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contents

editorial

Vulnerability has advanced to play a central role in risk and regulation research and practice. Its growing importance is not only driven by swelling levels of experienced individual and societal vulnerability. It also highlights how contemporary regulation itself is being increasingly questioned or seen to be in crisis.

Traditionally, the primary interest has been on how different types of vulnerability can be addressed by regulation. After all, the traditional justification for regulation includes protection of individuals from potential harm. However, disagreement exists as to what constitutes appropriate levels of protection. What makes whom vulnerable to potential harm divides those keen on emphasizing individual choice and pitfalls from state paternalism from those that stress the many sources in which market and political power reduce individuals' opportunity to exercise voice or choice. And it is not just individuals whose vulnerability is the target of regulatory activity. Considerable regulatory attention is being paid to encouraging organizations to make sense of their vulnerabilities and address these, for example, through the establishment of safety cultures. Since the financial crisis, more attention is also being paid to vulnerabilities that result from the interconnectedness of organizations and sectors; individual organizations may be good at focusing on their own vulnerabilities, but they are less likely to consider systemic issues that arise from interdependencies. What distinguishes the current interest in vulnerability from earlier discussions are therefore two elements; one concerns the interest in systemic vulnerabilities that cut across organizational boundaries, the other relates to the growing concern with the capacity of individuals to exercise meaningful voice and choice.

Vulnerability can further be a consequence of regulation, partly due to unintended consequences of regulatory regimes. Typical examples are regulatory interventions that were set up to address certain issues, whilst creating (potentially bigger) vulnerabilities elsewhere, or being 'blind-sided' by issues that one 'didn't' see coming'. In an age of crisis regulation, it remains a continuous challenge for regulators to devote resources to exploring emerging, yet unknown risks, and to probe existing models so as to reduce potential sources of vulnerability of risk regulation itself.

Articles in this issue of *risk&regulation* focus on questions of vulnerability across a range of dimensions. Suzanne McCarthy considers the rationale for regulating internet-based funding platforms, a new type of business model for organizing crowdfunding. Giovanni De Grandis, Irina Brass and Arthur Petersen explore the promise and perils of biotech in personalized healthcare. Yasmine Chahed and Zsuzsanna Vargha discuss how technological change disrupts the business model of professional service firms, while Stefano Cascino and Maria Correia examine how financial vulnerabilities of individual, but group-affiliated firms affect group-wide credit risk. Changing business models and vulnerabilities to existing providers and students are also at the centre of Inez von Weitershausen's contribution on higher education. Andrea Mennicken and Martin Lodge consider the latest calls for reform of the accounting profession. Organizational features loom large in the discussion of unintended consequences and blind spots by Tobias Bach, Kai Wegrich and Martin Lodge; organizational contexts also feature in Lodge's consideration of the centrality of expertise and advice in managing vulnerability in contemporary executive government.

For **carr**, current times most certainly do not allow for slothful complacency, whether it is due to the distinct vulnerabilities arising from our interdisciplinary interests in a world dominated by disciplinary silo-building or threats posed to international collaborative research because of the current political climate.

We depend on your support for the continued viability of **carr**, especially in view of its 20th anniversary in 2020. We hope you enjoy this issue of *risk&regulation*.

Martin Lodge & Andrea Mennicken

Vulnerability as the new frontier in regulatory debate

Martin Lodge and **Andrea Mennicken** discuss
the implications of the rise in interest in vulnerability

The theme of 'vulnerability' is enjoying considerable currency in contemporary debates of regulation. The current focus is less on concerns regarding the Achilles' heel and blind spots of particular regulatory arrangements and instruments. Rather, contemporary questions focus on who is being defined as being 'vulnerable' . Based on answers to those questions, what are the implications for regulation aimed at protecting and empowering citizens, public service users and consumers in vulnerable situations?[1]

Vulnerability relates to those without voice and choice in contemporary regulated arrangements. Such a shift in attention towards 'vulnerability' of the voice- and choice-less points to a potentially significant shift in contemporary debates regarding regulation in general, and the regulation of markets in particular. Whereas regulatory debates around vulnerability tended to concentrate on questions of resilience and the building of resilience at organizational and/or systemic level, the discussion centres now more on questions concerning the capacity of public service users, and consumers (e.g. students or electricity consumers) to exercise voice and choice.

Of course, sceptics would suggest that a focus on 'vulnerable customers' has always been at the heart of regulatory activities. The elderly, children and the interests of future generations have always featured in regulatory contexts. In the area of utility regulation, for example, vulnerable customers have been supported by ensuring that minimum access conditions are met (such as specifying maximum distances to postal and telephone boxes), ensuring continuity of supply, or by creating special watchdogs for consumer support and advocacy. Yet, in the last few years we have seen a remarkable increase in activity focusing on regulatory design for and around the vulnerable.

In economic regulation, 'vulnerable consumers' are usually classified as those who seem to lack the resources to undertake informed choices. Here, the focus is largely on creating conditions for informed choice. These include offering easy-to-understand information, creating tariff structures that reduce regressive effects (as resource-rich individuals are said to be benefit from hunting around for the latest offers), prohibiting certain products to be sold to particular sets of individuals, or researching why individuals may not be undertaking choices that would be economically beneficial to them.

Such a focus of regulatory attention largely assumes that regulated markets 'work' and that regulation and regulators are largely about ensuring that individuals are in a position to exercise meaningful choice. Acknowledging that individual choice on the market place needs support via regulatory interventions is already a major departure from those days where market liberalization in and of itself was praised as facilitating customer choice and market efficiency. Debating how much support individuals need for the exercise of meaningful choice is therefore fundamentally also about what one assumes individuals are capable of, and how 'paternalistic' regulation should be.

Definitions of who is regarded as 'vulnerable' and in need of support shift with regulatory paradigms. Regulation needs to consider the changing boundaries of who is regarded as vulnerable. This concerns also questions of how far vulnerability should be taken and where the boundaries of regulatory concern should lie; if it is largely about enabling individuals to partake in markets, then the agenda regarding vulnerable customers is mostly about adding so-called behavioural insights to the tool box of regulators. However, a regulatory agenda could also be much more far-reaching, namely by focusing on different conditions that create vulnerability, whether it is a lack of language competencies, trust in market providers, reluctance to engage with public authorities that might offer redress, or genuine incapacity. How regulators should involve the 'voiceless' (which might include the unborn when it comes to decisions about long-term investments in infrastructures) goes a long way beyond the traditional regulatory interest in correcting market outcomes in view of some ill-defined fairness objectives.

In particular non-economic regulation has a far more extensive agenda when it comes to vulnerability. In healthcare, for example, patients, especially elderly patients, are usually not well-positioned to exercise much choice; dementia patients in care homes are not able to inform, or take comfort from, benchmarking exercises. Furthermore, concerns about vulnerability – defined as the inability to exercise voice and/or choice – might not only be related to humans but also to animals (e.g. regulation aimed at ensuring the humane treatment of animals) or our planet (e.g. climate change debates).

The challenge for regulators in dealing with vulnerability lies, firstly, in the identification of different types of vulnerability. One key issue in this context concerns the question whether vulnerable individuals are easy to detect or not. For example, it might be easy to spot those individuals who are at risk of financial over-extension when seeking loans if records exist

about income and expenditure patterns. Equally, socio-economic and other background data might offer indications about which individuals should deserve special support in higher education. However, in other cases, such detection is far more problematic, especially when it comes, for example, to migrants or low-pay areas of the economy.

A second key challenge relates to distinguishing between those that identify themselves as vulnerable and those who do not. Sources of non-identification may be due to issues of optimism bias, but might also point to genuine ignorance about being vulnerable. For example, most of the victims in Grenfell Tower were arguably unaware of being vulnerable due to lacking fire safety installations. Similarly, customers of online banking may not regard themselves as vulnerable as they rely on their institutions to ensure cyber security. Likewise, laboratory animals are not in a position to identify themselves as vulnerable regardless of how inhumane their treatment might be.

Looking across these two sets of issues offers insight into the multi-dimensional nature of the regulatory challenges that are involved in dealing with vulnerability. Without wishing to suggest that one form of vulnerability is more important than others, a key regulatory challenge lies arguably in attending to the 'undetected and non-self-identifying'. At minimum, it suggests that regulatory concern should not merely be limited to those who are (already) identified as vulnerable. Regulatory attention has to move beyond existing knowledge and deal also with individuals who might be reluctant to cooperate with regulatory authorities (as they may be unwilling to deal with state authorities due to previous experiences in, for example, authoritarian contexts).

There are, of course, further complications. One relates to the question whether the 'harm occurred' (i.e. the actualization of the vulnerability) is 'reversible' or not. Similarly, there is also a question about relying on 'gatekeepers' and 'bottlenecks'. It might, for example, be argued that regulated organizations should be required to identify individuals as vulnerable (e.g. in banking) even if those individuals may not regard themselves as vulnerable. However, such a reliance on third parties' ability and willingness to identify vulnerability, is inherently problematic, as it depends on incentives; a 'trustee' role will not succeed in contexts where business models rely on the exploitation of vulnerable individuals (human and non-human). In these cases, the regulated sector may present a distinct form of vulnerability in itself.

To sum up, the boundaries of who and what is being defined as vulnerable are extremely fuzzy. For regulators to merely respond to vulnerability by looking at individual decision-making biases (and possibilities for 'nudging') suggests an ultimate faith in the potency of information and regulation to enable voice and choice among individuals. Such a response, in other words, is about enhancing a regulator's mandate to enhance (market) efficiency. It is a response that might be organizationally and ideationally convenient. But it neither touches on fundamental questions relating to vulnerability, nor deals it with the decreasing legitimacy of contemporary regulatory arrangements, and the vulnerability of regulation itself.

The current topicality of the vulnerability theme highlights a much deeper concern with the performance (and purpose) of the 'regulatory state'. A much more far-reaching debate about vulnerability is therefore warranted – one that inevitably will lead to difficult conversations about perceptions of fairness and efficiency and the trade-offs between them. Such conversations, albeit difficult, have the potential to transform understandings of regulation, and therefore deserve to be at the forefront of current discussions.

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1 See for example Ofgem, 'Protecting and empowering customers in vulnerable situations', *https://www.ofgem.gov.uk/about-us/how-we-work/working-consumers/protecting-and-empowering-consumers-vulnerable-situations* Accessed 25 October 2018.

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Recalibrating regulation of colleges and universities: adapting to a new landscape in higher education

Inez von Weitershausen highlights the limits of national regulatory approaches towards higher education

The times in which universities ruled the waves in higher education are long gone. Among the many new players, three groups are particularly influential: so-called alternative providers that have expanded their activities beyond their traditional focus on professional qualifications, such as in law and accounting, to other disciplines; education-focused companies producing bespoke (online) courses that allow students to acquire those skills that they are interested in; and big companies, including Google and Amazon, that have discovered higher education as a profitable business opportunity and a way to address the undersupply of qualified personnel in areas that are of importance to them.

In addition to pressures from new competitors, changes on the demand-side also challenge the position of universities. On the one hand, students and parents are becoming increasingly reluctant to pay ever increasing tuition fees, especially as the large number of free or affordable online alternatives becomes more and more accepted by employers. On the other hand, universities face growing dissatisfaction from faculty members who are exposed to accelerated work pressure and are disillusioned by a lack of career progression opportunities given the decreasing chances of ever obtaining one of the few coveted tenure positions.

Taken together, these developments give rise to a number of questions:

First, what will the *market for higher education* look like in the future? In other words, are we going to see an ever more crowded and diversified space, characterized by a growing number of new education providers that act alongside traditional higher education institutions (HEI)? Or will there be a consolidation of players, where a few powerful companies co-exist alongside existing universities that are trying to make up for lost market share by constantly searching for new business opportunities? Or are commercial companies eventually going to take over the higher education market, with the exception of a few outstanding universities that serve as national status symbols? The answer will – at least in parts – depend on the measures taken by politicians and regulatory agencies.

A second set of questions, then, relates to how *individual universities* will react to these changes. Which 'coping strategies' will prove to be particularly effective? Common responses, in particular by US universities which have been facing increasing economic pressure, include the commercialization of existing activities on the one hand, and the expansion of business activities on the other. The former category includes services such as bespoke curricula and programmes for wealthy individuals or groups, the design and distribution of new learning technologies, or assistance to foreign governments in setting up new universities. Activities that extend the core business of universities include universities effectively turning into real estate developers, startup incubators or financiers. While some particularly prestigious universities with sufficiently large resources might even be able to pursue all of the above strategies simultaneously, one may wonder what these activities will eventually do to the original vision, mission and *raison d'etre* of universities.

It is important to note that a small number of universities has taken an alternative path already. Rather than focusing on the commercialization or expansion of their activities, these institutions have established themselves as community anchors and entities with a strong commitment to the city or region in which they are physically located. Seeking to actively contribute not only to the latter's economic development, these universities focus on aspects such as social cohesion, inclusion, diversity, and integration, and foster outreach and engagement activities as well as a 'culture of volunteerism' that extends beyond the campus.

This trend then leads to a third question, namely 'What can and should society expect from universities – as opposed to alternative actors in the higher education space –especially when the former are recipients of public resources and benefactors of protective measures? Are high standards of quality assurance, both with regard to teaching and research enough, or should universities deliver more these days? Before we can address this question, however, we must acknowledge that already in the area of quality assurance, universities frequently underperform.

In the United States, for instance, we see not only some of the best universities in the world, but also a high number of disastrous 'education experiments', including the President's very own 'Trump University'. This is due to the fact that in the US regulatory oversight has traditionally been situated at the very liberal end. A reflection of the belief that institutional diversity fosters innovation, promotes creativity, and allows everyone to pursue their individual version of the American Dream, the regulatory system has been unable to prevent the emergence of institutions of inferior quality and the exploitation of people's beliefs in the value of a college degree. Despite these negative effects the current administration has made further

deregulation part of its crusade against 'big government' and is thereby responding to long-held calls for a reduction of regulatory oversight. Indeed, it was already in 2015, that the Task Force on Federal Regulation of Higher Education issued a report entitled 'Recalibrating Regulation of Colleges and Universities'.[1] This report argued that universities and colleges were faced with 'a jungle of red tape' and 'rules that are often confusing and difficult to comply with'.[2]

The fact that the document was later endorsed by the Association of American Universities (AAU), a highly reputable organization of more than 60 leading research universities in the United States and in Canada, suggests that the current changes do not solely reflect the attitude of the current government. Rather, they appear to be symptomatic of a regulation-critical attitude among the US universities themselves and society more broadly, and this has been increased further by the growing number of 'non-traditional leaders', i.e. university and college presidents who have taken office without having gone through the full-time tenured faculty track. Of course, one may argue that the rise of non-tenured academic leadership is not necessarily bad. After all, individuals who have proven to be effective and responsible managers elsewhere may be more qualified to navigate universities through the changing higher education landscape than academics who are forced out of their ivory towers to reluctantly preside over committees dealing with questions such as how to ensure an institution's financial viability, create an effective human resource strategy, or design a plan for the use and protection of data. At the same time, however, one may worry about this trend as experiences with hospitals, schools and even religious organizations, have indicated how the initial mission of an organization can be hybridized, if not corrupted, by an increased focus on efficiency and outputs and the deep-rooted scepticism towards quality control through governmental regulatory agencies that many business people share.

Trying to understand the direction in which universities and the higher education sector are heading these days thus requires an in-depth analysis of the following factors: overall market dynamics in the context of potentially ever more restrictive immigration controls, universities' specific 'coping strategies' in the context of digitalized learning technologies, and attitudes towards market regulation and quality control (and the balance between these two). How these factors will be addressed represents a fundamental challenge to any system of national higher education; furthermore, it is questionable whether these can be resolved within the national boundaries of higher education. Addressing these factors requires moving beyond established regulatory boundaries and perspectives.

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1 *https://www.nccpsafety.org/assets/files/library/Task_Force_Regulation_Report.pdf* Accessed 5 October 2018

2 The report raised a number of important issues. It suggested that the accounting standards applied by the Department of Education with regard to university endowments were outdated and, therefore, partly responsible for the failure of 'financially viable schools' in the context and aftermath of the 2008 financial crisis. Other points of criticism had to do with the authorization of distance education programmes, rules concerning verification of financial aid eligibility, and the responsibilities of accreditation agencies as well as the accreditation process itself. Arguing that the Department of Education had 'increasingly imposed unnecessarily bureaucratic procedural requirements on accrediting agencies', such as reviewing institutional compliance with fire codes and Title IV regulations on stu-

dents returning funding, the Task Force suggested that accreditation agencies were not able to focus on their primary duty of holding institutions accountable for educational quality, student learning, and institutional innovation due to an overload of responsibilities.

3 Beardsley, S. (2018) 'Shaking up the leadership model in higher education', McKinsey Quarterly (February). According to this recent study, this is currently the case for about a third of the 'presidential population' in the US. *https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/shaking-up-the-leadership-model-in-higher-education* Accessed 27 October 2018).

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From gatherers to hunters: technology-led disruption of the professional business model

Yasmine Chahed and Zsuzsanna Vargha predict that professional sales organizations will be the winners of knowledge automation in the new digital age

Professional firms have long been able to use technology to preserve the commercial value of their business model. From the electronic calculator to spreadsheet software, technological advances allowed these firms to streamline operations by delegating labour-intensive, low-value tasks to cheaper and more efficient machines.

However, the story of technology and professional work is about to change. A new generation of smart machines appears to threaten the core of the professional business model. Authors such as Richard and Daniel Susskind and Clayton Christensen have delivered the templates for consultants, lawyers, and accountants to be worried about the automation of even high-value professional activities. In the new digital world, they argue, established professional firms find themselves competing with start-ups developing technology solutions that can make expertise more accessible to a broad audience, respond to unstructured tasks, and induce trust in transactions, eliminating the need for highly-trained professionals.

The mantra of 'disrupt yourself or be disrupted' is driving record investments by the Big Four and other large professional firms into becoming digital innovators themselves. Dedicated technology teams oversee hundreds of projects to achieve technology-led change along every part of the audit, assurance, and advisory spectrum.

While everyone assumes that one must invest billions in technology to stay relevant, our research shows that the fundamental shift is to transform professional expertise into a product that has a stand-alone value to its users.

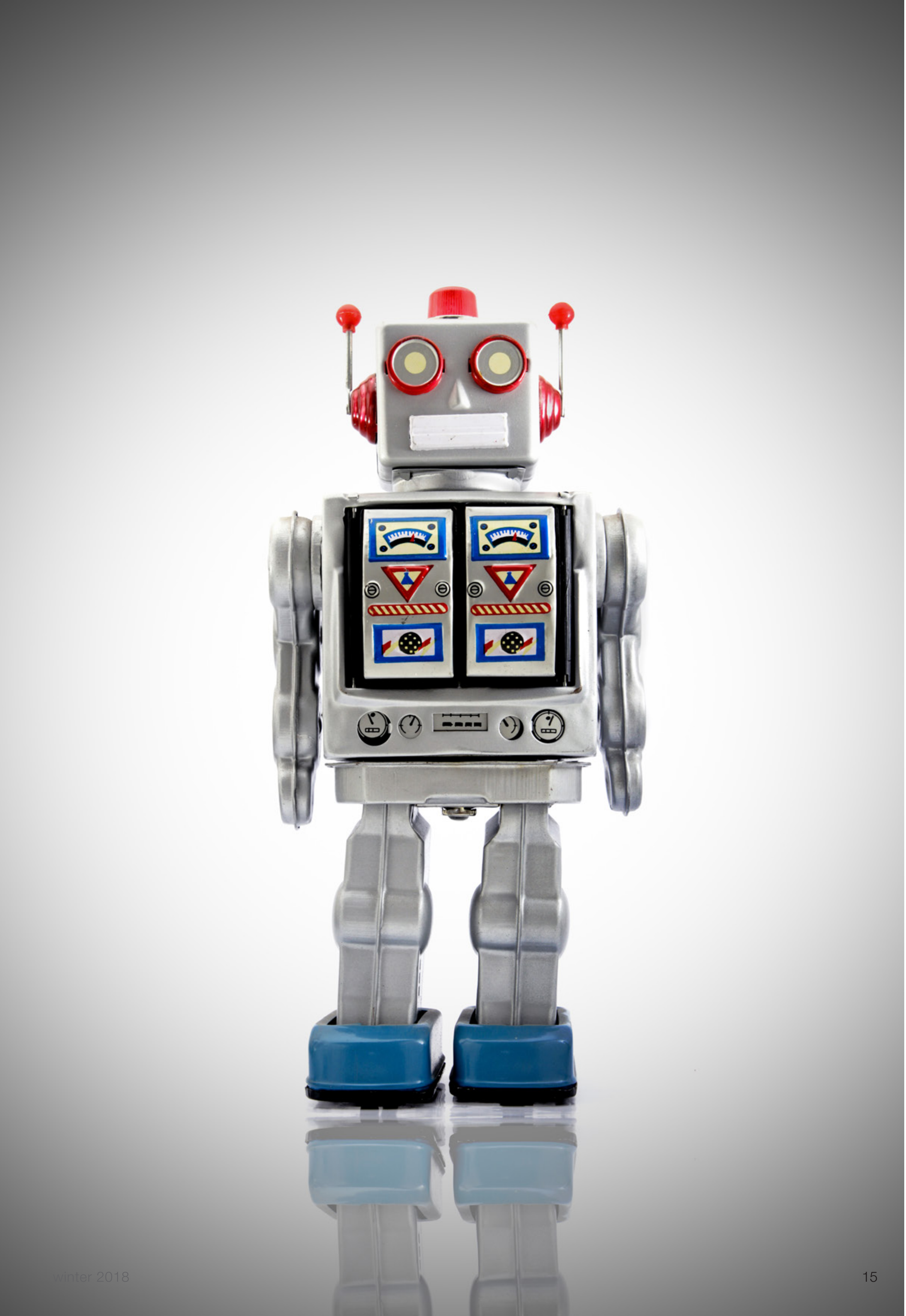
We observe a shift from the selling of billable hours to the selling of technology itself. When established professionals capture their knowledge and insight inside technology, building algorithms and analytics for clients, they create new objects. However, by doing that, can these professionals keep working the same way as they did before? We have to start out from the fact that the critical question for these experts now becomes, how to popularize their technology product—who will buy it and why? Here we can draw on the interdisciplinary literature on marketization, which has studied extensively the process by which objects are turned into products that circulate in markets.

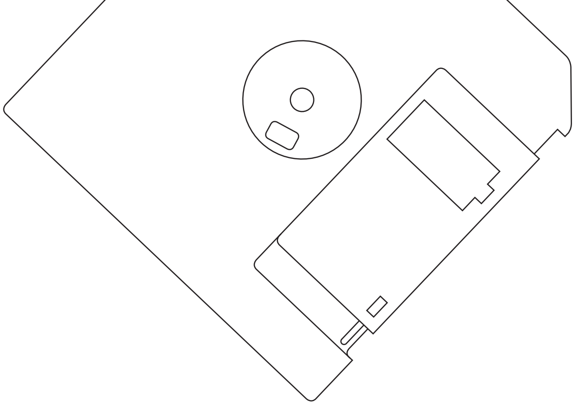
Theories of product qualification by economic sociologists such as Michel Callon argue that most products do not come with inherent and unchanging qualities that make them instantly appealing to users. Instead, a product and its market become defined together through an entangled process in which stand-alone product features are defined (objectification) and adjusted to the client's individual needs (singularization). Throughout the process, the object is progressively transformed into a product that is bought and used. As the product begins to enter the buyer's world, its relevant qualities that stabilize may be potentially disruptive to prior products (see the smartphone).

We use this theory to analyse technology development in professional services. What this theory suggests is that no matter how much established professionals aim to be ahead of the curve and develop cutting-edge big data tools, a novel technology that is not somehow attached to a buyer's needs is not disruptive (see Google Glass). Our research method is to follow tech projects in different Big Four firms over extended periods, interviewing their technology teams and decision-makers.

We find that the process of professionals providing technology unfolds not only as a constant back-and-forth shaping of product qualities and buyer needs, but also as one of transforming the professional organization. The increasing entanglement with products and markets has the potential to fundamentally disrupt the professional business model.

Prior expansions of the professional business model that involved technology were more similar to commodification, a process whereby accounting firms reworked new areas of expertise as a scalable assurance or advisory service. They articulated value propositions for hardware and software that had been developed elsewhere, by absorbing them into the traditional consulting model, selling thousands of billable hours of expert time -- ERP implementations being just one example.





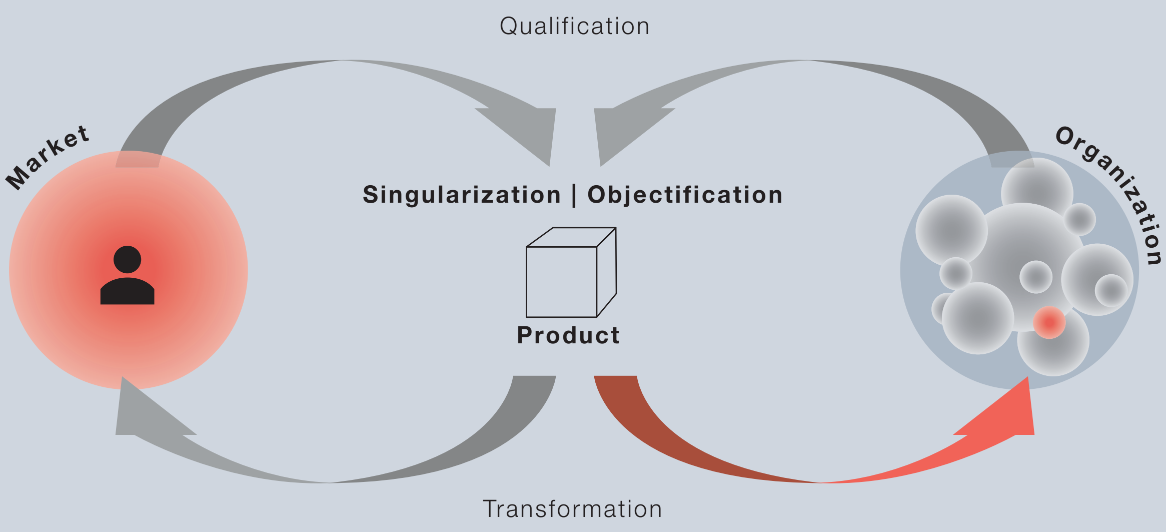
However, the new analytics tools that professionals are now developing, release aspects of professional work from the involvement of the (human) professional. In the traditional model the human expert sells billable hours and establishes trust in the superiority of her expertise through personal client relationships. Digital solutions are clearly distinguishable objects that sell for a usage fee. At the same time, they are up against the culture of the professional firm, for which product qualification is an alien concept, despite how commercialized these firms have become.

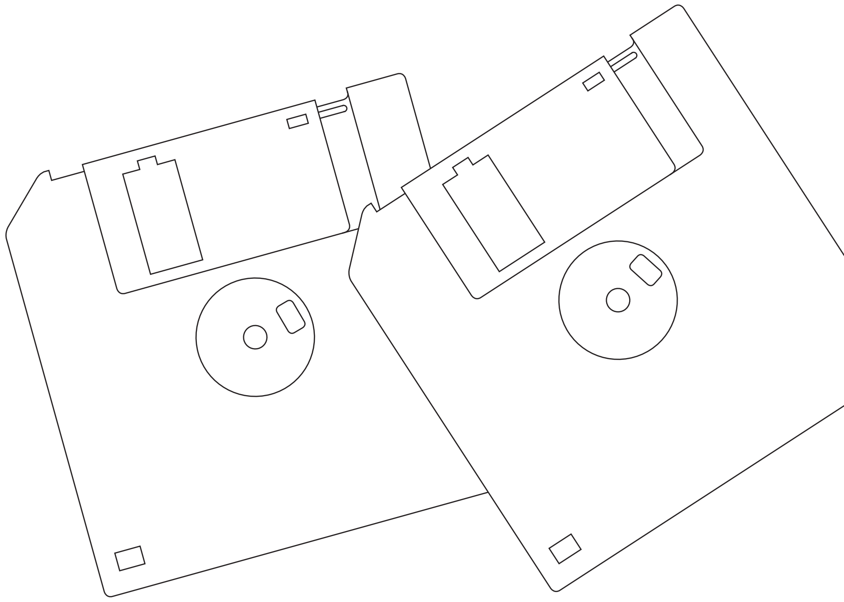
Most importantly, consultants have turned out to be little equipped to sell technology. The ways of working with clients, in long-term engagements and offering a wealth of services, does not prepare professionals to enlist a market in articulating the properties of a stand-alone device.

Disrupting the disruptors

Our story could end here with the prediction from a recent *Financial Times* article[1], citing organization scholars Henderson and Clark's classic study that established firms fail to innovate because they cannot replicate the agility that is necessary to innovate successfully. However, this is not what we see in the established professional firms. As they try to create and sell their technologies, they are gradually making changes in their organizations. While most of the publicly visible activity focuses on building digital skills, such as coding or data analysis, a parallel and equally significant

DISRUPTED DISRUPTORS
HOW TECHNOLOGY INVESTMENTS CHANGE THE PROFESSIONAL BUSINESS MODEL





change is taking place somewhat unnoticed. Chiefly, professional firms have had to create new roles and hire staff with new competencies in sales and marketing, who bring expertise to consultants on how to devise propositions specifically for technology, and guide product development teams in relating the capabilities of their technology applications to potential audiences.

However, having sales type roles in a partnership structure raises new questions in itself, such as those of compensation and career. Salespeople are usually paid in commission after deals instead of billable hours, and they do not fit the progression in the partnership structure if they do not 'own' client relationships. There is also a question of who owns and who is accountable for the technology products and budgets. We have seen the formation of in-house developer teams who work on their projects in addition to their consulting tasks, but equally, the launch of partnerships with proven technology firms. Finally, the very fabric of client relationships, which are core to professional services, is changing as consultants start using their analytics tools with and for clients. Consequently, trying to embed technology products more deeply in professional firms involves a change of culture, from consultants only proposing projects that are most likely to generate revenue ('gatherers'), to accepting uncertainty and potential failure ('hunters').

Transforming expertise from Big Four into Bit Four

Our research shows that creating demand for professional technology objects requires new competencies from professionals that have to do with markets. The professional firms we observed were gradually changing some of their defining structures to accommodate the needs of product qualification: the thinking about what a technology can do and who it can appeal to, in constant motion.

Our study calls attention to the market and marketing aspect of professional expertise. Besides the governance dilemmas surrounding the Big Four, such as auditor independence, we must now turn our attention to the market-building expertise, the sales and marketing affinities of audit firms. In fact, we cannot rule out that being in the business of technological disruption will involve the transformation of assurance and advisory businesses into sales-driven organizations.

Finally, the move into technology is deepening the divide between the Big Four firms and the rest of the accounting profession. Deep pockets separate those who can invest in advanced digital solutions, sales, and marketing from those who cannot and must be technology and client 'takers', in danger of being automated away and pushed out of market conversations. This new digital divide is a significant problem in a system of professions pledged to serve the public interest.

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1 See Financial Times, 'Why big companies squander good ideas', *https://www.ft.com/content/3c1ab748-b09b-11e8-8d14-6f049d06439c, accessed 10 October 2018*.

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Regulating wicked issues – the next round of accounting regulatory reform

Andrea Mennicken and **Martin Lodge** consider the likely disappointment of contemporary reform initiatives

Barely a day goes by where calls for reform in accounting regulation do not feature in the headlines. Whether it is calls for tighter controls over conflicts of interests, ethical behaviour, or changes to market structures to enhance competitiveness, taken together all these debates seem to signal a determination to tackle deep-rooted problems in the accounting profession. Yet, however valuable these calls are, the potential solutions to the diagnosed problems are likely to disappoint. Since regulating accounting is about regulating a distinct 'wicked issue', simple solutions won't do.

Current key criticisms relate to questions of market structure, auditor independence and auditor judgement. Questions about the power of the 'big four' accounting firms (Deloitte, E&Y, KPMG, PwC) highlight the considerable market concentration of large accounting firms, whose influence is further advanced by the close connection of accounting with associated consulting services. Another concern is the competence of individuals and organizations to properly 'audit' firms and exercise a sufficient degree of scepticism in their assessments, for example in their judgement of large uncertain accounting estimates, including fair value estimates and impairment write-downs. Furthermore, there are quests for a reform of the Financial Reporting Council, the UK regulator for auditors, accountants and actuaries. The proposal is to turn this body into a more muscular regulator with statutory authority, being accountable to Parliament. At the time of writing this article, an independent review of the Financial Reporting Council (FRC) led by Sir John Kingman is being conducted. The review's objective is to 'help government to assess the FRC's governance, impact and powers, to ensure they are fit for the future'.[1] The review encompasses an assessment of FRC's audit quality review process. It is currently planned that findings will be submitted to the Secretary of State for Business, Energy and Industrial Strategy and the FRC Board by the end of 2018.

None of the above listed concerns are necessarily new. They featured heavily in the aftermath of the collapse of Enron (and, subsequently, Arthur Andersen); they returned to the fore during the financial crisis; and they have received renewed attention in the context of recent failures, such as Carillion in the UK. In the case of Carillion, criticism was particularly directed at Carillion's auditors, KPMG, signing off on accounts just before the firm's first profit warning and, six months later, insolvency.

If concerns about auditor judgement, close relationships (i.e. lacking auditor independence), audit market concentration and timid regulatory oversight are nothing new for those interested in accounting regulation, then the same holds for regular attempts at tinkering with the regulation of accounting itself. In 2011, the House of Lords Select Committee noted distinct vulnerabilities arising not just from audit market concentration per se, but also from the peril that the collapse of any one of the large four firms would also present a risk to the sustainability of the audit market itself (House of Lords. Select Committee on Economic Affairs, 2011). Questions of market concentration were also very much at the heart of EU-led audit reform initiatives (see the Green Paper issued by the European Commission, 2010). At the time, the Anglo-Saxon resistance to extensive reform proposals contained in the Green Paper, such as the mandatory splitting up of the 'large four' to create 'more competition', was particularly noteworthy.

Since then, a range of initiatives have taken place. One is a mandatory audit firm rotation requirement that has formally become part of European Union law. Further, EU audit firms have been banned from providing a number of advisory, non-audit services to audit clients, including for example, services linked to management advice, or advice on financing, capital structure or investment strategy of the audited entity (drawing on US-SOX legislation).

In France, joint audits (i.e. audits of an entity by two or more auditors) have been required for listed companies since 1966. Inter alia, such a mechanism can reduce audit market concentration by offering smaller firms an opportunity to work alongside the big firms.

Yet, none of the above outlined initiatives (auditor/audit firm rotation, prohibition of non-audit services alongside audits, introduction of joint audits), is likely to lead to significant reform results as they do not go to the core of the 'wicked issue' character of accounting regulation. At one level, there is a problem of the target of regulation. On the one hand, accounting regulation is about professional standards aimed at the governing of individual professional conduct (individual independence, competence, objectivity, etc.). On the other hand, individual professionals operate in an organizational context of an audit firm context, which brings with it a number of different issues. Some of these issues are related to audit firm governance, internal incentive and compensation structures, client management and retainment demands, and so forth.

At first sight, calls for 'more scepticism' in auditor judgements sound plausible in view of accusations that recent bankrupt-

cies have found accountants to be asleep at the wheel. However, what exactly 'scepticism' implies is far from clear.[2] Most of all, this defines the problem as one of independent judgement at the level of the individual. Yet, most decisions are the result of a set of interconnected decisions which are often reached at group level. This 'many hands problem' in regulating accounting cannot be addressed by solely relying on measures aimed at increasing individual scepticism. Auditor judgements, to a great extent, are 'distributed' judgements that rely on the input of a number of individuals and effective coordination and drawing together of audit work. Furthermore, auditor judgement is increasingly aided by technology, including big data and algorithmic, machine learning technologies, which in themselves require a rethinking of traditional audit regulation and oversight arrangements.

As we are awaiting the findings from the latest review of accounting regulation, and the inevitable toing and froing over actual reforms, we should bear in mind the long lineage of criticism facing accounting regulation. Accounting regulation is a wicked issue – it has multiple dimensions and no stable solution, and how problems are being defined inevitably leads to particular, partial solutions, which in turn, generate their own vulnerabilities. While therefore increased spotlight on the world of accounting regulation can only be welcome, it is fairly unlikely that any subsequent reforms will mean an end to questionable practices, concerns about market structures or accusations of missing 'red flags' in future insolvencies.

1 See *https://www.gov.uk/government/publications/financial-reporting-council-review-2018* Accessed 25 October 2018.

2 See also *Auditor scepticism: raising the bar* issued by FRC's Auditing Practices Board in 2010, London: APB.

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The promise and perils of biotech in personalized healthcare: Can new regulatory pathways protect the vulnerable?

Giovanni De Grandis, Irina Brass and **Arthur Petersen** discuss critical questions for regulatory innovation in personalized healthcare

The coming of age of personalized therapies

In the last decades the hottest areas of medical innovation have been the fields of targeted therapies and personalized medicine – medical treatments tailored to the specific molecular features of patients or diseases. Monoclonal antibodies are the prime example of successful targeted therapies, while genuinely personalized treatments have not been as forthcoming as expected. The greatest promise in this area comes from cellular and genetic therapies, which have the potential to be curative by stopping the causal chain leading to disease, or by regenerating cells or tissues that have genetic defects or have been damaged, or by enhancing bodily functions, like the immune system capacity to fight disease. This latter is the mechanism of action of CAR-T cells: the class of treatment that has recently been hailed as the coming of age for cellular therapies and advanced biological treatments in general. Until the summer of 2017, only a few advanced biological therapies had made it to the market, and none has been a commercial success or has had a significant impact in terms of patients treated. In Europe, for instance, by the end of 2017 more than 500 clinical trials had led to only 18 marketing applications and 9 authorized products, 4 of which were later withdrawn from market. All in all, 111 patients had been treated with those products. But when in 2017 the Food and Drugs Administration (FDA) in the USA licensed the first two CAR-T cell therapies (Kymriah and Yescarta) – followed by the European Medicines Agency in 2018 – observers thought that this was a turning point and that treatments with a clear potential for commercial success and medical impact had finally hit the market. While initially approved for the treatment of some forms of leukaemia, it is expected that their therapeutic indications will expand and that new products will address an increasing range of tumours.

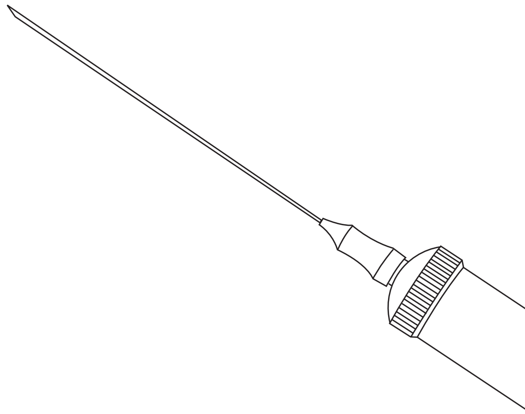
However, advanced therapies like CAR-T cells bring new challenges for the regulation and financing of healthcare products. For instance, while CAR-T cells can save the life of patients not responding to other therapies, they also have severe side effects, so that both the FDA and the European Medicines Agency (EMA) have required risk-management plans and enhanced post-marketing surveillance. More strikingly, these products have hefty prices: in the USA Kymriah and Yescarta cost $475,000 and $373,000 per patient respectively, which have triggered criticism and raised questions about rationing and financial sustainability.

The new regulatory landscape and its critics

Both CAR-T cells products have achieved market authorization on both sides of the Atlantic through some special regulatory pathways designed to assist companies with their development plans and to speed up the process of clinical evidence collection and regulatory review of the application. Both the FDA and the EMA have currently a portfolio of facilitated pathways which are the result of an important change in the role and mission of these regulatory agencies. Traditionally, the goal of pharmaceutical regulations has been to ensure the *safety, quality* and *effectiveness* of the products that are authorized for commercialization. But in the last decades, regulatory agencies have taken a broader mission, which next to their traditional function includes facilitating *faster and broader access* to innovative products for patients with serious medical needs, as well as the promotion of *medical innovation.*

This broadening of their mission has important consequences. While before the vulnerable group they were protecting was of patients receiving drugs, now they are also trying to help patients for which existing treatments are of no use or who may benefit from experimental drugs but may not wait until they achieve marketing authorization. Remarkably, the new mission of promoting early access and innovation forces rethinking of established regulatory practices. Ensuring safety, quality and effectiveness is time-consuming and imposes high costs on developers, and it delays market entry of innovative products and deters companies from developing products unless they have the potential for huge profits. Therefore, regulators have had to streamline the regulatory procedures and ease their requirements, in order to speed up the process and incentivize companies. The result is that the new regulatory focus on unmet medical needs creates trade-offs with the traditional values of safety, quality and effectiveness.

Unsurprisingly, the new facilitated pathways designed to promote faster access and innovation have been subjected to a number of criticisms. The robustness of the evidence that is accepted by facilitated pathways has been questioned: smaller and shorter trials, and sometimes reliance on only one phase 2 trial – as in the case of the 2 CAR-T cells therapies – is not considered sufficient to establish effectiveness and detect less common adverse events. Similarly, the use of surrogate endpoints instead of meaningful clinical endpoints has led to the approval of drugs that were later shown to be ineffective. The safety of the process has also raised concerns. First,



some studies have shown that strict review deadlines lead to decisions made under time pressure, which in turn are associated with higher incidences of post-marketing safety issues. Moreover, small trials on targeted populations provide limited information on the risks of wider use and thus make off-label use (notoriously difficult to discipline) rife with uncertainties and dangers. Another concern is the ability of these facilitated pathways to achieve their goals. Faster market authorization does not immediately translate into faster or wider patient access. Even advocates of facilitated pathways have acknowledged that achieving their goals needs a broader system approach that involves Health Technology Assessment bodies, payers, providers and clinicians. Finally, scepticism has been manifested about the capacity of regulatory agencies to make up for higher uncertainty at time of approval with enhanced collection of post-marketing data. Critics have pointed out that so far compliance with the performance of post-marketing studies and the implementation of lifecycle evaluation has been poor, and that things are unlikely to change as long as industry lacks incentives and healthcare systems lack resources for their fulfilment.

The new vulnerable

The new and extended mission of regulatory agencies in the medicinal domain is having significant impact on different vulnerable groups through reshuffling risks and benefits. Clearly, patients with serious unmet medical needs (i.e. not getting any really effective treatment for life-threatening or severe diseases) are given much more attention than before, and arguably future patients could also benefit from the emphasis on innovation. For the target population addressed by new therapies there is a lower risk to miss their therapeutic benefits, but increased uncertainty about side effects and durability of benefits. Future generations face a similar trade-off; they are likely to see more therapeutic options if facilitated pathways manage to promote innovation. However, not all innovation is valuable and unless ineffective products are removed from the market they will run the risk of missing the best therapies and mis-allocating their resources. Finally, new regulatory pathways redistribute risks between different patients' groups. This is where they generate new vulnerable groups. Given that healthcare budgets cannot be indefinitely expanded, providing hyper-expensive therapies comes with the risk that public healthcare systems and private insurers will have to introduce coverage cuts elsewhere. This means that some patients will be at risk of losing (full) coverage of effective treatments. Furthermore, if the innovative and hyper-expensive treatments are introduced on the basis of less evidence about their effectiveness, then the allocation process will become less consistent and fair: a given level of uncertainty would be acceptable for some products, but not for others. In light of these impacts on different vulnerable groups, it seems that the benefit and the justifiability of facilitated regulatory pathways is conditional on regulators building their capacity to acquire high quality post-marketing evidence and withdraw from the market products that fail to confirm their value.

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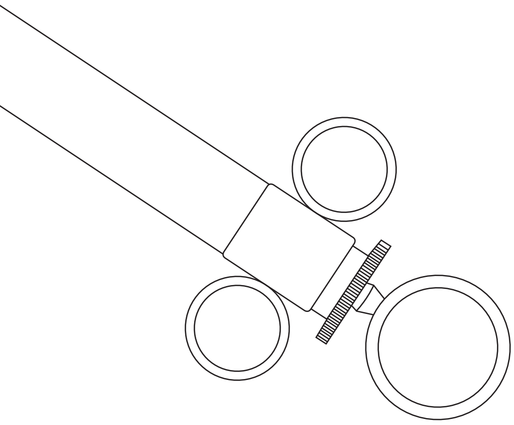
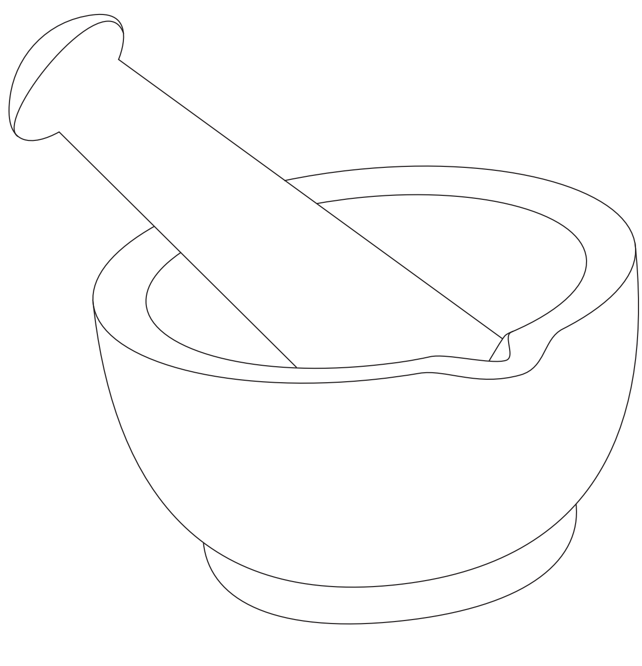
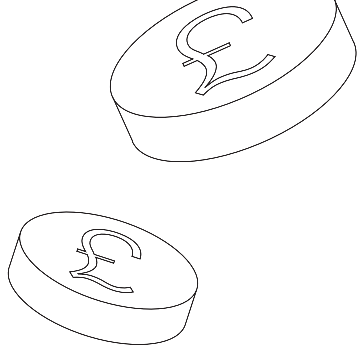






Fundraising platforms – fixing a regulatory black hole

Suzanne McCarthy considers the rationale for regulating fundraising platforms

In March 2017 a terrorist drove a car over Westminster Bridge near the Houses of Parliament killing six people and injuring at least 50. In May of that year another terrorist detonated a home-made bomb at the Manchester Arena killing over 20 people, wounding more than 100 including many children and causing countless others psychological trauma. In the following month Grenfell Tower, a 24-storey block of flats in West London, caught fire with the loss of 72 lives and many injured. All of these events led to an outpouring of financial donations with many of these made via online fundraising platforms. On the JustGiving platform alone 500 separate pages appeared after the Manchester Arena attack and 700 following Grenfell Tower. Others have used fundraising platforms to crowdfund for a particular project or cause such as the Charlie Gard GoFundMe appeal which raised £1.3 million towards the costs of sending that child to the United States for treatment (Guardian 2017), which sadly did not happen because of his death.

Online fundraising platforms and how they are used

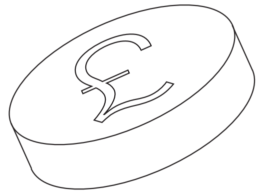
There is no official legal definition of online funding platforms. For the purpose of this article they are defined as websites or applications that are operated by commercial companies (for example, JustGiving; GoFundMe), corporate social responsibility initiatives (BT MyDonate; Virgin Money Giving); or registered charities (for example, PayPal Giving Fund). These platforms enable donors to give to charitable causes via their computers, smartphones and other electronic devices using their credit cards, debit cards or digital wallets (devices that allow electronic transactions such as Paypal). Charges and fees may be payable on many of the platforms. As it is very simple to register and set up a page, fundraising platforms are very attractive both to charities and individuals. It is no wonder that the number of platforms has grown like topsy.

Crowdfunding campaigns, such as for Charlie Gard, are used by individuals, groups of individuals and commercial organizations to raise funds for charitable purposes. Such appeals often appear on the same site as registered charity fundraising campaigns, and the public may not be able to distinguish between the two. If the fundraising is for a registered charity, then donors can check the charity's registration number with the Charity Commission, be assured that their donation will go into the charity's bank account and that the charity will file an annual report disclosing its finances. But where the money is raised via a crowdfunding appeal, it will be passed to the crowdfunder to distribute and there is no easy way of verifying if the crowdfunding asked is genuine or discover how donations will be used or funds spent.

The call for regulation of fundraising platforms

Appeals on fundraising platforms have been successful in raising money for charitable causes. One of the largest of these platforms, JustGiving, has helped people raise more than £3 billion for good causes since 2001. Nevertheless, anxieties started to be expressed in the media and by parliamentarians about the possibility of fraudulent activity (Independent 2017), lack of oversight of the purpose, destination of funds collected, and the need for accessible and clear information about how the platforms operate and the fees they charge. The *Mail Online* reported, for example, that JustGiving took more than 6 per cent from almost every donation made and £20m annually from fundraisers (Daily Mail 2017a) and specifically criticised that site for taking more than £25,000 in fees from money donated for the Grenfell Tower victims (Daily Mail 2017b, The Sun 2018). This criticism may be unfair considering that commercial platforms charge to cover their costs and to have funds to invest in their platforms. Nevertheless, there were worries that public trust and confidence in donating specifically via fundraising platforms and more generally could be adversely influenced by these concerns.

What became apparent was that fundraising platforms were unregulated. There are, of course, other areas where regulation is non-existent but might be desirable. One of these is political advertising, the subject of an earlier article I wrote for *risk&regulation* where I posed questions which I believe could assist in helping to identify if regulation of a sector is possible (McCarthy 2017). These are: whether regulation is feasible and appropriate given the subject matter; the type of regulation that might be introduced – self regulation, co-regulation or statutory; who would pay for the regulation – government or the sector involved; what powers and sanctions the regulator might be given; and how and to whom would the regulator be accountable. In respect of political advertising the conclusion reached was that, as things stood, regulation was not feasible both for reasons of principle (free press; freedom of political speech) and of pragmatism considering the problems associated with investigation, sanction and, most importantly, the co-operation of political parties. Fundraising via fundraising platforms is, however, a different proposition, and it is instructive to consider how it was possible for regulation, in contrast with political advertising, to make inroads into that area.



The Government made it clear that there was little prospect of statutory regulation of fundraising platforms being introduced. It asked the Fundraising Regulator and the Charity Commission to work with the platforms to address the public's concerns and promote high standards and good practice. Thus, it fell to the charity sector's statutory regulator for England and Wales, the Charity Commission, and a self-regulator, the Fundraising Regulator, which oversees fundraising by, or on behalf of, charitable, philanthropic and benevolent organizations in England, Wales and Northern Ireland, to act. The Government, while not willing to be directly involved, did remain very interested, looking particularly to the Fundraising Regulator, which took the lead in these discussions, to provide the Minister for Civil Society with reports on progress.

Bringing fundraising platforms into regulation

Through a series of meetings with many of the main online-giving platforms agreement was reached on a number of important issues. These included: working with the regulators to disseminate clear and consistent public advice about the choices available for donating; reviewing the platforms' counter-fraud measures and their resilience to fraud and creating a forum for sharing advice and intelligence about potential fraud threats; and recognising their legal responsibility to make clear to donors upfront what proportion of their donations would reach their charity by explaining their fees and charges (Charity Commission 2017). In addition, and importantly, it was confirmed that fundraising platforms would be allowed to register with the Fundraising Regulator and thus voluntarily comply with its regulation.

The platforms also agreed to work with the Fundraising Regulator on the introduction of a specific section in the Code of Fundraising Practice devoted to online fundraising. That section was introduced in June 2018 and includes, inter alia, obligations on the platforms to publish good practice guidance on how to set up a fundraising page. This covers raising money for a cause where no charity is identified as the beneficiary, and how an individual fundraiser should publicize their appeal to prospective donors on their fundraising page including who is organizing the appeal, what the money raised will be used for, and what they will do with the money if too little or too much is raised.

Conclusion

Unlike with political advertising, the reasons that prevented regulation of that subject were in respect to fundraising platforms either not present or could be overcome. As such, I suggest the following responses to the questions posed:

Yes, to whether regulation is both feasible and appropriate. However, as to the type of regulation and who will pay for it, considering that the Government remained interested in some type of control being introduced but uninterested in introducing statutory regulation, it was left to the Fundraising Regulator, a self-regulatory body, to do most of the heavy lifting with some assistance from the Charity Commission, with the sector paying. But it must be recognized that the Fundraising Regulator regulates with the consent of the fundraising community. If shaming and naming (for example, where things have gone wrong and the Fundraising Regulator's recommendations are not accepted) does not work, then the next step is for it to report the breach to a statutory regulator such as the Charity Commission or the Information Commissioner which have sharper teeth. The Fundraising Regulator is accountable to donors, the sector and to the public. Should it fail as a self-regulator, the Government may have no alternative but to bite the bullet and introduce statutory regulation of fundraising and to do so possibly by increasing the Charity Commission's jurisdiction to include fundraising platforms.

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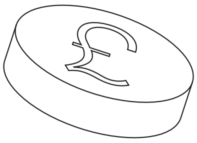

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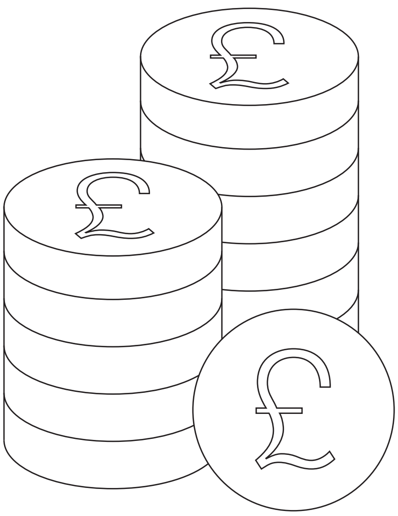


The transmission of credit risk within multinational business groups

Stefano Cascino and Maria Correia investigate default contagion within business groups

The importance of multinational business groups in the contemporary world economy is striking. About half of the world gross domestic product stems from foreign affiliates of business groups. Yet, little is known about how the interdependencies among group firms shape managerial decisions and the transmission of risk within groups.

Understanding the extent to which risk in general, and credit risk in particular, may be systemic to business groups is of paramount importance. Group bankruptcies tend to be large (e.g. Global Crossing, Maxwell, MG Rover, Parmalat), complex, and affect a significant number of stakeholders, often in multiple jurisdictions. Therefore, gauging the effects of group-affiliated firms' credit risk on group-wide financial health and assessing how business group information may be used to improve existing credit-risk models are important endeavours.

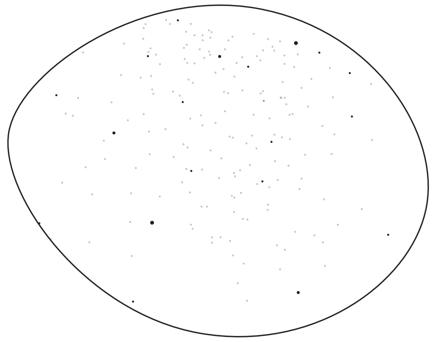
Credit risk, that is, the probability of financial default, affects firm value and the distribution of payouts to different stakeholders. Furthermore, while bankruptcy is a rare event, the costs associated with failing to predict default are substantial. Accordingly, academics and practitioners have devoted substantial attention to the prediction of firm default. Efforts to formally assess credit risk date back to the late 19th century, and currently involve the use of financial statement information, or a combination of financial statement and market price information in an unstructured or structured fashion.

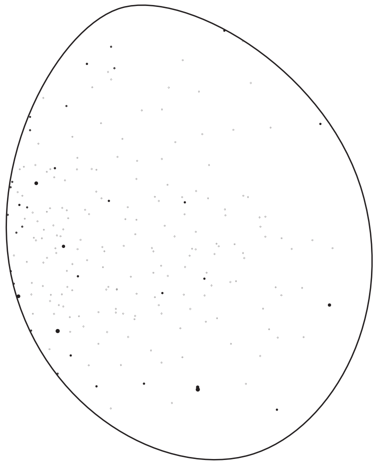
An important raison d'être of business groups is that ultimate owners can exert control over a large number of companies while containing their risk exposure to different parts of the business through limited liability. Unlike divisions of conglomerates in fact, business group subsidiaries are separate legal entities that can individually file for bankruptcy. Also, unlike conglomerates which have to absorb all of their divisions' losses to prevent their own bankruptcy, business groups because of their limited liability protection, may deliberately decide not to bail out distressed subsidiaries. Under the general principle of limited liability, business group parent firms cannot be held responsible for the obligations of their subsidiaries, and they may decide not to support a distressed subsidiary when this is too costly for the group. A business group may be required to support its financially distressed subsidiaries as a result of explicit or implicit agreements such as guarantees and comfort letters. In the absence of these agreements, a business group's decision to support a subsidiary depends on whether the expected costs of subsidiary bankruptcy outweigh the costs of offering support. The costs of subsidiary bankruptcy may include operational disruption, reputational damage, and default. Most importantly, in several countries, bankruptcy courts may rule to lift a parent's limited liability protection – so called veil piercing – and hold the parent firm responsible for its subsidiaries' obligations. As a result, the default of a subsidiary can impose non-trivial costs on the parent firm (among others: operational disruption, limited access to external capital, reputational loss). This, in turn, can generate a cascade of defaults within a group as in the case of cross-default clauses. Because of these costs and the possibility of veil piercing, parent firms may choose to support their financially distressed subsidiaries.

In two recent studies, we seek to understand how the failure of individual group-affiliated firms affects group-wide credit risk and how granular within-group financial information can be used to better forecast future bankruptcy events.

In Beaver et al. (2018a), we examine how corporate failure unfolds within business groups. Using a large cross-country sample of group-affiliated firms, we show that, by reallocating resources within the corporate structure, business groups actively manage intra-group credit risk to prevent costly within-group insolvencies. We find that large and diversified groups are more effective at insulating their subsidiaries from credit-risk shocks. Moreover, the pattern of capital reallocation appears consistent with groups supporting subsidiaries that are easier to monitor and whose insolvencies may spill over to other group firms. Finally, we document that recent regulatory changes related to the approval and disclosure of related-party transactions may limit groups' ability to shield their subsidiaries from credit-risk shocks.

In Beaver et al. (2018b), we propose a simple adjustment to traditionally used credit-risk models that can significantly improve their ability to predict the default of group-affiliated firms. We show that granular subsidiary financial information has incremental predictive power in consolidated group financial statements for parent default, especially when the financial reporting transparency of the parent-country is low and therefore the parent's consolidated statements are expected to be of lower quality. We further show that the predictive power of subsidiary bankruptcy models can be improved by including parent and other group-firms' financial information. To put the results of our study in context, one can think of parents as potential resources (obligations) for subsidiaries and, likewise, subsidiaries as potential obligations (resources) for parents. From a financial reporting perspective, these





resources and obligations represent off-balance sheet assets and liabilities in their respective financial statements, causing the 'true' firm leverage to be different from 'reported' leverage. Specifically, we find that a 1% increase (decrease) in parent default probability produces the same effect on subsidiary default probability as a 1.32% increase (decrease) in subsidiary leverage. This effect is higher for tightly controlled subsidiaries and subsidiaries with interlocked boards.

While these two studies focus on the transmission of credit risk, we believe understanding how other risks, including the risk of opportunistic earnings management (Beuselinck et al., 2018), propagate within the group is also of crucial importance to regulators, auditors, and financial intermediaries.

In conclusion, it is time to invest to improve the mapping of group structures and to look beyond the legal form boundaries of individual group-affiliated firms to unpack their interdependencies and better gauge their systemic risk implications.

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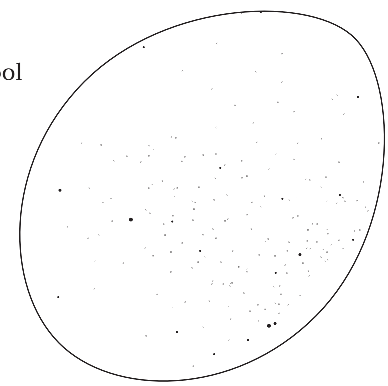

De-biasing administrative behaviour?

Tobias Bach, Kai Wegrich and **Martin Lodge** consider bureaucracies' inherent vulnerabilities

We all know stories about how bureaucracies fall short in identifying problems, seem incapable of tackling pressing issues, or fail to work together. What explains such accounts of bureaucratic dysfunction? One current response is to point to decision-making by individuals. Given a state of limited resources, individuals satisfice rather than seek out all options to address a well-understood problem, weigh these options and then opt for the 'best' one.

However, for explaining why bureaucracies fall short, such a perspective is inherently limited. It is critically important to understand how bounded rationality affects individual *and* organizational decision-making. Organizations are characterized by distinct biases in decision-making which shape the ways problems are identified, solutions selected, and interactions with other organizations conducted.

Organizational biases are critical for understanding the ways in which bureaucracies fall short in identifying problems or fail to cooperate. It is therefore organizational rather than individual biases that need to be put at the centre of attention. What, then, can we say about decision-making biases in a bureaucratic setting? What variety in decision-making biases can be distinguished?

The recently published book *The blind spots of public bureaucracy and the politics of non-coordination* identifies four different kinds of organizational bias. One type of organizational bias is *selective perceptions*. Such biases are reinforced by the task structure within organizations; the goal of a particular unit is not always aligned with the goals of other units within an organization, let alone with the overall goals of an organization. Selective worldviews therefore lead to coordination problems as units focus on their key priorities and thereby neglect areas of potential 'overlap' with other units. After all, individuals within organizations are rewarded for delivering policies in their area, even if this creates coordination problems further down the line.

Another type of organizational decision-making bias is *bureaucratic politics.* Examples of such biases are legendary; this is the territory of turf battles between different bureaucratic agencies, as expressed in a reluctance to exchange information, let alone working together, disputing other organizations' competence, or denying any form of responsibility for a given policy issue. All organizations are said to seek survival, autonomy from other organizations, stable resources, and popularity. They are therefore unlikely to welcome adding unpopular activities to their portfolio. Such reluctance can, for example, explain the presence of 'underlap' in bureaucratic life, i.e. the apparent disinterest of any organization in occupying a particular issue or problem, resulting in often vulnerable individuals falling between the cracks of organizational attention. Indeed, we find that 'underlap' is a much more common phenomenon than 'overlap'.

A third type of organizational decision-making bias is the *blind spot.* A defining characteristic of a blind spot is 'not seeing the not seeing'. In this case, the 'did not see it coming' emerges from a particular source – the genuine inability and incapacity to detect and process information due to an unawareness of its existence. Organizations are usually dominated by a particular profession's worldview that generates their very own blind spots. How a problem is defined very much depends on disciplinary upbringing. For example, it might be argued that prior to the financial crisis, the area of regulation suffered from a blind spot in that regulatory models relied on the capacity and motivation of financial institutions to risk manage themselves. Equally, disciplinary or professional biases emphasize some 'solutions' and are blind to others.

Finally, there is the so-called *Achilles' heel.* This is the kind of biases and vulnerabilities that emerges from particular organizational structures. As any connoisseur of football will appreciate, the way teams are organized has particular advantages and disadvantages; the proverbial 'parking the bus' (i.e. a highly defensive orientation) might increase the chances of muffling the opponents' attacks, but does not leave much scope for scoring oneself. Equally, organizing bureaucracy leads to certain biases: a 'flat' organization will inevitably have problems in filtering out proposals and come to clear decisions. In contrast, highly hierarchical organizations will have problems as information is distorted along the vertical production chain, while organizations set out as highly competitive will suffer from declining group work. The abandonment of individual performance pay in the public sector (as the case of New Zealand illustrates) is one example of responding to an increasing awareness of the Achilles' heel of such a highly individualist, competition-based arrangement.

Trying to address these biases is critical for reducing vulnerabilities to bureaucracies and to overall policy regimes. After all, attempts at managing financial vulnerability in health can enhance vulnerability to failure in other areas, such as quality management (as shown in the British Mid-Staffordshire hospital scandal).

Examples of de-biasing devices range from creating hybrid arrangements to balance, for example, financial and quality goals (so as to reduce the effects of Achilles' heel), designing joint-working and over-towering units, and individuals (to deal with bureaucratic politics), establishing interdisciplinary policy teams and challenge panels (to deal with selective worldviews), or imposing procedural devices (to deal with blind spots).

None of these options offers clear-cut remedies. They also introduce their own biases. For example, procedural devices, such as impact assessments or cost benefit analyses, are intended to create additional mirrors to ensure that policy-makers have enhanced vision so as to reduce their blind spots. However firmly such halls of mirrors are tied to the administrative decision-making process, one should never underestimate the capacity of organizations to creatively comply with these demands without really changing any behaviours.

In many cases, creative compliance strategies are even essential to address the biases introduced by such procedural devices. The 'one-in, two (or three)-out' rule for regulation is a good example. The underlying idea is to force bureaucracies to consider their regulatory 'stock' before allowing additional new 'inflow'. However, given the limited intelligence of such a provision that requires the scrapping of two or three regulations (or their equivalent cost) in order to allow for the introduction of a 'new' one, it is only understandable that creative counter-learning strategies have emerged. These include the discovery of zombie regulations that can be sacrificed on the scrapheap of 'bad regulation', creative accounting of costs or the reclassification of proposed regulations so as to ensure that one's own proposals remain exempt. The same holds for impact assessments; the comparison of different options often results in arbitrary and asymmetric beauty contests where the preferred option inevitably emerges victorious.

These examples are not intended to suggest that all attempts at de-biasing are inherently pointless or, worse, adding to vulnerabilities affecting bureaucratic decision-making. Instead, one needs to be aware of the biases of these devices as they represent a source of vulnerability themselves. In doing so one can move beyond the typical answer to questions of bureaucratic dysfunction offered by contemporary political science; somehow the 'agent' (bureaucracy) has succeeded in evading the mandate and controls of political principals. Similarly, for public administration watchers the answer to misfiring bureaucracies is usually also simple: the problem is likely to be political interference; if 'merit appointed' bureaucratic professionals were allowed to get on with their jobs, they would succeed. For others, it is all about a shortage of analysis and foresight in government due to a lack of specialist training, for example, in econometrics.

A focus on organizational biases also does not suggest that bureaucracy is inherently flawed. Nor do we imply that bureaucracy needs to be made 'more agile' by investing in one set of over-priced consultants or another. Instead, what we argue is that bureaucracy needs to be understood as a collective decision-making system where biases are inevitable. What is required is an understanding of the sources of *organizational* rather than individual biases in bureaucratic decision-making. This might then allow for 'smart de-biasing' that goes beyond ritualistic checklists downloaded from one behavioural insights team or another. Such an approach on individual biases will not work as the organizational biases outlined above are not cognitive shortcuts.

Bureaucracy's advantages, specialization and classification, are also its main vulnerabilities as it requires simplification of complexity. Therefore, our call is to take decision-making biases seriously and not ignore them through mystifying 'Weberian' bureaucracies or wishing biases away by advocating new forms of organization. Only by taking biases seriously is there any chance in mitigating the vulnerabilities of bureaucracy and, ultimately, in reducing the potential of bureaucracy to be a factor in generating vulnerabilities.

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See also T. Bach and K. Wegrich (2019, eds), *The blind spots of public bureaucracy and the politics of non-coordination*, London: Palgrave.

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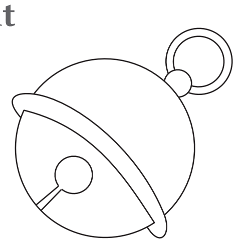
Speaking truth to power

Martin Lodge considers how questions of expertise and advice are central to understandings of contemporary executive government



Questions about 'speaking truth to power' and what qualifies as expertise are fundamental to the practice and study of executive government, e.g. the day-to-day management of the state. What is seen as competent and what particular forms of expertise are regarded as legitimate touches on fundamental questions about the confidence and trust of the wider political system, parliament and the wider public, in executive government. After all, this is the time when the wider [British] public is supposed to have had 'enough of experts'.[1]

Advice and expertise-related issues link to long-standing debates about what kind of skills and competencies are expected from public bureaucracies and how such expertise should be recruited, organized and rewarded. Questions about expertise and skills also touch on issues of loyalty. How should different forms of expertise be integrated and coordinated? What qualifies as a 'good' piece of policy-making in formal and informal ranking and evaluation systems? What mechanisms are taken to provide for 'balanced' and/or 'neutral' advice in executive government? What oversight or advisory bodies exist, if any, to ensure the impartial recruitment of expertise and the provision of 'speaking truth to power'?

Answers to these questions have changed over time. They relate to debates about loyalty and career structures, such as whether expertise and advice are provided as part of a 'personal' or 'partisan' loyal relationship between advice-giver and receiver, or whether expertise and advice are better organized on the basis of 'serial monogamy', i.e., the reliance on a permanent civil service that loyally serves the government of the day. Different kinds of advice-giving imply different kinds of loyalty understanding. Speaking 'truth to power' needs therefore to be understood in its diverse forms and potential consequences, whether it relates to questions about advising on ethics, political manoeuvring, or questions of scientific or legal expertise.

What is good, if not 'best in world' expertise and advice?

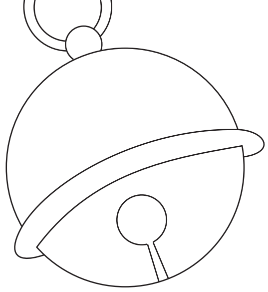
Debates about what constitutes appropriate competences and skills in executive government have varied over time, whether it is in terms of educational attainment levels, disciplinary requirements (lawyers vs economists) or types of skills (policy formulation vs. 'delivery'). Different views also exist as to whether government should have 'best in world' expertise in-house, or rely on the procurement of such advice, and/or see its role as a 'boundary-spanner', knowing where to find advice and expertise and bringing these together (Hood and Lodge 2006). For Max Weber, for example, civil service competence related both to subject and 'office' expertise (*Fachwissen* and *Dienstwissen*).

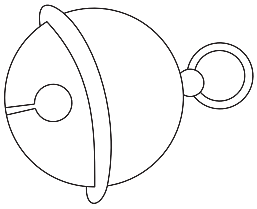
We also find differences in the ways in which official human resource management systems define 'competence', ranging from skills-based views to purely behavioural understandings (displaying some usually ill-defined 'excelling behaviours', for example). Examining the question of who defines what is competent and what is regarded as 'best in world' offers important insights into the ways in which the relationship between politics and administration is being defined. For example, it is suggested that in certain political systems the frame of reference for 'good advice' has changed, from one that is purely viewed in terms of 'good professional' advice to one that is 'good professional and politically useful' advice. Such changes in standards of reference to a more partisan and adversarial understanding of advice-giving, which some may call 'politicization', can have significant consequences, especially when it comes to legal-constitutional disputes about the extent of executive power.

How can 'best in world' expertise be recruited, organized and rewarded?

Different areas of government activity call for different types of expertise. In the UK, there have been attempts to formalize professional 'expectations' and demands on expertise through the creation of different 'professions', for example, the 'policy profession' (in contrast to, for example, the economic or 'counter fraud profession'). How such professional knowledge around policy advice can be created and developed is a challenging question. There are hardly any codified 'standards' when it comes to matters of policy formulation and the organization of public bureaucracy, unlike, for example, the legal or economic professions which have established knowledge bases, task areas and jurisdictions. Creating professional identities amongst experts providing advice also comes with certain risks. For example, if dominant professional understandings of what constitutes 'good expertise' crowd out potential sources of disagreement, this gives rise to concerns regarding 'conceptual capture', with risks arising from unquestioned shared worldviews between policy professionals, including regulators, and industries.

In certain areas of government, expertise might be highly specialized and in-house recruitment might compete with private sector organizations. One example was the call for 'trade poli-





cy specialists' in the context of the UK government's scramble for trade-deals post-Brexit. Another would be the search for 'big data'-related expertise in different public sector organizations. Such calls for the recruitment of lacking competency challenges standard bureaucratic career patterns. What kinds of career patterns exist and/or should be encouraged in these areas? Pay differentials between private and public organizations create a particular dynamic in terms of creating demands for 'creative' bureaucratic arrangements, such as revolving-door career patterns or a greater need to rely on so-called contractors which, in turn, increases the importance of expertise and advice on managing 'conflict of interest' and the creation of divesture rules. In other words, bringing in expertise is not just about ensuring the presence of specialist expertise on particular issues, it is also about safeguarding sufficient expertise to manage and organize recruitment and career patterns within executive government.

How to balance expertise and advice?

Debates about politicization often start with the basic dichotomy between 'partisan loyalty' and 'neutral competence'. Whether such neutral competence does exist is questionable. However, what steps can be taken that different aspects of a debate (amongst experts and between laypersons and experts) will be heard when there is a governmental preference for a specific kind of expertise that may come with a specific type of (desired) advice? Questions of ensuring an appropriate balance also point to issues regarding appropriate venues for advice-giving and expertise-sharing, given the often contested understandings as to what qualifies as 'legitimate' form of expertise.

There might be certain policy issues where expertise is highly concentrated and issue-specific. In such cases, it might be difficult to envisage how such expertise can be 'balanced'. For example, during a banking crisis, it is quite apparent that knowledge of banking is required, but a highly time-sensitive recruitment often collides with demands for vetting and avoiding conflict of interest situations. How such 'emergencies' are being navigated in times of crisis remains an under-explored research area.

Questions about biases in expertise have long-standing currency in debates about risk and science, for example whether experts wish to appear as, in the terms of Roger Pielke (2003), 'neutral scientists', 'science arbiters', 'honest brokers' or 'issue advocates'. However, the fulfilment of these roles relies on mutually shared understandings of appropriate forms of 'truth-telling'. The political appetite regarding the appropriate parameters of advice-giving and advice-accepting has proven to be highly variable across individuals and time. As in all relationships, such mutual understandings about roles and conventions are therefore also open to accusations of 'cheating' by the other side, for example, when advice proves not to be politically helpful.

How can advice-giving and expertise in government be monitored?

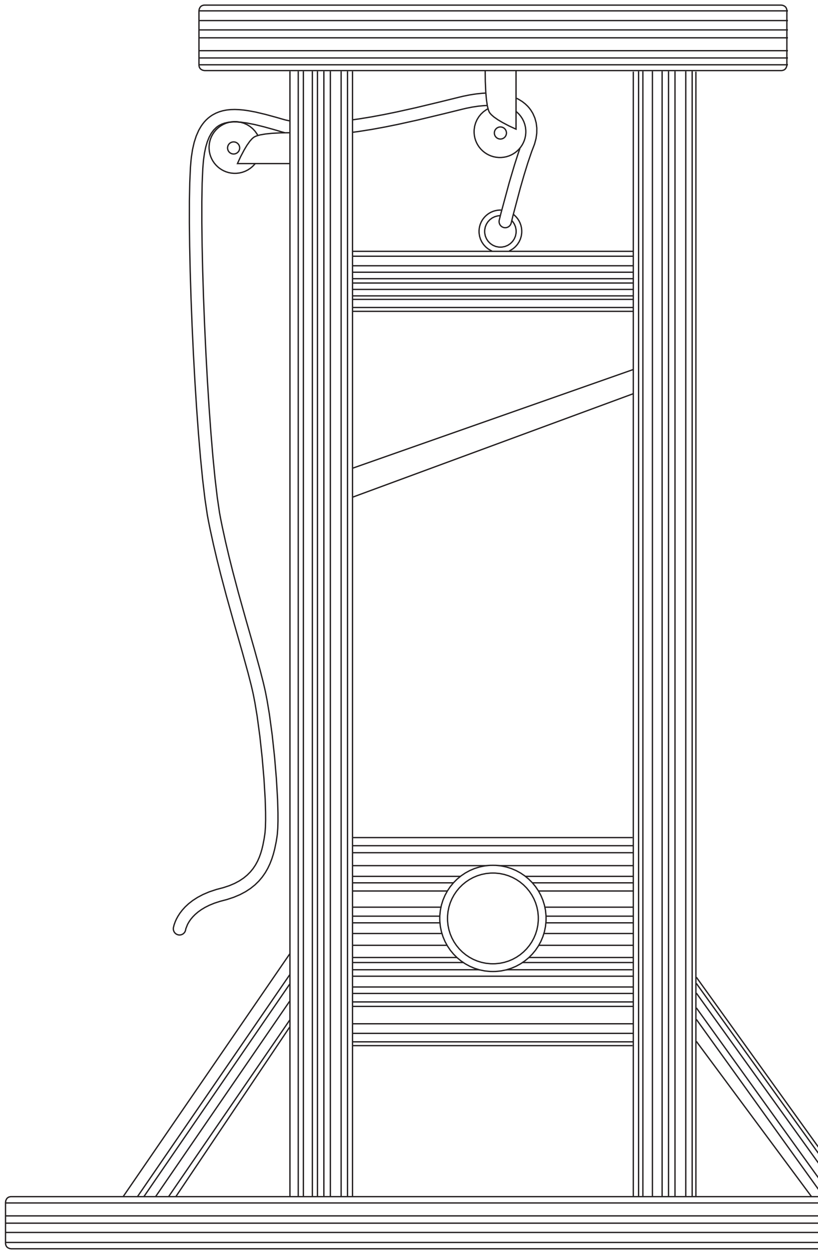
Finally, the reliance on particular bureaucratic arrangements (such as the recruitment of outside contractors and other short-term 'consultants' as well as a revolving-door career patterns) requires the development of specific expertise and advice capacity to deal with questions of procedural appropriateness, including ethics. The rise of ethics watchdogs in government can therefore be seen as a response to greater heterogeneity of career patterns within executive government. These bodies have, however, an unenviable set of tasks: How can recruitment of expertise be monitored to ensure appropriateness and balance, and what kind of powers should such monitoring bodies have? As the example of the US shows, the authority of the Office of Government Ethics is highly contingent on the willingness of politicians in power to respect that office in the first place.

The criticism that the public 'had enough of experts' points to a central challenge for the organization of executive government. There are different ways of 'telling truth to power' – how expertise is being defined and how this expertise is positioned vis-à-vis those in political power - and different political environments generate demand for different types of expertise.

For regulation, this poses two questions. One is what kind of expertise and competencies are required for regulators to understand and act upon changes inside (and outside) their jurisdictions. The other is how the recruitment of expertise and the operation of advice giving can be overseen – a context in which political authority expresses dissatisfaction with the traditional sources of advice is a distinctly uncomfortable place for those regulating the context of advice-giving.

This text reflects on the discussions at the **carr** workshop on ‘Advice and Expertise in Executive Government’.

1 As British cabinet minister Michael Gove put it during the 2016 Brexit referendum (‘Britain has had enough of experts, says Gove’, *Financial Times*, 3 June 2016).



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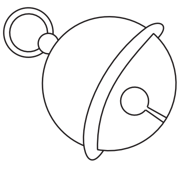

carr *news*

carr news

We say farewell to three of our research officers. **Lydie Cabane** has left to join Leiden University as Assistant Professor; **Jeremy Brice** has joined the LSE's Sociology Department as LSE Fellow; and **Alex Griffiths** has established his own consultancy company, Statica Research.

We welcome **Jose Bolanos** who has joined us as Research Officer. He continues **carr**'s co-financed work with the Food Standards Agency. Jose joins us from King's College London where he has finalised his PhD.

Congratulations to **Peter Miller** who has been elected as Fellow of the prestigious British Academy, the UK's national body for the humanities and social sciences, in recognition of his outstanding scholarship.

Congratulations to **Julia Black** who has been appointed to the Bank of England Prudential Regulation Committee. Congratulations also to **Mark Thatcher** who has been appointed as a member to the panel of the Competition and Markets Authority.

We are delighted to welcome two visitors to **carr** during this academic year: **Alison Harcourt** (Exeter) and **Alketa Peci** (Fundacão Getulio Vargas/EBAPE, Rio de Janeiro).

carr publications

Accounting, boundary-making and organizational permeability
Michael Power, Research in the Sociology of Organizations 57: 31–53.

Économicisation et démocratisation de la faillite: Inventer une procédure de défaillance pour les hôpitaux britanniques
Liisa Kurunmäki, Andrea Mennicken and Peter Miller, *Actes de la recherche en sciences sociales* 221–222: 80–99.

Flood crisis management in England
Martin Lodge in P. Laegreid & L. Rykkja (eds), *Societal Security and Crisis Management,* Palgrave, pp. 95–114.

The 2011 London riots
Martin Lodge in P. Laegreid & L. Rykkja (eds), *Societal Security and Crisis Management,* Palgrave, pp. 187–204.

carr events

In May, **carr** organized an international seminar on 'expertise and advice in executive government'. Among the speakers at this event were Arthur Petersen (UCL), Walt Shaub (Campaign Legal Centre), Karl R. Thompson (Jones Day) and Richard Banks (Policy Profession, HM Government).

As part of the international collaborative British Academy Newton Fellowship with Mauricio Dussauge at CIDE on 'Regulatory Capitalism and Development in Latin America', **carr** participated in a range of events in Mexico City in June. Together with Salvador Parrado (UNED), Sharon Gilad (Hebrew University Jerusalem) and Bruno Cunha (IPEA), Andrea Mennicken and Martin Lodge participated in a workshop on 'Regulation and Reputation' as well as in an international event on 'Regulation at the Crossroads' that considered different regulatory experiences and the future of regulation studies.

In September, **carr** hosted the second **Higher Education Roundtable.** We welcomed Dame Elizabeth Fradd who introduced the discussion on the theme of 'Preparing Higher Education Governance for Regulation? Lessons from other sectors'.

carr activities

Jeremy Brice presented a paper on 'Illicit meetings with horsemeat and how not to spot them: strategic ignorance, food supply chains and the horsegate affair' at the European Association for the Study of Science and Technology biennial conference in Lancaster in July. He also presented a paper on 'Technologies of ignorance and crises of trust: governing supply chain transparency and un-knowing the geographies of horsemeat' at the Royal Geographical Society Annual International Conference in Cardiff in August.

Bridget Hutter attended the annual meeting of the Law & Society Association in Toronto where she was discussant on a panel on 'Regulation and Power'. She also attended the annual meeting of the Nordic Societal Security Programme in Oslo where she chairs the Scientific Advisory panel. In August she completed her term as part of an Institute of International Education (IIE) Committee of the Rockefeller Foundation with a committee meeting in New York.

Martin Lodge presented joint work with **Lydie Cabane** from the TransCrisis project at the World Congress of the International Political Science Association in Brisbane, the ECPR Regulation & Governance conference in Lausanne, the ECPR general conference in Hamburg, a workshop of the international research group on Structure and Organisation of Government (SOG) at Potsdam University, and at a workshop on the future of executive politics at Vanderbilt University. During the visit to CIDE in June, he also acted as discussant at the OECD event in Mexico City on 'Measuring Regulatory Performance'. He also gave a lecture on 'Regulatory Capacity' at ENAP (Escola Nacional de Administração Pública) and contributed to a roundtable discussion on the regulation of logistics infrastructures at the Instituto Desburocratizar in Brasilia in June 2018.

Andrea Mennicken attended the 12th Interdisciplinary Perspectives on Accounting Conference in July in Edinburgh where one of her co-authors presented their paper on 'Accounting for immigration: everyday (e)valuation practices in the social media' (the paper is co-authored with **carr** Research Associate Silvia Jordan and Hermann Mitterhofer from Innsbruck University). Andrea Mennicken organized with Matthew Hall (Monash University) the Emerging Scholars Colloquium of the 12th Interdisciplinary Perspectives on Accounting Conference in July in Edinburgh.

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