Department for
Business, Energy
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# DESIGNING SELF- AND CO-REGULATION INITIATIVES: EVIDENCE ON BEST PRACTICES

## A literature review

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**Authors: Kate McEntaggart, Julien Etienne, Jennifer Uddin**

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# Contents

# Executive summary

This study has investigated what behavioural insights may be drawn from the literature to inform the design of alternatives to regulation, focusing on self-regulation and co-regulation.

A great variety of initiatives can be associated with self- and co-regulation, including, for example, voluntary programmes, certification schemes and Codes of Conduct, with varying degrees of government involvement. Moreover, because self- and co-regulation initiatives are often voluntary, it is important to understand not only what encourages compliance, but also what encourages participation.

This study has considered how the design of these initiatives is underpinned by behavioural assumptions and what evidence is available showing that the use of these assumptions leads to improved compliance and participation.

An initial review of literature on policy design and behavioural economics was used to develop a list of design elements of self- and co-regulation initiatives that were based on assumptions of how organisations will behave. These design elements can be summarised as: engagement with regulatees, providing knowledge and support, authority tools, reputational incentives, peer pressure and financial incentives. This list of design elements was then used as a framework to situate and categorise the evidence reviewed.

The first phase identified examples of self- and co-regulation initiatives in the UK, looking at their design and whether it had been supported by any evidence. The second phase looked more widely at the academic literature, considering both qualitative and quantitative studies from different countries and sectors that attempt to evaluate the design of self- or co-regulation initiatives. Most sources identified evaluated self- and co-regulation initiatives at the post-implementation stage.

Findings were categorised and then compared using the design elements framework. It is difficult to generalise across the available evidence, due to the diversity of types of initiatives and the range of sectors covered. Moreover, in practice, although the evidence here is considered in isolate, most examples of self- and co-regulation initiatives rely on all or most of the identified design elements.

Evidence suggested that **engaging regulatees** in design may lead to benefits, as it may provide valuable expertise and encourage greater participation. However, where regulatees have too much of a steer in the design of programmes, this may risk leading to lower standards and undermining policy goals. Self- and co-regulation initiatives that provide **knowledge and support** to regulatees help to improve compliance, particularly among SMEs.

The implicit or explicit threat that the state would regulate should industry fail to improve its performance—what scholars have called the '**shadow of authority'—**can motivate firms to implement self-regulation and to improve on existing self-regulation initiatives. However, surveillance and monitoring—without direct and explicit regulatory threats—may be more effective at improving outcomes than through the threat of regulation.

**Reputational incentives** can be effective at increasing participation in initiatives, but only work where there is enough awareness of an initiative among key stakeholders and where the initiative itself has a positive reputation. In some circumstances, reputational incentives may

also improve firm performance. **Peer pressure** is likely to encourage participation in self-regulatory schemes in industries that are small, relatively homogenous and interconnected.

**Financial incentives**—both implicit and explicit—clearly play an important role in all types of initiatives and can be leveraged to encourage both participation in and compliance with self- and co-regulation initiatives. Financial incentives may include regulatory relief, cost savings and positive economic incentives and sanctions.

# Introduction

There has been a growing interest for alternatives to ‘traditional’ regulation in policy circles. Alternative approaches to regulation see the state playing a less direct role in steering behaviours, either by relying on ‘soft’ instruments and strategies (such as information and communication, engagement, support, nudges), or by letting others–associations, trade bodies, businesses themselves–take care of regulatory tasks, such as standard setting, monitoring, or enforcing. The appeal of alternatives to regulation lies in their potential to achieve policy objectives comparatively quickly and at a reduced cost to the state, however it is recognised that not all ways of setting up alternative approaches to regulation may succeed, particularly if the behavioural assumptions that have informed their design are flawed. This study has investigated what insights may be drawn from the literature to inform the design of alternatives to regulation, focusing on self-regulation and co-regulation.

## Conceptual framework

The concepts of self-regulation and co-regulation have not been used in consistent ways by scholars and practitioners. This is, in part, due to the wide breadth and scope of relevant initiatives, which can make the task of labelling them confusing and difficult. Bartle and Vass (2005) have developed a typology for self- and co-regulation initiatives, based on the degree to which public authority and the law are involved in the initiative, thus making it easier to label and compare the available evidence.

Bartle and Vass (2005) set self-regulation and co-regulation initiatives on a spectrum between no regulation and statutory regulation and identify five distinct types of co-regulation and self-regulation initiatives on that spectrum. This understanding of the distinctions between different types of self- and co-regulation initiatives helped to set the scope of the research, identifying keywords relevant to self- and co-regulation. These distinctions have also helped to contextualise the evidence identified within this review, understanding that the behavioural assumptions underpinning the design of initiatives, and the evidence for these assumptions, is not always going to be equivalent between all types of initiatives.

**Figure 1 Categories of self- and co-regulation**

Table 6: Perceptions on the role of public authority and law and consolidated categories

| Role of public authority and law | Self-regulation | Co-regulation | Consolidated categories |
|---|---|---|---|
| Strong<br><br>Weak | 1. Self-regulatory scheme with statutory backing<br><br>2. No statutory obligation but significant role for public authority/ies and law (possibly threat of legislation, or oversight – reviewing, endorsing, approving).<br><br>3. No statutory obligation and little role for public authorities and law | 1. Co-operation between public authority and industry on matters which lead to statutory regulatory decisions and determinations.<br><br>2. Delegation of statutory powers by a public authority to an industry or profession body.<br><br>3. Public authority sets an industry/profession specific tasks with statutory backing.<br><br>4. Public authority encourages, reviews, approves or endorses self-regulatory schemes. The schemes themselves are not backed by the full force of statute. | 1. Co-operative. Co-operation between regulator and regulated on the operation of statutory backed regulation.<br><br>2. Delegated. Delegation of statutory powers by public authority.<br><br>3. Devolved. Devolution by parliament of statutory powers to a self-regulatory scheme.<br><br>4. Facilitated. The explicit encouragement and support of self-regulatory schemes themselves are not backed by the full force of statute.<br><br>5. Tacit. Non statutory backing and little explicit roe for public authorities. |

Source: Bartle and Vass (2005)

# Analytical framework

The purpose of all regulation on businesses is to modify organisational behaviour, and as such, all types of regulation—including alternatives to traditional regulation such as self- and co-regulation—are based on certain assumptions about how organisations behave. Traditional economic views see organisations as self-interested rational actors, and as such, financial incentives are often given precedence in policy design (Edelman and Suchman 1997). However, the growth in literature around behavioural economics has shifted this understanding and promoted an "inductive" approach to deriving principles of economic behaviour—based on repeated experimentation and observation of how people and organisations actually behave—and this approach has begun to impact the development of policy and regulation in countries around the world (Lunn 2014).

For the most part, however, policy based on behavioural insights—or "nudge"—has largely been targeted toward consumers. This is because the focus of behavioural economics tends to be on individual decision-making rather than organisational decision-making. Although "nudge" techniques have been used on businesses, Tikotsky et al. (2019) point out that in the OECD review (see Lunn 2014), only 4% of the interventions mentioned were nudges directed toward firms rather than consumers, and of these, most were experiments and not yet policies.

These types of interventions depend on organisational behaviour, and on coordination between representative bodies of the private sector (such as trade associations) and government. Therefore, the assumptions underpinning their design relate not only to how individual businesses will behave, but also how trade associations behave and how business within an industry will interact. This complicates using many of the insights derived from behavioural economics for policy design, as organisations behave differently from individuals, and there is also evidence to suggest that individuals will behave differently (and to a different ethical standard) in a professional context than they would in their personal lives (Feldman 2017). Moreover, because self- and co-regulation initiatives are often voluntary, it is important to understand not only what encourages *compliance*, but also what encourages *participation*. There are several examples of self-regulation initiatives that have failed because industry participation has been low, making it impossible for the initiative to achieve its goals regardless of whatever other incentives have been put in place (see, for example, Kunkel et al. 2015 on the self-regulation of food marketing to children).

For self-regulation and co-regulation initiatives, therefore, the use of inductive approaches to gathering evidence that will underpin policy design is minimal. Instead, it appears that the design of most initiatives has been deductive, based on assumptions about what constitutes rational behaviour (Lunn 2014).

While it does not appear there has been significant attention paid to using evidence to underpin the design of self- and co-regulation initiatives, there is a wealth of literature available evaluating the efficacy of different self- and co-regulation initiatives. Much of this literature tests the assumptions that underpin the design of such initiatives, and therefore offers observational evidence for these assumptions.

To make sense of this evidence, the study team has used a common framework that draws from the policy design literature in political science (Schneider and Ingram 1990) and the behavioural economics literature (NEF 2006). An initial list of design elements likely to be encountered in self- and co-regulation initiatives was developed based on this literature and used as a tool to identify these within the sources reviewed. The design elements included in this report are:

- Engagement with regulatees;
- Providing knowledge and support;
- Authority tools;
- Reputational incentives;
- Peer pressure; and
- Financial incentives.

This report has been structured around this framework.

# Findings

The following section presents evidence identified within the academic literature that either supports or contradicts the behavioural assumptions underpinning the design of self- and co-regulation initiatives. A fairly large literature (approximately 100 sources) has been reviewed. The review has found that:

- Most sources seem to evaluate self- and co-regulation initiatives at the post-implementation stage;
- Sources evaluate initiatives in a variety of ways, using both quantitative and qualitative methodologies; and
- Most studies appear to at least comment on aspects of the initiatives' design and the behavioural assumptions underpinning this design, although they vary in the degree to which this commentary is based on empirical evidence.

The evidence presented here stems in many instances from qualitative studies, where firms were asked about their own motivations for participation. Although this provides useful insight into business motivations, surveys and interviews can only collect the stated motivations of firms and may not always be reflective of actual behaviour. Some evidence was also available from comparative studies, where similar initiatives are compared between countries, focusing on differences in design and outcomes. The most robust evidence comes from some studies that take a more quantitative approach, using available data on outcomes in firms and comparing this against the presence of certain characteristics related to self-regulation. Only one example was identified of a study with an experimental design (see Van Koten and Ortmann 2014).

The above suggests that there are limits to the extent the evidence may be generalised. Furthermore, the range of experiences with self- and co-regulation suggests that a range of factors, many likely sector- and scenario-specific, will determine the success of any given initiative.

Details of the methodology used for this study are included in Annex A: Methodology.

Findings have been organised and presented in terms of each design element. Key findings have been highlighted for each and illustrated through examples from UK initiatives where relevant.

# Engagement with regulatees

Many of the arguments for the greater use of self- and co-regulation centre around the assumption that businesses themselves are in the best position to understand how to regulate their industry. By involving businesses in the process, regulation will therefore be more appropriate, and the collaboration and cooperation involved will lead to improved compliance in the long term.

**Key findings**

- Stakeholder expertise may benefit the design and implementation of some self- and co-regulation initiatives.
- A good balance is needed as where regulates have a significant steer in the design of programmes, this may risk leading to lower standards and undermining policy goals.
- Allowing the industry to develop their own standards may encourage greater participation.

## Lowering standards and “regulatory capture”

Involving regulatees in the development of their own rules can sometimes result in a more permissive set of rules. For example, Antweiler and Harrison (2007) show that in an example of a co-operative initiative undertaken in Canada, industry co-sponsorship did not have the intended effect, and instead resulted in certain aspects of the design being overly lenient, which undermined its credibility. Studies on the self-regulation of food and alcohol marketing in several countries have also found that industry-defined standards tend to be weak. Moreover, where companies have a strong steer in formulating the standards and benchmarks of a self-regulation initiative, these tend to be lower (Ronit and Jensen 2014, Noel et al. 2017, Kunkel et al. 2015).

At one extreme, this lowering of standards may be considered to amount to “regulatory capture”, a term used to describe the influence industry has on its own regulation at the expense of public interest. Regulatory capture is not unique to self- or co-regulation and has been notably documented in the regulation of the financial industry (see Kwak 2013). However, the involvement of industry in the development of regulations does not need to preclude the public interest, and there is a fine line between the sort of cooperation that leads to positive outcomes in the public interest and capture. Thaw (2014) seeks to illustrate this point through examples in self-regulation where cooperation can lead to benefits from areas such as education regulation, labour regulation and environmental regulation. In some instances, allowing industry a steer in the development of rules is needed to harness the required expertise.

**UK example: General Medical Council (GMC)**

The GMC is the regulatory body for medical practitioners in the UK and is run partly by the professionals it regulates. The highly-specialised, technical nature of the profession requires significant area-specific expertise, particularly as the GMC is responsible for setting standards in education and training, developing codes of conduct and investigating patient concerns. A similar situation exists among other professional bodies,

such as the Royal Institute of British Architects (RIBA) and the Bar Standards Board (BSB).

However, the self-regulatory nature of the GMC has faced significant criticism related to the autonomy it gives the sector and the perception that many practitioners see self-regulation as a license to operate as they please without oversight or fear of sanctioning (Davies 2014). There have been several challenges to the GMC's credibility, and critics have noted that the system faces challenges in dealing with conflicts of interest and taking appropriate action where problems with an individual practitioner have been identified (Cruess and Cruess 2005; this is also highlighted by the Jack Adcock case, see The Lancet 2018).

The GMC has also previously faced criticism for its inability to ensure that practitioners maintained their competence following their initial qualification (Cruess and Cruess 2005). This was addressed in part by the introduction of revalidation in 2012, which requires medical practitioners to undergo regular appraisal and revalidation every five years to maintain their licence to practise (Tazzyman et al. 2019).

Lowering standards in voluntary programmes may not always lead to negative outcomes, however, and in some scenarios will present a trade-off. Lower standards and allowing industry steer may encourage participation, and in some scenarios small improvements by a large number of participants may be preferable to large improvements by a smaller number of participants (Potoski and Prakash 2013).

# Providing knowledge and support

Engaging regulatees not only in the design of regulation, but also in its implementation, has the potential to improve compliance by addressing the lack of capacity some businesses have to comply. For example, self- or co-regulation initiatives may be run by industry associations who not only set rules, monitor behaviours and enforce undesirable practices, but may also provide advice and support to small and medium-sized enterprises (SMEs).

There may be many instances where firms want to comply, particularly when there are benefits attached to compliance, but do not have the resources or understanding to implement the processes or obligations required.

**Key findings**

- Self- and co-regulation initiatives that provide advice, support and expertise to regulatees help to improve compliance, particularly among SMEs.

Research has shown that SMEs in particular have a harder time implementing and complying with self-regulatory schemes and management systems due to capacity issues (Mensah and Julien 2011, Psomas et al. 2010 in Bradford-Knox and Kane 2014). The literature provides several examples of initiatives where addressing this barrier directly has resulted in improved outcomes.

Muela-Molina and Perelló-Oliver (2014) compared the self-regulation of the advertising industry between the UK and Spain. They found that one of the reasons the UK's system significantly outperformed Spain's system was due to the greater amount of "copy advice" provided to regulatees. Looking at an example of a voluntary food safety scheme in France, Rouvière and Caswell (2012) found that members received information and updates around regulations and laws relevant to their industry, as well as a compulsory training programme. By comparison, non-members would need to navigate these changes themselves. Short et al. (2019) found that in third party monitoring schemes, highly trained auditors led to greater improvements among firms, likely through their ability to provide targeted advice and support to firms.

**UK example: Safe and Local Supplier Approval (SALSA)**

SALSA was conceived by a retail executive who found that they were expending a large amount of resources on vetting smaller suppliers. SALSA was designed as a certification scheme specific to the needs of micro and small businesses, to help them comply with safety and quality requirements associated with national or regional retailers. SALSA's design requires auditors to make recommendations and draw up a list of mutually-agreed upon actions to address any non-compliances. It is also designed to keep the cost of gaining certification lower as compared to other schemes designed for larger businesses.

SALSA's focus on providing knowledge and support to members is also evident through their use of a mentoring programme, whereby members can access tailored support and advice separately from the auditing process (Bradford-Knox and Kane 2014).

SALSA also makes use of an online directory, where interested buyers can search for approved suppliers of products within a specific category and/or area. This acts as an additional marketing tool for participants.

# Authority tools

Where authority tools underpin the regulatory design, compliance is motivated "by a commitment to obey laws and regulations without the aid of tangible incentives" (Schneider and Ingram 1990, p 514). For self- and co-regulatory initiatives, where government authority often does not play a role or plays a limited role, it is often the belief that the government may pursue statutory regulation that acts as a motivating factor. Firms feel that if they do not act themselves to address issues that they understand to be on the government's agenda, they will lose control and potentially face obligations that might be inconsistent or inefficient (Thaw 2014).

Within self- and co-regulation initiatives, however, authority may not always refer to the authority of the state but the authority of the industry body managing the initiative.

**Key findings**

- The belief that governments may pursue statutory regulation can motivate firms to implement self-regulation and to improve on existing self-regulation initiatives.
- Surveillance and monitoring—without direct and explicit regulatory threats—may be more effective at improving outcomes.
- Active monitoring, either by the self-regulatory organisation or by a third party, is likely a pre-requisite to success for self- and co-regulation initiatives.

## Authority of the state

Coglianese and Mendelson (2010) find that self-regulation works best when there is an implicit risk of outside regulation. Héritier and Eckert (2008) also find that industry is more willing to engage in self-regulation initiatives where there is a possibility of outside regulation – and that the possibility of government action has a bigger impact than reputationally damaging campaigns in determining how stringent self-regulation is likely to be.

The belief that governments may take action impacts not only industry decisions to establish self-regulation, but may also encourage existing initiatives to improve their performance. DeMarzo et al. (2005) developed a model theorising that the risk of government enforcement would lead to more enforcement by self-regulatory organisations (SROs). This was subsequently tested experimentally by Van Koten and Ortmann (2014), who show that the threat of punishment alone can lead to improved self-regulation. Using data from U.S. industrial facilities subject to the Clean Air Act, Short and Toffel (2010) come to a more nuanced conclusion, finding that while high levels of surveillance appear to improve the implementation of self-regulatory commitments, direct and explicit regulatory threats were not shown to improve regulatory outcomes. In their analysis, Héritier and Eckert (2008) also note that greater levels of government control do not appear to lead to better performance.

**UK example: Self-regulation of the pubs industry**

Following public concerns around lessees being taken advantage of by Pub Companies (Pubcos), the government encouraged industry to self-regulate. Following a lack of progress, the government set a time limit for the industry to meet expectations. This was not met, as pubcos were both slow to revise their codes of practice with new

requirements and there was little effective sanction for those who refused to comply. Pubcos were again given the chance to address this through self-regulation, and again no progress was made (Helsey and Seely 2015). The government eventually moved toward statutory regulation, introducing the Pubs Code Regulations 2016.

The failure of self-regulation of the pubs industry offers an example of how even where there is a political mandate for progress in an area and an explicit threat of action, this may not be sufficient to drive behavioural change.

By contrast, the example of the British Lion Quality Mark (see page 16 for further details) is an example of a successful self-regulatory scheme where it appears that the government publicising its concerns (albeit without any explicit threat of regulation) helped motivate industry to self-regulate.

## Non-state oversight

In many self- or co-regulatory set-ups, initiatives may rely on monitoring and oversight by non-state entities. In some cases, this may be oversight by the SRO itself and in some cases third-party certifiers may be used to support self- or co-regulation.

Short and Toffel (2010) reference research that suggests that self-regulation only leads to improved compliance and outcomes where there is third-party monitoring. However, third-party monitoring is not itself a silver bullet for improving compliance. Recent research looking at the example of Responsible Care (Li et al. 2014) found that the introduction of mandatory third-party certification did not lead to a significant reduction in accidents, suggesting that while adequate monitoring may be a pre-requisite to success in self-regulation, it does not guarantee improved outcomes. Short and Toffel (2015) provide an extensive review of the literature on this subject, highlighting the various elements that lead to more effective third-party monitoring. For example, this review finds that third-party monitors tend to be more lenient when they are paid directly by monitored firms, when they face more competition and when they have longstanding relationships with monitored firms. Third-party monitoring may therefore play an important role in many self- or co-regulation initiatives, but not all third-party monitors are equally effective.

SROs may sometimes rely on active monitoring (as opposed to relying on external reports of non-compliance) themselves: Muela-Molina and Perelló-Oliver (2014) find that the use of active monitoring is one element that leads to better outcomes for advertising self-regulation in the UK as compared to Spain.

# Reputational incentives

Reputational incentives underpin many self- and co-regulation initiatives. These may come in the form of positive reputational incentives, such as being included on a register, denoted an "approved" business, or being allowed to use a specific label or marketing materials known to customers as an indicator of compliance or high quality. Reputational incentives may also be negative, where initiatives use sanctioning powers to name-and-shame businesses who do not participate or comply.

Many reputational incentives will have financial repercussions, and as such, there is a good deal of overlap between the evidence for reputational incentives and financial incentives (discussed in the following section).

**Key findings**

- Reputational incentives only work where there is enough awareness of an initiative and where the initiative itself has a positive reputation.
- The credibility of an initiative may be influenced by its perceived independence, as well as by its perceived efficacy.
- When engaging in voluntary self-regulation, firms that are highly motivated by reputation may focus more on implementing practices that offer the most visibility and publicity.

Reputation often underpins firm *participation* in voluntary initiatives–for example Khanna and Damon (1999) find that reputational benefits were one of the key motivators for firms participating in the 33/50 programme[1].

For reputational incentives to be effective in encouraging participation, it is important that there is sufficient awareness of the self-regulation initiative or the issue among consumers or the main customers of the industry. Several studies have found that a focus on increasing public awareness of an issue leads to more widespread self-regulation. For example, Héritier and Eckert (2008) found that in the case of PVC and paper industries, the industry was more likely to engage in self-regulation when there was an NGO-led public campaign against their industry.

The Démarche Qualité programme—a voluntary food safety programme for firms in France—also allows members to use a logo to signify their membership to the scheme. However, according to Rouvière and Caswell (2012), this logo was only recognised by other businesses rather than consumers and so did not boost their reputation in any way amongst customers, meaning that participating businesses could not charge a premium price. In a study among food businesses in Spain, a lack of awareness was also cited as a barrier to further participation in ISO 22000 (Escanciano and Santos-Vijande 2014).

**UK example: British Lion Quality Mark (Eggs)**

The British Lion Quality Mark for eggs is a particularly successful example of a tacit initiative in food. Like many self-regulation initiatives, it is based on an assumption that

[1] The 33/50 program is a voluntary programme run by the Environmental Protection Agency in the US to reduce the release of toxic chemicals.

producers are motivated to participate and comply due to positive reputational incentives. The Lion Quality Mark began in response to concerns about salmonella in eggs in 1998, which were raised by both the government and media and led to public concerns and drops in consumption. Industry moved to self-regulate largely to address their flagging reputation. The scheme has been highly successful at reducing salmonella, increasing participation (around 85% of British eggs are produced under the scheme) and increasing consumer confidence in the safety of eggs. This is supported by the fact that there is widespread public awareness of the mark, with evidence from 2018 showing that 83% of consumers strongly associate the Lion mark with a guarantee of quality and 70% recognise these eggs as safer than other eggs (Joret 2018).

The scheme involves compulsory vaccination against salmonella, regular independent auditing using third-party monitors, improved traceability and stricter hygiene controls at farms. In 2017, the Food Standards Agency (FSA) revised its previous advice, stating that it was now safe for those vulnerable to infection to consume raw or lightly cooked eggs if those eggs have been produced to the British Lion Quality Code of Practice.

While awareness is important to determine whether reputational incentives will be effective, the reputation of self- and co-regulation initiatives is determined by many other factors. Schemes must also be credible in the eyes of potential participants and their customers or intended audience. Credibility of a scheme will be impacted by a range of factors, depending on the sector or initiative in question. For example, Muela-Molina and Perelló-Oliver (2014) find that in the case of advertising self-regulation in the UK, the independent nature of sources of funding granted a level credibility to the scheme not evident in the equivalent Spanish initiative. In addition to sources of funding, perceptions that a scheme is otherwise ineffective may discourage firms from participation (Areté 2016).

**UK example: The Fundraising Regulator**

The self-regulation of the charity sector in the UK has only recently been reformed, and the previous SRO (the FSRB) was replaced with the Fundraising Regulator. One of the changes to the new design changed the funding model to incorporate a levy, in order to avoid concerns about conflicts of interest and improve the Fundraising Regulator's credibility.

Although the previous SRO was considered to be a failure, self-regulation was kept as a model for the charity sector because of an assumption that to maintain public trust in the sector, it would need to demonstrate "its commitment to high ethical standards". However, the reform also moved the SRO toward co-regulation, noting that the "self-regulatory system needs to be strengthened by an effective relationship with statutory regulators which can act as a 'backstop'." (Etherington et al. 2015)

Considering the relative recency of the reforms to the Fundraising Regulator, it is not clear to what extent these have been successful. However, the most recent Complaints Report put out by the Fundraising Regulator indicates a high degree of transparency around complaints, investigations and actions taken and suggests that they have worked with many of their members to improve practices in response to public complaints (see Fundraising Regulator 2019 for the full report).

Although there is evidence illustrating the role reputational incentives play in encouraging firm *participation* in self-regulation, reputational incentives may not necessarily lead to improved

*performance*. Several studies find that in cases of self-regulation, much of the focus ends up being on areas that are most visible to the public and most likely to have an impact on firm reputation. Howard et al (1999) find this in relation to the implementation of Responsible Care. Potoski and Prakash (2013) find a similar situation when considering whether the adoption of a voluntary environmental programme leads to a reduction in pollution. They found that there was some reduction in air pollution associated with adoption but no significant reduction in water pollution. The authors hypothesise that this is because water pollution is less visible, businesses consider it to be less reputationally damaging and therefore its reduction to be less reputationally beneficial.

Hence, relying on reputational incentives also depends on transparency being built into the design of the initiative. There may already be a means of making performance transparent in the ecosystem of the sector in scope: third parties such as NGOs, rating agencies, or the press may be reporting regularly on business performance. The role such organisations can play in improving compliance is evident in the literature. For example, Short et al. (2019) show that firms that have previously been exposed and are therefore particularly sensitive to reputational damage are more likely to show improvement. Toffel et al. (2015) find that self-regulatory schemes related to labour standards are more likely to be successful in countries with greater press freedom (i.e. where there is a greater risk of exposure) and where the ultimate customers of their products come from wealthier countries where there are greater market pressures to improve standards.

When third parties or instruments making regulatee practices transparent are missing from the environment, or they are now adequate, then they might be set up by regulators instead. An example is the U.S. Toxics Release Inventory (TRI), which was created by the Emergency Planning and Community Right-to-Know Act in 1986. Businesses in scope are required to report chemical toxic releases, which then are entered into the TRI and thus published. The TRI has provided a means of publicising the environmental performance of industrial firms, in the hope that the reputational impact (whether actual or anticipated) would drive them to improve their performance. The TRI is one of the most studied instances of regulation through information disclosure, and its role in driving performance has been much debated. One of the most detailed studies on the topic (Kraft et al. 2011) has concluded that transparency through the TRI has contributed to improving industrial performance. However, that has not resulted from interactions between industry and the general public. Indeed, the evidence does not suggest that industry has cared much about the public's perception of how much it polluted, or that there was much interest for the TRI from the part of the general public. Rather, the evidence shows that the information on the TRI has been used largely by regulators (for example, to set enforcement priorities). More generally, environmental performance has improved due to other initiatives, both self-regulatory and regulatory. In particular, state intervention in the form of regulatory requirements, monitoring or enforcement, what the authors call the 'regulatory backdrop' has contributed the improvements that others have tended to attribute to the TRI alone. This echoes the findings of Short and Toffel (2010) whereby self-regulation is effective when a level of state surveillance is maintained.

# Peer pressure

Peer pressure as a feature of self-regulatory or co-regulatory initiatives relies on the assumption that if certain [important or influential] members of an industry take part, others will follow their lead. This is because peers are perceived as showing others what is appropriate behaviour and what is not. Moreover, peers can exercise pressure on laggards, for example by publishing or discussing their poor performance in group gatherings.

**Key findings**

- Peer pressure will likely encourage participation in self-regulation in industries that are small, relatively homogenous and interconnected.

Some self-regulation initiatives appear to be based on the assumption that once a certain percentage of the industry signs up to an initiative, more will follow as it becomes the industry standard. The implied logic here is that norms evolve within a sector (which is, for instance, what some argue has taken place in the chemical industry through Responsible Care; Hoffman 1999). What motivates firms to sign up to such a standard is not clear, however, and the mechanisms behind peer pressure may stem from reputational incentives, through the development of collective norms or culture within the industry or through a desire to avoid standing out, based on a fear that those who do stand out are more likely to be targeted with sanctions.

**UK example: Vehicle Builders and Repairers Association Code (VBRA)**

The VBRA Code is applicable to vehicle body builders and the commercial repairs industry and approved members can both display this approval for marketing purposes and can be listed in the VBRA's register. Signing on to the Code is not mandatory to operate, but being included in the register is intended to help bring about additional business, pressuring firms in the industry to comply with the standard. The client in this sector is often insurance companies, so uptake of the use of the VBRA logo among members is not particularly high, but inclusion in the register is a motivational incentive.

Membership is voluntary and standards are intentionally kept high – only around a third of applicants to join the VBRA are accepted. Maintaining this level of credibility appears to be a key factor in the apparent success of the Code. This is supported by the VBRA's participation in the Consumer Codes Accreditation Scheme and the positive feedback received through that scheme (TSI 2014).

Coglianese and Mendelson (2010) find that self-regulation tends to work best when the industry regulated has a small number of players, is relatively homogenous and interconnected. It is also particularly effective in a context where the failure of one member of the industry is likely to negatively impact on all of them, as is the case in a number of sectors (nuclear industry, oil and chemicals industry, finance, etc.). In such a scenario, peer pressure is likely to be more effective in incentivising firms to participate. Rees (1994) shows this well in a detailed study of a highly successful self-regulatory initiative in the U.S. nuclear industry. Rees tells the story of the Institute of Nuclear Power Operations (INPO), an industry-only forum organised after the Three Miles Island accident. Three Miles Island had been a wake-up call for the industry. Federal legislation was passed to make the regulatory regime for nuclear activities more robust. Its implementation, however, was largely shaped by INPO's self-

regulatory initiative, in the sense that the regulator (the Nuclear Regulatory Commission) deferred to INPO guidelines, programmes, and activities on numerous aspects. At INPO, members' safety performance was recorded and discussed in groups. High performance was praised, low performance highlighted. Rees' analysis shows thatpeer pressure through praising and shaming effectively worked and drove performance higher. The effectiveness of the INPO also resulted from the moral authority that the INPO exercised over its members, which appears to stem largely from their credibility as authority figures (the INPO was led by former U.S. Navy officers). It should be noted that it is not always easy for industry bodies, such as trade associations, to play such a role as an authority towards their members, whereas they historically would have usually been rather at the service of their members (e.g. to lobby in their favour).

In contrast with other self-regulation initiatives which rely on transparency to generate reputational incentives, the INPO as a self-regulatory initiative relying on peer pressure has been characterised by secrecy. In other words, peer pressure may happen, but it happens between members of the group, and behind closed doors: in a safe space. Industry has regularly called for 'safe spaces' to be established before they could share information with peers and with regulators, including in the UK (a good example is the debate on food fraud after the horsemeat scandal), however there are no well-documented examples in which this has delivered substantial results (Etienne 2015). Rees (1994) and others have also criticised secrecy in industry self-regulation schemes, expressing doubts that secrecy was a condition for the success of those initiatives, and rather attributing the INPO's success to other features, in particular group organisation and leadership.

# Financial incentives

Financial incentives to support the participation in and subsequent compliance with self- and co-regulatory initiatives can come in several forms. These may be positive incentives, whereby participation is likely to lead to cost savings or profit, in some cases through regulatory relief. There is also a role for financial sanctions in self- and co-regulation initiatives, particularly where responsible industry bodies have significant authority in their sector or where initiatives are cooperative or delegated, and industry bodies are backed by statute.

**Key findings**

- Offering regulatory relief has been shown to incentivise firms to participate in self- and co-regulation initiatives.
- In some instances, compliance with a scheme can lead to financial benefits for participants, which can help to motivate both participation and compliance.
- Where self- or co-regulation initiatives rely heavily on financial incentives, these need to outweigh incentives offered by the market. Market pressures, such as those that stem from other actors in a supply chain, may also help to incentivise compliance or participation.
- The ability to issue financial sanctions, and the willingness to follow through on issuing sanctions, can positively impact the effectiveness and credibility of self- and co-regulation initiatives.

## Regulatory relief

Many self- and co-regulation initiatives have been designed to bring about regulatory relief. By turning the responsibility of regulation over to the industry themselves, both the regulator and regulatees may experience a reduction of compliance costs and regulatory burden. For regulatees, this ‘regulatory relief’ can often act as an incentive for participation.

Evidence suggests that the promise of regulatory relief can indeed encourage *participation* in self- and co-regulation initiatives. For example, research on the 33/50 program found that firms reported the reduction of liability and compliance costs as an important reason for their participation (Khanna and Damon 1999). Regulatory relief was also shown to be a motivating factor for participation in the “Démarche Qualité” programme where a survey of participants found that the avoidance of liability for official lab testing failure and thereby the avoidance of sanctions such as prosecutions and fines was a key motivating factor to becoming a member of the programme (Rouvière and Caswell 2012).

In Europe, the European Eco-Management and Audit Scheme (EMAS) has also illustrated the role regulatory relief can play in increasing participation. EMAS is a voluntary initiative, and overall participation has been low. There have been requests by industry to reduce regulatory monitoring in exchange for participation, but in most countries this has not occurred. In Germany, however, the government has offered participating firms regulatory relief. Participation rates show that uptake has indeed been higher as compared to other countries, with 6.5% of potential companies on the scheme in 2000 compared to 0.25% in the UK. Comparison between German states further illustrates this point: the main difference in implementation between Bavaria and North Rhine-Westphalia (NRW) is that the Bavarian

government provided a higher level of regulatory relief to participants. In turn, uptake was higher in Bavaria as compared to NRW (8% and 5%, respectively) (Wätzold et al. 2001).

**UK example: Driver Vehicle and Standards Agency (DVSA) Earned Recognition**

The DVSA Earned Recognition scheme is a voluntary scheme for commercial operators of vehicles run by the Department for Transport. Firms must have a compliant IT system, monitor certain KPIs, undergo an audit and share data with the regulator in exchange for reduced inspections and roadside checks (DVSA 2018). This scheme relies in part on the use of regulatory relief as an incentive for firm participation.

The scheme is still new and has not been subjected to any available evaluation. An interview with a participating operator from the DVSA's "Moving On" blog provides some anecdotal insight into the intentions of the co-regulatory programme. The operator notes in interview that the focus on being "transparent and self-critical" is daunting but ultimately beneficial, suggesting that in addition to the regulatory relief offered by the scheme, there are other, perhaps less tangible benefits. The interview also suggests that participation in the scheme has improved their working relationship with the DVSA "all because of a subtle shift in approach" (Moving On 2018).

## Cost savings and positive economic incentives

It is also possible that self- or co-regulation initiatives may offer firms other types of savings through participation, and thereby also encourage *compliance* with initiatives. For example, the Toxic Use Reduction Act (TURA) in Massachusetts required companies that engage in high usage of toxic chemicals to develop plans for how they would make reductions. Whilst developing the plan was obligatory, implementing it was not. A survey conducted by Keenan et al (1997) three years following the launch of the initiative however found that 81% of companies envisioned implementing at least "a few", if not most or all, of the projects identified in their reduction plans and 86% reported that even if it was no longer mandatory, they would still carry on with the emission reduction planning. Crucially, 67% reported that implementation of the plan was associated with savings, suggesting that financial incentives also played a role in encouraging firms to follow through (as cited in Coglianese and Mendelson 2010).

Another example of savings leading to participation and compliance comes from a European Commission report on supply chain initiatives in the food industry. This study found that those who participated in voluntary initiatives that sought to reduce unfair trading practices were motivated by the fact that these initiatives provided an alternative to seeking legal solutions, which would be far more expensive and time consuming. The same study also found, however, that joining such initiatives was associated with a range of indirect costs in terms of time and effort to meet stringent registration requirements. This is more likely to be a barrier for SMEs, resulting in the underrepresentation of this group (Areté 2016).

Where self- or co-regulation initiatives rely heavily on financial incentives, however, these need to outweigh incentives offered by the market. For example, Héritier and Eckert (2008) sought to understand what conditions were required to enable self-regulation for improving recycling performance within the PVC and paper industry. Their study attributed the comparatively poorer self-regulation performance of the PVC industry to the fact that there were no financial incentives to recycle. In the paper industry, however, there was a much more profitable market for recycling.

The market may offer other positive financial incentives for compliance (or negative incentives for noncompliance) through supply chain pressure. For example, Toffel et al (2015) found that suppliers were more likely to adhere to global labour standards when buyers, and in turn the consumers, were from wealthy countries and where there were market pressures for buyers to establish high labour standards across their foreign supply chain. This is common in the case of self-regulation in food, as pressure from retailers is often responsible for firms' participation in food safety or quality self-regulation initiatives (Henson and Holt 2000, Escanciano and Santos-Vijande 2014, Areté 2016).

## Sanctions

In the case of cooperative or delegated initiatives where self-regulation is backed by statutory powers, financial sanctions also play an important role in encouraging compliance, similar to traditional regulation. For example, Muela-Molina and Perelló-Oliver (2014) find that the self-regulation of advertising in the UK can attribute part of its success to the ASA's sanctioning powers and its ability to refer cases or issues to Ofcom, who can then take further action. Attempts to enact self-regulation without sanctions have been shown in the literature to be ineffective (see for example King and Lenox (2000) in relation to Responsible Care). In the case of SROs with sanctioning abilities, however, there is a risk that SROs may not actually make use of sanctioning powers, which can also work to undermine their effectiveness. This is evident in the example of the Independent Press Standards Organisation (IPSO) discussed below.

**UK example: The Independent Press Standards Organisation (IPSO)**

IPSO is an example of a tacit self-regulatory scheme. It was established following the Leveson Inquiry and regulates member newspapers and magazines by ensuring that members follow the Editor's code of practice and complete an annual statement demonstrating their compliance.

IPSO retains sanctioning powers—including the ability to fine members up to £1 million. However, these sanctioning powers have never been used, and IPSO has come under significant criticism for its failure to respond to the requirements set by the Leveson Inquiry. According to one review, it meets only 18 of the 38 requirements set following the Leveson Inquiry (Media Standards Trust 2013).

At the same time, another self-regulatory scheme was established for the press. Known as IMPRESS, this scheme did address the requirements set by the Leveson Inquiry and has been recognised by the Press Recognition Panel (PRP)[2]. However, participation in the IMPRESS scheme has been minimal and thus far has been limited to some small and regional newspapers.

The lack of ability to issue financial sanctions can raise doubts about the overall effectiveness of a self- or co-regulation initiative and therefore discourage potential participants from expending their resources on participation. This was shown to be the case among supply chain initiatives seeking to tackle unfair trading practices in the food industry (Areté 2016).

[2] The PRP was established by Royal Charter in 2014 to oversee the self-regulation of the press.

# Conclusions

This literature review has sought to identify instances in which behavioural insights have been used to inform the design of self- and co-regulation initiatives. The sources reviewed indicated that, while such initiatives may have been designed based on assumptions of how industries, individual firms and self-regulatory organisations (SROs) would behave, these assumptions have generally been tested before self- or co-regulation initiatives were implemented.

There is, however, extensive empirical literature evaluating and assessing the success of self- and co-regulation initiatives in various sectors and in different countries. Some of this literature goes beyond measuring the apparent outcomes of initiatives and examines particular aspects of their design. This evidence provides an outline of what behavioural insights could apply to self- and co-regulation initiatives, and what lessons could be taken forward when considering the future design of such initiatives.

It is challenging to generalise across this evidence. There is a great variety of initiatives that can be associated with self- and co-regulation, including voluntary programmes run by governments, certification schemes developed by industry, Codes of Conduct—both those promoted by governments and developed by industries themselves—and SROs backed by statute. One potential way to categorise these initiatives is by considering the degree of involvement the state has in the development and implementation of the initiative. This offers a helpful distinction in terms of behavioural assumptions: the degree of state involvement will often determine the shape tools based on behavioural assumptions will take.

For example, initiatives that are tacit (developed and implemented entirely by industry) or facilitated (developed and implemented by industry but with some government collaboration or steer) may be more liable to the risk that their standards will be lower and unlikely to achieve policy or public interest goals. Tacit or facilitated initiatives are also often likely to develop as a response to the possibility of government intervention, but these same initiatives are more likely to lack effective monitoring and surveillance, which evidence suggests may be the best way to encourage compliance and improvement among regulatees.

Not only do initiatives differ in terms of design and degree of government involvement, they also span a range of sectors. Depending on the sector in question, its complexity, the degree of regulation required, the size and homogeneity of businesses involved and the nature of the customer base it serves, different assumptions may be more or less relevant. This suggests that the design of self- and co-regulation initiatives should not simply rely on best practice models, but should rather consider how those models will apply to its own sector and the incentives that already exist.

Although the findings in this report are presented in isolate, in practice, most examples of self- and co-regulation initiatives bring many different design elements together. Moreover, although the distinctions made in this report have been helpful for the purpose of reviewing the available evidence, the distinctions between different types of incentives for compliance or participation may not be so clear-cut, and motivations will likely differ between firms.

The examples of UK initiatives reviewed suggest that those initiatives considered to be the most successful have leveraged a range of tools and incentives to encourage both participation and compliance among members. Examples such as the Advertising Standards Authority (ASA) and the British Lion Quality Mark use active monitoring, provide support and

advice to regulatees, enjoy high levels of awareness and a strong reputation among their intended audience, make use of reputational tools and offer financial benefits to regulatees.

Based on this, the following best practices can be identified:

- Self-regulation initiatives, particularly those that are largely developed and implemented by industry, should take measures to ensure that the standards they set are not overly lenient in a way that might undermine policy goals. Oversight from the government without direct intervention—the shadow of authority—may be one way to address this. Involving other relevant stakeholders, such as NGOs or independent experts, in the development process may be another option for achieving this.[3] Industry acknowledgment that the problem is severe and the standards need to be sufficient to tackle it can also be present without government oversight or intervention, but this tends to be the case only in industries which have experienced accidents or scandals that have threatened the very existence of the industry.

- All initiatives, regardless of the level of state involvement, can benefit from implementing approaches that provide targeted advice and support to regulatees who may not have the capacity to comply themselves. In many sectors, industry bodies are best placed to provide targeted advice and support and often do so through the publication of guidance, codes of practice and direct outreach to members.

- Surveillance and monitoring—without direct and explicit regulatory threats—may be more effective at improving outcomes. This is implicit in many co-operative initiatives, where there is a large degree of government involvement and the state still oversees the regulatory process. Where the state is not involved, implementing surveillance and monitoring may be more challenging, particularly for SROs who lack sufficient credibility or resources. Incorporating third-party audits and certification into initiatives may be another option for achieving this. There are risks to using third-party monitoring and there is an extensive discussion in the literature as to how third-party monitors may be subject to conflicts of interest. A succinct overview of the issues associated with this is available in Short and Toffel (2015).

- For voluntary initiatives, unless there is awareness of an initiative among customers or other relevant stakeholders, and unless the initiative has a positive reputation among those customers/stakeholders, participation is unlikely to be high. This poses a challenge to new initiatives or initiatives without government support, as they will either need to build a reputation over time or associate themselves with an existing association or firms who can encourage participation.

- Financial incentives—both implicit and explicit—clearly play an important role in all types of initiatives and can be leveraged to encourage both participation in and compliance with self- and co-regulation initiatives. There are many options for how financial incentives can be incorporated into the design of self- and co-regulation initiative and the most appropriate option will likely be sector-specific and depend on what other incentives the market offers.

[3] This has been discussed in the literature in the context of traditional regulation and the risk of regulatory capture. Ayres and Braithwaite (1991) refer to this type of solution as “tripartism” and there is literature available on the experience of this approach in different sectors.

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# Annex A: Methodology

The purpose of this study was to address three main questions:

- To what extent behavioural insights have been used to support alternative initiatives, in particular self, and co-regulation?
- Are there any learnings that can be applied in terms of best practice when designing alternative interventions?
- What, if anything, can be said about long-term sustainability of impacted behaviours (e.g. long-term evaluation of behavioural change)?

To address these questions, the study was divided into two main phases.

## Phase 1

The purpose of the Phase 1 Review was to identify and review existing examples of self- and co-regulation initiatives in the UK. The assessment of these initiatives sought to:

- describe and categorise self- and co-regulation initiatives;
- extract information on the manner these initiatives were designed, highlighting behavioural insights when relevant; and
- identify gaps and draw out suggestions for the second phase of the review.

The review described and categorised the initiatives based on a categorisation put forward by Bartle and Vass (2005). This framework distinguishes between five different types of self- and co-regulation initiatives depending on the degree of state involvement. This ranges from cooperative initiatives, where there is still a high degree of state involvement, to tacit initiatives which are designed and implemented by the industry itself with no involvement from the state.

The first phase review also established a framework for the consideration of behavioural assumptions, based on the literature on policy design and behavioural economics.

Based on non-academic sources principally, the first phase review identified an extensive number of examples of self- and co-regulation initiatives, both successful and unsuccessful, in the UK alone. The study team reviewed 21 of them. Very little evidence was identified on the motivations and rationale behind the design of these self- and co-regulation initiatives. Behavioural aspects of the design were either briefly mentioned or had to be inferred from the tools chosen.

## Phase 2

The second phase review involved a review of the academic literature related to self- and co-regulation initiatives in both the UK and third countries. The team relied on previously identified studies, recommendations from experts Jodi Short and Yuval Feldman, and a snowballing

approach to identify additional studies. Purely theoretical literature was not included in the review. No restriction was placed on the publication date.

In reviewing the literature, the study team took detailed notes on the studies reviewed, identifying how their findings related to the behavioural assumptions identified in Phase 1.

A fairly large literature was been identified. Initial results were discussed with the BRE and a more targeted review of the literature was used for the remainder of the study. This review:

- used combinations of keywords to identify relevant sources that ensure the sources were within scope (i.e. ‘marketing codes’, ‘code of conduct’, ‘management-based regulation’, etc.) and include only empirical tests (e.g. ‘testing’, ‘evaluation’, ‘data’, ‘case study’, ‘survey’, etc.);
- reviewed sources that were specifically recommended by our experts;
- reviewed sources that test behavioural aspects in the UK and in comparable countries, use a range of methodologies, or review empirical studies.

The study team excluded the following from this review:

- aspects for which a wide and robust evidence base has already been identified and reviewed (such as that on pure industry self-regulation initiatives such as Responsible Care);
- purely theoretical sources;
- sources that test whether or not initiatives have been effective without considering how the design of initiatives has contributed to this success;
- sources that discuss the design of a specific initiative without testing the initiative; and
- sources published before 2000.

Notes taken based on the literature review were then reviewed, evidence was categorised in terms of the behavioural assumptions and results were triangulated. For the final report, the study team also revisited the UK examples identified as part of Phase 1, considering how these examples relate to the evidence found in the academic literature.

This publication is available from: www.gov.uk/government/publications/designing-self-and-co-regulation-initiatives-evidence-on-best-practice-a-literature-review

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