentives with regard to pay and earnings management. In the banking sector, the complexity of organisations and the existence of deposit insurance schemes create specialist moral hazard implications.

The use of impression management in the financial reporting literature has furthered understanding on how positive messages are foregrounded in the annual report to investors. These focus on language used, graphs and pictures. Moreover, impression management and stigma have been used to explain management responses to change and crisis. Critical discourse analysis and linguistic frameworks have been advocated as a means of analysing accounting phenomena. The media has been cited as an important corporate governance mechanism of holding corporations to account, as well as influencing annual report content.

What the empirical studies have also highlighted are the myriad possibilities for investigating the phenomena identified in the research themes. This will affect the way that the research is conducted. For this reason, the next chapter considers the research method for the thesis when a number of different theories are being utilised.

# Chapter 6: Research Methods

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This chapter outlines the research methods used in completing the thesis. Common to all research themes was the use of a stakeholder approach and documents as source data. This allowed an understanding of the unfolding events and helped to prioritise branches of inquiry. After deep understanding was achieved on a more general level, the particular branches of inquiry were tailored for each research theme. Subsequently, the methods used for each research theme had particular features which responded to the nature of the inquiry and the distinct theories being used to explain phenomena. The specific methods are discussed in turn for each theme, reflecting on the main sources of data for each one and how these were analysed. The chapter however, starts with explaining the approach to general understanding.

## 6.1 Stakeholder Approach to the Research Design

The PhD has been investigating contemporary events which have occurred simultaneously with the investigation of RBS and LBG. As a result, a framework for general inquiry to assist understanding of the phenomena was required to provide robust analysis as research themes took shape over time. This was achieved by employing a stakeholder approach to the research design, drawing from key ideas in stakeholder theory. Stakeholder theory has been a controversial theory and has been described as a suite of approaches rather than a theory in itself (Freeman, 1994). Nonetheless, stakeholder theory has seen increasing recognition in the literature. This is due to increasing globalisation and the need to attract and retain customers and suppliers as well as investors. Moreover, there is awareness that corporations have a massive impact on the community and there is a need to be ethically robust in business dealings (*ibid*).

The basic idea of stakeholder theory is that it is normative, rather than instrumental or descriptive (Donaldson & Preston, 1995). It argues that the organisation should act in the interests of stakeholders to achieve social welfare and improved business performance (Friedman & Miles, 2006, p2). This includes financial reporting. The public/private sector divide is muted as a Government interest is recognised alongside other stakeholders (Freeman, 1984, p55).

For this PhD, a stakeholder is any individual or group who can affect or is affected by the achievements of the organisation's objectives (Freeman, 1984, p46). Yet the relationship between the organisations and stakeholders can change. Established stakeholder relationships with organisations fluctuate over time as management consider stakeholder salience (Mitchell et al, 1997) and stakeholder networks (Rowley, 1997).

The prioritisation of stakeholders through 3 relationship attributes: power, legitimacy and urgency, was used for analysis (Mitchell et al, 1997). 'Definitive stakeholders', who have the greatest portion of all of these attributes, occupy the central point in managements' considerations. However, the stakeholders' relative positions are fluid. Legitimacy and power therefore are two complementary factors in their identification of stakeholders. The third attribute, urgency, 'adds a catalytic component to a theory of stakeholder identification, for urgency demands attention' (*ibid*, p864). Management are central to stakeholder theory, as they control the 'decision-making apparatus' of the firm. Therefore, the perception of managers regarding the stakeholders is crucial in determining whose needs are attended to (*ibid*, p871). As a research approach here, then, it is the researcher who takes the place of the manager – determining what or who to delve analytic efforts into as time goes on. This was very suitable for a context which was consistently changing direction as the crisis developed.

A stakeholder approach also allows consideration of networks as a component of the research design. This is particularly important in the context of the media analysis which makes up part of the investigation. As the network relationships between stakeholders and the organisation influences behaviour (Rowley, 1997), the research approach responds by focusing on the pertinent groups. A dense network of stakeholders facilitates information exchange, leading to easy communications and increased pressure on the organisation to respond to stakeholder influences (*ibid*, p898). With stakeholders providing a wider circle of interest groups for analysis the aim is to investigate and explain how financial accountability is shaped by the stakeholders involved.

Stakeholder theory as a 'middle ground' research method between different research paradigms has been advocated previously (Simmons and Lovegrove, 2005). Using a stakeholder approach allows dynamism and flexibility in the research design, as the most salient stakeholders are focused upon over time. Whilst it may allow a subjective view of phenomena, open to interpretation, it also offers the possibility to incorporate positivist

philosophies into case studies (*ibid*). This is not, however, at the expense of the theories which inform and explain the issues arising here.

A stakeholder approach gave an overarching structure to the data collection. The contemporary, fast moving nature of the topic meant that decisions had to be made as to what line of enquiry to follow and when. As it was, documents were the most important part of the research. The next section therefore discusses the general role of documents in social research. How documents were subsequently utilised in each of the three research themes is discussed afterwards.

## 6.2 Documents

Documents are an integral part of social, organisational and political life. Documents can be used to both understand the context of the study but also ‘to illuminate deeper meanings which may be revealed by their style and coverage’ (Ritchie and Lewis, 2003). Nonetheless, the use of documentary analysis has often been as a supplement to other fieldwork, or a backup when access cannot be arranged (Ritchie and Lewis, 2003). Yet their capacity for rich insight goes beyond these uses. They do not act as surrogates for other forms of data but rather provide their own versions of contemporary life using literary conventions (Atkinson and Coffey, 2011). There are a number of ways which they can be used in qualitative research, as shown in Figure 6. 1 below:

**Figure 6.1: Approaches to the Study of Documents**

<i>Focus of research approach</i>	<i>Document as resource</i>	<i>Document as topic</i>
Content	(1) Approaches that focus almost entirely on what is ‘in’ the document.	(2) ‘Archaeological’ approaches that focus on how document content comes into being.
Use and function	(3) Approaches that focus on how documents are used as a resource by human actors for purposeful ends.	(4) Approaches that focus on how documents function in, and impact on, schemes of social interaction and social organization.

Source: (Prior, 2008)

When viewed under Prior's analysis in Figure 6.1 above, documents are not just about what they contain but how they may be considered as actors in their own right (Prior, 2008). For this study, documents are used both as a resource and as a topic. As a resource, documents are receptacles of evidence. As a topic, documents open up further avenues of research which may be concerned with the way that documents are active agents in "episodes of interaction and schemes of social organization" (Prior, 2008). Archaeological approaches (2) have analysis which is concerned with how the document content comes into being. This has resonance with the study of the annual reports and their focus on impression management. With (3) It is important to consider the relationship of documents to other documents for most texts make reference to other documents, even implicitly (Atkinson and Coffey, 2011). In (4) "the analysis concentrates on the relationship between the specific documents and their use or recruitment by identifiable human actors for purposeful ends" (Prior, 2008). The document is an actor which can drive political or economic activities just as much as humans (*ibid*, p833):

"The culturally competent reader knows how to use documentary sources to create the organisational reality they purport to describe...He or she reads into the text what might reasonably be assumed to be the case, given a shared stock of knowledge about how organisations typically function."(Atkinson and Coffey, 2011)

The study on the newspaper headlines is more oriented towards number four as it looks at the interaction between annual reports, conferences, press releases and the newspaper headlines. The reader is also always imagined in their construction and must be considered in the research of the document (Atkinson and Coffey, 2011).

Documents have a number of advantages. They are easily accessed over the internet. They are naturally occurring and not 'manufactured' by the researcher ( Silverman, 2013). They may also serve as a sense making function (Merkl-Davies et al., 2011; Weick, 1995) or as a concrete espousal of values. Documents are not a neutral reflection of organisational life but help to produce a reality through textual conventions (Atkinson and Coffey, 2011). Reflecting on an empirical research project which utilised interview and documentary data, the authors reflected:

"It was interesting to note the way in which the written word became enshrined in fact and history. The mission statements that were displayed in pride of place in many departments provided a good example of this. Few people questioned them, and with a few notable exceptions, there seemed little concern about developing strategies in order to achieve them." (Irvine and Gaffikin, 2006)

Documents can be affirmative and influential in deeply meaningful ways. Nonetheless, documents necessarily present a partial picture of what occurs in the ‘real world’. They are not a transparent account of what has occurred and may leave out much of what was discussed in face to face interaction (Irvine and Gaffikin, 2006). This has the potential of creating meanings or intentions which were not originally envisaged. Yet for this project it is impressions that count as much as records of proceedings:

“Documents can circulate and be exchanged partly because they are used to decontextualize events. We transform things by writing them into texts...from the specific and the local, and make of them ‘facts’ and ‘records’ which take on independent existence” (Atkinson and Coffey, 2011)

There is an inference on the researcher’s part in understanding the documents and interpreting what the actual events were. That inference must be justifiable and acknowledged (VK Dibble, 1965). It is not just the doing but the giving of signs that confirms facts which could otherwise remain obscure (Goffman, 1956b).

In the current study, the use of documents is critical in understanding the banking crisis but also in analysing the theoretical implications from it. The following section discusses the main methods and documents used in the thesis, responding to the particular requirements of the theories utilised. It aims to consider the wider role of these documents as part of social interaction.

## **6.3 Methods used for Research Theme One**

The main sources of evidence for research theme one is Parliamentary transcripts and press releases from the RBS and LBG. Other sources informed the content of the analysis. The theoretical frameworks employed were property rights theory and agency theory. The method of analysis is presented after the discussion on the documents.

### **6.3.1 Press Releases**

Throughout the crisis, the two banks have released press notices to respond to circumstances or press commentary. These are a significant source of documents for research. The data collected from the press releases has been used to build up a diary of events from the organisational point of view. Importantly, the press releases do more than act as a confirmatory instrument to newspaper articles. They represent the organisation to the outside world and are subject to impression management in the same way that annual reports



are (Garcia Osma and Guillamion-Saoron, 2011). The sole authors of the press releases are the corporations. The Press releases offer the opportunity for the companies to project the desired corporate image to the outside world. Likewise, they are not subject to the same financial reporting standards as the annual report. As a result, the press releases require detailed reading and conscientious financial analysis.

The actual collection of such information is straightforward, with a visit to the organisation's website where a PDF version of the document can be downloaded. The archive usually holds a numbers of years' worth of documentation, which means that a complete set of documents can be retrieved for the research period.

### **6.3.2 Parliament**

Parliamentary data has been collected through either electronic versions of Hansard when debates on the banking crisis have occurred or special reports by Select Committees. Although PDF files have been downloaded if possible, Hansard is also presented in HTML; thus summary notes are taken of the points of interest and recorded in a word document. These often include extensive quotes of the politicians concerned which are copied and pasted into the word document. Data has been used to the extent of identifying and understanding the events which have taken place to date.

In these documents, it would be fair to say that the agenda of politicians is to hold the Government to account. Furthermore, the politicians are seeking to obtain accountability direct from the banking industry itself. A useful source of documentation for achieving the latter is the Treasury Select Committee's collection of evidence.

Both Hansard and the oral evidence of the Select Committee is a transcript of verbal interaction and can be further amended by the speakers themselves. Information which has been spoken, rather than written first presents rather different data to other reports, which must be recognised during analysis. For instance, Molotch and Boden (1985) found that Watergate hearing transcripts replicated power differentials between respondent and questioner by undermining the credibility of the respondent's evidence through conversational means. For the authors, such discourse backed up the power structure in place during the testimonies. The agendas of the parties involved is no less apparent by the form in which the document is created but it is possibly expressed in alternative ways to the data created directly from written words, rather than spoken.

### **6.3.3 Analytical Approach**

Agency and Property Rights theories both stem from a positivist tradition, which impacted on the analytical approach used for the first research theme. The usefulness of positive theories lies in their predictive and explanatory powers (Watts and Zimmerman, 1990). Therefore, analysis was conducted in two streams. Firstly, the research utilising property rights and agency theory comprised the building up of an analysis based on incentives. To identify the predicted incentives, key pieces of literature were reviewed to tease out the important insights in agency theory (Jensen, 1994; Fama and Jensen, 1983; Fama, 1980; Jensen and Meckling, 1976) and property rights (Armen A. Alchian, 2008; Geddes, 1997; Alchian and Demsetz, 1973; Demsetz, 1967). The data was then analysed using this framework for empirical fit and accuracy. This approach has been an illuminating research method in property rights analysis (Wineicki, 1996; Riker & Sened, 1996; Libecap, 1978).

The phenomena identified during research which related to the theoretical predictions were coded as such and gathered together on an excel spread sheet. Positive approaches using agency theory are usually general, quantitative based studies (Watts and Zimmerman, 1990). But a qualitative approach allows rich data to analyse the characteristics of the contracts being produced (Jensen, 1983, p332). It was with qualitative data that the analysis was built up. The political and economic implications were then assessed.

Because of the distinct ownership structures of RBS and LBG, it was necessary to interrogate some of the standard incentives which may be identified in conventional public corporations with multiple disperse private investors. It has been suggested that more consideration of the standard incentives is good practice when testing agency theory (Broadbent et al., 1996). This particularly focused on the lack of market disciplinary effects currently being experienced e.g. takeovers stemming from subdued financial markets. The incentives did not fundamentally change, but their relative importance was established by this further theoretical work. Property rights, which looks to increase the specificity of rights (Libecap, 1978) did not seem to be so encumbered by the structures presumed under agency theory.

Secondly, once the data had been compared to the predicted models, the explanatory powers of the theories were considered. This was particularly important as both agency and property

rights do not provide for dynamism as events change quickly (North, 1990). The stakeholder approach allowed a scheme for comparison.

In contrast, the theories for research theme two, impression management and stigma, stem from a phenomenological position. This meant that the research approach adopted was different to that utilised in research theme one. A discussion of research theme two follows.

## **6.4 Methods Used for Research Theme Two**

The second research theme utilised the annual reports of RBS and LBG. The consideration of annual reports as documents is considered further below. Afterwards, the analytical approach is discussed, which is informed by the theories of impression management and stigma.

### **6.4.1 Annual Reports**

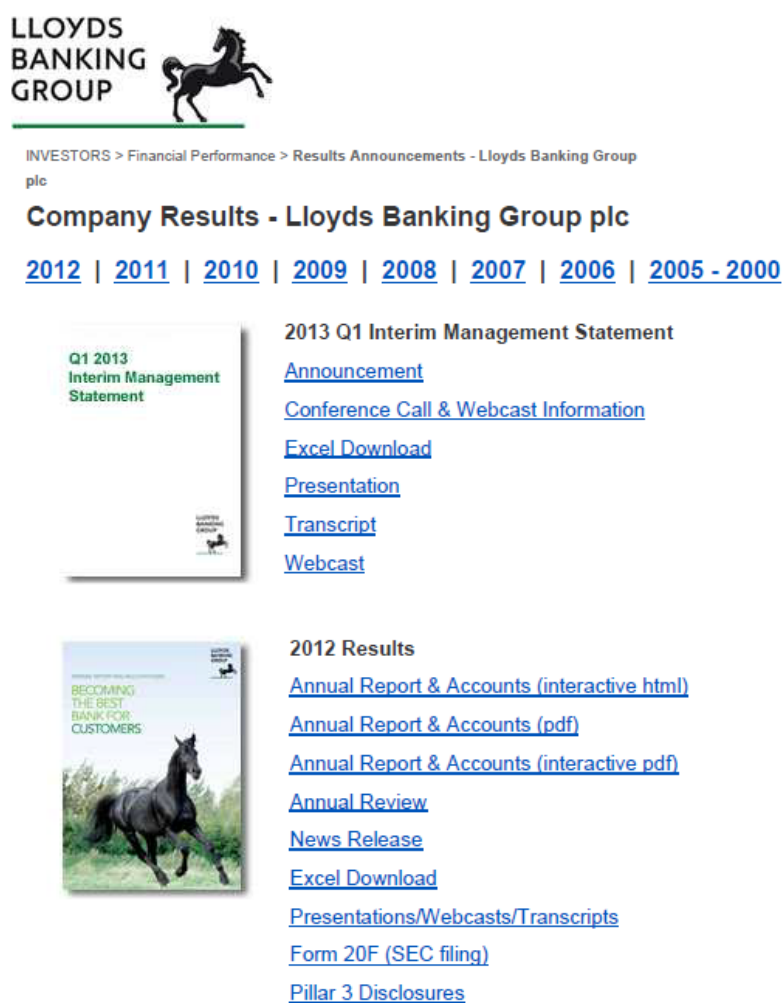
The processes involved in creating an annual report is mostly familiar to accounting researchers and will not be repeated here. Yet the way that annual reports are accessed now, electronically, versus earlier paper versions either sent in the post or at libraries is worth considering:

“The internet provides the means for creating, displaying and framing the objects of study and the boundaries for experience” (Markham, 2011)

In corporate financial reporting terms, there are many reasons why accessing the annual report over the internet may be different to hard copy (Amernic, 1998). These include the use of hyperlinks and the increased audience who may access the information content. Yet it may also become just another part of the website. Its role as a legal document may become blurred by other concurrent promotional material (Amernic, 1998).

The Annual reports are freely accessible over the web. To gain access, the investor relations website was sourced for LBG, HBOS and RBS. These showed the annual reports in a library of general financial performance announcements. There is a snapshot of the website at Figure 6.2:

**Figure 6.2: Lloyds Banking Group Annual Report Access**



**LLOYDS BANKING GROUP**

INVESTORS > Financial Performance > Results Announcements - Lloyds Banking Group plc

## Company Results - Lloyds Banking Group plc

[2012](#) | [2011](#) | [2010](#) | [2009](#) | [2008](#) | [2007](#) | [2006](#) | [2005 - 2000](#)

**2013 Q1 Interim Management Statement**

- [Announcement](#)
- [Conference Call & Webcast Information](#)
- [Excel Download](#)
- [Presentation](#)
- [Transcript](#)
- [Webcast](#)

**2012 Results**

- [Annual Report & Accounts \(interactive html\)](#)
- [Annual Report & Accounts \(pdf\)](#)
- [Annual Report & Accounts \(interactive pdf\)](#)
- [Annual Review](#)
- [News Release](#)
- [Excel Download](#)
- [Presentations/Webcasts/Transcripts](#)
- [Form 20F \(SEC filing\)](#)
- [Pillar 3 Disclosures](#)

Source: Lloyds Banking Group Investor Relations Website (accessed 17 June 2013)

In the Lloyds example above, the Annual Report is shown among the other reporting of finances to the markets, such as quarterly earnings statements or the half year results. The reading of the annual report may be via different formats. The options for Lloyds include the interactive html, the pdf and an interactive pdf. It also includes the press release and the presentations for analysts as well as the webcasts and transcripts of such meetings. The status of the annual report as a ‘pivotal presentation of the company’ (O'Donovan, 2002) may have diminished somewhat. Nonetheless, previous studies have suggested that the annual report is still viewed as more important than the quarterly earnings updates (Vergoossen, 1993).

The pdf document has been used in this thesis. Each annual report was sourced from the investor relations website. The documents' security properties were assessed on adobe. These confirm that the copyright conditions allow page extraction and commentary therein. The 'snapshot' tool was used to capture images of the annual reports used in analysis.

Whilst the content of annual reports have been intensely scrutinised over the years, there has been less of a focus on studies into the other aspects of the annual report and the position it occupies as an actor in social interactions such as (4) in Figure 6.1 above. Environmental accounting has provided some insight into the role of the annual report in its interaction with the press (Islam and Deegan, 2010) and other stakeholders (Deegan and Blomquist, 2006). In addition, there is evidence that management use content of annual reports to boost the legitimacy of the reporting corporation (O'Donovan, 2002). A number of studies have highlighted the self-promoting nature of the annual report document (McKinstry, 1996; Dyball, 1993).

#### **6.4.2 Analytical Approach**

The second research theme uses impression management and stigma to consider the annual reports of RBS and LBG. The technique employed here was slightly different, as no predictive model was built into the research process. Once the theory was deeply understood, the major insights of the theory were considered whilst investigating the annual reports. The first part of the process was the understanding of the numbers in the statutory accounts by performing standard analytical review on the published year on year numbers. This emulated the sort of analytical review that would be performed by auditors at the planning stage of an audit when trying to gather more knowledge about the entity (Auditing Practices Board, 2009). This helped to build up an accounting story of the banks' failure. The task was difficult due to corporate restructuring and shifts in accounting regulation. To ensure as much consistency as possible, the most recent published figures for each year were utilised. For 2010, then, the comparatives in the 2011 annual report were used. The implications for impression management were considered in light of these difficulties.

The second part of the analysis drew upon the key theoretical insights from Goffman (Goffman, 1968; Goffman, 1956b). Key themes were used to draw upon significant parts of the annual report, including images and text. These were then interpreted using 'Stigma' or 'Impression Management'. This used a more abductive approach, crossing between years

and banks to compare and contrast the impression management encountered. The wider context of the banks' activities was also considered in light of the annual reports.

Interpretive analysis of accounting reports has been less popular as a research method, but has provided insights into new and developing conceptualisations, such as sustainability (Laine, 2010). It has also provided insight into the process of institutional change within industry (Arndt et al, 2000). A strength of thematic analysis has been the ability to understand how core themes may interrelate with one another (Prior, 2003). As the research demonstrates, results are repackaged in increasingly complex ways to help manage impressions.

Impression Management has been well researched in the accounting literature using content analysis and word counts. This approach was not taken in the paper. By looking at aspects of the reports, findings are based on phenomena in isolation to the rest of the annual report, which may serve to provide a different context to the research (Davison, 2009). Content analysis techniques serve to consider large swathes of data but analyse words regardless of their context (Merkl-Davies *et al*, p337) and in so doing, cannot capture the more subtle impression management techniques that organisations can use (Neu *et al*, 1998, p275). Specifically, the non-reporting or omission of items may be disregarded through this research (Neu *et al*, 1998, p280). This is particularly the case when impressions are cultivated for various different audiences, whose own agendas serve to alter the impressions that organisations seek to project to them (Neu *et al* 1998; Preston *et al* 1996). Looking at the whole of the report for the two banks, as is being done here, helped to overcome some of these issues.

Moreover, characteristics used to proxy certain impression management techniques may occasionally be rather absolute. Bankruptcy survival measures have been used (Smith & Taffler, 1992). Commonly, positive or negative outcomes are based on accounting measures such as profitability or change in net income (Merkl-Davies *et al*, 2011). Whilst the good news/bad news dichotomy will follow the accounting measurements in the majority of cases there are a minority of organisations who buck this trend. The banking industry in the aftermath of the financial crisis, seeking to derisk and shore up capital and liquidity may be one example. Such priorities may negatively impact on the change in net income. As such the banks could be considered outliers in established statistical analyses and lend themselves more easily to interpretive analysis.

## **6.5 Methods used for Research Theme Three**

The main sources of documents used in research theme three were the headlines generated in the printed press. The purity of the corporate message in the Press for accounting research is limited, as so many different sources and authors make up the final newspaper articles. As a result, there is an extended discussion on the Press and how it may be used in accounting research. Following on from that, the analytical approach under critical discourse analysis is discussed.

### **6.5.1 The UK Printed Press Industry**

The printed press in the UK offers a variety of titles for a range of audiences. At the popular end, red top tabloids offer entertaining stories of celebrities and scandals. The news content of the papers is light and the factual basis of the stories is regarded as light. Nonetheless, they enjoy a large readership and retain significant influence over news making. The mid market papers consist of the Daily Express and Daily Mail. They also provide some entertaining stories on celebrities and gossip but provide comment and opinion on more serious news stories. There are a range of titles for the quality end of the market, traditionally called 'broadsheets'. These concentrate on news stories for the day and have very little gossip or scandals in them. The reliability of the stories is high with a number of sources consulted prior to running the news.

The national papers and their Sunday equivalents are listed below, along with their daily circulation figures.

**Table 6.1: National Titles and their Circulation Figures**

<b>Dailies</b>	<b>Readership</b>	<b>Tabloid/Mid Market/ Broadsheet</b>	<b>Readership Profile (NRS Social Grades)</b>	
			<b>% ABC1</b>	<b>%C2DE</b>
Daily Mirror	1,174,924	Tabloid	40	59
Daily Record	307,794	Tabloid	38	61
Daily Star	703,218	Tabloid	26	74
The Sun	2,795,601	Tabloid	32	67
Daily Express	629,764	Mid Market	57	43
Daily Mail	2,063,738	Mid Market	65	35
The Daily Telegraph	632,070	Broadsheet	89	11
Financial Times	331,883	Broadsheet	86	14
The Herald	48,629	Broadsheet	87	13
The Guardian	241,287	Broadsheet	86	14
i	191,077	Broadsheet	78	22
The Independent	180,470	Broadsheet	80	20
The Scotsman	42,581	Broadsheet	81	19
The Times	449,938	Broadsheet	85	15

Sources: Press Gazette (2011);(MediaUK, 2013; Daily Star, 2011)

The markets for newspapers are generally declining. Readership figures above are significantly below prior years. Tables 6.2 and 6.3 demonstrate this in income terms for a variety of titles.

The type of income for newspaper titles is very important for the market segments. On the one hand, the tabloid titles depend on mass consumption and newspaper sales to boost their income. In contrast, the quality end of the newspaper industry relies less on the revenue that is generated through sales. Instead, the advertising space that is sold within the broadsheets remains the main income generator. A comparison of the Trinity Mirror Group which includes 5 titles from the tabloid end of the market above with the Guardian Media Group demonstrates this:



**Table 6.2: Revenue by Type, Trinity Mirror Group**

Trinity Mirror Group (Daily Mirror, Sunday Mirror, The People, Daily Record)

Trinity Mirror Group plc: National Titles Divisional Performance	2010	% of total income	2009	% of total income
	£m		£m	
Advertising	128.8	30%	132.9	29%
Circulation	244.2	57%	266.8	58%
Other	57.3	13%	60.7	13%
	430.3		460.4	

Source: (Trinity Mirror Group, 2011) p 17

For each year the circulation revenue makes up 57% and 58% of total revenues respectively. Advertising is still a significant income generator, although not its main source. This can be contrasted with the quality end of the market, which relies more on advertising to generate income:

**Table 6.3: Revenue by Type, Guardian Media Group**

The Guardian and Observer Titles: Divisional Performance	2010	% of total income	2009	% of total income
	£m		£m	
Advertising	134.2	53%	156	56%
Circulation	90.9	36%	94.7	34%
Other	30	12%	29.3	10%
	255.1		280	

Source: (Guardian Media Group, 2010)

As table 6.3 shows, revenue from circulation in the quality end of the market makes up just over a third of total income, with advertising revenue making up over half. The tables above also show that the printed press market is declining. Nonetheless, the circulation figures provided in Table 6.1 show that over 9m copies of titles are consumed daily. This continues to show the importance of the printed press as a mass communicator.

## 6.5.2 Making the News: Implications for Accounting Research

Media information is good quality, easily accessible and is not modified by observers (Bell, 1991). However, its production needs considering, as this may impact on the way that accounting is portrayed within publications. Thus, this section considers how news is produced for mass consumption.

News is divided into 'hard news' and 'soft news'. Hard news is the staple product. Hard news includes reports of accidents, announcements, discoveries and other events which have come to light since the last publication occurred (Bell, 1991). Hard news will have the most distinctive news style of the publication. One off events, such as natural disasters, may be called 'spot news' due to their unscheduled nature. 'Soft news' does not have the same sort of immediacy and will often feature longer articles. Journalists may direct effort towards presenting 'soft news' items in a hard news way (*ibid.*). There are also special sections to a newspaper such as sport or business. These usually have their own mini-newsroom working on these articles.

The language of newspapers is 'frequently recycled' (Bell, 1991) with all previous iterations of articles embedded within the final product. Fairclough (2010) terms this as mediation in a true sense, as text and meaning making is taken from one source to another through press articles (*ibid.*, p72). This is often in the form of a public discourse entering the private domain (*ibid.*). Although the work is usually attributed to one journalist, its smooth and unified style can hide a number of different pens put to work (Fairclough, 1995; Bell, 1991)). Journalists are responsible for authoring the main article, with editors and subeditors refining and cutting down the work as required (Bell, 1991). In fact, the articles can be much less original than expected.

In all news communications, there are acute time pressures. This leads to the quickest production route to an article being used. News that comes pre-packaged for publication can therefore have an advantage over equally newsworthy items (Bell, 1991; Gans, 1980). Journalists' main sources for news stories come mainly from official sources, documents and channels. Many of these can often be anticipated ahead of time, such as crime statistics announcements (Leach, 2006). Panics can be created as the most worrisome or extraordinary features of the reports are selectively published and analysed to hold an

audience's attention (*ibid*, p607). This focus on the worrisome aspects of the news item could be beneficial, as deviance is defined and rooted out by public power (p608).

The preferred way to gather material is by interviews and speech, with the belief that verbal content is usually much more simple and concise than documentary evidence (Bell, 1991). The content of an article will be made up of extensive quotes or paraphrases of what someone has said (*ibid*, p41). Documentary inputs are nonetheless another important source, particularly if they have been prefabricated in a journalistic style. Three primary sources of documents are news agency copies (e.g. International Press Association), press releases and prior stories on the same topic (Fairclough, 1995; Bell, 1991).

Press releases are used frequently by journalists and may receive almost verbatim publication in a newspaper (Sissons, 2012; Bell, 1991). This is due to their convenience and reliability, particularly on dailies where journalists may be under considerable time pressure. Yet they are also 'despised' by journalists due to the agenda setting function they can fulfil for the interested parties (*ibid*, p59). At the same time as creating positive publicity for the organisation, they also relinquish the journalists from *their* agenda setting role (Sissons, 2012). Prior stories on the same topic offer a similar level of convenience for the journalist and can result in a herd mentality (Bell, 1991).

The editors' role is to ensure accuracy and coherence in an article. The language will often be changed, mostly by cutting down the words. The journalist may resent such intervention (*ibid*, p43). Editors also act as interpreters, deciding on the prominence of a story and how it is displayed. Deciding on the presentation and the headlines of a story can significantly affect how the story is understood (Bell, 1991).

### **6.5.2.1 Headlines**

Headlines are written by the editor rather than the journalist who has written the article. The headline is often a summary of the lead paragraph, and provides a digested account of the article itself. The construction of the headline is influenced by page space as well as by the article ((Bell, 1991). Headlines have distinct syntactic and grammatical styles (*ibid*). They are a standalone unit and can be an opportunity to present the news in an individual way.

Headlines thus have many functions. They are the product which competes for limited attention resources from readers (Molek-Kozakowska, 2013). Headlines can viewed as 'constructing the extraordinary', the way in which normality appears more exciting and

sensationalised (*ibid.*). Language is an important resource for constructing this newsworthiness. However, the headlines may not be any substitute for reading the full article. There can be a disjuncture between the headlines and the main subject of the story which follows (Andrew, 2007). Readers who scan the headlines then are going to have different conceptions of events than those who spend a little more time reading the full article (*ibid.*). In a recent study based at a national quality newspaper, the function of the headline was considered to serve as a relevance optimiser. Here the relevance referred to the new information or assumptions being placed in front of the reader whilst simultaneously referring to an internal reader's presumptions about the wider world (Dor, 2003). In this way, the readers could get the most of the context of the story from a very small amount of effort in reading the headline (*ibid.* p718) and by scanning the newspaper headlines, could choose which stories to read by prioritising those which had most relevance to their individual lives (*ibid.*, p718). Readers thus did not have to invest in the full effort of reading the entire piece but could glean enough information from the headline.

The use of newspaper headlines in the age of the Web 2.0 and social media may appear old fashioned. Yet the headlines and the leader in a paper article is a feature of all different types of media. Broadcasts over the TV and the radio have 'headlines' in their news bulletins before turning to the detail of each news item. 'Headlines' in the broadcast sense are more similar to headlines + leader in a newspaper article than just the stand alone headline. Headlines and leaders are also used in internet news sites, imitating a traditional newspaper headline. Printed newspapers still account for the vast majority of reading news time as opposed to audience (Press Gazette, 2013).

Newspapers also need to offer something new in their analysis of events. With the advent of 24 hour news, all 'hard news' events become old news by the time a newspaper is printed. Thus there is pressure for the newspapers to carry an alternative angle or more opinion on items than previously. There is an opportunity for reflection and critical analysis before the article is published, in a way that is not possible for the 24 hour news channels or websites. The transformational process from the original source and newsmakers to the final finished article is connected and embedded within the text. There are great 'genre chasms' present as the newspaper is challenged to present the standard news in a digestible format for its audience (Fairclough, 2010).

Overall, there is considerable churn in the production of a newspaper article and the creation of its headline. The headline itself has many functions. The analysis of headlines therefore must be aware of these factors when conducting research. The analytical approach taken in this thesis is presented next.

### **6.5.3 Analytical approach**

The Headlines for RBS and LBG were selected using Factiva.com to locate the data required. Here, the headlines for the day following the year-end earnings announcements- the first possible day for coverage- were downloaded. The national newspapers, including Scotland's own national newspapers, the Herald and the Scotsman, were included within the search<sup>9</sup>. With the exception of these two titles, the papers used were all based and printed out from a London base. Content available on the Factiva website were closely analysed before searching for completeness<sup>10</sup>. Searches were conducted using the official company tag in the database. This ensured that the focus remained at the group level. Not all stories related to the earnings results of these groups on the days for review. Where the stories related to a different topic, these were not included within the research for further review.

A simple count helped to establish which papers were publishing news stories on the banks in the first place. This was tabulated and is presented in results. This was partly to consider the silences or empty spaces (Parker, 2007) which may accompany the financial reporting process.

Finally, the linguistic analysis was then conducted on the newspaper headlines. This was done first by coding the headlines into themes which would reflect the main subject of the headline. Once in these categories, each headline was closely read and analysed. The theoretical framework chapter discusses the linguistic characteristics in detail.

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<sup>9</sup> Both RBS and major subsidiaries of LBG – HBOS and Scottish Widows – are based in Edinburgh. Thus, the banks' results generate a lot of local interest. They remain national newspapers for the country of Scotland, whilst the London based titles are national for Great Britain.

<sup>10</sup> The entire print editions of the newspapers were available. Some supplements were not covered for some of the newspapers. However, the stories were more of a hard news item so this was deemed not to have any substantial impact on the reporting of earnings.



The methodology of CDA is theoretically driven (Fairclough, 2010, p75). Analysis of texts includes intertextual (Fairclough, 2010) analysis of what genres, discourses and styles are drawn upon in the relevant text. Intertextuality moves beyond the written components of a document and consider how it relates to societal discourses on certain topics (Fairclough, 1995). It then makes use of linguistic devices to consider representations in the language of the particular discourse (*ibid*). For the thesis, the newspaper headlines were considered alongside a context in a number of ways. The first was alongside the annual reports studied in chapter 9 and the press announcements of the yearly earnings. Wires and analyst transcript proceedings, where available, were also analysed. Wires transcripts were only partially available for RBS on the web. LBG did not publish them alongside their other information. Nonetheless, the RBS ones give some indication of the nature of such proceedings. Finally, the wider world news of the day were considered, in case there was another story of an unscheduled nature which would have impacted on the coverage of RBS and LBG (Bell, 1991). These are all discussed alongside the empirical results.

The chapter thus far has considered the overall research design for the thesis. The first task of the research design was to provide a deep understanding and direction for enquiries. For this purpose, a stakeholder approach framed the research. Secondly, there are three research themes which have specific documentary evidence being used alongside analytical approaches which are coherent with the theories being utilised.

Figure 6.3 is a diagrammatic representation of the overall research design for the thesis based on research themes and the nature of data collected. The main sources of data are discussed above but a number of periphery sources were used to help enrich the contextual analysis of the cases. A full list of documentary sources is shown in Figure 6.3.

**Figure 6.3 Research Design of Thesis: Public Accountability and Crisis in the Banking Sector: The Case of the UK**

Theme 1: Quasi-Nationalisation		Theme 2: Financial Reporting		Theme 3: Newspaper Reporting of Finances	
Property Rights	Predictive Model based on Prior Theoretical Insights;	Impression Management	Longitudinal Analysis looking for developments over time, how the impressions change as the audience and story changes.	Critical Discourse Analysis	Major themes Identified + coded  Intertextual Analysis
Agency Theory	Predictive Model based on Prior Theoretical Insights;	Stigma	Analysing the way that the stigma is treated, what is viewed as the stigmatising aspects of rescue		Close look at linguistic make up of headlines, including lexical devices, semantics and grammatical make up

Focal Dimension	Research Context	Units of Analysis	Research Method	Analytical Approach	Data Collected
 	UK Banking Crisis 2008 - 2013	Financial Accountability Exercises of RBS & LBG: Annual Reports and surrounding Presentations; select committee hearings; interviews with the press and press conferences; Public information disclosures from banks or Government	Stakeholder Theory (Donaldson & Preston, 1995; Mitchell, 1995; Rowley, 1997; Friedman & Miles, 2006)	Abductive (Blaikie, 2007)	Annual Reports, Financial Statements, Press Releases, Newspaper Headlines and Articles; Hansard debates; Select Committee Reports, Evidence and Transcripts; Radio Programmes, TV Broadcasts; Government and Agency Websites; Accounting Websites; AGMS, Results Presentations, CEO and Figurehead Speeches, Images

The thesis was collated under a common umbrella of understanding using a stakeholder approach and documents. This understanding and documentary evidence was then analysed using theoretically informed approaches subsequently.

The remainder of the chapter now turns to the timing of data collection and the ethics of the research process.

## **6.6 Timing of Data Collection and Analysis**

The PhD has been completed concurrently with the events it is studying. Part of the challenge has been to keep abreast of rapidly changing developments and place these in the wider historical context. The use of contemporary events, however, allows researchers to generate their own data based on design rather than on relics which have survived by virtue of historical accident (Goldthorpe, 1991). Thus the topicality of the banking crisis can be seen as an asset.

The timing of the study begins with the day that credit markets contracted, resulting in an abrupt decline in liquidity. This is commonly agreed to be 10 August 2007 (HM Treasury, 2008). A point for stopping data collection also had to be chosen. This would ideally reflect either: a natural break driven by events (the publication of accounts may be a good place to stop); a theoretically informed goal post (for example, property rights would suggest this would stop when ownership change) or one which reflects a practical point for the PhD.

A transfer in property rights back from the Government to the private sector did not occur before writing up. Historical experience suggests that nationalised banks are held for many years before returning to the private sector (Laeven & Valencia, 2008). A practical point for the PhD would be the end of 2012, as this allows a suitable horizon for the completion of a PhD part time. Due to year end procedures, closing the books can take some time after the end of the financial year. The release of annual reports therefore happens before the end of March. Thus, the date past which no new data will be collected is March 2013.

The analysis of certain phenomena located within a particular time period allows the recognition of the past in the present. Any study of society has a deep and often implicit, sense of history, which is usually referred to in more recent events (Mills, 2000). The importance of market shocks for accounting today is frequently recognised. Enron left a huge and direct impact on the regulation of business in the US Sarbanes-Oxley Act (Canad *et*



*al*, 2007), which is still in force today; the flow and regulation of money is both cause and effect of financial crisis (Kindleberger & Aliber, 2006) and the accounting profession reacts to scandal to continue its own interests of existence (Wright, 1994). The decision to stop at March 2013 allowed the fullest extent of Government ownership to be considered prior to the two tranches of sales occurring in September 2013 and March 2014. The consideration of the privatisation process is an excellent opportunity for further research.

## **6.7 Ethics**

No major ethical issues have been encountered completing the PhD. The information utilised is publicly available information which can be collected quite easily over the internet. The documentary analysis has been conducted in a secure office on University grounds. All documents are backed up daily by University servers. Freedom of Information applies as a staff member (Scottish Parliament, 2002). No requests were made during the research process.

The author is a chartered accountant. Affiliation with the accounting profession inevitably suggests a tendency to bias, as loyalty to the profession is required for membership (IFAC, 2005). Nonetheless, this is resolved professionally by the duty of members to act in the public interest (International Federation of Accountants (IFAC), 2013) and researching the practises of accountants helps to fulfil this mission.

Copyright restrictions and licenses were thoroughly checked before any extraction of data from them occurred. These are discussed under the relevant sources above.

## **6.8 Concluding Remarks**

This chapter outlined the research methods employed in the thesis. Understanding of the cases was assisted by an approach influenced by stakeholder theory. This helped to direct the preliminary investigation into the cases. The chapter then discussed the role of documents in the thesis. The methodology for each research theme was discussed by considering the principal documentary sources used for analysis. Thereafter, the analytical approach used for each research theme was explained. Finally the timing of the data collection and ethical considerations were considered.

# Chapter 7: The Cases of RBS and LBG: The Historical Context

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The thesis now turns to the empirical investigation into RBS and LBG. There are three overarching themes:

1. The Impact of Government Intervention on the accountability of the UK Quasi-nationalised banks
2. The banking crisis through the lens of financial reporting for RBS and LBG
3. Media reporting of the banking crisis for RBS and LBG

This chapter provides a short introduction to the company histories of LBG and RBS. This considers the institutions from their origins up to their contemporary positions as quasi-nationalised banks. The rationale is to provide a deeper understanding of these banking institutions and the context of their role in the economy of the UK. For Scotland in particular, there is a long and proud tradition of banking. The Bank of Scotland, now part of Lloyds Banking Group, provides the original history for LBG below. Both banking groups have had recent high profile takeovers. RBS won a hostile takeover bid of ABN Amro, a Dutch bank. The takeover left RBS particularly vulnerable when the financial crisis came. Lloyds TSB took over HBOS (Halifax Bank of Scotland) during the crux of the crisis in 2008. These significant takeovers are discussed in more detail.

A second aim of the chapter is to consider the current position of the banks as quasi-nationalised entities. Defining RBS and LBG as ‘quasi-nationalised’ is justified in this chapter. Moreover, the stakeholders related to RBS and LBG are identified. This helped informed the initial data collection as discussed in chapter 6. With this understanding, it is hoped that a more penetrating analysis can be conducted in the following empirical chapters.

## **7.1 The Bank of Scotland and The Royal Bank of Scotland: The First 300 years**

The Bank of Scotland, taken over by LBG in September 2008, is Scotland’s oldest bank. Since the 17<sup>th</sup> century, it has had an important role in the economy of Scotland, and latterly, within the UK. Nonetheless, it has also shared an intense rivalry with the compatriot bank,

RBS. This first section therefore considers the history of these two banks. This helps to illuminate the understanding of rivalry up into the 2000s.

The Bank of Scotland was created by Royal Charter in 1695 (Checkland, 1975). It was funded with private monies and was always intended to be completely separate from the State (Checkland, 1975). Allocated share capital was £1.2m Scots, the equivalent of £100,000 sterling. Only 10% was called up in the initial creation of the company. It was to have a national focus, although its activities were mainly on Edinburgh. At the time of creation, it was granted a 21 year monopoly on banking activities.

Banking in the early years was about lending rather than deposits. Loans were funded out of the called up share capital. Loans were generally to mercantile or land owners, for between £100 - £500 sterling. Interest was 6% and the loans were to be repaid within a year. The loan value could not represent more than a third of the value of the unencumbered security (Checkland, 1975).

The monopoly and standard loan terms provided the Bank of Scotland with a stable business model until the creation of the Royal Bank of Scotland in 1727. The Royal Bank of Scotland started life with a larger capital than the Bank of Scotland. It also had greater monetary and political connections to the City of London, being “part of Walpole’s political control in Scotland” (Checkland, 1975).

From their earliest days, the ‘Bank’ and ‘Royal Bank’<sup>11</sup> were intensely competitive. Each bank held strategic reserves of the other’s notes. Rival staff were used to create runs on the banks by calling in the notes en masse at certain times (Checkland, 1975). To curtail these runs between rivals, a unique option clause was added to the issued notes (Checkland, 1975). The option clause allowed the banks times to a longer time period to issue the coin to the note bearer, with interest. This helped to stem strategic bank runs by rival banks (Cowen and Kroszner, 1989). Whilst the option clause may have caused stability, it has also been argued to have caused an over issuance of banking notes in Scotland. This caused depreciation on their value (Gherity, 1995).

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<sup>11</sup> Colloquial Scottish names for the Bank of Scotland and the Royal Bank of Scotland respectively

The banks were both innovators. At the Royal Bank, the first form of overdraft was created in 1728. Interest was only charged on any amounts drawn down (Checkland, 1975). In 1810, RBS opened the Commercial Bank of Scotland. This was the first bank that was open for a new class of client – traders, farmers and ordinary merchants (Royal Bank of Scotland, 2013e). Bank of Scotland also opened many branches, with 265 in operation throughout Scotland by 1939. The banks buildings were imposing and solid, meant to indicate permanence and prosperity (Royal Bank of Scotland, 2013e). One social observer noted:

“In the Middle Ages, the village was an accretion on the feudal castle. In modern Scotland, the village seems to have grown upon the bank...” anonymous quote in Rosenblum ( 1933)

Overall, the banks were ubiquitous throughout Scotland into the nineteenth century and provided counter services to many remote and rural areas throughout the twentieth century (BBC News, 2012). Nonetheless, throughout the lives of the banks, there has been an implicit reliance on the Bank of England as a lender of last resort (Cowen and Kroszner, 1989). London was needed regularly for specie, and particularly during periods of tumult, such as during the Jacobite uprising of '45 (Checkland, 1975). In fact, crises in the Scottish banks were often caused by the collapse of their London based correspondents (Cowen and Kroszner, 1989). RBS and Bank of Scotland, being the two largest public banks in Scotland did not fulfil a similar role to the Bank of England. The two banks did provide some limited stability measures when there was a collapse of a smaller rival. The City of Glasgow Bank, the last bank run on a British bank before Northern Rock, collapsed in 1878. The banks in Scotland joined forces and immediately agreed to accept the notes of the failed bank. In some instances, there were arrangements to transfer deposits away from the bank to the respective public banks (Acheson and Turner, 2011; Acheson and Turner, 2008). Nonetheless, the banks' involvement in the stability of the banking system was limited to co-ordinate efforts amongst the entire industry.

In the earliest days, the banks were funded and managed by the very wealthiest parts of society (Checkland, 1975). By the nineteenth century, the shareholder base of the Scottish banks was diverse and passive. The shareholders saw ownership as a means of accessing capital in the 1840s. However, shares gradually became less important in accessing capital. The practice of holding shares for capital access had died out by the 1870s and the shareholders had sold off as a result (Acheson and Turner, 2011)

The Scottish people developed a reputation for being good bankers, and RBS purposefully trained more bankers than they had employment for in the expectation that the employees would be recruited worldwide (Royal Bank of Scotland, 2013e). The Bank of Scotland offered a modern career as processes were replicated from branch to branch (McKinlay, 2002). Recruitment occurred through personal recommendation and individual social status was important for promotion opportunities. ‘The man was the bank’ and punishments were inflicted when personal conduct was unsatisfactory (McKinlay, 2002).

By the beginning of the first world war, the Royal Bank of Scotland was operating internationally (Royal Bank of Scotland, 2013e). The banks were both involved in supporting Government war loans and trading controls. The first women were employed in banking duties whilst men were fighting (Royal Bank of Scotland, 2013e). In the 1920s, competition for banking customers was intense. RBS started up the ‘homesafe’ accounts designed for customers who could only save a few coins at the time, as well as the very wealthy customers. In the 1970s, RBS was the first British clearing bank to offer a home purchase loan scheme to customers as well (Royal Bank of Scotland, 2013e).

Thus, Scottish banks and their bankers became internationally recognised for innovation and prudence through the centuries. Towards the end of the twentieth century, a change in banking culture can be identified as they looked toward international corporate expansion from mature domestic markets. This overall change in approach is discussed next.

## **7.2 The Banks into the Millennium**

Previously, the Bank and Royal bank were Scottish businesses. There were international connections but generally these were utilised to service their domestic customers. By the end of the twentieth century, the banks had become more ambitious. Both sought to expand geographically and by service line. This represented a new era for the banks, stepping away from their traditional markets and headed up by a new form of banking elite (Kerr and Robinson, 2011).

RBS was intent on diversification through acquisition. It purchased a number of companies in the 1990s, such as Green Flag, and created the successful Direct Line insurance brand (Royal Bank of Scotland, 2013e). Its famous success, however, was the acquisition of NatWest in 2000. Both the Bank and the Royal Bank entered a bidding war for the large

English bank. Advances were rejected fulsomely by the directors of NatWest at the time. The directors' claim was based on neither offers having 'the right management experience...claiming inflated merger benefits...and leading to unacceptable risks and potential value destruction'(NatWest, 2000). The takeover battle was portrayed in the media as a battle between the two bank chief executives who were looking to expand out of Scotland (Kerr and Robinson, 2011) and represented a new aggressive style in Scottish Banking (Kerr and Robinson, 2012; Kerr and Robinson, 2011). RBS succeeded.

RBS hailed the takeover of NatWest an enormous success, with savings in excess of the estimated £1billion and completed within 3 years (Kennedy et al., 2006). The integration successes were then replicated with the acquisitions of further companies later on, such as Ulster bank (Kennedy et al., 2006) and Churchill Insurance. RBS had moved from a national bank of 32,670 in 1999 (Royal Bank of Scotland, 2000) to a global corporation with 226,400 employees working in 53 companies (Royal Bank of Scotland, 2007b).

Bank of Scotland had been disappointed with failing to take over NatWest. A further bid to merge with Abbey National also did not proceed (Office of Fair Trading, 2001). In April 2001, the Bank of Scotland announced a merger with Halifax plc, an English based bank. The merger was a nil premium one for one share offer with targeted synergies of £620 million per annum (Halifax, 2001). The merger was promoted as favourable for competition:

"The combination of Bank of Scotland and Halifax to form HBOS will create a major and distinctive competitor in the UK financial services market, having the scale and expertise to challenge the 'Big 4' clearing banks" (Halifax, 2001)

For the Bank of Scotland, the deal with Halifax was seen as acceding power to England (Kerr and Robinson, 2011). Nonetheless, the newly merged group focused on a high growth strategy within the UK (HBOS, 2002) and did not acquire further businesses, even though opportunity arose (HBOS, 2004). In 2005, the old Chairman stepped down, with Andy Hornby becoming chief executive of HBOS (HBOS, 2005).

After the success of the NatWest takeover, the RBS strategy continued to be acquisitive. Much of RBS' funding problems originated from the large acquisition of ABN Amro in October 2007. This left it with a large amount of toxic assets and low levels of cash on the cusp of the global financial crisis. The bank, in consortium with Fortis and Banco Santander, had paid a premium for ABN which was then broken up between the three banking giants. ABN Amro was an internationally recognised bank based in the

Netherlands. Its takeover by the consortium is one of the largest hostile takeovers ever completed. The nature of the bid and the corresponding impact on RBS is worth documenting. It demonstrates the nature of RBS' acquisitive strategy, its desire to decrease risk through diversification, and its steadfast ambition to continue its purchase of ABN Amro, despite poison pills and severe uncertainty in the financial markets at the time of the takeover.

ABN Amro had been a successful bank and had a large international presence. It had acquired many banks in different countries and had achieved good growth through this strategy. However, the banks had also had a number of restructures during its acquisitive phase and the markets had not responded well to this (ABN Amro, 2010a). Moreover, its costs were very high compared to other banks and its share price remained low as a result. It was an attractive takeover target.

In February 2007, ABN Amro posted modest results, which showed that profits had risen but cost rises had outstripped earnings growth (Euroweek, 2007a). Before the shareholders meeting that April, there were proposed motions for the break up or sale of the bank and a demand to stop its acquisitions (Degorce P, 2007; Euroweek, 2007b).

Some weeks later, Barclays plc, a British based international bank announced to the market that it was in exclusive talks with ABN Amro about a proposed merger (Barclays, 2007a), putting ABN's bid share price at approximately €32.70/share (Dutch News Digest, 2007). These were exclusive discussions between the banks and lasted until the 20 April that year (Barclays, 2007b). A few days prior to the end of the talks, RBS, in consortium with Fortis and Banco Santander announced interest in the bank too. The consortium (hereafter known as RFS) agreed to meet with ABN Amro on 23 April to discuss their own proposal so that they may be considered alongside the Barclays offer (Royal Bank of Scotland, 2007f).

RBS would lead the break-up of the bank and asserted there was less transaction risk since all of the banks had presence in the markets in which ABN operated (Royal Bank of Scotland, 2007c). The banks requested the co-operation of the ABN board. They completed limited due diligence and had little further information over what had already been received by Barclays and by Bank of America (*ibid*, p1). ABN had reluctantly offered access to RFS for conducting due diligence, with the condition that an offer not proceed for 12 months (Royal Bank of Scotland, 2007c). The consortium then announced an intention the next day

to bid for 100% of the bank's shares. However, there were questions over the ability of RBS to come up with the cash for the deal and that the other banks would have to initiate large public rights issues (Economist, 2007).

The transaction would involve some complexity given that it was a break up bid. First of all the assets would transfer to a subsidiary of RBS, named RFS Holdings Ltd. This subsidiary was represented in the 2008 accounts of RBS. ABN Amro would then be reorganised into three divisions to help with the relevant parts of the bank ending up with the correct consortium partner (Royal Bank of Scotland, 2007a). RBS was seeking annual cost savings of €2.01bn and expected integration costs of €3.84bn (*ibid*, p13). RFS believed the consortium provided the breadth of expertise to enable the ABN businesses to be most successfully built upon and integrated, over a single buyer like Barclays. Likewise, they all had a good track record of previous acquisitions. RBS remarked upon the success of the NatWest bid, achieving over £2bn in cost synergies (*ibid*, p14).

The consortium had further issues with persuading the regulators of the deal, as the consideration for ABN would stretch the capital ratios of each of the banks to a 'degree that should make the rating agencies uncomfortable.' RBS, as the main partner, was effectively underwriting the deal by taking on the full bank through the subsidiary RFS Holdings Ltd. The banks also acknowledged that they didn't have a lot of facts about the bank, given that the consortium has based its offer on limited due diligence (FT.com, 2007).

On 16 July, the consortium revised its offer for ABN Amro. The acquisition vehicle remained RFS Holdings Ltd, an RBS subsidiary which would distribute the assets of ABN to the other banks as agreed (Royal Bank of Scotland, 2007d). For each ordinary share of ABN Amro, RFS was offering:

- €35.60 cash and
- 0.296 newly issued shares in RBS with a nominal value of £0.25 (*ibid*, p2).

This gave a total consideration for ABN Amro of €71.1bn which was declared binding in October 2007. Yet the preceding month had been one of considerable uncertainty for the financial markets as the pending US subprime crisis caused considerable mistrust in the wholesale money markets. However, the Dutch financial regulator, the DNB, did recognise the potential regulatory impact of these times and had made enquiries to this effect before giving its declaration of no objection to the takeover:



“In this context it should be noted that this recommendation is issued under special circumstances. Not only is the issue at hand an unprecedented case where a consortium of three banks desires to take over and break up a system-relevant bank, but, since several weeks [sic], also with great uncertainties in the financial markets. These special circumstances impose special responsibilities on all parties concerned...” (DNB, 2007)

Nonetheless, the banks were certain that there would not be an issue for them as they continued to have good credit ratings. The DNB urged caution and recommended that the financing be further secured before declaration of no objection would be in place:

“Despite the uncertainties on the financial markets..., the Applicant does not foresee problems for the success of the issues, given the financial status of the parties concerned. The above does not alter the fact that the consideration (largely in cash) involved by the public offer issued will still need to be produced. The present uncertainties on the financial markets, i.e. those created by liquidity drying up – which make banks increasingly dependent on call money and various segments of the capital market, such as securitisations, hybrids and bank debt certificates, have led to special attention being paid to the solvency and liquidity positions of both the Applicant and ABN AMRO Group...DNB therefore deems it imperative that the financing be adequately safeguarded” (*ibid*, pp9 – 10).

Despite the warnings of the DNB, the takeover of ABN Amro was completed. Shortly afterwards, the financial crisis occurred, with a sharp contraction in liquidity in the money markets after the collapse of Lehman Brothers in September 2008. There were also the large potential losses from the revaluation of financial instruments, such as the ABSs and CDOs. RBS suffered greater exposure to the financial instruments following the takeover. Moreover, RBS had limited capital and cash to absorb losses on assets, having invested in ABN Amro. 6 months after takeover, RBS announced a £12billion rights issue to increase capital ratios in the face of the turbulent financial sector and its capital write downs in the year (Royal Bank of Scotland, 2008a). The rights issue was 95% subscribed (Royal Bank of Scotland, 2008f). It was nonetheless met with a lot of criticism as the ABN Amro purchase was questioned. Moreover, there was concern at the dramatic change in RBS’ outlook in a very short time (Royal Bank of Scotland, 2008c). By October 2008, the bank was two hours away from having no funding or liquidity and required over £45bn in Government money to stay afloat (National Audit Office., 2010). The Chief Executive of RBS, Fred Goodwin, was succeeded by Stephen Hester shortly after Government intervention on 21 November 2008 (Royal Bank of Scotland, 2008b). The Chairman, Tom McKillop, was replaced by Phillip Hampton in April 2009 (Royal Bank of Scotland, 2008b).

Overall, the demise of RBS can be attributed to an extent on the ill-judged acquisition (Hamilton and Micklethwait, 2006) of ABN Amro. Overconfidence had been generated by a successful acquisitive history previously. ABN Amro, however, was a much larger acquisition and had not received extensive due diligence. Lloyds Banking Group, on the other hand, had become deeply entrenched in the crisis by acquiring HBOS. HBOS was bought at the peak of the crisis and with extensive exposure to the depressed property markets. The next part of the chapter therefore focuses on the story of LBG and HBOS.

### **7.3 Lloyds Banking Group**

Lloyds Banking Group was formed when it formally merged with the failed HBOS bank in January 2009. When the two companies merged, Lloyds Banking Group became the UK's largest banking provider. Currently, LBG has over 30 million customers in retail and commercial sectors. The bank Chief Executive is António Horta-Osório, who joined in 2011. Key to the appointment of Horta-Osório was his experience in integrating banking franchises in the UK (Lloyds Banking Group, 2010b). The chairman of the bank is Sir Win Bischoff. He joined the bank in 2009. Sir Win had previously been Chairman of Citigroup (Lloyds Banking Group and Llo, 2009).

Lloyds TSB was itself a product of a merger between Lloyds Bank and 'The Savings Bank' (TSB) in 1995 (Lloyds Banking Group, 2014). The TSB was set up in Dumfriesshire in 1810 by the Reverend Henry Duncan to encourage the poor to save. Lloyds bank originated in 1765 in Birmingham and operated out of a single office for nearly 100 years, before expanding into London (Lloyds Banking Group, 2014).

LBG sought a competitive advantage to buying HBOS at the height of the banking crisis. Competition concerns about the size of the merged bank were dismissed in favour of a private sector solution to the failure of HBOS (Darling, 2011). HBOS had been heavily exposed to downturn in the property market and overall market dislocation (HBOS, 2009). Interestingly, HBOS' exposure to the liquidity markets was less than Northern Rock. At the end of 2007, HBOS relied on wholesale markets for 56% of its group funding, £280bn (HBOS, 2009). As market conditions deteriorated, its ability to fund from the wholesale markets became increasingly difficult. The banks did not trust each other generally. However, HBOS was particularly vulnerable in the perilous conditions. It had embarked on an acquisitive programme of assets, and market expansion (House of Commons - Treasury

Committee, 2009a; HBOS, 2008e). It was offering more loans to customers using wholesale funding rather than customer deposits to drive the growth. Much of this growth was concentrated in the property sector. By June 2008, 38% of its total corporate treasury book was concentrated in the commercial property area (HBOS, 2008d). Added to that, the retail sector wrote a great deal of new mortgages, with ‘1 in 5 approved mortgages’ originating with HBOS (*ibid*). It was exposed to any downturn in the property markets.

HBOS tried to raise £4bn in a rights issue in July 2008 to strengthen its capital base. This would act as a buffer on assets at fair value and help to absorb property market impairments. The rights issue was fully underwritten and was offered at a 45% discount to the market value of the shares at the time. However, the rights issue failed, with only 8.29% of shareholders subscribing for the shares (HBOS, 2008b). The markets were concerned about HBOS’ ability to come through the crisis (Seib, 2008; Flanagan, 2008; Guardian, 2008; Croft J, 2008a; Croft J, 2008b).

The collapse of Lehman brothers on 15<sup>th</sup> September created widespread panic in the markets. The prospects for HBOS were particularly dim. Customers withdrew deposits, increasing pressure to obtain wholesale funding. From June to December 2008, HBOS lost over £36bn in customer deposits<sup>12</sup> attributed to withdrawal of deposits primarily from corporate customers (HBOS, 2009). Despite announcements from both HBOS (HBOS, 2008c) and the FSA (HBOS, 2008c) to the markets that the bank was satisfactorily funded, HBOS’s share price declined by 50% between 10<sup>th</sup> and 17<sup>th</sup> September<sup>13</sup>. On 17<sup>th</sup> September, HBOS announced it was in talks with Lloyds about a possible merger (HBOS, 2008a). On 18 September 2008, the merger was formally announced (Lloyds TSB, 2008c). For the Chancellor of the Exchequer, the economic situation overrode any concerns about competition:

“Lloyds had considered a takeover before but knew that it would fall foul of the competition rules in the UK, because the two banks’ combined share of the mortgage market would be too great. Nevertheless, it looks as if they would now be ready to take over HBOS, thereby providing the banks with the much-needed capital to stay afloat. I discussed the takeover with Eric Daniels on 17 September. I told

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<sup>12</sup> £258bn at 30 June 2008 (HBOS, 2008e); £222bn at Dec 2008 (HBOS, 2009)

<sup>13</sup> 299.75p at 10 Sept; 147.1p at 17 Sept 2008(Lloyds Banking Group, 2013c)

him that Lloyds would have to be satisfied that it knew what it was taking on. For our part, we would be prepared to consider amending the competition rules in these very exceptional circumstances. Until very late in the day, we had two draft announcements ready: one dealing with a Lloyd's takeover, the other with nationalization. I talked about this with Gordon, who was as keen as I was to achieve a private sector solution, if it would work. After all, if we were stuck with HBOS, we would have to wind it down, and competition in the mortgage market would be reduced anyway. The announcement of the takeover was made the following morning, 18 September." (Darling, 2011)

The merger announcement help to sustain the HBOS share price for only a few days. By 30 September 2008, the share price of HBOS had slid to 120p, well below the pre-merger announcement price of 147p (Lloyds Banking Group, 2013c). The deteriorating market conditions meant that both Lloyds TSB and HBOS would have to raise capital under Government recommendations (*ibid.*) The terms of the merger were duly revised to reflect the deteriorating circumstances (Lloyds TSB, 2008a). Nonetheless, the Lloyds TSB board were strongly minded that the deal was an excellent opportunity for Lloyds TSB:

"This will be a unique opportunity to accelerate and extend our strategy and create the UK's leading financial services group. Lloyds TSB/HBOS's [sic] outstanding franchise will enable it to service more of its customer needs with the balance sheet strength to prosper in challenging markets. This is a good deal for customers and shareholders." (Lloyds TSB, 2008c)

The official merger for Lloyds TSB and HBOS occurred on 19 January 2009 (Lloyds Banking Group, 2008). In June 2010, LBG announced a plan to streamline their international activities, cut jobs in the middle management of the banks and invest in their relationship brands of Lloyds and Halifax and Bank of Scotland.

For both RBS and LBG, Government intervention coincided with major corporate restructuring. The acquisitions and history described above gives context to the state of the banks at the time of the initial Government investment. The next part of the chapter moves on to discuss the conditions of the Government intervention in 2008 and as updated in 2009. This is useful in assessing the nature of ownership that the banks are subject to during the research period.

## **7.4 Conditions of the Government Intervention of October 2008 and the Asset Protection Scheme of January 2009**

In return for the large scale funding of both LBG and RBS, the State imposed additional conditions on the banks. These were made during the crisis in October 2008 and then updated in November 2009. The conditions centred on executive pay for bankers, small and medium sized enterprise (SME) lending, and the Government's right to appoint directors to the board.

### **7.4.1 Restraint on Pay and Bonuses**

The banks were criticised publicly for excessive remuneration in the banking industry. The Government sought to influence incentives and policy within the industry and particularly towards cash bonuses. With regard to bonuses, it was agreed that RBS would not award any bonuses to directors in 2008. For LBG, bonuses would only be awarded via shares. In 2009, in both banks there would be limit on discretionary bonuses for staff earning over £39,000. Directors bonuses would be deferred from 2009 – 2012. The banks were also obliged to follow best practice guidelines as set out by the G20, the FSA and the Walker Review (Lloyds TSB, 2008a; Royal Bank of Scotland, 2008e). The Government commented on the rationale for the bonus restrictions:

“...we are trying to stop irresponsible remuneration, whereby people are encouraged to do something that damages the banks and, therefore, the rest of the financial system. What we are suggesting means that in future the rewards will be tied to the long-term interests of the bank.” (Hansard HC, 2008)

The banks accepted the conditions but have found the need to attract talented staff with restricted remuneration policies a difficult balance. Further details of this are explored in chapter 8.

### **7.4.2 Board Appointments**

The investment in the banks granted the State the right to appoint directors to the board. For RBS, which had received a greater proportion of Government support, the State could appoint three non-executive directors. In LBG, there would be two appointments (Lloyds TSB, 2008a; Royal Bank of Scotland, 2008e). The reasoning behind the board appointments was articulated by the Chancellor of the Exchequer in Parliament:

“It is important that we nominate people who have the relevant experience and can bring their influence to bear. I have made this point before: the boards are the first line of defence, not just in preventing banks from getting into difficulties, but in the wider system.” (Hansard HC 2008, Col 550)

The State had thus direct influence on both board membership and incentives to executives. State investment was granted subject to the banks agreeing to conditions on lending policies as well. These are described next.

### **7.4.3 Lending to SMEs and Individuals**

As well as the changes at executive level, the Government negotiated involvement in lending policies for economic reasons. The banks were committed to maintaining lending at 2007 levels and to increase lending by £25bn (RBS) and £14bn (LBG) in 2010 and 2011 (HM Treasury, 2009a; Royal Bank of Scotland, 2009b; Lloyds Banking Group, 2009d). Moreover, both would create a customer charter which would lay out these commitments for mortgage lending. The banks would publish an annual report which detailed how they fulfilled these commitments (*ibid*). Customers would benefit further through increased shared equity projects and assistance for those who risked having homes repossessed (*ibid*). For LBG, the Mound in Edinburgh would be the Headquarters for the enlarged group (HM Treasury, 2009a; Lloyds TSB, 2008c).

The continuation of private sector investment in the banks was a critical component of the Government rescue package. The banks were to maintain the commercial orientation to their activities, allowing recovery and return to profit. This in turn would allow the Government to exit from the investment.

### **7.4.4 The Asset Protect Scheme**

By January 2009, the UK economy was deep in recession with falling asset values and increasing credit default rates (Bank of England, 2009: 9 – 12). Once again, the UK Government offered additional financing to the banking industry. This time funding came through an instrument named the Asset Protection Scheme (APS). The APS was a form of insurance policy designed to buffer the banks from losses against financial assets whose values had declined dramatically (HM Treasury, 2009b). The banks would incur a level of the losses on asset values, and anything above an excess would be incurred by the Government. In the interests of stability, both RBS and LBG agreed in principle to the APS at the beginning of the year. The detailed arrangements were then discussed over the

medium term. By November 2009, LBG considered the economy was buoyant enough to allow them to fund the losses by going directly to market for further capital instead of receiving further Government assistance. LBG subsequently left the APS scheme (Lloyds Banking Group, 2009d). Nonetheless, LBG paid an interim fee of £2.5bn for the Government assurance provided before opting to fund through markets (Lloyds Banking Group, 2009d). RBS remained committed to utilising the Asset Protection Scheme (RBS, 27 Nov 2009). RBS exited from the APS scheme in October 2012, without drawing down on Government funds (Royal Bank of Scotland, 2012b).

There was an inherent conflict in objectives given to the banks. On the one hand, there was been a requirement to preserve capital to meet BASEL regulations. On the other, lending commitments required capital to be invested in individuals and small firms in a challenging economic environment. The former can be seen as trying to protect the stability of the bank, whilst the latter was concentrated on protecting consumers as stakeholders and in assisting the wider economy recover from the crisis (House of Commons - Treasury Committee, 2009a). Moreover, executive remuneration created a popular backlash against the bankers' bonuses. Responding to public feeling, the entire banking industry in addition to RBS and LBG took responsibility for the lending to the UK economy in 2011 (Project Merlin, 2011). Executive pay would be linked to the performance of the banks against the agreed to lending targets. Later on in the same year, the Financial Services Authority (FSA) published a report into the failure of RBS, citing poor management and strategic decisions, as well as implicating their own loose rein of regulation as a cause for the failure of RBS (Financial Services Authority, 2011).

Figure 7.1 summarises the key events pertaining to RBS and LBG during the research period. There continues to be considerable regulatory activity surrounding the banks to the present day. These are discussed in more detail as appropriate throughout the thesis.

The UK banking crisis resulted in fast moving and complicated events. As a result, the conditions of ownership of the RBS and LBG were complex. The next section considers this Government ownership in RBS and LBG more fully. The shareholdings are analysed next. This helps inform the discussion on the banks' status as quasi-nationalised entities. Finally, the various stakeholders involved in the banks are discussed.

**Figure 7.1: Timeline of the UK Banking Crisis 2007 - 2013**





## 7.5 The Shareholdings in RBS and LBG 2008 - 2013

This section analyses in depth the nature of the Government ownership in RBS and LBG. The total Government shareholding in the two banks is shown below. In Figure 7.2, the RBS shareholding is presented. The ordinary share capital stage can be clearly seen. As well as the ordinary share capital, The Government also holds 51 billion convertible B shares, which translate into ordinary shares at a ratio of 10:1. These were part of the original APS scheme. Finally, the Government holds an enhanced Dividend Access Share. This gives the Government the right to receive the greater of 7% of the B share nominal amount or 250% of the ordinary share dividend (UKFI, 2013b; Royal Bank of Scotland, 2008d). The Dividend Access Share expires when the RBS share price is in excess of 650p in 20 out of 30 days (*ibid.*). Overall, the economic interest in RBS for the Government is 81%(UKFI, 2013b).

**Figure 7.2: UKFI Analysis of RBS Shareholding**

HM Treasury shareholdings in RBS		Shares <sup>2</sup>	Total capital injection	Per share	Value at 31 March <sup>3</sup>
		m	£m	p	£m
Initial recapitalisation	December 2008	2,285	14,969	655	6,296
Preference share conversion <sup>4</sup>	April 2009	1,679	5,058	318	4,626
APS B shares <sup>5</sup>	December 2009	5,100 <sup>6</sup>	25,500	500	14,051
<b>Total</b>		<b>9,064<sup>6</sup></b>	<b>45,527</b>	<b>502 (avg)</b>	<b>24,973</b>
Fees received <sup>7</sup>			(305)		
<b>Total, net of fees</b>		<b>9,064</b>	<b>45,222</b>	<b>499 (avg)</b>	<b>-</b>
APS exit fee <sup>8</sup>			(2,500)		
<b>Total, net of all fees</b>			<b>42,722</b>	<b>471 (avg)</b>	

(UKFI, 2013b)

**Figure 7.3: UKFI Analysis of LBG Shareholding**

HM Treasury shareholdings in Lloyds		Shares	Total capital injection	Per share	Value at 31 March <sup>1</sup>
		m	£m	p	£m
Initial recapitalisation <sup>2</sup>	January 2009	7,277	12,957	182.50	3,543
Preference share conversion <sup>3</sup>	June 2009	4,521	1,506	38.43	2,201
Rights issue	December 2009	15,810	5,850	37.00	7,698
<b>Total</b>		<b>27,609</b>	<b>20,313</b>	<b>73.6 (avg)</b>	<b>13,442</b>
Fees received <sup>4</sup>			(381)		
<b>Total, net of fees</b>		<b>27,609</b>	<b>19,933</b>	<b>72.2 (avg)</b>	<b>-</b>
APS exit fee <sup>5</sup>			(2,500)		
<b>Total, net of all fees</b>		<b>27,609</b>	<b>17,433</b>	<b>63.1 (avg)</b>	

(All figures from statutory accounts)

(UKFI, 2013b)

In Lloyds Banking Group, the share ownership fluctuated in the first year or so of Government intervention. This can be seen in Figure 7.3. The initial capitalisation of the banks took place in the separate HBOS and Lloyds TSB. HBOS received £11.5bn in return for equity capital and Lloyds TSB took £5.5bn. Without the merger with HBOS, Lloyds TSB would have had to have taken £7bn itself (Lloyds TSB, 2008a). The HBOS shareholders were given Lloyds Banking Group shares as consideration for their HBOS shareholding (Lloyds TSB, 2008b).

In June 2009, Lloyds Banking Group redeemed the HM Treasury preference shares in place. This was executed via the proceeds of an open offer of shares, which HM Treasury subscribed to pro rata (Lloyds Banking Group, 2009c). This relieved LBG of paying £480m in preference share dividends and allowed the group to work on paying ordinary dividends in the future, as well as retaining cash during the tumultuous market conditions (*ibid.*).

The Asset Protection Scheme exit was an opportunity for the bank to demonstrate its improved perception in the market. The Board launched a £13.5bn rights issue in its place, for which the Government took up its pro rata share and 95% took up the offer for the shares (Lloyds Banking Group, 2009b). In return for the implicit guarantee which the proposed involvement in APS had given LBG during its particularly difficult period in early 2009, the bank paid the Government £2.5bn (Lloyds Banking Group, 2009d). By the end of 2012, the

Government's share in Lloyds Banking Group represented 39% of the issued share capital, down 4% from its initial 43% share (UKFI, 2013b).

Overall, the Government's shareholding in the two banks has remained substantially stable since 2009. RBS did complete a share consolidation exercise in September 2012 which was designed to reduce the number of shares in issue and to potentially help with excess volatility (Royal Bank of Scotland, 2012a). Various modest share sales have lowered the Government's voting stake from 70.3% (Royal Bank of Scotland, 2009e) to 65% (UKFI, 2013b). In September 2013, outside the research period, HM Treasury successfully sold a 6% shareholding in LBG (UKFI, 2013c) and a further 7.8% stake in March 2014 (UKFI, 2014).

The National Audit Office provide figures on the extent of Government support for the entire banking industry (National Audit Office., 2010). The National Audit Office estimate the value of support at its peak reached £1,161.88bn, of which £132.85bn was outlaid in cash (NAO, 2011, p6). In fact, this number is an accounting construct. The support schemes and facilities were all available at different times, so this does not represent just one point in time but rather the maximum amount of monies pledged up to 2011 (NAO, 2011, p7). The exposure of the State did not reach this level.

The shareholding analysis above demonstrates that the Government has been the largest single investor in both RBS and LBG since the UK banking crisis. For RBS, the Government owns a majority of the shares. For LBG, the share ownership sits at a significant minority. Now that the shareholdings have been analysed in further detail, the next section discusses the rationale for calling the banks 'quasi-nationalised'.

## **7.6 RBS and LBG: Quasi-Nationalised**

This section considers on what basis the banks could be termed as quasi-nationalised. Ambiguity arises as to the nature of ownership in RBS and LBG because of the distinct features of Government intervention. Importantly, the banks still have significant private ownership. The banks' shares continue to be traded on the London Stock Exchange. The listing rules require at least 25% of a companies' shares to be publicly traded to allow stock

exchange listing (Financial Services Authority, 2003)<sup>14</sup>. Yet by far the largest shareholder in both LBG and RBS is the Government.

The UKFI, responsible for managing the day to day shareholding of the two banks, reflects the distinct status of the banks in its reporting structure. There is an explicit commitment to managing a privatisation process for RBS and LBG (UKFI, 2013b). These banks have retained a separate management structure and have been designed to trade out of difficulties. They have not been carved into separate businesses upon Government intervention, which was the experience of both Northern Rock and Bradford and Bingley plc (UK Asset Resolution Ltd, 2013a) In this sense, the reporting of RBS and LBG is distinct, and resonates with a particular desire for the recovery of these banks.

In contrast, the banks who were taken into 100% public ownership<sup>15</sup> and are being run down are dealt with by the UK Asset Resolution Team (UKFI, 2013b; UK Asset Resolution Ltd, 2013b). These banks have had tranches of their businesses sold off. What remains are the mortgage books of these banks which are being serviced by UK Asset Resolution. There is no overarching view to onward sale beyond the Government, although opportunities are being taken to do so (UK Asset Resolution Ltd, 2013b).

Public ownership is a complicated matter. It reflects not only on the shareholdings of the companies but also on aspects of control. As a precedent, a 50% Government share of British Petroleum was considered nationalised; the sale of its shares encompassed privatisation (Vickers and Yarrow, 1988). Control goes beyond proportionate shareholdings held by interested parties (Nyman and Silberston, 1977). Under Stakeholder theory, ownership shares are also a basis for classifying SOEs as such (Heath and Norman, 2004) but further characteristics of management style may help in drawing this conclusion (*ibid*).

An accounting perspective resonates with stakeholder theory by classifying publicly owned entities based on the assessment of control. IFRS 10 outlines the basis for consolidation based on the concept of control (IASB, 2011). Control is further defined by:

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<sup>14</sup> The RBS rescue included non-voting preference shares to ensure that the public listing could be retained (UKFI, 2013b).

<sup>15</sup> Bradford & Bingley and Northern Rock

1. power over the investee;
2. exposure, or rights, to variable returns from its involvement with the investee (see and
3. the ability to use its power over the investee to affect the amount of the investor's returns (IASB, 2011)

Power may issue primarily from the existence of voting shares, but can also arise through the ability to appoint or remove members of the key management personnel of the investees, direct activities of the investee or direct the investee into transactions for the benefit of the investor (IASB, 2011).

Under the accounting basis of IFRS and its predecessor IAS 27 (IASB, 2009a) both banks have been deemed to be public sector by the Office for National Statistics (ONS), a Government body producing information on State finances (Office for National Statistics, 2013).

In addition, the Auditor General qualified the Whole of Government Accounts (WGA) produced by the UK Treasury due to the decision to *exclude* RBS and Lloyds from consolidation, saying it did not consistently apply its own policies and did not meet IFRS standards (HM Treasury, 2012). This is particularly significant since the NAO's analysis on the WGA SFP includes specific mention on a drop in market value of these assets. Thus, the investments are material from a WGA point of view (HM Treasury, 2012). The Government's viewpoint is that these investments would

'dwarf other aspects of the WGA, distorting the accounts and making it difficult to determine trends...it would also be extremely costly to carry out the consolidation (mainly because of differing year ends) which would not represent good value for the taxpayer, given the temporary expected nature of their ownership' (HM Treasury, 2012)

It is surprising that the Government opted to exclude the investment in the banks from the WGA. Audit and accounting techniques are sophisticated enough to allow analysis to continue on other aspects of WGA despite the huge numbers involved in the banks. Materiality, after all, has qualitative aspects as well as quantitative considerations (Financial Reporting Council, 2009). Furthermore, since both banks provide quarterly earnings updates to 31 March like the WGA, consolidation would unlikely be an extremely costly process. And as the numbers involved are so large, the cost would perhaps be 'good value' for the

taxpayer. It can be speculated that the decision to exclude the banks is therefore politically motivated.

There is a strong case for considering the banks to be classed as public sector bodies. Moreover, the common parlance is of privatisation when discussing the exit of Government from owning the banks (Royal Bank of Scotland, 2013a; Royal Bank of Scotland, 2013b; UKFI, 2013d). The UKFI has recruited a “Privatisation Strategy Advisor” (UKFI, 2013a).

The above discussions demonstrate the controversy caused by the ownership structures of the banks. Whilst the banks are dominated by the Government investment, the continuation of market involvement implies it would be rather partial to attribute these banks as SOEs. Therefore, alternative descriptions of the banks were considered. Quasi-nationalised was deemed the preferred term.

Hybrid organisations may be another means to describe the banks’ current set up (Thomasson, 2009; Miller et al., 2008; Kurunmäki and Miller, 2006; Mitronen and Moller, 2003) but hybrid forms can refer to both processes and organisational forms (Miller et al., 2008). It is the context of ownership which is of interest here, and how this may impact upon processes, such as financial accountability exercises.

A further alternative would be to talk of the banks being under ‘temporary public ownership’, a term favoured by the Government keen to avoid the political history associated with ‘nationalisation’ (Darling, 2011; Darling, 2008; HM Treasury, 2008a). Yet this term is most closely associated with Northern Rock, whose particular circumstances were quite different to RBS and LBG (UK Asset Resolution Ltd, 2013a).

In preference, ‘quasi-nationalisation’ helps to delineate an important political history to the terms of banks ownership whilst representing the fact that private investment is still a critical factor in shaping the banks’ own operating strategy now and in the future. Other sources have described the Government intervention as quasi-nationalised as well (Myners and Costello, 2012; Kerr and Robinson, 2012) but it does not suffer from ubiquity as hybrids may do.

The implications of quasi-nationalisation are investigated further next. Here, the focus turns to whom the banks are accountable and how. The particular interest is on the Governmental

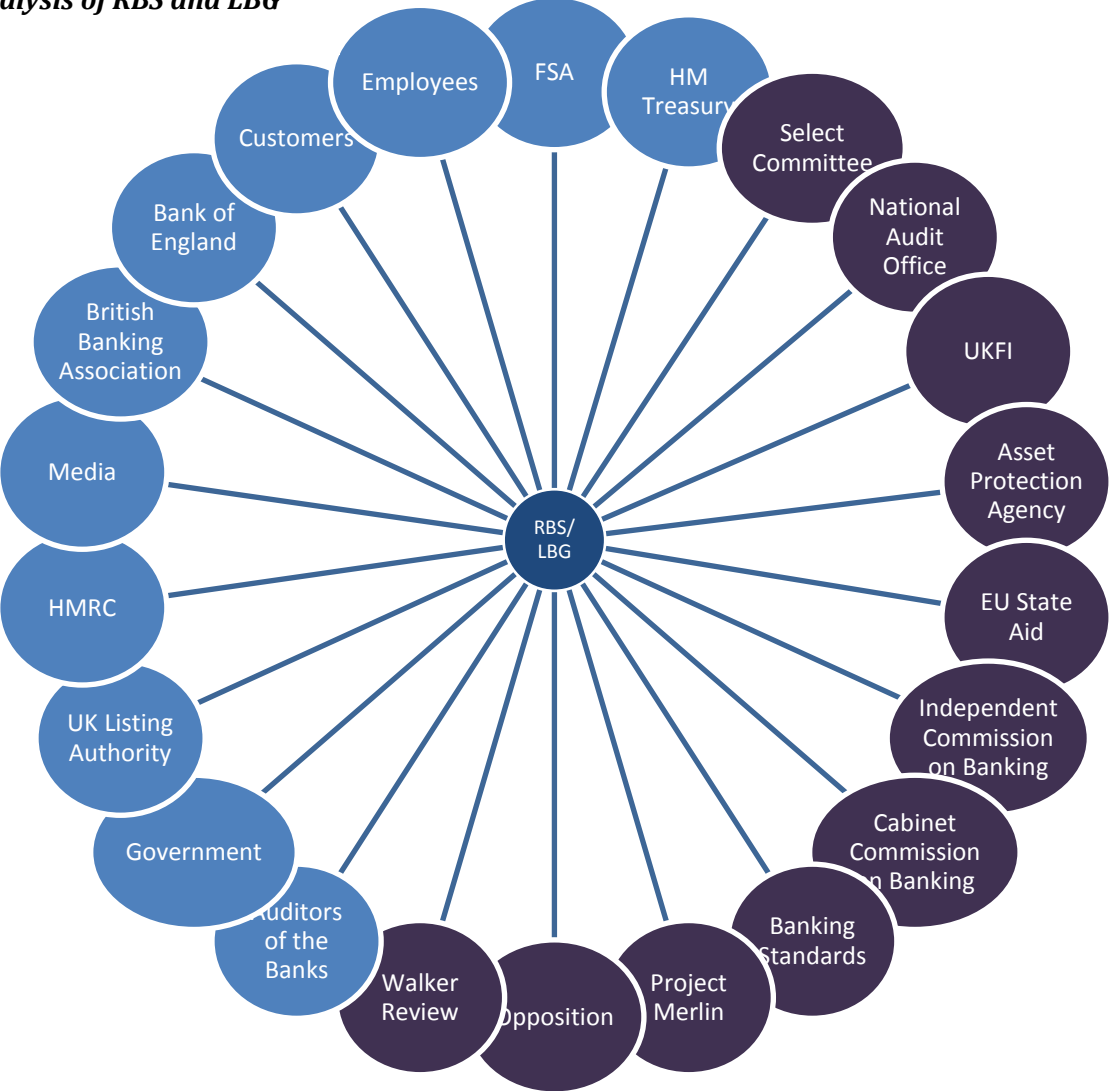
oversight bodies. The section demonstrates that accountability of the banks is extensive with State investment.

## **7.6 Accountability of the Quasi-Nationalised Banks**

Using a stakeholder approach, the diagram below shows the important stakeholders of RBS and LBG. The purple half of the diagram represents the new bodies which have had increased involvement since the Government intervention. The blue circles represent the more classical view of stakeholders involved in private corporations (Freeman R, 1984).

It is notable that there has been a large amount of activity related to the banks and banking industry since the quasi-nationalisation. The following discussion considers the additional stakeholders identified in the diagram below and gives a brief background on them. It considers stakeholders identified in Parliament, the regulators of the banks and then the numerous Government inquiries and commissions prompted by the banking crisis.

Figure 7.4: Stakeholder Analysis of RBS and LBG





### **7.6.1 Parliamentary Stakeholders**

Within Parliament, the most influential members are the Government. From the outset of the banking crisis until May 2010, Labour was in Government. Alistair Darling, as Chancellor of the Exchequer and Gordon Brown, as Prime Minister, were most influential in negotiating the intervention into RBS and LBG. The opposition, comprising of Conservatives and Liberal Democrats were elected to Government in May 2010. George Osborne, now Chancellor of the Exchequer and David Cameron, Prime Minister, continue to lead reform of the financial services industry (UK Parliament, 2012). Vince Cable, a Liberal Democrat, now part of the Coalition Government as Business Secretary, has also been an influential speaker and analyst on the banking crisis.

The Parliamentary select committees have been involved in analysing the events of the banking crisis. The Treasury Select Committee held an inquiry into the UK banking crisis in 2009 (House of Commons - Treasury Committee, 2009a). This encompassed a number of reports which focused on different aspects of the banking crisis. They took evidence from a number of prominent individuals at the centre of the crisis, including Fred Goodwin, Andy Hornby, Stephen Hester and Eric Daniels, all executive management at HBOS, RBS and LBG.

Other select committees considered the failure of RBS and LBG. The Scottish Affairs Committee considered the impact on Scotland by the failure of two very Scottish banks (Scottish Affairs Committee, 2010). The Economic Affairs committee look at the structure of banking in the UK (Economic Affairs Committee, 2009). Overall, Parliament has been very involved in investigating the banking crisis.

More recently, the Banking Standards Joint Select Committee has considered the culture and professional standards of the UK banking industry (Banking Standards Inquiry, 2013b). It included Justin Welby, the Archbishop of Canterbury and former business executive. It also published a report into the failure of HBOS (Banking Standards Inquiry, 2013a). The reports of their findings are outside the data collection period for this PhD.

## 7.6.2 Regulators

The banking industry has been subject to regulatory oversight during the research period of the Tripartite Authorities, comprising the Financial Services Authority, the Bank of England and HM Treasury<sup>16</sup>.

The Financial Services Authority had day to day oversight of the banks. They had ultimate authority to deem banks able to be ‘deposit taking institutions’ (Financial Services Authority, 2002). The authority was also author of the ‘Failure of RBS’ report after receiving extensive criticism on the way that it supervised this bank (Financial Services Authority, 2011). The UK Listing Authority, a branch of the FSA, regulates the securities traded on UK stock exchanges.

The Bank of England had responsibility for overall financial stability in the economy. It implemented a number of initiatives designed to assist the economy during the crisis. These included quantitative easing (Bank of England, 2013a); loose monetary policy with historically low interest rates (Bank of England, 2013b) and the funding for lending scheme. Funding for lending was an incentive scheme for banks to encourage further lending in the economy (Bank of England, 2012b).

Other regulators played important roles during the banking crisis. HMRC were responsible for assessing the corporations’ tax charges. This was politically charged as RBS temporarily forfeited the right to claim back tax losses as part of the APS Scheme (Royal Bank of Scotland, 2009c). The Office of Fair Trading was involved after the Independent Commission on Banking recommended that they investigate UK banking. RBS and LBG hold large portions of the UK retail banking market. The Office of Fair Trading conducted an industry review which is still on-going (Office of Fair Trading, 2013).

Finally, the external auditors of the banks play a quasi-regulatory role. By virtue of the Companies Act (2006) and its predecessors, auditors are required by the State to examine the financial statements of the largest UK companies.

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<sup>16</sup> There has been a substantial reform of banking regulation implemented in April 2013, after the cut-off date for the thesis (UK Parliament, 2012).

### **7.6.3 Government Agencies and Inquiries**

Government agencies have been responsible for the day to day running of the UK Government's investment in RBS and LBG. HM Treasury is the ultimate investor in the failed banks. UK Financial Investments Ltd (UKFI) was set up as an independent company, at arm's length from the Government, to manage the State's shareholdings in the banks. The Asset Protection Agency (APA) had responsibility for managing the Asset Protection Scheme. The agencies were independent to be buffered from political interference and to utilise specialist banking expertise (UKFI, 2009, para 7.1; APA, 2009). The commercial attitude to the shareholding has been captured by equating the UKFI to an institutional investor:

"I suppose the philosophy that runs through the Framework Agreement and through the Chancellor's announcement last autumn about setting us up was a belief that the best way of getting these banks back on their feet and back into the private sector properly was for them to be run commercially by proper independent boards and for those boards to be running the banks and not for the Government to be running the banks or indeed for UKFI to be running the banks. I see our role as managing the shareholdings, and I do see a very important part of that as having all the dialogue you would expect a serious shareholder to have around management, strategy, performance, capital, risk management, all of those issues, but we are not running the banks and I do not believe that, were we running the banks, we would get the quick exit that the Government wants to see and we want to see." (House of Commons - Treasury Committee, 2009c)

Nonetheless, the recruitment of senior staff for UKFI and APA are ratified by the State and give the Government the right of veto over strategic decisions of the agencies (UKFI, 2009; Asset Protection Agency, 2009). The monitoring of these agencies is HM Treasury and through their representatives the Treasury Select Committee and the UK Parliament (UKFI, 2009: 9.18 – 9.20; APA, 2010 part 7 & part 12). The APA was closed in October 2012, after RBS withdrew from the asset protection scheme. RBS did not draw down on the Asset Protection facility whilst it was in place (Asset Protection Agency, 2013).

The national audit office provide special reports considering the value of UK support to the banks (National Audit Office., 2012; National Audit Office., 2010). Thus there has been considerable scrutiny of the Government investment into RBS and LBG.

## **7.7 Concluding Remarks**

The aim of this chapter was to give an introduction to the research context of the study. The chapter started with a discussion on the long term history of the banks and discussed their rivalry since setting up in the 17<sup>th</sup> and 18<sup>th</sup> centuries. The banks were also pioneers. The

chapter then discussed some key corporate transactions for both RBS and LBG around the millennium. Government intervention at the height of the crisis was then discussed. The events of the UK banking crisis unfolded very quickly. Moreover, there was some complexity initially in resolving the positions of RBS and LBG. As a result of Government action, RBS and LBG have been given the chance to trade out of their troubles. The solution, it is arguable, was practical in a time of deeply distressed markets. It helped to shore up the economy by keeping trust in the UK banking system. Yet it also left the responsibility to sort out the banking losses within the private sector. The risk to the taxpayer was considerable but there is a possibility that this money will be recuperated in future years through privatisation.

The second part of the chapter considered the nature of the ownership of RBS and LBG. To do this, the Government shareholding was considered in detail. The rationale for terming the banks quasi-nationalised was discussed. Finally, the stakeholders now involved in the banks were analysed. The focus here was on the State. The nature and extent of Government ownership in the banks provide this novel context in which to consider accountability. The massive increase in stakeholders which has accompanied the State support of the banks confirms that accountability has the potential to be ambiguous (Thomasson, 2009) and fluid (Sinclair, 2002). The implications for quasi-nationalisation are discussed in the first empirical chapter next, which explores the negotiation of accountability post crisis using property rights theory and agency theory.

# Chapter 8: Negotiating Accountability Post Crisis: Implications of Quasi- Nationalisation

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This chapter analyses the additional accountability mechanisms created during the crisis from agency and property rights theory perspectives. These theoretical insights then allow the form and substance of quasi-nationalisation to be considered. As majority shareholder, the State enjoys the traditional market mechanisms of accountability through annual reports and other related market information. Yet the Government has also negotiated additional components of accountability when these banks faced failure. The analysis with property rights theory, below, asserts that the current accountability structures present a challenge to property rights theory, with its preference for private ownership. Nonetheless, property rights theory allows the implications of public sector ownership to be considered in light of a new owner identity. Following on from this, an agency theory perspective is considered. Agency theory highlights the importance of the share prices and of customers as incentives but fails to provide detailed insights into the mechanisms by which accountability is achieved with regard to bonuses.

Using insights from property rights theory and agency, the deeper implications of quasi-nationalisation for the bankers and the politicians can be considered. Overall, accountability is greatly influenced by the political process which agency contracting and property rights negotiations bring to the fore. Yet the theories are quiet as to why negotiations proceed as they do. Quasi-nationalisation in this respect provides a rationale for these peculiarities and advocates instead that the negotiation of accountability is less about political confrontation than it is about collaboration. The mechanism of quasi-nationalisation reinforces the sense of the banks retaining a commercially oriented agenda. Yet political negotiations can be done publicly and allow the State to intervene in times of heightened citizen interest.

The banking crisis and the subsequent actions to enable stability in the UK provide a natural forum for considering property rights theory. Whilst property rights theory has advocated that common ownership causes inefficiency and a lack of monitoring, the practical impact of quasi-nationalisation suggests otherwise.

## **8.1 Negotiating Accountability: A Property Rights Perspective**

The first part of the chapter analyses the accountability of the banks to the State using a property rights perspective. The first two sections highlight the shortcomings of property right theory's proposition against State ownership. The first part looks at the failure of the apparently more rigorous checks of the private sector. The second part looks at the need for more rather than less, State participation in banks which are 'too big to fail'. The third part of the analysis looks at the State's rejection of the bank investments as an asset and its conceptualisation of its intervention as a 'cost'. The final sections consider additional conditions of Government investment in relation to pay and lending and how these are monitored, negotiated and dispersed.

### **8.1.1 The Failure of Private Sector Scrutiny: Markets and Auditors**

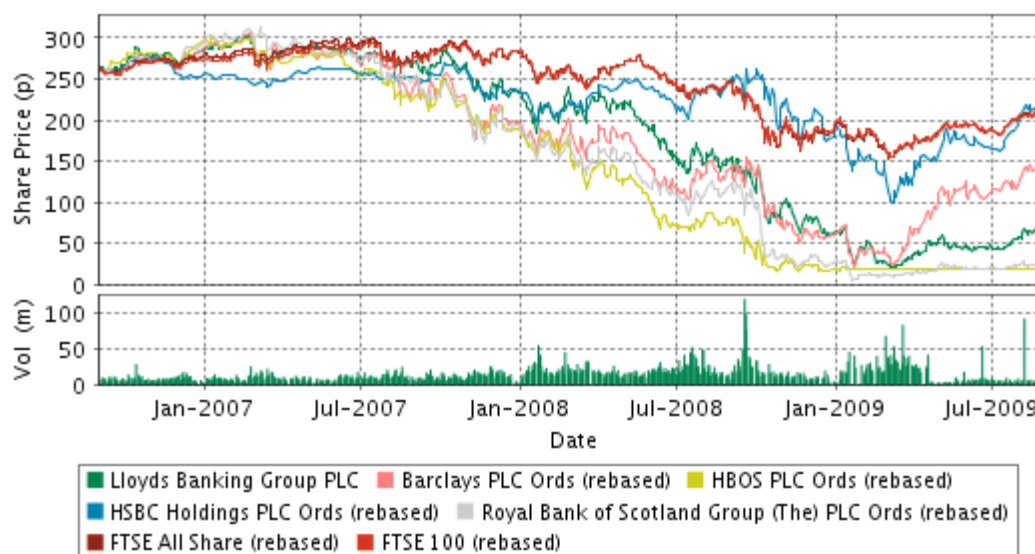
The standard means of monitoring corporations occurs in market mechanisms and the auditing of them. Property rights theory advocates that resources are utilised more efficiently under private ownership (Dewenter and Malatesta, 2001; Boardman and Vining, 1989). This is due to a more challenging and extensive monitoring system (Alchian, 1974; Alchian and Demsetz, 1973). Under public ownership, there is little incentive to monitor State owned corporations because the benefits from doing so are negligible. The only mechanism to express monitoring efforts is through the electoral vote, which monitoring and non-monitoring citizens have equivalent power over. Thus, it suffers from an extensive free-rider problem.

Yet, in the UK, private sector monitoring mechanisms did not anticipate the banking crisis. Losses incurred have been socialised whilst the banks trade out of difficulties. The following section discusses the lack of anticipation by private markets and the auditors of the big banks.

Figure 8.1 shows the largest UK FTSE banks' share prices from September 2006 to September 2009. The subprime crisis is generally agreed to have begun in August 2007, with the Northern Rock liquidity support happening in September that same year. There is an expectation under the strong form of efficient markets hypothesis (Malkiel & Fama, 1970) that all relevant market information would be incorporated into the share price of the banks and rightly or wrongly, the efficient markets hypothesis has been singled out for blame for not predicting the crisis (Ball, 2009). Figure 8.1 shows that share prices only started to go downwards after the subprime crisis began in August 2007. The crash pre-dated the major

readjustments in share prices of the banks, which may suggest a lack of anticipation on the part of market analysts.

**Figure 8.1: Banking Industry Share Prices: August 2006 – August 2009**



Source: Lloyds Banking Group Historic Share Price Comparisons: [http://www.lloydsbankinggroup.com/investors/share\\_price\\_information/share\\_price\\_charting.asp](http://www.lloydsbankinggroup.com/investors/share_price_information/share_price_charting.asp) accessed 2 April 2013

Share price crashes are an enduring feature of economic crises (Kindleberger and Aliber, 2005) and may be responded to with regulatory change (Carnegie and O'Connell, 2013). Whilst this may place crashes in a cycle of banking failures globally and across time ((Laeven and Valencia, 2008), it also points towards a continuing flaw in monitoring. Radical overhaul of regulation may be the answer (Carnegie and O'Connell, 2013) which could have a corroborating influence on Government protection of property rights.

Private property rights may be enhanced by the quality of auditor information provided to the principals (Iossa and Legros, 2004). In hindsight, the quality of auditor information for the banking industry has been negligible through the crisis. The audit reports did not identify any issues with the going concern of the UK banks in the run up to the crisis. Table 8.1 below shows the audit report outcomes for the banking industry since 2002. All the large banks have been given clean, boilerplate audit reports and opinions.

**Table 8.1: Audit Report Outcomes for the FTSE 100 UK Banks**

<b>Bank/ Year</b>	<b>RBS</b>	<b>LBG/ Lloyds TSB</b>	<b>HBOS<sup>18</sup></b>	<b>Barclays</b>	<b>HSBC</b>
<b>2002</b>	Unqualified <sup>19</sup>	Unqualified	Unqualified	Unqualified	Unqualified
<b>2003</b>	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
<b>2004<sup>20</sup></b>	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
<b>2005</b>	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
<b>2006</b>	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
<b>2007</b>	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
<b>2008</b>	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
<b>2009<sup>21</sup></b>	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
<b>2010</b>	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
<b>2011</b>	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified
<b>2012</b>	Unqualified	Unqualified	Unqualified	Unqualified	Unqualified

The UK banking crisis has not been reflected in the audit reports of the largest listed banks. Little is known about how audit processes help to arrive at the report itself (Sikka, 2009). Yet continued support of the State through equity investment has been required to keep HBOS, LBG and RBS as going concerns since 2008. A significant uncertainty which may impact on the going concern assumption may often result in an emphasis of matter paragraph in the report (ISA 700, para 47). Yet in this case, the auditors themselves have neither referred to the significant uncertainty nor the need for Government support. Instead, it appears the relevant auditors relied on Government representations to assess the going

<sup>17</sup> Group Annual Report Opinions for UK Listing Purposes Only

<sup>18</sup> HBOS was delisted from the stock exchange following the LBG takeover in 2008. Subsequent audit reports are for the old HBOS group and have not been required to meet listing rules.

<sup>19</sup> Unqualified opinion here also includes no emphasis of matter paragraphs, which did not impede the issue of a clean audit report (ISA 700).

<sup>20</sup> Transition year to IFRS for UK Listed Companies (IAS 1)

<sup>21</sup> Significant updates to IAS 700 Audit Reporting came in for the banks this year.



concern for RBS in 2008 (House of Lords, 2010 p224). It is unknown whether there was regulatory pressure to provide these particular reports (Sikka, 2009). Nonetheless, the validity of this report remains tautological, with the main beneficiary shareholder, the State, having its own reassurances forming the basis of the clean audit report. State (non)-action on the basis of a clean audit report can leave the profession having to defend itself when there is overreliance on its value (Wright, 1994).

Property rights theory may initially seem to be too trusting in its predictions for the quality of the private market monitoring, given the scale and complexity of the UK banking crisis. Yet it also provides a basis to assess the implications of public ownership on commercial enterprises and what this may mean under the structure of quasi-nationalisation. In this respect, quasi-nationalisation helps to balance out the failures of the market monitoring as well as some of the implications for public sector ownership as envisaged by property rights theory. Private sector monitoring is still enabled with a stock exchange listing. The State then becomes a beneficiary of private sector expertise (Alchian, 1974). In fact, the monitoring of the banks is heightened as high profile firms in the media receive more attention from investors than those who receive less press coverage (Fang and Peress, 2009). Yet at the same time, the Government is able to capitalise on its own position by smoothing the trading environment for the banks by facilitating clean audit reports at a time of considerable economic stress. In other words, quasi-nationalisation presents a space for the banks to exploit and return to financial health. The markets are left to run as before without radical overhaul from the Government. The spectre of nationalisation can be diminished through a light touch to the corporations (Darling, 2011). Yet political intervention and power can still be negotiated through ownership.

### **8.1.2 'Too Big to Fail' justifies more State Participation**

Property rights theory finds that State and mixed ownership firms are less efficient than those in the private sector (Dewenter and Malatesta, 2001; Boardman and Vining, 1989) and thus private ownership is desirable. There is an opportunity cost for not pursuing profitable opportunities as aggressively as in a private sector firm (Crain and Zardkoohi, 1978). Contrary to property rights theory thinking, the EU decreed that *Government* backing would create unfair advantages for the banks and distort the markets (Europa and Europa, 2008). The EU postulated that the banks had possible advantages of rapid expansion at the taxpayer's expense or increased sales on the back of Government guarantees (*ibid.*). It could also enforce preferences for particular member States (Europa and Europa, 2008). Social and political goals instead of economic efficiency may be at the heart of Government

ownership (Eggertsson et al., 1996). The costs are then borne by all EU citizens, whereas the benefits are concentrated in the British State. For RBS, the EU State aid directives have included the floatation of its insurance arm, Direct Line; divestments in Global Merchants Services and a Sempra Commodities JV, as well as the sale of 315 bank branches (RBS, 2012, p41). LBG too required a divestment of branches under EU State Aid (Europa, 2008, 1495). The Independent Commission on Banking recommended that the divestment of LBG be significantly enhanced to promote competition in the personal current account markets (ICB, 2011, p205).

Moreover, LBG accepted that it needed to pay for Government protection received from the Asset Protection Scheme in principle even though the legal format of the scheme had not yet been completed. When the time came to finalise the scheme, an upturn in markets generally allowed LBG to exit from the contracts (LBG, 2009). Nonetheless, a fee was still payable in recognition of the increased confidence in LBG in the markets which meant it could trade more favourably (LBG, 2009, p217). This benefit arose because the Government was able to consider the upside of keeping stability in the financial system overall. As a common benefit, financial stability would not be funded by private insurance because of the free rider problem. Yet the Government was able to invest in the national, common, interest – and so keep LBG able to run its business effectively.

The identity of owners can have allocative effects under property rights theory (Alchian and Demsetz, 1973, p22). The size and concentration of the UK retail banking market means that these institutions are arguably ‘too big to fail’ which has resulted in the recommended ‘ring fencing’ in the industry currently going through the UK Parliament (Osborne, 2013). The implicit subsidy of the banks has been estimated between £6bn and £100bn by Government during the financial crisis, through guarantees when banks fail (Bank of England, 2012a). Government subsidies may encourage risk taking and transfers resources from other parts of social investment to the financial sector (Bank of England, 2012a). As a result EU State Aid, the Bank of England and the Asset Protection Scheme state a commercial benefit to Government investment. The benefit of Government ownership is contrary to the general prediction of property rights, which suggests less efficiency and risk taking in the State owned enterprise. Property rights theory sees commercial advantage lost as the socio-political objectives enforced upon the organisations by politicians mean managers lose focus on profit making. In addition, there may be a need for State Intervention to protect the public interest and restrain unnecessary risk taking which could threaten the health of the financial system again.

An alternative explanation exists under property rights theory, which may help to explain the value of State Aid via quasi-nationalisation. Increased monitoring was necessary to give incentives to act in the interests of the State (Clarkson, 1972). Less pleasant jobs may be neglected when there is no profit incentive to carry them out (*ibid.*). Here, the overarching incentive of profit remained and could have impeded the economic objectives of financial stability and competitive markets negotiated via Government. EU State Aid requirements helped to redress that balance towards the societal obligations of the banks to maintain competition within the banking industry. Quasi-nationalisation then enabled management to divest in operations without the concomitant issue of political considerations as to what is divested when.

### **8.1.3 Monitoring the 'Cost' of Intervention**

The UK banking crisis has been costly in many ways. On the one hand, there was a huge cash injection at the crux of the crisis and exposure to extensive corporate losses (NAO, 2011). Yet the State has an asset in return, which they can sell when opportunity arises<sup>22</sup>. Property rights theory espouses that there is limited incentive to monitor the organisation (Geddes, 1997; Eggertsson, 1990; Clarkson, 1972). Studies have also suggested that State owned or mixed ownership corporations are less efficient than similar private corporations (Dewenter and Malatesta, 2001; Boardman and Vining, 1989). Yet in a competitive market with an arm's length Government shareholder, these differences did not always hold (Kole and Mulherin, 1997; Caves and Christensen, 1980). Property rights theory again provides some insights into the nature of public ownership, which allow the merits of quasi-nationalisation to be considered. This next section therefore considers how the investment in the UK banks has been presented by the State.

The UK Government has opted not to recognise an accounting asset in the form of the banking investments under the Whole of Government Accounts project (HM Treasury, 2012). The Auditor General qualified the Whole of Government Accounts (WGA) produced by the UK Treasury due to the decision to *exclude* RBS and Lloyds from consolidation, saying it did not consistently apply its own policies and did not meet IFRS standards (HM Treasury, 2012). This is particularly significant since the NAO's analysis on the WGA SFP includes specific mention on drop in market value of these assets. Thus, the investments are

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<sup>22</sup> The Government sold a 6% tranche of LBG shares on 17 September 2013 for 75p each (UKFI, 2013c), 12p above the 63p share price investment quoted in the UKFI's annual report (UKFI, 2013b)

material from a WGA point of view (*ibid*, p51). The Government's viewpoint is that these investments are short term and would unduly distort the WGAs (HM Treasury, 2012).

That there is a ‘cost’ rather than asset for the State is also demonstrated by the UKFI’s own analysis of the market investments. Here the investment is shown comparing the original cost and the current value of the shares:

**Figure 8.2: UKFI’s Analysis of the Bank Investments**

HM Treasury shareholdings in Lloyds		Shares	Total investment	Investment per share	Value at 31 March <sup>1</sup>
		m	£m	p	£m
Initial recapitalisation <sup>2</sup>	January 2009	7,277	12,957	182.50	2,445
Preference share conversion <sup>2</sup>	June 2009	4,521	1,506	38.43	1,519
Rights issue	December 2009	15,810	5,850	37.00	5,313
<b>Total investment</b>		<b>27,609</b>	<b>20,313</b>	<b>73.58 (avg)</b>	<b>9,278</b>
<b>Fees received<sup>4</sup></b>			<b>(381)</b>		
<b>Total investment net of fees</b>		<b>27,609</b>	<b>19,933</b>	<b>72.20 (avg)</b>	
<b>APS exit fee<sup>5</sup></b>			<b>(2,500)</b>		
<b>Total investment net of all fees</b>		<b>27,609</b>	<b>17,433</b>	<b>63.14 (avg)</b>	

UKFI, 2012, p23

The juxtaposition of the investment value versus the value of the same at 31 March 2012 based on the closing share price of Lloyds that day (33.61p) suggests that the recoupment of the investment ‘cost’ is part of the decision to privatise or not. This is discussed in further detail under agency theory analysis<sup>23</sup>.

Property rights theory predicts limited monitoring of State Owned Enterprise. Yet the above accounting examples suggest that the opposite applies, with a critical analysis of the investments being made in terms of value and inclusion to the State. In fact, Quasi-nationalisation allows the ‘cost’ to the State to be reinforced, by not accounting for a related asset. The costs of allowing the banking system to fail in the country arguably justifies the injection of large amounts of public funds, and certainly has been the rationale behind the

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<sup>23</sup> The idea of repayment resonates to other parts of the UKFI’s “When we launched UKAR in October 2010 we owed HM Treasury £48.7bn and by the end of 2012 that had reduced to £43.5bn. We still have a long way to go, but it remains our expectation and determination to repay that debt in full.” Richard Pym, Chairman of UKAR 11 March 2013”

rescue of Johnson Matthey in the past (Bank of England, 1985). Yet there remains an expectation that original investment will be recouped in full or in part, when the time is right (Darling, 2008). Quasi-nationalisation as a mechanism structures the public funding not as a public good but as a commercial investment. And Government as an arms' length shareholder has not affected the efficiency of the private corporations in the past (Kole and Mulherin, 1997). In fact, the notion of cost to the taxpayer/ State has perhaps been misdirected:

“It's often said, you know, that the bail-out of RBS has cost the taxpayer and the government and so on billions and billions and billions...but I think one of the messages that has been lost publicly is the people who've really lost money in RBS were the previous shareholders, which includes pension funds, private individuals, other asset managers, and so on. But the government's loss at the moment is very modest, and certainly it's our expectation that the government as a whole will be able to exit with a profit from its involvement in the Royal Bank of Scotland, and certainly our plans suggest that that is likely or expected.”(Royal Bank of Scotland, 2011a)

Quasi-nationalisation offers hope for the Government in recouping the investment. But it also may offer a small compensation for the shareholders who were already involved prior to its rescue. The banks have been offered the financial space to turn the business around and there may be some recouping of losses in the long term. This was not available to those who had invested in the outright nationalised Northern Rock (Anon, 2008).

The preceding analysis has shown some shortcomings in the predictive power of property rights theory. Monitoring has not been hindered by the Government ownership as predicted and profit incentives still remain. State ownership has been seen to be an unfair benefit to the banks, rather than a hindrance to its activities. Yet the theory does allow the implications of public sector ownership to be examined, and in this way, the design of the quasi-nationalisation rescue performed on the failed banks to be considered. In this regard, Quasi-nationalisation seems to have allowed the best of the private sector markets and incentives to continue, whilst retaining the opportunity for political intervention when necessary. The next two parts of the property rights analysis consider the evolution of the additional objectives given to the rescued banks. Although the monitoring remains problematic, it does demonstrate that an enhanced accountability within the industry has arisen as a result of quasi-nationalisation.

#### **8.1.4 Restricting the Sphere of Influence**

The additional conditions of State investment can be analysed under property rights theory as property rights which have been recently negotiated (Eggertsson et al., 1996; Libecap, 1978).

There was the opportunity to exploit vague delineation of property rights and lobby the Government to change these in the interests of management (Libecap, 1978; Riker & Sened, 1996). This had impact because the property rights pertaining to the additional conditions are limited to State ownership and are non-transferable. In consequence, to free them of further obligation, property rights theory predicts that management will lobby to reduce the impact of the obligations upon the bank and to return to the private sector.

Lobbying and change has been a feature of the relationship between the banks and the State since the Government Investment. On the general level, the banks have criticised the capacity and inclination of the State to intervene. Without a clear specification of the rights of influence, the banks are relatively powerless to reduce the Government involvement with their operations. Instead, they highlight the disadvantage of a politically driven agenda, and how this may be bad for State interests too:

"We have been very clear that the process of politicisation of RBS is damaging to our business and it is damaging to the taxpayer's interest. Our share price was 50p-a-share some three months ago...the subsequent stuff over bonuses has reduced the share price, and therefore the value of the state's shareholding in us, by a very considerable amount - nearly 40 per cent. That, by the way, is more than GBP 15bn of taxpayers' money." (Thomas, 2009)

There has been evidence that socio-political objectives of Government may depress market assessments of corporations in previous property rights literature (Boardman et al., 1986). Property rights theory would predict that management would be incentivised to reduce the influence of the State through further specifying property rights. In this case, negotiate circumstances *ex ante* which would constitute acceptable intervention operationally. The additional obligations already imposed on the banks offered this opportunity. Capturing property rights through ever increasing delineation of property attributes (Eggertsson, 1990) would allow the banks to repatriate small pockets of power back to management. Surprisingly, the banks have not done this as property rights may predict. Instead, they have presented a positive picture of the requirements:

"A significant proportion of the Group's capital supports assets which account for a disproportionate level of risk and are not consistent with the strategy of building sustainable, relationship based businesses...Given the less capital intensive and higher returning nature of relationship-based businesses, the Group believes it will be able to support its growth ambitions whilst shrinking its balance sheet at the same time." (Lloyds Banking Group, 2009a)

Looking at the detail of the targets shows that there has been interest in keeping them opaque rather than specifying them further. This is the opposite of what would be predicted (Barzel, 1997; Libecap, 1978). At first, the targets for lending appear precise due to the inclusion of

numerical quantities. However, the lending to business principle remains subject to current (depressed) levels of consumer demand and requisite (rising) costs of customer borrowing (Project Merlin, 2011). This is a logical caveat on the lending levels agreed but also an easy get out clause to the opportunistic bank who may fail to reach targets. The Government conceded:

“As subsequent events proved, trying to get an agreement on levels of bank lending that will stick is well-nigh impossible. It is simply not possible to force a bank to lend to a particular borrower.” (Darling, 2011)

Thus, by blurring the boundaries of success, the banks have further recaptured more operational discretion for themselves. Yet there was an incentive to keep the targets relevant as the Government would benefit directly from their execution. This meant that the property rights recaptured by the management – that of further discretion in lending decisions – were implicitly accepted by the State. This reiterates previous research which demonstrated the necessity of political incentives to the granting of property rights (Riker and Sened, 1991).

As before, property rights offers an analysis of events in the public sector, including the negotiation of property rights in a novel situation. It also offers an opportunity to consider the use of the quasi-nationalisation mechanism for the banks. Property rights predictive power does not initially anticipate the acceptance of Government imposed targets for operational decisions. However, the caveats to these targets allow operational discretion to remain in the hands of the banks. To this end, Quasi-nationalisation allowed a smooth mechanism by which these property rights could be discreetly conceded back to the banks for borrowing decisions, without political debate.

Nonetheless, it is the opportunity for politics to intervene generally by rights through large State ownership which has been resisted by the banks. This general capacity has caused difficulties in previous State owned enterprises as the remit of the politicians could often remain unclear (Kelf-Cohen, 1973; Tivey, 1966; O'Brien, 1937). Whilst there has been a successful attempt to specify the property rights of the Government over targets, it is difficult for the banks to diminish the moral and contractual right of the State to intervene in an opportunistic way. Viewed positively, this enables the State to continue to protect wider economic and social interests. But it also leaves the banks vulnerable to intervention based on political motivations only, rather than any other form of incentive which may be in the best interests of shareholders or citizens (Davies, 1988; Boardman et al., 1986; Crain and Zardkoohi, 1978; Dell, 1973).

The experience of previous state owned enterprise thus comes to bear on the banks as well, despite the existence of a competitive market and profit maximising firms. Social and economic objectives are difficult to define and thus hold the enterprises to account. In considering the factors above, Quasi-nationalisation does not provide a solution to this long standing problem in the public sector.

### **8.1.5 Reinterpreting Targets over Time**

Whilst the overall control of the targets can be problematic, changing attitudes towards the targets can be identified. Property rights help establish this as attributes of property rights are negotiated in new situations (Eggertsson et al., 1996; Eggertsson, 1990). As the targets are reinterpreted in a new light, there are political incentives for the State to collaborate with the new interpretations (Riker and Sened, 1991). The following section documents this change in attitudes before considering the implications for the quasi-nationalisation structure.

A key objective in the banking rescue of 2008/2009 was the availability of credit to banking customers to aid economic stability and growth. At the beginning of the crisis, management stated their own commitment to ensuring the best for 'UK plc':

"Would I prefer to have 1% more market share or save 50,000 businesses? Well I'd prefer that we saved 50,000 businesses."<sup>24</sup> (Hester, 2009)

The targets for lending thus allowed resurgence in customer salience, sponsored by State conditions. Yet these targets were reinterpreted over time in response to economic achievement. Early on, the NAO concluded that banks would fail to meet their agreed lending targets (NAO, 2009). Then, in 2010, when lending targets were achieved, criticism centred on the expense of lending charged by the banks to small business customers or on providing the right type of credit to them (CBI/ ACCA, 2010, p7). The banks opted to offer a reinterpretation of lending targets and their design at the crux of the crisis in October 2008:

"...we worked with government in terms of the reasoning behind the setting of those targets. What we were all concerned about, the banking population as well as government was that with the withdrawal of foreign banks... small and medium-sized enterprises especially would not have the necessary financing to continue their businesses. As we know, SMEs, the small and medium-sized enterprises, contribute over half the employment in the UK and contribute to over half of the gross domestic product. So we were very concerned. We worked with government to see how we could make up for that shortfall." (Eric Daniels, CEO of LBG, TC 2010 Q174)

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<sup>24</sup> Interview on 'Rebooting RBS' BBC Radio 4, 26 August 2009



Instead of being a condition of Government investment, the above explanation suggests that the lending target was to plug a gap in credit availability caused by a reduction in market players. This is a subtle, but significant change in management perceptions and priorities to one of overall economic wellbeing. A consistent ex post justification is also expressed by the RBS CEO:

“All of the discussions I was involved in with the Treasury at the time were all about trying to smooth the path of economic adjustment. It was never about lending a particular sum; it was about trying to remove the panic factor of people being starved from credit improperly, which could have happened.” (House of Commons - Treasury Committee, 2010a)

The rationale for the targets rested on *availability* of credit rather than the lending of a set amount of money. Targets have not been challenged by the banks but create further ambiguity as reflections on the conditions continue. This has had the consequence of weakening the political influence, with no recourse available to the State in the event that their targets have not been met:

“It is now well established and understood though that the lending agreements are conditional on there being attractive opportunities on commercial terms. In other words, the banks are not required to undertake high risk or uncommercial lending...” (House of Commons - Treasury Committee, 2009d)

Reconstructing these targets from one of maintaining lending to one of maintaining the availability of credit allows management to explain alternative priorities, without dispute from the State. Property rights theory found that slow adaptability to new information resulted in public funded exploration being less successful than private ventures (Karpoff, 2001). Quasi-nationalisation helps the State and the banks to collaborate to change the dynamics of the targets over time and avoid conflict. Whilst it diminishes the power of the State to hold the banks to account, the resulting impact on efficiency could be negligible if politics is at arms' length to the bank management (Kole and Mulherin, 1997).

### **8.1.6 The Relative Efficiency of the Quasi-Nationalised Banks**

Property rights theory is critical of State ownership. Managers are not incentivised to create maximum profits for the corporation as they do not get any direct benefit from their efforts (Alchian, 1974; Furubotn and Pejovich, 1974; Roland, 1972). Increased profits are instead absorbed into the public purse for benefits of all citizens (Armen A. Alchian, 2008; O'Hara, 1981; Alchian, 1974). Management respond by expropriating resources from the firm in other ways (Armen A. Alchian, 2008; Alchian, 1974). On a related matter, there is the possibility that some resources are directed towards political ends for securing or winning votes in the SOE (Crain and Zardkoohi, 1978). Property rights research has indicated that the

efficiency of state owned enterprises is less efficient than privately owned corporations (Dewenter and Malatesta, 2001; Boardman and Vining, 1989). This is also the case with mixed ownership enterprises (Boardman and Vining, 1989). The key industry ratios were the basis this for conclusion in examples of ownership comparisons (Karpoff, 2001; Crain and Zardkoohi, 1978; Davies, 1977; Davies, 1971). However, there was also an acknowledgement that competition helped to lessen the gap between state owned and private enterprise performance (Crain and Zardkoohi, 1978) and in one study of railroads, there was little substantive difference between the state and privately run corporations (Caves and Christensen, 1980). As an arm's length, temporary shareholder, the efficiency of the corporations was also negligibly different (Kole and Mulherin, 1997).

Table 8.2 below shows some key banking industry ratios for the two banks under consideration. Alongside these are ratios for two competitor banks: Barclays and HSBC. Comparisons are naturally difficult to draw between the two sets of banks due to differing strategies and consumer base. Moreover, the failed banks inevitably are tackling issues of failure, impacting results. Nonetheless, Barclays itself also had impending difficulties with capital at the beginning of the financial crisis but was able to find alternative private sector investment.

**Table 8.2: Key Banking Ratios for the UK FTSE 100 Banks**

<b>Bank Name</b>	<b>Net Interest Margin %</b>	<b>Cost to Income Ratio %</b>	<b>Return On Avg Equity (ROAE) %</b>	<b>Return On Avg Assets (ROAA) %</b>
<b>2012</b>				
<b>LBG</b>	1.23	60.33	-2.94	-0.14
<b>RBS</b>	0.90	85.34	-7.93	-0.41
<b>Barclays</b>	0.83	63.59	-0.37	-0.02
<b>HSBC</b>	1.59	54.45	8.78	0.58
<b>2011</b>				
<b>LBG</b>	1.38	62.83	-5.81	-0.28
<b>RBS</b>	0.91	74.12	-2.58	-0.13
<b>Barclays</b>	0.88	64.70	6.20	0.26
<b>HSBC</b>	1.78	57.58	11.18	0.72
<b>2010</b>				
<b>LBG</b>	1.44	53.17	-0.57	-0.03
<b>RBS</b>	0.98	69.32	-1.94	-0.11
<b>Barclays</b>	0.96	64.20	7.54	0.32
<b>HSBC</b>	1.77	53.21	9.77	0.59
<b>2009</b>				
<b>LBG</b>	1.32	73.39	10.98	0.40
<b>RBS</b>	0.69	77.34	-2.65	-0.11
<b>Barclays</b>	0.73	56.23	19.43	0.60
<b>HSBC</b>	1.79	46.17	5.68	0.27
<b>2008</b>				
<b>LBG</b>	2.04	62.63	7.64	0.21
<b>RBS</b>	0.76	114.64	-40.18	-1.61
<b>Barclays</b>	0.73	68.58	13.24	0.32
<b>HSBC</b>	1.87	51.52	5.52	0.27
<b>2007</b>				
<b>LBG</b>	1.84	52.65	27.75	0.95
<b>RBS</b>	0.99	54.63	11.27	0.56
<b>Barclays</b>	0.89	60.16	17.02	0.46
<b>HSBC</b>	1.92	51.14	16.34	0.97
<b>2006</b>				
<b>LBG</b>	1.72	47.74	26.26	0.89
<b>RBS</b>	1.38	53.01	15.65	0.79
<b>Barclays</b>	0.98	60.56	20.05	0.54
<b>HSBC</b>	2.21	50.68	15.17	1.00

Source: (Bureau Van Dijk Electronic Publishing, 2013)

Table 8.2 details the net interest margins, cost to income ratio, Return on Average Equity and Return on Average Assets. These are given for 2006 – 2012. These ratios give some indication of efficiency for the banks. Net interest margin and cost to income ratio are two of the banking industry’s headline ratios in banking reports<sup>25</sup>, indicating operational

<sup>25</sup> Barclays, RBS, LBG and HSBC all present the Cost: Income and Net Interest Margins in their headline ratios. See Annual Reports 2006 - 2012

efficiency and profitability. The banks self-identify these ratios as critical indicators of efficiency in their sector, so they have been used for analysis. Return on average assets also gives an indicator of efficiency. Return on average equity provides information on the return to the shareholder.

**Table 8.3: Efficiency Rankings of the UK FTSE 100 Banks**

<b>Efficiency Rankings</b>	<b>Net Interest Cost to Return On Return On</b>	<b>Margin</b>	<b>Income Ratio</b>	<b>Avg Equity Avg Assets</b>	<b>(ROAE) (ROAA)</b>
	<b>%</b>	<b>%</b>		<b>%</b>	<b>%</b>
<b>Ranked 1 over the years</b>	HSBC	HSBC	Mixed: HSBC/ Lloyds	HSBC	
<b>Ranked 4 over the years</b>	Barclays	RBS	RBS	RBS/ Barclays	
<b>Ranked 1 pre-crisis</b>	HSBC	HSBC/Lloyds	LBG	HSBC	
<b>Ranked 4 pre-crisis</b>	Barclays	Barclays	HSBC/ RBS	Barclays	

In Table 8.3, the top and bottom performers for these banking ratios are identified. Likewise, the top and bottom performers in the banking ratios are considered separately for 2006, and 2007, prior to the current government ownership.

The results are inconclusive. What can be seen is that HSBC is consistently ranked at number 1 for efficiency in cost income and net interest margin pre and post crisis. This may reflect the diverse markets the bank operates in. The other banks, with a British focus, operate in a mature and competitive banking market.

In terms of cost: income ratios, RBS has moved from being one of the best performers in the industry to coming at the bottom post crisis. This may be due to the large expenses incurred with the swings in fair value of own debt, the payment protection insurance payouts and general costs associated with divesting the businesses. What is clear is that the cost income ratios of all banks seem to have increased as a result of the crisis.

These results should be treated with a degree of caution, as they are limited to the British banks. Different accounting policies and different business strategies result in diverse ratios.

A longer term perspective post State intervention would perhaps yield more informative results as these banks have certainly been the greatest affected during the financial crisis. Nonetheless, the results may be encouraging for quasi-nationalisation. With this structure in place, there appear to be no radical decline in efficiency for RBS and LBG. Substantial differences have been found previously for mixed ownership enterprises (Dewenter and Malatesta, 2001). There may be some evidence of the effect of competition (Crain and Zardkoohi, 1978) as the results do not point to consistent underperformance of the State owned banks. Being arm's length may enable the banks to stay efficient compared to their peers (Kole and Mulherin, 1997). Moreover, there remains the incentive for management to share in the profits of the company through stock based remuneration packages (Alchian, 1974).

### **8.1.7 Diffusing Targets to the Wider Banking Industry**

In fact, the State has had an enormous influence on the whole banking industry in assuming further societal responsibility. In 2011, the wider banking industry agreed to lending goals for businesses under Project Merlin (2011). In this agreement, the largest UK banks, including HSBC, Barclays and Santander, who have not received any Government capital, agree to take collective responsibility for the lending targets originally aimed at RBS and LBG:

“In entering this agreement, the banks explicitly recognise their responsibility to support economic recovery... The banks expect, in the light of the statements contained within this document, a commitment by the Government to the stabilisation and improvement of the relationship between the Government and the banks; to the creation of a level playing field internationally for UK banks...and, subject to increasing shareholder engagement, the acceptance of the right of self-determination by bank boards. “ (Project Merlin, 2011, p1)

Like the rescue package designed to provide stability across the wider banking industry, Project Merlin also has been designed to provide stability for the banks in fulfilling their societal responsibilities. It is argued here that renewed management priorities have been the catalyst to provide more detailed operational targets than previously. For example, in relation to RBS' half year results and new organisational goals within, the CEO stated:

“Now normally I would consider it foolhardy to put out the targets that we are doing today, and it probably is... we have to overcome natural reticence and give you a clear road map and also give our, if you like, public policy audiences a clear sense of accountability in terms of what we think we can accomplish.” (Royal Bank of Scotland, 2009d) (Emphasis added).

This gives a clear indication that salience of other stakeholders impact upon the monitoring mechanisms designed for the private shareholder. Management accept a wider sense of responsibility for the financial results beyond the shareholder as intended audience.

Property rights theory would explain this action of the banks to be capturing property rights to a commonly owned resource previously – that of responsible banking and financial stability. Commonly owned resources can result in inefficiency (Alchian and Demsetz, 1973; Hardin, 1968; Coase R, 1960). The increasing delineation of aspects of property rights will help to encourage greater efficiency of the implicit support of the Government during all stages of the economic cycle (Barzel, 1997).

To summarise, the consideration of the banks' rescue under property rights theory highlights some shortcomings in the theory. Property rights predict that resources will be utilised more efficiently under private ownership – yet it was the markets and banks who failed under light touch regulation. Property rights advocates inefficiencies in managing public sector businesses due to political interference – yet it was the EU who decreed Government ownership would inspire unfair advantages for the two banks. Temporary ownership does not impact on the State's capacity or inclination to intervene (Kole and Mulherin, 1997). Property rights predicted that there would be a lack of monitoring of the banks – yet they been rigorously monitored both by the markets and the State. Property rights predicted that there would be increasing specification of targets set by Government – in fact these have been kept deliberately vague and it is the general capacity for Government to intervene that has concerned the banks. Finally, it is responsibilities rather than rights per se that have diffused these targets to the wider banking industry, who knew fewer restrictions residing in private ownership.

Despite its problems, however, property rights theory does give a good insight into the implications of public ownership and quasi-nationalisation. Moving beyond the historical political reluctance to nationalise banks (Darling, 2011), there are advantages to its structure borne out by the property rights analysis. Private sector advantages remain within the banks. These help the banks in terms of profuse monitoring and competitive pressures. Nonetheless, the State retains a capacity to intercede in areas of great public concern. Moreover, quasi-nationalisation has perhaps helped in diffusing societal responsibilities to the wider banking industry. This is particularly important in light of the failure of traditional market mechanisms.

Agency theory, looked at next, portrays an alternative perspective on the banking crisis. The theory helps to explain the necessity of State intervention and monitoring. Yet it is quiet on explaining the actions of management in the face of alternative motivations and needs further development in this regard. Nonetheless, it provides an additional perspective on the implications of Quasi-Nationalisation.

## **8.2 Negotiating through the Crisis: An Agency Theory Perspective**

The second part of the chapter considers implications of quasi-nationalisation using agency theory. Agency requires the existence of conflicts and the alignment of incentives to be considered (Jensen, 2004, p15). Because this is not a conventional relationship between shareholder and manager, the stated aims of the agents and principals are considered. Agency theory justifies the requirement of the State to monitor the companies closely in the face of market failure. It also demonstrates that the main priority remains fixed on market measures, such as share price and the road to privatisation. As a result, it is argued here that the State should be concentrating on the wider social goals, to change the orientation of the banks from profits to customers. This remains problematic, in the wake of weak lending priorities to SME customers and major scandals. Finally, the UK State's desire to document the history of the bank failures and maximise the value of its support is considered by agency theory.

### **8.2.1 The Muted Disciplinary Effects of the Markets**

The following section considers the unusual situation of quasi-nationalisation from an agency theory perspective. Overall, this results in a muted disciplinary effect of the markets. Depressed share prices and the market for takeovers have been identified as mechanisms which prevent inefficiencies occurring (Fama & Jensen, p313). However, the current market conditions mean that these two disciplinary effects will be suppressed. Firstly, agency theory predicts that mass selling of shares is a sign of discontented principals and thus would be a moderating mechanism on agents' consumption of non-pecuniary benefits (Fama & Jensen, 1983, p313). In this case, the mass sell-off of shares by UKFI is the ultimate goal. Thus the share price will not be a monitoring mechanism in its traditional sense of preventing inefficiencies occurring. Here, it may represent an improvement in prospects but does not incentivise the management to exceed the State's opt-out price. Secondly, the possibility of takeovers for these banks in the current economic climate is particularly low especially given their large market share and the potential competition

issues which could arise (UKFI, 2013b). The market is not a strong regulating force for the quasi-nationalised banks.

Market discipline is further stifled by Government backing of the financial system. Deposit insurance schemes have previously been cited as raising moral hazard as the managers do not bear the consequences of the risk that they bear (Houston and James, 1995). Empirically the effects of deposit insurance has been to decrease the impact of bank runs (Angkinand, 2009; Dell'Araccia et al., 2008; Hoggarth et al., 2002) but it does also make them more likely to occur. In the UK, moral hazard has perhaps been realised with the lifting of the deposit insurance limits when the banking crisis was at its peak. Moral hazard is increased further by the use of State support designed to keep the banks solvent.

Agency theory thus provides an insight into the rationale behind the EU State Aid requirements which were discussed above. To reiterate, the EU decreed that the State Aid gave an unfair advantages to the State supported banks and ordered certain divestments to avoid distortions in the market. Agency contracts demonstrate that there are dangers of unabated self interest in quasi-nationalisation. This is exacerbated by the muted market disciplines of takeovers and share prices which are available for other corporations.

Agency theory provides a penetrating insight into the consequences of quasi-nationalisation for the banks. Property rights theory demonstrated that there were advantages to be enjoyed through retaining private sector influence in the banks. Yet agency theory now demonstrates that the nature of this monitoring has changed as a result of market circumstances. Nonetheless, the next section sees that market discipline is still very much at the fore of the monitoring of the banks' management.

### **8.2.2 Interests Aligned on Share Price and Privatisation**

Agency theory points to the importance of the satisfactory share price and impending privatisation as the main motivator for both banks and the UK State. Under agency theory, agents are assumed to be the self-interested utility maximisers and will act in their own interests rather than the principal's (Jensen & Meckling, 1976, p308). Agent incentives can be used to align the principal and agents' interests (*ibid*, p323). Money is the ubiquitous reward, given its flexibility and ability to be tied to performance (Jensen, 2004). The motivations for the top executives running LBG and RBS go beyond profit maximisation (Jensen & Meckling, 1976) but the opportunity to significantly enhance their reputations (Jensen, 2004; Fama, 1980) by repairing the failed institutions. A key measurement of repair will be the ability of the banks to attract commercial investors once more through re-



privatisation of equity holdings. The share price is one key measure by which the market can assess the attractiveness of the banks as investments. Overall, then the share price of the company will be an area of keen interest for the banks' management.

For the principal, the UKFI is looking towards disposing of the banks' shares. Again, this will be achieved through the shares in the bank being suitably attractive to investors. The UKFI is also looking to share price performance by seeking to 'implement an agenda to maximise value of shareholders' and to implement a strategy of disposing of its market investments (UKFI, 2013b). The remuneration committee, who take on the role of decision control (Fama and Jensen, 1983) have made an explicit attempt to align the LBG CEO's remuneration with the recoupment of the Government's investment:

"The award for Mr A Horta-Osório will be delivered in the form of a conditional share award. This will be subject to the normal performance adjustment policy and will only vest if a share price of 73.6p<sup>26</sup> has been reached for a given period of time or the Government has sold at least 33 per cent of its shareholding at prices above 61p...The Board believes that these conditions are in the interests of all shareholders and support our common aim of repaying the taxpayer." ((Lloyds Banking Group, 2012)p102; emphasis added)

Even so, The UKFI is not solely motivated by profits. Privatisation is contingent on the price per share reflecting 'good value'. Share price will naturally be affected by the financial performance of the banks in which the UKFI identifies profitability and capital adequacy as being the main drivers (UKFI, 2013b). At this point, the UKFI's decision is that the regulatory and operational environments are too uncertain to allow the share price to be stable enough for repatriation back to the private sector (UKFI, 2013b). The UKFI carefully explain that this means the share price is realistic of 'future earnings prospects' and the method of disposal is sound, given the huge proportion of shares which will be sold over time, rather than based on the original cost of the investment.

Thus there is an alignment of goals in the form of an adequate share price to enable privatisation. Agency theory usefully contributes to the analysis by emphasising the critical motivations tied up in the share price as a number, both for executives and the UKFI.

The findings of agency theory in this regard would thus point to the opportunity for the UKFI to incentivise the UK bank executives in other ways, since privatisation is already a

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<sup>26</sup> This was the Government opt in price during the original rescue. See figure 8.2 for aggregate values.

natural and monetised incentive. Thus agency theory recognises the necessity of State monitoring on the one hand and the acceptance of the bank executives to this increased oversight on the other. Under the wider umbrella of motivations, agency theory highlights that bonuses/ remuneration and serving the customer well are important factors in assisting the return to the private sector. Unfortunately, both of these have resulted in unintended consequences, which are explored further next.

### **8.2.3 Incentives – Awarding and Refusing Bonuses**

At the heart of agency theory is the desire to align the interests of the agent with the principal (Jensen and Meckling, 1976). A large part of aligning interests is through the use of managerial incentives such as remuneration (Jensen, 1994). For the UK banking crisis, the nature and extent of bonuses has been a central topic of political debate. Remuneration has also been subject to a large degree of scrutiny and regulation. Shortly after the banks were taken over, the Walker Review recommended the change in the way that bonuses were awarded to bankers, with ‘claw back’ mechanisms in place for those subsequently found guilty of misconduct or misstatement (Walker, 2009). Moreover, short term bonuses should be paid over the longer term, with 3 years minimum (Walker, 2009). Politically, the onset of the financial crisis was attributed to greed and excessive remuneration (Hansard HC, 2008). All major party leaders at the time of the original intervention were in favour of the restriction of bonuses in the quasi-nationalised banks (Hansard HC, 2008). Bonuses have become a political discourse (Fairclough and Fairclough, 2012).

“We found that bonus-driven remuneration structures encouraged reckless and excessive risk-taking and that the design of bonus schemes was not aligned with the interests of shareholders and the long-term sustainability of the banks”(House of Commons - Treasury Committee, 2009b)

There has also been a bonus tax added to banks who pay their employees more than £25,000 in bonus each year to try and encourage more responsibility for remuneration in the UK banking sector rather than for increasing tax revenues (House of Commons - Treasury Committee, 2010b). The coalition Government has continued to express their concerns about pay and remuneration (HM Treasury and Department for Business Innovation and Skills, 2012). However, the monitoring of the State may be self-serving, as there are no associated cash incentives with bureaucratic oversight (Shleifer and Vishny, 1997). These interventions may be fuelled by personal or political interests rather than taxpayers (Dudley, 1994).

Yet this pro-active approach could be viewed as strength of monitoring for the banks formerly employed in excessive risk taking. For in a weakness of the separation of ownership and control, the shareholder is unable to monitor the *process* of remuneration and can only disagree with the remuneration proposals presented at the AGM (Broadbent et al., 1996). The UKFI has required RBS and LBG to lead the way in reigning in their remuneration policies, whilst at the same time being subject to established private sector scrutiny mechanisms (UKFI, 2013b; Lloyds Banking Group, 2012; Royal Bank of Scotland, 2011b; Lloyds Banking Group, 2011c; Royal Bank of Scotland, 2010a; Lloyds Banking Group, 2010a; Lloyds Banking Group, 2009a)

Naturally, the agent would be expected to be resistant to the idea of the restraint on their pay. In the long term, though, the manager will be paid for his own marginal product over his entire working life, smoothing out the results of his efforts, shirking and noise as his performance is assessed at each wage period (Fama, 1980).

In the case of the banks, bonuses were awarded to the top management executives within the confines of the new bonus regulations. However, ensuing media criticism meant that the bonuses awards were waived by the CEOs:

“ Stephen Hester subsequently decided to waive his bonus because the attention it received had becoming a damaging distraction for him and the Group...A balance is always required between minimising compensation costs, and so maximising profits in the current year, and protecting the business from which future profits can flow. We have sought to strike this balance fairly while erring on the side of restraint, reflecting the nature of our ownership.” (Royal Bank of Scotland, 2012b)

Here the bonus waiver was connected with the media criticism of the banker’s pay. Combined with this, is an acknowledgement that restraint must be shown to those who are publicly owned.

“We firmly believe that remuneration policy at all levels, including senior executives, needs to incentivise staff to deliver strong, sustainable growth whilst reflecting the work required to reshape the business to fit the new, challenging environment. We also need, however to be mindful of public concerns about equality and that remuneration reflects financial results. In asking not to be considered for a bonus in 2011, António made a principled decision with regard to his remuneration, a decision the Board fully supported.” (Lloyds Banking Group, 2011c)

If in the long term the managers are expecting greater rewards from constraint today (Fama, 1980) agency theory may explain the willingness of the CEOs in waiving their bonuses for the year. In other words, they will recoup the short term losses through more lucrative contracts in future years, with enhanced reputations for their work and high integrity. Whilst this explains why they may forsake remuneration, it does not, however, give an

understanding of *why* there was an award and subsequent waiver of bonus. The CEOs are subject to public disappointment when their pay is deemed excessive and problematic. Moreover, they appear less strong by backing down on agreed management decisions. A safer, and less public route, would have been to negotiate the contract with lower pay in the first place, in the expectation that future pay outs would compensate for the lower rewards currently. Agents may be willing to forsake benefits if these are seen as a lesser evil of excessive monitoring (Jensen & Meckling, p338).

An alternative mechanism for considering the bonus waiver under agency theory is offered through political constraints of pay (Jensen and Murphy, 1990a). The large public pressure to constrain top level management pay is offered as an explanation for a lack of sensitivity between pay and performance of CEOs. The conditions impose upon the contractual conditions *ex ante* rather than affecting the bonus awards *ex post* (*ibid*). Certainly restraint on pay has been regulated through the various initiatives in remuneration introduced by the Government to date. It has been contended that the free market should determine pay to allow good performance to be rewarded. In turn poor performance can also be appropriately remunerated (Jensen and Murphy, 1990b). In addition, there may be poor incentive to work at maximum capacity if pay will need to be conceded before receipt. However, the ability to partake in stock options of the corporation may help with the latter.

Yet this does not explain the willingness of the banks to give pay at higher levels in the face of public indignation. Thus agency theory gives only a partial explanation of bonus waivers. It gives credence to the future career considerations of the CEOs and it also demonstrates that politics can constrain pay. Nonetheless, it does not provide a framework to analyse the process by which these bonuses were awarded and waived rather than contractually omitted *ex ante*.

Quasi-nationalisation may help explain this process. For here, at least the banks save their own reputations by fulfilling contractual promises to pay bonuses and to retain a commercial orientation in their activities. Note the anxiety to pay competitively to attract and retain talented staff in the extracts from the annual reports above. Society/ Stakeholders, however, can then punish the well paid CEOs, as representatives for the banking industry generally, forcing them to concede earned pay. This confirms previous public sector studies which sought not to show excessive surpluses in order to justify current levels of funding (Pina et al., 2012). In a similar vein, restraint on pay has been used to demonstrate austerity within the publicly owned banks.

## 8.2.4 Interests in Conflict over SMEs and Large Customers?

Agency theory in itself is relatively silent over the merits of public or private ownership per se. There is a recognition that the bureaucratic control may lead to politically motivated interests muting more legitimate goals of disperse principals (Shleifer and Vishny, 1997). The undesirability of public ownership rests on the basis of empirical work which finds Government owned enterprises inefficient. There is however, uncertainty in this area, including in banks (Andrianova et al., 2012; Tulkens, 2006).

As a result, agency theory appears to have little basis for objecting to State ownership. Political motivations are certainly a concern. It could be argued that the goal of financial stability may override these concerns as it is a common good for UK citizens, as well as shareholders. Public policy initiatives, such as deposit insurance have been found to be an efficient use of State resources (Grove et al., 2011; Diamond and Dybvig, 1983). Moreover, it has been argued that banks have been efficient recipients of State Aid (Hainz and Hakenes, 2012). This is an important consideration as these resources could have been used elsewhere if they had not invested in the banks (Bank of England, 2012a).

Aside from the identity of owners, agency theory does provide some insights into the merits of shareholder concentration. There may be efficiency gains, as the block holder of shares is very motivated to monitor the agent (Grove et al., 2011). In this regard, the State is the interested party in the additional objectives set out at the first intervention into the distressed banks. The additional objectives discussed in chapter 7 demonstrate the desire to keep customer lending continuing. The rationale for bank investments was to enable liquidity in the real economy. Banks were encouraged to lend particularly in the SME sector. There is some evidence of this alignment continuing (Shleifer and Vishny, 1997). Customers are now at the heart of the strategy of RBS and LBG. LBG's Annual Report 2011 & 2012 strapline is currently 'Becoming the Best Bank for Customers' (LBG, 2011, 2012). RBS identifies customers as the main priority to become a good company and a good bank:

"The Bank's purpose is to serve customers well. The better we do this the better the results will be for all our stakeholders" (Royal Bank of Scotland, 2012b)

However, this may come at the expense of alternative shareholders who wish to see the banks become much more risk averse. Block ownership by the State silences these desires (Grove et al., 2011).

While there is considerable congruence on the need to prioritise customers, some practices of the banks have been highly criticised. Information asymmetry is increased in the banking

industry because the businesses are so complex (Grove et al., 2011). In terms of lending to the economy, evidence points to restricted credit conditions for this consumer segment (Bank of England, 2011, 2012; 2013). To help encourage further lending in the real economy, the Funding for Lending Scheme was set up to incentivise banks to lend to the SME customer. The incentive rested on the availability of cheaper credit from the central bank:

“A bank with an initial lending stock of £100bn that plans to shrink its lending by 5% can access £5bn of Treasury bills for a fee of £75m per year (a 1.5% annual fee). But if the bank shrinks its aggregate lending by 3% instead, it can save £30mn on its annual fee (it pays a 1% annual fee). That saving can be used by the bank to reduce loan rates so that it can achieve a 3%, rather than 5%, fall in lending.” (Bank of England, 2012)

Agency theory would explain the Bank of England scheme as an incentive for agents to pursue the policy of keeping credit affordable for SME clients (Jensen, 2004). Incentives come not in the form of remuneration but in the interests of business and the prospect of improving the onward rates the banks are offering customers. The funding for lending schemes are a contributory factor for credit spreads tightening for small corporations for the first time since 2004, although this was offset in part by an increase in fees and commissions (Bank of England, 2013a). In contrast, the medium and large sectors spreads had fallen significantly, with a small drop in medium corporation fees and commissions (*ibid*, p5). Even with a direct financial impact on the banks, the large clients are being favoured over the smaller enterprises that may be more risky for the banks, as commercial imperatives are prioritised with support from the State to help increase share prices.

RBS was fined £87.5million in February 2013 as a result of its involvement in the LIBOR rigging scandal expanding over the financial crisis from 2006 – 2012 (Financial Services Authority, 2013). 21 traders in RBS had been responsible for colluding on the LIBOR rate on a number of occasions in such a way as to gain advantage for their derivatives traders (*ibid*, p 2). In addition, RBS traders colluded with panel banks and broker firms to manipulation both CHF and JPY LIBOR (*ibid*, p3), including “wash trades” which had no underlying commercial rationale but were to garner influence with other firms. The FSA also found that RBS had a lack of any controls in its LIBOR trading activities, a delayed response to implementing controls in line with industry guidance and a complete failure in management oversight of LIBOR trading (*ibid*, p5).

RBS was part of a conglomerate of banks that were subject to regulatory fines. Part of the motivation in other banks was to help keep LIBOR rates artificially low during the crisis to give an impression of stability and financial health in these institutions. However, the

readily acknowledged primary motivation of the rate rigging was directed towards the individualistic bonus rewards (Banking Standards Inquiry 2013b). There was an admission that there had been a focus on the de-risking of the bank and the cultural attitudes of the bank took a back seat (Banking Standards Inquiry 2013a). It is unclear whether the bank itself benefited from these corrupt practices, although individual traders would stand to make significant personal gains based on favourable trading positions. Under agency theory, no explanations are proffered about the inherent conflicts within the individual (Donaldson, 1990). Thus, there is no explanation for bankers who here have acted in a way which either does not maximise their own utility or who forsakes greater profit for the sake of reputation (Donaldson, 1990).

Another scandal which undermined the banks' ostensible commitment to customer care occurred with the payment protection insurance (PPI) scandal. In 2010, the FSA ruled that the practice of selling payment protection insurance alongside loan products should be not allowed. The practice was applied retrospectively. Customers could only be marketed this product 7 days after they had signed up for a loan. In January 2011, the British Banking Association took the FSA to the high court for a judicial review to this retrospective application of PPI selling. The high court reported back in April 2011 and found for the FSA. Thus, the Payment Protection Insurance (PPI) mis-selling scandal has required large scale provisions in LBG (Lloyds Banking Group, 2012; Lloyds Banking Group, 2011c; Lloyds Banking Group, 2010a) which have caused the bank to be loss making under a statutory basis again for 2012 (Lloyds Banking Group, 2012, p2). PPI was a highly profitable product, helping to subsidise the low or loss making margins being made on cheap credit. It has been suggested that this would skew incentives to sell the PPI to all customers to help increase profitability (Banking Standards Inquiry, 2013b).

Again, agency theory provides some good insights into the implications not only of public ownership but also of how concentrated share ownership may cause power imbalance. Agency theory highlights that there is a common goal of creating a better experience for the customer - for both State as principal and the banks as agents. Yet, it is unable to account for why the LIBOR and PPI scandals are occurring under public ownership, for it does not provide alternative motivations for individuals who are not acting in their own or the business' best interests.

Quasi-nationalisation is problematic for changing the cultures of the banks. With relatively arm's length management, there has been an evolutionary approach to changing banking practices. A step change in culture of the bank takes time to achieve. Too little political

intervention, then, may be a problem as well as too much. The next section considers political intervention in further detail.

#### **8.2.4 Political Interference in Lending Decisions – Cadbury and Kraft**

Agency theory has identified that the shareholder concentration can stifle minority owners' interests, as well as increase the effectiveness of monitoring (Grove et al., 2011). Furthermore, there is a concentration of power in the State, who may use the banks to pursue political objectives, rather than corporate ones (Shleifer and Vishny, 1997). The ownership of the bank has caused political debate with regard to certain decisions made. RBS funded the hostile takeover of Cadbury by Kraft Foods. After it was completed, Kraft reneged on a promise not to close the Cadbury Somerdale factory. The Prime Minister reiterated the commercial freedom of the banks and the markets (Hansard HC, 2010). However, there has been anger at RBS' involvement in the Kraft takeover in Parliament:

“When British taxpayers bailed out the banks, they would never have believed that their money would be used to put British people out of work” (Hansard HC, 2010)

There has also been the suggestion that the Government could have intervened and required RBS to fulfil societal objectives when Cadbury was taken over (Business Innovations and Skills Committee, 2010). In terms of agency theory, the decision control aspect of management (Fama and Jensen, 1983) has spilled over into the House of Commons. This portrays the ultimate conflict for the State. While it benefits from the commercial activities of RBS and its contribution towards profitability, when social objectives for employment are at odds with its commercial decisions, the banks (and its investors) are open to criticism.

#### **8.2.5 The State as Saviour – Nationalising and Quantifying the Story of Failure**

The concentration of ownership can result in more effective monitoring and holding of management to account (Grove et al., 2011). The State has been pivotal in this regard during the crisis. The self-interested nature of agents means that a full account of the banks' failings which contributed to the crisis is not published in the annual report. Information asymmetry is exploited, as there is no personal gain from exposing all the failings of the bank (Jensen and Meckling, 1976). Yet there is a political incentive to make the banks accountable for their failings (Shleifer and Vishny, 1997). The State, through political impetus and block ownership, accomplishes what is not possible elsewhere – the authorised account of failure. In order to provide a public account of RBS' demise for citizens, it has been the Government agencies report rather than the bank itself (Financial Services



Authority, 2011). However, this also results in conflicting interests of multiple principals (Benz, 2007). The State is taking on multiple roles. As interested shareholder, it is enforcing accountability of the management. Yet as regulator, it implicates itself in the demise of the banks. Even though this additional form of accountability has been achieved, it has a number of drawbacks. It fragments the duties and responsibilities of the principal, caused by a number of principals involved in the scrutiny of RBS (Benz, 2007). Moreover, it undermines the status of the annual report, which should account for the activities of the corporation in its recent past and, indirectly Governmental policy in relation to the banks (Steccolini, 2004).

The failure of RBS is attributed to the inherent riskiness of the bank prior to and during the crisis. Here published accounting information is subject to retrospective application of the new Basel III rules, which are yet to be formally implemented<sup>27</sup>:

“RBS’ liquidity position at end-August 2008 would have translated to an LCR<sup>28</sup> (as currently calibrated) of between 18% and 32%, versus a future standard requirement of 100%. RBS would, therefore, have had to increase by between £125bn and £166bn its stock of high-quality unencumbered liquid assets or, alternatively, reduce its reliance on short-term wholesale funding in order to comply with the LCR standard.” (FSA, 2011, p23)

Tied up within this illustration of failure, therefore, is an admission of the inadequate regulatory regime in place at the time of the crisis. Yet another principal is added to the demands on the agents (Benz, 2007): future regulation. Financial accounting captures the scale of the inadequacy previously.

Quasi-nationalisation thus helps to provide a comprehensive account of the reasons behind the failed businesses. This is achieved simultaneously with the repair of the banks. The reasons for failure do not impact too much on the future potential of the banks to reprivatize. At the same time, the reports allow the State to fulfil its goal of holding the banks to account for political advantage (Shleifer and Vishny, 1997).

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<sup>27</sup> Basel III rules will be implemented incrementally with liquidity ratios in place from 2015

<sup>28</sup> Liquidity Coverage Ratio

### **8.3 Concluding Remarks**

Using insights from agency theory and property rights theory, the quasi-nationalisation of RBS and LBG has been considered. Whilst the theories both contained shortcomings that could not address some of the particular circumstances of quasi-nationalisation, they did nonetheless provide a deep insight into the potential impacts of public ownership. Property rights theory's opposition to common ownership invariably results in it being critical of State investment. Agency theory also provides a predictive model at the level of the individuals concerned and tries to identify conflicts through differing goals.

Property rights theory generally revealed some advantages to quasi-nationalisation. Where private monitoring in the banks was clearly deficient, the incentives to monitor a private corporation still apply in quasi-nationalisation. The audit report was unchanged throughout the turbulence of failure and quasi-nationalisation. The clean audit reports were facilitated by Government guarantees to the auditors, but lowered the information value of the report to other shareholders. A property rights analysis did not predict that Government ownership could be used to a commercial advantage, where EU State Aid rules suggested otherwise. It did demonstrate that there was a necessity to incentivise the management to consider public goods, such as financial stability, as well. Quasi-nationalisation nonetheless retained the natural incentive of profitability. The State is treating the banks like a commercial investment rather than a funded service. In this way, the cost of the intervention is monitored by the State, even if no corresponding asset is rightfully accounted for in the Whole of Government Accounts. Property rights also gave some consideration to how the targets agreed at the time of intervention were set out. Even if the actual effect was to keep the targets deliberately vague rather than more specific, quasi-nationalisation allowed the State to concede power quickly in response to changing economic circumstances. In considering headline banking ratios, property rights predicted inefficiency to result. It seems that the relative efficiency of the banks hasn't dramatically changed since intervention, despite social and economic goals being worked into the quasi-nationalisation agreement. The competitive efficiency of the banks thus demonstrated that the arm's length approach to quasi-nationalisation was a good decision.

Agency theory provided an alternative perspective. First of all, it considered the nature of market discipline since quasi-nationalisation. This was considered oppressed in the particular economic circumstances. Monitoring of banks management would thus be even more important. Nonetheless, there was considerable interest alignment amongst all to improve the share price of the banks and so assist a return to private sector ownership.

Quasi-nationalisation allowed a mutual goal to exist in this regard. On the other hand, the political interest in bonuses has meant that the CEOs have been obliged to return earned incentives in recent years. Quasi-nationalisation has meant that the banks have been made to lead by example for restraint in pay in the banking sector. The agency analysis provided reasoning for the decline in remuneration in the form of political costs and also in expectations of future earnings. Yet it did not give any insight into the mechanism by which award and waiver was appropriate. Quasi-nationalisation pointed to the obligation to keep up with competitors, but also allows the flexibility to respond to citizen feelings regarding pay.

The potential for political intervention, however, may not have gone far enough. Agency theory pointed towards another aligned interest between the State and the banks in terms of prioritising customers. Yet there have been a number of scandals where customers were not served well. Quasi-nationalisation could have provided the opportunity to change the culture of the banking world much faster than perhaps has been the case through arms' length management. Moreover, the relative independence of the banks has resulted in the State publishing on the failings of the banks, rather than requiring the banks to expose themselves. This involved implicating the State in poor regulation. It therefore highlights the potential conflicts that the State has to deal with in having many interested parties involved in the management of the quasi-nationalised banks.

Was quasi-nationalisation the solution to the banking crisis then? It has generally been a positive exercise. It was a practical measure, politically achievable and has allowed an increased sense of responsibility to be diffused among the entire banking industry. Political accountability is fairly light, given the scale of investment. Yet it retains the flexibility of intervention on demand. The banks have not failed but have been given the breathing space to return to profitability. Overall, then quasi-nationalisation have proven to be a fruitful mechanism for ensuring financial stability in the UK.

Theoretically, both agency and property rights theory were found wanting. Property rights theory's preference for private property rights does not hold up to scrutiny in the case of the UK banking crisis. There have been a number of benefits to public ownership which were not predicted by property rights. Agency theory did provide some pertinent explanations for why quasi-nationalisation had been problematic at points, but was not able to provide explanations for the means by which objectives were achieved. As a result, it has been suggested that agency is considered alongside other theories to gain deeper insight into corporate behaviour (Grove et al., 2011; Eisenhardt, 1989).

The next chapter just does that. It looks at the classic mechanism of accountability in the annual report. Utilising theories of impression management and stigma, it explores how the annual reports of RBS and LBG provide an insider perspective into the UK banking crisis.

# Chapter 9: Creating Impressions in a Banking Crisis: The Annual Report as Stage and Stigma Management

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This chapter considers the banking crisis through the lens of financial reporting for RBS and LBG. The banking crisis has been the subject of much criticism in the media. The annual report provides an insider view of the banks' response to these criticisms.

Impression Management and Stigma provide the theoretical framework for this analysis. There is an expectation that organisations will engage in a variety of impression management techniques in order to present themselves in the best possible light (Goffman, 1968, p9). Stigma provides a particular form of impression management, as the stigmatised entity seeks to minimise its impact on social interactions (Goffman, 1968). Naturally, banks employ impression management in the interests of giving off the best possible impression of their corporations. It has already been established that the annual report may act as a public relations document (McKinstry, 1996). The annual report is not merely there to disseminate financial information, but there to promote the corporate image of the banks.

This chapter moves away from the conceptualisation of the annual report as a one dimensional performance. It is not; many audiences are using the document for their own ends. Multiple audiences have been considered in impression management literature previously (Neu et al., 1998). The banks themselves may have multiple reputations that they wish to uphold (White and Hanson, 2002). Yet at the same time, the report itself must be coherent:

“In those instances where the individual presents a product to others, he will tend to show them only the end product, and they will be led into judging him on the basis of something that has been finished, polished and packaged.”(Goffman, 1956a)

This chapter conceptualises the annual report as two different performances. The front end of the annual report may be conceptualised as the ‘corporate narrative’ – where the banks explain themselves in the financial crisis. Its regulation is much looser compared to the regulatory accounting information contained elsewhere (‘the back end’). It has been recognised for some time that there may exist a conflict between the two stories being reported (Hopwood, 1996a; Smith and Taffler, 1995)

“Where an apparent conflict exists between the message conveyed by the narrative and the financial statements, attempts to reconcile the conflict may frequently result

in undue emphasis being placed on the less reliable source [the narrative]. The nature of the conflict between alternative sources and its implications for the users of accounting messages remain a complex research area worthy of further development.”(Smith and Taffler, 1995)

Football clubs still reported upbeat front ends when their financial results were extremely poor (Morrow, 2005). Likewise, for the banks, the annual report is addressing many shifting areas of accountability connected with Government ownership (Sinclair, 2002); stakeholders (Friedman and Miles, 2006; Freeman R, 1984) and with the investors to whom the annual report primarily connects to (IASC, 1989). It is inevitable therefore those performances are in conflict:

“In their capacity as performers, individuals will be concerned with maintaining the impression that they are living up to the many standards by which they and their products are judged. Because these standards are so numerous and so pervasive, the individuals who are performers dwell more than we might think in a moral world. But qua performers individuals are concerned not with the moral issue of realizing these standards, but with the amoral issue of engineering a convincing impression that these standards are being realised.” (Goffman, 1956b)

This chapter attempts to provide a holistic study of the banks’ annual reports. Three performances are identified: the Lloyds Banking Group Corporate Narrative; the RBS Corporate Narrative and the Statutory Story. Sometimes, these performances reinforce each other; at other times, they undermine the desired projected impression. This approach allows the tensions or contradictions in performances to be considered as well. This chapter emphasises how important these narratives are in order to understand the crisis within these banks. Accounting shapes the narratives in several ways, but the story of the statutory numbers is relegated to an austere back end of the annual report.

The prominence with which the failure of the banks is presented perhaps offers a novel perspective on impression management compared to previous research. The approach to negative news is more complicated than covering up the huge losses or focusing on the positives (Morrow, 2005; Clatworthy and Jones, 2003). Distance created between the losses, contained within the separate division or accounting figures allows the banks to promote satisfactory trading performance despite their respective failures. The toxicity of the losses is conceptually contained, providing room for a positive story amidst very poor results.

There are five main sections to this chapter. The first section looks at the annual report as a whole and considers the proportion of regulated accounting information to corporate narrative. The second part then considers the corporate narrative of Lloyds Banking Group. Within the portrayal of the banking crisis, LBG maintains its poise and tries to externalise the banking events. However, accounting numbers means that the banking failures are

discreetly acknowledged within the analysis of performance. Accounting thus creates a tension to the performance LBG wants to portray. In the third part, RBS employs a different strategy for its corporate narrative. Here, the story is not one of externalising events, but containing them internally and creating a performance of fundamental business change. Accounting is disruptive as it portrays shifting perceptions of the history of the crisis. Perhaps because of this shifting perception, cultural change via the ‘tone at the top’ is created only in the latest years of reports. The fourth section considers the role of the statutory accounting story and how it sits in the annual report. The performance of the accounting information is austere and limited to a select audience. Audit, likewise, plays a minimal role in the accounting performance, yet at the same time validates the story. Finally, the chapter considers the wider performance of the banking industry, and how these performances are supported by their fellow UK large banking corporations.

## 9.1 The Corporate Narrative and the Statutory Story

The analysis begins by considering the basic features of the corporate narrative and statutory story in each of the annual reports of RBS and LBG. In Goffman’s ‘Presentation of Self’ (1973), an individual’s impression management is mastered through the ability to control the impression that others receive through the impressions which are given off (*ibid*, p2). The preliminary aspect is for the individual to define the situation in which the encounter is taking place. As Goffman observes:

“...it will be in his interests to control the conduct of the others, especially their responsive treatment of him. This control is achieved largely by influencing the definition of the situation which the other comes to formulate, and he can influence this definition by expressing himself in such a way as to give them the kind of impression that will lead them to act voluntarily in accordance with his own plan” (*ibid*, p3)

In the context of an organisation’s annual report, the definition of the basic situation is well established – the annual report provides the financial results of the company throughout the last financial period. For RBS and LBG, it also provides a direct channel to explain the Government ownership to private shareholders. However, there is a multitude of readers interested in the content of the annual report and companies must consider the interests of its readers and their tacit background knowledge (White and Hanson, 2002; Neu et al., 1998).

This section looks at the very basic features of the annual report. The overall length of the annual reports is considered. This provides a glimpse into the performances devoted to corporate narrative and that devoted to the accounting story. It provides a preliminary

indicator in changing approaches to the communications of the companies (Merkl-Davies et al., 2011; Laine, 2010; McKinstry, 1996). LBG's and RBS' length of documents and proportion as a whole of the report devoted to regulatory requirements is shown in the table below.

**Table 9.1: RBS Annual Report Length and % Regulatory Information**

RBS Annual Report, 2006 - 2012	2006	2007	2008	2009	2010	2011	2012
Number of Pages	262	252	299	390	445	490	543
Statutory Information <sup>29</sup> %	55%	56%	48%	45%	43%	45%	37%

**Table 9.2: LBG Annual Report Length and % Regulatory Information**

LBG Annual Report, 2006 - 2012	2006	2007	2008	2009	2010	2011	2012
Number of Pages	133	166	200	272	296	371	372
Statutory Information <sup>28</sup> %	65%	61%	63%	61%	58%	50%	50%

The tables above show the absolute number of pages in the annual reports of LBG and RBS for the years 2006 – 2012. There has been a significant rise in the number of pages over the period. The 2012 reports are twice as long as the reports produced in 2006. Since the financial crisis, both banks have been concerned about being open and transparent. This may lead to a more positive corporate reputation and a decrease in the cost of capital (Armitage and Marston, 2008). Alternatively, it may be a means of promoting a positive picture through upbeat narrative commentary and subduing the story of the negative

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<sup>29</sup> Includes all information subject to audit and requires positive reporting. Following McKinstry (1996) includes information in the Chairman's Statement; the Director's Report, Corporate Governance Report and Remuneration Report; and the Financial Statements and related notes.



accounting results (Morrow, 2005; Smith and Taffler, 1995). More non-statutory information has been included to assist in managing the impressions of the reports.

The banks follow the convention of including the corporate narrative first, and then following on with the statutory accounting information. Regulation has affected the financial parts of the annual report. The increase in pages is in line with the big UK banks generally. RBS and LBG are 1<sup>st</sup> and 3<sup>rd</sup> respectively in the proportional increase in size from 2008 – 2009 (Deloitte, 2010). Deloitte attributed this to the acquisitions of new businesses in the UK and an increase in the disclosures under IFRS 7, relating to financial instruments. However, the table above shows that for RBS and LBG, regulatory information declined in overall share of the annual report.

The approach taken here distinguishes between the regulatory information – the accounting story; and the corporate narrative (non-regulatory information). The corporate narrative is incrementally becoming the more noteworthy contribution for the banks. It creates a new mission in the production of the annual report, one which has moved from providing financial information to one which is a vehicle for the intended corporate message. Impression management implies that accountants may be outsourcing their role:

“some organizations resolve this dilemma by officially delegating the dramatic function to a specialist who will spend his time expressing the meaning of the task and no time actually doing it.” (Goffman, 1956b)

For those whose interest lies in a detailed exposition of the financials, the accounts may hold a more critical aspect. It can be seen as one of the more uncontrollable aspects of the performance, being so rigidly regulated. It may also be the location where impressions fostered on the front stage are contradicted (Goffman, 1956a). The audience may look to features of the performance that can't be readily manipulated to assess the sincerity of the performance (Goffman, 1956b). Here it is not about whether the performance is true or false but whether the numbers justify the impressions given off elsewhere in the report (*ibid*, p59). The implications of this are in the establishment of trust. The impressions originally seen in the front end of the report can be reviewed again with trust and a co-operative audience. But even relatively minor things that give a false impression may lead to the whole performance being called into question (Goffman, 1956b). Thus it is crucial to ensure consistency in numbers and approaches between the front end corporate narrative and that of the regulated accounting information at the back end of the report.

As a result, the next two sections consider the capacity for impression management in the corporative narrative of LBG and RBS. The banks undertake distinct strategies for managing the impressions of the crisis befalling them and their road to recovery.

## **9.2 Considering Corporate Narratives**

The necessity of State rescue can be deemed a deeply discrediting event which tarnished the banks' reputations. Readers are most likely aware of these damaging events prior to reading the annual report. Thus:

“the issue is not that of managing tension generated during social contacts, but rather that of managing information about his failing.” (Goffman, 1968)

An obvious stigma will be part of the definition of a situation whether or not the stigmatised wants it to be (Goffman, 1968; Goffman, 1956b). Concealment of the stigmatising attribute becomes impossible (*ibid*). Instead, organisational responses to the stigma of bankruptcy embody informational control techniques like defining the situation (Sutton & Callahan, 1987, p422).

Defining the situation in wake of the financial crisis and the Government ownership is therefore a central task for both RBS and LBG. The banks take divergent approaches to defining their own situation. These embody the particular circumstances of their failures and the ability to move out beyond the stigma of their failures. RBS uses the explicit technique of ‘core’ and ‘non-core’ assets/businesses to contain the failed part of the banks and the opportunities continuing to arise in the remaining parts. LBG uses the HBOS acquisition to capture failure. It is reshaping of this which underpins its definition of the situation. Interestingly, this does not undermine the previous impressions given by the old Lloyds TSB, nor indeed the identity of the group as presented in the annual report. However, a closer inspection of the events leading up to Government intervention helps account for the different approaches. The Corporate Narrative for LBG is explored next.

### **9.2.1 Lloyds Banking Group: Maintaining Poise**

Despite the Government investment in Lloyds banking group in 2008, this has not challenged the fundamental corporate identity that LBG consciously project. This stability is demonstrated in the consistency of their corporate narrative. The front covers below show enduring features throughout the crisis. This is a bank that wants to continue as before, built on a reputation of prudence and a UK focus. The difficulties occurring during the crisis are managed by the bank in a technique described as ‘passing’. Passing involves concealing the

stigmatising attribute. It may not be an absolute concealment but involves many different variations (Goffman, 1968). LBG deflect the crisis and its stigma from the bank by creating an impression that it was an external, rather than internal, event. This is achieved with the repeated use of the phrase 'market dislocation'. Finally, the tension between the corporate narrative and accounting is revealed as the combined business reconciliation and the statutory profit show a transaction in a light which is not politically expedient for the bank.

LBG presents itself as a strong bank building upon its Lloyds TSB heritage. The identity and ethos of LBG does not appear to have been extensively upset by its acceptance of Government help or the HBOS acquisition. Instead, it hints it has been an aide to the State, having rescued the Government from the burden of HBOS' liabilities rather than one which has fallen victim to the financial crisis itself:

"The acquisition of HBOS provides a unique strategic opportunity to create the best financial services business in the United Kingdom. The combination of Lloyds TSB and HBOS creates a new stronger organisation and helps support the stability of the UK financial system." (Lloyds Banking Group, 2008)

That the enlarged group has been subject to State intervention does not undermine the inherent strength and stability of the original Lloyds TSB. It is called one of the 'safest banks' (Lloyds Banking Group 2008 p6) and its business approach is the basis of the newly combined group:

"The strong risk management culture and more prudent risk appetite previously prevalent within Lloyds TSB has been applied to the enlarged Group." (Lloyds Banking Group, 2009a)

Indeed it was the strength of the Lloyds business model which allowed it to take over HBOS at the height of the crisis. HBOS continues to suffer losses as it had heavy exposure to the commercial property sector. By applying the LBG prudent approach, captured by the more prudent provisioning of the group, HBOS will provide synergies and future growth opportunities. What is not at question is the fundamental business model which Lloyds had worked with over the previous years. Yet Lloyds TSB would have been obliged to raise £7bn extra capital itself had it not taken on HBOS at the height of the crisis (Lloyds TSB, 2008b). The confident business approach is captured in the front covers of the annual reports.

## 9.2.2 Front Covers of Annual Reports for LBG 2007 - 2010

### Annual Report and Accounts 2007

Building long-term relationships



Lloyds TSB | for the journey...



### ANNUAL REPORT AND ACCOUNTS 2008

CREATING THE UK'S LEADING  
FINANCIAL SERVICES PROVIDER



### ANNUAL REPORT AND ACCOUNTS 2009

CREATING THE UK'S BEST  
FINANCIAL SERVICES PROVIDER



ANNUAL REPORT  
AND ACCOUNTS 2010

### CREATING THE UK'S BEST FINANCIAL SERVICES PROVIDER





Pictures and images are important in the annual report. They reinforce the corporate message. They provide visual stimulus as to the value of the corporation, which may not otherwise be captured in the financial numbers (Davison, 2010; Davison, 2009; Preston et al., 1996). The front covers of the reports show a consistency amongst Lloyds Banking Group before and after the takeover of HBOS. The black horse dominates the front cover and the limited colour scheme is apparent in all photos. In 2008, even though HBOS was not integrated into the accounts, the new Lloyds Banking Group logo was used, along with a new strapline of ‘Creating the UK’s Best Financial Services Provider’ and ‘Becoming the Best Bank for Customers’. This is the mission statement of the newly enlarged group. The previous strapline, ‘Building Strong Relationships’ remains an important feature of the bank’s strategy.

This sends a strong initial image to the reader of the report – the bank is still a successful business with ambitions intact despite the financial crisis. The fundamental identity of the bank remains strong and competitive despite the drop in market fortunes. Overall, there is an impression of maintaining its own poise – it has not questioned its identity in face of the financial crisis and the integration of the failed HBOS.

Like the bowler hat in an image study of Bradford & Bingley (Davison, 2009), the horse is not a picture of products or services the bank renders. Instead, the image speaks to metaphorical or suggestive levels of impressions. The horse can be seen as strong, sturdy, powerful creature but also one which has been a long standing servant to humans. These images may all evoke the qualities of the horse that Lloyds Banking Group wish to emulate.

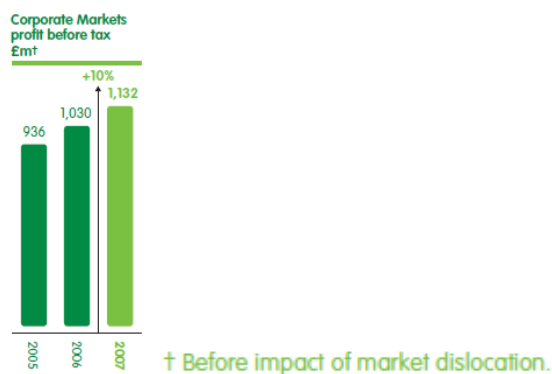
### 9.2.3 Containing the Crisis: Market Dislocation

Whilst there is consistency and confidence exuded from the annual report front covers, LBG must acknowledge the failures associated with loan impairments and Government rescue. LBG tries to contain the crisis through the use of accounting for ‘market dislocation’. The use of ‘market dislocation’ in its annual reports is looked at here.

From 2007 – 2009, LBG uses the term ‘market dislocation’. The term implies that short external events to the organization have had an impact on the results, but which are not a tangible part of everyday operations at the bank. Lloyds appeals to the externality of market movements. In this way, the stigma is externalized to the organization and is happening to everyone else as well as them (Sutton and Callahan, 1987). Results could be blamed on the external environment (Clatworthy and Jones, 2003). In this way, LBG can continue to maintain poise (Goffman, 1956b).

Market dislocation is a prominent feature of the annual reports, and is used to explain performance in the group’s results analysis. It is first used in 2007, when there is a £280m movement in the wholesale and international banking divisions explained in these terms. Some graphs exclude the ‘market dislocation’. An example of this is shown at Figure 9.1. This means that positive corporate messages can be emphasized. Trends are shown to be increasing upwards; profits are increasing, with the £280m ‘market dislocation’ charge excluded. Selectivity of information in graphs like this has been a feature of impression management research (Jones, 2011).

**Figure 9.1: Selectivity of Information in Graphs, 2007: Excluding Market Dislocation**



Market dislocation is used as a phrase multiple times at the height of crisis. The Chief Executive’s Review explains its use:

“Whilst we cannot overlook the impact of the dislocation on our results, these numbers are more reflective of the on-going performance of the Group.” (Lloyds TSB, 2007)

In the 2008 accounts, ‘market dislocation’ is used in a number ways. Figure 9.2 demonstrates its use in key narrative. In the ‘Key Highlights’ section, the performance is reported, excluding market dislocation. In this way, year on year growth can be asserted, allowing a strong performance to be maintained. At the same time, it is also a new accounting, allowing a quantification of the market turmoil. In turn, by quantifying this figure, the key highlights can exclude its effects from the performance commentary. A more regular trading year is presented to flush out any short term changes to the trends through accounting adjustments.

The 2008 report does not explain the basis for the ‘market dislocation’ calculation or the items recognized within it. The 2009 report gives some indication that it relates to trading portfolios marked to market and gives a sideways acknowledgement that it has had an effect on subdued income growth. Yet there is always space between the combined business performance and the statutory performance, with a majority of the differences coming down the ‘market dislocation’ and HBOS gain that LBG have. In the 2010 report, perhaps because the crisis in the banking markets is less dramatic, the term does not get used at all.

LBG uses ‘market dislocation’ to distance itself from its failures. This is achieved because in 2008 Lloyds did not consolidate the HBOS accounts and could still keep its self-view as a safe player in the banking industry. The impression is given that these losses are not the responsibility of the Lloyds management teams. Stakeholders are given the acknowledgement and apology for the position of the bank over the crisis, but are offered hope for the future through strong remaining businesses, retail brands and a new board.

### **Figure 9.2: Summary of Group Results, LBG 2008**

**Statutory profit before tax reduced** by 80 per cent to £807 million. A resilient underlying business performance was offset by the impact of market dislocation and adverse volatility relating to the Group's insurance businesses.

**A resilient business performance.** Profit before tax, on a continuing businesses basis, totalled £2,426 million, a decrease of 35 per cent which reflected the impact of £1,270 million of market dislocation and higher impairment levels.

**Robust income performance.** Income, excluding market dislocation, grew by nine per cent reflecting strong revenue growth from the Group's relationship banking businesses. On a statutory basis, income was eight per cent lower at £9,872 million.

**Excellent cost management.** The Group's cost:income ratio, excluding market dislocation, improved by 1.1 percentage points to 47.0 per cent.

**In a difficult economic environment, asset quality remains satisfactory.** Impairment losses increased by 68 per cent to £3,012 million, reflecting the impact of market dislocation, the slowdown in the UK economic environment and the impact of the falling house price index.

**Strong liquidity and funding position maintained** throughout the recent turbulence in global financial markets.

**Robust capital ratios.** Adjusting the year end capital ratios for the Government's recapitalisation of UK banks, completed in January 2009, and the estimated impact of the acquisition of HBOS, the enlarged Lloyds Banking Group's pro forma core tier 1 capital ratio stands at 6.4 per cent, the tier 1 ratio at 9.8 per cent and the total capital ratio at 12.5 per cent.

(Lloyds Banking Group, 2008) [Emphasis added]

#### **9.2.4 The Corporate Narrative of Numbers: Pro-Forma Accounting**

The corporate narrative within the Lloyds banking group features a great deal of numbers. These numbers, however, are not the regulated accounting required for production. Rather, they are 'pro forma' ones outside the regulatory scope of the annual report. It usually involves selective editing from the larger body of information contained in the regulated accounts (Weetman, 2011). This selective accounting information may not in itself represent a true and fair view. Alternatively, investors may prefer this information as it is more indicative of 'core earnings' than the regulated accounts (Bhattacharya et al., 2003).

From the time of the HBOS acquisition LBG opt to report pro forma earnings, termed 'combined businesses':



**Figure 9.3: Headline Figures, LBG 2009 Report**

<b>COMBINED BUSINESSES<sup>1</sup> – RESULTS SUMMARY</b>		
	2009 £m	2008 £m
Net interest income	12,726	14,903
Other income	11,875	6,933
<b>Total income</b>	<b>24,601</b>	21,836
Insurance claims	(637)	(481)
<b>Total income, net of insurance claims</b>	<b>23,964</b>	21,355
Operating expenses	(11,609)	(12,236)
<b>Trading surplus</b>	<b>12,355</b>	9,119
Impairment	<u>(23,988)</u>	(14,880)
Share of results of joint ventures and associates	(767)	(952)
<b>Loss before tax and fair value unwind</b>	<b>(12,400)</b>	(6,713)
Fair value unwind	6,100	–
<b>Loss before tax – combined businesses</b>	<b>(6,300)</b>	(6,713)
<b>RECONCILIATION OF COMBINED BUSINESSES LOSS BEFORE TAX TO STATUTORY PROFIT BEFORE TAX</b>		
<b>Loss before tax – combined businesses</b>	<b>(6,300)</b>	(6,713)
Integration costs	(1,096)	–
Volatility	478	(2,349)
GAPS fee	(2,500)	–
Negative goodwill credit	11,173	–
Amortisation of purchased intangibles and goodwill impairment	(993)	(258)
Pre-acquisition results of HBOS plc	280	10,825
Insurance grossing adjustment	–	10
Results of BankWest and St. Andrews	–	90
Loss on disposal of businesses	–	(845)
<b>Profit before tax – statutory</b>	<b>1,042</b>	760

(Lloyds Banking Group, 2009a) [Emphasis added]

At the bottom of the figure, LBG provide a reconciliation between their ‘combined business basis’ and the ‘statutory’ profit before tax. This is identified as significant under impression management, for it is the area between the front and back stage of the performance:

“one of the most interesting times to observe impression management is the moment when a performer leaves the back region and enters the place where the audience is to be found, or when he returns therefrom, for at these moments one can detect a wonderful putting on and taking off of character”(Goffman, 1956a)

This is in fact, one of the most revealing performances for the bank. Here, impairment (underlined) is prominently shown for the year, causing an extensive loss for the bank. However, the statutory results actually show a profit. It is counterintuitive to what might be expected, where a profit would be formulated in the pro forma numbers covering a loss in

statutory results. However, the single transaction causing the loss to be reported rather than a profit is the HBOS takeover. Three figures relate to the HBOS transaction in figure 9.3 above, although only one item explicitly names HBOS in the results. The first is the Fair Value Unwind of £6,100m shown just before the Loss before tax on a combined business basis. The second is the £11,173m of negative goodwill credit shown as part of the reconciliation to statutory profit before tax. The third is the pre-acquisition results of HBOS plc.

The negative goodwill credit arose from buying HBOS for less than the book value of its assets. It is a standard accounting adjustment as per IFRS 3 (IASB, 2008, para 34). The fair value unwind has arisen as adjustments to the acquisition balance sheet reflect current market based credit spreads for HBOS' lending portfolios and own debt (Lloyds Banking Group, 2009a).

The HBOS transaction was one facilitated by Government and therefore carries a political dimension. The conclusion of the HBOS deal and the additional Government support offered through the APS occurred within days of each other (16<sup>th</sup> Jan 2009 for the former vs. 19<sup>th</sup> Jan 2009 for the latter). The Government support was to be one of last resort, in the event of not being able to fund sufficiently through market mechanisms (HM Treasury, 2008a). It is argued therefore that the bank has to present a failed group, to justify their own level of support from the State. As a result, the loss mutes any suggestions that LBG were profiteering from the sale of HBOS to Lloyds TSB when markets were at crisis point back in September 2008.

This left LBG with a profitable transaction which must be conveyed as being an expensive take over. This means presenting a front which can fit with the immediate situation, even if this is a poor impression (Goffman, 1956b). In general, the preferred choice is to incorporate the accredited values of society (Goffman, 1956b) and this is shown here by the option to show a pro-forma loss.

This then, is a stigma of a completely different sort. The stage must be presented to the audience which conforms to the collective representation of society – the crisis, the loss of money and the loss of jobs. Here, the story is not one of striking at a massive opportunity, a £11bn immediate gain on 'negative goodwill' on a troubled company which is what the statutory accounting portrays. Taxpayers, as well as shareholders, must then have the story confirmed of a bad result, a bad decision to take on HBOS, through short term accounting

numbers of profit before tax, even if the rationale for Government support in the case of capital adequacy was a longer term concern.

Thus, the regulatory account provides a conflict with the corporate narrative. It tells a story of gains from others' misfortune, not only of HBOS but of the Government too. LBG do not want to be that bank. The preference is to be seen as a good corporate citizen, who took on HBOS, rather than a bank that was setting out to take advantage of the poor economic conditions.

Overall, regulatory accounting forces the stigmatising attributes of the LBG business to be revealed. The company attempts to 'pass' these by dressing them as 'market dislocation' or through the 'combined businesses' approach. Yet, regulatory accounting forces these to be revealed in prominent pages by the bank. The bank cannot safely or legitimately talk about its business without explaining the crisis as well.

The corporate narrative of RBS is now considered. What is dealt with here is another means of managing the stigma of Government rescue and financial crisis. In contrast to LBG's attempt at passing, RBS opt to highlight change.

### **9.3 RBS' Corporate Narrative: A Performance of Fundamental Change**

RBS deal with the stigma of failure in a markedly different way to LBG. Instead of reinforcing the company values, the bank is now undergoing fundamental change. The origins of the crisis are found within the bank and are being managed. The bank is going back to its roots of UK based customer banking and opting to leave its global businesses behind. This is demonstrated through the construction of the front covers of its annual reports, but also in how it reports on the crisis itself. RBS explicitly set up a 'non-core division' which represents its troubled past and which is to negotiate the wind down of its operations. For RBS, the extraordinary external environment is to be acknowledged and categorized as separate from the bank's 'real' business. In this way, invisible costs of doing business – here the response to poor business decisions by divestment - are dramatized and rendered visible (Goffman, 1956b). It also allows sympathy to be gained from the audience and thus may be seen as a more rational response compared to other forms of passing (Sutton and Callahan, 1987). The following sections look at how the corporate identity is presented in the annual report front covers over time, before discussing other aspects of the corporate narrative.

### 9.3.1 Annual Report Front Covers of RBS: 2007 – 2012



Annual Report and Accounts 2007



rbs.com

Make it happen



Annual Report and Accounts 2008



rbs.com



Annual Report and Accounts 2009



rbs.com



Annual Report and Accounts 2010



rbs.com

Annual Report and  
Accounts 2012

It can be argued that the annual report covers of the RBS group reflect the changing fortunes in the bank (Davison, 2009) and the different corporate messages they want to project (Preston *et al* 2006). In 2007, a strong successful corporate image is presented. There, on the covers, is the evidence of its financial success, with growing dividends and ROE. This is a company worth investing in. Its corporate culture is projected through images of workers and a business environment of the office. Ethnic diversity encapsulates an image of a global business. In 2008, there is a stark change with the Government taking a majority share in the group. There is only 1 image, a sober photo of the RBS Group logo. This could be interpreted as a reflection of cost cutting and driving through an agenda for change by responsible managers (*ibid*, p119).

The report of 2009 sees a return to the photo montage used in 2007 and previously. Yet the nature of photos is now quite different to the 2007 covers. UK based brands are shown as well as the RBS logo itself. RBS customers feature, rather than workers. There are shop front images, ones known to retail customers, not the images of inside offices, capturing the environment shown in 2007. This suggests confidence in the RBS businesses – at core, the business is still successful in banking but has evolved to be meeting the needs of a changed environment. It highlights the increasing concern for the RBS small business customer, with a large photo of the motorcyclist in a prominent position. Importantly, the numbers used in 2007 disappear.

In 2010, the montage again features images familiar to the group's retail customers. In contrast to 2009, here the customers of RBS are shown interacting with the RBS staff on the cover, rather than featuring separately. This could be interpreted as customers are building

relationships and getting positive help from the bank. The Customer Charter is also given a picture on the front cover. Some RBS staff look directly at the camera, rather than being pictured doing other things. The various brands of the group are featured in the background. This sends messages of a bank which engages with the customer, shareholder and is not exclusively dealing in high concept business. Interestingly there is a return to some office images like used in 2007 and ethnic diversity is present in a stronger manner. This may highlight a return of confidence in the bank but sits at odds with the customer focus, UK based bank that is being projected elsewhere.

The 2011 cover is a step away from the photo montage back to the corporate logo used in 2008. The logo of RBS is not faithfully reproduced but large scale pieces of the logo are incorporated. The colours are stronger blue and the font of the title is in white, to make it stand out. It appears more confident than the 2008 cover, with its thematic collage of the logo rather than just a straightforward photograph. This is not a year for reinventing the company but perhaps one which has become more comfortable in the clothes that it has worn previously.

2012 front cover photos represent a much simpler montage for the bank. There is only RBS and NatWest brands shown. It is in black and white. There are two pictures showing a worker helping customers, and then two with customer and a worker individually. Ethnic and gender diversity are shown. The bank continues to slim down its global reach and has made significant divestments, including those of Direct Line and the planned divestment of Citizens. These images represent the external image the bank wants to project, and its current stance of putting customers at the heart of its recovery. The next section considers the chairman's statement, which also shows features of change.

Overall, the front page of the annual report is a critical graphical representation of the impression that the banks want to convey. In impression management terms, it can be seen as a crucial device in defining the situation. For RBS, messages of change and increased focused can be interpreted. This contrasts with LBG, whose front covers show consistent graphical themes, projecting an underlying confidence in the banking group's ethos.

The front cover may be the start of fostering the desired impressions, but consistency in message throughout the annual report is important as well. Therefore, the next section of the chapter considers another well-read aspect of the annual report – the Chairman's Statement.

### **9.3.2 The Chairman's Statement: Addressing a Different Audience, a New Style of Performance**

The chairman's statement is one of the most read parts of corporate annual reports and has had extensive research conducted on its content (Clatworthy and Jones, 2006). It is a critical part of defining the situation of the annual report and interpreting this in narrative form for the reader. Theoretically, the impressions presented in the Chairman's statement will reflect the standards by which the banks are trying to live up to (Goffman, 1956a).

The tone and content of the 2012 RBS Chairman's statement is different to those of prior years. There is the image of the Chairman himself, standing more informally with his hands in the pockets. The tone and lexical content of the statement suggest a different audience to previous years. The top tier of management is referred to as 'Your Board' from 'The Board' employed in previous years. The tone is humble. The vocabulary is simpler:

"We are delivering what we said we would do in our strategic plan. We have made RBS safer. It is much closer now to being in the good financial health that would allow shareholders to receive a dividend and the Government to start to sell its stake. The challenge that remains is to serve customers better and to do business in a way that makes you and us proud to be part of RBS." Philip Hampton, (Royal Bank of Scotland, 2012b)

It is aimed at the lay person, rather than the sophisticated investor. This may be associated with the upbeat results RBS are reporting. Although the bank is still loss making, it has a positive story to tell about achieving the strategic targets first outlined in 2009. The readability of the document is difficult under negative conditions but will become more readable if business prospects improve (Linsley and Lawrence, 2007; Courtis, 2004) Contrast to the tone of the 2011 annual report where the tone is more authoritative and edging on the defensive:

"It is the Board's view that running the business on commercial grounds is the best way to make the bank safer and more valuable for everyone who depends upon it. I do not believe there is a workable alternative if our aim is to provide the opportunity for the UK government to sell its shares in the public markets in a reasonable timescale." (Royal Bank of Scotland, 2011b)

Here, the discussions of the day are widely apparent as to the State ownership of the bank. The Chairman uses the platform of the annual report to comment on these debates more generally.

The message between 2011 and 2012 does not change in that the exit of Government is a key strategic priority. The language, however, has changed considerably and appears to seek

more empathy in the later year. This gives a markedly different impression to that in 2011. Goffman acknowledges:

“Often we find that if the principal ideal aims of an organization are to be achieved, then it will be necessary at times to by-pass momentarily other ideals of the organization, while maintaining the impression that these other ideals are still in force. In such cases, a sacrifice is made not for the most visible ideal but rather for the most legitimately important one.” (Goffman, 1956b)

The legitimacy of the corporation may be best served by appealing to the customer focus of the bank rather than its ‘commercial orientation’. Both retail and commercial banking provide robust net interest margins for the bank. Impression management thus could suggest that the corporative narrative and chairman’s statement is not sourced directly from accounting results. In contrast, it is generated from the key (socio-political) discourses of the day.

### **9.3.3 Key Financials in the Corporate Narrative**

Like LBG, RBS has pro-forma accounting in its corporate narrative. Pro-forma accounting is thus a key mechanism of impression management. The numerical aspect of pro-forma gives it a legitimacy which may not be present in other corporate narrative. Like, LBG, RBS employs ‘passing’ in an interesting way with pro-forma accounting. *Prima facie*, there is an expectation that negative aspects of the organisational performance would be backgrounded within the content of the annual report (Courtis, 1998). RBS, however, ensure that the market turmoil is presented in the key financial results. The important aspect is to manage the stage and audience’s impressions by defining the situation for the reader. For RBS, this is done by exerting prominence in the annual report, even before the Chairman’s statement, of the market events. This achieves two things: it promotes trust in the reader, because it is consistent with poor results evident in the statutory accounting; and it allows the bank to project the best impression possibly by defining the market turmoil in its own way. There is nonetheless a difficult balance to maintain as the statutory results, reported alongside the pro formas, can undermine the impressions generated. The extract of the key financials below demonstrates this.



**Figure 9.4: Headline Figures, 2008 RBS Report**

## 2008 Key financials

<b>Pro forma</b>	
Underlying profit <sup>(1)</sup>	£80 million
Loss attributable to ordinary shareholders <sup>(2)</sup>	£7.9 billion
Total income <sup>(3)</sup>	£26.9 billion
Impairment losses <sup>(4)</sup>	£7.0 billion
Credit market losses <sup>(5)</sup>	£7.8 billion
Write-down of goodwill and other intangible assets <sup>(6)</sup>	£16.2 billion
Total capital ratio	14.2%
Core Tier 1 capital ratio <sup>(7)</sup>	7.0%
Tier 1 capital ratio	9.9%
Basic loss per ordinary share <sup>(8)</sup>	(61.0p)
<b>Statutory</b>	
Loss before tax	£40.7 billion
Loss attributable to ordinary shareholders	£24.1 billion
Basic loss per ordinary share	(145.7p)
Core Tier 1 capital ratio	6.8%

(Royal Bank of Scotland, 2008b)

The above extract from the RBS Accounts shows how the pro forma and statutory accounting in the 2008 report is presented. This is the first page of the report, arguably the most important in terms of defining the situation for RBS. Similar to LBG, this reconciliation can be seen as the passage between the front stage and the back stage and where contradictions may occur (Goffman, 1956a). Viewed critically, the pro forma account can be construed as a means to create a better impression. Pro Forma accounts are placed more prominently and show an ‘underlying’ profit of £80m. The losses on a statutory basis show RBS losing £40bn further down the page, exerting less prominence. Yet in the case of RBS and LBG, proformas also can be viewed as an important segmental analysis for readers. The pro forma numbers isolate and show the effect of the unusual market events, which are left unexplained by statutory results. In this way, RBS acknowledges that there has been an extremely poor performance resulting in huge losses for all shareholders, including the Government. Headline information, whether positive or negative, is shown.

The placing of the statutory information after the pro forma analysis could also be viewed as a comment on the information value of this compared to the pro forma numbers. It is argued here that the reader is subtly encouraged to collude with RBS in devaluing the importance of the statutory information:

“... if the individual’s activity is to become significant to others, he must mobilize his activity so that it will express during the interaction what he wishes to convey” (Goffman, 1956a)

The relevance of statutory accounting is questioned in the following years by RBS as the fair value of its own debt makes for counter intuitive results. For instance, in the 2012 results, RBS suffer a £4.649bn accounting write down because their fair valued debt has gone up. This leads the CEO to conclude:

“It was a big loss but most of that was technical [wrinkles nose] and in accounting terms, the underlying profit was the highest we have achieved since 2008” (Royal Bank of Scotland, 2013d)

Fair value movements have been a controversial topic throughout the crisis, and encourage pro-cyclical movements in asset values. The Chief Executive is perhaps expressing frustration that positive business activities are nonetheless being pushed out of profit by accounting adjustments, over which the bank has little control. Therefore, tangible work effort is promoted through the pro forma numbers.

Moreover, RBS focus on the divisions made between core and non-core to promote the restructuring and change of the bank since the financial crisis. This is discussed next.

#### **9.3.4 RBS: Constructing the Core and Dismantling of Non-Core**

The global financial crisis, the extent of Government support and the media coverage devoted to the collapse of the banks ensure that there is no possible way for the banks to conceal the assistance required to continue trading. Therefore, impression management through defining the situation is imperative in helping to repair damaged reputations. The stigma is widespread as RBS has been prominent in the news with regard to Government failure. Their reputation precedes them. Goffman considers the implications of this:

“ Where an individual has a public image, it seems to be constituted from a small selection of facts which may be true of him, which facts are inflated into a dramatic and newsworthy appearance, and then used as a full picture of him. In consequence, a special type of stigmatization can occur. The figure the individual cuts in daily life before those with whom he has routine dealings is likely to be dwarfed and spoiled by virtual demands (whether favourable or unfavourable) created by his public image.” (Goffman, 1968)

For RBS, the stigmatizing attribute of corporate failure may dominate its other corporate reputations (White and Hanson, 2002). The overriding media picture of RBS is a failure. Nonetheless, successful and profitable activities remain within the large banking group. RBS seek to manage a delicate balance between celebrating its profitable areas, demonstrating change, and isolating the poorly performing parts of the bank.

RBS respond to this by creating a separate division in its books termed ‘non-core’. This is first proposed in the 2008 annual report:

“We will create a “non-core” Division of RBS during the second quarter of 2009, separately managed, but within the existing legal structures of the Group and matrix-managed to donating Divisions where necessary. This Division will have approximately £240 billion of third party assets, £145 billion of derivative balances and £155 billion of risk-weighted assets, comprising individual assets, portfolios and businesses of the Group that we intend to run off or dispose of during the next three to five years.” (2008, CEO Review, p5)

In 2009, the non-core division is presented in the annual report and has its results reported.

The non-core is thus defined:

“Our Non-Core Division is central to the strategy that will return RBS to self-sufficiency. On the one hand, it is managing assets that are no longer core to our strategy and the continuing operations of RBS, and which we plan to sell or to run down. On the other, partly because Non-Core will reduce the asset side of our balance sheet, it will improve our funding position and make RBS a safer bank. Non-Core Division was created to facilitate the re-shaping of RBS on its journey to self-sufficiency and is responsible for one of the largest bank restructurings being undertaken globally and one of the largest in history.” (Royal Bank of Scotland, 2009a)

Although as a proportion of business, the non-core dwarfs the efforts of other divisions<sup>30</sup>, the label defines and encloses the crisis. The bank benefits in dual ways from the creation of the Non-core division. It gains credibility from accepting responsibility for the failure by the audience, and thereby gets the audience predisposed to accept the impression that it makes in both this area and the rest of the report. The stigma is openly disclosed – and then an attempt is made to move it backstage (Goffman, 1956a p43).

The impression projected suggests that this not a failed group which is presenting results. Rather, it is a group which contains a poisonous component. It is nonetheless separable from the rest of the healthy business and with hard work can be removed to the benefit of the other divisions. In this way, the ‘core’ represents the hope for the future, whereas the non-core is a product of the troubled past.

### 9.3.5 Restating RBS’ Biography

Whilst passing is managed through the creation of the non-core division, Goffman notes in Stigma (1968) that personal identity is an important part of the management of stigma. In social situations, personal identity may impact on the ability to conceal or pass the

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<sup>30</sup> £14.3bn of operating losses in 2009 compared to a Group overall loss of £2.59bn statutory loss.

stigmatising attribute. The biography of the individual, along with the visible marks on the person, makes up this identity. Goffman notes features of biography. It is often subject to retrospective construction and there is an assumption that only one such biography exists. When this past biography appears unusual, there is an expectation that further information is divulged, despite the social cost to the entity concerned (*ibid*, p64). Divulgement is a means of managing stigma, as any discrepancy between social identity and ‘personal’ identity which is later revealed can be more costly than admitting to the discrepancy directly (Burns, 1992).

RBS shows evidence of a shifting social identity as it responds to changes in its own biography, prompted by changes in regulation and updated with current events in the organisation. This responds to changing social expectations in the form of financial reporting regulation from the IASB and corporate restructuring. This is part of the decision-usefulness of the Financial Statements, to remove irrelevant items from the accounts so that the remaining business can be usefully assessed.

Yet there is also a suggestion that the move to close the gap between the organisation’s social identity and its personal identity is a result of a process of construction of the personal identity as time goes by rather than solely a rectification of social identity. Here, retrospective sense making as a feature of impression management (Merkl-Davies et al, 2011) is illuminating.

To further consider the features of biography and retrospective sense making, the year of crisis as presented by RBS is discussed below. The crisis numbers are reclassified over the years. Unfortunately, reclassification with the benefit of hindsight can serve to obscure the financials. This is particularly difficult when the year in question is one of complete change, as 2008 was for RBS. Below, an abridged group income statement is shown over the years 2008 – 2010. Analysis of pertinent differences then follows.

**Table 9.3: The Year of Crisis: 2008 as reported 2008 – 2010**

Year	2008	2008	2008	2008	2008	2008
Basis	Statutory	Statutory	Statutory	Pro Forma	Pro Forma	Pro Forma
Source	AR 2010	AR 2009	AR2008	2010	2009	2008
	£m	£m	£m	£m	£m	£m
Total income	20,730	25,868	25,868	19,367	20,599	21,234
Operating expenses	(35,065)	(54,202)	(54,033)	(16,188)	(16,188)	(15,916)
Impairment and insurance net claims	(11,356)	(12,502)	(12,502)	(11,349)	(11,349)	(10,879)
Impairment losses on reclassified assets	--	--	--	--	--	(466)
Fair Value of Own Debt	--	--	--	1,232	--	--
GROUP OPERATING (LOSS)/PROFIT	(25,691)	(40,836)	(40,667)	(6,938)	(6,938)	(6,027)
(Loss)/profit from continuing operations	(23,524)	(38,513)	(38,344)	(7,016)	(7,016)	(6,847)
(Loss)/profit from discontinued operations, net of tax	(11,018)	3,971	3,971	(86)	(86)	--
(Loss)/profit attributable to ordinary shareholders [before write-down of goodwill & other intangible assets]	--	--	--	(8,110)	(8,110)	(7,855)
Write down of goodwill and other intangible assets, net of tax	--	--	--	(16,196)	(16,196)	(16,196)
(Loss)/profit attributable to ordinary shareholders	(24,306)	(24,306)	(24,137)	(24,306)	(24,306)	(24,051)

Source: RBS Annual Report 2008 - 2010

The table above provides an abridged income statement of RBS in 2008 as presented in the 2008, 2009 and 2010 annual reports<sup>31</sup>. The numbers given most prominence are the pro forma numbers, being referred to in the Chairman's Report, the Chief Executive's report and used in the financial highlights at the beginning of the document. As the Chairman's report is the most read part of the annual report, the use of the pro forma numbers is significant. Moreover, the profitability or otherwise of the company is projected through the 'underlying' or 'operating' profit. This suggests that the board is focused upon the business of the bank rather than statutory accounting of the group.

Looking directly at the bottom line in table 9.3, the reader can see that the 2008 loss attributable to shareholders is relatively stable over the various publications and formats at circa £24bn. However, the means of reporting this has been subject to some reorganisation over the 3 years. Taking the statutory figures only, IFRS regulations and corporate restructuring have meant that 2008 has been restated to provide comparatives with later years. The big change has been the disposal of a number of ABN Amro assets, leading to them being classified as discontinued operations under IFRS 5. The effect on the 2008 numbers is that the results of that particular operation is removed from the body of the income statement and instead inserted as a net figure into the line 'discontinued operations, net of tax.' The consortium that acquired ABN Amro was led by RBS and utilised an entity called RFS Holdings. RBS consolidated RFS holdings into its own accounts after acquisition in October 2007 until ABN was legally separated in 2010. From that point onwards, the activities which were attributable to the other consortium partners were classified as discontinued operations and this is shown accordingly in the 2008 statutory results from the 2010 report. Income reduces by £5bn whilst operating expenses reduce substantially from £54bn to £35bn. A large proportion of this (£15bn) is to do with impairment costs which have been put 'below the line'. 'Below the line' refers to the operating profit number which is the headline figure to indicate quality of earnings<sup>32</sup> for the underlying business of RBS. As a result, the 2008 figures, through 2010 lenses, look different to that which was reported in 2008. It is arguable that making 2008 really poor was

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<sup>31</sup> 2008 comparatives are not used from 2011 onwards in the accounts. From 2011, the lows of 2008 are used to demonstrate progress within the corporate narrative.

<sup>32</sup> Quality of earnings describes the portion of earnings which are persistently achievable in later years to give some indication of future potential of a company (Abdelghany, 2005). It excludes any one off items in the results.

an opportunity for the new board to suggest business failure resulted from poor decision making by the previous incumbents (Godfrey et al, 2003). Subsequently the new board members would then make decisions which would lead RBS back to profitability again. However, much may be attributed to the regulatory requirements in the form of IFRS 5 and IFRS 2. Between 2008 and 2009, the overall statutory profit also changed by £169m. Again, this was driven by regulatory demands in the form of IFRS 2 Share Based Payments. This added £169m to the staff costs in 2009.

RBS did not use pro forma figures at all until 2008. The reasoning given at the stage was due to the consolidation of the RFS Holdings into RBS. To aid assessment of the figures, only the business units which were to be retained by RBS were included in the pro forma results (Royal Bank of Scotland, 2008b) Moreover, significant one off items, such as the credit write downs, were also shown separately for the group. By 2009, however, the credit market write-downs were classified as part of the net non-interest income line. In 2010, there was a separate line item for the gains arising on the fair value of own debt. RBS values some of its own issued debt at fair value. Wider credit spreads on the group's debt in the bond market means that a gain is recorded (i.e. the value of RBS' debt is reduced at fair value – RBS have a lower liability – results in a gain in the income statement). This meant that the operating profit shown in the 2010 accounts precluded this movement and the pro-formas for 2008 were restated accordingly. As Gaynor et al (2011) contend this makes for counterintuitive movements in the income statement, but one which follows regulatory demand.

Each year, history is rewritten as the crisis of RBS is reinterpreted and refined for investor consumption. As pertinent issues arise, the group revisits its past results to allow this progress to be reflected from a point of crisis to calmer times (Godfrey et al 2003). In so doing, the reader is left confused about what happened in RBS at the point in crisis, thereby obscuring the mark of progress that the company may have made since then. This echoes some of the findings of Carlin (2004) in constant movement in indicators makes the measure of progress difficult; and thereby, decreases the impact of accountability from the reporting organisation.

Again, the conflict between the statutory accounting information and the corporate narrative serves to undermine the performance that RBS tries to generate in its impression management. RBS is eager to demonstrate fundamental change. Yet this change is itself dynamic and moves incrementally over time. Whilst change is apparent from the tones of the front cover from 2008, it is only in 2012 that culture change is demonstrated by the

change of voice in the Chairman's statement. The words have caught up with the pictures of a new bank. Accounting provides alternative forms of constructing this change. The regulatory numbers creep into the corporate narrative but largely reside outside the front end of the report.

Even though the statutory accounting numbers remain backgrounded in the annual report, they still retain an important clarification role. They create an obligation on the part of the banks to explain why the regulated numbers are different to the board perspective of business performance. Therefore, the next final part of the chapter considers the statutory story further.

## **9.4 The Statutory Story: Alternative Performances in the Annual Report**

This section considers the use of statutory accounting within both RBS and LBG. The statutory accounts are relegated to the back of the large report on the businesses. Using Goffman's impression management, its status is considered further below.

### **9.4.1 The Statutory Accounts and Related Notes: Compliance over Information**

Impression Management offers alternate views to how the accounts are utilised in RBS and LBG. The receiving audience is important. They are the *raison d'être* of the earnings announcement process. Yet the numbers reside in the back pages. They are preceded by management commentary and pro-forma accounting. Images are omitted from the statutory content. The format of the primary financial statements are driven by the regulations in IFRS 1 (updated by IFRS 5, 7, 9) and IAS 7 (John Wiley & Son, 2013). The notes originate from disclosures required in the IFRS standards and UK regulation.

On the one hand, the placement of the accounts at the back may create an impression that these are part of the back stage:

“Some aspects of the performance are accentuated and other aspects, which might discredit the fostered impression, are suppressed. It is clear that the accentuated facts make their appearance in what I have called a front region; it should be just as clear that there may be another region – a ‘back region’ or ‘backstage’ where the suppressed facts make an appearance.” (Goffman, 1956a)

This is a relevant analogy for certain readers who may not be as interested in the detailed financials. It is the area for constructing the front stage impressions (*ibid.*). In the



backstage, the performer can relax and step out of character (Goffman, 1956a). Here, the impression fostered is that of accounting, rather than of the corporate identity.

Yet labelling the statutory accounts as backstage is inaccurate, as they are not part of a private process (*ibid*, p116). Rather, the accounts are always public. Goffman recognises that regions can change dependent on performances:

“...still there are many regions which function at one time and in one sense as a front region and at another time and in another sense as a back region ” (Goffman, 1956a)

The statutory accounts then act as a public back stage or front stage dependent on audience. The consideration of the publics involved in the reading of the annual report is therefore critical (Neu et al., 1998). The statutory accounts are full of technical terms and numbers, opaque to the untrained. Figure 9.5 demonstrates:

Figure 9.5: Lloyds Banking Group income Statement 2012

CONSOLIDATED INCOME STATEMENT				
for the year ended 31 December				
	Note	2012 £ million	2011 £ million	2010 £ million
Interest and similar income		23,535	26,316	29,340
Interest and similar expense		(14,460)	(13,618)	(16,794)
<b>Net interest income</b>	5	<b>9,075</b>	12,698	12,546
Fee and commission income		4,731	4,935	4,992
Fee and commission expense		(1,438)	(1,391)	(1,682)
<b>Net fee and commission income</b>	6	<b>3,293</b>	3,544	3,310
Net trading income	7	13,554	(368)	15,724
Insurance premium income	8	8,284	8,170	8,148
Other operating income	9	4,700	2,799	4,228
<b>Other income</b>		<b>29,831</b>	14,145	31,410
<b>Total income</b>		<b>38,906</b>	26,843	43,956
Insurance claims	10	(18,396)	(6,041)	(19,088)
<b>Total income, net of insurance claims</b>		<b>20,510</b>	20,802	24,868
Regulatory provisions		(4,175)	(3,375)	(500)
Other operating expenses		(11,756)	(12,875)	(12,770)
<b>Total operating expenses</b>	11	<b>(15,931)</b>	(16,250)	(13,270)
<b>Trading surplus</b>		<b>4,579</b>	4,552	11,598
Impairment	12	(5,149)	(8,094)	(10,952)
Loss on disposal of businesses	14	–	–	(365)
<b>(Loss) profit before tax</b>		<b>(570)</b>	(3,542)	281
Taxation	15	(773)	828	(539)
<b>Loss for the year</b>		<b>(1,343)</b>	(2,714)	(258)
Profit attributable to non-controlling interests		84	73	62
Loss attributable to equity shareholders		(1,427)	(2,787)	(320)
<b>Loss for the year</b>		<b>(1,343)</b>	(2,714)	(258)
Basic earnings per share	16	(2.0)p	(4.1)p	(0.5)p
Diluted earnings per share	16	(2.0)p	(4.1)p	(0.5)p

The accompanying notes are an integral part of the consolidated financial statements.

(Lloyds Banking Group, 2012)

Figure 9.5 is an extract of the income statement for Lloyds Banking Group, 2012. The colour of the font is in the corporate colours of the organisation. Otherwise, the performance fostered is austere and numerical. The boxes surrounding numbers can cause confusion rather than clarity. They direct the trained to how the numbers add up; to the uninitiated this is not immediately obvious. What is added and what is subtracted is bracketed rather than shown in mathematical notation. The technical terms are also difficult for the untrained. ‘Impairment’ is naturally associated with assets to the accountant, but may conjure up connotations of physical disability for the lay person. ‘Non-controlling interests’ is another phrase which may be confusing to the lay person. The words are not explained. The income statement does not invite engagement for those unwilling to be a financial detective. It is accountants performing to members of the same clan:

“...in the social sphere which encompasses his display of professional competency, he will be much concerned to make an effective showing.” (Goffman, 1956b)

The statutory accounts are a performance for the financially trained. Non accountants may self-select and opt to not remain in the audience.

As a backstage item, the results here can form as a distraction from the performance that the banks want to give off. For the lay reader, such as many tax payers, accounting will be the “long tedious hours of lonely labour” that contribute to the front stage performances located in the front end. Here it is speculated the interest lies in the viability of the banks as standalone entities or in their customer service approach. At the extreme end, the regulated accounting has become the ‘dirty work’ (Goffman, 1956b) contributing to the creation of the glossy annual report’s corporate narrative.

#### **9.4.2 The Audit Report**

The front stage occupies a small but very crucial position on the performance delivered by the audit report. That impression has changed over time as the engagement partner signs off in his/her own name rather than on behalf of the firm. It is a report which appeals to the personal integrity of the auditor with overtones of ‘my word is my bond’.

Like the statutory accounts, the audit report remains consistent with the relevant auditing standards (Financial Reporting Council, 2013a) and has not been altered given the financial crisis or the State as shareholder. The continuing clean audit report is very surprising. It has not responded in any way to the immediate events surrounding LBG and RBS. Goffman suggests that routine fronts can become institutionalized:

“The front becomes a “collective representation” and a fact in its own right”(Goffman, 1956b)

Such information may seem tedious but suggests that the regulatory information is an instrument of compliance rather than one intended to inform (Skaerbaek, 2005; Hopwood, 1996b). Even if a desire to change is present, the audit report would have to choose between regulated alternatives under ISA 700 or engage in lengthy discussions with the client to avoid risking litigation. There are scant examples of audit reports which are not qualified but contain non regulatory prose within<sup>33</sup>. Qualifying the opinion may be a poor fit with the impression wanting to be showcased (ibid, p29). An alternative viewpoint expressed by Goffman may be more critical of processes such as auditing:

“The audiences must not acquire destructive information about the situation that is being defined for them. In other words, a team must be able to keep its secrets and have its secrets kept.” (Goffman, 1956a)

The report is bolted on to the financial statements and does not contribute to the communication of corporate values. Yet it also legitimates the numbers and impressions published, contributing to the robustness of the performance required by financial analysts (Goffman, 1956a). The implication is that the audit report may act as a distraction to the back stage or contradictory performances played out to an alternative audience.

“By bringing the specialist into one’s organization and even one’s team, there is also greater assurance that he will employ his skills in the interest of praiseworthy but irrelevant matters such as a balanced view, or the presentation of interesting theoretical data to the specialist’s professional audience.” (Goffman, 1956a)

Impression management offers an interesting interpretation of the auditors’ role in the financial statements. Instead of portraying the auditors acting in the interests of shareholders under agency theory (Fama, 1980), they become part of the team creating impressions in the annual report.

Even when regulatory requirements to abstain from preparation of the financial statements are applied, auditors are intimately connected to the financial reporting performance in the annual report. Their own performance is inconsequential – ‘irrelevant’ in Goffman’s language. Yet it encourages those who create it to ensure that the performances surrounding it are consistent with the financial statements (International Federation of Accountants

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<sup>33</sup> More information will be required in Audit reports for periods beginning on or after 1 October 2012 (FRC, 2013)

(IFAC), 2012). In this sense, then the auditors are implicated in all aspects of the annual report performance.

Auditors are not alone in supporting the performances of the banks. The audience may be asked to invoke tact and ignore any inconsistencies in the performance (Goffman, 1956a). Moreover, there may be other members of the team who are there to provide a supporting role (Goffman, 1978, p214). These include major competitors to the banks, which are considered next.

### **9.5.1 Teamwork in Impression Management: The Wider Banking Industry**

This section looks at the wider banking industry. Although Goffman is mainly interested in the impressions that an entity 'gives off' to ensure that they are thought of well, there is an acknowledgement that the successful creation of impressions is through tacit co-operation of a whole team of performers and a sympathetic audience (1973, p76). This provides a further seam of investigation for examining the role of the wider UK banking industry in both responding to RBS' and LBG's demise, but also in a role as intimates (Goffman, 1968), helping to protect the banks as they gain momentum to become standalone private companies. First of all the relevant themes of Goffman are explained before considering the impact on the industry.

It is not only the individual with the stigmatising attribute who may suffer its consequences. Goffman also notes that closely related persons may also incur differential management. He notes that this is

"A relationship that leads the wider society to treat both individuals in some respects as one." (Goffman, 1968 p30)

Such 'courtesy stigma' leaves the closely related individual in an in between situation. They are not categorised as someone without the stigma, yet they do not belong fully within the stigmatised group (*ibid*, p32). Their own relation to wider society is thus affected. Although there is not much further elaboration on courtesy stigma in Goffman's book, the presence of courtesy stigma has been noted as a feature of bankrupt company managers' families previously (Sutton and Callahan, 1987). More recently, it was noted as the impetus for the accounting profession to take remedial action when a Canadian bank collapsed after a noted audit failure (Neu & Wright, 1992). Given the importance of the auditors involved in the failure, it was not in the interests of the profession to scapegoat the particular auditors (*ibid*, p662). It is argued here that the banking industry have met a similar fate. Whilst RBS

and LBG have suffered the stigma of extensive public bail out through the State equity investment, other large UK banks have also received stigma over the extent of support to the banking industry. This has concentrated particularly on the socialisation of losses from the banks whilst the financial services industry has received huge financial rewards previously.

The original State ownership package in October 2008 did not directly name RBS and LBG as its intended recipients. Rather, the package was offered to the entire banking industry and invited volunteers to take advantage of the Governmental support. Right from the peak of the crisis, therefore, the whole industry was designated as requiring recapitalisation. Although the take up of Government support was limited to RBS and LBG, expectations regarding supporting the economy, bonus payments and lending to small businesses appeared to diffuse to other large banks within the UK.

Bonus payments, which had caused widespread political outrage, were one area of concern addressed by many banks. Although recommendations were established by the FSA later on, restraint on bonuses was exercised by other banks from the reporting date of the 2008 year end:

“At HSBC, we are committed to the principle of sensible market-related pay, structured to align executive actions with long-term shareholder interests. A small number of individuals in a market system will inevitably receive compensation that is high in absolute terms, but this must be genuinely linked to long-term shareholder interests. It is clear that the banking industry got it wrong in the go-go years: we will play our part in helping the industry respond appropriately to the new realities” (HSBC, 2008).

The Barclays annual report for 2008 expressed a similar sentiment. Further to that, the 2008 report refers to a group responsibility to restore confidence:

“There is a universal benefit to be obtained from a return to confidence in the banking system and from the restoration of the reputation of the banking industry in general. I give you my assurance that we at Barclays will do our utmost to play our part in procuring this vital objective.” (Barclays, 2008a)

The stigma of public bail out then was perceived by organisations beyond RBS and LBG. They had all utilised the Bank of England’s assistance through the Special Liquidity Scheme and the Quantitative Easing Programme. The global financial crisis had discredited the banking industry across the world. Yet courtesy stigma is still a useful concept to help explain how the additional obligations which were attached to RBS and LBG as a condition of Government help became a more widespread requirement. In a voluntary agreement in February 2011, the wider UK banking industry acknowledged their responsibilities through the Project Merlin agreement:

“In entering this agreement, the banks explicitly recognise their responsibility to support economic recovery. The components of the agreement are lending, tax, pay and other economic contributions beyond those. The banks expect, in the light of the statements contained within this document, a commitment by the Government to the stabilisation and improvement of the relationship between the Government and the banks” (Project Merlin, 2011, p1).

Earlier on in the thesis it was acknowledged that the impact of the agreement was diminished by various sub clauses which allowed the banks to retain much discretion over their commercial decisions, whatever their stated social obligations. That the banks felt it necessary to reach agreement on these principles, which had originally been directed specifically at the State owned banks, had now diffused beyond these organisational boundaries.

The diffusion of State requirements to fully privately owned banks may call into question the link between ownership and accountability. Management and controls have been cited as the more important influence on enterprise performance and requirements rather than public ownership per se (Heald, 1985; Dudley, 1999; Stuart & Geys, 2009). Nevertheless, the opposite view is taken here. On the contrary, the diffusion of State requirements across the industry can be viewed as strong evidence that ownership does impact on accountability to such a large extent that it transcends organisational boundaries. Stein (2008) identified the encouragement of a moral train of thought in board members with the introduction of corporate governance codes. A similar reprioritisation can be found here by the corporations themselves. Encouraged by the experience of courtesy stigma, the banking industry has acknowledged their responsibility in the economic wellbeing of the entire country and the resultant increase in attention to social welfare.

Impression management theory thus allows a wide circle of analysis. It considers the impressions given off but also how the interactions sit alongside other interactions taking place. There is evidence to suggest that the entire banking industry has been stigmatised in the financial crisis, even though the Government investment was restricted to a small number of banks. Further to this analysis, the consideration of teamwork is presented next, as the UKFI managing the Government's shareholding, unites with the banks to demonstrate a working relationship between RBS, LBG and the State.

### **9.5.2 Teamwork in Impression Management: The Silence of the UKFI**

Goffman's work in *The Presentation of Self in Everyday Life* devotes some time to considering the teamwork that is achieved in sustaining suitable impressions. He states:

“...we commonly find that the definition of the situation project by a particular participant is an integral part of a projection that is fostered and sustained by the intimate co-operation of more than one participant” (Goffman 1968, p67).

This is a particular challenge for the banks in the capacity of the UKFI. Although it exists to co-operate with the banks and assist their business recovery, their own duties towards the State can result in considerable tension in managing impressions. The UKFI states that it is acting in line with an institutional shareholder. Yet the expectation is that the size of the shareholding is so significant that the agency should appear to be considerably more involved than has been first presented. Indeed, the UKFI have been criticised for being too secretive (House of Commons - Treasury Committee, 2009a). The UKFI do not participate publicly in shareholder meetings. If the nature of the accountability is akin to that of an institutional investor, their public role of holding the banks to account could be more prominent. Nonetheless, the public responsibility of managing the shareholder impacts upon the relationship between the UKFI and the banks. This allows the strong monitoring role of private shareholders to continue, particularly if they are incentivised to create value for the Government. This is encouraged through the stressing that the ownership of the companies is a temporary phenomenon and there will be an active agenda to return the banks to private ownership. If additional monitoring is occurring, it is not visible to the electorate, despite its requirement to report to the Treasury on the other conditions attached to the Investments in the banks (UKFI, Oct 2009).

Contrary to expectations, this public opportunity to exercise the banks' accountability mechanisms is not fulfilled. Whilst there is indirect evidence that the banks and the UKFI are extremely engaged with one another (UKFI, 2013b), there is no public dialogue occurring between the two bodies. All of this is done in private and then fed back to the public in separate channels.

## **9.6 Concluding Remarks**

The aim of this chapter was to consider the banking crisis through the lens of financial reporting. Impression management (Goffman, 1956b) and Stigma (Goffman, 1968) provided the theoretical framework. The annual reports revealed aspects of the banking crisis and how the banks responded to their respective failures. But the reports also encompassed multiple performances, where the corporative narrative at the front provided different impressions from the austere accounting back end. These tensions in relations have been noted previously in research (Jones, 2011; Morrow, 2005; Smith and Taffler, 1995). Nonetheless, the banking crisis reverberates in the accounts provided by the two banks and

the particular techniques for explaining it can be found through consideration of the regulatory accounting story and the corporate narrative.

In LBG, the corporate narrative was one where the banks' fundamental identity was not questioned as a result of the crisis. This was despite the fact that it had received extensive Government support. There was the suggestion that LBG had been altruistic in its takeover of HBOS. Yet the reconciliation between pro forma numbers and the statutory figures suggested that LBG enjoyed considerable commercial gains received from the HBOS takeover. These were moved backstage by the pro forma numbers. The opportunities provided by the HBOS deal were more critically appraised by the Independent Commission on Banking (2011) who recommended further divestments in the interest of competition. Moreover, the nature of the crisis was externalised and new accounting for the 'market dislocation' helped to separate LBG's own failure from the market shocks occurring during the reporting periods.

RBS took an alternative approach to accounting for the crisis. In their case, RBS demonstrated an eagerness to embrace a complete corporate change. Over time, the visual images on the front cover changed to reflect the new strategic priorities. The pro forma accounting prominently acknowledged the failure and responsibility was accepted for corporate losses through the creation of the 'Non-core' division. On a wider basis, the use of pro forma accounting had the effect of stripping out some of the effects caused by the controversial fair value accounting (Barth and Landsman, 2010). Failure thus was internalised for RBS, whereas it was kept distant at LBG.

Nonetheless, the change in corporate priorities took some time to take hold. The year of crisis was reconceptualised over time as accounting standards required comparatives to be restated. The language of the Chairman's statement also changed over time as the news of strategic targets being met began to be reported.

Both banks displayed ambivalence to the statutory story which resided in the annual reports. In line with current trends, the pro forma accounting numbers stripped out the statutory results from the corporate narrative and relegated the technical accounting production to the back of the report. The accounting story was sombre compared to the corporate narrative. It appeared to be a front stage performance only for the most technically minded readers. Yet it was also a validated performance as the audit report confirmed and supported it.

Finally, the wider banking industry acknowledged responsibility for financial stability by the signing of the Project Merlin agreement and through Chairman's Statements on the issue of



pay. This demonstrated that wider parties were supporting the performance of RBS and LBG by acknowledging the banking crisis had occurred to all those in the market.

In companies whose failures have been dramatic and well known, impression management offers a framework which can analyse the response to that failure. The banks acknowledge the government support but seek to move beyond it by containing crisis in their own distinct ways. Accounting, by its necessary presence, sometimes can disrupt the performance in the corporate narratives. Nonetheless, a partial or biased account of the crisis is given, allowing upbeat stories about trading performance to endure despite negative financial results. Impression management still remains a strong feature of their financial reporting.

The next chapter considers how these results are communicated to a mass audience via the press. In this way, the banks fulfil a democratic accountability to citizen stakeholders.

# Chapter 10: From Business Page to Front Page: Accounting in the Headlines

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This empirical chapter moves beyond the financial reporting of the banks and looks to how these results are reported in the press. The media is an important channel of public accountability of the quasi-nationalised banks.

Using Fairclough's Critical Discourse Analysis and Media Discourse (Fairclough, 2010; Fairclough, 1995), the headlines on the accounting results are considered. Analytically, there are two levels of investigation made. The first is the 'Order of Discourse'. The process of reporting on the accounting results by the banks is considered. In addition, the aggregate headlines generated by the accounting results are analysed. The second level of investigation is the 'Communicative Event'. The communicative events in this case are the headlines and leaders. Headlines are analysed with regard to theme of discussion and their linguistic construction. Leaders assist in providing context for the headlines.

The investigation confirms that the accounting results make headlines, often via the use of the profits of the banks or remuneration disclosures. The results are used in many imaginative ways to draw the readers into the article. The results are used to comment on other bank issues. Accounting is seen as a neutral phenomenon, which can challenge the banks' strategic discussions. Bonuses dominate the headlines during the research period. However, bonus discussion is an important part of the Press' role in corporate governance (Jansson, 2013). Moreover, the discourse does change as the banks look to reprivatisation in later years.

The structure of the chapter is as follows. Section 10.1 discusses the order of discourse surrounding the results announcements. Section 10.2 considers the industry's interest in the RBS and LBG annual financial performance. Sections 10.3 – 10.7 look at the yearly headlines generated after results are made, and consider these in the context of the banks themselves and news of the day.

## **10.1 The order of Discourse: the Results Announcements.**

This section considers the means by which accounting results are delivered to the newspapers each year. Announcements are part of the most newsworthy stories, especially

when they come pre-packaged for onward communication through journalists (Fairclough, 1995; Gans, 1980). Publication of the results and the associated press release occurs at 7am in the morning, with the management webcast at 9am (RBS) /930am (Lloyds Banking Group, 2013a). The CEOS and Chairman will usually then perform interviews with the media. Stephen Hester, the CEO of RBS has usually been in the media prior to the analyst meeting, often 8am on the Today programme. For some time after the analyst meetings, there will be discussions again with the media (Royal Bank of Scotland, 2013a)

There are multiple genres within the announcements. There is the genre of the earnings announcement itself, and a different, more colloquial genre with the media and analyst meetings. Within the realm of the newspapers, there is the genre of hard news and of the particular language construction of business news (Koller, 2004; Jucker, 1992). The tabloids have their own particular genre, being more colloquial and playing on polyphony and cliché to entertain and grab the attention of readers (Molek-Kozakowska, 2013; Chovanec, 2005; Schaffer, 1995). The broadsheets have a more formal genre (Fairclough, 1995). In previous studies, the genres are intertwined in a complex manner throughout the articles (Fairclough, 1995). Translations of the official discourses helps to legitimize these sources to the audience (*ibid*, p71). Numbers are also favoured by journalists as they lend an air of authenticity to the article (Bell, 1991). Nonetheless, these orders of discourse have become conventionalized (Fairclough, 1995). However, RBS and LBG have faced considerable challenges since the crisis. The banks' results then do not only provide information on their own business; they also provide an indirect means of commenting on the decisions of Government. Viewed in this light, the banks' results can be seen as a political commentary (*ibid*, p71).

The following section discusses the newspaper headlines in detail for LBG and RBS. The first section and Table 10.1 discusses the overall headlines by year, newspaper type and organisation to present an overview of the data being worked with. This shows that coverage remains high as public investment in the banks continues. In addition, it shows engagement across all market segments of newspapers, indicating the high public interest in the earnings results. Finally, it demonstrates that LBG has been subject to less press scrutiny than RBS.

The second section of the analysis looks in detail at the headlines for both organisations by year. Here, the overarching impact of accounting on the headline is identified before discussing aspects of the linguistic construction in detail. Features of linguistics which serve to penetrate the headlines further are discussed in the narrative which follows.

Ultimately, what the headlines demonstrate is both the high degree of public scrutiny across all market sectors of the banks' results. In addition, accounting is being utilised to help inform the public of their investment in the banks.

## 10.2 The Newspaper Industry's Taste for Earnings Stories

Table 10.1 below shows the overall number of headlines dedicated to LBG and RBS' earnings the day after the year end announcements. The headlines were downloaded from Factiva.com (Factiva, 2013).

**Table 10.1 Headline: Analysis by Number and Newspaper Type**

Year	Newspaper Type	RBS	LBG	Total Articles: RBS + LBG
2009 (2008 results)	Broadsheet <sup>1</sup>	77	30	
	Mid Market <sup>2</sup>	11	5	
	Tabloid <sup>3</sup>	5	1	
	Total	93	36	<b>129</b>
2010 (2009 results)	Broadsheet <sup>1</sup>	37	16	
	Mid Market <sup>2</sup>	7	3	
	Tabloid <sup>3</sup>	8	2	
	Total	49	21	<b>82</b>
2011 (2010 results)	Broadsheet <sup>1</sup>	21	51	
	Mid Market <sup>2</sup>	4	4	
	Tabloid <sup>3</sup>	5	3	
	Total	30	58	<b>88</b>
2012 (2011 results)	Broadsheet <sup>1</sup>	41	14	
	Mid Market <sup>2</sup>	8	5	
	Tabloid <sup>3</sup>	9	3	
	Total	58	22	<b>80</b>
2013 (2012 results)	Broadsheet <sup>1</sup>	26	19	
	Mid Market <sup>2</sup>	8	1	
	Tabloid <sup>3</sup>	7	7	
	Total	41	27	<b>68</b>

The above table indicates that there is extensive media coverage of the annual accounts in both RBS and LBG the following day. There are multiple articles in selected titles, with commentary and analysis from a range of authors. The public interest in the banks' performances means that there are headlines devoted to accounting results in the tabloid papers. This is particularly true for RBS.

Comparing the two banks' coverage, RBS receives the most coverage, with double the amount of headlines. This may be due to the fact that the taxpayer has a larger overall investment in the bank than in Lloyds Banking Group. As a result of this large investment, there has been a sharp contraction in the size of RBS' Balance Sheet. In contrast, LBG has less press coverage as it took over the failed HBOS and has needed only half of the Government equity investment of RBS. It also maintained the CEO and Chairman prior to the crisis for the first two reporting years afterwards.

The size of RBS' losses in its 2008 results, and the relatively fresh approach from the Government to support the banks with the equity injection in October are reasons for the large number of headlines. The poor results of 2009 are reflected in the headlines of 2010, with the bonuses of the executive staff dominating.

By 2011, the overall number of headlines has risen sharply. This represents a decline in headlines for RBS, whose strategy has been implemented and is generally successful in selling off its risky assets and streamlining its business. On the other hand, LBG's coverage has increased. There are two reasons for the increase. Firstly, Lloyds announced a provision to cover the PPI mis-selling scandal. This generated a lot of headlines, including a number on the personal banking front about how to claim. In addition, there was a new CEO in place from March 2011, who was anticipated to make changes to the overall strategy of the bank. The bank had been required to make a number of disposals for State Aid commitments as required by the EU (European Commission, 2009).

Newspaper headlines increase in 2012. For RBS, these increases are attributable to the Direct Line IPO and the possibility of privatisation in the near future. LBG also has privatisation as its agenda. Nonetheless, bankers' pay continues to provide headline news.

In 2013, there is an overall decline in newspaper reporting. RBS has fewer headlines as there are no major corporate transactions announced. LBG headlines increase modestly due to the increasing prospects for privatisation.

The rest of the chapter now looks at the individual years of reporting for the banks to demonstrate the means by which accounting is invoked in headlines of the press. The nature of headlines is important for the accounting results:

“Journalists don’t only recount events, they also interpret and explain them, try to get people to see things and to act in certain ways, and aim to entertain.” (Fairclough, 1995, p91)

The journalistic understanding of the accounting results is thus very important in considering the public accountability of the banks.

### **10.3 2009 Headlines: 2008 Results: Accounting for Nationalisation, ‘Fred the Shred’ and Bonuses**

2008 was an extremely disappointing year for both LBG and RBS. Both had received extensive Government investment in order to continue trading. The year end results were widely anticipated to present huge losses and depress the share price of the banks, which were already sitting well below the strike price of the Government bailout. As a result, there was great interest in the financial results of the banks. The Press can shape public debate:

“Reports are rarely even-handed with all the various voices represented. Some are given prominence, and some marginalized. Some are used to frame others. Some are legitimized by being taken up in the newsreader’s or reporter’s voice, others are not. Equity and balance cannot be assessed by merely noting which voices are represented, and for instance, how much space is given to each; the web of voices is an often subtle ordering and hierarchization of voices.” (Fairclough, 1995, p81)

The following analysis looks at the role of accounting, whether direct or indirect, as contributing to the construction of the headlines. This reveals a multitude of roles. At one end, accounting acts as the informant, bringing the results to the public and allowing the newspaper to report the finances. It is not just the bottom line which is reported but the extent of losses which make the headlines. At the other end, some headlines focus on the individuals rather than on the corporations that they head. These two aspects to the headlines of 2008 – that of the corporation and its status, and that of the individuals who headed them up- are considered

At points, the accounting and financial information is hidden from the headline entirely. However, these headlines are all products of a financial reporting process – the release of results and the subsequent media discussions between organisation and journalists. Thus, accounting is in all headlines, an input.

### **10.3.1 Factual Headlines: Accounting as a Serious Informant**

Accounts contribute to the traditional construction of a newspaper headline which summarises the facts of a story (Dor, 2003). Focus is given to the bottom line – losses sustained in the banks during the crisis are reported. However, these losses are reported in a number of ways. The loss is quantified in some headlines. Others, in contrast, focus on the loss itself. Some of these headlines also carry an additional piece of information to help orient the story in the context of the crisis:

**Lloyds Banking Group slumps to GBP10.1bn loss Specialist team to run HBOS loan book (The Herald)**

**ROYAL BANKRUPT OF SCOTLAND; Boss loses £24billion...but keeps pension of 690K-yr (The Sun)**

Thus accounting becomes the dominant focus of the headline as well as its stimulus for the stories in the first place. Yet diversity exists in the bottom line which is reported as headline figures. For LBG, the pro forma loss of £10.1bn which excludes the HBOS gain in the accounts is provided by the Herald (Lloyds Banking Group, 2008). The Sun probes somewhat deeper into the accounts of RBS and reports on the statutory loss rather than the pro forma accounting which the press release and annual report highlight (Royal Bank of Scotland, 2008b).

For other papers, it is not the extent of losses that make headline news, but the implications of the loss on the future of the bank. The following 3 headlines consider the results of RBS:

**RBS seeks extra £25bn as it posts record loss (The Times)**

**RBS investment banking arm makes GBP 11bn loss - but bosses still defend it (The Scotsman)**

**Bank plans to self-help after 'unambiguously bad' results (Financial Times)**

Lexically, the 3 headlines above imply varying characteristics of RBS. The first headline, in the Times, suggests that by 'seeking' the extra £25bn, the bank has lost direction and momentum. It omits to state that the further £25bn will be State backed. In the Scotsman's headline, the bank is active in a more negative sense, in that is 'makes' a loss as actively as one can 'make' money. Yet the hyphenated phrase afterwards implies an air of naïve confidence in investment banking, which could be considered out of touch with reality. The

FT, on the other hand, emphasises that the bank is actively trying to regain independence and will look to trade its way out of trouble.

The accounting results set a tone for the pieces, implying that the annual results are a serious business, and not to be sensationalised or ridiculed. This resonates with the characteristics of the accounting professional (Carnegie and Napier, 2010). Nonetheless, implicit values still run through the construction of the headlines in the papers.

All of the headlines above could be seen as a response to the phenomenon of 24 hour news availability through the TV and internet (Fairclough, 2010). The earnings results of the big banks are already public knowledge as the readers are expected to have learned of the losses through other forms of media. Instead the news focuses on a variety of angles for the losses.

Accounting therefore contributes to the financial accountability of the banks as results are reported upon in the papers. Not only does the press provide the information as messenger for a mass audience but it helps in the interpretation and implications of the results. In this way, the public accountability of the companies is facilitated as the results stimulate further consideration of the overall business strategy of the banks.

### **10.3.2 Nationalised Entities: Accounting as Decree**

The particular circumstances of the banks in February 2009, shortly after the second intervention with the Government Asset Protection Scheme, means the accounting results act as a window on to the status of the banks.

**'RBS and Lloyds nationalised in all but name' -Bank Governor tells MPs Daily Telegraph**

**Saving HM Royal Bank of Scotland; RBS insurance scheme is muddled - but might still work (Financial Times)**

Here, the 'HM' is akin to Her Majesty's, the official department or office of the crown. This is commonly used for Government departments and vessels in operation for protection of the realm. In the Times' headline shown below, the headline is spun around a version of National Westminster Bank, a large and important subsidiary of RBS:

**Nationalised Westminster Bank; Public anger at bankers' rewards is justified, but agreements made in the full knowledge of government must not be jettisoned out of expediency (The Times)**



## **National: Banking Crisis: Expert view RBS is bust, and we have nationalised it but don't want to admit it (The Guardian)**

The first sentence of the Guardian's article shows how the accounts act to provide clarity for the public:

"The death throes of British finance have been slow and painful to watch, but yesterday [results announcement] was the day the penny finally dropped: our banks are bust." The Guardian, 27 Feb 2009

Accounting thus acts as a decree of status on the banks – one whose significant public ownership may be classified as outright nationalisation. Yet, the earnings announcements make no such determination. Instead, accounting here is a front for this decree which originates not from accounting rules and regulations but rather from a journalistic viewpoint. Accounting is used as a legitimate point of entry to reignite this talk of public ownership and nationalisation. This has implications for accounting and how it is communicated to a mass audience. Accounting is not just a vehicle for the earnings discussions and how these then generate further discussion. It can also be used as stimulus to further public debate.

The accounts may also have direct effects on individuals. One of the aspects of the newspaper discourse during the crisis was that of bankers' pay. The accounting results reveal the details of pay for executive staff.

### **10.3.3 Sir Fred Goodwin's Pension: Accounting as Moniker**

Fred Goodwin was a prominent individual in the 2008 result headlines even though he had stepped down as Chief Executive of RBS in October 2008. The accounts confirmed the pay he received post resignation via the directors' remuneration report in the annual accounts. Popularly known as 'Fred the Shred', Sir Fred had been well known for cost cutting exercises which kept RBS very efficient. RBS managed to retain a cost: income ratio<sup>34</sup> at around 41%, the lowest in the industry. Fred the Shred was a name derived from a business approach exemplified by cost cutting in his previous institution of Clydesdale Bank..

After his resignation, 'Fred the Shred' moved from being an admiring, although forceful, nickname to one of disdain. The Chief Executive had retained contractual rights on pension payments despite popular pressure to relinquish them. Fred the Shred had previously been a

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<sup>34</sup> Cost: Income is a key ratio measuring efficiency in the banking industry

person of admiration, particularly in the Scottish Press where RBS was a huge employer and source of pride for the nation, to one of widespread disgust. His unapologetic retention of the right to the pension was reported on quite negatively. Although it appealed to the tabloid end of the market, the name was one originating in the London financial market place. As a result, it was referred to widely in the broadsheet newspapers as well:

**Fred the Shred's GBP16m pushes ministers and RBS into a corner Government and former bank bosses drawn into row over pension details THE LEAK (The Herald)**

The Herald uses the nickname as an informal and thus derisory comment. Here, Fred the Shred is contributing yet more to the banking crisis but his obstinate refusal to decrease his pension helps set the tone of the piece. Unusually, here the power is attributed to the downfallen character's pension and it is the Government and the bank which occupy the position of subordinate objects. This emphasizes the domineering character of the bank but also suggests Government incompetence, which had allowed such riches to be retained post failure.

Further newspaper headlines made reference to this nickname by mentioning shredding in their titles as an intertextual reference of this character. The tabloid papers use the nickname to call for further accountability for Sir Fred:

**Shred Fred; THE SCOTTISH Sun SAYS (The Sun)**

**VOICE OF THE DAILY Mirror: Shred his pension (The Mirror)**

The Times, on the other hand, removes explicit reference to Sir Fred from its headline, instead concentrating on the political ramifications of the pension package agreement:

**Darling survives a toxic shredding - for now (The Times)**

'Darling' refers to the Chancellor of Exchequer, Alistair Darling. By using 'shredding' in the headline, the reader is told that the piece refers to his relationship with Sir Fred Goodwin. As an unmentioned agent in the piece, Sir Fred retains power over the Government's involvement in RBS. Yet, isolated from its original phrase nickname, shredding one again takes on a sinister air. Sir Fred's greed is the emphasis in this tabloid headline:

**FRED THE SHRED :<\$><\$> I'LL KEEP THE LOT (Daily Star)**

This is one of the few examples which involves the Tabloid Newspaper the Daily Star. It is unusual to see 'smileys', usually associated with instant messenger programmes and

electronic communication, be used in conventional printed press reports, whose vernacular is part of the brand of newspaper. However, this one adds to the headline in a move beyond grammatical or lexical structure. The symbols produce a pair of eyes where money (\$) are being the sole focus of the individual concerned. Symbols of money and inevitably, accounting, help emphasize the greediness of this tarnished banker.

#### **10.3.4 Headlines on HBOS: Accounting as Privileged Exposé**

In light of the criticism over pay with Fred Goodwin, HBOS also faced questions over executive pay. In particular, Peter Cummings, former HBOS senior executive, was given a large financial pay out despite the fact that HBOS had collapsed prior to the Lloyds rescue. This had been a large sum of money at the time when the bank had received a great deal of Government investment.

The tabloid end of the market was the most critical of the pension pay-outs, personalising the story to the beneficiary, Pete Cummings. This acted to demonise the individual. The phrase 'fat cat' was used frequently, used to suggest a wealthy person who had received excessive remuneration.

**PETE THE POCKET; Shamed HBOS fatcat nets £344k pension First there was Fred the Shred...now meet (The Sun)**

**THE NEW £10M BANK FAT CAT (Daily Mail)**

**NEWBANK FAT CAT'S £10M PENSION POT; DAILY MAIL REPORTER (Daily Mail)**

In contrast, the quality end of the market focused on the inquiry as the main object of the headline rather than the persons being investigated. This could be due to the fact that Pete Cummings was not previously a high profile individual in the media. Alternatively, the semantic structure of the headline could suggest a shift in relative power of the senior staff at the banks. It has been noted previously that powerful persons or institutions are often the active agent in a newspaper headline and the less powerful person or institution is the object (Fowler, p96). The senior staff members become the object and in so doing, become represented in a less flattering light (Fairclough, 1995):

**Lawyers examine payoff of banker blamed for losing billions at HBOS (The Times)**

**Government inquiry into HBOS payoffs (The Independent)**

The headlines thus cue a shift in relative power in the staff members of the former HBOS bank and the newly combined LBG. Where once the prestige and privilege of the bankers was extremely high, the Government ownership of the bank has humbled them. This is reflected in the semantic structure of the headlines, where the once powerful institution and its management become less influential by shifting from being active agents in the headlines to being passive agents or demoted to objects under the scrutiny of their Government rescuers.

Accounting retains a central role in this shift in headline construction. It is only by the release of the annual reports and accounts, and in particular the directors' remuneration report, that the senior staff can be held to account.

Finally, we see nominalization occurring as a noun is used in place of a verb: in this case, the use of 'inquiry'.

#### **HBOS payoff inquiry; IN THE NEWS (The Times)**

Nominalization is arguably an extremely effective shortening device. It helps keep newspaper headlines succinct, but can also result in ambiguity. A large amount of information is omitted when nominalization occurs (Fairclough, 1995; Fowler, 1991). In the particular example above from the Times, the inquiry makes up the headline but it does not specify who is making the inquiry. Readers are only alerted to the fact that HBOS is the subject of the inquiry.

In summary, accounting is used in conventional and imaginative ways in 2008. It can be characterised as a sensemaking process. It was the beginning of a discourse surrounding the banks and their political nature. This was exemplified by the discussion on accounting and the status of the banks as nationalised entities. Failure was personified in the large payments made to the executive staff who were sacked after leading the banks into failure.

### **10.4 2010 Headlines: 2009 Results: Acrobatics, Acquisitions and Bonuses**

The headlines generated from the 2009 year end results for RBS and LBG present accounting in a different light. Whereas there was the use of the accounts as a decree and a moniker, the 2009 results features less sensationalist analysis of the banking figures. Nonetheless, there remains considerable imagination in the way that accounting is used to draw the readership's attention. Here, it is lexical devices, including vocabulary and literary

techniques, such as metaphor, which help develop an image of the bank through the use of accounting information.

There is a contrast between the approaches given for RBS and LBG in the 2010 headlines discussing the 2009 year end results. LBG is portrayed, both lexically and transitively as a bank continuing to fail. RBS, on the other hand, receives more positive reporting.

#### **10.4.1 Accounting in Hindsight: The HBOS Acquisition**

The difficulties in LBG are headlined in a number of ways. Metaphorically, the debts of HBOS are portrayed as heavy or a great weight. Grammatically, the use of Lloyds as an object, vulnerable to the vagaries of the HBOS bad debts also emphasizes the challenges lying ahead. But it is the accounting numbers that are quoted which are most diverse.

##### **£58BN TOXIC SHADOW OVER LLOYDS; DAILY MAIL REPORTER**

##### **Mountain of bad debt leaves Lloyds £6.3bn in red again (The Independent)**

##### **HBOS legacy hurts as bad debts at Lloyds hit GBP 24bn (The Scotsman)**

##### **Lloyds faces struggle to impress (Financial Times)**

##### **£42bn bill for Lloyds from toxic HBOS (Financial Times)**

It would be expected that the £42bn, £58bn and £24bn numbers quoted against the expected losses of HBOS would all be a consistent number. Instead, the accounts are used in different ways to arrive at the debt burden of HBOS. Probing further into the FT.com article shows that this £42bn loss is a cumulative figure, combining losses of £30bn from the HBOS bank in the last two years, along with the signalled £12bn anticipated loss in the coming year. For the Scotsman, the £24bn quoted is the total amount of impairments reported in loans for the year of 2009, a more direct extract from the annual report, most of which relates to HBOS bad debt legacies. The largest number, quoted by the Daily Mail, is the total (gross) amount of impaired loans, rather than the impairment being written off.

As a result, the headlines on the same story present a markedly different picture of the crisis facing LBG over the HBOS acquisition. It is questionable whether accounting information thus becomes a credible accessory to the headline, rather than generating the news itself. It is argued here that the size of the numbers is an effective device in attracting readers to the article (Chovanec, 2005; Bell, 1991).

## **10.4.2 Financial Reporting Quality**

The nature or process of accounting was not a prominent feature for the financial reports. Likewise, the newspapers do not discuss in details the vagaries of the accounting process. However, there is an exception in the Financial Times.

### **Story of contrast over disclosure and transparency (Financial Times)**

This story is one comparing the relatively good disclosure given by RBS with the rather less transparent results given by LBG. The analysts and investors were questioning it, particularly with regards to segmental analysis. Significantly, this is perhaps the only article to provide commentary on the quality of the accounting provided by the annual results, rather than on the reported numbers. Another important qualitative factor is the direct comparison of the two banks. This is quite rare. It may reflect the better resources and knowledge of the business press journalists who can assess the quality of the reporting and potentially uncover fraud or poor practice (Miller, 2006).

## **10.4.3 Metaphor: Accounting as acrobatics**

In reporting the 2009 results, the Chief Executive of RBS cultivated a neutral metaphor which was then used to generate accounting headlines. The tightrope was referred to 3 times by Stephen Hester in the newswires conference. He highlighted the difficulties of restraint on pay with ability to recruit talented staff; and remaining a commercial business whilst paying due respect to the public nature of ownership:

“Whatever my personal, political and philosophical views, my job is to lead RBS to a successful commercial turnaround; and so I have to accept with and deal with the commercial realities of the market place. We’re trying to do that in a responsible way, in a restrained way; we’re trying to be leaders in reform, but we nonetheless are bounded by the business realities that we face and within which we have to get back taxpayers their money. So, in that sense, I believe that we have walked the tightrope appropriately.” (Royal Bank of Scotland, 2010b)

This idea of tightrope was then referred to in the Press:

### **Hester's long tightrope walk to freedom will continue (Financial Times)**

### **Royal chief juggles and treads state tightrope to City delight (The Herald)**

### **RBS jumps (Daily Mail)**

The freshness of the acrobatic metaphor may draw readers to the article (Koller, 2004). In addition, the headlines are more positive for the bank. They place the CEO firmly in control of a journeying bank. Where Fred Goodwin was responsible for the failure of RBS in the

previous year, Stephen Hester is attributed responsibility for the more upbeat results (Hayward et al., 2004).

Accounting thus becomes an opportunity to update the discourse on the banks. The discourse of the newspapers may be inherently conservative to satisfy readership (Mullainathan and Shleifer, 2005), but the banks are also able to update the press on their progress. Over time, this can help change the discourse related to the banks. In some cases, the banks are also able to successfully cultivate headlines. There may not be verbatim reporting of the news releases (Sissons, 2012) and they may be critically assessed by journalists (Maat, 2007) but some upbeat messages can still filter through.

The accounts thus act as an opportunity to update the press on the achievements of the company. The spoken word for the press calls may be as important as the press release on which the information is based or the analyst meetings (Westphal and Graebner, 2010; Bell, 1991).

#### **10.4.4 Bonuses**

As in 2008, bonuses remain a sensitive topic for the banks as results are posted. In the current year, it is aggregate payouts rather than individual circumstances that are criticised. For RBS, there is a useful contrast between the losses of the bank and the total in bonuses paid out. This is designed to showcase excessive pay rewards:

**Bank loses £3.6bn - but still finds £1.3bn to pay its staff bonuses (The Times)**

**RBS staff collect £1m in bonuses as bank reports £3.6bn net loss (Financial Times)**

Here, the nature of the Financial Times' headline is less critical than the Times by being more matter of fact in its reporting. This may be a response to the type of readership in each of these papers, with more highly paid business people making up a greater majority of the readership for the Financial Times. Newspapers respond to the prejudices of their readership in a competitive environment (Mullainathan and Shleifer, 2005).

A more popular way of reporting the bonuses was reporting on the numbers receiving very large bonuses:

**RBS under fire again as 100 bankers each get £1m bonus (The Herald)**

**100 BANKERS GET £1M (The Sun)**

**Bankers pocket £1m; IN THE NEWS (The Times)**

## **100 RBS BANKERS GET BONUS OF AT LEAST £1M (Daily Mail)**

## **Now RBS creates 100 millionaires (and you're paying for it) (The Independent)**

## **Pay row: RBS admits 100 bankers got bonuses of more than pounds 1m (The Guardian)**

## **RBS to award 100 bankers £1m bonuses despite losses (The Herald)**

Bonuses are a natural headline for the papers. It is interesting to the reader as the amounts can be related to the individual personal experience. The individual is grabbed by the immediate relevance on an individual, rather than aggregate pay packet. On the other hand, such a huge amount, like the £3.6bn loss reported in the Financial Times and the Times does not have immediate relevance at the individual level.

This information provided by the accounts is that the average bonus pot for the GBM divisional staff. The actual relationship between the £1m bonus and the staff numbers is probed further by the journalists through the press conference with RBS. The rationale behind the Press interest is also stated. The relevant extract of the wires conference is given below:

“Becky Barrow – The Daily Mail

I am sorry to go back to the issue of bonuses but just to be clear you have got 16,800 bankers in GBM and they share a bonus pool of £1.3billion. Can you guide us as to how many of those bankers receive a bonus of more than £1 million?

Stephen Hester/Phillip Hampton – Royal Bank of Scotland

No.

Becky Barrow Because you don't know, or because none of them received a bonus of more than £1 million?

Philip Hampton Why do you want to know?

Becky Barrow It is always interesting. You know, it must exasperate you our obsession with bonuses but I would say that a lot of people who own this bank i.e. office tax payers, receive a basic salary of £25 000 per year and don't get a bonus. So, I think it is a legitimate question and it would be very interesting to know the answer.

Philip Hampton I am not sure it is an important business question but it may be a matter of public interest, in fact I am sure it is. It would certainly be a good number of people, but I would much rather not put a specific number on it. We are certainly into more than 100.” (Royal Bank of Scotland, 2010b)



Thus the annual results are not just about the information reported therein. Accounting becomes an instrument for dialogue between the Press and the bankers. In so doing, what is being reported on is not so much the performance per se; but the story/angle which is the preference of the journalistic community even before the press conference. Here, the relevance is made back to the taxpayer owners of the bank and their own earnings capacity. As with the acrobatic metaphor, the importance of the media dialogue becomes apparent.

This particular relationship is reported on across the range of newspapers, including the tabloids whose own particular linguistic structure resembles those of the quality end of the market. Nonetheless, there remain a number of uniquely tabloid style headlines generated from the bonus story in the Sun:

### **PROFIT & LOTS; SLUMP? IT'S ALL RIGHT FOR SOME (The Sun)**

### **WHEN THE GOING GETS TROUGH... (The Sun)**

The form refers directly to the traditional accounting statement, although here it is given a twist to suggest the excesses of pay. The implication is that it doesn't matter what the accounting results are, there will be always excellent remuneration. These are then linked to the poor general economic conditions. 'Slump? It's all right for some' has the effect of separating both accounting and bankers from the general readership of The Sun, fostering a 'them and us' culture. The juxtaposition of all of these elements in the headlines entails great inferential leaps from the reader.

"The upshot of all this is that local coherence relations are very significant indeed in the ways in which text position people as subjects and cumulatively shape identities and how texts work ideologically."(Fairclough, 1995)

Whilst the readership may be suffering from job losses and cutting public budgets, the bankers continue to thrive in the tough times.

## **10.5 February 2011 Headlines: 2010 Results – Bonuses, tax and Executive Performance**

In 2011, the results of LBG and RBS were considerably better. Both had downsized their balance sheets and had returned to profit. Nonetheless, the attitude was fairly neutral towards results. This is in contrast to a press release which is generally more self-promoting (Guillamon-Saorin et al., 2012; Bowen et al., 2005; Bell, 1991).

The newspapers had a dip in reporting on 2011 announcements. There is an opportunity to consider what else was going on in the news at the time of the announcements. There were various items on the BBC and a move up to Salford and the pay of some of the stars of the BBC (for example, Andrew Marr: £600k/year). There was also a continuing story about the founder of WikiLeaks Julian Assange and his extradition to Sweden on rape charges. Nonetheless, the main stories were RBS and LBG on the day (Factiva, 2013).

Three themes are considered in reporting 2010 results. The first continues the dominance of the bonuses reporting. The second considers other societal responsibilities in the banks to pay tax. Finally, the headlines reflect on the management performance of Eric Daniels, the LBG CEO who stepped down this year. Accounting results provide information not only on results but on corporate governance generally for the banks. The headlines generated for 2010 allow the Press to fulfil their own role in corporate governance as an accountability mechanism (Jansson, 2013).

### **10.5.1 Bonuses: A Stagnant Discourse**

As in prior years, the nature of executive pay remains a prominent feature of the news headlines. In contrast to previous years, however, the dialogue between the banks and the media is muted. These numbers are not openly discussed in the analyst presentation (Royal Bank of Scotland, 2011a). The media discourse with the bank was as follows:

“Our profits are down; therefore the bonus pool is down; and therefore the number of millionaires is also down. The only thing that’s gone up is the number of people that we’re paying a zero bonus to, which is not an inconsiderable number. It’s some tens of per cents who get precisely zero, because we don’t splash these all over the place, and we pay our top people very well, and if people are not performing they don’t get very much, and sometimes they don’t stay” (Royal Bank of Scotland, 2011a).

Apart from this there is no specific information in the annual report, remuneration, additional disclosure or the news announcement about the amount of staff receiving bonuses in excess of £1million (Royal Bank of Scotland, 2011b). Thus, there must have been another source outside the official discourse which allowed the journalists to cite these figures. The press may be making reference back to previous stories (Bell, 1991) and the wider discourse about bonuses generally. The headlines bear a similarity to those in the previous year:

**100 RBS BANKERS' £1M EACH FOR LOSING £1BN (The Sun)**

**£1.1bn What RBS lost in 2010 £1.1bn What it paid in bonuses (Scottish Daily Record)**

## **LOSSES OF £1BN ...BUT BAILED -OUT RBS STILL PAYS 100 BANKERS £1M (Daily Mail)**

### **Winners and losers in the RBS bonus stakes as losses top £1bn (The Times)**

Thus, the discourse is influenced to a greater or lesser extent by discourses other than the current year's accounting results. Again conservatism of the press in confirming reader beliefs and larger discourses about bankers' pay comes to the fore. The bonuses contribute to the media panic about remuneration in the banking sector (Leach, 2006). The fact that numbers of people received a smaller bonus did not make the headlines, with the exception of this one in the Mirror:

### **Pay may seem high, but the number of millionaires is down - RBS chairman Sir Philip Hampton as loss-making bank hands out bonuses (The Daily Mirror)**

Nonetheless, the critique on bonuses remains as the adjective describing RBS as 'loss-making' is positioned to the 'handing out' of bonuses. Word choices are significant in this respect (Fairclough, 1995). The bank is portrayed as liberally distributing money it does not have to staff members. An alternative perception on the bank would be that it was fulfilling its contractual obligations with employees.

"There are always different ways of saying the same thing, and they are not random accidental alternatives" (Fowler, 1991, p4)

The bonuses are portrayed in a negative light for the banks. Responsibility is attributed to the top management of the banks. The following headline, through verb choice and naming of the RBS Chief Executive, displays a similar tactic:

### **Hester to take £2m bonus as total payouts rise by a third (The Independent)**

There is a personal element added to the bonuses in the current year. 'Take' contains connotations of stealing rather than earning. The bank performance is again turned into an individual's story (Hayward et al., 2004). The reference to previous media stories (Bell, 1991; Gans, 1980) and the need to sustain media panics (Leach, 2006) for continuing newspaper sales reverberates with the repeated nature of the stories.

The discourse is slow to change when society still criticizes the banks for their inappropriate handling of the economic crisis, and there may exist tensions between the organisational reality of the corporations and the Press portraiture of them (Kjaergaard et al., 2011).

## 10.5.2 Accounting for Social Responsibility: Tax Payments

Unlike RBS, LBG made a profit in 2010. However, even this good piece of news can be critiqued. The profit is shown in a negative light in some headlines which suggests Lloyds is deflecting on societal responsibilities:

**LLOYDS MAKES £2.2BN PROFIT... GUESS HOW MUCH TAX IT'S GOING TO PAY? NOTHING (The Daily Mirror)**

**LLOYDS BANK MAKE £2.2BN PROFITS... BUT PAY ZERO TAX (Scottish Daily Record)**

Two newspapers emphasise the £2.2bn profits highlighted in LBG's press release. It then uses 'but' as a contrasting coherence relation (Fairclough, 1995) to state that no tax is being paid. Numbers add to the authentic feel of the headline (Bell, 1991). The responsibility for the banks to pay tax is linguistically constructed through the actor being the banks (Fairclough, 1995; Fowler, 1991). From this, the interpretation of the writer is indicated, as they choose to interpret the profits in light of the actual tax payments to HM Treasury. As Fairclough asserts:

“When people represent in language events, actions, relationships and states, the people and objectives involved in them, the time and place and other circumstances of their occurrence, and so forth, there are always choices available...these choices are also partly a matter of grammar. The grammar of language differentiates a small number of 'process types' and associate 'participant types'. It may seem at first glance that the difference between an action (with a causal actor) and an event (without a causal act) is a difference in reality, in the nature of things, but that is not so, at least in any simple sense. When people represent in language something that happens, they have to choose whether to represent it an action or an event.” (Fairclough, 1995)

The placement of Lloyds as the actor, and the profits as the object, has an important interpretation here. The news becomes the annual results and it is foregrounded as the most important story (*ibid*, p97). The results are the hard news (Bell, 1991), the event worthy of reporting. But the profits by themselves are not. This may be partly to do with the increase in 24 hour news reporting and the requirement to bring more analysis and a new angle to the announcement by the later printing of the papers (Coulmas, 1997).

Contrast the Times headline below, which uses ostensibly the same facts but what with a different object and foregrounding:

**Lloyds won't pay tax until profits hit £15bn; Departing boss still weighing up whether to accept £1.45m bonus (The Daily Telegraph)**

The foregrounding of the ‘won’t pay tax’ becomes the main focus of the story – and in so doing, it is more critical than the tabloid constructions. Surprisingly, it is also more sensationalist. Sensationalism is traditionally more common in the tabloid end of the market (Chovanec, 2005). The connotation of ‘won’t’ suggests a refusal to pay tax, rather than LBG being entitled to offset current profits against past losses for tax purposes. It also incorporates the massive number of £15bn, which is not a result for the year but a future aggregate. The wording of the headline implies that this would have to be £15bn a year, rather than on a cumulative basis. Moreover, the next clause about LBG’s Chief Executive bonus refers to a different discourse but its juxtaposition with LBG’s tax policy implies his bonus decision is affected by taxation. The informal tone adopted is surprising in a broadsheet business article. It may point to the trend towards more colloquial vocabulary and the emphasis on the personal in news generally (McKay, 2006).

Using an intertextual analysis (Fairclough, 1995) shows that the headlines are rather misleading. The £2.2bn profit relates to the combined business basis (see (Lloyds Banking Group, 2011b)). The taxable profits are worked out separately from the accounting results themselves. The accounting tax charge was positive (Lloyds Banking Group, 2011b). However, the bank had large deferred tax losses with which it could offset any current tax liability for the year.

“...choices of vocabulary and sentence structure give particular shape to experience affecting how reality is depicted in deep and significant ways. Basically reality is not ‘out there’ easily available to be grasped in any straightforward and simple way; it is socially constructed with language playing a centrally important role, so that the patterning of vocabulary and sentence structure shows us reality in a particular light and guides our comprehension of it.” (Fairclough, 1995, p250)

The taxation of the banks relates to a longer term discourse regarding wider societal responsibilities (Fairclough, 1995). The banks had just released the Project Merlin statement in early February 2011, where those in the group had an “expectation to contribute a cumulative £8billion in total tax take” (Project Merlin, 2011). The discussion on tax at the results announcement was actually very little. However, the finance director did say:

“In terms of paying corporation tax, I would love to be paying corporation tax. What that would be doing is having the wonderful situation of paying tax on profit and delivering value to all of our shareholders which obviously will include taxpayers through the shareholding held by UKFI. I look forward to getting there as soon as we possibly can. Obviously the larger the profits you make the nearer the effective tax rate would actually trend towards the statutory rate” (Lloyds Banking Group, 2011a)

The accounts become a foil and a means of critiquing other parts of the banks. For RBS, there was a similarity between the amount of losses and the bonuses paid out. It would be

inconsistent to criticise LBG for paying bonuses when the bank had been profitable. Tax, like bonuses, are part of an easy translation of the public official discourse into the private domain of the audience for whom the journalists write (Fairclough, 1995). This is important as there is a greater need to take the official report genre and create the genre of the newspapers themselves (Dor, 2003). This also helps to attract readers (Schaffer, 1995).

### **10.5.3 Accounting for Executive Performance**

The need to translate the official discourse into one of individual stories also occurs in the assessment of management performance. The accounting results provide an opportunity for the media to reflect on the outgoing Lloyds CEO, Eric Daniels. This is important for corporate governance generally (Bednar, 2012), as the media may be influential when it comes to board appointments.

#### **UNREPENTANT DANIELS BEATS A LONELY RETREAT; COMMENT BY ALEX BRUMMER CITY EDITOR (Daily Mail)**

**As Daniels sails off into sunset, he leaves new skipper a ship in fair shape; Comment (Daily Telegraph)**

#### **MERGER STILL CASTS CLOUD OVER LLOYDS (Daily Mail)**

**The shipping forecast means yet more trouble for banks; Wighton on Saturday (The Times)**

The legacy of the HBOS transaction is still a talking point for the banks. In this context, metaphors are used to describe the leaving of the CEO. The news is personalised to the CEO and attributes success/failure to him. There are two interpretations given to the success of Eric Daniels' career at LBG. The Daily Mail sees the merger as a disaster for LBG whilst the Daily Telegraph considers that the results are improving. The use of metaphor is quite common in the business press and is particularly apposite here as the banks have all been on a journey (Koller, 2004).

Thus, accounting results in the headlines does not always focus on the bottom line. Reflecting wider responsibilities about the acknowledged responsibility to pay tax and reflecting on the leaders of the organisation is part of the wider corporate governance of the banks. The press fulfils its own role as a corporate governance mechanism holding corporations to account (Jansson, 2013).

## **10.6 February 2012 Headlines: 2011 Results on Ownership, Bonuses and Alice in Wonderland**

The 2011 results present some consistent themes in headlines to previous years. There remains an interest in the ownership of the banks as well as in the nature of bankers' remuneration. There exists an unusual analogy drawn between the accounting produced, describing it as 'Alice in Wonderland'. From an accounting perspective, in 2011, both banks made large losses. These arose due to exceptional items rather than underlying business results. RBS took on an extra £1bn of losses due to a lower risk strategy, which resulted in the sale of European assets as the Euro Crisis deepened. LBG created a new provision for payment protection insurance. Yet it is the consistent themes of ownership, bonuses, losses and metaphor which continue to headline the 2011 results.

The Financial Times took a political slant to the RBS results:

### **How to free RBS from the shackles of state ownership (Financial Times)**

### **RBS chief warns of the risks from political interference (Financial Times)**

Here the nature of the story was not about the accounting news but is still relevant to the readers of the newspaper. It grabs the attention of its audience who will respond to the most worrisome aspects of the news being presented (Leach, 2006) – in this case the political interference for the shareholders. The analyst's meeting began with a discussion regarding the nature of ownership and UKFI, trying to reassure those present that all shareholders have been considered. The first headline portrays the bank as a prisoner of the State, sensationalising the item (Molek-Kozakowska, 2013). However, the second headline is less dramatic. This perhaps demonstrates the impact that editors and subeditors, who generate headlines from the article provided, have regarding what is presented in the foreground (Bell, 1991). Yet there is consistency in the approach given by the newspaper to its story. Newspapers are ruled by commercial interests and aim to make a profit. To do so, the paper needs to attract readers and for this cohort focused on markets, there may be a natural scepticism of public ownership (Mullainathan and Shleifer, 2005).

Whilst FT steers clear of the issue, other publications continue with the bonuses debate. Again, this issue dominates the headlines.

### **10.6.1 Bonuses**

Bonuses remain a prominent issue in the discussion of the banks' results. However, the accusatory nature of the bonus payments softens in the broadsheets. Instead, the discourse moves to political aspects of the remuneration debate:

#### **Public and political pressure forces RBS to slash bonus pool (The Times)**

#### **RBS in new bonus storm as it prepares to give staff payouts worth £785m (i)**

The midmarket and tabloids papers focus on the payouts, rather than the implication of political pressure. The bonuses relate both to the amounts paid out to the investment bankers only of £400m and the £795m is to all staff:

#### **A £2bn LOSS, yet the state-owned RBS is paying £800m bonuses (Daily Express)**

#### **Anger as RBS 'cuts' bonuses... to £400m (Daily Express)**

#### **RBS TRADERS TO GET £390m BONUS; But pay is frozen for High Street staff (Daily Mail)**

These headlines move away from the individual pay packets headlined in the prior year back to aggregate sizes. Nonetheless, the linguistic style of headlines may foster a distinction between the readership of the tabloid/ mid-market end of the newspaper and the wealthy bankers. It is resonant of the need to reinforce cultural stereotypes (Fowler, 1991) or societal values (Fairclough, 2010). Here, the papers with the less wealthy readership, attracted by tabloid titles, are generally of a lower social class than those of the broadsheets (Seale et al., 2007). These stories encourage dissatisfaction at the extremely high wages being earned in a bank which is receiving taxpayer support. RBS is attributed the blame as headlines make RBS the actor/agent (Fowler, 1991).

This has important implications for the discourse over the banks:

“...we may say that there are always alternative ways of wording any [aspect of a] social practice, that alternative wording may correspond to different categorizations, and that such alternative wording and categorizations often realize different discourses” (Fairclough, 1995, p114).

The media does fulfil a duty of accountability with regard to remuneration of executives but this is influenced by nature of the publication being.



## **10.6.2 Lloyds Losses**

The loss at Lloyds was also reported by the Press. The reasons for the loss were outlined in the headlines:

**DEBT SENTENCE (Daily Mirror)**

**Lloyds at a loss over mis-selling scandal (Daily Express)**

**Bad loans lead to £3.5bn Lloyds loss (The Herald)**

**LLOYDS IS £3.5BN IN RED AFTER PPI SCANDAL (Daily Mail)**

**Annual loss at Lloyds rises to £3.5bn after PPI scandal (The Independent)**

**Lloyds losses top GBP3.5bn - and bank warns of more to come (The Scotsman)**

In line with noted tendencies, the word play in the headlines is concentrated in the mid-market/tabloid end of the papers (Chovanec, 2005; Schaffer, 1995). Two causes are attributed to the losses in the papers. These are the PPI provision and the bad debts written off. In the Herald and the Independent, the loss and loans are made the actor and Lloyds is the object. Representation as objects rather than agents can help to dampen the power of the entity discussed. In contrast, the Daily Mail headline confer full responsibility on Lloyds itself by making the bank the actor of the clause (Fairclough, 1995).

Interestingly, the Scotsman and the Independent in the final headlines have accounting results as the actor. Accounting results here are imbued with responsibilities.

## **10.6.3 Metaphor in Headlines: Alice in Wonderland**

Unusual analogies continue to make up headlines to capture readers' attention (Chovanec, 2005; Dor, 2003; Schaffer, 1995).

**RBS's 'Alice in Wonderland' accounting; Eurozone turmoil 'spooked' bailed-out bank so much it took an extra £1bn of losses for 2011, admits... (Daily Telegraph)**

**Hester's £700bn 'Wonderland' balance sheet starts to shrink; RBS results reveal 'Alice through the looking glass' world of accounting where... (Daily Telegraph)**

Accounting in these headlines is significant, even if critically dressed. The 'Wonderland' accounting relates to a more risk adverse approach to banking assets in Euro markets. When prospects for the Euro markets were looking bad, the bank took the decision to crystallise losses of £1bn rather than continue to hold the risk. The implication of the wonderland

accounting is that there are weaknesses in the business still – and this is exemplified through loss making approaches. Yet this isn't really about accounting but a strategic decision made by the bank itself to fully realise these losses in the current year, rather than wait until the planned time of sale.

For Lloyds, the corporate logo is drawn upon to sum up the performance for the year:

### **BLACK HORSE STILL LOOKS LAME; COMMENT (Daily Mail)**

Despite a good underlying business performance, the exceptional items, such as provisions for PPI, are perhaps causing undue pessimism on the banks. This would be consistent with the societal attitudes towards the two banks, which have been strongly criticised for needing public support. The dissonance between the organisational reality and the media portrayal of the organisations can cause tension for members of the organisation (Kjaergaard et al., 2011). Yet there is also evidence of critical reading of press releases, where the less attractive numbers provide the drama for the headline (Maat, 2007).

## **10.7 February 2013 Headlines: 2012 Results: Spring Cleaning, the Bottom Line and Privatisation Prospects**

RBS had complex accounting in 2012. The underlying profit hit targets but the bank reported a loss based on a large charge against the fair value of its own debt. This is counterintuitive (Gaynor et al., 2011). The major news items were the potential privatisations in the future of both RBS and Lloyds. Bonuses headlined at the tabloid end and in relation to Mr Horta-Osorio. Profits were discussed alongside the bonuses. RBS' IPO success with Direct Line also made headlines. Other divestments were headlined, including the announcement to sell Citizens, its US bank and the offer of TSB banks as part of Project Verde.

Generally, 2012 results have less sensationalist headlines. There appears to be a more discreet reporting style, shown by fewer metaphors, intensifiers and the use of the banks as subjects rather than objects (Molek-Kozakowska, 2013; Fairclough, 1995). Some of the more unusual facets of headlines are discussed below.

### **10.7.1 Accounting Metaphors at RBS and LBG**

Metaphors such as war and games and machines were used in the headlines. Unusually, metaphors of domestic chores were used in relation to RBS. This originated from the wires call for the announcement.

“...we are spring cleaning this house, it's getting to look shinier and I do think that we have a strong future serving customers well, being valuable for shareholders and contributing to society.” ((Royal Bank of Scotland, 2013b).

Thus the call ended with the metaphor of spring cleaning. This translated into a metaphor used across the newspaper markets:

### **RBS SPRING CLEAN; CITY FOCUS (Daily Mail)**

The Daily Mail's headline can be read in two ways. One is that RBS (Group) are spring cleaning in an active sense using the present continuous sense. Alternatively, it can be read as a nominalization, with the verb becoming the noun 'spring clean'. Nominalization omits both the actor and the subject, allowing space in the headline (Fowler, 1991). But it also makes it abstract and distances the subject from concrete events (Fairclough, 1995). The leader suggests that the metaphor is inadequate when it describes the task for the bank as 'Herculean', which the spring cleaning analogy. The suggestion is that the spring cleaning analogy does not adequately capture the scale of activities required to help bring the bank back to financial health.

Spring cleaning in this sense is quirky when related to the banking industry. The use of spring clean can also be seen as the hook to attract the attention of the reader's eye in the competition for attention (Molek-Kozakowska, 2013; Chovanec, 2005).

The second clause 'City Focus' helps to direct the reader to the genre of the article and its business news language.

Contrast the spring cleaning metaphor used by the Financial Times:

### **Spring-cleaning edges RBS nearer to sell-off (Financial Times)**

Here, the actor is omitted in the headline. This places RBS as the object of the 'spring clean'. RBS is then given a passive role through the transitive verb of 'edge'. This helps to designate a less powerful RBS (Fowler, 1991). The responsibility for actions is then implied by the object, RBS, rather than the State. Responsibility for this sell off is implied by an anonymous actor, the State, rather than on the organisation headlined (Fowler, 1991).

The careful placement of the CEO's metaphor of a fresh, new RBS fits well into the discourse of the bank. Journalists do not take this at face value. The promotional aspect of the metaphor is toned down with the use of syntactic choices which put RBS as passive

character. This is resonant with previous work on press releases (Maat, 2007) where corporate disclosures were reviewed with scepticism.

Another distinct metaphorical device present in the headlines is the use of navigation. These are concentrated in the broadsheet end of the market. Broadsheets are more willing to use more literary devices such as metaphors to gain readers' attention rather than the punning and clichés more concentrated in the tabloids (Chovanec, 2005).

**Lloyds sale on horizon after rise in share price (The Times)**

**'Light at the end of the tunnel' as RBS rallies; Bank's chief targets 2014 for Government to start selling some of taxpayer's stake (The Daily Telegraph)**

**RBS has return to private sector in sight despite suffering £5.2bn loss (The Times)**

This reiterates the navigational metaphors that have been present in previous years. The metaphor is picked up through important sources for the journalists and translated into headline news— the Wires call and prior stories on the topic (Bell, 1991; Gans, 1980). The journey for these banks is the return to the private sector, reinforcing the political and organisational communication that the Government ownership is a temporary phenomenon. The newspapers then amplify these official discourses in their articles (Fairclough, 1995) and restate the dominant views of society, with privatisation being seen as a desirable outcome (Fowler, 1991). The headlines are generally upbeat. Nonetheless, the journey is some way off yet being completed with 'horizon' and 'end of the tunnel' suggesting some distance hence. 'Targets' used in the Daily Telegraph and 'in sight' used in the Times provides a sense of space but also have overtones of military practice, a common, masculine metaphor used in business discourse (Koller, 2004).

The positivity of the headlines is tempered by its linguistic constructions. The use of nominalization in the Times Headline is apparent in the use of 'Lloyds sale'. It does not refer to the Government as the main owner selling its asset, Lloyds shares, and therefore avoids responsibility being handed to the State. Nominalization has been used in this way to direct responsibility (Fairclough, 1995; Fowler, 1991). Lloyds in fact have no say in when privatisation occurs, as this is handled exclusively by the shareholder. Nonetheless, the 'Lloyds sale' with the syntactic structure, suggests that Lloyds' results have a direct correlation with the decisions of HM Treasury. By shifting responsibility for the privatisation onto the banks, the newspaper continues to allow the crisis, and its solution, to lie squarely in the realm of the banks.

## 10.7.2 The Bottom Line: Reporting on the Financial Results of the Banks

In terms of financial results, the banks still reported a loss for 2012. The accounting, nonetheless, was potentially difficult for communication. Each bank had an underlying profit, suggesting good quality of earnings. It was large accounting charges which resulted in losses being ultimately incurred. For RBS, there was a £3.5bn charge as a result of an increase in the fair value of their own debt. Financial instruments must be fair valued under IFRS and this includes debt that RBS has in the money markets. As RBS' prospects improve the sale price of their debt increases, which causes an increase in the liabilities of the bank and an expense on the income statement (RBS, 2013). For Lloyds, the loss was directly attributable to large scale provision for the PPI mis-selling scandal.

The bottom line results in these cases were not generally the main focus of the news headline. Rather they were used as contextualising information to locate the other angle the headlines were capturing. This may reflect the time delay in newspaper printing and the requirement to offer something 'new' in the articles rather than reiterating information the consumer may have already received through 24 hours news media (Fairclough, 2010; Leach, 2006). It may also contribute to sensationalism in the headlines (Molek-Kozakowska, 2013).

The following section considers the RBS results before moving on to Lloyds. The consideration of the actual results is given to provide an insight into the original press release received by the journalists from RBS and Lloyds to provide a deeper understanding of the relationship between what is published by the organisations compared to what is published by the Press.

RBS:

Each announcement by RBS starts with the conventional 'highlights', which act as a concise summary of the announcement. These function quite like headlines in that they can be viewed as relevance optimisers (Dor, 2003), although the genre and style are different. The headlines generated in the press release are shown below:

"RBS reports a 2012 operating profit (1) of £3,462 million, up from £1,824 million in 2011

Core RBS 2012 operating profit £6,341 million versus £6,045 million in 2011

2012 Core return on tangible equity 10%

2012 pre-tax loss of £5,165 million, after £4,649 million accounting charge for improved own credit

Core Tier 1 ratio 10.3%, loan: deposit ratio 100%, Non-Core assets down to £57 billion”

(Royal Bank of Scotland, 2013c)

The highlights exhibit many features previously associated with press releases. The positive news is emphasised first in the press release (Guillamon-Saorin et al., 2012), with the operating profit announced before the statutory loss. Pro-forma results are also used instead of the GAAP numbers (Marques, 2010). On a closer linguistic analysis, it is notable that RBS is the subject of the first highlight and uses an active, yet ostensibly neutral verb of ‘reports’. The subject and use of active verb has been associated with positions of power (Montgomery, 2008; Fowler, 1991). The first highlight is the only one which has a subject and verb. All other highlights are without these, indicative of a list after the main part of the news, rather than news information.

**RBS SELL-OFF NEXT YEAR, VOWS BOSS; But £5bn loss for bailed bank The Sun,**

**RBS has return to private sector in sight despite suffering £5.2bn loss (The Times)**

**RBS reprivatisation creeps closer as 'chastening' year delivers £5bn loss (Financial Times)**

**£600m bonuses at RBS despite £5bn loss (The Herald)**

Looking at the dialectical relations between the source and the newspaper (Fairclough, 2010), the result which is headlined is the pre-tax loss, rather than more prominent operating profit in the press release. This suggests that there exists scepticism in the press releases from the financial journalists (Maat, 2007). Moreover, there is consistency in this number being reported. This contrasts to previous years where the bottom line result has been varied across the media.

The makeup of these headlines is very similar, despite the cut across the tabloid/broadsheet markets. The Sun’s headline is more informal, representing the style of the paper (Fowler, 1991) and its tabloid origins (Fairclough, 1995). They all start with the possible reprivatisation of the bank, and then caveat that against the poor profits of the past year. In linguistic terms, ‘despite’, ‘but’ ‘as’ are all examples of local coherence relations (Fairclough, 1995). The clause invites the reader to question the feasibility of returning to the private sector when the banks are continuing to make losses. The headlines are made up of

facts, which when taken together provide an overt critique of the information released by the organization.

This may suggest something about accounting in general. On the one hand, accounting is not the news. Instead, it can be seen as adding context to debates which are started and continued elsewhere. It also provides a credible and robust alternative counter-story to the self-promotional bias of the pro-forma operating profits, allowing the journalists and the readers to critique the official discourse being promoted.

The accounting results are used in a different way in the Lloyds group results and these are discussed more below.

### **10.7.3 Lloyds' Bottom Line and the Headlines for 2013**

The discourse around LBG is slightly different to RBS. RBS' results the day before contribute to the perception of LBG's results. Furthermore, LBG was dealing with the historic PPI mis-selling scandal, which received a lot of press coverage.

LBG's press release takes a different style to RBS. It starts off with a quote from the CEO and a bold headline in quotation marks:

**'AHEAD OF OUR PLAN TO TRANSFORM THE GROUP, DESPITE THE CHALLENGING ENVIRONMENT'**

This focuses on the strategic aspect of the news, rather than the financial results. Next, the financial highlights are presented. These list a number of bullet points with bold thematic leaders. These are organized around income; balance sheet; positioning for growth; corporate citizenship; and future prospects. The first set of bullets pertaining to income is shown below:

“Significantly improved Group performance; continue to work through legacy issues

- Substantial increase in Group underlying profit from £638 million to £2,607 million
- Full year Group net interest margin of 1.93 per cent, in line with guidance
- Costs further reduced by 5 per cent to £10.1 billion, in line with strategic review target two years ahead of plan; Simplification run-rate savings increased to £847 million
- Credit quality continues to improve; 42 per cent impairment reduction to £5.7 billion, significantly ahead of original guidance; impairment charge as a percentage of average advances improved to 1.02 per cent (2011: 1.62 per cent)

- Statutory loss of £570 million primarily due to PPI provisions of £3,575 million (including £1,500 million in the fourth quarter of 2012), and including £3,207 million of gains from sales of government securities”

Source: (Lloyds Banking Group, 2013b)

Thus, the highlights for LBG cover many aspects of the income statement rather than just the final result. The press release also uses a note format rather than prose to list the main points of the results for the year. Similar to RBS, the press releases focuses on the underlying profit rather than the statutory loss. It also features the net interest margin. Focusing on pro-forma numbers rather than GAAP and emphasising sales is an established preference in the communication of results in press releases (Guillamon-Saorin et al., 2012; Marques, 2010).

The headlines below show the way that the Lloyds results are portrayed in the next day’s newspapers. The tabloids are shown at the top and the broadsheets follow:

**LLOYDS LOSE £570m...THEN SPLASH OUT £365m IN BONUSES; BANK FATCAT TO POCKET £1.5m Chiefs minted as low-paid get crumbs (Scottish Daily Record)**

**BANK LOSSES: £570m BOSS'S BONUS: £1.5m (The Sun)**

**£570M LOSSES: £570M £1.5M BONUS: £1.5M; Fury at payout for Lloyds banking boss (The Sun)**

**Lloyds loses £570m but still hands £1.5m bonus to boss (i)**

**Taxpayer stakes in bailed-out banks may be sold off cheaply: Lloyds records pounds 570m loss but pays pounds 375m in bonuses Boss's payout...(The Guardian)**

**Gilts sales cut Lloyds losses by £3.2bn; State-backed lender £570m in the red, but points to improving balance sheet Government may be... (The Daily Telegraph)**

As in the case of RBS, the profit results are used in conjunction with another aspect of the announcement. In this case, it is almost exclusively focused on the bonuses of the Chief Executive. The Daily Record headline reiterates the idea of ‘Fatcat’ which is not present in the broadsheet papers. This is resonant of previous years’ stories which focused on the bonuses. These cut across the private/public domain (Fairclough, 1995), but also adds a sense of drama to the results (Molek-Kozakowska, 2013; Chovanec, 2005). In the Scottish Daily Record, there is reference to the rich bankers and the poorly paid. The Sun’s headline is more minimal, using just the numbers tied into these two figures, to give it authenticity



(Bell, 1991). It may also be indicative of the business section of the newspaper (Jucker, 1992). The conversational style of the papers is still resonant with the lexical choices of 'boss' and 'minted'. It is suggestive of an ideology which is that the bosses take all the money whilst the low paid do the work. This is akin to common sense and metaphors used in the text (Fairclough, 1995).

### **Lloyds chief in line for GBP1.5m despite bank being GBP570m in red (The Scotsman)**

The Scotsman's headline imparts the same sort of information as the Tabloids but the subject is the Lloyds loss rather than the payment per se. Here the Boss is replaced with 'chief' who is 'in line' for his bonus rather than 'pocketing' the remuneration. Nonetheless the use of 'in red' is more of a conversational phrase, confirming that the broadsheets also do use tabloid headline tactics such as punning (Chovanec, 2005). Whilst the Chief is the subject of the headline and thus is in the powerful position, being 'in line' for the bonus suggest passivity (Fowler, 1991).

## **10.8 Concluding Remarks**

The aim of this chapter was to discuss the use of accounting results in newspaper discourse surrounding the failed banks. The units of analysis here were the reporting of finances via the headlines of the national papers in the UK on the day after the results announcement. Results make the news across all segments of the Press. The broadsheets were most engaged but the tabloids also had coverage on the accounting results. This is important given the larger number of tabloid readers.

Headlines were arranged by theme. The contributing discourse to the headlines was considered, as well as the linguistic make up of the headlines themselves. What is clear from the analysis is that accounting itself is a catalyst for talk on divergent issues. At the heart of all these debates is the insight accounting affords for contemporary popular debate in the printed press. Sometimes accounting is not directly referred to in the headlines. Nonetheless, the accounting results represent a significant event on the organisational calendar and provide an important component of discourse with the media. But the discourse is tempered by media factors:

Media texts do indeed function ideologically in social control and social reproduction; but they also operate as cultural commodities in a competitive markets...are part of the business of entertaining people, are designed to keep people politically and socially informed, are cultural artefacts in their own right, informed by particular aesthetics; and they are the same time caught up in – reflecting and contributing to – shifting cultural values and identities." (Fairclough, 1995, p47)

This meant that the headlines sometimes appeared to be tangential to the bottom line results being reported.

A number of aspects came to the fore in the discussion on newspaper results. First of all, accounting results are talked about. The regularity of the announcements, the accommodation of the media by the banks and the 'hard news' aspect to the results means that headlines are extensive the day after the announcement. This is largely positive for the banks in fulfilling democratic accountability. Furthermore, the banks get the opportunity to update the Press and the readers about how the banks are doing and change the discourse surrounding them.

Secondly, accounting is used very positively as well in discourse. Selected profit or loss numbers were used in newspaper headlines.. There appears to be no preference for proforma or GAAP. Numbers give authenticity to headlines (Bell, 1991) but also can be used for drama and sensationalism (Molek-Kozakowska, 2013). There is evidence of critical reading of the press releases (Maat, 2007) and not verbatim reporting of a PR authored announcement (Sissons, 2012). Using the accounting results, newspapers could voice authoritative scepticism of the corporate narrative occurring elsewhere in the news making process. In 2012, the use of accounting numbers helped to provide a critique on the possibility for bank privatisation in the near future. Accounting thus adds an alternative perspective to the discourse on strategy and business issues facing the banks. The particular status of accounting is important in this regard:

"The single figure provided by the calculative practices of accounting appears to be set apart from political interests and disputes, above the world of intrigue, and beyond debate." (Miller, 2001)

Accounting thus contributed to the democratic and corporate governance processes that the Press fulfils for the corporations (Jansson, 2013; Bednar, 2012).

Thirdly, accounting is used in imaginative ways in the press. There are established (Koller, 2004) and unusual metaphors used to capture readers' attention. Word play is also commonly used to build a relation with the reader. Language is used to add interest and drama to the accounts. Yet these also contribute to the way that accounting is seen by the wider audience. The newspaper coverage offers a perspective on popular ideas of accounting. Previously accountants have been studied with regard to their image (Jeacle, 2012; Smith and Jacobs, 2011). Here, it is not persons, but techniques which come into focus. Some important functions of accounting are working here, and that is being used as a stimulus for discussion and debate. This is very positive. It also has an active role in the

shaping of the banks fortunes. This may seem role reversal as it is the underlying activities designed to generate the accounting numbers themselves. However, it does also point to the concern that accounting rules have affected the success or otherwise of the banks so greatly in recent years. Perhaps this is indicative of the respect and desire for accounting numbers. The numbers are seen as honest and trustworthy. Vagaries of technical detail are not the discussion. Accounting, not just accountants, are imbued with the characteristics of the profession (Carnegie and Napier, 2010).

Finally, the discourse is dominated by headlines about bonuses. Some minor differences emerge, such as the relationship with performance and bonus pots versus the pay of high earning individuals in earlier years. CEOs contributed to the headlines and were a critical part of the leaders. This resonates with the idea of CEO celebrity/infamy and excessively personalising the success or otherwise of the banks to its leaders (Hayward et al., 2004).

Yet it is the easy relevance of the bonus number – and the large public interest in it – that encourages newspaper headlines in this regard. The press have to entertain as well as inform the readership (Royal Bank of Scotland, 2010b; Miller, 2006; Fairclough, 1995; Entman, 1989). Moreover, the press are invested to create public panics (Leach, 2006). This suggests that the press continue to have an agenda setting function (Bednar, 2012; McCombs and Shaw, 1972) and weed out ‘deviance’ (Leach, 2006).

In some ways, then, the dominance of bonuses on reporting accounting results can be seen as a lazy route for journalists. There has been sustained interest in bankers’ pay and it is easy to relate to readers. Yet this would be denying that the press also fulfils an important corporate governance role in reporting pay. The press reduces information asymmetry and allows informed shareholders to consider the fairness of performance related pay. Thus, the response to the press could arguably be seen as appropriate. In this case, the media collectively have been able to suggest considerable influence as both banks’ CEOs have waived bonuses in the face of public pressure (Bednar, 2012). As Miller argues:

“Executive compensation plans, based on accountancy's ideal of summarizing the individual in a single financial figure, make possible comparisons with an economic norm. The manager can be represented as an object, evaluated and acted upon by others as a result of the visibility, calculability, and comparability that accounting provides. And the actions of managers can be linked with the calculations of others, whether these are financial analysts seeking to advise on optimal investment strategies for their clients, governments concerned with national economic performance, or boards of management keen to weed out loss-making divisions of an enterprise and those managers who do not deliver.” (Miller, 2001)

There was a difference in reporting of bonuses amongst the broadsheet and tabloid newspapers. The tabloids reflected on the greediness of the individual pay packets, whereas the broadsheets first moved to orient the bonuses in relation to the accounting results. Over time, however, the broadsheets diverted the discourse away from the bonuses to other items. This provides a consideration into how accounting is perceived and legitimated across broad sectors of newspaper readership.

This resonates with the view that in a competitive market, the readers' values are reflected back at them in the nature of headlines. Prejudices are voiced through print (Kjaergaard et al., 2011; Mullainathan and Shleifer, 2005):

“...certain dominant styles of linguistic construction prefer certain ways of seeing and thinking about an event. And the more widely and pervasively a structure circulates, especially in privileged communicative contexts such as mass circulation daily newspapers, the more difficult it becomes to select differently – and hence to see and think differently about the depicted events” (Fairclough, 1995, p245)

Whilst it may be effective to report on the bonus issues for newspapers, it does also divert attention from other areas of the business. This can lead to considerable frustration for the banks themselves. Moreover, it does not mean that more effective monitoring of the banks is taking place. Nonetheless, the bonus debate is abating, with a move to privatisation considerations. Discourse changes before ideology (Fairclough, 1995) so there may be a reduction in appetite for the bonuses story in the future.

Understanding how accounting is reported in the headlines for these banks provides some insight into how the quasi-nationalised entities fulfil public and financial accountability. In many cases, the ‘accounting’ is invisible as headlines. Yet it is the financial reporting process which prompts the stories and the headlines on the banks. The headline view is necessarily partial as the Press cope with various factors which may impact on reporting. These include the pressure to entertain, inform and affirm reader values. The next chapter concludes the thesis and reflects on the overarching themes identified from the three main empirical chapters.

# Chapter 11: Conclusion

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This thesis has looked at the quasi-nationalised UK banks, RBS and LBG, to analyse public accountability as a result of a change in ownership. In so doing, it aimed to provide further insight into the UK banking crisis. It looked at three broad research themes:

1. The impact of Government intervention on the accountability of the UK quasi-nationalised banks
2. The banking crisis through the lens of financial reporting for RBS and LBG
3. Media reporting of the banking crisis for RBS and LBG

The findings of the research themes are now summarised in turn. Property rights theory and agency theory were used to ascertain the implications of public ownership in the quasi-nationalised banks. Then the structure of quasi-nationalisation was assessed using these theoretical insights. Property rights theory was generally favourable of quasi-nationalisation because it retained the benefits of private sector ownership, such as market scrutiny and monetary-based managerial incentives. It also provided an analysis of the changing dynamics relating to Government objectives imposed as a condition of investment. These showed that quasi-nationalisation was able to respond quickly to the different economic circumstances and allow the banks further operational discretion in trading through difficulties. The State conceded some power in this regard, but retained a general capacity to intervene when required. Property rights did provide some deeper implications of the public ownership but its predictive power was limited in the face of quasi-nationalisation. Contrary to theory, the EU decreed the banks had undue advantage with Government ownership and required substantial divestments. The efficiency of the banks relative to competitors under public ownership was inconclusive. Moreover, market scrutiny had failed, leading to such extensive public investment in the first place.

Agency theory suggested that the disciplinary effects of the market were muted due to the particular circumstances of the banks. However, there was a strong alignment of interests between principal and agent to increase the share prices and thereby attractiveness of the banks for private investment in the future. In this regard quasi-nationalisation helped to foster success. On the other hand, quasi-nationalisation had failed to make radical change in the banks' cultures as scandals such as PPI and LIBOR fixing were identified. There was a muted change in pay and awards for the chief executives for the banks but a high pay culture remained for a selected core of privileged staff, namely those involved in investment

banking. Overall, quasi-nationalisation had been a pragmatic and successful arm's length response to the deep crisis that the UK faced in October 2008 and beyond.

The second theme looked at the banking crisis from the perspective of the banks. Using Impression Management and Stigma (Goffman, 1968; Goffman, 1956b), an alternative view to the crisis was explored through the banks' financial reporting. There existed a tension between the corporate narrative and regulated accounting story therein. Within the corporate narrative, both banks had quite distinct ways of reporting the crisis. RBS responded to the crisis by a stark change in corporate strategy. This was accounted for in the annual report via the set up a non-core division whose primary task was to divest and de-risk the bank. In contrast, LBG attributed its losses to 'market dislocation' and implied it had been acting in the public interest in taking over the failed HBOS. Yet the accounts reveal another aspect to the story which was not politically salient for the bank to highlight – that it had made a substantial accounting gain on HBOS through negative goodwill.

The financial reports also revealed some of the challenges of regulatory accounting. Even when its methods have been centre stage in the crisis, the regulated accounting remains a performance only for the trained professional. Furthermore, the audit report, expressing an opinion on the financial statements, has a limited role. Indeed, its role is expressed through teamwork with the client and by implication, the necessity of keeping 'team' secrets. The austere nature of both auditing and accounting put them in a peculiar position in crisis - they contribute to its definition and its impact but ultimately remain 'dirty work' (Goffman, 1956b) where only selected bits of information penetrate through to be integrated into the corporate narrative. Sometimes, these selected parts of the regulated accounting disrupted the performance being conducted using pro forma numbers.

The banks engaged in shifting view of the crisis as understanding and hindsight built up over time. It was only in 2009 that a fuller picture of crisis could emerge. RBS presented many versions of its 2008 failure in subsequent years as it responded to corporate restructuring and accounting change. LBG presented its full group results only in its 2009 accounts as the takeover of HBOS did not complete until January 2009. Thus, understanding the crisis has been an incremental process in the corporations. The overall tone in the RBS Chairman's statement in 2012 shifts from a corporate, defensive tone used previously to that of a more readable, simpler 'good bank', appealing to customers and other stakeholders.

The third empirical chapter extends the scope of financial reporting research and focuses on its presentation in the newspaper headlines and leaders the day following publication.

Drawing upon media discourse (Fairclough, 1995), the newspaper reporting of the banks' accounting results is considered first as a broader contribution to public discourse on the quasi-nationalised banks. It then uses linguistic analysis to highlight the implications of communicating the accounting results. The banks' financial results generate headlines. These occur across a broad spectrum of titles and through a number of articles in each broadsheet publication. When it comes to headlines, the biggest accounting number is favoured for the corporation. But other smaller numbers also generate much interest, especially bankers' bonuses. The need to turn the public information for private consumption is present here, with the self as reference point for the bankers' bonuses (Fairclough, 1995). When it comes to the commentary, there is evidence that press releases are not reprinted verbatim in the newspapers but are critically read before publication. Unusual analogies become popular in attracting readers' attention, with novel metaphors cultivated by the corporation and published by the newspaper. The annual reports provide an important counterpoint to the news context of the banks. Increasingly, the headlines have focused on the possibility of privatisation against the large scale losses being incurred. Framed positively, accounting is portrayed as a neutral challenger to the public relations feel of the annual report and fulfils a democratic role in informing the electorate of the banks. A more critical view would be that the respected nature of the accounts and their predictable routine for news making allows journalists to shoehorn their own personal agendas into the ostensibly new item of the results. It is in the interests of papers to create and sustain media panics (Leach, 2006)

### **11.1 Contribution**

There are number of contributions made by the thesis. In its subject, it provides greater understanding of a major crisis period in UK banking. The thesis is concerned with the UK banking crisis but in so doing contributes to the wider debate regarding the global financial crisis, where Western capitalism faced great challenges. The result is that a number of journals called for papers on the global financial crisis (CIGAR, 2013; British Accounting Review, 2012; Journal of Accounting and Public Policy, 2011). The thesis responds to such calls, and particularly those who advocate qualitative research (Arnold, 2009) and multi-theoretical research (Jacobs, 2012; Kurunmäki et al., 2003).

The scale of Government investment at the height of the crisis justifies its perspective of two extremely large beneficiaries of UK Government support: RBS and LBG. It takes a comprehensive look at understanding these two banks and their history; the challenges faced

in governing the corporations; and takes a holistic approach to researching their annual report publications. The thesis contributes to the literature regarding the nature of public ownership. Quasi-nationalisation in this case has been a successful response to the banking failures in that it has allowed the banks the commercial freedom to trade out of their difficulties. Nonetheless, the opportunity for political interference means that there is a justified access to intervention in corporate policies when opportunity dictates. This may have been dominated by the bonuses and remuneration but has also allowed economic policies such as a customer focus and SME lending to be given due consideration as the UK trades out of recession. Again there have been problems with the details of the targets. Yet there remains a renewed humility and sense of responsibility in the banking industry that they work for stakeholders and not just shareholder returns.

The thesis provides a rounded approach to the study of financial reporting and impression management, which allows the interaction of words and images to be considered (Davison, 2009). It also contributes to the call for alternative methodologies to financial reporting generally (London School of Economics, 2011; Brennan and Solomon, 2008; Parker, 2007). In so doing, there has been some deep consideration for the statutory accounts as a whole as in the context of the annual report. Despite being the reason for the annual report the statutory accounting figures are hidden at the back of publication and deter all but the most trained and determined shareholders to whom the report is addressed. Moreover, the audit report has been shown in an alternative light – not as verification of the financial statements but rather as supporting act to validate the financial reporting performance of the corporations. In this way, the auditors are conceptualised as part of a team of performers.

Furthermore, the thesis has considered the increasing interest in media in accounting and finance research (Islam and Deegan, 2010; Deegan et al., 2000) and the calls to consider accounting in popular media such as tabloids (Jeacle, 2012). Accounting is utilised in important ways in the media – not least as a means to encourage debate on the wider business issues that corporations face. In this regard, accounting can act as an important counterpoint to the public relations authored documents which are produced in concert with annual reports. Moreover, accounting is used in imaginative ways with interesting metaphors and monikers providing a critique on business discourse. Negatively, however, the media can become self-referential and use accounting results as a justification for reincarnating prior media panics, e.g. bonuses (Leach, 2006; Bell, 1991). These may not reflect the most important issues which would fulfil a democratic accountability ideal for the electorate but do allow for reader digestibility (Fairclough, 1995). The study responds to



calls for linguistic analysis in accounting research (Evans, 2010) and in particular, the application of Fairclough's critical discourse analysis (Merkl-Davies and Koller, 2012).

## **11.2 Contribution to Theory**

This section outlines in detail the contribution to theory made by the empirical work carried out in the thesis. This is organised by research theme, below. Firstly, a brief reflection is presented on what constitutes a theoretical contribution.

Theoretical contributions to the social sciences may be defined by the ability of theories to withstand empirical testing in contexts beyond their original use (Rule, 1994), as well as being important to the understanding of a discipline or a sense of loss if the theory did not exist (*ibid*). However, it is a positivistic view to consider theoretical advancement to hinge upon the production of a single universal theory (Cole, 2001). Thus, progress may also hinge on multiple explanations existing under many theories (Fitzgerald et al., 1995) or indeed in the rejection of a particular theory (Cole, 2001). Furthermore, scholarship at the margins may ask different questions and produce different theories. These new theories in turn can be used to re-explore past questions (Fitzgerald et al. 1995).

Theory in management may be seen as offering either utility or originality (Corley and Gioia, 2011). Originality may be incremental in theory building, such as adding a new variable to an existing theory or it may be more revelatory in nature (*ibid*, p16). Contribution may also be drawn upon through integration of different theoretical concepts as well. Originality is not a sufficient criterion, however, and it must be useful to other researchers who work within the same theoretical framework (*ibid*, p19).

With these reflections in mind, the contribution to theory in this thesis can be characterised as an incremental contribution. The understanding of theory has been enhanced by applying theory to the UK banking crisis and illustrating their explanatory power in a new context. The multi-theoretical framework helped to address the organisational and institutional complexity of the case studies (Jacobs, 2012) and allowed a deeper understanding of the features of public accountability considered. Taking each research theme in turn, the discussion below considers the contribution made to each theory utilised.

### **11.2.1 Contribution to Property Rights Theory**

The main contribution to property rights theory is on its usefulness. The cases used in the thesis challenged some of the underlying generalisations made about the nature of public sector ownership. The discussion on quasi-nationalisation and negotiation of post crisis

accountability was explored using property rights theory. The features of quasi-nationalisation demonstrated that the predictive capabilities of property rights theory were limited. Broadly supportive of the retention of private sector ownership, the theory does not recognise that private sector scrutiny and monitoring failed, resulting in banking failure in the first place. Moreover, Government ownership was seen as creating inefficiencies, whereas the regulatory response was that State involvement would create a market advantage for the banks under consideration. Furthermore, lobbying for the further specification of property rights was predicted by the theory. In contrast, it was in deliberate attempts to keep targets vague that the banks secured maximum operational discretion, rather than for the State.

Property rights theory may be developed by considering factors other than the *identity* of owners. These may include the implications of competition for property rights for industries where SOE are present.

### **11.2.2 Contribution to Agency Theory**

The contribution of the thesis to agency theory can also be characterised by an incremental approach to confirming the usefulness of the theory. Agency theory was applied to the novel context of the UK banks and demonstrated its continued applicability to organisational change. Agency theory provided deep insight into the potential of quasi-nationalisation amidst the banking crisis. It not only provided some critique of the institutional set up of the banks, but was able to provide a window into the potential outcomes of the accountability decisions made at the time of the crisis. In this way the usefulness of the theory has been enhanced by further testing with empirical evidence.

Nonetheless, whilst predictions were insightful, agency theory was not able to provide a model of the processes of change in the quasi-nationalised banks. In this way, the criticisms of agency theory as resting on the one dimensional concept of utility maximisation could be confirmed (Wright and Mukherji, 1999).

### **11.2.3 Contribution to Impression Management and Stigma**

Impression management and stigma have been applied to financial reporting research previously. However, this particular study demonstrated its robustness in the corporate reporting context. The quasi-nationalised banks were a case which offered an opportunity to assess its usefulness at the margins, and to stretch the theory (Yin RK, 2003). It was able to provide an explanatory framework to two performances related to the banking failure, even though these responses to the crises were quite distinct from one another. Furthermore, the

holistic approach utilised in the study demonstrated that the multifaceted performances in the annual report could be analysed together to provide a coherent interpretive explanation of the performers' intent. This was even the case when aspects of the annual report, such as the accounting numbers, could be viewed through the theoretical lens as a back stage and front stage performance dependent on the audience. Thus, the contribution to utility was to demonstrate its ability to explain phenomena beyond that originally worked upon by Goffman in face to face interaction (Goffman, 1956b).

#### **11.2.4 Contribution to Critical Discourse Analysis**

The thesis illustrates the usefulness of critical discourse analysis in a new context of accounting and banking. The theoretical contribution of CDA is not in its ability to explain events, but to advance the understanding that explanation is rooted in the way that discourse occurs and is linguistically constituted (Fairclough, 2010). A useful theory may emphasise generalities (Corley and Gioia, 2011). Here, the contribution to theory can be understood as creating multiplicity in the theoretical frameworks applied to accounting research (Fitzgerald et al., 1995).

Nonetheless, critical discourse analysis offers a somewhat vague explanation to events by itself. This was attractive in the current empirical project, as it was unknown what the nature of the data may produce. However, due to its lack of explanatory power, CDA can be used as an method of analysis only, with an accompanying, more explanatory theory to understand phenomena (Eshraghi and Taffler, 2012). The use of Blame Avoidance as analysed by Hood (2010) may offer a potential further analysis of media discourse for the quasi-nationalised banks.

### **11.3 Lessons for Accounting and Auditing Practice**

The global financial crisis has identified a number of issues associated with accounting and auditing practice. These were discussed in further detail in section 2.4, including the implications of fair value accounting and the practice of auditing post crisis. For audit in particular, this has resulted in a large degree of regulatory review, culminating in the Barnier Proposals currently underway with the European Parliament and the Competition Commission's findings on audit market concentration.

The thesis deliberately sought to consider public accountability in its broadest light. Yet it offers a number of lessons for accounting and auditing practice which are discussed here. Accounting and auditing policy needs to consider the nature of communicating the numbers

which are produced by them. It is not enough to consider the ‘true and fair view’ but also how these numbers are then reported onwards.

Looking at the process of quasi-nationalisation, the use of accounting was heavily based on the private published accounts of the banks. This was the basis for the UKFI’s analysis of the bank investments (UKFI, 2013b). Moreover, HM Treasury decided upon non-consolidation of the banks into the whole of Government Accounts. The non-consolidation of the banks was the basis for qualifying the opinion on the whole of Government accounts (HM Treasury, 2012).

Therefore, public sector scrutiny has lost an opportunity to subject the accounts to its own particular audit. This includes analysis of the performance of these banks, not on the basis of bottom lines or profitability but on the basis of public sector service delivery. A best value audit would perhaps subject the banks to a different type of scrutiny of financial stewardship. This would emphasise not only financial outcomes but outcomes such as service delivery and economic impact. The analysis under agency theory noted the problem of the customer service delivery. Property rights theory demonstrated a sacrifice of control over the lending targets to customers and SMEs as well.

Turning to the analysis of the financial reports themselves, impression management highlighted the back stage nature of the accounts. In contrast, the corporate narrative told in words, pictures and pro-forma accounting displayed much more prominence. Accountants are delegating their job to non-experts (Goffman, 1956b). Alternative views of the annual report are that it is a public relations exercise (McKinstry, 1996; Lee, 1994) or a graphical design project (Neu et al., 1998). In so doing, non-accountant input threatens the relevance of accounting in the very report which exists because of it.

Lessons for auditing, particularly, should focus on the means of disclosure of statutory numbers. Disclosure, by itself, does not increase transparency of organisations (Heald & Hood, 2007). Thus auditors need to look beyond the act of disclosure to the characteristics of information given prominence. Considerable negotiation skills may be required by audit partners to achieve this, and the need to maintain high levels of independence in the face of the resistance from the audit client (Beattie et al., 2004). Certainly, some important steps are being taken in this regard with the call by professional bodies for positive assurance over management commentary in the financial report (ICAS, 2013) and the increasing commentary provided in the new form of audit reports (Financial Reporting Council, 2013b).

Accountants thus need to consider not only ‘spinning’ the image of the profession generally (Jeacle, 2012; Smith and Jacobs, 2011) but also the spin given to numbers within the financial reports, which may be picked up in the media. Rightfully, the freedom of the Press underpins democracy. The accountants’ aim, therefore, is ensuring that journalists get easy access to the important accounting numbers in a business story. This may ensure that numbers are reported in a fairer manner, and reduce the stagnation of discourse within the media, in this case on bankers’ bonuses. The right to speak for auditors, currently incorporated in the Companies Act 2006 for the AGM, could be extended to the press conference. More prescriptively, a duty to speak on the numbers, by highlighting the differences in the ‘results’ presented could also improve the nature of the communication between the Press and the companies being reported upon.

## **11.4 Overarching Themes**

There were a number of themes which bridged the empirical chapters. It is argued that these can be considered the defining features of public accountability in the UK banking crisis. These are:

- Bonuses
- Banking’s Societal Responsibilities
- RBS being more culpable than LBG
- Profitability
- Audit Reporting

These may or may not be the most important causes of the crisis, or the recuperation since. However, they are the themes which contribute to the public understanding of the banking crisis. In this way, they become the milestones by which the banking industry can restore its reputation and move beyond the crisis.

Remuneration has been intimately wrapped up with the UK banking crisis since the Government opted to take an equity stake in the banks (Hansard HC, 2008). The fall out of Fred Goodwin’s refusal to cut his pension entitlement in November 2008 flared up the backlash against bankers’ pay (Darling, 2011). It has continued to define the crisis and become part of the political discourse (Fairclough and Fairclough, 2012). Moreover, it has been used to incentivise management with regard to share price and long term sustainability of the banks (Lloyds Banking Group, 2012; Royal Bank of Scotland, 2012b). The financial

reporting process provides explicit detail on the remuneration of top executives. As time has gone on, regulations have also required the publication senior staff remuneration and not just the board (Walker, 2009). Bonus restraint has infiltrated amongst all members of the top UK banks. Moreover, it has been the subject of a sustained media panic (Leach, 2006) over the greediness (and by implication, moral ineptitude) of bankers generally. Media, political and public pressure have certainly driven down the receipt of performance pay as top executives waived their bonuses.

In tandem with bonuses, there has been a positive move towards more explicit corporate social responsibility. Banking services are a public good, providing people the options to purchase their own homes, store their money safely and earn interest on savings. Pre-crisis, the public service nature of banking had become somewhat subdued in the face of shareholder returns. Now, there is a return to the acknowledgement of responsibility to the community. This has infiltrated all the big banks and not just the two corporations investigated closely here. It has also allowed State support of the banking industry generally to be considered, through mechanisms such as the deposit insurance scheme and the State Aid endowed on RBS and LBG.

There is a sense of proportionality applied to the ownership of RBS and LBG, with RBS receiving a lot more scrutiny by the State and Press than Lloyds Banking Group. Arguably, this is fair as RBS received a great deal more money from the Government in order to continue to trade. Chapter 9 demonstrated that its entire strategy was called into question and there has been a great effort to become once more a British bank whose focus was on de-risking. LBG did not have such a great change in business culture, as it was already very British focused. Moreover, RBS' prospects for reprivatisation remain a lot more distant than LBG, whose Government ownership has already decreased through a sale of a tranche of shares (UKFI, 2013c). Nonetheless, this sense of proportionality perhaps detracts from the fact that LBG still required huge Government outlay at considerable cost to the economy. LBG were explicitly grabbing an opportunity to increase its UK market share and took advantage of the Government predicament in HBOS at the height of the crisis to achieve it by overriding competition rules. This threat to competition was highlighted by the EU but it was the Independent Commission on Banking who also required the bank to respond to its huge market share (Independent Commission on Banking, 2011). In addition, if it is accepted that banking is a public good and LBG is subject to the conditions of investment in 2008 that RBS is, perhaps there is scope to increase the scrutiny of LBG as well.

Banking remains a profit making enterprise. The success or otherwise of the Government intervention will remain on reprivatisation back to the private sector. This depends on the future profitability of RBS and LBG. Moreover, it is the focus on the bottom line which penetrates management commentary on the financial reports and the newspaper headlines on the banks' performance over the years. In this way, quasi-nationalisation does not represent a departure from the banks' motivations in pre-crisis years. The implementation of increased societal responsibilities provides a useful counterbalance to the profit maxim. Policy would do well to encourage this sense of responsibility in future years and continue to nurture it amongst the wider banking profession.

By its inertia, the audit report also produces a defining feature of the crisis. In this case, it is what has been missed in terms of reporting developments which is of interest. There is no response to Government ownership in the audit reporting process, despite the necessity of Government funding to continue to operate. The audit report is considered in an alternative light in Chapter 9 on financial reporting. And yet it stays out of the limelight completely in newspaper headlines. This contrasts greatly with previous corporate scandals such as Enron (Sikka, 2009). Nonetheless, the audit profession has had increasing scrutiny itself over independence and competition in the UK and EU (Competition Commission, 2013; EU Single Market, 2013). The audit profession's challenges to retain legitimacy continue in spite of a more benign press environment in the UK banking crisis. Public policy should continue to consider the role of the audit in the smooth functioning of the markets.

The perspective on crisis adopted in the thesis brings these themes of bonuses, societal responsibilities, profitability, audit and proportionality of Government ownership together. Public accountability is seen to be fulfilled through public understanding of the crisis. It is these arenas whereby accountability is exercised most. And in failure, it is those connected with the regulation of the banks – the Government agencies and the auditors – that also bear some responsibility for failure too.

## **11.5 Limitations**

The thesis has a number of limitations. Its findings are limited to two corporations during the UK banking crisis. It is not a representative sample and thus, the findings are not generalizable (Ritchie and Lewis, 2003). The findings do provide some analysis of extreme circumstances and contribute to understanding of the nature of public ownership generally.

The very nature of the crisis thus makes it critical for investigation, moving beyond the positivist paradigm (Arnold, 2009; Ritchie and Lewis, 2003). Moreover, there is ample scope to extend the study as suggested in future research directions, below.

The analysis on which the findings are based has been limited to documentary analysis. It did not collect insider views on the corporations. This was not extremely limiting during the study as it was public accountability which was of particular interest. However, documents provide only a polished account of what occurs in organisations and in meetings/conversations and does not give any background to the development of these reports (Irvine and Gaffikin, 2006). Insider views may have provided further understanding of the phenomena investigated.

The research on accounting in the headlines considered the headlines in isolation of the body of the article and its typographical layout on the newspaper page. The story indicated in the headline and that which is told in the body of the article can differ (Andrew, 2007; Dor, 2003). The scope of the study could be increased to incorporate the body of articles by using computer software (Seale et al., 2007). Typography/layout may also indicate the relative importance of the story compared to other pieces (Althaus and Tewksbury, 2002).

Finally, the research suffers from the subjectivity of qualitative research (Modell, 2010). This means that researcher bias will be present in the study as to what has been investigated and the nature of interpretation given thereon. The quality of information was particularly important in the study and primary source documentation was utilised wherever possible to ensure validity of data.

## **11. 6 Further Research Areas**

The thesis has explored many aspects of the UK Banking crisis. There are a number of research opportunities for further study. Three particular areas of interests are introduced below.

The quasi-nationalisation of the banks has provided a fruitful ground for study. Further research opportunities abound in their subsequent privatisation, one of a suite of privatisations planned by the current UK coalition Government in the next few years. The State has already sold off a tranche of LBG shares in September 2013 (UKFI, 2013c). In October 2013, Royal Mail Group shares were sold to the public (Royal Mail plc, 2013). The Government is now a minority shareholder. In addition, a Government company operating the East Coast main line will be re-privatised around February 2015 (East Coast, 2013).



These industries are already competitive with other private corporations. Privatisation has been a controversial topic over the years, particularly with regard to whether it is ownership or control which may impact on its efficiencies. The impact of privatisation in a new political context is worthy of future research.

The nature of audit has already been highlighted as an important theme in the thesis. However, audit is also changing. From October 2013, auditors will be required to report on the risks of material misstatement that they identified during the audit and discuss their concept of materiality (Financial Reporting Council, 2013b). The notion of auditors as part of a team in the performance of financial reporting was noted in chapter 9. It is argued that these changes to the auditor's report resonate with this teamwork perspective. Further research could be carried out on the nature of audit as members of a team, rather than presenting them as entirely independent of the client being audited. The banks would be a naturally interesting and fulfilling place to start this research, given that the risks of material misstatement were apparently missed by the auditors, amongst others, leading up to the financial crisis.

A further research opportunity arises through the discussion of the media. It has already been noted that there is a trend towards discussing the relationship between media, accountability and markets. The final empirical chapter aimed to show the importance of political accountability of the banks' finances. This is especially important for Governmental institutions as well. As a result, further research is being conducted on the media accountability of Scottish Public Finances. Thus, further questions have evolved which expand possibilities to consider public accountability in institutions under State ownership.

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