

## **The Sedimentation of an Institution: Changing Governance in UK Financial Services**

### **Abstract**

The Financial Services Act (FSA) 1986 was the first comprehensive attempt to create a unified statutorily based system of regulation within the UK financial sector. It generated a framework of regulation that is in a continuous state of development and modification. In this paper we study the development of UK financial regulation between 1986 and 2011. We trace how competing theorizations and logics of regulation have led to the institutionalization of a meta-form of financial regulation. In doing so, we address the conundrum of conscious, strategic theorizations leading to cognitive taken-for-granted institutions by identifying four catalysts that contribute to institutionalization when concurring with theorization. These are: the evocation of political ideologies, the appropriation of scandals, the growing number of actors and the increasing organization of actors. Finally, we argue that sedimentation is the appropriate metaphor for the version of institutionalization occurring in this setting.

## 1. Introduction

Financial regulation has never really had good press. Despite much talk about deregulation, the number of laws, rules and external controls continues to grow in contemporary society (March, Schulz, & Zhou, 2000; Moran, 1991, 2003; Power, 1997). This is particularly evident in relation to financial markets where events such as Enron, WorldCom, Barings Bank and the global financial crash of 2007 – 2009 have raised questions about the role of deregulation of financial markets (Crotty, 2009). The events of the last few years suggest that deregulation has increased the amounts of risk for financial institutions leading in some cases to catastrophic losses and failures. In the US for example, there was the failure of Lehman Brothers. In the UK, Northern Rock and parts of Bradford and Bingley were nationalised and most of the other banks were – in one way or another rescued by the UK taxpayer. This has resulted in further demands for new legislation and calls for the decoupling of retail and investment banks as well as changes within the regulatory function in particular, the way it is organized and its nature and purpose<sup>1</sup> (Cukierman, 2011; Goodhart, 2008).

Against the background of these international events, the UK financial regulatory environment provides a captivating story about financial regulation – how it gained notoriety, and became synonymous with poor practice and failure(s) of governance. The story begins with the inception of financial regulation in 1986 when the Thatcher Government<sup>2</sup> unleashed the Financial Services Act (FSA) 1986 – otherwise known as ‘Big Bang’ in the UK financial environment (Singh, 2007). Prior to this Act, State intervention in the financial services sector was less direct and did not manifest itself in the form of regulation that contemporary financial services professionals are now faced with. The FSA 1986 generated a framework of

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<sup>1</sup> For an illustration of the common perception of the financial services industries see Vance (2009).

<sup>2</sup> The Conservative government came into power in 1979 under the Prime Minister Margaret Thatcher.

regulation that was in a continuous state of development and modification – a state that continued under the Financial Services and Markets Act (FSMA) 2000. Nevertheless, financial scandals continued – not just in banks but across the whole financial services sector. The Maxwell scandal in 1991 made the public wary of occupational pensions, the pensions mis-selling scandal<sup>3</sup> of 1988-94 made the public wary of personal pensions. Added to this, there was the mortgage endowment mis-selling scandal of the early 2000s (Farrow, 2002), the collapse of Keydata in 2009 (Levene, 2009) which sold structured products to investors the Payment protection insurance (PPI) mis-selling scandal of 2011 (Wearden, 2011) and the 2012 scandal around the mis-selling of interest rates swaps scandal (Grierson, 2012).

Despite these turbulences, financial regulation has become taken-for-granted as an inevitable response to all sorts of problems and scandals of contemporary financial services (cf. for instance Vit, 2007). Simultaneously, however, no distinct logic of financial regulation has been able to cement itself as the functionally appropriate solution – indeed, every version has been portrayed as failing. At the field level, we find proponents of different theories of financial regulation (be it market-based or more interventionist) engaged in fierce competition fuelled by various scandals. In this paper we address the question how these controversial logics, which are regularly perceived to be failing, have led to taken-for-granted State-led, organized financial regulation in its contemporary meta-form. Institutional theory gives us the vocabulary to address a more general and abstract version of this question: how do conscious and sometimes even strategic theorizations (Munir, 2005; Strang & Meyer, 1993) of actors lead to cognitive taken-for-granted institutions? This is the conundrum motivating the paper.

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<sup>3</sup> The personal pensions mis-selling review began in 1994, and was aimed at people wrongly sold personal pensions between 29 April 1988 and 30 June 1994.

This paper seeks to address this gap in our knowledge by tracing the history of personal / retail financial services in the UK from 1986 to 2011, and provides insights into how these regimes emerge and are shaped (Morgan & Engwall, 1999; Morgan & Knights, 1997). The case presented here offers an opportunity to consider from a long-term perspective, how various competing logics led to the sedimentation of an institution. Based on documentary analysis and secondary sources we trace the changes in financial regulations on three dimensions: the theorizations by actors, the institutional logics by which actors group themselves around more stable theorizations and the taken-for-granted, cognitive institution of financial regulation as such. Scrutinizing the connections between these dimensions we withstand the current fashion in institutional theory to confuse every kind of micro-level change initiative with substantial *institutional* change (Suddaby, 2010).

Our contribution is therefore two-fold: First, by observing the conundrum of active theorizations leading to taken-for-granted institutions, we identify four catalysts which benefit institutionalization when concurring with theorization. These are: the evocation of political ideologies, the appropriation of scandals, the growing number of actors and the increasing organization of actors. Second, we offer a conceptualization of the form of institutionalization which occurs in response to the theorizations and competing institutional logics by mobilizing the notion of sedimentation (Cooper, Hinings, Greenwood, & Brown, 1996; Kitchener, 2002; Tolbert & Zucker, 1996). We thus answer Munir's (2011) call for advancing institutional theory in the light of the recent economic crisis.

The paper is structured as follows: the next section explains the theoretical background. This is followed by a description of the research methods and sources of data. Section four provides a description of the process of evolution of the regulatory field over the last twenty-five years. Section five provides an analysis of this story in relation to the theoretical

background. This followed by a discussion of the implications and some conclusions for future research.

## **2. Theoretical Background**

Financial regulations come and go. In the past twenty-five years UK financial services have been regulated by different approaches. The question how to best regulate this sector has kept a plethora of regulators, regulatees and other stakeholders busy without reaching a convincing conclusion. While the volatility of regulatory approaches is well documented in the public media, so is the perceived need for financial regulation as such. Abandoning regulation for financial services is not an option anymore, a feeling strengthened by the turbulences of the global financial crisis of 2007-2009 and the more recent euro-crisis. As researchers, this leaves us with a conundrum: how did the various actions by numerous actors, which concerned themselves with devising regulation usually perceived as failing, lead to the successful institutionalization of financial regulation as a whole? Put into the language of institutional theory, how did the conscious theorizations of groups of actors lead to the sedimentation of a cognitive institution? In this section we will present some theoretical concepts necessary to unpack our conundrum and provide a background for the following empirical narrative. We will now elaborate on the concepts of theorization, institutionalization and institutional logics.

Let us start with actors trying to find the best possible financial regulation – their theorizations of financial regulation. Following Strang and Meyer's (1993) seminal interpretation, we define theorization as “the self-conscious development and specification of abstract categories and the formulation of patterned relationships such as chains of cause and effect” (p. 492). Put more simply “theorization is a strategy for making sense of the world” (p.

493). The concept has found its way into many models of institutionalization as a distinct phase (e.g. Greenwood, Hinings, & Suddaby, 2002) or part of one phase (e.g. Tolbert & Zucker, 1996). More recent authors (Birkinshaw, Hamel, & Mol, 2008; esp. Munir, 2005; cf. also Munir & Phillips, 2005; Perkmann & Spicer, 2007, 2008) have, however, established the insight that theorization is a process permeating all stages of institutional change. Theorization as a focus of research becomes even more important if we take the social constructionist roots of institutional theory seriously (Phillips & Malhotra, 2008). Tracing the social constructions of actors, especially their theorizations, can lead to deeper insights into institutionalization and institutional change, but has so far been curiously marginalized (Phillips, 2003; Phillips & Malhotra, 2008; Rao, Monin, & Durand, 2003, p. 835). From a social constructionist point of view, then, a crucial aspect of institutionalization is how actors make sense of their world by mobilizing or generating various theorizations. In our case actors try to theorize financial regulation and end up with several approaches to the phenomenon.

The other half of our conundrum concerns the concept of institutionalization. Given neo-institutional theory's early focus on isomorphism (DiMaggio & Powell, 1983), it has become something of a cliché to denounce the lacking attention to institutional change. More recent contributions, however, have increasingly focused on the process of institutionalization, the becoming of an institution. As Greenwood et al. (2008) and Phillips and Malhotra (2008) highlight, a major obstacle institutional theory had to overcome – in order to provide a meaningful theory of institutionalization – was a missing consensus on what an institution actually is. While some scholars have emphasized the rule-based regulatory nature of institutions (for instance Edelman, Fuller, & Mara-Drita, 2001), others have opted for an alternative, defining institutions as “more-or-less taken-for-granted repetitive social behavior that is underpinned by normative systems and cognitive understandings that give meaning to

social exchange and thus enable self-reproducing social order” (Greenwood et al., 2008, p. 4f). Again others, most prominently Scott (2008), have tried to reconcile these views. Phillips and Malhotra (2008) show that such a compromise fails due to the methodological and epistemological incommensurability of the two perspectives. Since studying theorization is argued to benefit from a rigorous social constructionist approach (Munir, 2005) we will use the second definition and conceptualize institutions through their taken-for-granted and cognitive aspects. This has two implications for our case study: First, the changing financial regulations in their various incarnations are not the institution(s) we want to discuss. Rather, we understand the cognitive pattern which underlies the idea of financial regulation as such, as the relevant institution. We will pick up this aspect in more detail shortly. The second implication of this social construction perspective is the conundrum motivating this paper which we now can frame more precisely: explicit acts of theorization by actors led to taken-for-granted institutions which lay beyond the realm of theorization. When theorizations (re-)occur, this is the trigger for a process of de-institutionalization, i.e. what was taken for granted ceases to be so and hence, is no longer an institution (Greenwood et al., 2002; Oliver, 1992).

Existing models of institutional change have only dealt with this conundrum to a limited extent. Offering a systematic overview of the plethora of models and approaches to institutional change, Van de Ven and Hargrave (2006; 2004) identify four distinct and internally consistent approaches. While all four perspectives (institutional diffusion, institutional adaptation, institutional design, and collective action) deal, to a varying extent, with forms of institutionalization, only collective action models fully allow us to observe theorization as part of an active social construction process (Greenwood et al., 2008). However, models such as Greenwood et al.’s (2002) do not provide detailed explanations about the connection between theorizations and institutionalization. Accounts which discuss actual theorizations in some detail (for instance: Munir, 2005; Perkmann & Spicer, 2007,

2008) provide rich evidence in this respect. Another approach, allowing for an assessment of theorizations particularly suited to our empirical investigations, is the recent debate around the concept of institutional logics (Friedland & Alford, 1991; Lounsbury, 2007, 2008; Rao et al., 2003; Thornton, 2002; Thornton & Ocasio, 1999).

In their review, Thornton & Ocasio (2008) emphasize that institutional logics provide a link between institutions and actions (p. 100). They argue that the benefit of the institutional logics approach in bridging this gap is that it focuses on institutional effects rather than focusing on non-institutional influences (p. 121). Following this approach, three levels of institutional logics are generally researched: the societal, the organizational field and the level of the individual. Each of the institutional logics found at one level of analysis corresponds to larger or smaller institutional logics at another level. Our own level of analysis is at the inter-organizational field level. We will use this level as a springboard to discuss the connections of our empirical observations to the other levels of institutional logics.

Following Thornton & Ocasio (2008, p. 101) we define institutional logics “as the socially constructed, historical patterns of material practices, assumptions, values, beliefs, and rules by which individuals produce and reproduce their material subsistence, organize time and space, and provide meaning to their social reality”. The focus on meaning and social construction provides evidence for the closeness of the concept to our understanding of theorization. Consistently, we understand institutional logics as groups of associated theorizations. Providing actors with patterns of values, beliefs etc., they constitute a frame of reference which is more institutionalized than the distinct theorizations initially constituting them. However, we are concerned with theorizations (rather than institutional logics) at the individual level, as we study conscious intellectual attempts to shape financial regulation rather than addressing questions associated with individual-level institutional logics such as



identities or identity work. In our empirical investigation we found four institutional logics competing at the field level: profession-based, State-based, market-based as well as market - and risk-based logics of financial regulation. At the time of writing none of these competing logics had marginalized others permanently but none had gained the status of a taken-for-granted, cognitive field-level institution (Greenwood et al., 2002) despite some degree of diffusion (Ansari & Phillips, 2011; Colyvas & Jonsson, 2011). At the field level we observed a dynamic process in which theorizations challenge and contaminate ideal type institutional logics. Our findings suggest, that despite the criticisms of the various incarnations of financial regulation, its' resilience can be explained by the idea that an institution had sedimented itself; financial regulation as such, and a certain meta-form of it has become beyond taken-for-granted. Note that institutional logic, as a concept, is a connection between wider society and the individual level; the fact that logics are competing at the middle field level is not the source of change but rather an outcome of change (Thornton & Ocasio, 2008, p. 118). Following this original interpretation of the concept of institutional logics we suggest that the field level is a pivotal link between single and distinct theorizations (or groups thereof) and larger institutions. Furthermore, we argue that, we need to better understand the mechanisms by which the three dimensions of our model depicted in *figure 1* are linked in order to fully appreciate the role of institutional logics in this process.

Our research therefore draws on three dimensions of taken-for-grantedness (theorizations, institutional logics, field-level institutions), depicted in *figure 1*. We will pick up on these three dimensions and how they help us to unpack the conundrum of conscious theorizations (dimension 1) resulting in taken-for-granted institutions (dimension 3) in the discussion section.

**\*\*\* insert *figure 1* around here \*\*\***

Our interest is to elaborate how strategic and intentional theorizations (dimension 1) lead to taken-for-granted, cognitive institutions (dimension 3) which are beyond strategic reflection (without a de-institutionalization process). As outlined by Thornton & Ocasio (2008), institutional logics serve as a linking concept between the individual and the societal level. The institution we scrutinize is financial regulation (in the UK) which firmly resides at the field level. On the other hand, institutional logics, link field and societal levels. This means that institutional logics and institutions form a dialectical relationship. Institution logics (e.g. market-based financial regulation) draw on institutions on various levels (e.g. the market) but since they inform actors' behaviour, they also constitute and reproduce these institutions. While prior literature has extensively discussed how large institutional logics such as market logics have shaped behaviour and institutions (Lounsbury, 2007; Rao et al., 2003; Thornton & Ocasio, 1999), we place our focus on how strategic theorizations influence institutions. Before we elaborate on the logics evident in the field of UK financial regulation and discuss the catalysts that ultimately led to sedimentation, we will outline the methods used in this study.

### **3. Methods**

To address our core objective to understand the formation of the regulatory field – in particular, the sedimentation of the institution of financial regulation and the competing logics and theorizations within it over the twenty-five year time frame, we conducted a qualitative analysis of a range of secondary and archival (documentary) data. As the formation of the regulatory field from 1986 to 2011 involved interactions between the regulators and the regulated companies, our analysis focuses predominantly on these actors. However, other actors, for instance: the Government, Government ministers; the Bank of England and the

Treasury, media correspondents, consumer groups and other regulatory bodies (such as the Office of Fair trading (OFT)) entered and exited the field at various stages throughout the process. The archival material encompasses the formal regulations of the time-period in question. This includes documents issued by the Securities and Investment Board (SIB) and associated regulators, as well as the Financial Services Authority (FSA). For example, publications, policy notices and documents, consultation papers, discussion papers, press releases, FSA Handbook of Rules and Guidance, policy reports and speeches and newspapers such as the Financial Times and other UK broadsheets (see Table 1 for a full list of data sources).

The documentary / archival data falls into two categories: the first set of data relates to phases 1-3 (1986-1997) when the lead regulator was the SIB. The second set of data phase 4 (1997-2011) was collected under the tenure of the FSA. The data set analysed in relation to phases 1-3 consists of both archival and secondary data. This includes documents from the SIB and associated regulatory organization. The secondary data is drawn from a series of studies on the regulation of personal financial services conducted between 1990-97 at the Financial Services Research Centre, UMIST, UK. These studies were undertaken by academic researchers (including one of the current authors) on behalf of a group of financial services companies and were presented to practitioners as unpublished ‘technical’ reports. Specifically, the data presented here is drawn from six studies that focused on strategic issues companies faced in relation to regulation. These in-depth studies provide rare insights into the impact of regulation on companies and their responses – providing valuable understandings of the role of various actors and their contribution to the various logics and theorizations in the formation of the financial regulatory field. The first study, (full details in Morgan & Knights, 1997) looked at the impact of the Financial Services Act on life insurance companies. The second is a study that focuses on strategic issues in personal financial services (Morgan,

1992). The third is a series of interviews conducted in 1995 on the Training and Competence Initiative and regulation more generally (reported in Morgan, 1995, 1996a) and finally, a questionnaire survey plus a range of interviews conducted by Morgan (1996a, 1996b) and Morgan and Soin (1999) that explored the impact of regulation, attitudes towards compliance and the role of compliance cultures within financial services organizations. In addition, the paper draws on the work of Morgan and Soin (1997) which provides an overview of the structure and function of The Financial Services Act (1986) – in particular the organization of regulation and the associated regulators. It also synthesises the six studies identified above and provides an in-depth narrative of the changes in the regulatory field from 1986 –1997. The aim of this chapter is to highlight the importance of the “organizational” approach to regulation (Morgan & Soin, 1999). This differs from the perspective presented in this paper that focuses on the sedimentation of the institution of financial regulation.

The findings in these reports were (re)-analysed in order to understand the practice of regulation, the strategies employed by companies and attitudes towards compliance within companies. Following Suddaby, Cooper and Greenwood (2007), these studies were not used a primary data sources, but to inform our understandings of the theorizations of a particular set of actors in this process – namely the regulated companies.

The data analyzed in relation to phase 4 (1997 - 2011) consists of archival data largely drawn from the FSA and newspaper articles. A range of documents were examined including: FSA publications, policy notices and documents, press releases, consultation and discussion papers and progress reports. The data is therefore predominantly accessed via written material and the external communications of regulators. While this might not be adequate for all fields of research we argue that it is suitable for financial regulation. Whereas in other, non-regulatory, fields the tacit interpretations of actors and subsequent actions are of paramount importance,

regulation can by definition, only have effects when it is expressed verbally or more commonly in written language. Therefore we take the written regulation and to a lesser degree public statements of their intentions as deliberate and carefully constructed – providing evidence of actors’ theorizations and the social construction shaping institutions.

The data was analysed in an iterative process in which each author first identified central themes: the main organizational actors in the field (see table 2) and the four phases of regulation (see table 3). This was followed by a further round of data interrogation in which we developed understandings of the theorizations of organizational actors, the under-pinning logics and how these logics were changing through the phases. This led us to a final iteration in which we identified our four catalysts that, we will later argue, contributed to the sedimentation process. We argue that institutionalisation occurs when things get ‘taken-for-granted’ i.e., they are not ‘talked about anymore’ in public discussions and hence become sedimented in some way. One such example could be the risk-based approach: post financial crisis, the discourse and theorizations have shifted to pronouncements around the end of ‘soft touch’ regulation (Elliott, 2008) and more ‘intervention’ and ‘intrusion’ at the product design stage (FSA, 2009a, 2009b, 2011b). Nevertheless, the risk-based approach is still a central feature of the regulatory approach adopted by the regulator. We will discuss the theoretical mechanisms underlying this process after presenting our empirical material in depth in the next section.

#### **4. The Regulatory Structure (1986 - 2011)**

In this section we trace the development of UK financial services regulation in some detail. We start by outlining the key organizations and their foundations in chronological order. The main part of this section addresses the four phases of financial regulation from 1986 to the

present day, and introduces what the actors in the field recognize as contemporary financial regulation. Each phase is characterised by the (co)existence of four competing logics – the profession-based, the State-based, the market-based as well as the market- and risk-based logic – but in each phase one dominates. In phase one, the phase of “practitioner based statute-backed regulation” (Laurence, 1999p. 662) the profession is presented as the dominant logic. Organizations in the field were encouraged to regulate themselves through normative isomorphic pressures expressed between practitioners. In this phase, the coercive pressure of the State is largely absent. In phase two, the dominant logic was the State and this phase was characterised by “command and control”, “State intervention” and “protection”, which resulted in rigid enforcements that were argued to inhibit innovations. In the third phase, the phase of “competition” and the “the market”, it is the market logic that dominates. Finally, the fourth phase presents a variation of market-based regulation by emphasising the notion of risk within this frame. Buzzwords such as “risk-based regulation” and “risk management” dominate in this period. These phases are not static or discrete; instead, they are dynamic, overlapping and fluid with the preceding phase loosely merging into the next.

### *The Emergence of Financial Regulation in the UK*

Before we elaborate on the individual phases and logics we will provide an overview of the main organizational actors in the field, the organizational dramatis personae of our story. The Financial Services Act (1986) resulted in the implementation of a regulatory framework that had a largely self-regulatory element and consisted of a two-tier structure. Regulation of securities and investments was delegated to the Securities and Investment Board Ltd (SIB). The SIB was a private company and had a legally private character. It was funded via a levy on the markets and its members were appointed jointly by the Secretary of State for Trade and Industry and the Governor of the Bank of England (Morgan & Soin, 1999). Major areas

within the financial services sector were overseen by self-regulatory bodies (SRO's) – under the overall supervision of the SIB, which was responsible to Parliament – initially through the Department of Trade and industry and then through the Treasury (Clarke, 1999; Laurence, 1999). The SIB had four main tasks. The first was responsibility for devising 'model rules'. The second was a policing role in respect to a range of offences against the Act. The third responsibility was for the licensing and supervision of individual businesses (although in general, it encouraged businesses to join the lower tier regulators – the SRO's). Finally, it was responsible for authorising the 'self-regulatory organizations'.

The SRO's were core to the regulatory process. Their principle function was to authorise members to carry out their particular business and they were responsible for the licensing and supervision of individual businesses. Any investment business which operated without authorisation was subject to fines and imprisonment (Morgan & Soin, 1999; White Paper, 1985). Five SRO's were initially established: FIMBRA (the Financial Intermediaries, Managers and Brokers Regulatory Association) and LAUTRO (the Life Assurance and Unit Trust Regulatory Organisation) were the SROs responsible for ensuring the protection of investors in the market for retail investment products. The AFBD (the Association of Futures Brokers and Dealers) licensed and supervised firms in commodities and futures. The TSA (the Securities association) was formed from the old regulatory arm of the Stock Exchange and IMRO (the Investment Managers Regulatory Organisation), specialised in the regulation of investment fund managers. In 1991 the AFBD and the TSA combined to form the SFA (the Securities and Futures Authority). In 1992 FIMBRA and LAUTRO, as well as some parts of IMRO, combined to form the PIA (the Personal Investment Authority), which was responsible for investor protection for retail financial services. The PIA regulated banks, building societies, insurance companies and brokers. *Table 2* provides a summary of the regulatory organizations and their tasks.

The Financial Services Authority (FSA) was formed in 2001, under the Labour Government, which came to power in 1997. The two-tier structure (of SIB and the SRO's) was abolished and, in an attempt to eliminate the fragmented nature of regulation, the Government imposed consolidated State regulation for the financial sector. The Authority is the single statutory regulator directly responsible for the regulation of deposit taking, insurance and investment business. The FSA adopted an integrated approach to authorising firms. There is a single process, common to all applicants, which enables a firm to seek permission to conduct a number of different regulated activities (FSA, 2000a, 2000b). There is also an emphasis on *both* consumer and practitioner involvement (FSA, 1997a, 1997c). FSA staff are drawn from a wide range of backgrounds – financial, industry, legal and accounting professions, the civil service, other regulatory bodies and consumer organisations. In addition, individuals are seconded to and from other relevant sectors. The FSA's approach suggests that companies with 'good' risk management systems will face a 'lighter' regulatory touch. And, the regulator will be making assessments of a company's commitment to regulatory objectives, their record of compliance, the quality of management – in particular, senior management responsibility – and capacity to comply. These considerations will influence the regulators motives to intervene in a company's affairs (FSA, 2000a, 2002, 2006d).

**\*\*\* insert *table 2* around here \*\*\***

### **Phase 1: 1986 – 1988: Profession-based logic**

In 1986, a complex web of events, competing political logics and theories on how financial markets work culminated in the Financial Services Act (1986) otherwise known as the 'Big



Bang' of UK financial regulation (Singh, 2007). From its inception political ideologies had a decisive influence on financial regulations, especially in the form of the rhetoric of deregulation<sup>4</sup>. Deregulation was theorized as a response to demands for a more flexible market organisation, the development of overseas investment and international trading in equities, improved technology and communication, and the developing role of institutional investors in the market. Government, regulators and regulatees alike argued that deregulation would enable London to attract a substantial proportion of international financial business (Morgan & Engwall, 1999). Successful regulation was theorized as one of non-intervention and a conviction that free market forces, healthy competition and self-regulation would provide effective regulation (Augur, 2000).

As the field was still in its infancy, only a limited number of actors participated in the debates leading to the 1986 regulation: The Government, the Bank of England, the Treasury, SIB, the SROs and the regulated companies. There was a general feeling of uncertainty about the purpose and nature of the regulatory process and consequently the organization of the regulators was highly fragmented (Morgan & Soin, 1999). Soon, a powerful group of actors emerged to fill the lack of meaning of financial regulation: industry professionals and practitioners. These practitioners shaped, through their theorizations, the logic dominating this phase of financial regulation. This interpretation is strengthened by the SIB's first Chairman, Sir Kenneth Berrill, who characterised the logic of this phase as being "practitioner-based, statute-backed regulation" (Laurence, 1999, p. 662) or, 'self-regulation with significant practitioner input' (SIB, 1990, p. 4). The influence of practitioners is reflected in the

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<sup>4</sup> Deregulation, although widely considered to be a genuine alternative to regulation, usually encompasses a large amount of rules and regulations. The difference is that the state takes on an alternate role: instead of direct intervention, the state takes on the function of a 'game-keeper' enforcing the rules of the game. This enforcement is, however, again achieved through rules and regulation (Harcourt, 2011). The situation is further complicated as professionals in the field, as we will see, promoted a theorization of regulation which rhetorically drew on deregulation but involved other interpretations of the term.

governing body which comprised key individuals from the financial services sector because this was seen as the source of the most qualified people (Moran, 1991) – people who were theorized to understand the markets better than the regulators.

This first phase of financial regulation focused on establishing the system. While regulatory agencies participated in this initial phase, it was the practitioners' theorizations that exerted the strongest influence over regulation. Consequently, the predominant governance mechanism in this phase drew on a professional logic. Professional governance is characterized by relatively loose accountability, a high degree of autonomy and a preference for collegial or peer-based controls (Greenwood, Hinings, & Brown, 1990). Thus, in this stage, practitioner based controls and self-regulation were theorized as superior to coercive State controls. Regulation by the State was seen as 'unnecessary' and 'disruptive' and the regulators had to continually justify their actions to the regulated companies (Morgan & Soin, 1999).

In a climate of neo-liberalism, practitioners drew strategically on political ideologies to promote their version of deregulation. In the 1980s political climate of 'Reaganomics' in the US and 'Thatcherism' in the UK, deregulation was a fashionable discursive resource. However, the practitioner logic actually differed from pure neo-liberal economics as the State was not theorized as the 'game-keeper' and market mechanisms were largely absent. We can therefore identify the first catalyst which helped theorizations permanently shape an institution: *the evocation of political ideologies*. We will return to the relevance of this catalyst for the sedimentation of an institution later. For now, it is important to note that these theorizations did not remain unchallenged by other logics.

In competition with the profession-based logic, the State-sponsored Gower report (1982, 1984, 1985) identified four areas of concern with respect to investor protection: First that there was no single, regulator, prosecutor or complaints bureau. Second there was nothing to regulate takeovers and third, there was virtually no regulation of the marketing of investments, ‘cowboy’ fund managers and investment advisers. Finally, the scope and amount of investment by consumers was increasing. Essentially, proponents of State-based regulations challenged practitioners’ theorizations by suggesting the need for regulation in the name of investor protection.

After a relatively short period of domination of profession-based theorizations, the competition between practitioners and advocates of State intervention escalated in late 1987 and early 1988. Some practitioners felt that Sir Kenneth Berrill, the founding Chairman of the SIB was promoting an approach that was too ‘legalistic’ and ‘inflexible’. What were described as “powerful groups within the City” (Financial Times, 29 March 1988; Sunday Times, 21 February 1988) managed to prevent the renewal of Sir Kenneth Berrill’s contract as head of the SIB. Despite this success, the rule of practitioners started to wane after proponents of a more interventionist theorization of financial regulation were provided with heavy ammunition, in the form of problems with the commission based reward system and the mis-selling of financial products – the most striking of which was the pensions scandal: The essence of this scandal was that between 1988 and 1994, many people had been persuaded to leave perfectly respectable pensions schemes and invest the lump sum withdrawn into a personal pension. As a result, many were found to be worse off when they came to pensionable age than they would have been if they stayed in the same occupational pension scheme (Morgan & Soin, 1999). Through the theorization of this scandal, practitioners lost influence. The scandal was connected to issues surrounding financial regulation and practitioners could not provide a credible response. As we will see, the pensions mis-selling

scandal could not be convincingly addressed until 1997. For now, however, it is important to note that although financial regulation had not yet found a specific form or wide-spread legitimacy, the debate was picking up pace.

### **Phase 2: 1988 – 1993: State-based logic**

The pensions mis-selling scandal and the commission based reward system proved to be a decisive moment in the early incarnation of financial regulation in the UK. Actors who theorized the scandal as tightly linked to overall financial regulation, reaching far beyond advice on pensions, quickly gained power. A side effect of these competing theorizations and logics was that financial regulation as such started to cement itself in both the minds of actors and the general public. We therefore identify the *appropriation of scandals* as a second catalyst for the sedimentation of an institution. Nevertheless, at this stage the sedimentation was not very far advanced.

Now the pendulum had swung in favour of proponents of State intervention – mainly the regulatory bodies themselves – a different kind of regulation was dominating: a State-based logic of regulation. Self-regulation was now deemed ineffective (Morgan & Soin, 1999). Under the State logic of financial regulation, there was a shift to a more ‘interventionist’ approach by the regulator. And, although the structures didn’t change, the way they operated did and, as a result of the theorization of the scandal, the discourse on regulation shifted towards customer and investor ‘protection’.

Another important aspect that was evident in this phase was that the debate became more institutionalized as more actors entered the field. While the abstract category of “the consumer” was frequently evoked in public debates, two more distinct organizational actors emerged: first the Office of Fair Trading (OFT) entered the fray. The OFT (1993a, 1993b)

came up with a number of criticisms of the commission based reward system most notably that they were concealed from the public. On the back of this, SIB introduced another actor – an independent consultancy service – National Economic Research Associates (NERA), to consider the impact of disclosing commissions. Their most prominent theory was that disclosure would increase competitive pressure in the industry and enable consumers to make a ‘better informed’ choice about products (Morgan & Soin, 1999). These new actors still drew loosely on the rhetoric of neo-liberalism but de-emphasized the deregulatory aspects.

Interventionist changes by the State related to two key principles – ‘know your customer’ and ‘best advice’. The objective underlying these was to ensure that: “the seller of the product had gathered sufficient information about the current and future financial position of the client to enable him / her to advise on the best product (and premium level) out of the portfolio of products which they were authorised to sell” (Morgan & Soin, 1999, p. 170). A key aspect of this related to sales force training. It emerged that: “...there was little or no training for sales people in most companies. As their earnings were usually based on commissions, they were only paid when they sold. Companies therefore took on more and more sales people to whom they gave minimal training – perhaps a couple of days. The sales people then either sank or swam! Either way, it cost the companies very little because of the commission system... ..The notion that people with a couple of days training could even come close to meeting ‘know your customer’ and ‘best advice’ requirements was untenable” (Morgan & Soin, 1999, p. 171). LAUTRO intervened by introducing the Training and Competence Initiative (TCI). Under this initiative every member of LAUTRO had to produce a scheme that showed how they were going to train and develop their sales force.

Again, the prevalence of this logic was only temporal. By 1991 several of the regulatory agencies’ theorizations of successful financial regulation faced dissent by other actors. Soon

the market-based logic would take over as the dominant logic, promoting yet another interpretation of deregulation. As part of this struggle, the various regulatory bodies offered competing assessments of the situation and the on-going pensions mis-selling scandal. SIB and LAUTRO in particular disagreed on a number of issues. Questions started to (re)-emerge about the nature and purpose of and the role of the regulatory bodies – as well as the style, structure and effectiveness of regulation (DTI, 1992a). SIB, in its role as lead regulator, was forced to act on these controversies but it could only act through the SROs which remained dominated by industry interests i.e. the professional logic. In 1992, perceived problems of legitimacy and lax monitoring procedures, in particular on the part of LAUTRO, triggered the merger of LAUTRO, FIMBRA and parts of IMRO into a new regulatory authority, the Personal Investment Authority (PIA). Once again, the field had been re-shuffled, both in terms of power structures and in terms of organization of the sector.

This phase has a number of common features with the phase preceding it: different actors compete in promoting their theorizations with only the temporal prevalence of a single logic. However, the discourse has already sedimented itself in a more solid form: financial regulation, despite disagreement on its shape, has become largely taken-for-granted. A key factor we can identify in this process is our third catalyst: *the growing number of actors* participating in the field. The discourse of financial regulation had to reach a critical mass in order to become taken-for-granted. Additionally, one of the new actors in this field, NERA, proved to be a successful advocate for a new logic of theorizations in the next phase: market-based regulation.

### **Phase 3: 1993 – 1997: Market-based Logic**

In 1992 the pensions mis-selling scandal was still widely discussed in the field. Here we learn something important concerning our catalysts – in particular, the evocation of ideologies

(catalyst 1) and the appropriation of scandals (catalyst 2), which is, that these strategies are not exclusive to one group of actors. The theorization of the pension mis-selling scandal as an issue of financial regulation came back to haunt the proponents of the State-based logic as advocates of the competing market-based logic turned their own arguments against them by connecting the scandal to deep-seated issues about the way in which financial products had been sold. In this phase the market was the dominant logic perceived most suitable to address past problems. Again neo-liberal ideologies of deregulation were evoked – although this time emphasising the market mechanism. A powerful actor advocating this group of theorizations was the new Chairman of the SIB from 1992-1997, Andrew Large. His arguments were most apparent in the Large Report issued in 1993.

The Large Report provides an influential example for a new form of theorization. Prior practices of the lead regulator SIB were portrayed as lacking “bite” (specification) and thus market-based regulations were justified as a veritable course of action. Current practices (like concealing commissions) meant “that there could be no proper ‘choice’ and therefore no proper market in which competitive pressures could operate” (Morgan & Soin, 1999, p. 176), and that the “role of regulation was to act in order to ensure that such a market came into being”, (Morgan & Soin, 1999, p. 176). This idea of regulation as ‘market-making’ was, part of the broader neo-liberalist agenda, or free market dominance, that was taking place in other sectors in the UK at the time for example, utilities.

Morgan and Soin (1999, p. 176) highlight an interesting aspect of the pervasiveness of the market-argument in the field: There was a shift in emphasis from investor ‘protection’ to investor ‘choice’. This effectively shifted responsibility onto the consumers and crucially, away from the regulators. In addition, “this language of the market and choice also resonated with that of the companies themselves. It made it harder for them to resist the logic of the

regulators, reducing them to the claim that customers did not want to know these sort[s] of details.” Morgan and Soin (1999, p. 176). Once again, the rhetoric of deregulation resurfaced in yet another form. The Deregulation Task Force that was set up by the Government to tackle ‘red-tape’ placed a firm emphasis on the notion of “regulatory effectiveness”, arguing the need for cost benefit analysis of regulatory actions (DTI, 1992a, 1994; Deregulation Initiative 1996a, 1996b, 1996c).

These theorizations manifested themselves through distinct changes in the field. Two noteworthy developments concerned the regulatory SROs and the consumers. First, some of the SROs, namely FIMBRA, LAUTRO, and IMRO, were merged in 1992 to form the Personal Investment Authority (PIA). The PIA went on to promote a more homogenous and market-based theorization explicitly developing a strategy involving consumer representatives and consumer opinions (Morgan & Soin, 1999, p. 178). The PIA was made up of a governing body of non-industry representatives for example, academics and consumer lobbyists. In 1996, they created a special Consumer Panel (PIA, 1996b, 1996c) as a means of bringing the consumer into the regulatory debate and so, another new actor entered the regulatory field.

In this phase we can observe the fourth and final catalyst of the sedimentation of an institution, the *increasing organization of actors*. The more fragmented actors such as the diverse regulatory agencies and the formerly disorganized “consumers”, while not including all participants of their respective categories, became more organized and structured, promoting certain theorizations and logics. This further institutionalized the need for financial regulation as well as the debates around its form. As we will see the specific form proved unstable, yet the debate took on a more coherent and sustained form. Simultaneously, however, actors promoting different theorizations and logics still competed.



In contrast to SIB, the PIA developed a different idea of ‘regulatory effectiveness’ which was to be measured in a range of ways, most of which were not financial but were indicators of the quality of selling, for example, the persistency ratio. In an effort to further organize the different actors, the PIA instituted what was known as the Evolution Project (PIA, 1996a) “to discuss with a wide range of stakeholders including companies the future direction of regulation, including the possible selective elimination and/or reduction of certain regulatory requirements” (Morgan & Soin, 1999). These activities further contributed to the tensions, conflicts and contradictions between the regulators particularly, as this was at odds with the SIB’s approach that markets and competition could sit comfortably together. The PIA also became embroiled in the aforementioned pensions mis-selling scandal which ultimately undermined its credibility.

Despite the Deregulation Task Force and neo-liberal ideology, proponents of State intervention still had a say in the field and challenged the dominant market-based logic. The State logic was clearly evident in the activities of the PIA and its’ pursuit of consumer protection, rather than ‘choice’. A further example of the lingering State logic relates to initiatives around training and competence – but there was a notable shift in tone. For example, the Training Handbook (IMRO, 1996) was written to “assist Firms with the implementation of the Training and Competence Rules and Code” (p.5), stating that (the Training Handbook) is ‘not formal guidance and is in no way meant to be prescriptive’ (p.5).

In this phase we saw a more structured and advanced debate on financial regulation in the UK. All four catalysts were evident to varying degrees in the struggles and social construction processes of actors. The pension mis-selling scandal continued to be used as ammunition to torpedo other competing logics. Political ideologies, neo-liberalism and deregulation more specifically, were evoked and appropriated to fit rivalling theorizations. Although more

people participated in the discourse, i.e. the number of actors grew – they were organized more tightly promoting a more limited set of theorizations.

The institution of financial regulation in its meta-form had already sedimented itself to some degree that is to say, a constraint on what is thinkable and legitimate i.e. the cognitive taken-for-granted nature of an institution. Parts of the discourse, such as the profession-based logic or the abandoning of financial regulation in its State-led form, were already excluded from the debate. Therefore we see a process of the institutionalization of financial regulation, despite the individual regulations being continuously theorized as failing. This process continued in the next phase.

#### **Phase 4: 1997 – present: Market- & Risk-based Logic**

In phase four, the dominant logic of financial regulation is what we term a market- and risk-based logic because it essentially relies on market mechanisms extended by theorizations incorporating the notion of risk. Despite the election of a new Labour Government in 1997, neo-liberal ideologies continued to be evoked because the new Government wanted to distance themselves from the old style paternalism they had traditionally been associated with – and were intent on pursuing the former Governments policy on ‘rolling back the State’. While a new range of actors enter the field, the evocation of a neo-liberal ideology (catalyst 1) continued.

The Labour Government maintained the commitment to market-based regulation, but was also keen to emphasise its dedication to consumer protection and consequently the number of actors further increased. A Financial Services Consumer panel was set up in 1998, the Chairman was the former Chairman of the PIA consumer panel that had been set up in 1996 (FSA, 1998b). Consultation papers such as FSA (1998b) focused on both consumer and

practitioner involvement as well as input from other groups “including public and voluntary bodies with an interest in consumer protection, ... (in particular, lawyers and accountants), other experts (for example, actuaries, academics and think tanks) ...” (FSA, 1998b, p. 3). In addition, another – maybe even stronger – variation on the theme of market-based financial regulation was provided in subsequent regulations by a new focus on risks and risk management.

The market ideology adopted by the SIB was broadened to encompass the ‘risk-based’ approach to regulation (FSA, 1998a; Hutter & Power, 2000) and is based on the Turnbull guidance (ICAEW, 1999). Significantly, risk-based regulation is about regulatory agencies becoming explicit about their limited resources and the need to direct them to where they are needed most (Power, 2007) – thus continuing the ideas around cost effective regulation that were apparent in phase three (FSA, 2006c). While this can be traced back to the Large Report (1993) (cf. phase 3), this change was coupled with the creation of a new regulator – the Financial Services Authority (FSA) which was formed in 2001, and assumed its powers under the Financial Services and Markets Act, 2000. In effect, the regulatory actors become more organized (catalyst 4): The FSA was a single super-regulator, which took over the functions of SIB, the SROs and part of the functions of the Bank of England.

This new set of theorizations further marginalized the earlier State-based logic. For instance, the FSA Training and Competence Sourcebook (FSA, 2000c, p. 1) states that: “The rules and guidance set out in the T&C sourcebook provide the industry with a more flexible and less prescriptive approach to meeting the appropriate standards of competence for employees”. And, instead of rule-making based on detailed prescriptions, there was a shift to high-level principles (FSA, 2000a, 2006d) for example, by reducing ‘the scope of our detailed rules on training and competence’ (FSA, 2005, p. 1). In 2006, the Chief Executive of the FSA argued

that there was a danger that ‘we’ (the regulator) are heading towards over regulation and that “only carefully judged regulatory intervention can add to rather than detract from the positive impacts of market forces.” (FSA, 2006a)

Proponents of the market- and risk-based logic theorized the regulatory agencies as taking a strategic overview and disengaging from operational questions. As (Haines, 1998, p. 335) highlights: They took a “flexible approach to setting standards and supervision, reflecting the nature of the business activities concerned, the extent of risk within particular firms and markets, quantity of firms management controls and the relative sophistication of the consumers involved” For example, the FSA started a campaign of ‘naming and shaming’ companies who had not responded swiftly enough the pensions mis-selling crisis highlighted above (FSA, 1997b, p. 31). Again, the scandal was used to blame divergent practices, this time publicly. Ironically, the pensions mis-selling scandal which was first used to target profession-based theorizations by advocates of the State-based logic was then used to undermine this very State-based logic and even some proponents of market-based versions of regulation.

The market- and risk-based form of financial regulation enjoyed a relatively long tenure. We hypothesize two possible causes for this success: First, the sedimentation process had advanced to a considerable stage, effectively narrowing down thinkable alternatives and legitimate theorizations of financial regulation. The very concept of sedimentation suggests that actors’ efforts to de-institutionalize an institution will face stronger opposition as the sedimentation process advances – as will daring and new theorizations. The second possible reason for the success of the market- and risk-based logic of financial regulation is the absence of catalyst two, the appropriation of scandals, in the early 2000s. The IT-bubble that hit the US hard and the collapse of WorldCom and Enron were not theorized as connected

with faulty UK financial regulation – at least not by the most powerful actors in the field. This underscores our argument that scandals need to be theorized in order to have an effect on the sedimentation of an institution and do not do so automatically.

The story of UK financial regulation took a sharp turn with the global financial crisis of 2008. At the time of writing more interventionist ideas have started to re-surface based on theorizations of the crisis. In 2008, the chairman of the FSA announced the ‘days of soft-touch regulation were over’ (Elliott, 2008). We will discuss some of these on-going developments in the implications section. As of now we cannot draw definite conclusions on what the next dominant logic will be. What we can conclude, however, is that financial regulation is a taken-for-granted part of our contemporary business world and that we are yet to encounter the final solution to the problem of its form. Table 3 provides a concluding summary of the evolution of financial regulation in the UK from 1986 to 2011.

**\*\*\* insert *table 3* here \*\*\***

## **5. Discussion**

Overall, our findings, portrayed in four phases, are akin to those in other sectors. For instance, Scott et al. (2000) found in their extensive study of the US health care sector a new managerial-market-based logic building on earlier logics of medical professionals and the federal government. Blomgren & Sahlin (2007) could reproduce these findings in a Swedish context. We follow these latter authors in their interpretation of the repeated finding of this pattern – namely, that these developments correspond to a wider societal development. We can also reproduce some key observations around these developments such as the different phases were not entirely clear-cut and built on each other (Blomgren & Sahlin, 2007, p. 158).

Our study, however, differs in some important respects. Empirically, the financial services sector constitutes a unique case, as the managerial logic found to enter other fields such as health care or higher education publishing (Thornton & Ocasio, 1999) was part of the profession from the start. Theoretically, we identified four catalysts which only partially correspond to drivers of change found in the existing literature. We also focus on the additive aspect of institutional logics which we argue is best represented by the notion of sedimentation (Cooper et al., 1996). We will now elaborate, first, on the four catalysts and, second, on the concept of sedimentation.

a) Four catalysts

In our empirical investigations we found four catalysts which contribute to the sedimentation of an institution beyond competing field level institutional logics. We identified these catalysts as follows: the evocation of political ideologies, the appropriation of scandals, the growing number of actors and the increasing organization of actors. The first two catalysts concern specific forms of theorizations while the latter two are beyond individual actors and concern the context of theorizations. *Table 4* provides an overview of the four catalysts, the historical phases and the institutional logics attached to them. We will now discuss each of the four catalysts and how they relate to, and extend prior literature.

**\*\*\* insert *table 4* around here \*\*\***

*The evocation of political ideologies*

The first catalyst we identified occurred when theorizations were connected to wider public discourses such as political ideologies. Such actions were, for instance, visible in the first phase of the sedimentary process, when financial regulation ceased to be theorized as an

entirely technical issue but was problematized as part of a more general political ideology. Drawing on neo-liberalism gave certain theorizations more legitimacy and shifted the locus of the genesis of regulation. Alternatively, the importance of these connections between theories and ideologies can be explained the other way round. Wider political ideologies provide a repertoire of thinkable theorizations and thus limit our imaginary (Castoriadis, 1987). It is important not to confuse such ideologies with institutional logics as the evocation of scandals is a strategic theorization which some actors employ as rhetoric to act as institutional entrepreneur. The social movements literature provides useful insights in this respect. Green (2004), for instance, discusses which rhetoric forms promise more or less success with regard to adoption. Greenwood & Suddaby (2005) find five theorizations of change which helped the Big Five accounting firms to institutionalize a new organizational form. Prior literature places this rhetorical strategy in relation to other strategic theorizations. In our study, the role of political ideologies – as the other catalysts lies in a different sphere, which we elaborate later. Methodically, discourse analysis (Fairclough, 1993; Phillips, 2003; Phillips & Malhotra, 2008) could provide a framework to further inquire into the connection between theorization and the motivation of wider political ideologies when the latter are understood as powerful discourses.

### *The appropriation of scandals*

Some models of institutional change (e.g. Greenwood et al., 2002) emphasize the importance of scandals and crises as jolts which set processes of institutionalization in motion (cf. Reay, Golden-Biddle, & Germann, 2006, p. 994 for a critique). We did find evidence for the importance of scandals (such as the pensions mis-selling scandal) and crises (such as the global financial crisis of 2007-2009) for institutional change. However, not all scandals in the history of financial services were perceived as connected to financial regulation. As we saw in the case of the pensions mis-selling scandal, the same scandal was appropriated by different

actors. Following this evidence, we suggest adopting Munir's (2005) interpretation and emphasize that scandals do not trigger institutional change per se but need to be theorized themselves. When they were theorized as being connected to (faulty) financial regulation, the sedimentation of an institution gained momentum and legitimacy. To be sure, scandals cannot be theorized as connected to free will by actors. Based on our empirical material, boundary conditions for this catalyst could be identified as the need for a critical mass of actors to pick up the rhetoric of crisis as well as a certain level of media amplification. In fact, all theorizations of scandals that contributed to sedimentation in one form or another, enjoyed significant attention from the UK's leading media. Taken from this perspective, our study provides insights into the role of the public media and the rhetorical struggles played out in shaping regulation (Hood, James, Peters, & Scott, 2004).

#### *The growing number of actors*

The third catalyst we observed concerned the diffusion of theorizations by a growing number of actors in the field. We found that an increasing number of actors, both individuals and organizations participate in the social construction process by theorizing the subject. In a sense, a critical mass of actors has to be reached for the sedimentation of an institution to occur. As discussed in the prior literature, a growing number of actors is, by definition, essential for diffusion (Strang & Meyer, 1993). However, since diffusion and institutionalization are distinct phenomena (Ansari & Phillips, 2011; Colyvas & Jonsson, 2011), the role of this catalyst is less obvious with regard to institutionalization. Colyvas & Jonsson (2011) outline that some practices become adopted but not taken-for-granted or legitimate and vice versa (p. 29). In our case we found that adoption is often taken as given and not problematized. We found that, when portrayed as failing, regulation itself becomes re-theorized rather than how it is enacted. In the case presented here, the number of actors in the field does not primarily concern adopters but rather those taking part in the discursive



struggles of theorizing financial regulation. More theorizations then invite more actors to take part in this process, thereby generating momentum for the sedimentation of the institution of financial regulation, but potentially decoupled from actual practices. This is, to some extent, a reversal of what has been found in prior literature such as Ansari & Phillips (2011) which highlights the effect of text messaging in the UK and how unorganized consumers led to diffusion and institutional change.

### *The increasing organization of actors*

A final catalyst evident from our empirical investigations is the increasing organization of actors around theorizations. This too, connects to Strang & Meyer's (1993) original observations. They found that "theorization renders diffusion less structured by social relations and differences across adopters. General models facilitate meaningful communication and influence between weakly related actors, and between theorists and adopters" (p. 493). While we do not concern ourselves specifically with diffusion<sup>5</sup>, the unifying aspects of theorizations, creating cultural categories which appeal to larger numbers of actors by their abstract and universal nature, remain important.

We found that while the number of regulatory bodies (not the number of overall actors in the field) decreased, they became increasingly organized around certain theorizations. The consolidation of various regulatory agencies into the FSA had two effects: First, actors dissenting with the FSA found it harder to promote their theorizations. Second, a change within the FSA's approach led to a more significant shift as to which logic dominates at a particular stage. The existing literature on regulatory field formation (Hedmo, Sahlin-Andersson, & Wedlin, 2006) is likely to be a fruitful area of research here. In some sense, our

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<sup>5</sup> Following Rogers's seminal work we define diffusion as occurring when "an innovation is communicated through certain channels over time among the members of a social system" (Rogers, 1995/1962, p. 14 cited in Strang & Meyer (1993), p. 487f)

whole empirical material is a story of the actors in field becoming more tightly organized around theorizations. This kind of organization significantly influenced the shape of the institution. If, for example, the first profession-based phase had prevailed, a much lower degree of organization would be expected.

The high degree of organization of regulatory actors is in itself a sediment of the State-based phase of regulation, providing evidence that the catalysts themselves changed over time. This catalyst also demonstrates that the four catalysts are interdependent: We found that it was crucial for actors to build a critical mass of taken-for-granted theorizations – in order to sustain a logic that was robust enough to enable the organization of actors. Cultural meanings had to be deeply sedimented in order to enable this which in turn facilitated more sedimentation. We will elaborate on the connection of the four catalysts at the end of this section. First, however, we want to outline what these catalysts can actually contribute to the sedimentation of an institution.

#### b) Sedimentation

All four catalysts contributed to a form of institutionalization which we argue can best be described by the metaphor of sedimentation (Cooper et al., 1996; Tolbert & Zucker, 1996). In our empirical material we found three dimensions of taken-for-grantedness, outlined earlier. *Figure 1* summarized these three dimensions. First, theorizations were, as part of social construction, fairly conscience and strategic. Although Foucauldian scholars have shown that all social interactions are shaped by underlying discourses and power structures (Oakes, Townley, & Cooper, 1998; Townley, 1993), these willful and considered theorizations display the most basic dimension of taken-for-grantedness beyond reflection. Second, institutional logics, which we defined as groups of associated theorizations, were more suitable for mental

lock-ins than theorizations. For instance, market-based financial regulation can automatically be seen as the foundation of financial regulation by die-hard free market aficionados. Still, these institutional logics were frequently evoked in strategic ways suggesting a certain degree of consciousness and strategic intent. In particular in the later stages of our period of observation, we found that ideas combining prior exclusive institutional logics, namely market-based and risk-based logics, were strategically used to gain legitimacy. However, because the institutional logics were still open to conscious new, or altering, theorizations the institutional logics had not achieved field-level institutionalization (Greenwood et al., 2002) and are unlikely to do so in the near future. Third, we found that financial regulation was seen as the best answer to financial turbulences and, shaped in some fairly general form, had sedimented itself as by-product of competing theorizations and institutional logics.

Following Cooper et al. (1996) we suggest that sedimentation is the appropriate metaphor for understanding the form of institutionalization occurring in the field. Sedimentation refers to the layering of one logic upon the other and, to take the geological analogy further, to understand the visible surface a result of “a complex and historical process of faults and disruptions (for example from local crises and conflicts, rather than the plate movements of geology), erosions (from technological and market forces, rather than water) and strengths of” logics (p. 624). From this perspective, “[c]entral to the geological metaphor is that it includes not only layers and the disruptions caused by sudden transformations but also the gradual erosion and movements” (p. 635). Sedimentation is best understood as a mode of institutionalization, not as an alternative to institutionalization. The benefit of this metaphor is its dynamic nature as opposed to other forms of institutionalization such as linear or oscillating transformations (p. 643). The concept of sedimentation also helps us to address the conundrum of theorizations leading to taken-for-granted institutions. In each phase a layer is sedimented which slowly becomes part of the emerging institution of financial regulation.

This sediment influences future theorizations without being ostensibly visible or consciously available. But the sediment is not solid and disruptions such as the evocation of political ideologies and the appropriation of scandals can change the surface significantly while still not fully disposing of the sediment left by prior theorizations. The more subcutaneous aspects of sedimentation, which go beyond strategic theorizations, are reflected in the other two catalysts, the growing number of actors and their increasing organization. Viewed this way, theorizations lead to institutionalization through the sedimentation they leave behind for future theorizations. Competing institutional logics, consistent with Thornton & Ocasio (2008), are then the product and not the source of change. Change comes from the theorizations of institutional entrepreneurs which cannot wilfully determine cognitive taken-for-granted institutions but influence them through the sediments their theorizations leave behind.

The institution that came about through the process of sedimentation has several defining features. Financial regulation has achieved taken-for-grantedness in the sense that abandoning it is not an option for a knowledgeable actor in the field. Only far left autonomists and anarcho-capitalists would today argue against any form of financial regulation. Additionally, certain conceptions about what is financial regulation have become institutionalized. For instance, the State as a central actor is evoked in nearly all discourses that occurred after phase one. Alternative theorizations, such as “gentlemanly” self-regulation (Augur, 2000), ceased to be meaningful alternatives. A little more UK-specific but still firmly sedimented is the establishment of specific organizations and types of organizations by States. Individual organizations, their names and specific functions vary along the phases and logics. The need for these types of organizations as a part of financial regulation, however, is undisputed. By 1997, when phase three came to an end, the repertoire of thinkable and legitimate theorizations had already become severely limited. For instance, drawing on the notion of

deregulation had become taken-for-granted, although this was not necessarily obvious – given the State’s influence on financial services. Also, the term deregulation is theorized in various ways with no single interpretation achieving institutionalization despite some degree of diffusion. We understand the diffusion of regulatory practices as evidence of the institutionalization of something more general – namely, that the concept of financial regulation is an inevitable way to organize the financial services sector. This conceptualization of institutionalization connects not only to Tolbert & Zucker’s (1996) model but also to what has been more recently discussed as the formation of a regulatory field (Hedmo et al., 2006).

While each of the four catalysts are, at least partially, discussed in the prior literature, part of their novelty lies in their combination. Whereas institutional logics connect the individual-, field- and societal-levels, the proposed catalysts firmly rest at the field-level. Thus, they allow us to understand how theorizations by actors in the field led to field-level taken-for-granted institutions. Due to the qualitative and exploratory nature of our empirical inquiry we cannot fully determine the interdependencies of the catalysts. However, our case gives us the opportunity to observe some connections which might be developed into testable propositions in future research. As shown in table 4 not all catalysts were evident in all phases, we know that all catalysts do not need to be present in order for sedimentation (institutionalization) to occur. Consistent with the social movements literature which emphasizes the power of rhetoric (Green, 2004; Suddaby & Greenwood, 2005), the evocation of scandals was the springboard for the sedimentation process by putting financial markets on the agenda. In general we found the catalysts to be additive, the more of them occurred, the stronger the sedimentation process. This additive moment was also evident within the catalysts. According to particular theorizations, the organization of the actors in the field, grew stronger over time and thus facilitated the sedimentary process. In general, the four catalysts are mechanisms by

which the visible surface is shaped and the lower levels, which are the sediments of older theorizations, move (or cease to move).

## **6. Implications**

Following Dover & Lawrence (2010) we believe that institutional theory offers important insights for practitioners and in the following, we highlight some key conclusions for the practices of financial regulation:

Since we found the relation between theorization and institutionalization was mediated by what we called catalysts of sedimentation, practitioners will need to be aware of the by-products of their on-going struggles. As previous literature has shown, actors can actively contribute to institutionalization – cf. Kodak’s attempts to institutionalize amateur photography (Munir, 2005; Munir & Phillips, 2005). Our research extends this insight by suggesting that even when theorizations or whole institutional logics ostensibly become obsolete, they leave behind a sediment which adds to a cognitive institution and has to be taken into consideration. This implies that those promoting certain financial regulations need to be wary of the taken-for-granted legacy of prior theorizations. This effectively limits the legitimate options of proponents. The four catalysts we identified above provide indications of occurrences that are closely associated with the production of such sediments. Some of them are more deliberate (the evocation of political ideologies and the appropriation of scandals), while others are more indirect (the growing number of actors and the increasing organization of actors).

Our point is that we are not aiming to give actors advice on how to best promote or undermine a certain form of financial regulation. Rather, we want to draw attention to aspects of the

(public) debates which are often neglected in favour of quarrels between competing proponents of institutional logics. Also, current developments support our insight that the field level struggles of actors are far from over and that theorizations pronounced long dead still have direct and indirect influences: At the time of writing, current thinking – under a coalition Government elected in 2010, suggests that regulation of financial markets in the UK is moving back towards a two-tier structure – with the break-up of the FSA and the suggestion that two new regulators should be created: one would be the new Consumer Protection and Markets Authority (CPMA) which will focus on retail financial services, the other on the prudential side (FSA, 2011b, 2012). The language of the regulator has, once again, shifted to ‘intervention’ and also, ‘intrusion’ – in particular, a suggestion that there will be ‘heavy weight’ interventions in retail financial services: The main difference is that the regulatory authority (CPMA) will target products (i.e. financial promotions, product disclosure, how firms design products) in addition to selling practices – as was the case in the past, (FSA, 2011b). Industry representatives are, unsurprisingly, arguing that heavy-handed regulation will increase costs and reduce customer choice (Masters, Ross, & Powley, 2011) .

## **7. Conclusion**

In this paper we have discussed the connection between theorization and institutionalization. We started out by outlining the motivation of the paper: how do conscious and sometimes even strategic theorizations lead to cognitive taken-for-granted institutions? Empirically, we have shown how, over the last twenty-five years, competing institutional logics within UK financial services regulation have led to the institutionalization of financial regulation and is characterised by three features: First, there are no alternatives to financial services regulation; second, the State is naturally regarded as central actor and third, a web of organizations is naturally seen as necessary for financial regulation. We also identified four catalysts which,

when concurring with theorization, foster the sedimentation of an institution. By sedimentation we mean the lasting by-product of the continuous and dynamic struggles of actors in the processes of social construction.

However, every study has its limitations. Our study mainly draws on secondary material and focuses on one particular regime. Future research will have to show whether all four catalysts hold in different empirical settings. Also, future research will be needed to identify the influences that determine why some theorizations contribute directly towards institutionalization while others, as found in this case, only do so indirectly.

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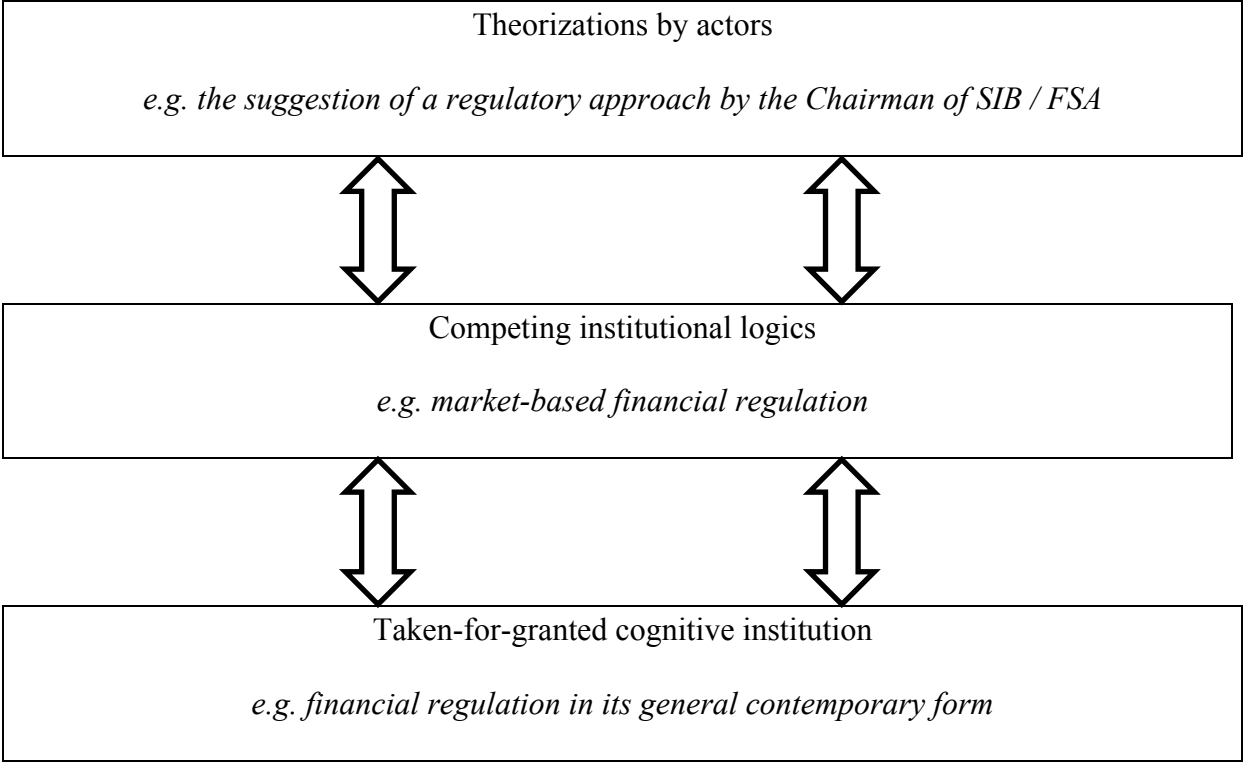


Figure 1: Dimensions of taken-for-grantedness