# The Private Management of Public Regulation: the need for research

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## Abstract

This developmental paper argues that public policy and management lack a sound, empirically-based understanding of how firms manage regulation, providing a summary and assessment of the relevant literature to support the argument. It proposes that research to remedy this deficiency would enable: one, a more accurate assessment of the impact of management on regulation; two, better design and implementation of regulation; three, more efficient management of regulation by the firm. It then develops a number of models of firm management of regulation based on the limited literature available, as a guide to further research.

## INTRODUCTION

This paper has three major objectives: one, to argue that we lack a sound, empirically-based understanding of how firms manage regulation; two, that given the validity of this argument, there is a need for empirical research that will overcome that deficiency; three, to develop simple models of the management of regulation within the firm, based on the existing literature, as a guide to further research. Such research is important as:

- It will improve understanding of the impact of management on regulatory compliance.
- It will enable the design of more efficient and effective regulation.
- It will assist in the design, of ‘best practice’, management of regulation.

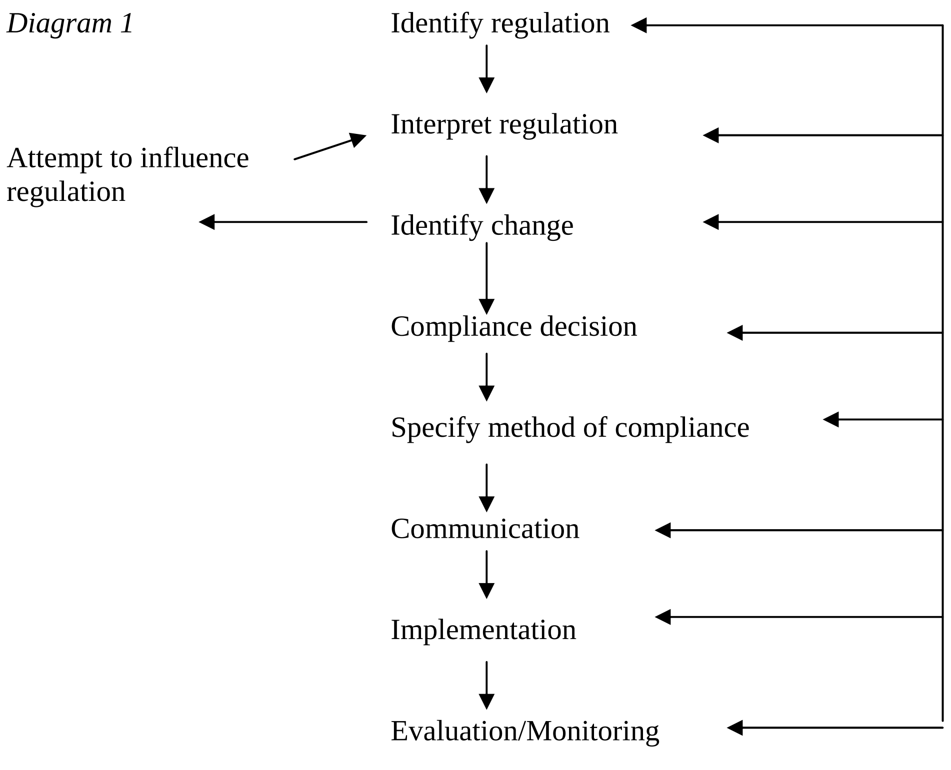
The paper is divided into two major sections: the first assesses the literature to support the claim that we have a limited understanding of the management of regulation in the firm; the second develops conceptual models of the management of regulation as a guide to further research.

## A REVIEW OF THE LITERATURE

In contrast to economic models of the costs and benefits of regulation, there are very few general models of the *management* of regulation (for economic models see, for example, Becker 1968, Heineke 1978, Pyle 1983). Those that exist fall into two broad types, prescriptive and empirical. Prescriptive models have risen rapidly in number over the last decade, developed, in particular, by large accounting firms and consultants working in the field of compliance (for example, KPMG 2005, Deloitte 2005). Others have been developed by regulatory agencies, (for example, FSA 2006, ACCC 2005, ATO 2000, Codex Alimentarius Commission 1993, OSHA 1992). Several industry and professional associations also have developed prescriptive, voluntary models for their members, commonly for specific areas of management, for example, customer complaints and relations and dispute resolution (ARA 2006, Australian Compliance Institute 2006). Standards Australia has, uniquely, develop a model for the management of regulatory compliance (Standards Australia 2006, Carroll, McGregor-Lowndes 2001). However, most of the prescriptive models are limited in their value, as they are not based on systematic, empirical investigation of firms in regard to regulation. Most are based on personal experience, anecdote, material provided in legal cases and infrequently, survey responses. While of value, they do not provide the reassurance that more detailed, systematic, empirical research can provide. An example of the latter is Henson and Heasman's study of the management of food regulation in the UK, in which a decision model of firm-based decision making is developed, following a survey and extensive face to face interviews, as noted in Diagram 1 (1998). Henson and Heasman indicate that the number of stages in their model will vary and it does not assume that compliance is achieved. Nor is it assumed that all of the decision stages eventuate. Where non-compliance is the management decision, for example, only the identification, interpretation and decision stages might be involved.

The Henson and Heasman model is useful but, as with all models, it has limitations, four of which stand out. The first is the fact that the sample was restricted to food manufacturers and retailers in the UK, so their responses may not be representative of all firms, either in the UK or elsewhere. The second is that the respondents were asked to indicate how they responded to food regulations, not to the full gamut of sector-specific and generic, regulation to which firms are subject. Thus, it would be dangerous to argue that their responses would be representative in regard to either generic (e.g. corporations tax), or sector-specific regulation, either in the UK or elsewhere. Thirdly, as noted above, the study focuses on how the firms responded to *new* food regulation, not how they dealt with existing regulation, so the stages noted might not be applicable to regulation already in place and which has been already incorporated in firm routines. Fourthly, while Henson and Heasman do indicate that non-firm actors are associated with the stages in their model, including trade associations, lawyers and regulators, that role is not described at any length,  although, as Rawlings notes in a later study, they can play a significant role in the actual management of regulation process (2005).

*Diagram 1*



Rawlings' study, while not intended to develop a formal model, was aimed at gaining an understanding of how firms manage tax regulation (2005). The initial assumption was that the management of tax regulation would take place within the firm. This proved not to be the case, for the most part, particularly for small and medium sized firms (SMEs), a finding also confirmed by Evans, Carlon and Massey (2005). Rawlings found that the management regime in regard to tax regulation for small firms consisted of a network of both internal and external actors, almost always involving an external, accounting firm, sometimes a solicitor, and, particularly for the larger SMEs, the Australian Tax Office (ATO). The notion that the management of regulation should be  based on a cooperative network of internal and external actors, including regulatory agencies, has been promoted increasingly by such agencies for compliance purposes (see, for example, Terentis, Sander, Madden, Stone, Cox 2002, in regard to the Financial Services Authority, and as promoted by the ATO 2000). Interestingly, with the larger SMEs, Rawlings found that the number of external actors in the management network fell, with, for example, the accounting function being performed internally. In the smaller firms the external accountant is involved as part of a small firm's standard operating procedures relating to tax regulation, alerting the firm to new regulation, interpreting its implications, suggesting how procedures might be designed or redesigned and, in the shape of the annual accounts and associated documentation, implementing operations that result in their annual submission to the tax office. The solicitor, in contrast, tended only to provide advice, rather than be involved directly in management processes and activities, as was the ATO, to which several of the SMEs turned to for advice when faced with difficult tax issues, a phenomenon noted also by Henson and Heasman (1998: 14-15). As with Henson and Heasman, there are a number of limits to Rawlings' study, the most significant for general, model-building purposes being its restriction to tax regulation and SMEs, and a very small sample size of only ten firms.

There exists a large and growing body of writing on compliance, focused increasingly on firm compliance with regulation (Parker 2002a). Somewhat disappointingly, until recently, most of these studies were either single firm case studies, usually of compliance failure (for example, the many cases provided in the journal Ethikos), or prescriptive suggestions as to how compliance could be achieved, with relatively few publications examining on a systematic, empirical basis how firms managed regulation, and the relationship between this dimension of management and compliance (notable exceptions include Braithwaite 1992, 1993, Braithwaite and Makkai 1994, Parker 2002b, Parker and Nielsen 2005). Rather, their focus has been, for the most part, on single or small numbers of examples of compliance failure, although, recently, the work of some compliance authors has begun to focus more closely on the management of regulation, not only on compliance failure (Parker, 2002b, Parker, Nielsen 2005). However, for the most part, the work of most writers in this area still focuses on compliance failure, with somewhat of a tendency to neglect the fact that the notion of compliance refers simply to the *performance* of an organization in achieving objectives and targets set by the firm, as required by government regulation. In turn, organizational performance in this compliance-related sense is determined by many factors, including, but not limited to, the management of the firm, especially where it relates to the mandated objectives and targets. Thus, we might have expected more from those working in the field of compliance, although most of the current authors in the area have backgrounds in law, economics and sociology, rather than business, so this criticism might be misplaced.

The specific types of regulation covered in the literature vary greatly, including the management of labour and employment relations (Pratten, Lovatt 2005, Marlow 2002, Marlow, Strange 2000), equal employment opportunity regulation (Kohl 1983, Harris 2000, Dibben, James, Cunningham 2001), occupation health and safety (Gunningham 1996, Chinander, Kleindorfer, Kunreuther 1998), food regulation (Henson and Heasman 1998), the influence of industry standards on management and product processes, both domestic and international (e.g. the ISO 9000 and 14000 series, Capmanya, Hooker, Ozuna, Tilburg 2000, Zaibet 2000, Potoski, Prakash 2004, King, Lenox 2000, US Department of Labor 2006), sexual harassment (Parker 1999), the environment (see, for a few examples out of many in this area, Steger 2000, Coglianese, Nash 2001) wages (Druker, White, Stanworth 2005) taxation (Webley, Adams, Elffers 2002), nursing homes (Braithwaite 1992, 1993), trade practices (Parker and Nielsen 2005), to name only a few. The literature that focuses on the *impact* of regulation on a particular stage or phase of management processes is more limited, but includes publications related to issue identification (Parker 2002c, Pratten, Lovatt 2005), issues interpretation (Patterson 1998, Peterson, R, 2001, Fairman, Yapp, 2005), the compliance decision (Bennett, Robson 2004), implementation, monitoring and review (Griggs 1996, Marshall 2005), and networking (Thomas and Thomas 2006). There is also, of course, an increasing literature on ethics and corporate behaviour (for a very few examples from a large field, see Weaver, Trevino, Cochran 1999, Ruhnka, Boerstler 1998, Wenzel 2001).

The work of Parker and Nielsen deserves particular attention, for it reports the results of a major survey of managers' knowledge and beliefs in regard to compliance with Australian trade practices legislation, including their relevant management systems and practices (Parker, Nielsen 2005, especially chapter four). It should be stressed that their study is not yet complete and the details provided here are from the authors' preliminary report. Their survey was intended to gain data that would enable them to test the validity of a wide range of hypotheses generated by an explanatory model (Parker, Nielsen 2005: 23-7). In the model, the degree of compliance with regulation is treated as the dependent variable, determined by eleven independent variables, including awareness of the regulation, the influence of third parties and the resources of the firms, including management policies, processes and structure (Parker, Nielsen 2005: 36). In particular, their study focuses on the impact of variations in the type of implementation processes and variations in organization culture on variations in firm compliance with trade practices regulation. Respondents to their survey were asked a number of questions aimed at identifying whether or not their firms had, for example, written compliance policies and manuals, performance management systems that incorporated compliance-related targets, and their views as to how the policies and systems worked in practice. The results, though tentative, provide some of the most informative detail about firm policies and practices in regard to the management of regulation that is available in the literature. They found, for example, that there were no significant variations by industry on most of the measures of compliance (self-estimated actual compliance and culture of compliance, employment of compliance personnel and compliance management in practice, Parker, Nielsen 2005: 64). However, they did find significant variation by industry in regard to the implementation of ‘compliance system elements’, with firms and organisations in the Primary Industries and Other Services and Education sectors generally having the lowest level of compliance system implementation and those in the Financial/Insurance, Property/Business Services and Transport/ Storage sectors as having the highest level of implementation (Parker, Nielson 2005: 64). They found, also, that larger firms displayed those factors most commonly associated with a higher degree of compliance, including relevant management systems (Parker, Nielsen 2005: 199). While the study is, methodologically, the most sophisticated of those examined, it is: one, restricted to management and compliance in regard only to trade practices legislation in Australia; two, the data is based on the views of responding members of the firms, rather than direct observation, though the questionnaire does include measures designed to minimise the subjectivity involved.

In summary, it needs to be re-stressed that few, if any of the publications attempt to develop formal models of firm regulation, in whole or in part. Rather, to varying extents, they offer insights that are of some value in constructing such models. Pratten and Lovatt, for example, in their study of the impact of employment legislation on micro-businesses in the UK, indicate that owner-managers of micro-businesses have only a limited knowledge of employment legislation that applies to them. This finding, in turn, might indicate that for such businesses, their capacity in relation to the identification and interpretation stages of management decision processes will be very limited, leading, possibly, to non-compliance through a lack of capacity, or ignorance, or both, a finding supported by Patterson (Pratten, Lovatt 2005: 297-8, Patterson 1998). Thomas and Thomas (2006), in a study of SMEs in the tourism sector, show how even small firms can utilize networks to influence tourism policy, at least at the local level, a type of management practice related to regulation rather neglected by students of management, if not by political scientists. In a detailed study of corporate ethics policies in the Fortune 1000 firms in the mid-1990s, Weaver and colleagues found that many of the firms had adopted ethics policies, but that, in practice, their communication, implementation and enforcement was very limited, suggesting a considerable gap between policy, action and performance regarding regulation and compliance (Weaver, Trevino, Cochran 1999: 293). A first item on a new research agenda would be to mine this literature for the light it can shine on firm management of regulation.

## DEVELOPING MODELS OF THE MANAGEMENT OF REGULATION

The existing literature suggests that a general model of the management of regulation would be of limited value and that several models would be more appropriate. This is because the pattern or type of management of regulation in firms seems to vary substantially, depending on whether or not the regulation with which it is dealing is new, at least from the perspective of the firm, or familiar regulation which is managed according to established, often formalised processes and work routines. The introduction of new or modified regulation, in contrast, may involve differing processes, depending upon whether or not it is capable of being accommodated within the established processes. Even where it can be so managed, there will be an intervening period in which management will undertake a period of consideration and decision, followed by either the regulation’s accommodation within the established processes, or within processes modified to cope with the regulation’s new requirements, or, infrequently, within wholly new processes, designed to cope with the special demands of the regulation in question.

Hence, it is probably more useful to conceive of the management of regulation not as one model, with some fixed set of activities and processes, but as a series of models, consisting of a varying set of activities, processes and decisions, or management regimes, that can be divided, for purposes of analysis, into perhaps four broad types of regime model: one, the *standard operating regime*, consisting of activities and processes which have become formalized and routine, based on familiar regulation; two, the *modifying regime*, consisting of a set of existing processes and activities, plus a set of decision processes concerned to deal with the modifications to that regulation, modifications of varying degrees of complexity; three, the *new regime*, in which more complex sets of design, decision and implementation processes are apparent as either, for example, a new firm commences operations, or an existing firm moves into a new product area with differing regulatory requirements, or where an established firm is faced with entirely new regulation. The fourth type of regime model is rather different, the *non-complying regime*, involving, by definition, a more limited range of activities and processes. In Table 1, below, following Henson and Heasman (1998), the typical processes that seem to be involved in each of these four regime types are marked with an ‘x’.

Table 1 Types of management regime in regard to regulation

| **Management processes** | **Non complying regime** | **Standard Operating Regime** | **Modifying Regime** | **New Regime** |
|---|---|---|---|---|
| Identification | x | | x | x |
| Interpretation | x | | x | x |
| Design | | | x | x |
| Decision | x | | x | x |
| Communication | | | x | x |
| Implementation | | x | x | x |
| Monitoring and review | | x | x | x |

As can be seen, the processes and activities involved in the modifying and new regime types are similar, at least at first glance. They involve, also, a greater range of processes and related activities than the non-complying and standard operating regimes, although, in practice, their apparent similarity will vary. It will depend, for example, upon the type and extent of modification to existing management regimes that is being considered, decisions, in part at least, determined by the nature and extent of any new or modified regulation being considered. Where major modifications to existing regulatory processes are being considered, then the processes involved in the modifying regime will be very similar to those in the new regime type. In contrast, where a new regulation is of a minor nature, then the processes involved in the new regime type will be similar to those in the modifying regime. Where modifications are minor and a new regulation is of major import, then the modifying and new regime types will be most dissimilar. The non-complying regime and standard operating regimes are different, both from each other and from the modifying and new regimes. The former might be restricted to identification, interpretation and decision activities and processes, on occasion involve design processes (where the decision not to comply occurs after consideration of design elements), and is followed by the decision not to comply, with no implementation and, probably little, if any, communication or monitoring and review activity. The standard operating regime will involve, for the most part, routine, formalized, implementation activities, with some monitoring and review activity, although the Parker and Nielsen study suggests these latter processes are somewhat uncommon, at least at the level of individual performance management (2005: 55-8).

At any one point in time within the firm any one or more of these management regimes might be in existence, depending upon the extent of change taking place in the regulatory environment. Similarly, the significance of each regime type will vary, for example, depending upon the life cycle phase of the firm in question, as illustrated in Table 2. In the case of life cycle phases, we might expect to see, as noted by an ‘x’, in the relevant cell, the new firm, particularly start-ups, involved frequently in all those activities, processes and decisions involved in dealing with new regulations, or, rather, regulations which are new to the firm in question. The mature firm, in contrast, will be focused on existing regulation with which it is familiar and which have been accommodated within standard operating routines and, to lesser, but variable extents, on modifications to that regulation. The declining firm will be focused merely upon existing regulation leading up to its exit from the market, keen to avoid the costs involved in dealing with modified or new regulation in this termination phase. The non-complying regime could occur at any stage of the firm's life cycle, but is likely to be more frequent for new and declining firms, though for rather different reasons. In the case of new firms, non-compliance might occur because of a lack of resources, a lack of competence, or genuine ignorance and (hopefully), be a temporary phenomenon, with compliance increasing as resources, competence and knowledge increases.

Table 2 Life cycle phase and management regimes in regard to regulation

| **Life cycle phase of the firm** | **Non complying regime** | **Standard Operating Regime** | **Modifying Regime** | **New Regime** |
|---|---|---|---|---|
| New | | | | x |
| Mature | | x | x | |
| Declining | x | x | | |

Table 3 provides a more detailed picture of the management processes perhaps most characteristic of firms at different phases of the life cycle. As might be imagined, the new firm might be involved in all of the processes as it attempts to comply with a wide range of regulations for the first time. However, its lack of resources, competence and knowledge could mean, for example, that it temporarily neglects appropriate communication and monitoring and review activities. In contrast, mature firms will be characterised predominantly by routine implementation activities, possibly a degree of monitoring and review, although this latter is more likely in regard to production areas with very specific, detailed regulatory requirements, such as food processing, and declining firms, at best, in probably faltering implementation of established routines.

Table 3 Life cycle phase and management process activity

| **Management processes** | **New firms** | **Mature firms** | **Declining firms** |
|---|---|---|---|
| Identification | x | | |

| | | | |
|---|---|---|---|
| Interpretation | x | | |
| Design | x | | |
| Decision | x | | |
| Communication | | | |
| Implementation | x | x | x |
| Monitoring and review | | x | |

Also, it is important to realise that while, for our purposes, we consider the management of regulation in the abstract, as if it were a distinct and separate practice, it does not take place in a vacuum, but may be embedded within a complex set of other management regimes. Some of these will be firm-wide, such as within the more general audit processes of the firm and strategic management and planning, others will be more narrowly, often functionally focused, for example, in the area of operations management or marketing. Indeed, in most cases, particularly the SMEs that make up the bulk of any economy, the management of regulation will tend not be a separate, specialised function, organised as a separate process, with separate staff or a separate unit within the firm, but a responsibility of an existing unit and its staff, as illustrated in Table 4. A human resources division, for example, normally will have responsibility for the management of employment regulation.

Hence, at any one point in time the particular type of regulation regime will vary from intra-firm unit to unit, depending upon the nature and extent of regulatory change in that part of the firm's environment of most relevance to the unit in question. Thus, for example, the management of regulation in a HR division might be of the *modifying regime* type, as illustrated by the 'x', mark in each cell in Table 4, while the Finance division might, at the same time, perhaps faced with the impact of new regulations regarding corporate governance, be of the *new regime* type, again as illustrated in Table 4. In the largest firms, particularly within the banking and finance sector, where compliance has long been of major concern, specialised compliance divisions have begun to appear, often with an overall responsibility for the firm's corporate governance, though this is uncommon in most other sectors (see, for example, Westpac 2006, Parker, Nielsen 2005). However, this is most definitely not the case for an SME, where functional specialization is usually not well developed and where responsibility for compliance is likely to lie largely with the owner-manager and, to varying extents, the external accountant. Unfortunately, the vast bulk of studies relating to the management of regulation and compliance have focused on large firms, generalising from their organization, processes and activities and, perhaps, leaving us with an inaccurate understanding of the management of regulation within most firms.

Table 4 Management processes involvement of intra-firm units

| **Management processes** | **Human Resource Management** | **Accounting and Finance** | **Production** | **Compliance Division** |
|---|---|---|---|---|
| Identification | | x | | x |
| Interpretation | | x | | x |
| Design | | x | | x |
| Decision | | x | | x |
| Communication | x | x | | x |
| Implementation | x | x | x | |
| Monitoring and review | x | x | | x |

While it is not intended, the descriptions of the four regime models might be taken to imply that the actors involved in the management processes characteristic of each of the models are confined to the members of the firm. This is not always, if ever, a valid assumption, particularly for small and medium sized firms (SMEs), notably in regard to the role of accountants (Rawlings 2005, Evans, Carlon, Massey 2005). Rather, a more accurate image is one in which the actors involved in any one of these processes might be external to the firm, working together with employees, with some variation in the number and type of actor both by process and by regime type.

Often, for example, regulators will not only inform a firm of modifications to regulations, in essence working with the firm in the identification stage, but they will provide advice and assistance in relation to any of the stages. The website of the UK’s Office of Fair Trading, for example, offers businesses a wide range of advice and information in regard to its areas of responsibility, including lists of the regulations that apply to different categories of business, and contact numbers for its staff, as well as in-firm training (OFT 2006). In Australia, the Australian Tax Office has gone even further, adopting an 'Australian Tax Office Compliance Model', that involves working closely with large firms in positive partnerships to design management systems for the firm in order to achieve what is described as cooperative compliance (ATO 2006, Braithwaite and Wirth 2001), a model that has been adopted in similar form by the UK Inland Revenue (2001).

Table 5 suggests the types of actors that might be particularly associated with each phase or stage in management decision processes, assuming three types of actor, firm, contractor, and regulator. Regulators might be involved only with helping to identify and interpret new regulations for the firm and, in their inspection role, with monitoring and review, a practice very common in firms involved in food production, where health and safety concerns are prominent and regulation regularly enforced to a greater extent than in many other industries. The involvement of contractors is likely to vary by size of firm, industry and, as a result, type of contractor, with accountants contracted by small firms most likely to be involved in most stages. Indeed, it might be that each of the four regime models described are characterized to some extent by the involvement of differing actors, as suggested in Table 6. It is also likely that some value would be gained by breaking down the firm actor into a variety of types of in-firm actor, depending upon division and level in the hierarchy of authority, up to the level of the board.

Table 5 Type of actor associated with management processes

| **Management processes** | **Firm Actor** | **Contractor** | **Regulator** |
|---|---|---|---|
| Identification | x | x | x |
| Interpretation | x | x | x |
| Design | x | x | |
| Decision | x | | |
| Communication | x | | |
| Implementation | x | | x |
| Monitoring and review | x | x | x |

## CONCLUSION

Our understanding of how firms manage their responsibilities in regard to regulation is limited, based, for the most part, on a very few models of regulation management and a larger, but distinctly limited body of primarily case study based research. The findings from that research do provide, as indicated, useful ideas as to how regulation is managed within the firm and would reward further, even more detailed examination than can be given in a paper of this length. However, as the extent of regulation has grown and, in response, governments focus on both reducing its extent and improving its performance, then it is increasingly necessary that students of public and private sector management undertake research to fill in the very obvious gaps in our knowledge about firm-based management of regulation. On the basis of the discussion in this paper, at least the following questions need to be addressed on the basis of more rigorous, empirical and comparative research than has been undertaken, for the most part, to date. If such research is not undertaken then it is likely that both the design of regulation by regulatory agencies and the development of systems for its management within the firm will be less than optimal.

- What is the role of the board in regard to the management of regulation?
- What is the role of senior management in regard to the management of regulation?
- What is the place of regulation in firm strategy and plans?
- What is the impact of regulation on the organization of the firm?
- What are the factors that determine the management of regulation within the firm, including, for example, the regulation to which it is subject, industry sector, stage of firm life cycle, size and location?
- What determines perceptions of regulation within the firm and what is their impact on management of regulation?
- What is the role and significance of external actors in the management of regulation?

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