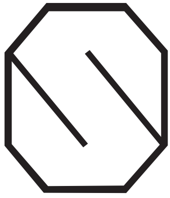

# Codes of Good Governance Worldwide: What is the Trigger?

Ruth V. Aguilera and Alvaro Cuervo-Cazurra

*Ruth V. Aguilera*
University of Illinois at Urbana-Champaign, USA

*Alvaro Cuervo-Cazurra*
University of Minnesota, USA

**Abstract**

This article examines the mechanisms underlying the worldwide diffusion of organizational practices. We suggest that the two main theoretical diffusion explanations in the diffusion literature, efficiency and legitimation arguments (Tolbert and Zucker 1983), can be complementary. More specifically, we argue that endogenous forces seek to enhance the efficiency of existing systems, while exogenous forces seek to increase legitimation. To assess our argument, we explore the worldwide diffusion of codes of good governance. These codes are a set of 'best practice' recommendations regarding the behavior and structure of a firm's board of directors. We suggest that codes are issued to compensate for deficiencies in a country's corporate governance system regarding the protection of shareholders' rights. We have collected data on codes of good governance for 49 countries. We operationalize efficiency needs in terms of the characteristics of shareholder protection, and legitimation pressures in terms of government liberalization, economic openness, and presence of foreign institutional investors. Our categorical data analysis supports the argument that both efficiency needs and legitimation pressures lead to code adoption. In addition, our empirical results show that countries with legal systems with strong shareholder protection rights tend to be more prone to develop codes, possibly for efficiency reasons. This article contributes to organization studies by illustrating that the diffusion of codes fosters both cross-national corporate governance convergence as well as some degree of country hybridization, particularly depending on the type of code issuer.

**Keywords:** corporate governance, diffusion, boards of directors, codes of good governance

## Introduction

Recent comparative studies have emphasized that despite the convergence of managerial structures and strategies, substantial differences in the economic organization of capitalism across countries prevail (Aguilera and Jackson 2003; Crouch and Streek 1997; Hall and Soskice 2001; Hollingsworth and Boyer 1997; Orrú et al. 1997; Whitley 1994, 1999), often resulting in country-specific comparative institutional advantages (Hall and Soskice 2001). However, in a manner similar to that in which certain practices spread across organizations, as illustrated by workplace innovations (Abrahamson and Fairchild 1999; Baron et al. 1986; Osterman 1994; Westphal and Zajac 1997), organizational

Organization Studies
25(3): 417–446
ISSN 0170–8406
Copyright © 2004 SAGE Publications (London, Thousand Oaks, CA & New Delhi)


DOI: 10.1177/0170840604040669

practices also diffuse across national borders. For example, the transplantation of Japanese work practices to the American factory floor (Florida and Kenney 1991), the spread of small-group activities in Japan, Sweden, and the USA (Cole 1985), the adoption of human resource practices by European firms (Gooderham et al. 1999), and the implementation of quality certification programs (Casper and Hancké 1999; Guler et al. 2002) demonstrate some degree of cross-national convergence in organizational practices.

Diffusion studies have investigated how practices spread over time in different organizational settings (Strang and Soule 1998). A diffused practice can be defined as an innovation within a social system, although the innovation does not necessarily entail an 'improvement', but rather a change in the current state (Strang and Macy 2001). Scholars within the diffusion literature often disagree about whether the adoption of new practices is due to *efficiency* or due to *legitimation* effects (Strang and Macy 2001; Tolbert and Zucker 1983; Westphal et al. 1997). In this article, we show that these two theoretical logics, usually presented as being incompatible, can be reconciled and thereby account for the spread of practices across countries with different economic organization. We do so by proposing two different mechanisms or antecedents shaping efficiency and legitimation. In particular, we propose that while endogenous forces influence efficiency factors in a given country, exogenous pressures lead to legitimation by triggering the adoption of taken-for-granted practices. The present study examines efficiency and legitimation effects on innovation in the context of the adoption of codes of good governance around the world. The development and adoption of a code of good governance is defined as a country innovation signaling the country's commitment to improve its corporate governance system.

Corporate governance issues have recently received much attention from policy-makers and the public. Two parallel processes, globalization (such as the liberalization and internationalization of economies, developments in telecommunications, and the integration of capital markets) and transformations in the ownership structure of firms (due to the growth of institutional investors, privatization, and rising shareholder activism), have increased the perceived need for more effective monitoring mechanisms and appropriate incentive schemes to improve corporate governance systems. It has been argued that pressures for change lead to the convergence of various corporate governance practices (Useem 1996; Fleming 1998; OECD 1998; Lannoo 1999), and to the consequent call for agencies and actors in individual countries to assess the introduction of new corporate mechanisms so as to compete in the new global corporate governance environment. Similar to Mayer and Whittington (1999) and Whitley (2000), we note that although there is a converging trend in organizational practices worldwide, a dual level (loose perspective) of institutional pressures must reconcile national institutions with international practices.

Countries with effective corporate governance systems become not only attractive locations for domestic companies to prosper (World Bank 2000) and invest (La Porta et al. 1998), but also for foreign investors, and thus promote economic growth (Levine 1999). Effective corporate governance

systems provide countries with a location advantage (Dunning 1977), where governmental actions (Murtha and Lenway 1994) and other local actors, such as domestic entrepreneurs, help support the development of internationally competitive firms (Porter 1990). This location advantage is not likely to dissipate as it diffuses slowly across borders (Kogut 1991), enabling continuous development.

However, despite the benefits attached to effective corporate governance and increasing pressures to enhance it, changing governance systems is not an easy task because governance practices are embedded in the broader institutional environment (Aoki 2001; Hollingsworth et al. 1994; Hollingsworth and Boyer 1997; Whitley 1999). There exist at least two possible ways to introduce the necessary disciplinary mechanisms to manage the classic principal-agent conflict of interests (Jensen and Meckling 1976) and to protect shareholders from expropriation (Fama and Jensen 1983), specifically in case of separation of ownership and control (Berle and Means 1932). On the one hand, countries can reinvent their legal systems to heighten shareholder protection. This is the approach followed by those economies in transition to the market that lack mechanisms for protecting private property rights (Coffee 1999). However, in general, reinventing the legal system is not easily accomplished, not only because of the difficult and lengthy process of introducing changes into an existing legal system, but also because the legal system is deeply embedded in the institutional legacies of a given country (Roe 1994). Alternatively, countries may introduce new corporate governance practices into the existing corporate governance system in order to increase technical effectiveness or respond to legitimation demands.

This article focuses on the adoption of new practices in an existing corporate governance system. We analyze what factors trigger the adoption of new corporate governance practices that complement the legal system in some countries and not others. One such practice is the introduction of codes of good governance to complement the binding legal system, and mitigate its imperfections. The remainder of the article is organized as follows. We first turn to a brief description of codes of good governance and their worldwide expansion, leading to a discussion of their effectiveness and legitimation properties. We examine basic assumptions drawn from the institutional environment literature about sources of change in country practices in order to propose hypotheses regarding the adoption of codes of good governance worldwide. We then explain the research design and methods used to test our hypotheses, and present our main results. We conclude with a discussion of further theoretical implications for organization studies.

## Codes of Good Governance

Codes of good governance are a set of 'best practice' recommendations regarding the behavior and structure of the board of directors of a firm. They have been designed to address deficiencies in the corporate governance system by recommending a comprehensive set of norms on the role and

composition of the board of directors, relationships with shareholders and top management, auditing and information disclosure, and the selection, remuneration, and dismissal of directors and top managers. Although the content of codes varies slightly across countries, the two objectives every code states are improving the quality of companies' board governance and increasing the accountability of companies to shareholders while maximizing shareholder or stakeholder value. Ultimately, codes of good governance attempt to improve the firm's corporate governance overall, especially when other mechanisms, such as takeover markets and the legal environment, fail to guarantee adequate protection of shareholders' rights. Examples of code recommendations are the general agreement to include independent directors on the board so as to ensure proper shareholder representation and the need to designate independent directors to board subcommittees (in particular audit, remuneration, and nomination committees).

### The Historical Diffusion of Codes of Good Governance

The first code of good governance came into being in the USA in the late 1970s in the midst of great corporate ferment, with business, legal, academic, and political constituencies squaring off on what the role of the board of directors should be. It was a period of transition from the conglomerate merger movement of the 1960s (Chandler 1990) to the empire-building behavior by management through hostile takeovers (Blair 1993; Hirsh 1986) and to the shareholder rights movement of the late 1980s and early 1990s (Davis and Thompson 1994). In the context of charges and countercharges surrounding the takeover movement, the Business Roundtable issued a report in January 1978 entitled *The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation*, which was, according to Monks and Minow (1992), a response to the trend of corporate criminal behavior and an attempt to pass legislation curbing hostile takeovers. The Business Roundtable report, chaired by J. Paul Austin, chief executive officer (CEO) of Coca-Cola at the time, turned out to be a claim for the legitimacy of private power and the enforcement of accountability. The report shifted the role of directors from being merely 'ornaments on a corporate Christmas tree' (Mace 1971) to proclaiming the director's main duties as: (1) overseeing the management and board selection and succession; (2) reviewing the company's financial performance and allocating its funds; (3) overseeing corporate social responsibility; and (4) ensuring compliance with the law (Charkham 1995). These were drafted as the first guidelines to improve governance capacity in US corporations.

In the USA, the Securities Exchange Commission, the New York Stock Exchange, and the Roundtable, among others, have continued to issue codes since the late 1970s. However, it was not until a decade later that another country created a code of good governance. In 1989, the Hong Kong Stock Exchange issued its first 'Code of Best Practice, Listing Rules', and in 1991 the Irish Association of Investment Managers drafted the 'Statement of Best Practice on the Role and Responsibility of Directors of Publicly Listed

Companies'. Nevertheless, the development of codes grew rapidly in the early 1990s, following the 1992 *Cadbury Committee Report: Financial Aspects of Corporate Governance* in the UK.

The Cadbury Report became the flagship guideline that deliberately challenged the effectiveness of voluntary regulation and British corporate democracy (Stiles and Taylor 1993). The 1990 British recession as well as a series of high-profile corporate failures in which the weakness of internal corporate control was a contributing factor, raised the issue of corporate accountability both in the public mind and in the House of Commons (Monks and Minow 1995). As stated in paragraph 2.1 of the Cadbury Report (Cadbury Commission 1992), the code was issued because of concern regarding 'the perceived low level of confidence both in financial reporting and in the ability of auditors to provide the safeguards which the users of the company reports sought and expected'. The Cadbury Report also emphasized the need for independent directors, greater shareholder involvement, and the establishment of board committees (Charkham and Simpson 1999). Moreover, sanctions were introduced to ensure that companies floated on the London Stock Exchange would comply with the Code, or otherwise are required to justify any areas of noncompliance. The Cadbury Report's recommendations are highly codified, allowing both companies and stakeholders to benchmark best practices, as well as emulation by other country issuers.

The emergence of codes of good governance across countries did not follow a linear path. Figure 1 shows the evolution of codes of good governance by country and number of codes developed. As noted, there is a gap between the first code issued in the USA in 1978 and the second code published in Hong Kong in 1989. After 1989, new codes appeared steadily throughout the early 1990s, and particularly since the issuance of the Cadbury Report in 1992, there has been an exponential rise in the adoption of codes, and overall shareholder activism (Davis and Thompson 1994). Thus, by the end of 1999, 24 industrialized and developing countries had issued at least one code of good governance, resulting in a total of 72 codes of good governance.

### The Nature of Codes of Good Governance

It is important to note that although compliance with code provisions is voluntary, country surveys in countries where codes have been issued show that publicly traded companies tend to respond to code recommendations (Gregory and Simmelkjaer 2002). This might be due to market forces and pressures to comply with legitimating practices or 'doing the right thing'. In addition, in several countries, listing rules require quoted firms to justify the reasons for noncompliance with the country code of good governance in their annual reports. This 'comply or explain' mandatory disclosure requirement adopted by most stock exchanges further encourages firm compliance. Pellens et al. (2001) surveyed German companies in the DAX100 and found that 95.6 percent of the firms agreed with the German code of good governance and 48.5 percent had already implemented some of the code guidelines. Moreover, existing research reveals that codes of good governance influence firm

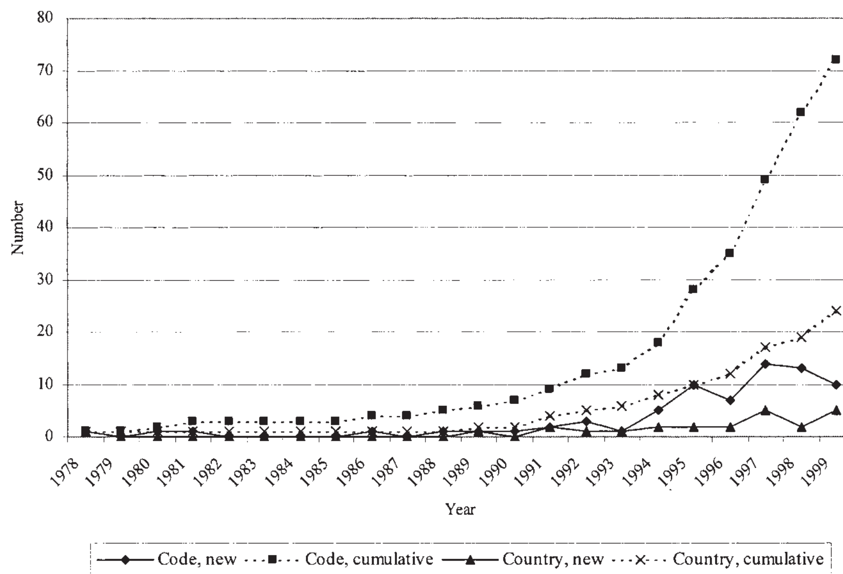


Figure 1. Evolution of Codes of Good Governance Worldwide: Countries and Total Number, 1978–99

behavior in several ways. First, Canyon and Mallin (1997) and Weir and Laing (2000) show that despite the voluntary nature of the Cadbury Report, British quoted firms to a large extent comply with the Code's recommendations in terms of dual leadership (functional separation of the CEO and chairman of the board), the percentage of outside directors on the board, and the appointment of board subcommittees. Second, it has been demonstrated that adopting some of the practices recommended by the codes is directly related to higher firm performance. For instance, Weir and Laing (2000) tested a sample of 200 British firms in 1992 and 1995 and showed that market returns were higher when firms followed the Cadbury Report and established a remuneration committee. Similarly, Dahya et al. (2002) demonstrate that the adoption of the Cadbury Report in 1992 increased CEO turnover in the UK (due to the need for separation of chairman and CEO) and heightened the sensitivity of CEO turnover to poor performance. Lastly, highly publicized financial scandals have contributed to the influence of codes of good governance. This is corroborated by statements such as: 'On December 1992, when Sir Adrian Cadbury and his committee published their final report on 'The Financial Aspects of Corporate Governance,' they started a train of events that changed the face of British boards and led to a *worldwide movement for the reform of corporate governance*' (Stiles and Taylor 2001: v, emphasis added). Stiles and Taylor also add: 'Following the Cadbury Code, most large quoted companies changed their board structures ... , reducing [the] size [of] boards, separating the roles of the chairman and the chief executive, appointing a new group of 'independent' non-executive directors, and establishing board committees' (2001: vi). In sum, codes of good governance are becoming increasingly visible in advanced industrialized countries where there is a call for firm transparency and accountability.

**Types of Code Issuers**

It is also important to understand *who* the issuers of codes of good governance are in the different national contexts and over time because identifying these actors provides critical information regarding the source of innovation. In addition, by accounting for the type of issuer, we will have a better appreciation for why codes are subsequently developed and how strongly they are enforced. We classify the type of issuer of codes of good governance into six categories: (1) *stock exchange*, when the issuer is the stock exchange or the overseer of the stock exchange (securities and exchange commission); (2) *government*, when the issuer is the central or federal government or one of its ministries; (3) *directors' association*, when the issuer is an association of directors; (4) *managers' association*, when the issuer is an association of managers; (5) *professional association*, when the issuer is an association of accounting or law professionals; and (6) *investor's association*, when the issuer is an institutional investor or an association of investors. Codes developed by the stock exchange in collaboration with other organizations are classified as being issued by the stock exchange.

The nature of the code issuer denotes the type of existing institutional pressure to embrace new practices. Regardless of technical or efficiency reasons, global institutional pressures contribute to cross-national isomorphism, or the emergence of common organizational practices over time (DiMaggio and Powell 1983). In the case of code issuers, codes issued by the stock exchange are conducive to coercive isomorphism in that these new practices often become part of the requirements for publicly traded firms. Similar coercive isomorphic pressures exist when codes are issued by investors, particularly due to explicit demands for code compliance from institutional investors. Conversely, codes issued by directors' associations, professional associations, and the government are likely to exert normative isomorphism, that is, compliance with the codes is consistent with legitimate values and norms. Lastly, codes issued by managers' associations are more likely to be endorsed because of mimetic isomorphism, that is, because other successful peer players have adopted them.

Figure 2 shows the adoption of codes of good governance by type of issuer and illustrates that issuer types have shifted over time. Managers' associations and stock exchanges conceived the initial codes, and they were succeeded by investors, professional, and directors' associations, which undertook a very active role particularly after 1992. Only in the late 1990s have governments issued codes of good governance.

Table 1 summarizes the number of codes developed by country and by type of issuer for the period from 1978 (when the first code of good governance was developed) to 1999. The issuer of the first code of good governance in each country reveals the active role of coercive issuers. We find that the first codes were issued by the stock market in ten countries, by managers' associations in six countries, by directors' associations and by investors' association in three countries, and by the government in two countries. It is to be noted that in no country did a professional association develop the first

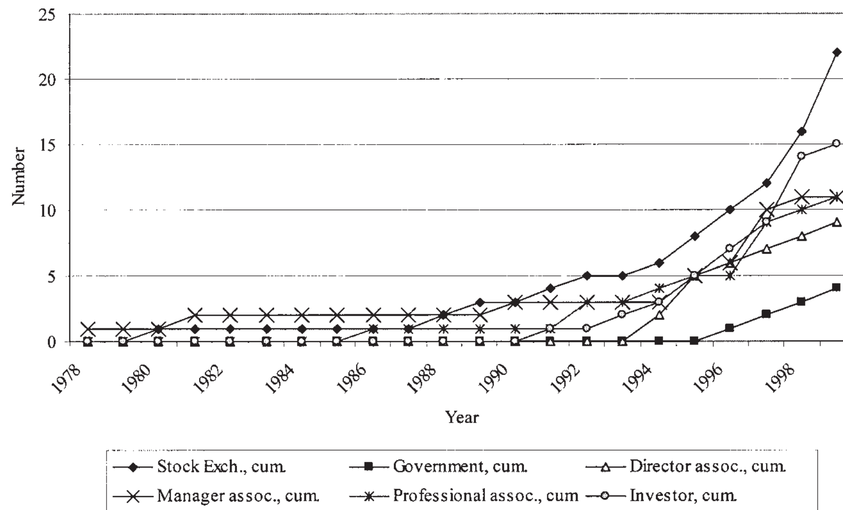


Figure 2. Evoulution of Codes of Good Governance Worldwide: Type of issuer of Code, 1978–99

code. Therefore, the popular claim that institutional investors were the primary triggers of good governance (Useem 1996) is not supported by our data, though these investors may have pressured stock-exchange commissions to issue codes of good governance. Instead, the active role played by managers' and directors' associations indicates their collective desire to bring more effectiveness to their existing corporate governance systems.

## The Cross-National Adoption of Codes of Good Governance

Codes of good governance provide a voluntary means for innovation in corporate governance practices. Identifying the factors that influence the adoption of codes in different countries permits a better understanding of the cross-national diffusion of practices (Strang and Soule 1998) and highlights the degree of convergence in corporate governance systems.

Diffusion studies explain the adoption of new practices within a social system by referring to two main theoretical sources: efficiency (or rational) accounts and social legitimation (Strang and Macy 2001; Tolbert and Zucker 1983). Rational accounts point to the efficiency or effectiveness gains that may follow innovation or the adoption of a practice. The adoption of the multidivisional form (Chandler 1962), the creation of professional programs by failing liberal arts schools (Kraatz and Zajac 1996), or the introduction of conventions into the broadcasting field (Leblebici et al. 1991) are examples of adoptions motivated by technical or rational needs. Conversely, social legitimation suggests that practices are adopted because of their growing taken-for-grantedness improving qualities which make adoption socially expected. If practices become institutionalized, their adoption brings legitimation to the adopting organization or social system. Institutionalization is 'the process through which components of formal structure become widely

Table 1. Codes of Good Governance Worldwide, 1978–99

| Country | Number of codes | | | | | | | Issuer of first code | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Total | Stock Exch. | Govern-ment | Director assoc | Manager assoc | Profess. assoc | Investors | Stock Exch. | Govern-ment | Director assoc | Manager assoc | Profess. assoc | Investors |
| **English-origin legal system** | | | | | | | | | | | | | |
| Australia | 4 | 2 | 0 | 1 | 0 | 0 | 1 | 1 | 0 | 0 | 0 | 0 | 0 |
| Canada | 4 | 1 | 1 | 0 | 0 | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Hong Kong | 4 | 1 | 0 | 0 | 0 | 3 | 0 | 1 | 0 | 0 | 0 | 0 | 0 |
| India | 2 | 1 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 |
| Ireland | 2 | 0 | 0 | 0 | 0 | 0 | 2 | 0 | 0 | 0 | 0 | 0 | 1 |
| Malaysia | 1 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 |
| Singapore | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 |
| South Africa | 1 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 |
| Thailand | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 |
| UK | 11 | 4 | 0 | 1 | 0 | 3 | 3 | 1 | 0 | 0 | 0 | 0 | 0 |
| USA | 17 | 2 | 0 | 3 | 4 | 4 | 4 | 0 | 0 | 0 | 1 | 0 | 0 |
| **French-origin legal system** | | | | | | | | | | | | | |
| Belgium | 4 | 2 | 0 | 1 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 |
| Brazil | 1 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 |
| France | 4 | 1 | 0 | 0 | 2 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 0 |
| Greece | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 |
| Italy | 2 | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 |
| Mexico | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 |
| Netherlands | 2 | 1 | 0 | 0 | 0 | 0 | 1 | 1 | 0 | 0 | 0 | 0 | 0 |
| Portugal | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 |
| Spain | 2 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 |
| **German-origin legal system** | | | | | | | | | | | | | |
| Germany | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Japan | 2 | 0 | 0 | 0 | 2 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 |
| Korea | 1 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 |
| **Scandinavian-origin legal system** | | | | | | | | | | | | | |
| Sweden | 2 | 0 | 0 | 1 | 0 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 0 |
| **Total** | | | | | | | | | | | | | |
| Countries: 24 | 72 | 22 | 4 | 9 | 11 | 11 | 15 | 10 | 2 | 3 | 6 | 0 | 3 |

accepted, as both appropriate and necessary, and serve to legitimate organizations' (Tolbert and Zucker 1983: 25). In the case of codes of good governance, practices are emulated across countries because they are societally defined as appropriate and efficient. Yet, social legitimation arguments claim that there is little concern in assessing whether the adoption of a practice will, in fact, have an effect on the actual efficiency or effectiveness of the adopting organization (Meyer and Rowan 1977; Zucker 1987). Hence, as stated by Tolbert and Zucker, the adoption of practices 'fulfils symbolic rather than task-related requirements' (1983: 26).

Efficiency and legitimation theoretical perspectives are often posed as mutually exclusive categories where early in the process of diffusion, practices are adopted because of their unequivocal effects on efficiency or effectiveness, while later adoption is seen as a social legitimation process regardless of net benefit. As pointed out by Strang and Macy, this dichotomy is theoretically costly because 'ideas about rationality and effectiveness come to be cast in opposition to ideas about imitation' (2001: 148). We subscribe to Scott's (2001: 157) suggestion that efficiency and legitimation accounts both compete with and complement each other. In effect, once institutionalized practices are adopted, they may be 'decoupled' from efficiency goals and persist on a legitimation basis (Meyer and Rowan 1977), as illustrated by Westphal et al. (1997) in the customization versus normative implementation of total quality management programs in US hospitals. When examining adoption patterns across countries, we propose that it is theoretically useful to differentiate between endogenous and exogenous sources triggering adoption. Specifically, we argue that one of the key differences between endogenous and exogenous sources is that efficiency accounts tend to be endogenously driven, while social legitimation is motivated by exogenous sources.

Endogenous and exogenous mechanisms help explain the adoption of codes of good governance in different national systems around the world. First, endogenous characteristics of a system, such as the strength of the stock market, will influence the adoption of codes. For instance, a developed stock market is likely to encourage the implementation of codes of good governance in order to increase the efficiency of the country's corporate governance system — or at least that of quoted firms. Because codes of good governance complement the legal system by reducing legal flaws regarding the protection of shareholders, they are a rapid way to fill gaps in the legal system, provide a means for holding managers and directors accountable, and generally improve corporate governance, without the immediate need to modify the existing legal system.

Second, we contend that an inefficient corporate governance system is a necessary, but insufficient condition to explain the diffusion of new governance practices. There also exist exogenous pressures to introduce practices in the system in order to legitimate a country's corporate governance system in the global economy. Integration in the global economy functions as a transmission belt for the need to innovate and facilitate the transfer of practices across countries. Thus, economic integration in the world economy, government liberalization, and the presence of foreign institutional investors

are defined as critical exogenous forces influencing the adoption of institutionalized practices, adding not only efficiency, but legitimation to a country's corporate governance system.

These dual forces can explain the development of codes of good governance across countries. The theoretical logic is that there will be an endogenous opportunity to increase effectiveness in the country's corporate governance system when the system is deficient, but there might also be the need to bring legitimation to the country's corporate governance system when the country is subject to exogenous pressures.

#### Endogenous Forces to Increase Effectiveness in the Corporate Governance System

Codes of good governance are capable of solving deficiencies in the corporate governance system, particularly the workings of the board of directors as the direct corporate governance mechanism that oversees the management of the firm in its representation of shareholders. We argue that one of the functions of such codes is to compensate for deficiencies in the legal system regarding minority shareholders' protection. Minority shareholders are the most vulnerable shareholders at risk of being expropriated. Following this logic, we would expect less effective corporate governance systems to be more likely to develop new governance practices such as codes of good governance.

Deficiencies in the corporate governance system are linked to the legal tradition of a country (La Porta et al. 1997, 1998, 1999, 2000). A country's legal tradition can be classified into two main legal families according to the origin of the legal system: common law based on the English system and civil law originating from Roman law (Reynolds and Flores 1989; Glendon et al. 1994). The civil-law tradition (the most widely spread around the world) uses statutes and comprehensive codes as a primary means for ordering legal material, whereas the common-law tradition (dominant in Anglo-Saxon countries) is based on judicial precedent on specific issues. As demonstrated by La Porta et al. (1998), countries with common-law legal systems grant better legal protection to investors than countries with a civil-law legal system. Among the latter, the French-based legal system is the least effective in protecting shareholder rights (La Porta et al. 1998). Hence, we would argue that codes are adopted to make up for the lack of minority shareholder protection in the legal system and would be more likely to be adopted in civil-law countries. Therefore, we propose that:

*H1a: Codes of good governance are more likely to be developed in countries with a civil-law legal system than in countries with a common-law legal system.*

However, there also exist variations across countries and within families of legal systems in terms of the ability of minority shareholders to challenge the workings of the board of directors and managers in corporate decision-making. The protection granted to shareholders is contingent upon the specific regulations and enforcement of such regulations in a given country.

Particularly relevant to the adoption of codes is the existence of laws that already regulate the relationships between shareholders and boards of directors. La Porta et al. (1998) constructed an anti-director index to measure the country's degree of protection of minority-shareholder rights. In particular, this index measures the mechanisms available to shareholders to protect themselves against expropriation by the board of directors by conceding the following six shareholder rights: (1) mailing their proxy votes to the firm; (2) waiving requirements to deposit their shares prior to a general shareholder meeting; (3) allowing cumulative voting or proportional representation of minorities on the board of directors; (4) enabling minority shareholders against perceived oppression by directors; (5) having a minimum percentage of share capital that entitles a shareholder to call an extraordinary shareholder meeting of less than or equal to 10 percent; and (6) having preemptive rights that can only be waived by a shareholder vote (La Porta et al. 1998). In countries with strong anti-director rights, minority shareholders have more mechanisms available to influence corporate decision-making and protect their rights, whereas in countries with weak anti-director rights, shareholders are less protected and directors are less accountable. Therefore, the adoption of codes of good governance could serve as a mechanism to compensate for weak anti-director shareholder rights in the legal system by encouraging the development of instruments that increase the effectiveness of a country's corporate governance by promoting firm transparency and board accountability toward shareholders. Hence, we propose that:

*H1b: Codes of good governance are more likely to be developed in countries with weak anti-director rights than in countries with strong anti-director rights.*

### Exogenous Forces to Legitimate Corporate Governance Systems

The development of codes of good governance is influenced not only by the endogenous need to increase effectiveness and hence compensate for potential deficiencies in the corporate governance system, but also by exogenous pressures to introduce practices that are socially legitimate or widely perceived as appropriate and effective (Tolbert and Zucker 1983). Hence, as Djelic (1998) showed in the diffusion of systems of industrial production from America to Europe following World War II, the cross-national transfer of practices not only necessitates that domestic innovators are ready for change, but it also requires familiarity with foreign practice and its perceived superiority. Similarly, Guler et al. (2002) reveal that cross-national transfer of innovations is explained by the extent to which countries compete with each other in the global economy. Drawing from these studies, we argue that countries exposed to other national economic systems experience greater pressure to harmonize and legitimate their corporate governance systems. A mechanism to achieve such legitimation is through the adoption of codes of good governance. It often occurs that despite the awareness of the need to improve the corporate governance system, these changes are not feasible until exogenous pressures to undertake change in the system occur.

Exogenous pressures act as a catalyst for the development of codes of good governance and are related to globalization processes, facilitating the transfer of practices across countries. Globalization forces induce the transformation of the workings of not only the corporate governance system, but also of the overall economic system of the country (Sachs et al. 1995). For example, Guler et al. (2002) show that the position of countries in trade networks affects the rate at which ISO 9000 quality certification is adopted across countries. Therefore, we suggest that new governance practices, such as codes of good governance, are more likely to be developed in countries subject to globalization pressures than in countries less exposed to globalization pressures. The integration of a national economy into world trade reduces the possibilities of shielding inefficiencies behind barriers to trade, inefficiencies not only in the production system, but also in the corporate governance system. Hence, economic openness will increase the likelihood of the development of legitimate corporate governance practices that promote transparency and accountability among directors, management, and shareholders, and in turn facilitate firm competitiveness. The trade openness of a country also implies greater exposure to foreign practices and ideas. For example, as a country A becomes commercially entangled with other countries, individuals and firms in country A are exposed to foreign practices that might appear to be effective in other countries, and hence country A might chose to emulate their behavior by adopting those practices. We would expect that countries competing in the global economy will have greater exogenous pressures to adopt legitimate governance practices. Hence, we contend that:

*H2a: As countries become more integrated in the global economy, they are more likely to develop codes of good governance.*

Murtha and Lenway (1994) have articulated how different attributes of government affect the strategy and performance of firms. Governments are exposed to globalization pressures to undertake liberalization and deregulation. Recently, governments have redefined their economic role by retrenching from direct economic intervention via control of productive assets to indirect intervention via regulation of economic activity (Sachs et al. 1995). This government transformation involved the sale of state-owned assets, including the redefinition of property rights through privatization. Privatization diminishes government direct intervention in the economy and generally facilitates the expansion and greater competitiveness of the newly privatized firms (Vickers and Yarrow 1988). Yet, privatized firms require new sets of governance practices on how to behave as private firms (Cuervo and Villalonga 2000). Thus, the change in ownership structure needs to be accompanied by a change in governance practices because the new governing body must run an efficient firm and be accountable to investors seeking shareholder value. Codes of good governance can serve as a guide for the appropriate behavior of the firms' boards of directors where, previously, the boards of directors were mostly composed of political appointees. Privatized companies are especially relevant because they tend to be large and occupy critical industrial sectors in a country's economy. This is especially the case

when firms are privatized via initial public offers and they become the leading component of the country's stock exchange blue chip index. Hence, we propose that:

*H2b: Codes of good governance are more likely to be developed in countries that have experienced higher levels of liberalization than in countries that have experienced fewer liberalization processes.*

Lastly, globalization and rapid growth in international markets have increased the presence of US-style institutional investors in foreign equity markets (Davis and Steil 2001). Foreign institutional investors, such as pension funds, became important capital providers, particularly as local equity markets struggled to provide sufficiently accessible capital (Brancato 1997). The presence of Anglo-Saxon institutional investors in the global equity market is likely to act as a catalyst for the worldwide diffusion of corporate governance practices. Institutional investor activism started in the USA in the early 1980s during the takeover wars and it spread rapidly in most advanced capitalist countries. Activism represented a shift from passive, dispersed, and faceless individual shareholders to institutions challenging managers and directors on a variety of issues, such as urging firms to make structural changes in their boards of directors and redesign firm voting procedures. Leading institutional investors, such as CalPERS in the USA, believe that 'good governance is good business', and hence will by default create shareholder value. The fact that in 1996 CalPERS established a corporate governance office to pressure domestic and international firms to adopt shareholder-friendly proposals and other measures designed to improve stock performance is an example of growing shareholder activism.

The increasing power of institutional investors searching for worldwide investment opportunities is accompanied by their vocal calls for effective governance (Brancato 1997; Hadden 1994). Firms seeking to obtain capital in international securities markets will be compelled to adjust their governance practices to meet the expectations of potential institutional investors. Pressures from foreign institutional investors to improve standards of behavior, financial reporting, board accountability (OECD 1998; Gregory 1999), and shareholder activism (Davis and Thompson 1994) stimulate the development of codes of good governance. For instance, in June 2002, the UK pension-fund manager, Hermes, wrote a letter to the boards of all Italian blue-chip companies (MIB 30 index) requesting the enhancement of shareholders' voting rights on six major issues, including auditor independence and composition of the board of directors and its committees. These requested corporate governance issues were also recommended in the Italian code of good governance (the Draghi Report). Interestingly, the letter closes claiming that Hermes will monitor the implementation of the suggested practices in the Italian companies it invests in (see www.hermes.co.uk). Thus, we argue that:

*H2c: Codes of good governance are more likely to be developed in countries that receive more investment from foreign institutional investors than in countries that receive less investment from foreign institutional investors.*

## Research Design

### Sample

We have built a comprehensive database of codes of good governance developed worldwide from 1978 until the end of 1999. Our main sources of information are the World Bank (2000) and the ECGN (2000). In order to complete and cross-check information, we consulted Van den Berghe and De Ridder (1999), the Commonwealth Association for Corporate Governance (1999), and Gregory (1998, 1999). For reasons of consistency, our database includes only codes of good governance per se. We exclude laws or legal regulations, revisions and new editions of original codes, corporate disclosure codes, reports on compliance with codes already issued, codes on the behavior of top management, consulting-firm reports, and individual company codes.

We selected the 49 countries included in the data set of La Porta et al. (1998) for comparability reasons and so as to be able to use some of their measures. These are countries with publicly traded firms, excluding 'transition' and socialist economies. By the end of 1999, 24 out of the 49 countries had issued at least one code of good governance: Australia, Belgium, Brazil, Canada, France, Germany, Greece, Hong Kong, India, Ireland, Italy, Japan, Korea, Malaysia, Mexico, the Netherlands, Portugal, Singapore, South Africa, Spain, Sweden, Thailand, the UK, and the USA. Table 1 summarizes the database by country and type of issuer of existing codes from 1978 to 1999. We have delimited our analysis to the period 1988–99 for two reasons. First, from 1978 to 1987 only four codes were developed, all in the USA, and second, because 1988 is the milestone after which there is a rapid growth in codes and the number of countries issuing codes.

### Variables and Measures

We codify our dependent variable, development of codes of good governance, in two different ways to capture the event and its magnitude. The first is a dummy variable measuring whether a country developed a code of good governance between 1988 and 1999. The second is a count variable that measures the total number of codes of good governance developed in a given country between 1988 and 1999.

We measure the independent variables of a country's endogenous efficiency accounts to improve the corporate governance system in two ways. First, we codify the legal system through a dummy variable that indicates whether the legal system is a civil-law system (French, German, or Scandinavian in origin) or a common-law system. We coded it as 1 for a civil-law system and zero otherwise. Second, we measure shareholders' rights deficiencies in a given country with an index that denotes the strength of anti-director measures available to that country's shareholders (La Porta et al. 1998). The index ranges from 0–6, where zero represents the weakest anti-director rights and 6 the strongest anti-director rights. For instance, within

the countries with a civil-law tradition, the USA and UK have an anti-director index of 5, while Israel and Thailand have an index of 3 and 2, respectively.

We measure the three independent variables of exogenous pressures to legitimate through a corporate governance system in three different ways. First, we operationalize the degree of a country's economic integration into the world economy through the openness of its trade, as obtained from the CD-ROM of the World Bank's *World Development Indicators*. This is calculated using the sum of exports and imports as a percentage of gross domestic product (GDP), to control for the size of each country's economy. Second, government retrenchment from the economy is measured using an indicator of the reduction in government consumption, ownership of assets, and economic output (Gwartney et al. 1996; Holmes et al. 1997; Johnson et al. 1998, 1999). This is a scale of 1–5, where lower scores represent a low level of government intervention. Lastly, the influence of foreign institutional investors is measured by the proportion of foreign portfolio investors in the country's stock market, as obtained from the International Financial Corporation.

We control for the importance of capital markets to account for differences in the size of capital markets, since countries with larger capital markets are more likely to develop rules and norms to improve the protection of shareholders' rights and promote effective corporate governance practices. We take the logarithm of this control variable to prevent problems of multicolinearity with the independent variable for foreign institutional investors. Table 2 summarizes these variables, explains their measurement in more detail, and provides data sources.

### Method of Analysis

We use probit models and Poisson regression to analyze the determinants of the adoption of codes of good governance because our dependent variable is constructed as both a binary variable (existence of at least one code per country) and a count variable (number of codes per country). The results of these analyses should be interpreted as factors influencing the likelihood that codes of good governance will be developed in a given country. We study the cumulative influence of the discussed endogenous and exogenous independent variables on the country's adoption of codes of good governance by 1999.

The first model examines the likelihood that a code of good governance will be developed in a given country by 1999. Since this is a dichotomous variable (code or no code), we use a probit model with the following specification:

$$\textit{Code of good governance} = \beta_0 + \beta_1 * \textit{Civil law legal system} + \beta_2 * \textit{Anti-director rights} + \beta_3 * \textit{Economic integration} + \beta_4 * \textit{Government liberalization} + \beta_5 * \textit{Foreign institutional investors} + \beta_6 * \textit{Control for size of capital markets} + \epsilon$$

When analyzing the number of codes of good governance adopted in a given country by 1999, which is a count variable, we use a Poisson regression with the following specification:

Table 2. Summary of Variables, Measures, and Sources

| Variable | Measure | Source |
|---|---|---|
| Code of good governance | Dummy: equals if the country developed at least one code of good corporate governance, a set of recommendations or 'best practice' about the structure and behavior of the board of directors between 1989 and 1999, and zero otherwise. | Database of codes of good governance by country based on data from World Bank (2000), ECGN (2000), Van den Berghe and De Ridder (1999), CAGN (1999), and Gregory (1998, 1999) |
| No of codes of good governance developed | Number of codes of good corporate governance developed between 1989 and 1999. It includes only the first issue of each code and not subsequent revisions. | Database of codes of good governance by country based on data from World Bank (2000), ECGN (2000), Van den Berghe and De Ridder (1999), CAGN (1999), and Gregory (1998, 1999) |
| Civil-law legal system | Dummy: 1 if the legal system is civil-law based (French, German, or Scandinavian-origin), zero otherwise. | La Porta et al. (1998) based on data from Reynolds and Flores (1989) |
| Anti-director rights | An index aggregating shareholder rights labeled as 'anti-director rights'. The index is formed by adding one when: (1) the country allows shareholders to mail their proxy votes to the firm; (2) the shareholders are not required to deposit their shares prior to a General Shareholder Meeting; (3) cumulative voting or proportional representation of minorities on the board of directors is allowed; (4) mechanisms for minority shareholders to confront directors exist; (5) the minimum percentage of share capital that entitles a shareholder to call an Extraordinary Shareholders Meeting is less than or equal to 10 percent; and (6) shareholders have preemptive rights that can only be waived by a shareholder vote. The index ranges from 0 to 6. | La Porta et al. (1998) |
| Economic integration | Sum of exports and imports as a percentage of gross domestic product, all expressed in millions of US dollars. Average for 1989–98. | Data from World Bank (2000) databases |
| Government liberalization | Change in the indicator of governmental intervention in the economy. Equals one if the indicator dropped in value between 1989 and 1998, zero if there was no change, and minus one if the indicator increased in value between 1989 and 1998. The indicator of governmental intervention in the economy is a composite of government consumption as a percentage of gross domestic product, government ownership of businesses and industries, and economic output produced by the government. Scale from 1 to 5, with lower scores for lower levels of governmental intervention. Data for 1989 was transformed from a scale of 0 to 10 to a scale of 1 to 5 in line with data for 1998. | Based on data from Gwartney et al. (1996) and Holmes et al. (1997), Johnson et al. (1998, 1999) |
| Foreign institutional investors | Inward foreign portfolio investment flow in equity as a percentage of gross domestic product, both expressed in millions of US dollars. Average for 1989–98. | Data from IMF (2000) |
| Importance of capital markets | Logarithm of market capitalization expressed in millions of US dollars. Average for 1988–98. | IMF (1992), International Financial Corporation (1999) |

$$\textit{Number of codes of good governance} = \beta_0 + \beta_1 * \textit{Civil law system} + \beta_2 * \textit{Anti-director rights} + \beta_3 * \textit{Economic integration} + \beta_4 * \textit{Government liberalization} + \beta_5 * \textit{Foreign institutional investors} + \beta_6 * \textit{Control for size of capital markets} + \epsilon$$

## Results

Table 3 provides the means, standard deviations, and correlation matrix of the variables used in our analyses. The correlation matrix indicates that there is a statistically significant negative correlation between the civil-law system and anti-director rights, between the civil-law system and economic integration, as well as between anti-director rights and foreign institutional investors.

Table 4 shows the results of the analysis of the influence of endogenous and exogenous factors on the likelihood of the development of codes of good governance in a given country by 1999. The first model (probit analysis) reveals that countries with a civil-law legal system are significantly less likely to issue a code (.01 level). This result goes in the opposite direction to our prediction. Consistent with our prediction (Hypothesis 1b), the presence of strong anti-director shareholder rights in a country's corporate governance system decreases the probability of the development of a code of good governance, although this result is only marginally significant (.10). Regarding the influence of exogenous pressures, as predicted, economic integration in the global economy (Hypothesis 2a), degree of government liberalization (Hypothesis 2b), and the presence of foreign institutional investors (Hypothesis 2c) increase the probability of the adoption of a code of good governance, though only the coefficient of government liberalization is statistically significant (.05). Therefore, the probit analysis yields statistically significant support for Hypothesis 1b and marginal support for Hypothesis 2b.

The second model shown in Table 4 provides results from a Poisson regression of the number of codes of good governance developed from 1988 to 1999. Results are in the same direction as the probit model, demonstrating at least intuitively a linear relationship. This analysis corroborates that the civil-law legal system and the anti-director shareholders' rights are negatively related to the development of codes of good governance at a statistically significant level (.01 and .05, respectively). As expected, economic integration, government liberalization, and foreign institutional investors are positively related to the development of codes of good governance, although in this count case only the coefficient of foreign institutional investors (Hypothesis 2c) is statistically significant (.01). Therefore, the Poisson regression provides statistically significant support for Hypothesis 1b and Hypothesis 2c.

The results of our empirical analysis suggest that codes of good governance compensate for deficiencies in the corporate governance system as they tend to be issued in countries with weak anti-director shareholder rights. Therefore, we find some support for the theoretical efficiency (rational) account in diffusion research, in that codes of good governance are developed to enhance the effectiveness of national corporate governance systems. Our interpretation

Table 3. Summary Statistics and Correlation Matrix

| | Mean | S. D. | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
|---|---|---|---|---|---|---|---|---|---|
| 1. Code of good governance | 0.489 | 0.505 | 1 | | | | | | |
| 2. No. of codes of good governance | 1.387 | 2.556 | 0.559 *** | 1 | | | | | |
| 3. Civil-law legal system | 0.632 | 0.487 | −0.184 | −0.318 ** | 1 | | | | |
| 4. Anti-director rights | 2.448 | 1.191 | 0.007 | 0.331 ** | −0.607 *** | 1 | | | |
| 5. Economic integration | 56.723 | 49.866 | 0.239 * | 0.034 | −0.289 ** | 0.075 | 1 | | |
| 6. Government liberalization | 0.285 | 0.763 | −0.100 | −0.292 ** | 0.064 | −0.052 | −0.153 | 1 | |
| 7. Foreign institutional investors | 2.025 | 4.471 | 0.159 | 0.100 | 0.176 | −0.340 ** | 0.134 | −0.009 | 1 |
| 8. Size of capital markets | 4.564 | 0.929 | 0.674 *** | 0.639 *** | −0.036 | 0.236 | 0.089 | −0.252 * | 0.064 |

Note: ***, ** and * indicate statistical significance at 1, 5, and 10 percent, respectively

Table 4. Analysis of the factors influencing the likelihood of the development of codes of good governance worldwide

| | Hypotheses | Model 1: Probit model | Model 2: Poisson regression |
|---|---|---|---|
| Rational accounts | H1a: Civil-law legal system | −2.263 *** | −1.510 *** |
| | | (0.806) | (0.385) |
| | H1b: Anti-director rights | −0.8298 * | −0.285 ** |
| | | (0.490) | (0.134) |
| Social legitimation | H2a: Economic integration | 0.003 | 0.001 |
| | | (0.005) | (0.001) |
| | H2b: Government liberalization | 0.917 ** | 0.111 |
| | | (0.448) | (0.236) |
| | H2c: Foreign institutional investors | 0.174 | 0.047 *** |
| | | (0.146) | (0.013) |
| Control | Size of capital market | 2.602 *** | 1.587 *** |
| | | (0.601) | (0.188) |
| | Intercept | −11.576 *** | −8.013 *** |
| | | (2.418) | (1.092) |
| | Log likelihood | −11.865 | −47.271 |
| | Wald chi-square(6) | 33.93 *** | 196.61 *** |
| | Number of observations | 49 | 49 |

Note: ***, ** and * indicate statistical significance at 1, 5, and 10 percent, respectively
White's heteroskedasticity-consistent standard errors are given in parentheses

is that provided that legal systems cannot be modified easily, deficiencies can be addressed through the adoption of codes of good governance.

Counterintuitively, our analysis suggests that codes are less likely to develop in countries with a civil-law legal tradition and more likely to be developed in countries with a common-law legal tradition. The latter legal system is generally defined as having greater overall protection for minority shareholders as well as higher liability standards for directors and managers (La Porta et al. 1998). We explain this unpredicted result in two ways. First, in order to deal effectively with the changing global competitive environment, corporate governance practices need to be continuously updated and aligned with global standards. Practices and systems become obsolete as new conditions appear with the development of new business practices, which need to be accounted for in the protection of shareholders via the adoption of codes. The widespread introduction of contingent pay systems in the 1980s (Westphal and Zajac 1994) that subsequently necessitated independent directors on the board's remuneration subcommittee is an illustrative example. Consequently, countries with strong shareholder protection rights embedded in their legal system (such as common-law) are likely to continue fostering effective governance practices via codes of good governance. Second, the intrinsic characteristics of the common-law legal system facilitate the enforceability of codes of good governance. Although in the common-law legal system practices that are 'good' business practice tend to reach the level of enforceability in courts, in civil-law systems such practices do not have enforceability through the courts unless they become codified into law (Cuervo 2002). Thus, in countries with a common-law legal system, the development of codes of good governance

can provide additional mechanisms to protect shareholder rights, whereas this is not automatically the case in countries with a civil-law legal tradition.

Our results show that codes of good governance are developed not only because of the intrinsic intention to improve the effectiveness of corporate governance systems, but also because there exist exogenous pressures to legitimate the current system by introducing such practices regardless of their degree of implementation. First, a country's economic integration in the world economy in terms of international trade is positively related to the adoption of codes, as predicted — although the relationship is not statistically significant. Country openness facilitates the transfer of ideas across countries and the diffusion of codes of good governance, but according to our results, it does not directly affect the governance of firms. Second, processes of government liberalization in a given country are positively related to the adoption of codes, as predicted. The withdrawal of government presence in the economy and the subsequent need to redesign the governance structure of newly privatized firms explains the adoption of codes. Thus, the transfer of property rights from the government to private hands opens a window of opportunity to promote sound governance principles in firms that used to have strong ties to the government. Lastly, the presence of foreign institutional investors is positively related to the number of codes adopted, as predicted. Institutional investors need assurance that their investments are going to be protected since they might not hold enough capital or information to influence decision-making. In effect, we show that institutional investors are willing to pay a premium for good governance (McKinsey & Company 2000), that is, they will search for firms that have good governance practices and are eager to promote the adoption of codes of good governance.

## Conclusion and Discussion

This article examines the forces influencing adoption of codes of good governance in countries around the world. We regard codes as a practice adopted to improve national corporate governance systems. We argue that codes are developed in response to a combination of endogenous and exogenous pressures to solve deficiencies in a country's corporate governance system. Internal pressures aim to increase efficiency in the system, and exogenous pressures seek to acquire legitimation. The identification of the forces underlying adoption allows us to decouple the traditional explanations of diffusion processes: efficiency and legitimation. This article is also an important first step in the examination of the factors influencing the development of new corporate practices around the world. It tests the work of La Porta et al. (1997, 1998, 1999, 2000) on legal systems and corporate control, and expands on their research by seeking to understand why corporate governance practices that complement the legal system are adopted in some countries and not others.

We describe the diffusion of codes of good governance worldwide and empirically analyze the complementary endogenous and exogenous

mechanisms influencing adoption. We find that, for a sample of 49 countries, codes of good governance are more likely to occur when a country lacks strong shareholder protection rights. That is, codes tend to be developed in countries where the legal system has fewer protections for shareholders from board misconduct. Moreover, we demonstrate that exogenous institutional pressures influence the development of codes. Specifically, codes of good governance are more likely to be issued in countries where there is high government liberalization and a strong presence by foreign institutional investors.

An interesting and unpredicted finding from our empirical research is that countries with more effective governance systems in terms of the overall legal system, that is, a common-law legal system, are more prone to continue improving their systems and to develop codes. This finding may possibly illustrate that some countries' efforts to protect shareholder rights and improve corporate governance is not a static action, but rather a dynamic process in which corporate governance practices are revised and enhanced contingent on new corporate realities.

These unpredicted results speak to the fact that corporate governance is a system of practices. Importing a practice to solve limitations in the overall system is an improvement over the previous situation, but still requires that these innovations fit with the existing system. Practices are generally adapted to the characteristics of the system (Djelic 1998; Boyer et al. 1998; Sorge 1991). For example, the adoption of just-in-time (JIT) by American manufacturers is a good illustration of transformations that occur when adopting foreign practices (Dyer and Nobeoka 2000). In the case of corporate governance, codes tend to be adapted to the country's economic environment and address the country's most salient governance problems. For instance, codes developed by the Hong Kong Stock Exchange refer to the existence of family-owned groups, while the Italian Draghi Report calls for the need to bring more accountability to Italian pyramidal groups. However, despite differences across countries, codes tend to have similar recommendations regarding the behavior of the board, tackling primarily the transparency and accountability of board practices through encouraging an increase in the percentage of independent directors and the creation of board subcommittees.

Our research has important implications for organizational studies of convergence. First, we show that there exists some convergence in the adoption of governance practices across countries, at least at the structure and strategy level and generally toward emulating the Anglo-Saxon model (Mayer and Whittington 1999). This convergence is partly explained by cross-border mimetic isomorphism (Djelic 1998). Our research also indicates that despite convergence patterns, countries have a say in what they decide to do (Whitley 2002) and who the instigators of the codes are, contingent on mechanisms triggering adoption and the timing of adoption. We suggest that the impact of the codes is related to the issuer's ability to enforce changes in the corporate governance of firms. On the one hand, codes developed by governments and stock markets, and to some extent investors, have the strongest enforceability, since they can be established as norm for operation, and thus might have a

greater impact on promoting good governance. On the other hand, codes developed by professional associations, director associations, and management associations have lower enforceability, as many of them are voluntary in nature and consequently are more likely to have a lower impact on improving deficiencies in corporate governance.

In this article, we treat code adoption as a discrete phenomenon, neglecting to examine variation in terms of the form of adoption itself or implementation. A logical follow up to this research would be to investigate whether codes are faddish cycles (Abrahamson 1991; Strang and Macy 2001) or end up being entrenched in the system (Zeitz et al. 1999). Other interesting questions for future research would be to disentangle whether the mechanisms triggering adoption vary over time and to what degree we observe decoupling, in that late adopters are pressured by efficiency accounts or symbolic pressures, as well as to what degree codes are reshaped to fit different country characteristics. Lastly, one avenue for future research should be a systematic comparative analysis of the impact of codes of good governance on corporate governance and firm performance.

## Note

John Dencker, Bob Hancké, Mathew Kraatz, Huseyin Leblebici, Harry Sapienza, participants at the 2000 SASE conference at the London School of Economics and at the 2000 European International Business Association Meeting in Maastricht, seminar participants at the University of Minnesota Strategy Research Seminar, and especially two anonymous reviewers provided helpful comments. The financial support of the University of Illinois CIBER and Fewcett Grant, and the University of Minnesota International Programs are gratefully acknowledged. All errors remain ours.

## References

Abrahamson, Eric
1991 'Managerial fads and fashions: The diffusion and rejection of innovations'. *Academy of Management Review* 16: 586–612.

Abrahamson, Eric, and Gregory Fairchild
1999 'Management fashion: Lifecycles, triggers, and collective learning processes'. *Administrative Science Quarterly* 44: 708–740.

Aguilera, Ruth, and Gregory Jackson
2003 'The cross-national diversity of corporate governance: Dimensions and determinants'. *Academy of Management Review*, forthcoming.

Aoki, Masahiko
2001 *Towards a comparative institutional analysis*. Cambridge, MA: MIT Press.

Baron, James N., Frank R. Dobbin, and Paul D. Jennings
1986 'War and peace: The evolution of modern personnel administration in U.S. industry'. *American Journal of Sociology* 92: 350–383.

Berle, Adolph A., Jr, and Gardiner C. Means
1932 *The modern corporation and private property*. New York: Commerce Clearing House.

Blair, Margaret M., *editor*
1993 *The deal decade. What takeovers and leveraged buyouts mean for corporate governance*. Washington, DC: Brookings Institution.

Boyer, Robert, Elsie Charron, Ulrich Jürgens, and Steven Tolliday
1998 *Between imitation and innovation. The transfer of hybridization of productive models in the international automobile industry*. Oxford: Oxford University Press.

Brancato, Carolyn K.
1997 *Institutional investors and corporate governance. Best practices for increasing corporate value*. Chicago, IL: Irwin.

Cadbury Commission
1992 *Code of best practice: Report of the Committee on the Financial Aspects of Corporate Governance*. London: Gee.

CAGN (Commonwealth Association for Corporate Governance)
1999 *CAGN guidelines. Principles for corporate governance in the commonwealth. Towards global competitiveness and economic accountability*. Mimeo. Marlborough, New Zealand: CAGN.

Canyon, M. J., and Christine Mallin
1997 'A review of compliance with Cadbury'. *Journal of General Management* 2: 24–37.

Casper, Steve, and Robert Hancké
1999 'Global quality norms within national production regimes: ISO 9000 standards in the French and German car industries'. *Organization Studies* 20: 961–985.

Chandler, Alfred D., Jr
1962 *Strategy and structure*. Cambridge, MA: MIT Press.

Chandler, Alfred D., Jr
1990 *Scale and scope: The dynamics of industrial capitalism*. Boston, MA: Harvard University Press.

Charkham, Jonathan
1995 *Keeping good company. A study of corporate governance in five countries*. New York: Oxford University Press.

Charkham, Jonathan, and Anne Simpson
1999 *Fair shares. The future of shareholder power and responsibility*. New York: Oxford University Press.

Coffee, John C.
1999 'Privatization and corporate governance: The lessons from securities market failure'. *Journal of Corporation Law* 25: 1–39.

Cole, Robert E.
1985 'The macropolitics of organizational change: A comparative analysis of the spread of small group activities'. *Administrative Science Quarterly* 30: 560–585.

Crouch, Colin, and Wolfgang Streek
1997 *Political economy of modern capitalism: Mapping convergence and diversity*. Thousand Oaks, CA: Sage.

Cuervo, Alvaro
2002 'Corporate governance mechanisms: A plea for less code of good governance and more market control'. *Corporate Governance: An International Review* 10/2: 97–107.

Cuervo, Alvaro, and Belen Villalonga
2000 'Explaining the variance in the performance effects of privatization'. *Academy of Management Review* 25/3: 581–590.

Dahya, Jay, John J. McConnell, and Nickolaos G. Travlos
2002 'The Cadbury Committee, corporate performance, and top management turnover'. *Journal of Finance* 57/1: 461–483.

Davis, E. Philip, and Benn Steil
2001 *Institutional investors*. Cambridge, MA: MIT Press.

Davis, Gerald F., and Tracy A. Thompson
1994 'A social movement perspective on corporate control'. *Administrative Science Quarterly* 39: 141–173.

DiMaggio, Paul J., and Walter W. Powell
1983 'The iron cage revisited: Institutional isomorphism and collective rationality in organizational fields'. *American Sociological Review* 48: 147–160.

Djelic, Marie-Laure
1998 *Exporting the American model: The post-war transformation of European Business*. Oxford: Oxford University Press.

Dunning, John H.
1977 'Trade, location of economic activity and the MNE: A search for an eclectic approach' in *The international allocation of economic activity*. B. Ohlin, P. O. Hesselborn, and P. M. Wijkman (eds), 395–418. London: Macmillan.

Dyer, Jeffrey H., and Kentaro Nobeoka
2000 'Creating and managing a high-performance knowledge-sharing network: The Toyota case'. *Strategic Management Journal* 21/3: 345–367.

ECGN (European Corporate Governance Network)
2000 'Corporate governance codes, principles and recommendations', URL: http://www.ecgn.ulb.ac.be/ecgn/codes.htm, 1 March.

Fama, Eugene, and Michael Jensen
1983 'Separation of ownership and control'. *Journal of Law and Economics* 26: 301–325.

Fleming, Rowland W.
1998 'Worldwide changes in corporate governance'. *The Corporate Board*, November–December: 1–4.

Florida, Richard, and Martin Kenney
1991 'Transplanted organizations: The transfer of Japanese industrial organization to the United States'. *American Sociological Review* 56/3: 381–398.

Glendon, Mary Ann, Michael W. Gordon, and Christopher Osakwe
1994 *Comparative legal traditions*. St. Paul, MN: West.

Gooderham, Paul N., Odd Nordhaug, and Kristen Ringdal
1999 'Institutional and rational determinants of organizational practices: Human resource management in European firms'. *Administrative Science Quarterly* 44: 507–531.

Gregory, Holly J.
1998 *International comparison of board 'best practices' — Investor viewpoints*. Mimeo. Weil Goshtal & Manges LLP.

Gregory, Holly J.
1999 *Comparison of board 'best practices' in developing and emerging markets*. Mimeo. Weil Goshtal & Manges LLP.

Gregory, Holly J., and Robert T. Simmelkjaer II
2002 *Comparative study of corporate governance codes relevant to the European Union and its member states*. Weil, Gotshal & Manges LLP.

Guler, Isin, Mauro F. Guillén, and John Muir MacPherson
2002 'Global competition, institutions, and the diffusion of organizational practices: The international spread of ISO quality certificates'. *Administrative Science Quarterly* 47/2: 207–232.

Gwartney, James, Robert Lawson, and Walter Block
1996 *Economic freedom of the world 1975–1995*. Vancouver, BC: Fraser Institute.

Hadden, Tom
1994 'Corporate governance by institutional investors' Some problems from an international perspective' in *Institutional investors and corporate governance*. T. Baums, R. M. Buxbaum, and K. Hopt (eds). New York: Walter de Gruyter.

Hall, Peter A., and David Soskice
2001 *Varieties of capitalism: The institutional foundations of comparative advantage*. Oxford: Oxford University Press.

Hirsch, Paul M.
1986 'From ambushes to golden parachutes: Corporate takeovers as an instance of cultural framing and institutional integration'. *American Journal of Sociology* 91: 800–837.

Hollingsworth, J. Rogers, and Robert Boyer
1997 *Contemporary capitalism. The embeddedness of institutions*. Cambridge: Cambridge University Press.

Hollingsworth, J. Rogers, Philippe C. Schmitter, and Wolfgang Streeck
1994 *Governing capitalist economies*. Oxford: Oxford University Press.

Holmes, Kim R., Bryan T. Johnson, and Melanie Kirkpatrick
1997 *Index of economic freedom*. Washington, DC: Heritage Foundation.

IFC (International Financial Corporation)
1999 *Emerging markets data base*. URL: www.ifc.org.

IMF (International Monetary Fund)
1992 *International Financial Statistics*. Washington, DC: IMF/IFS.

IMF (International Monetary Fund)
2000 *International Financial Statistics*. Washington, DC: IMF/IFS.

Jensen, Michael C., and William H. Meckling
1976 'Theory of the firm: Managerial behavior, agency costs and ownership structure'. *Journal of Financial Economics* 3: 305–360.

Johnson, Bryan, Kim R. Holmes, and Melanie Kirkpatrick
1998 *Index of economic freedom*. Washington, DC: Heritage Foundation.

Johnson, Bryan, Kim R. Holmes, and Melanie Kirkpatrick
1999 *Index of economic freedom*. Washington, DC: Heritage Foundation.

Kogut, Bruce
1991 'Country capabilities and the permeability of borders'. *Strategic Management Journal*, special issue, 12: 33–47.

Kraatz, Mathew, and Edward J. Zajac
1996 'Exploring the limits of the new institutionalism: The causes and consequences of illegitimate organizational change'. *American Sociological Review* 61/5: 812–836.

Lannoo, Karel
1999 'A European perspective on corporate governance'. *Journal of Common Market Studies* 37: 269–294.

La Porta, Rafael, Florencio Lopez-de-Silanes, and Andrei Shleifer
1999 'Corporate ownership around the world'. *Journal of Finance* 54: 471–517.

La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny
1997 'Legal determinants of external finance'. *Journal of Finance* 52: 1131–1150.

La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny
1998 'Law and finance'. *Journal of Political Economy* 106: 1113–1155.

La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny
2000 'Agency problems and dividend policies around the world'. *Journal of Finance* 55: 1–33.

Leblebici, Huseyin, Gerald R. Salancik, Anne Copay, and Tom King
1991 'Institutional change and the transformation of interorganizational fields: An organizational history of the U.S. radio broadcasting industry'. *Administrative Science Quarterly* 36/3: 333–363.

Levine, Ross
1999 'Law, finance, and economic growth'. *Journal of Financial Intermediation* 8/1–2: 8–35.

Mace, Myles L.
1971 *Directors: Myth and reality*. Boston, MA: Harvard Business School Press.

McKinsey & Company
2000 *Investor Opinion Survey*. URL: www.mckinsey.com/features/investor_opinion/index.html.

Mayer, Michael C. J., and Richard Whittington
1999 'Strategy, structure and 'systemness': National institutions and corporate change in France, Germany and the UK, 1950–1993'. *Organization Studies* 20: 933–959.

Meyer, James W., and Brian Rowan
1977 'Institutionalized organizations: Formal structure as myth and ceremony'. *American Journal of Sociology* 83: 340–363.

Monks, Robert A. G., and Nell Minow
1992 *Power and accountability: Restoring balance of power between corporations, owners and societies*. New York: Harper Business.

Monks, Robert A. G., and Nell Minow
1995 *Corporate governance*. Cambridge, MA: Blackwell Business.

Murtha, Thomas P., and Stephanie A. Lenway
1994 'Country capabilities and the strategic state: How national political institutions affect multinational corporations' strategies'. *Strategic Management Journal*, special issue, 15: 113–129.

OECD (Organization of Economic Cooperation and Development)
1998 *Corporate governance: Improving competitiveness and access to capital in global markets*. Paris: OECD.

Orrú, Marco, Nicole W. Biggart, and Gerald G. Hamilton
1997 *The economic organization of East Asian capitalism*. Thousand Oaks, CA: Sage.

Osterman, Paul
1994 'How common is work place transformation and who adopts it?'. *Industrial and Labor Relations Review* 47: 173–188.

Pellens, Bernhard, Franca Hillebrandt, and Björn Ulmer
2001 'Implementation of corporate governance-codes in German practice — An empirical analysis of the DAX 100 companies'. *Betriebs-Berater* 56: 1243–1250.

Porter, Michael E.
1990 *The competitive advantage of nations*. New York: Free Press.

Reynolds, Thomas H., and Arturo A. Flores
1989 *Foreign law: Current sources of codes and basic legislation in jurisdictions in the world*. Littleton, CO: Rothman.

Roe, Mark
1994 *Weak owners, strong managers. The Political roots of American capitalism*. Princeton, NJ: Princeton University Press.

Sachs, Jeffrey D., Andrew Warner, Anders Aslund, and Stanley Fisher
1995 'Economic reform and the process of global integration'. *Brookings Papers on Economic Activity* 1: 1–118.

Scott, Richard W.
2001 *Institutions and organizations*. Thousand Oaks, CA: Sage.

Sorge, Arndt
1991 'Strategic fit and the societal effect: Interpreting cross-national comparisons of technology, organization and human resources'. *Organization Studies* 12/2: 161–190.

Stiles, Philip, and Bernard Taylor
1993 'Benchmarking corporate governance: The impact of the Cadbury Code'. *Long Range Planning* 26: 61–71.

Stiles, Philip, and Bernard Taylor
2001 *Boards at work. How directors view their roles and responsibilities*. Oxford: Oxford University Press.

Strang, David, and Michael M. Macy
2001 'In search of excellence: Fads, success stories, and adaptive emulation'. *American Journal of Sociology* 107/1: 147–182.

Strang, David, and Sarah A. Soule
1998 'Diffusion in organizations and social movements: From hybrid corn to poison pills'. *Annual Review of Sociology* 24: 265–290.

Tolbert, Pamela S., and Lynne G. Zucker
1983 'Institutional sources of change in the formal structure of organizations: The diffusion of civil service reform, 1880–1935'. *Administrative Science Quarterly* 28: 22–39.

Useem, Michael
1996 *Investor capitalism: How money managers are changing the face of corporate America*. New York: Basic Books.

Van den Berghe, Lutgart, and Liesbeth de Ridder
1999 *International standardisation of good corporate governance. Best practices for the board of directors*. Boston, MA: Kluwer.

Vickers, John, and George Yarrow
1988 *Privatization: An economic analysis*. Cambridge, MA: MIT Press.

Weir, Charles, and David Laing
2000 'The performance-governance relationship: The effects of Cadbury compliance on UK quoted companies'. *Journal of Management and Governance* 4: 265–281.

Westphal, James D., and Edward J. Zajac
1994 'Substance and symbolism in CEOs' long-term incentive plans'. *Administrative Science Quarterly* 39: 367–390.

Westphal, James D., and Edward J. Zajac
1997 'Defections from the inner circle: Social exchange, reciprocity and the diffusion of board independence in U.S. corporations'. *Administrative Science Quarterly* 42: 161–183.

Westphal, James D., Ranjay Gulati, and Stephen M. Shortell
1997 'Customization or conformity' An institutional and network perspective on the content and consequences of TQM adoption'. *Administrative Science Quarterly* 42: 366–394.

Whitley, Richard
1994 'Dominant forms of economic organization in market economies'. *Organization Studies* 15/2: 153–182.

Whitley, Richard
1999 *Divergent capitalisms: The social structuring and change of business systems*. Oxford: Oxford University Press.

Whitley, Richard
2000 'The institutional structuring of innovation strategies: Business systems, firm types and patterns of technical change in different market economies'. *Organization Studies* 21/5: 855–886.

Whitley, Richard
2002 'Developing innovative competences: The role of institutional frameworks'. *Industrial and Corporate Change* 11/3: 497–528.

World Bank
2000 *Corporate governance. Best practices*. URL: http://www.worldbank.org/html/fpd/privatesector/cg/codes.htm.

Zeitz, Gerald, Vikas Mittal, and Brian McAulay
1999 'Distinguishing adoption and entrenchment of management practices: A framework for analysis'. *Organization Studies* 20/5: 741–776.

Zucker, Lynne G.
1987 'Institutional theories of organization'. *Annual Review of Sociology* 13: 443–464.

**Ruth V. Aguilera**

Ruth V. Aguilera is an assistant professor at the College of Commerce and Business Administration and the Institute of Labor and Industrial Relations at the University of Illinois in Champaign-Urbana. She received her PhD in 1999 in Sociology from Harvard University. She has published in the *European Sociological Review*, *Academy of Management Review*, *Economic Sociology* and has several book chapters in edited books on corporate governance. Her current research interests are corporate governance, mergers and acquisitions, institutional analysis, and inter-corporate relations.

*Address*: Department of Business Administration, College of Commerce and Business Administration, University of Illinois at Urbana-Champaign, 1206 Sixth St., Champaign, IL 61820, USA.
*E-mail*: ruth-agu@uiuc.edu

**Alvaro Cuervo-Cazurra**

Alvaro Cuervo-Cazurra is an assistant professor of Strategic Management and Organization at the University of Minnesota's Carlson School of Management. He received his PhD in 1999 from the Massachusetts Institute of Technology's Sloan School of Management in strategy and international management after earning a PhD in 1997 in business economics from the University of Salamanca, Spain. His current research lies at the intersection of strategic and international management, studying how firms change and develop resources to become competitive, and how then they become international. Another line of research deals with corporate governance issues, studying the influence of the private objectives of shareholders on firm behavior and institutional controls on the board of directors.

*Address*: University of Minnesota, Carlson School of Management; 321–19th Avenue South, 3-376 CSOM, Minneapolis, MN 55455, USA.
*E-mail*: acuervo@csom.umn.edu