The Emergence of ‘Comply or Explain’ as a Global Model for Corporate Governance Codes

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Abstract

The introduction of the Cadbury Code in the UK in the early 1990s marked an important turning point in the evolution of corporate governance around the world. The ‘comply or explain’ approach pioneered by the Cadbury Code prioritised flexibility and the role of market discipline in its approach. While those characteristics can be linked to earlier trends in the evolution of corporate governance in the UK, it is more difficult to explain why the Cadbury Code has exerted so much influence over systems which differ from the UK in their approach and evolution. In this article we focus on the extent to which the ‘comply or explain’ approach has been adopted in other countries and attempt to explain why this has occurred. We propose three explanations for the diffusion of ‘comply or explain’ codes around the world and undertake qualitative and quantitative (leximetric) analysis to test these propositions.

Keywords

Corporate governance, codes, ‘comply or explain’, listed companies, disclosure, transplantation

1. Introduction

1.1. Research Context

The adoption of the Cadbury Code[1] in the UK in 1992 appeared at the time to be a

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[1] Sir Adrian Cadbury, *The Report of the Committee on the Financial Aspects of Corporate Governance* (1992) (hereafter ‘the Cadbury Report’).

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response to specific local problems in financial reporting, audit and accountability that emerged towards the end of a decade marked by a boom in mergers and acquisitions, financial deregulation and a series of corporate governance scandals. In retrospect, however, it is clear that the Cadbury Code has exerted significant influence on corporate governance around the world, with many countries choosing to emulate the 'comply or explain' approach that was pioneered by Cadbury. Moreover, the Cadbury Code has itself evolved considerably over time. It became the Combined Code in 1998 and was updated in 2003, 2006 and 2008 as it consolidated the work of a series of reviews; and it became the UK Corporate Governance Code (hereafter 'UKCGC') in 2010, with an update in 2016 and the most recent update in 2018. The process of evolution has moved the code some considerable way from its initial narrow focus on the relations between shareholders and the board, with diversity, stakeholder interests and corporate culture being notable features of recent updates. Its influence on governance practice is reflected not only in emulation in corporate governance frameworks around the world but also in other governance domains such as sports and charity governance. While Cadbury was preceded by Codes developed mainly in the United States,[2] its adoption of the 'comply or explain' approach was innovative and a key factor in its emergence as a global model.

The context in which the UK model exerted such influence around the world was dominated by two key developments. The first was the decline of market segmentation as capital markets around the world became increasingly integrated, leading to the emergence of global investment strategies and investment firms. The second was the increasing salience of corporate governance as a concept and a value proposition. While the term was virtually unknown to market practitioners and absent from most academic discourse in corporate law in the UK in the 1980s, it rose to prominence as supranational agencies such as the OECD and World Bank recognised its significance for economic development and began to link corporate governance reform to economic development programmes. That approach led to the development of the OECD Principles of Corporate Governance as an international benchmark in 1999.[3] It was supported by evidence demonstrating a 'governance premium' attaching to the share prices of foreign firms listed on exchanges which demanded higher standards of governance by comparison with those of the country of incorporation.[4]

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[2] For a summary of the early history see Ruth V. Aguilera and Alvaro Cuervo-Cazurra, *Codes of Good Governance Worldwide: What is the Trigger?* 25(3) Organization Studies 415-443, 418 (2004).

[3] See generally, *The G20/OECD Principles of Corporate Governance* <http://www.oecd.org/corporate/principles-corporate-governance/> accessed 5 May 2020. See also Cally Jordan, *Voluntary Codes of Corporate Governance: Evolution and Implications* in Oonagh E. Fitzgerald, ed.,*Corporate Citizen: New Perspectives on the Globalization of the Rule of Law,* ch 12, 209 (Waterloo ON: CIGI Press, 2020), arguing that the OECD provided the conduit for the Cadbury Code to be transformed into an international standard.

[4] McKinsey & Company, *Investor Opinion Survey* (June 2000) <https://www.oecd.org/daf/ca/corporategovernanceprinciples/1922101.pdf.> accessed 5 May 2020.

Against that background, we aim to evaluate the extent to which the Cadbury model has been emulated around the world and to explain why it has proven to be amenable to adoption in countries where the legal system, corporate law and institutional investment frameworks are very different from the UK. Our approach differs from earlier studies on the diffusion of codes in three key dimensions. First, our study extends over the period 1992-2020 whereas earlier studies omit the later phases in the introduction and development of codes. Second, our study is framed explicitly in the context of comparative corporate governance, whereas earlier studies focused on the diffusion of managerial practice, driven by efficiency and social legitimation effects.[5] Our focus enables 'comply or explain' codes to be located more explicitly in the overall legal framework of corporate governance so as to identify and explain the nature of the regulatory space that they occupy. It also allows us to build on leximetric research which clarified and corrected some of the comparative observations which underpinned the earlier research on diffusion of codes.[6] Third, we encompass evolution in codes after their adoption, in recognition of the dynamic and flexible nature of such codes by comparison with statutory corporate law.

We propose three explanations for the spread of 'comply or explain' codes around the world. We view these explanations as most likely operating in tandem rather than as alternative and independent drivers of the spread of 'comply or explain' codes. The first is that the spread of 'comply or explain' could be viewed as the outcome of a process of competition and convergence in global corporate governance. According to this view, the attraction of the 'comply or explain' model would be that it offered a superior form of corporate governance that would not displace the local model but would offer an additional tier of corporate governance superimposed on the basic statutory framework and operating in a more flexible manner. The second explanation is that 'comply or explain' codes offer a form of transplantation of corporate governance principles and rules that avoids the complications associated with the structure and operation of national systems of corporate law. Viewed in this light, 'comply or explain' codes offer a different rule type and form of enforcement by comparison

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[5] See e.g. Aguilera and Cuervo-Cazurra, *supra* n.2; Alessandro Zattoni and Francesca Cuomo, *Why Adopt Codes of Good Governance? A Comparison of Institutional and Efficiency Perspectives* 16(1) Corporate Governance: An International Review 1-15 (2008).

[6] See in particular Mathias M. Siems, *Convergence in Shareholder Law* (Cambridge: Cambridge University Press, 2008). See also Mathias M. Siems and David A. Cabrelli, *Comparative Company Law: A Case-Based Approach* (2nd ed., Oxford: Hart Publishing, 2018).The studies referenced in Aguilera and Cuervo-Cazurra, *supra* n. 2 and Zattoni and Cuomo, *supra* n. 5 relied on the approach of La Porta et al., which emphasised 'legal origins' in their account of the links between law and finance in a series of influential articles at the end of the 1990s; see Rafael La Porta, Florencio Lopez-De-Silanes, Andrei Shleifer et al., *Legal Determinants of External Finance* 52(3) The Journal of Finance 1131-1150 (1997); Rafael La. Porta, Florencio Lopez-De-Silanes, Andrei Shleifer, and Robert W. Vishny, *Law and Finance* 106(6) Journal of Political Economy 1113–1155 (1998); Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, *Corporate Ownership Around the World* 54(2) The Journal of Finance 471-517 (1999). Siems in particular has demonstrated the limitations of the 'legal origins' claim.

with corporate law.[7] Thus, ‘comply or explain’ codes facilitate reform of corporate governance by reference to a *sui generis* form of regulation that is not tied to national law. From this perspective it is the relationship of codes with local legal systems that is the key aspect rather than alignment with all the details of the UK model. The third explanation is that the spread of ‘comply or explain’ codes demonstrates the capacity of markets as a source of normative experimentation. Viewed in this light, the spread of ‘comply or explain’ codes can be seen as the creation of a *transnational* system of corporate governance driven by market actors around the world.[8] On this view, ‘comply or explain’ codes demonstrate a degree of uniformity in terms of structure, content and operation such that they can be considered to form a distinct system of transnational ordering.

We begin by clarifying our methodology and in part 2 we trace the origins and rationale for the ‘comply or explain’ technique. In part 3 we examine the evolution and operation of ‘comply or explain’ in the UK. In part 4 we present and discuss data drawn from our survey of countries and codes. Part 5 then elaborates on our three explanations for the emergence of ‘comply or explain’ as a global model and part 6 concludes.

1.2. Methodology

Our research question encompasses two related issues: first, the extent to which the UK code has served as a model for other countries; and second, why the UK code was amendable to adoption in legal and institutional settings that are very different from the UK. We approach these issues from the perspective of comparative corporate governance. We present descriptive and leximetric data drawn from a number of sources covering a total of 43 countries (44 including the UK), comprising the EU 27 and the G20[9] plus Nigeria.[10] We focus in particular on country characteristics, the structure and legal effect of codes, the extent to which codes aligned with the UK model when they were created and the extent to which they have adapted to take account of evolution in the UK code since Cadbury. Our primary focus is on govern-

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[7] See generally on rule type in corporate law Brian R. Cheffins, *Company Law: Theory, Structure, and Operation* (Oxford: Clarendon Press, 1997).

[8] This perspective is linked to the characterisation of transnational law first proposed by Philip Jessup. He writes that he ‘shall use the term “transnational law” to include all law which regulates actions or events that transcend national frontiers. Both public and private international law are included, as are other rules which do not wholly fit into such standard categories’: see Philip C. Jessup, *Transnational Law* (New Haven, Connecticut: Yale University Press, 1956). See also Fabrizio Cafaggi, *New Foundations of Transnational Private Regulation* 38(1) Journal of Law and Society 20-49 (2011); Colin Scott, Fabrizio Cafaggi, and Linda Senden, *The Conceptual and Constitutional Challenge of Transnational Private Regulation* 38(1) Journal of Law and Society 1-19 (2011).

[9] We exclude the US as it has not adopted a ‘comply or explain’ corporate governance code, and the EU, as an entity, as codes have been adopted individually by the member states and have not been subject to harmonization.

[10] We include Nigeria as the largest economy in Africa to compensate for the low representation of the African continent in the G20.

ance design, code structure and objectives rather than the fine detail of substantive provisions, which can vary between different countries which have adopted the 'comply or explain' model.

Our data in Appendix A is gathered from a number of different sources. In Table A1 we draw mainly on OECD data and the Shareholder Protection Index developed by the Centre for Business Research at the University of Cambridge.[11] This data provides an overview of country characteristics that helps to understand the legal and institutional setting in which the respective codes have been adopted. It encompasses share ownership patterns, the relative distribution of powers between shareholders and directors and the extent to which corporate law protects shareholders (from agency costs posed by directors and majority shareholders respectively). As the data is drawn from several datasets with differences in scope and focus, we do not have entries for every variable for every country. Nevertheless, we believe that the aggregation of this data provides a useful perspective on country characteristics and enables some relevant observations to be made on the context in which 'comply or explain' codes have been adopted.

In Table A2, we present a typology of corporate governance codes that focuses on key features of the regulatory design and implementation of codes, encompassing the custodian of the code, its legal status, scope of application, structure and form of disclosure required.[12] Our objective in the selection of code characteristics is to focus on how codes align with existing regulatory frameworks for listed companies, bearing in mind that similar substantive rules could operate differently in different settings.

In Table A3 we draw on hand-collected data to measure the degree of convergence against the UK code using leximetric coding.[13] In the case of initial convergence, we compare codes with three key provisions of the Cadbury Code 1992 (the initial UK code): board composition, directors' remuneration and reporting, audit & risk control.[14] We then compare codes with three key stages of evolution in the UK code, referencing the first version of the UK code in which the new provision appeared.[15] The three stages relate to diversity, stakeholders and culture respectively. For both initial convergence and evolution we use the current version of codes outside the UK for comparison, as the introduction and amendment of such codes is spread over many years, albeit with a concentrated phase in the late 1990s and early 2000s.

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[11] See the Key and footnotes to Table A1 for further details.

[12] As specified in Table A2, this data is drawn partly from the OECD (2019 Factbook) and partly from the relevant custodian's website. We comment in the relevant footnotes linked to Table A2 when the OECD data differs from that of the relevant custodian and/or our own evaluation.

[13] We use non-binary coding with three scores (2,1,0) to reflect the options open to countries, as evidenced by their codes: provisions functionally equivalent to the UK Code; different provisions on the same issue; and no provision in the Code (leaving the matter to be governed by corporate law). See generally on leximetric coding Priya Lele and Mathias Siems, *Shareholder Protection: A Leximetric Approach* 7(1) Journal of Corporate Law Studies 17, 18 (2007). The coding exercise was undertaken with ex-ante calibration and ex-post sample checking by both authors to ensure consistency.

[14] The relevant provisions are reproduced in Appendix A after Table A3.

[15] The relevant provisions are reproduced in Appendix A after Table A3.

Our discussion of the origins of 'comply or explain' in part 2 and the evolution of the UK system in part 3 provide contextual background for understanding the UK as the comparator system and the originator of the 'comply or explain' principle. In part 4 we present the data and make initial observations on country characteristics, code characteristics and convergence with the UK model. The figures in part 4 focus on key aspects of the data in Appendix A that are linked to our analysis. In part 5 we aim to analyse and explain our data and observations by reference to the three key themes in comparative corporate governance already mentioned in part 1.1 above. While our data cannot provide direct causal links, we believe that it provides strong contextual support for our claims linked to those themes.

2. The Origins and Rationale for 'Comply or Explain'

In this part we trace the origins and rationale of the 'comply or explain' principle which underpins most corporate governance codes. We identify three main influences. The first is flexibility in corporate governance, which has a long history in UK company law. The second is accountability in corporate governance, which is linked historically to the relatively broad discretion given to boards of directors by UK company law and the default articles of association, and in more recent times with concern over the reliability of financial reporting and audit. The third influence is the tradition of self-regulation in UK corporate governance, which is linked to the emergence of powerful collective organizations of shareholders that have historically demarcated a space for self-regulation which, at least prior to the spread of 'comply or explain' codes around the world, was much less evident in other jurisdictions.

2.1. Flexibility in Corporate Governance

The rationale for the 'comply or explain' principle is often said to be that it offers flexibility in corporate governance, thereby enabling the governance structure to adapt to the needs of the business.[16] At a conceptual level, that approach follows a trend in UK company law that has been evident since 1856, when the articles of association were moved from the main body of company law and designated as default rules that could be altered by shareholder resolution.[17] Ever since then, company law statutes in the UK have contained relatively few provisions on corporate governance with the result that the articles of association have been the main source of such rules. While a special resolution[18] is required to change the articles, it remains the case that share-

[16] In line with the corporate governance literature, the UKCGC has consistently emphasised that one size does not fit all, and that governance and financial performance can be enhanced by adapting the governance structure to align with the needs of the individual company.

[17] The Joint Stock Companies Act 1856 (19 & 20 Vict. c.47).

[18] A special resolution requires a 75% majority of votes cast: see Companies Act 2006, s. 21.

holders can design and modify the governance structure with a degree of freedom that is often not available in other jurisdictions.[19]

In the context of corporate governance codes, flexibility can be understood in two different ways: first, as an element of rule design and compliance; and second, as an element of self-regulation that facilitates evolution and adaptation in a more agile manner than is possible within a system of statutory regulation.[20] With regard to the first element, it has been argued, in the context of the UK, that the flexibility that is claimed to result from the 'comply or explain' principle is not fundamentally different in nature or degree from the flexibility that would result from the adoption of the Code as a set of default rules in company law.[21] The second dimension of flexibility is evident in the multiple revisions of the UKCGC since the original Cadbury Code in 1992. Reform of statutory company law is a more complicated and rigorous process involving broad consultation and cost-benefit analysis.

2.2. Accountability in Corporate Governance

The emergence of a 'comply or explain' Code in the UK can also be viewed as an accountability mechanism which addresses the inevitable agency problems that arise when broad powers are granted to the board of directors. The UK has historically been a 'shareholder-primacy' country in terms of the distribution of powers between shareholders and the board, with a wide range of decisions reserved to shareholders.[22] Nevertheless, the broad powers granted to the board in the conduct of the business of companies by the default articles open up the risk of excessive or inappropriate risk-taking, manipulation of financial results and excessive remuneration. While monitoring of and engagement with individual companies on these issues might provide a solution, the development of a 'comply or explain' code provided a collective solution with a degree of flexibility to accommodate individual company needs. That approach

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[19] Cottrell (1980: 52), describing the UK as the most permissive regime in Europe following the consolidation of company law in the Companies Act 1862: P. L. Cottrell, *Industrial Finance, 1830–1914: The Finance and Organization of English Manufacturing Industry* (London New York: Methuen, 1980). The benefits of flexibility may also be linked to firm size; see e.g QCA Research Report, *Corporate Governance on AIM* <https://www.theqca.com/news/briefs/194281/corporate-governance-on-aim-new-qca-research-report.thtml> accessed 27 May 2020, demonstrating the preference of AIM-listed companies for the QCA Code over the UKCGC as a result of its greater flexibility.

[20] See Andrew Keay, *Assessing Accountability of Boards Under the UK Corporate Governance Code* (7) Journal of Business Law 551 (2015).

[21] Iain MacNeil and Xiao Li, *"Comply or Explain": Market Discipline and Non-compliance with the Combined Code* 14(5) Corporate Governance: An International Review 486-496 (2006).

Underlying that argument is the observation that the role of shareholders would be broadly equivalent under either approach in the sense of directing the company towards the optimal governance structure either by selection/rejection/amendment of default rules or compliance/non-compliance with provisions of the Code. The position would be different in countries in which mandatory rules play a more important role in company law. In those countries, the flexibility provided by 'comply or explain' can be seen as a mechanism for delivering flexibility across a limited range of governance issues without disrupting the balance between mandatory and default rules or the broader doctrinal foundations of company law.

[22] Ibid.

aligned both with the tradition of shareholder primacy and with the self-regulatory tradition that it facilitated, as corporate governance in its more modern form became more clearly recognised.[23]

From a more instrumental perspective, the primary driver for concerns over accountability was distrust with regard to both financial reporting and audit.[24] With regard to the former, the rise of 'creative accounting' and off-balance sheet transactions[25], linked to a boom in M & A activity, raised serious questions about the credibility of financial reporting and the relationship between institutional investors and companies. With regard to audit, it was observed that the process became commoditised as competition increased and pressure was exerted on auditors to accept practices that 'sailed close to the wind'. Meanwhile, the decision in the *Caparo* case[26] served to expose confusion over the role of auditors while at the same time providing a warning over the limited extent to which investors could rely on audited accounts. The establishment of the Financial Reporting Council[27] in 1990 attempted to address these issues, but they remained to the fore in the establishment of the Cadbury Committee and in its Report.[28]

With these concerns to the fore, the Cadbury Report made three basic recommendations addressing these issues: the CEO and Chair of companies should be separated; boards should have at least three non-executive directors, two of whom should have no financial or personal ties to executives; and each board should have an audit committee composed of non-executive directors.[29] While these proposals were framed as best practice, they were more aspirational than a description of the prevailing arrangements. In this respect, it has been observed that the UK lagged behind the US in the development of corporate governance, with requirements for non-executive directors and audit committees featuring in the NYSE Listing Rules long before Cadbury.[30] Nevertheless, in contrast with the 'tome' which emerged from the American Law

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[23] As noted by Laura F. Spira and Judy Slinn, *The Cadbury Committee: A History* (Oxford: Oxford University Press, 2013), the term corporate governance did not come into general usage until the late 1980s. See also Brian R. Cheffins, *The Rise of Corporate Governance in the UK: When and Why* 68(1) Current Legal Problems 387–429 (2015).

[24] See generally Spira & Slinn, *supra* n. 23, ch. 2.

[25] See generally Doreen J. McBarnet and Christopher J. Whelan, *Creative Accounting and the Cross-Eyed Javelin Thrower* (New York: Chichester; J. Wiley, 1999).

[26] *Caparo v Dickman* [1990] 2 A.C 605 (HL).

[27] The independent review of the FRC led by Sir John Kingman recommended (in December 2018) that the FRC be replaced with an independent statutory regulator called the Audit, Reporting and Governance Authority, see <https://www.gov.uk/government/news/independent-review-of-the-financial-reporting-council-frc-launches-report> accessed 5 May 2020.

[28] The opening section of the Report comments as follows: 'The Committee has sought to bring forward proposals which would promote good financial corporate governance, without diminishing the competitive ability of companies. The Committee's recommendations ae sharply focused on the control and reporting functions of boards, and on the role of auditors. This reflects the Committee's purpose, which was to review those aspects of corporate governance specifically related to financial reporting and accountability'. Committee on Financial Aspects of Corporate Governance, *supra* n.1, para. 1.2.

[29] Ibid., paras 4.9, 4.11 and 4.35(b).

[30] See Cally Jordan, *supra* n.3; Cheffins, *supra* n.23.

Institute's project on corporate governance[31] around the same time, the Cadbury Code provided a simple model focused on high-level principles rather than detail, and avoided overlap with the statutory framework for corporate law.

The development of the UKCGC from Cadbury onwards can also be viewed as shifting the accountability paradigm from a primarily *ex post* focus to having a more *ex ante* focus. The *ex post* focus is evident primarily in board responsibility for preparing financial reports for shareholders and the role of courts in reviewing directors' actions by reference to directors' duties. Starting with the Cadbury Code, the UKCGC has progressively developed a more *ex ante* focus by introducing requirements relating to board structure and composition and in particular by strengthening the role of independent non-executive directors in making key decisions. Moreover, in the light of what has been argued above with regard to flexibility, it seems likely that accountability ought to be considered the most important contribution of the UKCGC in its domestic context[32], even if, as argued later, the flexibility aspect may be just as important for countries in which the corporate law framework lacks that characteristic.

2.3. The Tradition of Self-Regulation in UK Corporate Governance

The emergence of corporate governance as a distinct category from company law in the UK can be linked with the growth of institutional shareholding after the second world war and the increasing role of large public-listed companies in the economy. These developments drew attention to the powerful role of institutional shareholders and raised questions around the appropriate design of governance in an era in which the public interest was more prominent than had previously been the case. These questions inevitably extended beyond the limits of company law because they encompassed the relationship between institutional shareholders and underlying investors and broader issues of political economy regarding the balance of power between capital and labour.[33]

Viewed in this light, the emergence of the 'comply or explain' principle in the Cadbury Code in 1992 can be linked with a longer tradition of self-regulation in the UK approach to corporate governance.[34] This approach served to demarcate a relatively broad field of self-regulatory control for institutional shareholders and was linked both to the historic role of shareholders in controlling the company constitution and the relative lack of attention to the interests of other stakeholders. For example,

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[31] For background on the ALI project and process, see Bayless Manning, *Principles of Corporate Governance: One Viewer's Perspective on the ALI Project* 48(4) The Business Lawyer 1319-1332 (1993). For an early articulation of the concept of the 'monitoring board' in the US context see Melvin A. Eisenberg, *The Structure of the Corporation: A Legal Analysis* (Little, Brown and Co. 1976).

[32] This perspective is consistent with the framing of the Cadbury Code as 'best practice' rather than a change to the corporate governance framework as well as the explicit focus on the control and reporting functions of the board.

[33] For a review of developments in the post -war period see Spira & Slinn, *supra* n.23 ch.1.

[34] Albeit there was some support on the Cadbury Committee for a statutory approach; see Spira & Slinn, *supra* n.23, p.74.

the Jenkins Committee, which recommended changes in company law in 1962, warned against excessive regulation of the corporate sector.[35] In 1973, the CBI published a report entitled 'The Responsibilities of the British Public Company'[36] in which it argued that self-regulation and evolution in corporate governance were preferable to statutory intervention. Many of the principles adopted by the Cadbury Code can be traced back to the Principles of Corporate Conduct proposed by the CBI at that time. Another factor supporting self-regulation was the activity of collective investor bodies such as the Institutional Shareholders Committee (ISC), the Investment Management Association (IMA), the Association of British Insurers (ABI) and the National Association of Pension Funds (NAPF).[37] These bodies represented the collective interests of institutional investors in listed companies and while they could no doubt operate effectively whether corporate governance was subject to statutory intervention or not, their existence and power made self-regulation workable. Without such organizations, much of the impetus for developing and implementing 'soft law' codes of corporate governance would be missing.

Some challenge to the self-regulatory tradition and its implicit endorsement of a shareholder-primacy oriented model of corporate governance was evident in moves to formalise worker representation on corporate boards along the lines that had already developed in some European countries such as Germany. Both the EU's Fifth Company Law Directive[38] and The Bullock Report in 1977[39] proposed forms of worker representation on larger company boards which could have moved the UK closer to a stakeholder model of corporate governance with a more limited self-regulatory space in which shareholders could operate. Ultimately, however, that initiative failed and it was not until the introduction of the Business Review in 2007 that serious attention to stakeholder interests appeared on the UK corporate governance agenda.[40] And even in tandem with that move, the tendency to favour self-regulation over statutory intervention was continued by the government-sponsored review of company law that foreshadowed the Companies Act 2006, on the basis that it provided for a more competitive and effective system of regulation than statutory regulation.[41]

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[35] Board of Trade, *Report of the Company Law Committee* Cmnd 1749 (1962) 3 para.11.

[36] CBI, *The Responsibilities of the British Public Company: Final Report of the Company Affairs Committee* (1973).

[37] For more detail regarding these organisations, see Iain MacNeil, *An Introduction to the Law on Financial Investment,* ch.5.7 (2nd edn, Oxford: Hart Publishing, 2012).

[38] Directive (EU) 2017/1132 of the European Parliament and of the Council of 14 June 2017 relating to certain aspects of company law [2017] OJ L169/46.

[39] Report of the committee of inquiry on industrial democracy (1977) Cmnd 6706.

[40] The Business Review was introduced by the Companies Act 2006 and superseded by the Strategic Report in 2013.

[41] See *Modern Company Law for a Competitive Economy,* Final Report (1998) para. 1.28 (referencing the need for self-regulatory codes as part of the broad governance framework); *Modern Company Law for a Competitive Economy* (1998) The Strategic Framework ch. 5.5 *The Boundaries of the Law* at para 5.5.3.<https://webarchive.nationalarchives.gov.uk/20060214184106/> <http://www.dti.gov.uk/cld/comlawfw/index.htm>, commenting as follows: accessed 5 May 2020: 'Non-statutory regulation enables flexibility and dynamism in the development of rules and other guidance, while it tends to permit in

Moreover, while the Company Law Review Steering Group recognized that the 'the present structure offers the benefit of familiarity even if it sometimes appears to lack logic',[42] it concluded that 'we would expect the general trend to be away from prescriptive rules set out in the statute and enforced by criminal sanctions. These might in appropriate cases be replaced by more flexible rules in the form of codes of practice, expressed in sufficiently general terms to permit the exercise of judgement and common sense in their application to individual cases.' That approach, albeit lacking in a rigorous comparison of alternatives (such as consideration of the flexibility inherent in statutory default rules) effectively endorsed the self-regulatory dimension of the Cadbury Code and, by leaving open considerable space for self-regulation, facilitated the later development of the Stewardship Code focusing on the role of shareholders as stewards for their ultimate investors.

However, over time the purely self-regulatory character of the Code has lessened as conformance with the Code has been required by the UK Listing Rules.[43] Conformance in this sense distinguishes between obligations attached to the principles of the code and its provisions.[44] In the former case, listed companies are required to provide a statement explaining how the principles have been applied (so called 'apply and explain'). In the latter case, the 'comply or explain' principle is followed, with the result that conformance can take the form of non-compliance with the provision accompanied by an explanation of the reasons for non-compliance. There are no stipulations as to the nature of the explanations for non-compliance and the policy has been that this is a matter for shareholders rather than regulators, in line with the self-regulatory origins of the code.[45] The self-regulatory dimension has also been

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appropriate contexts a higher level of generality or vagueness in expression, combined with more sensitive discretionary enforcement to meet the merits of varying cases. The drawbacks can include lack of precision; lack of transparency in both the rule making and the enforcement activities; and suspicion, well founded or not, that the authorities administering the rules may tend to favour their own members or clients, or wider commercial considerations.'

[42] Ibid., para. 5.5.5. The absence of logic in the common law is well known; see the sources cited in Pierre Legrand, *European Legal Systems are Not Converging* 45(1) The International and Comparative Law Quarterly 52, 67 (1996).

[43] See FCA Handbook, LR 9.8.6(R)6 for the current requirements. See also DTR 7.2 for details of the corporate governance statement that must be included in the annual report. This statement must include, inter alia, the corporate governance code to which the company is subject and all relevant information on how the corporate governance principles have been applied. This linkage to hard law corresponds with the hybrid approach proposed by Anita Anand, *Voluntary vs. Mandatory Corporate Governance: Towards and Optimal Regulatory Framework* (2005) American Law and Economics Association Annual Meeting <https://law.bepress.com/cgi/viewcontent.cgi?article=1537&context=alea> accessed 5 May 2020.

[44] We follow the earlier approach of MacNeil and Li, *supra* n.21 in distinguishing compliance and conformance. In particular, we refer to non-compliance with provisions of the Code accompanied by a satisfactory explanation as conformance with the obligation imposed by the UK Listing Rules.

[45] The issue of the quality of explanations has, however, attracted considerable attention. See Keay (n. 20) for a detailed discussion of the UK corporate governance reports. See also, FRC, *The UK Approach to Corporate Governance* (October 2010) for a detailed analysis of the UK's approach. For a short history of the 'comply or explain' approach see Marc T. Moore, *The End of "Comply or Explain" in UK Corporate Governance?* 60(1) Northern Ireland Legal Quarterly 85, 87 (2009).

diluted through the role of a public custodian (the FRC) in monitoring implementation and updating the code in consultation with the market.

3. The Evolution and Operation of 'Comply or Explain' in the UK

In this part we focus on two key features of the Code that are linked to its role as a global model. The first is the process of evolution. As already mentioned, one element of the flexibility associated with the 'comply or explain' model is that it is amendable to more rapid revision than would be possible with statutory provisions. We analyse that process by reference to two forms of evolution: the first with respect to substantive provisions and the second with respect to adjustment to the 'comply or explain' principle through the partial movement to the 'apply and explain' principle. The second aspect that we focus on is the operation of the 'comply or explain' principle and in particular the quality of explanations that are given when a company chooses not to comply and the nature of the oversight and enforcement that is associated with such non-compliance. In a broad sense, both of these features can be viewed as indicators of the success of the UK Code, measured by reference to its objectives, and could be expected to influence the selection of the UK Code as a model by other countries in preference to a hard law (statutory) alternative.

3.1. Evolution

(i) Substantive Provisions

The Cadbury Code marked the beginning of a process of evolution which eventually led first to the Combined Code in 1998[46] and more recently to the UK Corporate Governance Code in 2010.[47] Building on the Cadbury approach and with a view to adjusting elements in light of experience, various other reports were published between 1995 and 2014 such as the Greenbury Report,[48] the Hampel Report,[49] the Turnbull Report, the Higgs Review and the Smith Report.[50]

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[46] On 25 June 1998 the London Stock Exchange published the Code of Best Practices (the Combined Code), which incorporated the recommendations of the Hampel and Greenbury Committees. This was updated in 2003. The 2003 Combined Code derived from a review of the role and effectiveness of non-executive directors by Derek Higgs and a review of audit committees by Sir Robert Smith. In December 2006 the 2003 Combined Code was updated.

[47] In 2010 (revised in 2012 and 2014) and 2016 and the most recent one in 2018 <https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code> accessed 5 May 2020.

[48] *Directors' Remuneration Report: Report of a Study Group chaired by Sir Richard Greenbury* (1995).

[49] *The Hampel Committee Report* (January 1998) <https://www.icaew.com/technical/corporate-governance/codes-and-reports/hampel-report> accessed 5 May 2020.

[50] *The Turnbull Report, Internal Control: Guidance for Directors on the Combined Code* (1999) <https://www.icaew.com/technical/corporate-governance/codes-and-reports/turnbull-report>; Derek Higgs, *Review of the role and effectiveness of non-executive directors* (January 2003) <https://webarchive.

Board independence has been a central theme from the outset and has influenced the Code provisions on board structure and composition. This approach has always been based on the presumption that independent boards – those with a high proportion of members who are independent of the company – make better decisions. Evidence supporting that proposition, especially in the US where the tradition of independent directors was longer established, was already available in the 1990s[51] and has generally remained influential, even if the global financial crisis exposed the risk of having too little operational experience on the board.[52]

In terms of substantive content, we observe several key phases of development. The first relates to remuneration. Public concern over pay (especially in the newly privatized utilities) in the early 1990s led to the establishment of a so-called 'study group' under the chairmanship of Richard Greenbury in 1995. The group adopted what were described by the chairman as a 'radical set of proposals embodied in a new Code of Practice'. The Code endorsed the move already underway in some companies towards having a remuneration sub-committee responsible for setting remuneration and required that the committee be comprised only of independent non-executive directors. The Code also expanded the statutory disclosure obligations of listed companies[53] and encouraged better linkage of pay with performance. The later Hampel Report in 1998 generally endorsed the approach of Greenbury, including an *ad hoc* approach as to whether shareholders be invited to approve the remuneration policy at the annual general meeting. With the benefit of hindsight, that compromise proved to be probably the single most significant error in the early development of the Cadbury Code as it is the sole instance of the removal of a significant issue from the self-regulatory ambit of the Code. The government responded to continuing public concern by expanding statutory disclosure requirements, and when that had failed to change behaviour, by introducing a 'say on pay' vote for shareholders, first in an advisory and later in a binding form. It was only at the very end of that process that any material change occurred in remuneration practice across listed companies as a whole.[54]

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nationalarchives.gov.uk/20121106105616/> <http://www.bis.gov.uk/files/file23012.pdf>; and the *Smith Report* (2003) <https://www.icaew.com/technical/corporate-governance/codes-and-reports/smith-report> all accessed 5 May 2020.

[51] See e.g. Sanjai Bhagat and Bernard S. Black, *Independent Directors* 2 *The New Palgrave Dictionary of Economics and the Law* 283-287, 284 (1998) on whether board independence corresponds with the long-term performance of large American firms; Anup Agrawal and Charles R. Knoeber, *Firm Performance and Mechanisms to Control Agency Problems between Managers and Shareholders* 31(3) Journal of Financial and Quantitative Analysis 377-397 (1996); Scott W. Barnhart and Stuart Rosenstein, '*Board Composition, Managerial Ownership, and Firm Performance: An Empirical Analysis* 33(4) Financial Review 1-16 (1998).

[52] See e.g. Emilios Avgouleas and Jay Cullen, *Market Discipline and EU Corporate Governance Reform in the Banking Sector: Merits, Fallacies, and Cognitive Boundaries* 41(1) Journal of Law and Society 28-50 (2014).

[53] Appendix 1 of the Greenbury Report sets out the relevant disclosure obligations (in the Companies Act 1985).

[54] See generally Betty (H.T.) Wu, Iain MacNeil and Katarzyna Chalaczkiewicz-Ladna, *"Say on Pay" Regulations and Director Remuneration: Evidence from the UK in the Past Two Decades* 20(2) Journal of Corporate Law Studies 541-577 (2020).

The second phase relates to board composition (non-executive directors) and structure[55] (committees). The Cadbury Report already included recommendations on the structure of the board, the role and independence of the non-executive director and terms of office for directors.[56] In 1998 the Report of the Committee on Corporate Governance Final Report 1998 (hereafter the Hampel Report) was published. The brief of the Hampel Committee covered all issues relating to corporate governance, and so was not as restricted as that of the Cadbury and Greenbury Committees.[57] It also had the task of looking afresh at the roles of directors, shareholders and auditors in corporate governance. Among other things, it recommended that the board should include a balance of executive and non-executive directors and that the roles of chairman and CEO should be separate. In April 2002 Derek Higgs was appointed to lead an independent review of the role and effectiveness of non-executive directors and his report was published in January 2003. The Higgs report contained various recommendations on the role of the board, non-executive directors, independence of directors, appointment and induction of directors. It specifically recommended (inter alia) that: at least half of a board (excluding the Chair) be comprised of non-executive directors; and that a senior independent director be nominated and made available as a conduit for shareholders' concerns. The FRC published good practice suggestions from the Higgs report in June 2006; this guidance has since been withdrawn and replaced by the FRC Guidance on Board Effectiveness.[58]

The third key phase of development relates to diversity (gender). Starting with the Davies Review in 2011,[59] this issue has received ample attention over the last 10 years: the 'Women on Boards' report which followed the review set a voluntary target of 25% for women on the boards of FTSE 100 companies by the end of 2015. The 2016/2017 'Corporate Governance Inquiry' of the Government underlined a positive connection between the gender diversity of boards and financial performance and pointed out an increase of the number of women on boards from 12.5% in 2010 to

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[55] The Cadbury Report focused on the recommended responsibilities of the board. This included recommendations on the structure of the board, the role and independence of non-executive directors and terms of office for directors (see paras 4.1-4.6 and paras 4.10-4.17 on NEDs).

[56] Ibid., paras 4.1-4.6 and paras 4.10-4.17.

[57] The remit of the committee was to review the Cadbury Code and its implementation, and to ensure that the original purpose was being achieved. The committee was also asked to pursue any relevant matters arising from the Greenbury Report, but it also had an additional task, namely: to look afresh at the roles of directors, shareholders and auditors in corporate governance.

[58] See FRC, *Guidance on Board Effectiveness* (July 2018) <www.frc.org.uk/getattachment/61232f60-a338-471b-ba5a-bfed25219147/2018-Guidance-on-Board-Effectiveness-FINAL.PDF> accessed 5 May 2020. It provides non-mandatory suggestions of good practice to support directors and their advisers in applying the Code. It is meant to be helpful also to a wide range of stakeholders when assessing the actions taken by the board in relation to the governance of the company. Importantly, it underlines that the Code "promotes a more inclusive approach to stakeholder engagement and encourages boards to reflect on the way in which decisions are taken and how that might affect the quality of those decisions."

[59] The Davies Review is a government-backed commission, which was first introduced in 2010 to examine the underrepresentation of women on boards. Lord Davies of Abersoch, Minister of State for Trade, Investment and Small Business, spearheaded the review.

26.1 % in 2015.[60] The Inquiry recommended companies to ensure that women are encouraged and equipped to progress to executive director posts, where the proportion of women was lower. Companies would also need to communicate how they achieve these goals. The aim of the Hampton-Alexander Review[61] in 2016 was to build on the work of the Davies Review to increase the number of women on FTSE 350 boards to 33% by 2020, with an important new focus aimed at improving the representation of women in leadership positions of FTSE 350 companies.[62] The target of 25% was met and in October 2015 Lord Davies released his five-year summary of the report, raising the target to 33% by 2020 on FTSE 350 boards.[63] Unlike the case of remuneration, and in contrast with some other EU countries, these parallel self-regulatory initiatives have likely been influential for diversity remaining within the self-regulatory domain of the UKCGC rather than being the subject of mandatory regulation.

The fourth key stage of evolution was the focus on stakeholder interests. A consultation on UK corporate governance reform was launched in November 2016 and in August 2017 the Government suggested strengthening stakeholders' interests through improved reporting, UKCGC changes, raising awareness and more guidance.[64] That process was already evident with regard to non-financial reporting, with the 2014 EU Non-financial Reporting Directive[65] and subsequent UK legislation expanding the obligations of companies to report across a broader range of non-financial issues, including environmental, diversity and human rights.[66] However, the articulation of

[60] House of Commons BEIS, *Corporate Governance Inquiry* (Third Report of Session 2016-2017, March 2017) paras 120 and 121 <https://publications.parliament.uk/pa/cm201617/cmselect/cmbeis/702/702.pdf> accessed 30 July 2017.

[61] This is an independent review body building on the work of the Davies Review to increase the number of women on FTSE 350 boards. The Review adopts a voluntary business-led approach.

[62] Hampton-Alexander Review, *FTSE Women Leaders – Initial Report* (8 November 2016) 10 <www.gov.uk/government/publications/ftse-women-leaders-hampton-alexander-review> accessed 17 July 2017, and the recent version, published in November 2019<https://ftsewomenleaders.com/> accessed 5 May 2020. Regarding reporting on board diversity, see <https://www.frc.org.uk/getattachment/62202e7d-064c-4026-bd19-f9ac9591fe19/Board-Diversity-Reporting-September-2018.pdf> accessed 5 May 2020. This is dealt with in Principle J and Provision 23 of the UKCCG 2018. See also s.414C(8)(c) of the Companies Act 2006 (strategic reporting requirements for quoted companies).

[63] In the latest Alexander-Hampton Report, it is indicated that 'The FTSE 100 has progressed in line with expectations and is close to the target with the number of women on FTSE 100 Boards at 32.4% in 2020 up from 30.2% in 2018'.

[64] BEIS, *Corporate Governance Reform Green Paper* (November 2016) <www.gov.uk/government/uploads/system/uploads/attachment_data/file/584013/corporate-governance-reform-green-paper.pdf> accessed 30 July 2017, and subsequently BEIS, *Corporate Governance Reform: The Government Response to the Green Paper Consultation* (August 2017) <www.gov.uk/government/uploads/system/uploads/attachment_data/file/640470/corporate-governance-refo rm-government-response.pdf> accessed 4 September 2017.

[65] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups [2014] OJ L 330/1.

[66] Irene-Marie Esser, Iain MacNeil, and Katarzyna Chalaczkiewicz-Ladna, *Engaging Stakeholders in Corporate Decision-Making through Strategic Reporting: An Empirical Study of FTSE 100 Companies*

stakeholder interests remains rather underdeveloped in the UKCGC and represents an example of the Code following developments in hard law (strategic reporting) rather than the more established pattern of employing soft law to extend the corporate governance framework.

The most recent theme in the evolution of UK corporate governance concerns 'corporate culture'.[67] The FRC's approach is that 'Culture in a corporate context can be defined as a combination of the values, attitudes and behaviours manifested by a company in its operations and relations with its stakeholders. These stakeholders include shareholders, employees, customers, suppliers and the wider community and environment which are affected by a company's conduct.' It is interesting to note that, in the latest report of the FRC there are 29 references to 'culture' and it is observed that most companies deal with culture in their reports, but the link between the purpose of the company and its culture is still problematic.[68]

While these substantive changes do not explicitly adjust the 'comply or explain' mechanism, they are linked to two developments which are important for the evolution of the UKCGG. The first is the gradual movement from a self-regulatory model, led mainly by market actors, to one in which the FRC, a regulatory body constituted by statute,[69] became the main driver of code development. In that sense, what had been a self-regulatory space occupied by the code became a hybrid regulatory space with significant input from a regulator. The second is the reversal of the feedback loop between the UKCGC and statutory law. While remuneration moved from the Code to statute (in the form of disclosure obligations and 'say on pay' votes for shareholders) in the early 2000s, stakeholder interests only appeared in the Code in 2018, foreshadowed by earlier developments in strategic reporting in the UK and the EU Non-Financial Reporting Directive.[70]

29(5) European Business Law Review 729-772 (2018) ; and Irene-Marie Esser, Iain MacNeil, and Katarzyna Chalaczkiewicz-Ladna, *Engaging Stakeholders in Corporate Decision-Making through Strategic Reporting: An Empirical Study of FTSE 100 Companies (Part 2)* 31(2) European Business Law Review 209 – 242 (2020). See also, Climate Disclosure Standards Board, *Comply or Explain, A Review of FTSE 350 Companies' Environmental Reporting and Greenhouse Gas Emission Disclosures in Annual Reports* (2016) <https://www.cdsb.net/sites/default/files/cdsb_comply_or_explain.pdf.>accessed 1 May 2020.

[67] FRC, 'Corporate Culture and the Role of Boards'<https://www.frc.org.uk/directors/the-culture-project>accessed 1 May 2020.

[68] See FRC, *Annual Review of the UK Corporate Governance Code* (January 2020) 9<https://www.frc.org.uk/getattachment/53799a2d-824e-4e15-9325-33eb6a30f063/Annual-Review-of-the-UK-Corporate-Governance-Code,-Jan-2020_Final.pdf> accessed 1 May 2020.

[69] The FRC was established in 1990 as a company limited by guarantee by order of the Secretary of State under the powers contained in Companies Act 2006, s 525 and 1252. For a detailed outline of the FRC's powers and the relevant statutory authority, see FRC, Roles and Responsibilities, Schedule of Functions and Powers (June 2017) <https://www.frc.org.uk/getattachment/67835f0e-e4c2-4d2a-9aeb-e57feed885be/FRC-Roles-Responsibilities-Schedule-of-Functions-Powers-June-2017.pdf> accessed 25 May 2020.

[70] Esser, MacNeil, and Chalaczkiewicz-Ladna, *supra* n.66.

(ii) Evolution in Structure

The 1998 Combined Code contained both principles and detailed Code provisions. The principles operated on an 'apply and explain' basis:[71] although this term was not specifically mentioned it was made clear that companies should explain their policies in light of the principles.[72] The provisions operated on a 'comply or explain' basis.[73] That approach differed from the Cadbury Report, which was a unitary set of good corporate governance principles that operated on a 'comply or explain' basis. In the 2003 Combined Code, main and supporting principles and provisions were introduced, still operating on this tiered approach.[74] This was the same in the 2006 Combined Code as well as the later corporate governance codes. The 2018 Code, which is divided into principles and provisions, focuses on the application of the principles and reporting on outcomes achieved.[75] With respect to the Code's provisions, companies should disclose how they have complied with these or provide an explanation appropriate to their individual circumstances. It can thus be said that the UK system has gravitated towards a tiered basis of principles, being applied on an 'apply and explain' basis and the provisions on a 'comply or explain' basis.

3.2. Operation

Corporate governance in the United Kingdom is based on the principle of flexibility, which implies that companies should be able to choose whether to comply fully with principles of good governance or not.[76] The notion that implementation of the Code should be uniform was rejected from the beginning and it was argued that a 'one-size-

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[71] The Combined Code (May 2000) <https://assets.publishing.service.gov.uk/media/5329db50e5274a2268000045/financial_reporting_council_presentation.pdf> accessed 1 May 2020. This 'apply and explain' approach can best be described with reference to the position in South Africa. *King III* (2009) adopted an 'apply or explain' approach. The King III committee found the word 'apply' more appropriate than 'comply'. It was argued that the 'apply or explain' approach shows an appreciation for the fact that it is often not a case of whether to comply or not, but rather to consider how the principles and recommendations can be applied. The most recent *King Report* (IV) favours the 'apply and explain' approach.

[72] Ibid., para 4.

[73] Ibid., para 5.

[74] See further Bobby V. Reddy, *Thinking Outside the Box – Eliminating the Perniciousness of Box-Ticking in the New Corporate Governance Code* 82(4) MLR 692-726 (2019), drawing attention to the complicated status of supporting principles.

[75] This approach is also followed in the Wates Corporate Governance Principles for Large Private Companies (2018) <https://www.frc.org.uk/getattachment/31dfb844-6d4b-4093-9bfe-19cee2c29cda/Wates-Corporate-Governance-Principles-for-LPC-Dec-2018.pdf.> accessed 1 May 2020. It is also the case with the new Stewardship Code (2019) <https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf>accessed 1 May 2020.

[76] Philip J. Shrives and Niamh M. Brennan, *A Typology for Exploring the Quality of Explanations for Non-Compliance with UK Corporate Governance Regulations* 47(1) The British Accounting Review 85-99 (2015) . See also FRC, *The UK Approach to Corporate Governance* (October 2010) for a detailed analysis of the UK's approach.

fits-all' approach is not realistic. Therefore, UK listed companies can 'opt-out' of the requirements of the Code, subject to providing valid reasons and justifications for doing so. This 'opt-out' procedure is preferred as it gives the board the discretion not to comply with a principle in the Code if it is not cost effective or inappropriate to the company's specific circumstances, subject to providing an explanation.[77]

Explanations of non-compliance are the cornerstone of the 'comply or explain' approach.[78] This approach is based on the premise that the market and shareholders will act as enforcement mechanisms. The market will monitor compliance and will either penalise non-compliance through lowering the share price or accept the non-compliance based on the justifications provided.[79] If companies do not conform with the Listing Rule obligations linked to the UKCGC, the FCA can in principle penalise the failure to comply.[80] On the other hand, it seems clear that the framing of the disclosure obligation in the Listing Rules does not envisage a role for the regulator in evaluating the quality of explanations, in line with the self-regulatory ethos of the 'comply or explain' principle.[81]

A number of studies have been undertaken in the United Kingdom to determine the level of conformance with the Code. The studies mainly seek to determine, in cases of non-compliance, to what extent adequate explanations are given.

In 2006 Arcot and Bruno[82] examined the effectiveness of the 'comply or explain'

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[77] Moore, *supra* n.45, 101. It was stated in the Cadbury Report that: 'The Code is to be followed by individuals and companies in the light of their own particular circumstances. They are responsible for ensuring that their actions meet the spirit of the Code and in interpreting it they should give precedence to substance over form'. See Committee on Financial Aspects of Corporate Governance (n.1) para. 3.10.

[78] Shrives & Brennan, *supra* n.76, 85.

[79] MacNeil and Li, *supra* n.21, 487. See also Andrew R. Keay, *Directors' Duties* (2nd edn, Bristol: Jordan Publishing, 2014).

[80] Financial Services and Markets Act 2000 (c.8) s.91. The Listing Rules also require auditors to review the parts of the corporate governance disclosure statements that relate to provisions 6, 24 and 29 of the Code: see FCA Handbook LR 9.8.10(R) 2. See Keay (n.20) 560 footnote 69; Marc T. Moore *"Whispering Sweet Nothings": The Limitations of Informal Conformance in UK Corporate Governance* 9(1) Journal of Corporate Law Studies 95-138, 136 footnote 176 (2009).

[81] See Kathryn Cearns and Eilis Ferran, *Non-Enforcement Led Public Oversight of Financial and Corporate Governance Disclosures and of Auditors* (March 2008) ECGI – Law Working Paper No. 101/2008 <https://ssrn.com/abstract=1111779> accessed 1 May 2020, noting at p.59 the endorsement of the ECGI of this approach. Other countries have adopted a more intrusive regulatory stance in connection with governance standards linked to Listing Rules: see e.g. the action taken by the JSE (in South Africa) in connection with the matter of Victor Farkas <https://www.fsb.co.za/appealBoard/Documents/VictorFarkas_OthersvJSE%20Limited.PDF> accessed 1 May 2020. See further on this Irene-marié Esser, *Corporate Governance: Soft Law Regulation and Disclosure – The Cases of the United Kingdom and South Africa* in Du Plessis, J. J. and Low, C K. (eds.), *Corporate Governance Codes for the 21st Century: International Perspectives and Critical Analyses* (Springer, 2017).

[82] Sridhar Arcot and Valentina Bruno, *In Letter But Not in Spirit: An Analysis of Corporate Governance in the UK* (2006) London School of Economics Working Paper No. 031 <https://ssrn.com/abstract=819784> accessed 1 May 2020.

approach by reference to 245 non-financial companies[83] over the period 1998-2004.[84] They evaluated both the degree of compliance with the provisions of the then Combined Code and the explanations given in cases of non-compliance.[85] They found that only 10% of companies complied (with their selected provisions) between 1998-1999, but that over the period 2003-2004 a significant increase to a 56% compliance rate was recorded. With regards to non-compliance, they found that 70% of companies provided some sort of explanation (with 17% providing no explanation at all), but that there were significant problems with the quality of the explanations provided. A later study in 2009[86] found that there was an increase in compliance with the Combined Code (less than 10% of companies were not compliant with a single provision), but more frequent use of standard explanations. In other words, conformance was not met in many instances of non-compliance due to the poor quality of the explanations provided.

An informal examination of 60 UK annual reports by the FRC in 2012 indicated that explanations were indeed sometimes rather perfunctory, not giving a full explanation of why the company in question has deviated from agreed best practice.[87] A later study by Shrives and Brennan[88] in 2015 also showed that there were serious concerns over the quality of explanations for non-compliance. They highlighted the danger of companies complying in a box-ticking manner, as that is the simplest way to avoid the need to craft good explanations indicating reasonable justifications for non-compliance. A similar observation was evident in Grant Thornton's Corporate Governance Review 2019 which found that, despite a declared increase in compliance with the UKCGC (in the context of FTSE 350 companies), only 32% of companies engaged with the code provisions in a meaningful way.[89]

Three conclusions can be drawn from these studies. First, compliance is left to the discretion of the companies. There is no common ground on how and when the 'comply or explain' principle is actually satisfied.[90] Some companies indicated that they

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[83] Financial companies were excluded because the overall regulatory environment for those companies differs significantly from that of non financial companies.

[84] This period was chosen as the Combined Code was in force during 1998-2004. The authors collected the data from the corporate governance and remuneration reports included in the annual reports.

[85] They focused on 8 provisions of the code, namely: separation of CEO/chairperson; the existence of a senior NED, the total number of NEDs classed as independent, the proportion of independent NEDs; the terms of service contracts; the nomination committee; the remuneration committee and the audit committee.

[86] Sridhar Arcot, Valentina Bruno, and Antoine Faure-Grimaud, *Corporate Governance in the UK: Is the Comply or Explain Approach Working?* 30(2) International Review of Law & Economics 193-201 (2010).

[87] FRC, *What Constitutes an Explanation Under 'Comply Or Explain'?* (Feb 2012) Introduction.

[88] Shrives & Brennan, *supra* n.76, 85-99.

[89] Simon Lowe, *Corporate Governance Review 2019 : The Issue of Trust* (November 2019) <https://www.grantthornton.co.uk/insights/corporate-governance-review-2019-the-issue-of-trust/> accessed 1 May 2020.

[90] Keay, *supra* n.79, 291, and Moore, *supra* n.80, 103.

did comply with the Code, even though in reality they did not.[91] These companies will not provide explanations for non-compliance and the market will judge the formal statement of compliance and not the substance of the company's corporate governance.[92] Second, in cases of non-compliance explanations are often inaccurate, very brief, generic and based on the use of boilerplate statements.[93] Third, it seems as if the market has chosen compliance as the rule instead of viewing non-compliance with quality explanations also as compliance. The underlying premise of the 'comply or explain' approach is precisely to allow for non-compliance if adequate reasons are provided,[94] but the 'explain' option has been increasingly marginalised.[95]

These observations are supported by the FRC's latest annual report on corporate governance which mainly deals with the 2016 UKCGC but also with 'early adopters' of the 2018 Code. The report is generally positive, but it does highlight that many annual reports lacked information on the outcomes of governance policies and practices, including any areas for future improvement.[96] With regards to the 2018 Code it was noted that companies devoted much more attention to corporate culture and workplace engagement mechanisms. This is to be expected given the changes in these areas and the attention given to it by the FRC in the last few years. Generally, however, compliance and especially the quality of compliance with the 2018 Code has been mixed. Thus, the evidence suggests that the operation of the UKCGC has proven to be and remains problematic, despite the institutional setting being conducive to the exercise of market discipline. That observation introduces another element to the question of why the UK code should have spread so widely into systems that were very different from the UK, and it is to that issue that we now turn.

4. The UK Code as a Global Model – Survey of Countries and Codes

In this part we present empirical data in order to evaluate the extent to which the UKCGC represents a model that has been adopted by our sample of countries. While even a brief historical analysis of the adoption of 'comply or explain' codes around the world would reveal clear links to the UK model, our aim is to explain why the UK model could prove so influential in jurisdictions where the legal and institutional frameworks are so different. Our focus is on the design, structure and objectives of

[91] Shrives & Brennan, *supra* n 76, 92.

[92] MacNeil & Li, *supra* n.21, 491.

[93] Shrives & Brennan, *supra* n.76, 92 and p.96. Boilerplate statements include generic, non-specified statements with little information. See also Moore, *supra* n.80, 125, on boilerplate statements. Poor quality explanations are also a feature of the operation of codes in other countries: see World Bank, *Improving the Effectiveness of Corporate Governance Codes in Emerging Markets: Lessons from Experience* (2015) Report No. ACS13998.

[94] Keay, *supra* n.79, 289.

[95] Shrives & Brennan, *supra* n.76, 91-92. This leads to a so-called 'box-ticking' approach to compliance: see Reddy, *supra* n.74.

[96] See FRC, *supra* n.87.

'comply or explain' regimes and not their fine detail. As the explanation we presented in part 2 for the emergence of the UK code was linked to local factors, we investigate the institutional structure in host countries to identify potential drivers for the diffusion of codes. We then examine key features of the 'comply or explain' codes in host countries to determine whether, and if so to what extent, they are aligned with the UK model. An overview of the methodology underlying our approach was set out in part 1.2 above and is explained in further detail below.

In part 4.1 below we examine some of the key characteristics of countries in which 'comply or explain' codes have been adopted. In part 4.2 we first compare the current version of Codes in our sample countries with the 2018 version of the UKCGC across a range of characteristics. We then focus on the extent to which our sample evolved in line with three key phases in the evolution of the UKCGC. For this purpose, we record first the degree of initial convergence[97] with three of the key provisions of the Cadbury Code 1992 (board composition, directors' remuneration and reporting, audit & risk control) and then the degree of convergence with the UKCGC provisions on diversity (in the 2014 version of the Code), stakeholders and culture (both in the 2018 version of the Code). These results are coded in 'leximetric'[98] style in Tables A1, A2 and A3 in Appendix A. We test and comment on the statistical relationship between key variables through t-tests and correlation, with the detailed results presented in Appendix B.

4.1. Country Characteristics

Table A1 in Appendix A presents our data on country characteristics.[99] We focus first on the pattern of share ownership, distinguishing between different levels of concentration. This follows the well-established differentiation in the literature on the distinction between systems with concentrated ownership, in which majority shareholders can exercise effective control over the board and decision-making, and dispersed systems in which such control and accountability are less evident and there are 'free rider' problems associated with shareholder monitoring and activism.[100] We observe that share ownership in most of the host countries is strongly concentrated,

[97] This compares the current version of the Code in our sample countries with the Cadbury Code 1992. This approach takes account of the long timeframe over which the various codes were adopted in other countries.

[98] See generally Lele & Siems, *supra* n.13.

[99] The data does not cover our entire sample of countries across all the variables as it is drawn from earlier studies which have generally covered smaller samples. See the key to Table A1 for elaboration of the various sources. Nevertheless, it does provide an overview of key variables which have been recognised in prior studies as influencing the nature and priorities of systems of corporate governance.

[100] See e.g. Ronald J. Gilson, *Controlling Shareholders and Corporate Governance: Complicating the Taxonomy* (2005) ECGI-Law Working Paper No. 49/2005 <http://ssrn.com/abstract=784744> accessed 1 May 2020, for an overview of the issues. The recent strong growth of index funds challenges the conventional understanding of the operation of dispersed systems of ownership. See Lucian A. Bebchuck and Scott Hirst, *The Specter of the Giant Three* (2019) ECGI-Working Paper No. 608/2019<https://ssrn.com/abstract=3385501>accessed 1 May 2020, indicating that the largest three index fund managers now

with fewer examples of moderate concentration (15 in our sample of 44 countries) and only one example of dispersed ownership (South Korea).[101] This suggests that the benefits of a UK style code could in principle be significant for any system irrespective of its share ownership structure, contrary to the standard paradigm which views the principal/agent issues between shareholders and the board as being most problematic in dispersed systems of ownership. However, there are reasons to doubt that 'comply or explain' can work as effectively under conditions of strong ownership concentration, especially in systems with state-owned enterprises, where the government plays the dual role of shareholder and regulator. Since the controlling shareholder controls appointment to the board, it is unlikely that directors will not conform without consent from the controller, and even if there was no consent, enforcement would be unlikely if it damaged the government's interest as shareholder.[102]

Our second focal point is the degree of foreign and institutional ownership respectively. Both are linked to the role of globalisation in financial markets as a driver of the adoption of 'comply or explain' codes. The general picture here is of significant (and growing) levels of foreign and institutional ownership[103] in the relevant countries, which tends to support the contextual evidence around the time of adoption of codes that international investors were a significant influence. In that sense, the self-regulatory drive towards codes can be linked much more directly to global investors than had been the case with the Cadbury Code in the UK, which was a more local development. While the statistical evidence presented in Appendix B suggests that neither foreign nor institutional ownership are significantly linked with code adoption, our sample is relatively small and has little variation in the data on code adoption. Thus, we do not see the absence of a statistical link as negating the contextual evidence of global investors driving the adoption of codes.

Our third characteristic is based on categorizing countries according to whether their system of corporate law prioritizes the interests and powers of shareholders or the board of directors. This provides an indication of whether a code might represent a mechanism to improve board accountability (as per Cadbury in the UK) and empower shareholders. While our sample is quite small (11) it does include a diverse

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collectively hold an average stake of 20% in S & P 500 companies. Their projections suggest that this figure could reach 34% in the next decade.

[101] In line with our source data we categorise the UK as moderately concentrated although it is often cited in the literature as an example of a system of dispersed ownership. That shift is also noted by the OECD in its 2019 survey, where it comments '…while the degree of ownership concentration at the company level still differs between markets and companies, no jurisdiction systemically features the kind of atomistic dispersed ownership structure that still influences much of the corporate governance debate.' See De La Cruz, A., A. Medina and Y. Tang, *Owners of the World's Listed Companies*, 18 (OECD Capital Market Series, Paris, 2019) <https://www.oecd.org/corporate/ca/Owners-of-the-Worlds-Listed-Companies.pdf> accessed 1 May 2020.

[102] Ernest W K Lim, *Concentrated Ownership, State-Owned Enterprises and Corporate Governance*, 41(3) Oxford Journal of Legal Studies 663-691 (2021).

[103] See De La Cruz, Medina and Tang, *supra* n.101. As shown in Table A1 in Appendix A, 21 of 44 countries have foreign ownership at 30% or above and 10 of 44 have institutional ownership at 30% or above.

set of countries in terms of legal origin and institutional framework for corporate governance.[104] All the relevant countries demonstrate an orientation towards shareholder primacy. Thus, as could well be said of the UK, it would not seem to be the case that adoption of a UK style code can be explained by reference to a rebalancing of the system of corporate governance to empower shareholders. But it would leave open the possibility that empowering shareholders through corporate law might be a necessary but not sufficient condition for good corporate governance and that additional safeguards in the form of a code might well improve accountability by spreading good practice more evenly across the system.

Our fourth characteristic focuses on the extent to which the system of corporate law in the host country protects shareholders. We adopt this as a proxy for the potential for a 'comply or explain' code to enhance shareholder protection and thereby to strengthen local capital markets. It is drawn from data assembled by the Centre for Business Research at Cambridge and comprises a single measure of shareholder protection based on ten core variables linked to shareholder protection covering 25 countries over the years 1995-2005. For each relevant country we show the aggregate score in the year before the adoption of the relevant Code (so as to exclude the effect of the Code which is included in the variables). For 10 of the 25 countries that year falls outside the scope of the Index and so they have not been included in our analysis. Higher scores correspond to higher shareholder protection and the maximum possible score is 10.[105]

The results demonstrate considerable divergence in shareholder protection prior to the introduction of the relevant national codes, even within the EU, where the harmonization of company law was already quite advanced prior to the adoption of codes.[106] Thus, the Netherlands is an outlier in terms of the lack of shareholder protection just before it adopted its code in 2003, but by 2005 its score was much closer to France and Germany. Nevertheless, codes are only one aspect of the functional assessment of shareholder protection in the indices and the overall quality of corporate governance comprises a broader range of factors than shareholder protection. Moreover, as the results are based on 'law on the books' rather than 'law in action', they

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[104] Our data is drawn from David Cabrelli and Irene-marié Esser, *A Rule-Based Comparison and Analysis of the Case Studies* in Siems and Cabrelli, *Comparative Company Law: A Case-Based Approach*, ch. 12, *supra* n.6.

[105] Our dataset (see Appendix A, Table A1, under the 'Shareholder Protection Index' column) includes also data from the same source referencing a smaller sample of five countries over the period 1970-2005 so as to provide an indication of how shareholder protection may vary with respect to the board and other shareholders (indicating the potential for principal/agent conflict between shareholders and the board, and between majority shareholders and minority shareholders, respectively).

[106] Although the Shareholder Rights Directive (Directive 2007/36/EC of the European Parliament and of the Council of 11 June 2007 on the exercise of certain rights of shareholders in listed companies [2007] OJ L 184/17) was not adopted until 2007, by which time most EU countries had already adopted a corporate governance code. See Commission Recommendation 2005/162/EC of 15 February 2005 on the role of non- executive or supervisory directors of listed companies and on the committees of the (supervisory) board [2005] OJ L 52/51.

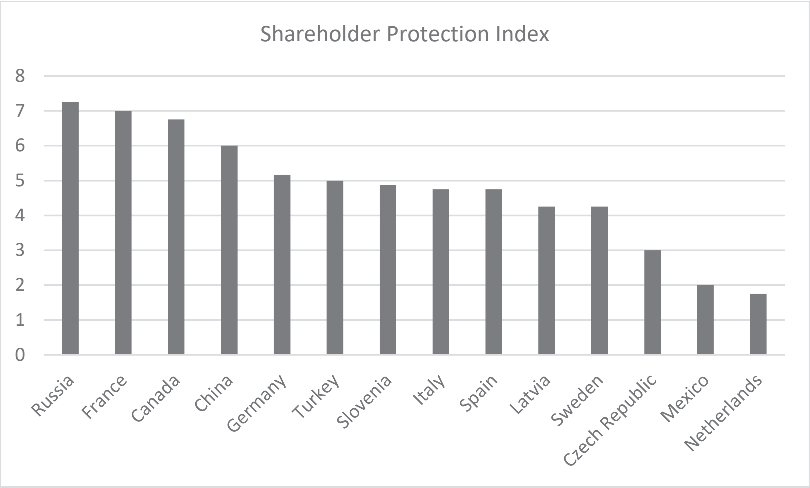

Figure 1: Shareholder Protection Index before Adoption of Code

do not capture the impact of enforcement and other aspects of a financial system on shareholder protection.[107]

Some observations made by Lele and Siems,[108] who compiled the 5-country index used in our data, provide useful context for interpreting Figure 1. First, they conclude that the common law – civil law distinction does not matter for the level of shareholder protection. Second, they found that substantial convergence in shareholder protection occurred from 1993 onwards.[109] Third, they found that protection of minority against majority shareholders was stronger in 'blockholder' countries. From the perspective of our focus on the spread of 'comply or explain' codes, the most significant aspect is the degree of divergence,[110] indicating that codes proved attractive to very different systems and likely delivered quite different 'added value' in different countries (even before account is taken of the flexibility in governance at the firm level made available by the operation of 'comply or explain'). Such 'added value', at the system level, would represent the (voluntary) addition to shareholder protection represented by the provisions of the code by comparison with the (default) provisions of local law.[111]

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[107] See e.g. Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law* 109(8) Harvard Law Review 1911-1982 (1996) for a discussion of this issue in the context of emerging markets.

[108] Lele & Siems, *supra* n.13.

[109] See Lele & Siems, *supra* n.13, 42, Figure 7 (mean of all differences) for illustration of the trend.

[110] The limited significance of shareholder protection as a predictor of adoption of a 'comply or explain' code is borne out by the correlation result (-0.2090) shown in Figure B4 (column 1), Appendix B.

[111] In the UK, where the statutory provisions on boards are very limited, the 'added value' is substantial and refers inter alia to independent non-executive directors and board committees. In countries with more detailed statutory provisions on boards the 'added value' might be less.

Our final characteristic focuses on the process of monitoring and enforcing conformance with the code (including explanations for non-compliance) through the process of issuing national reports on the operation of ‘comply or explain’ codes. This type of activity is different from formal enforcement, which typically rests with the securities regulator but is rarely if ever exercised as some form of disclosure is generally made in conformance with the relevant rules, and the ‘comply or explain’ paradigm envisages that it is for investors rather than regulators to take further measures.[112] For that to occur effectively would in principle require investors to be well-informed about conformance across the market so as to respond appropriately. Responsibility for this activity mostly rests with the relevant stock exchange or securities regulator and the reports generally reference all listed companies. While we attach some significance to the existence of this process in terms of informing investors and encouraging conformance, and perhaps also in facilitating the evolution of the code, it is more difficult to attach significance to the different institutional arrangements for reporting on codes in terms of their effectiveness. But it does at least seem clear that comply or explain codes can and do, fit differently into the institutional framework in different countries.

4.2. Code Characteristics – Initial Convergence in Design (The UK as the ‘Model Code’)

We surveyed a total of 43 corporate governance codes in 43 countries[113] and collected data on the custodian of the code, its legal status, the scope of application, the structure of the code (i.e. tiered or unitary) and the form of disclosure required.[114]

The current version of the UKCGC has the following profile in terms of those descriptors:

Custodian:	*Legal status:*	*Scope of application*:	*Structure:*	*Form of disclosure:*
Mixed[1]	Mandatory disclosure	All Listed Companies	Tiered	Apply and Explain, ‘comply or explain’

[1] As coded in OECD, *Corporate Governance Factbook-2019* (June 2019) Table 2.3, albeit we would classify the FRC as a public body. See *supra* n.69 for details on the FRC’s status.

Figure 2 below summarises the data presented in Table A2, in Appendix A, with reference to the countries in our sample (excluding the UK). The data on custodians of codes indicates that the primarily self-regulatory origins of the UK Code have been

[112] But the case has been made for regulators to have broader powers – see Andrew R. Keay, *Comply or Explain: In Need of Greater Regulatory Oversight?*, 291 (2012) <https://ssrn.com/abstract=2144132> accessed 1 May 2020.

[113] This includes the EU 27 and the G20, plus Nigeria. The results in the text exclude the UK.

[114] See Table A2 in Appendix A.

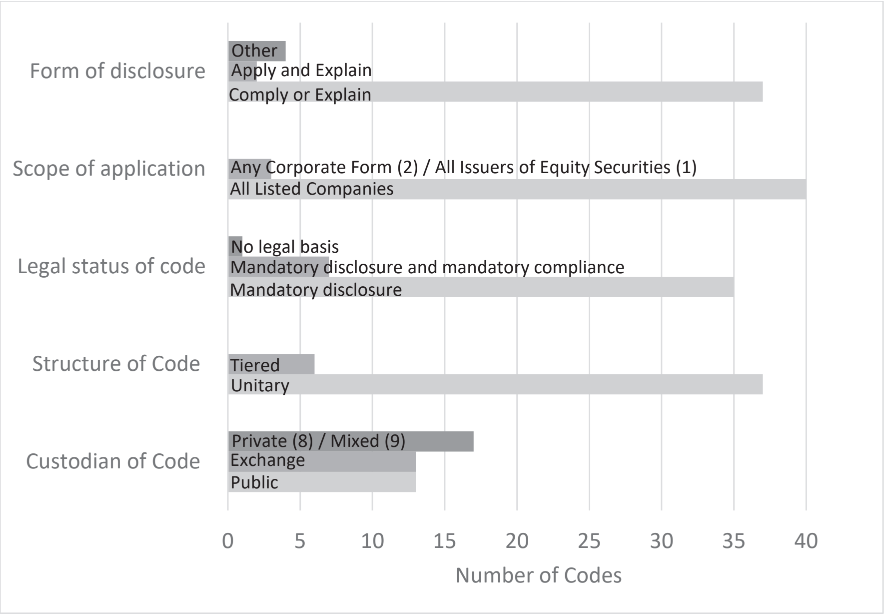

Figure 2: Comparison of key features of Codes.
Note. 'Other' under 'Form of Disclosure' includes: Comply or Explain & Nondisclosure (1) / If not, why not (1) / Nondisclosure (1) / Apply or Explain (1).

diluted over time as public bodies or (regulated) exchanges have taken on a more significant role in host countries.[115] In terms of structure, tiered codes (6), which facilitate the operation of different disclosure standards to different parts of a code, are very much the exception, with the majority now adopting a unitary format (37).

A Code can either have no legal basis or be subject to mandatory disclosure or mandatory compliance. Mandatory compliance goes beyond disclosure and requires substantive compliance with the relevant provision. Mandatory disclosure is the favoured technique in the majority of instances. In terms of scope, the majority of codes apply to listed companies only, with the exception of Portugal and South Africa (any corporate form) and Nigeria (all issuers of equity securities).

The majority of codes follow a comply or explain approach, with the exception of the Hungarian code, which follows a comply or explain and nondisclosure approach,[116] the South African and Nigerian codes following an 'apply and explain' approach,

[115] See FRC, *supra* n.45. As noted earlier, a similar development occurred in the UK when the FRC assumed responsibility for the UKCGC in 2003.

[116] Alignment and compliance with the Recommendations are recommended, but not mandatory for companies listed on the stock exchange.

Brazil following an 'apply or explain' approach, China non-disclosure and the Australian code the 'if not, why not'[117] approach.

It seems clear from this analysis that the UK model has been followed quite closely in the design of codes in host countries in our sample.[118] In the next section we examine whether the same pattern is evident in terms of key substantive provisions of codes.

4.3. Code Characteristics – Convergence and Evolution

Building on this data on the 'model code' we looked at the same set of codes and countries but with reference to how corporate governance *evolved*. In this instance we code initial convergence with UK Cadbury Code and subsequent convergence as the code evolved in the UK. The results are presented in Table A3 in Appendix A and summarised in figure 3.

	Number of countries	
Score	**Convergence score (initial)**	**Convergence score (evolution)**
6	42	8
5	0	2
4	1	11
3		7
2		10
1		1
0		4

Figure 3: Alignment of Codes vs UK Cadbury Code

The convergence score (initial) equals the sum of the scores obtained in relation to board composition, directors' remuneration, reporting, audit & risk control (all based on comparison with the *Cadbury Code*). The maximum score (i.e., full, initial convergence) equals 6 points. The convergence score based on evolution equals the sum of the scores achieved for diversity, stakeholders and culture (again with a maximum score of 6 points). We took the 2014 version of the UK Code[119] as the

[117] We take the Australian approach to be functionally equivalent to 'comply or explain' in the UK, albeit some aspects of the guidance for implementation of 'if not why not' differ from the UK. See e.g. ASX, *Corporate Governance Principles and Recommendations* (4th edn, 2019) p.4, setting out guidance on disclosure of the implementation of recommendations, including reference to policies and practices.

[118] The pattern is less clear with regard to custodian, reflecting the shift in responsibility in the UK from market actors to the FRC in 2003. The version of the 'Combined Code' published in that year was the first under the auspices of the FRC.

[119] See FRC*, The UK Corporate Governance Code* (September 2014) Principle B.2.

comparator for diversity as it is the first code with detailed provision on that issue. For the same reason we took the 2018 version of the *UK Code*[120] as the comparator for stakeholders and culture. Based on our scoring, initial convergence was at the maximum for all countries, except for Argentina, whereas convergence in terms of evolution is more varied, with only 8 countries recording the maximum score of 6.

	Number of countries		
Score	**Diversity**	**Stakeholders**	**Culture**
2	24	30	12
1	2	5	5
0	17	8	26

Figure 4: Evolution of Codes vs UKCGC

Figure 4 provides a different perspective on convergence in evolution by focusing on aggregated country scores for the three key variables (each column – diversity, stakeholders and culture – shows the spread of aggregated convergence scores across our sample of 43 countries, excluding the UK). Generally, there is a high degree of convergence in evolution of codes, although markedly less so with regard to culture. It is notable that stakeholders scored more highly than diversity despite the latter having been introduced earlier into the UK code. However, it is likely that stakeholder interests may have already been better protected in other countries[121] and so it is the UK that may have been catching up rather than the reverse. Among the BRICS countries only Brazil and South Africa converge on diversity and there are 8 EU countries scoring zero despite references to diversity in EU sources.[122] Linking this aspect back to our data on ownership, we observe that the degree of institutional ownership is statistically significantly linked to the convergence score (evolution)[123], supporting the contextual evidence that global investors were a key influence.

[120] See FRC, *The UK Corporate Governance Code* (July 2018) Provisions 5, 1.B and 2.

[121] See e.g. Siems & Cabrelli, *supra* n.6, 501, Table 12.4 measuring stakeholder protection based on the results of 9 case studies (relevant to shareholder protection, director primacy and stakeholder protection). The UK scored quite low with a score of 2 (the highest in that study being the Netherlands with 5).

[122] See EU Commission, *Action Plan: European Company Law and Corporate Governance – A Modern Legal Framework for More Engaged Shareholders And Sustainable Companies* COM (2012) 740 final, p.5.

[123] See Appendix B, Figure B3 (t-stat -1.9070) and Figure B4 (correlation 0.2875, $p<0.10$).

5. Rationalizing the Emergence of Comply or Explain Codes as a Global Model

In this part we address more directly three potential explanations for the spread of 'comply or explain' codes introduced in part 1 above, referencing the data and analysis presented in the intermediate parts. We noted in part 2 that the emergence of the UK code was linked to flexibility in corporate governance, concerns around board accountability related to the reliability of financial reporting and audit, as well as the tradition of self-regulation. Those specific drivers, which materialized at a particular point in time and in a distinct institutional setting, were not evident in the same way in other countries that subsequently adopted codes, and even had they been it seems unlikely that solutions developed locally would have been configured in the same way as the UK code.[124] In part 4, we noted that while there was significant divergence in the characteristics of the corporate governance frameworks of countries adopting 'comply or explain' codes, there was strong convergence with the UK code in terms of initial design and subsequent evolution. In the light of those findings, we now turn to three paradigms that have emerged in comparative corporate governance to attempt to explain the diffusion of the UK code. They have to date been developed primarily in the context of hard law, but the same approach can be applied to soft law.

5.1. Competition and Convergence in Corporate Governance

The claim that global convergence in corporate and securities law has been driven by a process of competition (in which US corporate law has emerged as the winner) is most clearly linked to influential scholarship that emerged around the turn of the millennium.[125] At the level of corporate law, competition is made possible to the extent that the law facilitates choice in the jurisdiction of incorporation,[126] while competition in securities law is driven mainly by the relevant conditions for foreign listing.[127] The competition claim was linked to the capacity of national systems of corporate governance to deliver effective systems of corporate governance, viewed primarily from the perspective of shareholders,[128] and support for the potential benefits of competition

[124] The introduction of The Sarbanes-Oxley Act in the US in 2002 provides an example of a very different response from the UK Code, focused on hard law, mandatory disclosure obligations and legal liability for directors.

[125] See Henry Hansmann and Reinier Kraakman, *The End of History for Corporate Law* (2000), Yale International Centre for Finance Working Paper no. 00-09; John Coffee, *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications* 93(3) Northwestern University Law Review 641 (1999); Amir N. Licht, *International Diversity in Securities Regulation: Roadblocks on the Way to Convergence* 20(1) Cardozo Law Review 227 (1998).

[126] See Siems, *supra* n.6, ch.9.

[127] See Iain MacNeil, *Competition and Convergence in Corporate Regulation: The Case of Overseas Listed Companies* (August 1, 2001)<https://ssrn.com/abstract=278508 >accessed 1 May 2020.

[128] Ibid.

was linked to the beneficial effect within the US system of competition between state systems of corporate law.[129]

Elaboration of the forms that convergence might take was provided by Gilson, who drew attention to the capacity of national systems to converge through functional rather than formal convergence.[130] In the latter case, national rules and institutions would be aligned in accordance with the selected template, whereas in the former the focus would be on aligning outcomes and that could be achieved through alternative techniques such as contract or design of financial instruments. Building on that approach, Coffee[131] demonstrated the capacity of the 'bonding effect' of listing rules to effect convergence as foreign firms increasingly sought the valuation premium associated with the higher governance standards required for a listing in New York (but less so in London[132]).

However, the extent of convergence in national corporate laws has been questioned, both in terms of theory and empirical evidence.[133] For example, path dependence in national systems has been identified as a considerable barrier to change, even in the presence of competition.[134] Moreover, leximetric evidence of convergence suggests that even functional convergence between systems has been limited.[135] For example, the data presented in Table A1 in Appendix A shows that the shareholder protection index[136] for selected countries in the year before adoption of the relevant code varied widely, indicating that shareholder rights across those countries varied considerably long after the 'end of history' claim made by Hansmann & Kraakman at the turn of the millennium. That observation is supported by the absence of any significant statistical link between the shareholder protection index prior to adoption of a 'comply or explain' code and its adoption.[137]

Nevertheless, we find that within the specific context of 'comply or explain' codes that there has been considerable convergence between systems. The pattern was already evident at a relatively early stage in the evolution of Codes. For example, in

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[129] See Roberta Romano, *Empowering Investors: A Market Approach to Securities Regulation* 107(8) Yale Law Journal 2359-2430 (1998); Joel Trachtman, *Regulatory Competition and Regulatory Jurisdiction* 3(2) Journal of International Economic Law 331-348 (2000).

[130] Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function* (May 2000) Stanford Law and Economics Olin Working Paper No. 192; Columbia Law and Economics Working Paper No. 174<https://ssrn.com/abstract=229517> accessed 1 May 2020.

[131] Coffee, *supra* n.125.

[132] On foreign listing in London, see MacNeil, *supra* n.127.

[133] See generally Siems, *supra* n.6.

[134] See Licht, *supra* n.125; Lucian A. Bebchuck and Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance* 52(1) Stanford Law Review 127-170 (1999).

[135] Cabrelli and Esser, *supra* n.104 finding that the convergence claim is not borne out by their study of 12 legal systems.

[136] CBR, 'Law, Finance & Development' Datasets <https://www.cbr.cam.ac.uk/research/research-projects/completed-projects/law-finance-development/#item-2. >accessed 5 May 2020.The Index is based on ten core variables linked to shareholder protection and covers 25 countries over the years 1995-2005. See also n.105 for explanation.

[137] See *supra*, n. 110, referencing the statistical data in Appendix B.

2005 Dr Gerhard Cromme, Chairman of the German Government Commission on Corporate Governance commented:

> There are now 47 different corporate governance codes in Europe. These display a remarkably high degree of agreement, even though company law in the individual member states continues to be characterised by significant differences. In particular, the practical solutions are similar and indicate a distinct trend towards convergence.[138]

Our evidence supports and updates that observation in two ways. The first is in terms of the basic characteristics of ‘comply or explain’ codes shown in Table A2. Here we specifically looked at the structure of the code, the legal status, the form of disclosure and the scope of application. The second is in terms of the convergence scores shown in Table A3. We measured initial convergence by reference to the extent to which codes followed key provisions of the original Cadbury code and subsequent convergence (evolution) by reference to the extent to which the latest version of national codes follows three key developments in the UKCGC (diversity, stakeholders and culture). In particular we find evidence of a significant statistical link between institutional ownership and convergence (evolution).[139]

While the evidence for convergence in terms of codes is clear, the case for it having been driven by competition between national systems is more indirect and contextual.[140] There are two main observations supporting that case. The first is that the context in which many of the national initiatives introducing ‘comply or explain’ codes were framed referred to the need to position the country’s system of corporate governance to be relatively attractive by international standards.[141] The second is the timing of the key period for the adoption of ‘comply or explain’ Codes (from the early 1990s to the mid 2000s). This period coincided with major structural changes in stock exchanges worldwide, in particular the transition in the major exchanges from mutual organisations run primarily in their members’ interests to listed companies operating on a for-profit basis.[142] Those changes drove exchanges to compete more intensely for listing business. At the same time, the globalisation of capital markets encouraged

[138] Gerhard Cromme, *Corporate Governance in Germany and the German Corporate Governance Code* 13(3) Corporate Governance: An International Review 362-367, 363 (2005).

[139] See further, *supra* n. 123 and related text.

[140] For a more generalised argument against competition between legal systems as a factor driving legal change, see Michele Graziadei, *Comparative Law, Transplants and Receptions* in Mathias Reimann and Reinhard Zimmermann *(eds), The Oxford Handbook of Comparative Law* (2nd ed., OUP 2019); Daniel Berkowitz, Katharina Pistor, and Jean-Francois Richard, *The Transplant Effect* 51(1) The American Journal of Comparative Law 163-203 (2003).

[141] This overlaps with the exogenous ‘legitimation’ and endogenous ‘efficiency’ explanations for code diffusion proposed by Aguilera and Cuervo-Cazurra, *supra* n.2.

[142] See Cally Jordan*, International Capital Markets: Law and Institutions* (1st edn, Oxford: Oxford University Press, 2014); R. C. Michie*, The Global Securities Market: A History,* ch. 9 (New York: Oxford; Oxford University Press, 2006). The consolidation of exchanges over this period also generated some momentum towards harmonisation of standards.

larger numbers of companies to seek foreign listing as a means of enhancing liquidity in their shares, broadening their shareholder base and gaining access to the 'liquidity premium' associated with 'bonding' to higher standards of corporate governance. Moreover, the lack of credible evidence of any general trend towards deregulation in corporate law over the relevant timeframe also supports the view that investor pressure was the main driver.[143]

Why did the UKCGC win out in this competition, contrary to the Hansmann & Kraakman paradigm of the US model as the international leader? One reason may be that London's pre-eminence as an international financial market leader[144] gave it the reputational heft that was needed to create, unilaterally, a *de facto* transnational standard. Whether that standard was in reality the winner in a competitive process to develop better global corporate governance is less clear[145], and so it seems likely that adoption of a code was in some instances more a signal of alignment with (voluntary) global standards. Other reasons are those explored below, which are more clearly linked with the self-regulatory tradition that was already well established in the UK, the emphasis on shareholder primacy (especially versus the board of directors, in contrast with the US model) and the flexibility that had been embedded in its structure of corporate governance from an early stage (especially via shareholder control over the articles of association and limited statutory regulation on the structure, composition and operation of the board of directors).

5.2. Transplantation and Adaptation

The process of transplantation and adaptation has attracted much interest in recent years as an explanation of the process of legal change associated with globalisation and legal development, especially in transition economies.[146] While there remain doubts as to the extent to which effective transplantation can occur,[147] largely as a result of the different contexts in which the same rules may be applied, there can be little doubt that transplantation and adaptation have been significant factors in the

[143] See Siems, *supra* n.6, 58.

[144] Evident in accounting (the development of International Financial Reporting Standards was largely led from the UK) and leadership of key trends in EU company and securities law harmonisation.

[145] If adoption of a UK style code were indeed the outcome of regulatory competition we could expect a negative correlation between shareholder protection (prior to adoption) and the adoption of such a code but our date in Figure B4 in Appendix B shows only an insignificant negative correlation (-0.2090).

[146] See e.g. Katharina Pistor, Martin Raiser, and Stanislaw Gelfer, *Law and Finance in Transition Economies* (June 2000), Harvard University, Cambridge, MA CID Working Paper Series 2000.49, <http://nrs.harvard.edu/urn-3:HUL.InstRepos:39570414> accessed 1 May 2020. For a discussion of the concept of transplantation in the context of the UKCGC provisions on independent directors, see Harald Baum, *The Rise of the Independent Director in the West, Understanding the Origins of Asia's Legal Transplants* ch.1 in Dan W. Puchniak, Harald Baum, and Luke Nottage*, Independent Directors in Asia: A Historical, Contextual and Comparative Approach* (Cambridge: Cambridge University Press, 2017).

[147] See further the competing claims of Alan Watson (advocating for the possibility of effective transplants) and Pierre Legrand (arguing against) in Graziadei, *supra* n.140.

spread of corporate law rules and techniques in recent times.[148] Factors driving that trend have been primarily (a) the prestige[149] of rules and related institutions in the country of origin, often supported by initiatives of multilateral institutions such as the World Bank, IMF or EBRD; (b) the pre-eminence of the London Stock Exchange as an international capital market, leading on foreign listing in the 1990s – the period marking the beginning of the realignment of exchanges around the world and the associated monitoring role of competing markets[150]; and (c) the process of diffusion itself influencing the likelihood of adoption of key provisions of codes.[151] Thus, transplantation and adaptation can be mechanisms through which the process of competition and convergence referenced above can occur, but they may also be driven by other factors such as broader convergence in legal culture.[152]

While the degree of convergence noted in part 4 is in principle indicative of transplantation of a UK style 'comply or explain' code across many countries, that perspective does not focus sufficiently on the *process* of transplantation as an element relevant for its success.[153] Central to the process are the conditions under which the transplant is received in the host country and the manner in which the local institutions interpret and enforce the relevant rules. A key feature of the spread of 'comply or explain' codes has been the capacity of such codes to be adopted without adjustment to national corporate law and to be enforced by market discipline largely without reference to national systems of enforcement or adjudication. While the operation of codes will inevitably be linked with local capital market culture and traditions, the increased role and reach of global investors, as well as the role of global rating agencies and proxy advisers in influencing shareholder voting, distances the operation of governance codes to some extent from local influences.

That aspect probably also mitigates the impact of the transplantation differing by country in terms of its impact on the local legal system. The gap between the (default) local corporate law and the provisions of the adopted code mean that the scale and impact of the transplantation will be variable.[154] Similarly, the enforcement capability

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148 See Siems, *supra* n.6; Pistor, Raiser, and Gelfer, *supra* n.148.

149 See Alan Watson, *Comparative Law and Legal Change* 37(2) Cambridge Law Journal 313-336 (1978).

150 Jordan, *supra* n.142, 119.

151 See Carsten Gerner-Beurle, *Diffusion of Regulatory Innovations: The Case of Corporate Governance Codes* 13(2) Journal of Institutional Economics 271-303 (2017).

152 See further, Siems, *supra* n.6, ch.8.

153 See Graziadei, *supra* n.140, 17, claiming that 'The crucial factor in evaluating the chances of success for a proposed legal change seems to be the character of the transfer process rather than the nature of the law at stake.'

154 See also, *supra* n. 111. South Africa, for example, provides a rare example of overlap between code provisions and legislation. Some of the recommendations in *King IV* are also in company legislation. See here, for example, Principle 8 of *King IV* on committees (of the governing body) and the relevant provisions on audit committees in s 94 in the Companies Act, 2008. It is, however, important to note that King IV applies to all organisations, regardless of the manner or form of incorporation and the 'enhanced accountability' provisions in Chapter 3 of the Companies Act only apply to certain companies. A Loubser, *The King Reports on Corporate Governance* in Irene-Marié Esser and M.K. Havenga (eds),

of the host system (encompassing courts, regulators and market discipline) would be a significant factor differentiating the host from the source system. In principle, that gap would represent an important contextual factor for the reception and operation of a 'comply or explain' code, but we surmise that global investors would play some role in standardising the operation of such codes across countries.[155]

Adaptation refers to the extent to which transplanted rules are subject to change either at the time of adoption or subsequently. As noted in Table A3, we observe a very strong form of convergence with the original Cadbury Code when the initial 'comply or explain' codes are adopted elsewhere and less so by reference to the key changes in the UK code which have since occurred (diversity, stakeholders, culture). It has been argued that soft law hardens when its function arrives at a state of 'stabilisation of normative expectations'[156], yet this has generally not occurred with 'comply or explain' codes beyond the point of linking the disclosure obligation with hard law via listing rules.[157] We attribute that outcome to two aspects of such codes: one is that they have an explicit development focus, facilitated by their self-regulatory origins; and secondly, conversion into hard law would remove much of the flexibility associated with 'comply or explain' as well as the key role of market discipline in enforcement.[158]

5.3. Markets as a Source of Normative Experimentation

The global spread of 'comply or explain' codes can also, we believe, be explained by reference to the role of markets as a source of normative experimentation. One version of this approach can be traced back to Hayek,[159] who viewed private law and markets as having the capacity to solve problems of resource allocation and related

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Corporate Governance Annual Review (LexisNexis, 2012), provides a detailed discussion on all the principles of *King III* with cross-reference to the relevant, if any, company law provision.

[155] Our data does not capture this dynamic, but it might well take the form of shareholder activism leading to adjustment of local default rules to align them more effectively with code provisions.

[156] Gralf-Peter Calliess and Moritz Renner, *From Soft Law to Hard Code: The Juridification of Global Governance* 22 Ratio Juris 260 (2009).

[157] But see Eddy Wymeersch, *The Enforcement of Corporate Governance Codes* 6 Journal of Corporate Law Studies 113 (2006), noting the potential for hard law links to codes to extend beyond disclosure obligations, such as the use of codes as 'blank norms' to fill out gaps in tort law or directors' duties. See also David Seidl, Paul Sanderson, et al., *Applying the 'Comply-or-Explain' Principle: Discursive Legitimacy Tactics with Regard to Codes of Corporate Governance* 17(3) Journal of Management & Governance 791-826 (2013), identifying migration to hard law as a potential response to so-called 'principled' explanations for non-compliance, which indicate rejection of the relevant code provisions. This occurred in respect of remuneration disclosure: for the UK, see Wu, MacNeil and Chalaczkiewicz-Ladna, *supra* n.54; for Germany, see Seidl et al. p.813.

[158] As noted earlier in Wymeersch, *supra* n.157, the extent of the loss of flexibility would be linked to the capacity of shareholders to use local corporate law default rules to adjust the governance structure.

[159] Friedrich A. Hayek, *Law, Legislation and Liberty: A New Statement of the Liberal Principles of Justice and Political Economy* (London: Routledge, 1982, previously published in three volumes as *Rules and Order* (1973), *The Mirage of Social Justice* (1976), and *The Political Order of a Free People* (1979).

issues of organisational structure more efficiently than state control. While Hayek focused on a comparison of public and private law, his approach was later extended to the operation of the common law, identifying its indeterminate rule structure, pragmatism and close attention to context in adjudication as drivers of normative experimentation.[160] While elements of that approach are evident in more recent claims about the role of the common law as a facilitator of financial market development,[161] our research indicates that ‘comply or explain’ codes have been transplanted across a diverse range of common law, civil law and hybrid legal systems. Thus, while the emergence of the Cadbury Code may be linked with the type of common law system prevailing in the UK (or at least *English* common law) and the institutional structure surrounding it, we do not see the spread of ‘comply or explain’ codes around the world as being driven by common law characteristics in host countries.[162]

Another version of that approach can be linked to the role of experimentalism in developing regulatory regimes following the general move away from ‘command and control’ from the 1980s onwards. According to Sabel and Simon, experimentalism adjusts the classic regulatory model in several key dimensions: first, norms are often presumptive rather than mandatory; second, the regime provides incentives to actors to engage in investigation, information sharing, and deliberation about problems with multiple dimensions; and third, experimentalism emphasises stakeholder participation to elicit a broader view of the relevant issues.[163] Moreover, from the perspective of principal-agent theory, experimentalism allows principals to learn from the problem-solving activities of their agents, especially when there is some uncertainty as to what their objectives should be.[164]

Following the experimentalism paradigm, the role of markets as a source of normative experimentation in ‘comply or explain’ regimes can be approached both in terms of the type of norms that are created and their substantive content.

With regard to the first aspect, the initial development of the Cadbury Code in the UK and its subsequent transplantation around the world demonstrate the capacity of market actors to develop or adopt norms outside the conventional taxonomy of hard

[160] See further Simon Deakin, *Law as Evolution, Evolution as Social Order: Common Law Method Reconsidered* (2015), Centre for Business Research, University of Cambridge, Working Paper no. 470, p.16, and for a discussion of the distinctive nature of rules in the common law, Legrand, *supra* n.42.

[161] See e.g. La Porta, Lopez-De-Silanes, Shleifer, et al., *Legal Determinants of External Finance*, *supra* n.6.

[162] We note also that any such claim would struggle to explain the failure of ‘comply or explain’ to gain traction in the US and its adoption both by EU countries and (as a disclosure obligation rather than a code) by the EU itself. See also Aguilera and Alvaro Cuervo-Cazurra, *supra* n.2 for a similar finding, contra their hypothesis that civil law systems would be more likely to adopt codes to address deficiencies in corporate governance.

[163] See Charles F. Sabel and William H. Simon, *Minimalism and Experimentalism in the Administrative State* 100(1) Georgetown Law Journal 53, 78 (2011).

[164] See Charles F. Sabel and Jonathan Zeitlin, *Experimentalist Governance* in David Levi-Faur (ed.), *Oxford Handbook of Governance* (Oxford: Oxford University Press, 2012).

law.[165] On that view, the capacity of markets to operate and evolve by reference to such rules is the key facilitator of normative experimentation. For that to be possible requires an institutional and informal enforcement framework which can support self-regulation by acting as an effective functional substitute for hard law counterparts. Beyond the more general self-regulatory tradition in the UK mentioned earlier and in the specific context of 'comply or explain' codes, the process has been facilitated by the globalisation of the key players in the governance framework and deeper integration between stock markets, both of which support the operation of market discipline. Admittedly, the role of regulators as custodians of codes has changed their character to some extent to be market regulative[166] rather than just market facilitative, but it remains the case that market discipline is the key differentiating factor of the 'comply or explain' approach.

As regards the second aspect (the substantive content of codes), there are two key issues. One is the relationship between the code provisions and corporate law. Ever since the Cadbury Code, the provisions of the UKCGC have been framed so as to avoid overlap across any dimension (rule type and formulation, operation and enforcement) with statutory corporate law. Put another way, the self-regulatory character of the UKCGC was ensured by locating it in a self-regulatory space. While that outcome was not, at the time of the adoption of the Cadbury Code, part of any larger project to frame corporate law as a whole, the approach was later endorsed by the steering group set up to consult on reform of company law which led to the Companies Act 2006.[167] With regard to other systems, it is less clear that codes have been tailored to the local self-regulatory space determined by local corporate law as we find evidence both of significant alignment to the UK model (in terms of both initial convergence and evolution) and some evidence of tailoring to local corporate law by reference for example to two-tier boards.[168] Thus, experimentation seems to be more prominent in the initial development of 'comply or explain' in the UK than in the process of dissemination around the world.

The other key issue is the evolution of code provisions over time. We observe (Table A3) that the key evolutionary stages in the UKCGC have been emulated by a significant majority of countries in our survey. That process demonstrates the capacity of codes to respond quickly to emerging concerns and to adapt their focus in ways that run counter to the original shareholder primacy focus of the Cadbury Code. Thus, the more recent focus on employee and stakeholder interests, as well as culture, are dimensions of codes that could not have been easily foreseen in their early stage of

[165] Albeit, as noted by MacNeil & Li, *supra* n.21, a functional equivalent of 'comply or explain' would have been possible within the flexible structure of British Company Law. But that model is unlikely to have been capable of such extensive transplantation as 'comply or explain' since it would have required adjustment to both the structure as well as content of company law in host countries.

[166] That turn has prompted the observation that the Code is not appropriate for such regulatory intervention, which should be pursued through legislation: see Reddy, *supra* n.74.

[167] See *Modern Company Law for a Competitive Economy* (n.41).

[168] See also, *supra* n. 154, with reference to South Africa, which was the only instance we encountered in our sample of overlap between a corporate governance code and corporate law.

development. But that same process also potentially expands the self-regulatory space in which codes operate by effectively pre-empting hard law and that trend may ultimately test the potential for countries with less market-focused systems of corporate governance to continue to follow developments in the UKCGC. The articulation of sustainability in codes is likely to represent the next major challenge. To date, what we term the 'financialization' of sustainability has meant that it has been more directly addressed in financial market benchmarks, taxonomies for financial products, disclosure rules and the duties of asset managers rather than in corporate governance codes. However, beyond a vague reference to 'sustainable success' in the 2018 version of the UKCGC it is notable that sustainability has not yet exerted any direct influence on the content of the Code.[169] We will be keen to observe the consequences when that trend changes, as we expect.

6. Conclusions

While the Cadbury Code was not the first soft law code of corporate governance, it emerged over time as the global model for such codes. Our examination of country characteristics demonstrates that codes have been adopted across diverse legal and financial systems. This is particularly the case with regard to initial convergence (by comparison with the original version of the Cadbury Code), but it is also generally the case with regard to evolution (by comparison with key stages of evolution in the UK code). The exception is the recent move in the UK Code to focus on corporate culture, where a majority of our sample of countries have not yet adjusted their codes. While Cadbury may have emerged in a common law system with a strong tradition of self-regulation and tendency towards shareholder primacy in corporate law, it is clear that those conditions are not replicated in many of the host countries which have adopted its approach.

Innovation is evident in terms of rule type and enforcement, thereby avoiding overlap with local legal systems. The 'comply or explain' approach sits outside the conventional taxonomy of rules in corporate law and has facilitated the adoption of soft law codes in countries with different approaches to corporate law and its enforcement. Thus, emulation of Cadbury leaves scope for considerable divergence in the role and operation of soft law codes by comparison with the UK. For example, in countries where stock markets are less liquid and institutional investors less prominent, it is unlikely that market discipline, as an enforcement strategy, will work effectively.

In line with the UK model, the linkage of codes to hard law is generally only through disclosure obligations in listing rules, preserving the character of codes as a

[169] While a full treatment of the linkage between sustainability and board decision-making is beyond the scope of this article, our preliminary view is that it may be explained by a process we characterize as 'financialization' of ESG, whereby ESG obligations have a more prominent place in the duties of asset managers and financial market benchmarks than in the duties of directors of investee companies.

system which has limited interaction with hard law. That has been a key factor enabling the adoption of codes in legal systems which have been less open to self-regulatory initiatives and the role of market discipline than the UK. The process represents a carve-out of a significant self-regulatory space in which a de facto *transnational* code of corporate governance has been created and operated by market actors.

We sought to explain the spread of codes by reference to three themes that have been developed in comparative corporate law but have not been extensively discussed with reference to soft law codes. Each makes a contribution to understanding why the 'comply or explain' model which emerged in the unique setting of the UK was amenable to adoption across a diverse set of countries with different approaches to corporate law and governance. In the case of the 'competition and convergence' paradigm we concluded that the evidence for competition between capital markets as a driver for the diffusion of 'comply or explain' codes was persuasive, albeit indirect and contextual. In the case of 'transplantation and adaptation' we found that the process of transplantation, linked to the nature of a 'comply or explain' code as a system that operates separately from hard law, was a key factor in explaining the success of the UK as a global model. Finally, we argued that the emergence of the Cadbury code and its widespread emulation could be linked to the role of market actors as a source of normative experimentation, at least where the institutional framework of corporate governance is conducive to such an approach. Of course, the extent to which such an approach can thrive in situations that are less conducive remains to be tested, especially as some countries have a much shorter experience of codes than the UK.

What is less clear, and more difficult to test, is whether the diffusion of 'comply or explain' codes has, in overall terms, improved standards of corporate governance around the world. While in principle that is the expectation associated with the adoption of codes, it could only be realized if they were appropriately implemented and institutional investors were sufficiently alert in their monitoring of conformance (including explanations for non-compliance). Moreover, even that perspective does not capture the contested, contingent and evolutionary nature of corporate governance and the associated challenges of setting benchmarks by which corporate governance standards might be judged. Thus, even after a long phase of development of 'comply or explain' codes we could expect the emerging focal points of stakeholder interests, corporate culture and sustainability to expose failings in corporate governance. As always, the solutions are only provisional.

Appendix A

Table A1: Country characteristics

Country	**Share Ownership Pattern**	**Foreign Ownership [Institutional Ownership] [%]**	**Shareholder/ director primacy**	**Shareholder Protection Index *(vs. Board)* *[vs. other shareholders]***	**National reports on corporate governance (Issuer – Coverage)[1]**
UK	MC	44 [68]	Shareholder	n/a (23.125) [8.5]	(M – F)
EU 27					
Austria	SC	30 [20]			(P – ?)
Belgium	SC	52 [18]			(R – O)
Bulgaria	SC			n/a	(R – ?)
Croatia	SC			n/a	(S – ?)
Cyprus	MC				(S – ?)
Czech Republic	SC	48 [28]		3	(R – ?)
Denmark	MC	28 [33]			(S – F)
Estonia	SC	23 [10]			(R – F)
Finland	MC	29 [31]	Shareholder		(M – F)
France	SC	27 [20]	Shareholder	7 (26.75) [10.25]	(R – F)
Germany	SC	34 [21]	Shareholder	5.167 (22.75) [11.417]	(P – F)
Greece	SC	31 [10]			(M – ?)
Hungary	SC				(S – ?)
Italy	SC	30 [16]	Shareholder	4.75	(S – F)
Latvia	SC	67 [9]	Shareholder	4.25	(S – F)
Lithuania	SC	24 [8]			(S – F)
Luxembourg	MC	73 [15]		n/a	(S – F)
Malta	SC				(R – ?)
Netherlands	SC	53 [39]	Shareholder	1.75	(M – F)
Poland	SC	33 [34]	Shareholder		(S – ?)
Portugal	SC	44 [17]		n/a	(R – F)
Republic of Ireland	MC	36 [40]			(M – F)

[1] This is the issuer of the report, not necessarily the custodian as per *Table A2*.

Table A1: Country Characteristics (*cont.)*

Country	**Share Ownership Pattern**	**Foreign Ownership [Institutional Ownership] [%]**	**Shareholder/ director primacy**	**Shareholder Protection Index *(vs. Board) [vs. other shareholders]***	**National reports on corporate governance (Issuer – Coverage)[1]**
Romania	SC				(S – ?)
Slovakia	SC	89 [5]			(M – ?)
Slovenia	SC	14 [8]		4.875	(S –F)
Spain	SC	32 [30]	Shareholder	4.75	(R – F)
Sweden	MC	25 [27]		4.25	(P – F)
G20 (inc. India)					
Argentina	SC	40 [7]		n/a	(R – ?)
Australia	MC	23 [29]			(M – ?)
Brazil	SC	45 [22]		n/a	(P – ?)
Canada	MC	28 [43]		6.75	(S – ?)
China	SC	7 [8]		6	(M – O)
Indonesia	SC	39 [7]			(R – ?)
Japan	MC	25 [31]	Shareholder	n/a	(S – F)
Mexico	SC	27 [19]		2	(P – ?)
Russia	SC	24 [8]		7.25	(R – O)
Saudi Arabia	MC	4 [2]			(R – O)
South Africa	MC	32, [33]	Shareholder	n/a	(P – ?)
South Korea	D	21 [13]			(P – ?)
Turkey	SC	28 [11]		5	(R – O)
India	MC	30 [19]		n/a (23.625) [8.917]	(R – ?)
Nigeria	MC	51[2] [n/a]			(R – O)
New Zealand	MC	26 [18]			(S – ?)

[2] Nigerian Stock Exchange, 'Data on Foreign Transactions Value in 2018' <http://www.nse.com.ng/market_data-site/other-market-information-site/FPI%20Report/NSE%20Domestic%20and%20FPI%20Report%20September%202019.pdf> accessed 5 May 2020.

Key
Share ownership pattern: SC = Strong Concentration; MC = Moderate Concentration; D = Dispersed[170]

Foreign ownership [Institutional Ownership]: 2017 OECD data[171]

Shareholder/director primacy: Shareholder = shareholder primacy; Director = director primacy[172]

Shareholder Protection Index: The aggregate score derived from CBR Extended Shareholder Protection Index[173] in the year before the adoption of the relevant Code. Where that year falls outside the scope of the Index we enter ‘n/a’. As Codes are encompassed by the Index, it provides a proxy for shareholder protection before the introduction of the Code. Higher scores correspond to higher shareholder protection and the maximum possible score is 10.

Shareholder Protection Index (vs. Board) and [vs. other shareholders]: The aggregate score derived from the CBR Shareholder Protection Index for the UK, the US, Germany, France, and India for the respective sub-variables[174] in the year before the adoption of the relevant Code. Higher scores correspond to higher shareholder protection. The maximum possible score for protection against the board is 40 and for protection against other shareholders 20.

National reports on corporate governance (*Issuer – Coverage*): The results presented in The OECD Corporate Governance Factbook 2019 at Table 2.4.[175] *Issuer*: R = Securities Regulator; S = Stock Exchange; P = Private Institution; M = Mixed. *Coverage*: F = Full coverage of listed companies and code provisions, O = Otherwise, ? = Unavailable.

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[170] Source: Gur Aminadav and Elias Papaioannou, *Corporate Control around the World* (2018) <https://www.doipconference.com/Portals/176/Corporate_Control_MainPaper.pdf?ver=2018-12-11-160601-210> accessed 5 May 2020. The coding of share ownership is based on the data presented in Table 1: Corporate Control and Ownership Concentration around the World in 2012. We define strong and moderate concentration to be where the mean of the voting rights of the 5 largest shareholders (column C5 in Table 1) exceeds 50% and 30% respectively.

[171] Source: A De La Cruz, A. Medina and Y. Tang, *Owners of the World’s Listed Companies* (OECD Capital Market Series, Paris 2019) <https://www.oecd.org/corporate/ca/Owners-of-the-Worlds-Listed-Companies.pdf.> accessed 5 May 2020.

[172] This coding follows the approach in D Cabrelli and I-M Esser, *A Rule-Based Comparison and Analysis of the Case Studies* in Mathias M. Siems and David A. Cabrelli, *Comparative Company Law: A Case-Based Approach,* ch.12 (2nd ed., Oxford, Hart Publishing, 2018). See Table 12.4 for their results, based on 10 scenarios analysed across 12 countries (including the US which is not included in our study). Cabrelli and Esser recorded instances in which the case studies demonstrated that corporate law in the relevant countries provided qualitative evidence of shareholder primacy and director primacy. We code for shareholder primacy where Cabrelli and Esser’s score for shareholder primacy is greater than the score for director primacy, and for director primacy where the opposite is the case.

[173] See Centre for Business Research (CBR), *‘Law, Finance & Development’ Datasets* <https://www.cbr.cam.ac.uk/research/research-projects/completed-projects/law-finance-development/#item-2.>accessed 5 May 2020.The Index is based on ten core variables linked to shareholder protection and covers 25 countries over the years 1995-2005.

[174] See CBR, *‘Law, Finance & Development’ Datasets* <https://www.cbr.cam.ac.uk/research/research-projects/completed-projects/law-finance-development/#item-2>accessed 5 May 2020. The index is based on 60 variables (including sub-variables) over the period 1970-2005. The index employs 40 variables to measure shareholder protection against the board and management, and 20 variables to measure protection against other shareholders.

[175] OECD, *OECD Corporate Governance Factbook 2019* (2019), <http://www.oecd.org/corporate/Corporate-Governance-Factbook.pdf> accessed 5 May 2020.

Table A2: Typology of Corporate Governance Codes[176]

Country (43, plus the UK)	**Code**	**Year of Adoption of Code [Latest]**[1]	**Custodian of Code**[2]	**Current Legal Status of Code**[3]	**Scope of Application of Code**	**Structure of Code**	**Form of disclosure required**[4]
UK	The UK Corporate Governance Code	1993 [2018]	Mixed[5]	MD	AL	Tiered	AaE,[6] 'comply or explain'
EU 27							
Austria	Austrian Code of Corporate Governance	2002 [2018]	Private	MD, MC	AL	Tiered	'comply or explain'
Belgium	The Belgian Code on Corporate Governance	2004 [2020]	Mixed	MD	AL	Unitary	'comply or explain'
Bulgaria	Bulgarian Code of Corporate Governance	2007 [2012]	Exchange	MD	AL	Unitary	'comply or explain'
Croatia	Corporate Governance Code	2007 [2009]	Exchange	MD	AL	Unitary	'comply or explain'
Cyprus	Corporate Governance Code	2002 [2012]	Exchange	MD, MC	AL	Tiered	'comply or explain'
Czech Republic	Corporate Governance Code Based on OECD principles	2001 [2004]	Public	MD MC	AL	Unitary	'comply or explain'

1 Extracted from the results presented in *The OECD Corporate Governance Factbook 2019*, Table 2.3. In some instances, later versions have been published; we always list the latest version available. This is also checked against the ECGI Corporate Governance Codes Database <https://ecgi.global/content/codes.> accessed 5 May 2020.

2 Extracted from the results presented in *The OECD Corporate Governance Factbook 2019*, Table 2.3.

3 Extracted from the results presented in *The OECD Corporate Governance Factbook 2019*, Table 2.2 ('Disclosure in annual company report' column) and adjusted for MC where relevant.

4 Extracted from the results presented in *The OECD Corporate Governance Factbook 2019*, Table 2.2 ('Approach' column).

5 As coded in the source (n.11), albeit we would classify the FRC as a public body. See text at n69 in main text.

6 Although not recognised in the source (n.13), AaE is applicable to the Principles of the Code.

176 Custodian, legal status, scope, structure and form of required disclosure are all based on the latest version of the Code.

Country (43, plus the UK)	**Code**	**Year of Adoption of Code [Latest][1]**	**Custodian of Code[2]**	**Current Legal Status of Code[3]**	**Scope of Application of Code**	**Structure of Code**	**Form of disclosure required[4]**
Denmark	Recommendations on Corporate Governance	2001 [2017]	Public	MD	AL	Unitary	'comply or explain'
Estonia	Estonian Corporate Governance Recommendations	2005 [2006]	Public	MD	AL	Unitary	'comply or explain'
Finland	Finnish Corporate Governance Code	1997 [2020]	Private	MD	AL	Unitary	'comply or explain'
France	Corporate Governance Code of Listed Corporations	2003 [2018]	Private	MD	AL	Unitary	'comply or explain'
Germany	German Corporate Governance Code	2002 [2019]	Mixed	MD	AL	Unitary	'comply or explain'
Greece	Hellenic Corporate Governance Code for Listed Companies	2013 [2013]	Mixed	MD	AL	Unitary	'comply or explain'
Hungary	Corporate Governance Recommendations	2004 [2012]	Exchange	MD	AL	Tiered	'comply or explain', ND
Italy	Italian Corporate Governance Code	1999 [2020]	Mixed	MD	AL	Unitary	'comply or explain'
Latvia	Corporate Governance Principles and Recommendations on their Implementation	2005 [2010]	Exchange	MD	AL	Unitary	'comply or explain'
Lithuania	The Corporate Governance Code for Companies Listed on NASDAQ Vilnius	2006 [2019]	Exchange	MD	AL	Unitary	'comply or explain'
Luxembourg	The X Principles of Corporate Governance of the Luxembourg Stock Exchange	2007 [2017]	Exchange	MD	AL	Unitary	'comply or explain'

Table A2: Typology of Corporate Governance Codes (*cont.*)

Country (43, plus the UK)	**Code**	**Year of Adoption of Code [Latest]**[1]	**Custodian of Code**[2]	**Current Legal Status of Code**[3]	**Scope of Application of Code**	**Structure of Code**	**Form of disclosure required**[4]
Malta	The Code of Principles of Good Corporate Governance	2001 [2005]	Exchange	MD	AL	Unitary	'comply or explain'
Netherlands	The Dutch Corporate Governance Code	2003 [2016]	Mixed	MD	AL	Unitary	'comply or explain'
Poland	Best Practice for WSE Listed Companies	2002 [2016]	Exchange	MD	AL	Unitary	'comply or explain'[7]
Portugal	The Portuguese Corporate Governance Code	2011 [2018]	Private	MD	ACF	Unitary	'comply or explain'
Republic of Ireland	UK CGC (Irish Annex) applied by Irish Listing Rules	2003 [2019]	Mixed	MD	AL	Unitary	'comply or explain'
Romania	Code of Corporate Governance	2001 [2015]	Exchange	MD	AL	Unitary	'comply or explain'
Slovakia	Corporate Governance Code for Slovakia	2003 [2008]	Mixed	MD	AL	Unitary	'comply or explain'
Slovenia	Slovenian Corporate Governance Code for Listed Companies	2004 [2018]	Exchange	MD	AL	Unitary	'comply or explain'
Spain	Good Governance Code of Listed Companies	1998 [2015]	Public	MD	AL	Unitary	'comply or explain'
Sweden	The Swedish Corporate Governance Code	2005 [2016]	Private	MD	AL	Unitary	'comply or explain'
G20 (Inc. Nigeria)							
Argentina	Argentine Corporate Governance Code	2007 [2019]	Public	MD	AL	Unitary	'comply or explain'

[7] In this instance, the 'comply or explain' approach requires immediate reporting under the rules of the Warsaw Stock Exchange.

Country (43, plus the UK)	Code	Year of Adoption of Code [Latest][1]	Custodian of Code[2]	Current Legal Status of Code[3]	Scope of Application of Code	Structure of Code	Form of disclosure required[4]
Australia	Principles of Good Corporate Governance and Best Practice Recommendations	2003 [2019]	Mixed	MD	AL	Unitary	INWN[8]
Brazil	Brazilian Corporate Governance Code-Listed Companies	2016	Public	MD	AL	Tiered	AoE
Canada	National Policy 58-201 – Corporate Governance Guidelines[9]	2004 [2014]	Mixed	MD	AL	Unitary	'comply or explain'
China	Code of Corporate Governance for Listed Companies in China	2002 [2018]	Public	MD, MC	AL	Tiered	ND
Indonesia	Code of Good Corporate Governance	2000 [2006]	Public	MD MC	AL	Unitary	'comply or explain'
Japan	Japan's Corporate Governance Code etc.	2015 [2018]	Exchange	MD	AL	Unitary	'comply or explain'
Mexico	Code of Best Corporate Practices	1999 [2018]	Private	MD	AL	Unitary	'comply or explain'
Russia	Russian Code of Corporate Governance	2002 [2014]	Public	MD	AL	Unitary	'comply or explain'
Saudi Arabia	Corporate Governance Regulations	2003 [2019]	Public	MD, MC	AL	Unitary	'comply or explain'
South Africa	King Report on Corporate Governance in South Africa (King IV Report)	1994 [2016]	Private	MD	ACF	Tiered	AaE[10]

8 See (n.117) in the main text.

9 See Toronto Stock Exchange <https://www.tsx.com/listings/tsx-and-tsxv-issuer-resources/tsx-issuer-resources/corporate-governance> accessed 5 May 2020.

10 Although coded in the source as CoE, King IV applies on the AaE basis.

Table A2: Typology of Corporate Governance Codes (*cont.*)

Country (43, plus the UK)	Code	Year of Adoption of Code [Latest][1]	Custodian of Code[2]	Current Legal Status of Code[3]	Scope of Application of Code	Structure of Code	Form of disclosure required[4]
South Korea	Code of Best Practices for Corporate Governance	1999 [2003]	Private	MD	AL	Unitary	'comply or explain'
Turkey	Turkish Corporate Governance Principles	2003 [2014]	Public	MD MC	AL	Unitary	'comply or explain'
India	Corporate Governance Voluntary Guidelines[11]	2009 [2009]	Public	N	AL LPC	Unitary	'comply or explain'
Nigeria	The Nigerian Code of Corporate Governance	2003	Public	MD	AI	Unitary	AaE
New Zealand	NZX Corporate Governance Code	2003 [2017]	Exchange	MD	AL	Unitary	'comply or explain'

[11] In addition to these guidelines, the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (the Listing Regulations) specify mandatory corporate governance obligations for listed companies. We focus on the voluntary guidelines as the appropriate comparator for codes elsewhere (but see also n1 below for adjustment to the Table A3 results to take account of the relevant SEBI provisions).

Key

Custodian of Code (meaning responsibility for drafting and amending): Public/Private/Stock Exchange/Mixed Initiative[177].

Current Legal status of code (2019): N = No legal basis; MC = Mandatory Compliance; MD = Mandatory disclosure required (multiple coding reflects different forms of disclosure applicable to different parts of the Code).

Scope of Application of Code: AL = All Listed Companies; SL = Segment of Listed Companies; AI = All Issuers of Equity Securities; LPC = Large Private Company; ACF = Any Corporate Form; ULC = Unlisted Companies.

Structure of Code: Tiered = Different provisions with different compliance obligations; Unitary = a single set of provisions with uniform compliance obligations.

Form of disclosure required: AaE = Apply and Explain; AoE = Apply or Explain; 'comply or explain' = Comply or Explain; INWN = If not, why not; ND =No Disclosures Required.

[177] Extracted from the results presented in *The OECD Corporate Governance Factbook 2019*, Table 2.3.

Table A3: Comparison of Key Code Provisions vs. the UK

Country	**Board Composition**	**Directors' remuneration**	**Reporting, audit and risk control**	**Diversity**	**Stakeholders**	**Culture**	**Convergence score (initial)**	**Convergence score (evolution)**
EU27								
Austria *Austrian Code of Corporate Governance*	2	2	2	2	2	0	6	4
Belgium *The Belgian Code on Corporate Governance*	2	2	2	2	1	1	6	4
Bulgaria *Bulgarian Code for Corporate Governance*	2	2	2	0	2	0	6	2
Croatia *Corporate Governance Code*	2	2	2	0	2	0	6	2
Cyprus *Corporate Governance Code*	2	2	2	0	0	0	6	0
Czech Republic *Corporate Governance Code Based on OECD principles*	2	2	2	0	2	0	6	2
Denmark *Recommendations on Corporate Governance*	2	2	2	2	2	0	6	4
Estonia *Estonian Corporate Governance Recommendations*	2	2	2	0	0	0	6	0
Finland *Finnish Corporate Governance Code*	2	2	2	2	0	0	6	2
France *Corporate Governance Code of Listed Corporations*	2	2	2	2	2	1	6	5
Germany *German Corporate Governance Code*	2	2	2	2	2	0	6	4

Table A3: Comparison of Key Code Provisions vs. the UK (*cont.)*

Country	**Board Composition**	**Directors' remuneration**	**Reporting, audit and risk control**	**Diversity**	**Stakeholders**	**Culture**	**Convergence score (initial)**	**Convergence score (evolution)**
Greece *Hellenic Corporate Governance Code for Listed Companies*	2	2	2	2	2	0	6	4
Hungary *Corporate Governance Recommendations*	2	2	2	0	2	0	6	2
Italy *Italian Corporate Governance Code*	2	2	2	2	1	0	6	3
Latvia *Corporate Governance Principles and Recommendations on their Implementation*	2	2	2	0	0	0	6	0
Lithuania *The Corporate Governance Code for Companies Listed on NASDAQ OMX Vilnius*	2	2	2	1	2	0	6	3
Luxembourg *The X Principles of Corporate Governance of the Luxembourg Stock Exchange*	2	2	2	2	2	0	6	4
Malta *The Code of Principles of Good Corporate Governance*	2	2	2	1	2	0	6	3
Netherlands *The Dutch Corporate Governance Code*	2	2	2	2	2	2	6	6
Poland *Best Practice for WSE Listed Companies*	2	2	2	2	0	0	6	2
Portugal *The Portuguese Corporate Governance Code*	2	2	2	2	1	0	6	3

Country	Board Composition	Directors' remuneration	Reporting, audit and risk control	Diversity	Stakeholders	Culture	Convergence score (initial)	Convergence score (evolution)
Republic of Ireland *UK Code (The Irish Corporate Governance Annex)*	2	2	2	2	2	2	6	6
Romania *Code of Corporate Governance*	2	2	2	2	0	0	6	2
Slovakia *Corporate Governance Code for Slovakia*	2	2	2	0	2	0	6	2
Slovenia *Slovenian Corporate Governance Code for Listed Companies*	2	2	2	2	2	0	6	4
Spain *Good Governance Code of Listed Companies*	2	2	2	2	2	2	6	6
Sweden *The Swedish Corporate Governance Code*	2	2	2	2	0	0	6	2
G20 (Inc. Nigeria)								
Argentina *Argentine Corporate Governance Code*	2	0	2	0	2	2	4	4
Australia *Principles of Good Corporate Governance and Best Practice Recommendations*	2	2	2	2	2	2	6	6
Brazil *Brazilian Corporate Governance Code-Listed Companies*	2	2	2	2	2	2	6	6
Canada *National Policy 58-201 – Corporate Governance Guidelines*	2	2	2	0	1	2	6	3
China *Code of Corporate Governance of Listed Companies in China*	2	2	2	0	2	0	6	2

Table A3: Comparison of Key Code Provisions vs. the UK *(cont.)*

Country	**Board Composition**	**Directors' remuneration**	**Reporting, audit and risk control**	**Diversity**	**Stakeholders**	**Culture**	**Convergence score (initial)**	**Convergence score (evolution)**
Indonesia *Code of Good Corporate Governance*	2	2	2	0	2	2	6	4
Japan *Japan's Corporate Governance Code*	2	2	2	2	2	2	6	6
Mexico *Code of Best Corporate Practices*	2	2	2	0	1	0	6	1
Russia *Russian Code of Corporate Governance*	2	2	2	0	2	1	6	3
Saudi Arabia *Corporate Governance Regulations*	2	2	2	0	2	2	6	4
South Africa *King Report on Corporate Governance in South Africa (King IV Report)*	2	2	2	2	2	2	6	6
South Korea *Code of Best Practices for Corporate Governance*	2	2	2	0	2	1	6	3
Turkey *Turkish Corporate Governance Principles*	2	2	2	2	2	0	6	4
India[1] *Corporate Governance Voluntary Guidelines*	2	2	2	0	0	0	6	0
Nigeria *The Nigerian Code of Corporate Governance*	2	2	2	2	2	2	6	6
New Zealand *NZX Corporate Governance Code*	2	2	2	2	2	1	6	5

[1] In the case of India, inclusion of the SEBI Listing Obligations in the evaluation would result in a score of 2 for each of diversity, stakeholders and culture and therefore a score of 6 for convergence (evolution).

Key

Board Composition = 2 if provisions are, at a minimum, functionally equivalent to provisions 1.2 and 13 of the Cadbury Code (1992), 1 if there is any other provision, otherwise 0.

Directors' remuneration = 2 if provisions are, at a minimum, functionally equivalent to provisions 3.2. and 3.3 of the Cadbury Code (1992), 1 if there is any other provision, otherwise 0.

Reporting, audit and risk control = 2 if provisions are, at minimum, functionally equivalent to provisions 4.1, 4.3 and 4.5 of the Cadbury Code (1992), 1 if there is any other provision, otherwise 0.

Diversity = 2 if provisions are, at a minimum, functionally equivalent to Principle B.2 of the UK Corporate Governance Code 2014, 1 if there is any other provision, otherwise 0.

Stakeholders = 2 if provisions are, at a minimum, functionally equivalent to provision 5 of the UK Corporate Governance Code 2018, 1 if there is any other provision, otherwise 0.

Culture = 2 if provisions are, at a minimum, functionally equivalent to Principle 1.B and provision 2 of the UK Corporate Governance Code 2018, 1 if there is any other provision, otherwise 0.

Convergence score (initial) = the sum of the scores in the first three columns (all based on comparison with the Cadbury Code, maximum score = 6).

Convergence score (evolution) = the sum of the scores in the columns: diversity, stakeholders and culture (maximum score = 6). We take the 2014 Code as the comparator for diversity as it is the first code with detailed provision on that issue. For the same reason we take the 2018 Code as the comparator for stakeholders and culture.

Code Provisions referenced in Table A3

Board Composition – Cadbury Code (1992)

1.2 There should be a clearly accepted division of responsibilities at the head of a company, which will ensure a balance of power and authority, such that no one individual has unfettered powers of decision. Where the chairman is also the chief executive, it is essential that there should be a strong and independent element on the board, with a recognised senior member.

1.3 The board should include non-executive directors of sufficient calibre and number for their views to carry significant weight in the board's decisions.

Directors' remuneration – Cadbury Code (1992)

3.2 There should be full and clear disclosure of directors' total emoluments and those of the chairman and highest-paid UK director, including pension contributions and stock options. Separate figures should be given for salary and performance-related elements and the basis on which performance is measured should be explained.

3.3 Executive directors' pay should be subject to the recommendations of a remuneration committee made up wholly or mainly of non-executive directors.

Reporting, audit and risk control – Cadbury Code (1992)

4.1 It is the board's duty to present a balanced and understandable assessment of the company's position.

4.3 The board should establish an audit committee of at least three non – executive directors with written terms of reference which deal clearly with its authority and duties.

4.5 The directors should report on the effectiveness of the company's system of internal control.

Diversity – 2014 UK Corporate Governance Code (2014)

B.2: Appointments to the Board Main Principle There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board. Supporting Principles.

The search for board candidates should be conducted, and appointments made, on merit, against objective criteria and with due regard for the benefits of diversity on the board, including gender

Stakeholders – UK Corporate Governance Code (2018)

1 Board Leadership and Company Purpose

Provision 5 The board should understand the views of the company's other key stakeholders and describe in the annual report how their interests and the matters set out in section 172 of the Companies Act 2006 have been considered in board discussions and decision-making. The board should keep engagement mechanisms under review so that they remain effective. For engagement with the workforce, one or a combination of the following methods should be used:

• a director appointed from the workforce;
• a formal workforce advisory panel;
• a designated non-executive director.

If the board has not chosen one or more of these methods, it should explain what alternative arrangements are in place and why it considers that they are effective.

Culture – UK Corporate Governance Code (2018)

1 Board Leadership and Company Purpose

Principle B The board should establish the company's purpose, values and strategy, and satisfy itself that these and its culture are aligned. All directors must act with integrity, leadership by example, and promote the desired culture.

Provision 2 The board should assess and monitor culture. Where it is not satisfied that policy, practices or behaviour throughout the business are aligned with the company's purpose, values and strategy, it should seek assurance that management has taken corrective action. The annual report should explain the board's activities and any action taken. In addition, it should include an explanation of the company's approach to investing in and rewarding its workforce.

Appendix B

	Adoption of 'Comply or Explain'		
	No	**Yes**	
	Mean (# obs.)	**Mean (# obs.)**	**Difference (t-stat)**
Foreign Ownership (%)	31.60 (5)	35.09 (33)	-3.49 (-0.4303)
Institutional Ownership (%)	23.00 (4)	20.76 (33)	2.24 (0.3087)
Shareholder Protection Index	6.00 (1)	4.68 (13)	1.32 (n/a)

Figure B1: Adoption of a 'comply or explain' code versus foreign ownership, institutional ownership and shareholder protection index (t-stats)[178]

[178] The underlying data is drawn from Table A1 in Appendix A. We use the basic form of shareholder protection index shown in column 5 of that table.

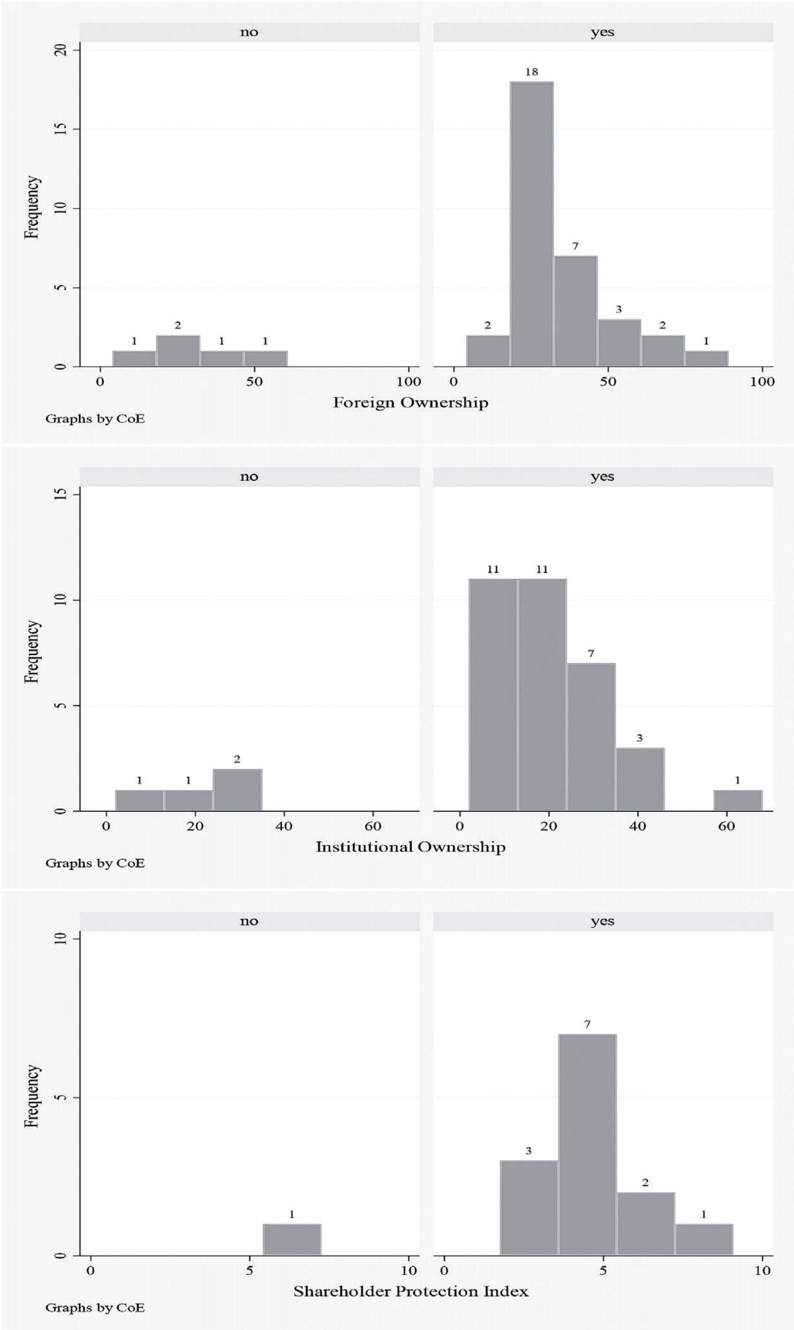

Figure B2: Adoption of 'comply or explain' codes by foreign ownership, institutional ownership and shareholder protection index.

	Foreign ownership – Low	**Foreign ownership – High**	**Total**	**Difference in total (t-stat)**
Institutional Ownership – Low	2.73 (11)	3.13 (8)	2.89 (19)	-1.11* (-1.9070)
Institutional Ownership– High	3.71 (7)	4.33 (6)	4.00 (13)	
Total	3.11 (18)	3.64 (14)	3.34 (32)	
Difference in Total (t-stat)	-0.53 (-0.8865)			

	Shareholder protection Index – Low	**Shareholder protection Index – High**
Total	2.86 (7)	3.83 (6)
Difference in Total (t-stat)	-0.97 (-0.9741)	

Figure B3: Mean of convergence score (evolution) for countries that adopt 'comply or explain' codes[179]

[179] The convergence scores (evolution) are drawn from Appendix A, Table A3, column 9. We divide our sample into low and high groups for each variable (institutional ownership, foreign ownership and shareholder protection index) to test the link with the convergence score (evolution).

	Adoption of "comply or explain"	**Foreign ownership**	**Institutional ownership**	**Shareholder protection index**	**Convergence score (Evolution)**	
Adoption of "comply or explain"	1					Correlation
						p-stat
	44					# obs.
Foreign ownership	0.1134	1				
	0.4977					
	38	38				
Institutional ownership	-0.0901	0.3648**	1			
	0.5958	0.0264				
	37	37	37			
Shareholder protection index	-0.2090	-0.4399	-0.3255	1		
	0.4733	0.1154	0.2562			
	14	14	14	14		
Convergence score (Evolution)	-0.3779**	0.0355	0.2875*	0.1091	1	
	0.0125	0.8347	0.0891	0.7105		
	43	37	36	14	43	

Figure B4: Correlations of relevant variables[180]

[180] Foreign ownership and institutional ownership are transformed (taking the natural logarithm of its value) for correlations. *p < 0.10, **p < 0.05, ***p< 0.01