

The Worldwide Diffusion of Codes of Good Governance

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Introduction

Good corporate governance is beneficial for the country. Countries with good governance systems become better locations not only for domestic firms to operate but also for foreign companies to invest. Good governance facilitates interactions among parties and the development of the country (World Bank 1997, 2002). It also helps the development of external capital markets necessary for firm investment (La Porta, Lopez de Silanes, and Shleifer 1999; La Porta *et al.* 1997, 1998, 2000) and facilitates economic growth (Levine 1999).

Good governance can be promoted by developing corporate governance practices. These are, in theory, established to ensure that the firm is run in a profit-maximizing manner and that the rights of shareholders and, sometimes, stakeholders are protected. The initial discussion on corporate governance practices focused on the protection of shareholder rights from misbehavior by managers (Fama and Jensen 1983 a,b ; Jensen and Meckling 1976). However, recent debates reveal the existence of different types of shareholders with private objectives that differ from the maximization of the value of the overall firm. These studies highlight the need to protect the rights of minority shareholders from the misbehavior of not only managers but also large shareholders (Barclay, Holderness, and Pontiff 1993; Cuervo-Cazurra 1997, 1999; Shleifer and Vishny 1997). Another strand of the literature has focused on the need to develop corporate governance practices that protect the rights of not only shareholders but also of other stakeholders in the firm (Aguilera and Jackson 2003; Alkhafaji 1989; Freeman 1984).

In this chapter, we study corporate governance practices that are bundled in codes of good governance. Codes of good governance are a set of ‘best practice’ recommendations regarding the behavior and structure of the board

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of directors. Although the board of directors can serve several functions (Cuervo-Cazurra 1996), we focus on its role as a control mechanism. Moving beyond the convergence-divergence debate, we study the diffusion of codes by asking: (a) why codes develop; (b) how fast the first code emerges; and (c) who the actors involved in their development are.

This chapter contributes to the literature in four ways. First, drawing on the seminal work on legal systems and corporate control by La Porta and colleagues (La Porta, Lopez-de-Silanes, and Shleifer 1999; La Porta *et al.* 1997, 1998, 2000), we provide an understanding of how corporate governance practices can strengthen the legal system in the protection of the rights of shareholders (Aguilera and Cuervo-Cazurra 2004; Morgan and Engwall 1999). Second, we suggest theoretical explanations of the reasons and dynamics of the development of codes of good governance worldwide. This theoretical exercise extends previous research on codes analyzing the determinants and consequences of the development of a code of good governance in a single country (for example, Cadbury 2000; Pellens, Hillebrandt, and Ulmer 2001; Stiles and Taylor 1993) or describing codes of good governance in several countries (for example, Gregory 1998, 1999; Gregory and Simmelkjaer 2002; Van den Berghe and de Ridder 1999). Third, we go beyond the debate on convergence-divergence on corporate governance practices by examining how a converging trend, namely, the emergence of codes in different countries, has led to divergence in the speed of diffusion. Finally, we contribute to the literature by stressing the difficulties in transferring practices across countries, which lead to different speeds of diffusion. We highlight the importance of the exposure to foreign knowledge, in addition to willingness and understanding (for example, Grant 1996; Szulanski 1996), in the explanation of the transfer of knowledge across countries.

The rest of the chapter is organized as follows. In the second section, we describe codes of good governance, their potential contribution in improving national corporate governance systems, and their historical evolution. In the third section, we review the factors triggering the adoption of codes of good governance worldwide. We borrow from institutional theory to build our arguments. In the fourth section, drawing on the knowledge-based view of strategic management, we propose a theoretical model to explain the speed in the worldwide diffusion of codes, and conduct an empirical test of our model. In the fifth section we describe the differences in the issuers of codes of good governance across and within countries. We conclude the chapter with a summary of our main findings and their implications for theory and research in corporate governance.

Improving Corporate Governance: Codes of Good Governance

All countries need to improve their prevailing corporate governance. Good governance is not part of a country's endowment but has to be fostered.

Countries with poor corporate governance can improve it in two main ways: changing the overall corporate governance system and introducing innovations in the existing corporate governance system.

The national governance system can potentially be reinvented to heighten shareholders' protection, as has been the case in transition economies that lacked measures for protecting private property rights (Coffee 1999). These countries are exceptional cases. They usually embarked on the creation of a corporate governance system and a new legal framework as part of the overall transformation of the economic and political system—from public ownership of productive resources and allocation of their use through command, towards private ownership and allocation through price mechanism (Blanchard 1997; Svejnar 2002).

The transformation of the corporate governance system does not have to be this radical, however. Countries can improve their existing legal framework to deal with new governance challenges (World Bank 1997). However, in general this is not an easy proposition. Introducing changes into an existing legal system is a difficult and lengthy process, not least because of the political consensus required. More importantly, the legal system is deeply embedded in the institutional legacies of a given country (Roe 1994) and it is part of a system of institutions that change very slowly (North 1990).

Alternatively, sets of corporate governance practices can be introduced to address the deficiencies in the corporate legal system incorporating the idiosyncrasies of the country's corporate governance system (Shleifer and Vishny 1997), ownership patterns (Barca and Betch 2001; Bebchuck and Roe 1999; Bergloff 1990), or stakeholder rights (Aguilera and Jackson 2003). This customization of practices responds to the limitations in the use of practices developed in one legal system into another (Cuervo 2002; Cuervo-Cazurra 1998).

Codes of Good Governance

One important practice developed to improve national corporate governance is codes of good governance. They present 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 specific code recommendations vary across countries, the two principles every code rests on are 'the need for adequate disclosure and the need for appropriate checks and balances in the governance structure' (Cadbury 2000: 9). Ultimately, codes attempt to improve the overall corporate governance of firms, especially when other mechanisms such as takeover markets and legal environments fail to ensure adequate protection of shareholders' rights. Although most of these codes are not statutory, firms nevertheless tend to adopt them. There are two reasons explaining

such adoption. First, in several countries, listing rules require quoted firms to adopt the recommendations of the codes or justify the reasons of non-compliance with the country code of good governance in their annual reports. This ‘comply or explain’ mandatory disclosure requirement adopted by most stock exchanges encourages firm compliance. Surveys in countries where codes have been issued show that publicly traded companies tend to respond to code recommendations (Gregory and Simmelkjaer 2002). For example, Pellens, Hillebrandt, and Ulmer (2001) surveyed German companies in the DAX100 and found that 95.6 per cent of the firms agreed with the German code of good governance and 48.5 per cent had already implemented some of the code guidelines. Second, codes of good governance serve as a signal of the quality of the firm and may give automatic legitimization to adopting firms because of the additional information made available to shareholders. The adoption of codes provides shareholders with information on the corporate governance practices that are (or are not) being implemented in the firm. This information gives them the opportunity to either voice their disagreement with how the company is being governed or—if they do not agree with it—to sever the relationship (Hirschman 1970). As such, firms that adopt the recommendations will be perceived as showing more concern for shareholders than those that do not do so.

The adoption of the recommendations of the codes has induced changes in firms. The adoption of the codes forces firms to change their corporate governance practices to comply with, if not the spirit, at least the letter of the code, and improve upon previous protection of shareholders, especially minority ones. Existent research reveals that codes of good governance influence firm 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, such as the appointment of board subcommittees or the presence of outside directors in the board, and other recommendations that were not explicit in the code such as dual leadership, the functional separation of CEO and Chairman of the board. 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, McConnell, and Travlos (2002) demonstrate that the adoption of the Cadbury Report in 1992 increased CEO turnover in the UK—reflecting the need for the separation of Chairman and CEO—and heightened the sensitivity of CEO turnover to poor performance. Finally, highly publicized financial scandals have contributed to the adoption 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 continue: ‘Following the Cadbury Code, most large quoted companies changed their board structures . . . reducing their size 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).

Historical Development of the Codes of Good Governance

The first code of good governance came into being in the United States in the late 1970s in the midst of great corporate ferment with business, legal, academic, and political constituencies squaring off on what should be the role of the board of directors. In the context of charges and countercharges surrounding the takeover movement, the Business Roundtable issued a report in January 1978 titled *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, 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: (i) overseeing management and board selection and succession; (ii) reviewing the company’s financial performance and allocating its funds; (iii) overseeing corporate social responsibility; and (iv) ensuring compliance with the law (Charkham 1995). It was drafted as the first guidelines to improve governance capacity in US corporations.

In the United States, the Securities Exchange Commission, the New York Stock Exchange, and the Roundtable, among others, continued to issue codes from 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. Despite the slow start, the development of codes grew rapidly in the early 1990s, especially following the Cadbury Commission’s report (1992) in the United Kingdom. The Cadbury Report became the flagship guideline in corporate governance codes that deliberately challenged the effectiveness of voluntary regulation and corporate democracy (Stiles and Taylor 1993).

Figure 14.1 shows the evolution of codes of good governance in capitalist countries by country and number of codes developed. The emergence of codes of good governance across countries did not follow a gradual path.

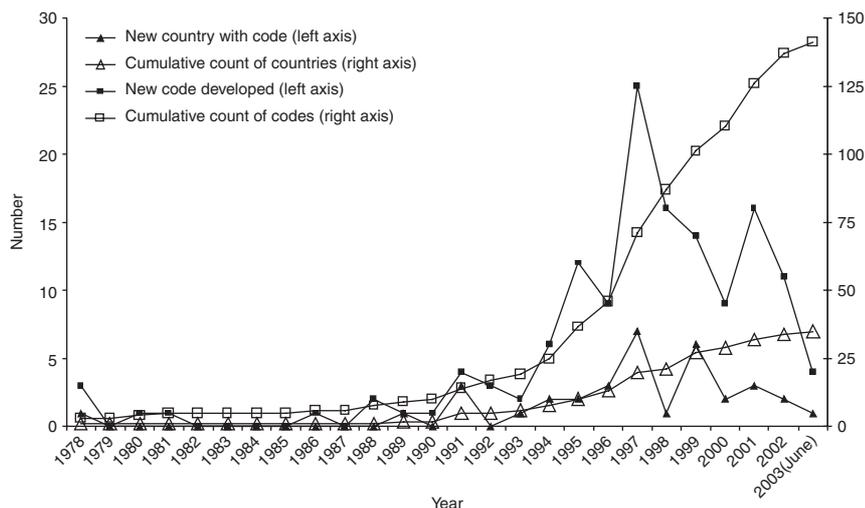


FIGURE 14.1 *Dynamics of codes of good governance worldwide: Number of countries and number of codes, 1978–2003.*

Source: Authors' calculation using data from CAGN (1999), ECGI (2003), ECGN (2000), Gregory (1998, 1999), Gregory and Simmelkjaer (2002), Van den Berghe and de Ridder (1999), and World Bank (2000).

As noted, there is a gap between the first code issued in the United States 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 publication of the Cadbury Report in 1992, there has been an exponential rise in the adoption of codes and overall shareholder activism. This path in the emergence of codes in the 1990s is correlated with the increasing discussion of shareholder value that emerged across corporate governance systems around the world and increasing activism in global stock markets.

An additional impetus in the development of the codes of good governance came from the work of supra-national bodies, particularly the Organization for Economic Cooperation and Development (OECD) among developed countries, and the World Bank among developing countries. The OECD issued the influential 'OECD Principles of Corporate Governance', which the OECD member countries adopted as non-binding principles to improve their corporate governance regulation. The World Bank promoted the development of good governance in general and good corporate governance in particular as part of the recommendations for the transformation of economic systems in developing countries, especially in the 1990s. It also acted as a catalyst in the development of corporate governance and codes of good governance in transition economies. These countries, however, are not part of our analyses. Other supra-national bodies that have issued codes

are the European Union and pan-European associations and bodies, and the Commonwealth. By the middle of 2003, thirty-five developed and developing countries had issued at least one code of good governance. In this list we do not include codes issued by supranational bodies. Countries that developed codes of good governance earlier continue to develop subsequent codes. This resulted in a total of 141 codes of good governance developed by the middle of 2003. As some areas were addressed by a code, new requirements appeared, inducing the development of other codes to address them. As such, even countries that had already developed codes of good governance continued improving their corporate governance system by issuing new ones to address existing limitations in the protection of shareholders.

Development of Codes of Good Governance: Effectiveness and Legitimization

Guidelines and codes of corporate governance are important as they provide a voluntary means for the adoption of essential practices of good governance. Identifying the factors that influence the development and diffusion of governance practices in different countries permits a better understanding of their impact despite the lack of formal legal rules (Strang and Soule 1998). 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 legitimization (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. Alternatively, social legitimization suggests that practices are adopted because of their growing taken-for-granted improving qualities, which make adoption socially expected.

The efficiency and legitimization 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 legitimization process regardless of net benefit. Nevertheless, 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). Hence, we argue that these two theoretical rationales, usually presented as 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 shaping effectiveness and legitimization. In particular, we propose that, while endogenous forces influence effectiveness factors in a given country, exogenous pressures lead to legitimization by triggering the adoption of taken-for-granted practices.

In Aguilera and Cuervo-Cazurra (2004) we theorize and empirically test the factors that led to the development of codes of good governance

between 1988 and 1999 in a sample of forty-nine countries, which includes twenty-four countries that had developed codes. We theorize that codes of good governance are triggered by (i) endogenous forces increasing their corporate governance effectiveness and by (ii) exogenous forces legitimizing their corporate governance system.

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 on behalf of shareholders. One of the code's functions is to compensate for deficiencies in the legal system regarding minority shareholders' protection. Hence, following this logic, we expect that countries with less effective corporate governance systems are more likely to develop new governance practices such as codes of good governance; codes complement the legal system. We look at two measurements of effectiveness in the protection of shareholders rights: type of legal tradition and ability of minority shareholders to shape firm governance.

Deficiencies in the corporate governance system are linked to the legal tradition of a country (La Porta, Lopez de Silanes, and Shleifer 1999; La Porta *et al.* 1997, 1998, 2000). As indicated 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, in principle, we argue that codes are adopted to make up for the lack of minority shareholder protection in the legal system and are more likely to be adopted in countries with civil-law traditions.

Empirical tests undertaken in Aguilera and Cuervo-Cazurra (2004) find that this logic is not supported. Conversely, they show that codes of good governance are less likely to be developed in countries with a civil-law legal tradition and more likely to be developed in countries with a common-law legal tradition. Two explanations account for this counter-intuitive result. 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. Consequently, countries with strong shareholder protection rights embedded in their legal system, such as the common-law legal tradition, are more likely to continue fostering effective governance practices via codes of good governance. As such, codes are developed to fill in gaps in the legal system in the overall protection of shareholders. Second, the intrinsic characteristics of the common-law legal system facilitate the enforceability of the codes of good governance. Although in the common-law legal system practices that are 'good' business practice tend to be enforceable by the courts, in civil-law legal systems such

practices are not enforceable 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.

However, countries and families of legal systems vary in the ability of minority shareholders to challenge the workings of the board of directors and managers in corporate decision-making. 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 a country's degree of minority shareholders rights protection, which evaluates the mechanisms available to shareholders to protect themselves against expropriation by the board of directors. 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, we expect that the adoption of codes of good governance serves as a mechanism to compensate for weak anti-director shareholder rights in the legal system. This is accomplished by encouraging the development of instruments that increase the country's corporate governance effectiveness such as promoting firm transparency and board accountability towards shareholders. Empirical findings in Aguilera and Cuervo-Cazurra (2004) confirm that the adoption of codes of good governance tend to be issued in countries with weak anti-director shareholder rights, providing support for the effectiveness account. All in all, codes complement a country's legal system in the overall protection of shareholders in the country.

Exogenous Forces to Legitimize the Corporate Governance System

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). In Aguilera and Cuervo-Cazurra (2004) we show that three exogenous factors influence the likelihood of code development at the country level: globalization pressures exemplified by economic openness, government liberalization, and the significant presence of foreign institutional investors.

First, a country's economic integration in the world economy in terms of international trade facilitates the transfer of knowledge across countries and the diffusion of codes of good governance. Moreover, integration of a national economy into world trade reduces the possibility of shielding governance inefficiencies behind barriers of trade. This economic openness is

positively related to the adoption of codes, although the relationship is not statistically significant. Second, 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. We find that processes of government liberalization in a given country are positively related to the adoption of codes. Finally, institutional investors need the assurance that their investments are going to be protected since they may not hold enough capital or information to influence decision-making. In effect, institutional investors are willing to pay a premium for good governance (McKinsey 2000). That is, they search for firms that have good governance practices and are eager to promote the adoption of codes of good governance. We demonstrate that the presence of foreign institutional investors is positively related to the adoption of the number of codes.

In conclusion, 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 effectiveness in the system, and exogenous pressures seek to acquire legitimization. These two theoretical logics—effectiveness and legitimization—usually presented as being incompatible, can be reconciled and thereby account for the spread of practices across countries with different governance systems.

Speed of Worldwide Diffusion of Codes of Good Governance as Transfer of Knowledge

We extended the analysis of factors triggering the worldwide adoption of codes of good governance with a study of the speed in the diffusion of codes among those countries that have developed them. The details of this appear in Cuervo-Cazurra and Aguilera (2003). The specific research question we tackle is: what are the determinants of the speed in the development of the first code in a given country? We conceptualize 'speed of code development' as how early the first code of good governance was developed in a given country. This is another dimension to consider when analyzing the diffusion of practices. As we have discussed above, the diffusion of practices is usually presented as a discussion of the efficacy versus legitimization of adopting a practice.

However, diffusion arguments assume that it is easy to transfer the knowledge embedded in a practice across organizational or in this case, country boundaries. Instead, the knowledge-based view shows that the transfer of practices tends to be complex, both within the firm (Grant 1996; Kogut and Zander 1992; Szulanski 1992; Von Hippel 1994; Zander and Kogut 1995) and across countries (Kogut 1991; Kogut and Zander 1993). Therefore, to fully

capture the complexity understanding of the diffusion of practices across countries, we need to examine not only the factors that influence the diffusion of practices, but also the factors that influence the speed in the transfer of practices across countries.

The development of the first code is a critical initial step towards the development of additional codes. The first code will generally cover some of the deficiencies in the national corporate governance system, but there are always new issues that appear as corporations and their governance changes over time. Subsequent codes can address areas that were not properly dealt with in previous codes, or areas that have appeared as new demands for additional governance. As such, codes of good governance are not a one-time solution to corporate governance problems, but part of an evolving pattern of corporate behavior, or more adequately misbehavior, and the solutions to it. However, the most difficult code to develop is the first one, as it requires being aware of the existence, acknowledging its need, and its analysis and adaptation. Once the first code is developed, subsequent codes will emerge more easily. Therefore, we study the speed of development of the first code of good governance in a given country.

The Speed in Diffusion as a Problem of Transferring Knowledge across Countries

We analyze the determinants of the speed in the diffusion of practices across countries as a problem of transferring codified knowledge across countries (Kogut and Zander 1993). This approach has a long tradition in technology research (for example, Roberts 1983) and is increasingly being used in management research (Grandori and Kogut 2002). Whereas some view the transfer of practices across countries as not particularly problematic, the literature has acknowledged that knowledge transfer is in fact difficult (Grant 1996; Kogut and Zander 1992; Teece 1980), and particularly problematic across countries (Kogut 1991; Kogut and Zander 1993; Teece 1977).

Most of these studies analyze the transfer of knowledge among parties already involved in a transaction, whether units within the same company (Szulanski 1996; Hansen 2002; Winter and Szulanski 2001) or partners in an investment project (Almeida, Song, and Grant 2002; Teece 1980). These studies indicate two key factors that facilitate the transfer of knowledge: understanding and willingness. Understanding refers to the necessity to be able to de-codify each other's knowledge (Arrow 1974; Cohen and Levinthal 1990; Grant 1996; Szulanski 1996). Willingness refers to the need for the two parties involved in the transaction (the source and the recipient of knowledge) to be sufficiently motivated to establish interactions and share their knowledge (Kerr 1975; Milgrom and Roberts 1992; Szulanski 1996).

The receiving party must also be exposed to the existence of this knowledge in the first place. This is not a problem when the transfer of knowledge is between parties that are formally related—either because it is part of

the best practices of the firm and may help other units (see, for example, Szulanski 1996) or because it is part of formal relationships to transfer knowledge from one firm to another (for example, Teece 1980). However, this exposure may not be the case in the transfer of knowledge across countries among entities that are not formally related. Therefore, we will discuss exposure to foreign knowledge as a third determinant of the transfer of codified knowledge across countries.

Hence, we now specify the hypotheses in our particular setting, codes of good governance worldwide. We argue that the speed in developing the first code of good governance in a country depends on three factors: understanding of foreign knowledge, willingness to use foreign knowledge, and exposure to foreign knowledge.

The understanding of codes of good governance in other countries speeds the development of a code because governance practices codified in one country can be understood and applied to another (Arrow 1974; Cohen and Levinthal 1990; Grant 1996). In the case of codes of good governance, these practices are already codified and simplified as 'best governance practices' when they are assembled in the code. This reduces the additional problems of transferring knowledge in terms of tacitness and complexity of the knowledge (Kogut and Zander 1992; Nonaka 1994). The challenge becomes one of teachability across countries (Kogut and Zander 1992, 1993).

The ability to learn about the codified knowledge embedded in codes depends on the similarity of the institutions across countries (Johanson and Wiedersheim-Paul 1975). One of the key institutions influencing code content is the legal system (La Porta *et al.* 1998). The two legal families as described by La Porta *et al.* (common law and civil law) have different understanding of corporate behavior and accountability. The first code was issued within a common-law system, the United States. Hence, institutional similarity leads to a speed advantage in the adoption of codes in countries that have a common-law legal tradition. Practices developed in one country transfer more easily to other countries that have similar institutions, as managers are able to understand the information transferred more easily. Therefore, we expect that countries with a common-law legal system are more likely to adopt codes than countries with civil-law legal systems.

The willingness of using foreign knowledge is correlated with the expected returns (Milgrom and Roberts 1992; Szulanski 1996), which influence the speed of development. Following this logic, we predict that the speed in the development of new practices such as codes of good governance will also depend on their expected returns. Specifically, in the case of the codes of good governance, benefits stem from filling gaps in the existing legal system regarding the protection of minority shareholders. Hence, we expect that countries with legal systems that do not provide appropriate protection for minority shareholders will be more likely to take the lead in developing codes. Codes of good governance help address deficiencies in the legal system, and

are an easier and cheaper way to do so, since altering the legal system is a complex process (Coffee 1999) because it involves changes in a large system (Whitley 1999).

The willingness to develop codes will also be dependent on the relative importance of capital markets in the economy. Corporate governance problems are more likely to appear in public companies in which managers or large shareholders are better equipped to expropriate other shareholders. In private companies, the concentration of shares is higher and the overseeing of managers is stronger (La Porta *et al.* 1998). We expect that the speed in adopting codes of good governance increases if there is a large benefit in terms of shareholder protection. Higher benefits compensate for the costs of developing codes of good governance. The benefits in developing codes of good governance can be separated into the impact on the number of companies and the size of the capital markets. Countries with a large number of companies listed benefit more from the fast development of capital markets, as there are more companies that can improve their corporate governance. Moreover, countries whose capital markets are an important source of external firm financing, those that have a large economic size, also benefit from the improvement in corporate governance. In sum, we expect a direct relationship between the country's development of capital markets and the speed in the development of the code.

Speed in the transferability of practices is influenced by the exposure of potential code developers to foreign governance practices and in particular codes. This factor is not part of other discussions of knowledge transfer since these already have identified the knowledge to be transferred, hence concentrating on analyzing dimensions of willingness and understanding that facilitate the transfer. However, in the transfer of practices across countries among entities that are not related to each other, exposure to foreign knowledge becomes relevant. In this case, there are no mechanisms that facilitate the exposure to knowledge, such as boards of directors (Davis and Thompson 1994) or competitive interactions (Guler, Guillen, and MacPherson 2002). Hence, exposure to foreign knowledge comes indirectly, from other exchanges among countries, such as trade and investment flows. Countries more open towards international trade and investment are more likely to be exposed not only to diverse goods, services, and capital but also to new knowledge. Transferability of knowledge across countries can be part of the transfer of product and services, or through trade. Hence, we expect that countries more open to trade tend to develop codes more quickly. Alternatively, the transferability of knowledge across countries can accompany the transfer of capital for investment. This is more relevant when investments are done in the capital markets. Foreign direct investment in private firms suffers less from corporate governance problems since the foreign investor can always establish the appropriate controls. Portfolio investments are more vulnerable to corporate governance problems because

they do not have control over the firm, as their investments are below 10 per cent of the stock of the firm. Hence, we expect that countries with a large foreign equity investment are more likely to develop codes of good governance quickly.

Research Design

To test these arguments, we built a comprehensive database of codes of good governance developed worldwide from 1978, the year the first code of good governance was developed, until June of 2003, the time of writing. Our main sources of information are the European Corporate Governance Network (2000), and the European Corporate Governance Institute (2003), and the World Bank (2000). In order to complete and cross check information, we consulted Commonwealth Association for Corporate Governance (1999), Gregory (1998, 1999), and Gregory and Simmelkjaer (2002), and Van den Berghe and de Ridder (1999). Our database includes only codes of good governance. We exclude laws or legal regulations, revisions, and new editions of original codes, corporate disclosure codes, reports on the compliance with the codes issued, codes on the behavior of top management, consulting firm reports, and individual company codes. We analyze capitalist countries. We have excluded 'transition' and socialist economies because the changes that accompany their transformation from communism to capitalism require a different approach to corporate governance. By the middle of 2003, thirty-five countries had issued 141 codes of good governance. Table 14.1 summarizes the number of codes issued in each country, the year when the first code was developed, and the types of issuers of codes.

Table 14.2 summarizes the variables, explains their measurement in detail, and provides data sources. We defined speed of development, our dependent variable, as how early the first code of good governance is developed in each country. We operationalize it as a count variable that measures the years that have passed since a given country developed its first code of good governance until 2003. We use this measure to be able to interpret the coefficients of the independent variables directly. The sooner the first code of good governance was developed in the country, the more years have passed from then until 2003. We measure understanding of foreign knowledge in terms of the similarities in the legal system, using a dummy variable that indicates whether the legal system is a common-law legal system (English origin), which is the legal system of the first country that issued a code, the United States. We operationalize willingness to use foreign knowledge in terms of deficiencies in the protection of shareholders and in terms of the size of capital markets. We measure deficiencies in the protection of minority shareholders by using the indicator of the anti-director rights in the legal system (La Porta *et al.* 1998). We measure the importance of capital markets in terms of number of domestic public companies

TABLE 14.1 *Issuers of codes of good governance worldwide, 1978–2003*

Country	First code developed			Cumulative number of codes										
	Stock exchange	Government	Directors' assoc.	Directors' assoc.	Managers' assoc.	Profess. assoc.	Investors	Total Stock exchange	Government	Directors' assoc.	Managers' assoc.	Profess. assoc.	Investors	
English-law legal system (15 countries)														
Australia	1	0	0	0	0	0	0	4	2	0	1	0	0	1
Canada	0	0	0	0	0	0	1	7	4	1	0	0	1	1
Cyprus	1	0	0	0	0	0	0	1	1	0	0	0	0	0
Hong Kong	1	0	0	0	0	0	0	7	3	0	0	0	4	0
India	0	0	0	1	0	0	0	2	1	0	0	1	0	0
Ireland	0	0	0	0	0	1	0	2	0	0	0	0	0	2
Kenya	1	0	0	0	0	0	0	1	1	0	0	0	0	0
Malaysia	0	1	0	0	0	0	0	3	2	1	0	0	0	0
Pakistan	1	0	0	0	0	0	0	1	1	0	0	0	0	0
Singapore	1	0	0	0	0	0	0	2	1	1	0	0	0	0
South Africa	0	0	1	0	0	0	0	2	0	0	2	0	0	0
Sri Lanka	0	0	0	0	1	0	0	1	0	0	0	0	1	0
Thailand	1	0	0	0	0	0	0	1	1	0	0	0	0	0
UK	0	0	1	0	0	0	0	26	5	4	2	0	4	11
USA	0	0	1	0	0	0	0	30	4	2	5	6	4	9
All	7	1	2	3	0	2	0	90	26	9	10	7	14	24
French-law legal system (12 countries)														
Belgium	0	0	1	0	0	0	0	5	1	0	2	1	1	0
Brazil	0	0	1	0	0	0	0	2	1	0	1	0	0	0
France	0	0	0	1	0	0	0	7	2	0	0	4	0	1
Greece	1	0	0	0	0	0	0	2	1	0	0	1	0	0
Indonesia	0	1	0	0	0	0	0	1	0	1	0	0	0	0
Italy	0	1	0	0	0	0	0	2	1	1	0	0	0	0
Malta	1	0	0	0	0	0	0	1	1	0	0	0	0	0
Mexico	1	0	0	0	0	0	0	1	1	0	0	0	0	0
Netherlands	1	0	0	0	0	0	0	3	1	0	0	0	0	2
Peru	0	0	0	0	0	1	0	2	1	0	0	0	0	1

Portugal	1	0	0	0	0	0	0	0	1	1	0	0	0	0	0	0	0
Spain	0	0	0	1	0	0	0	0	3	0	2	0	1	0	0	0	0
All	5	2	2	2	0	1	0	1	30	11	4	3	7	1	4	4	4
Scandinavian-law legal system (3 countries)																	
Denmark	0	1	0	0	0	0	0	0	2	0	1	0	0	0	0	0	1
Finland	0	0	0	1	0	0	0	0	2	0	1	0	1	0	0	0	0
Sweden	0	0	0	1	0	0	0	0	3	0	0	1	0	0	0	2	2
All	0	1	1	1	0	0	0	0	7	0	2	1	1	0	0	3	3
German-law legal system (5 countries)																	
Austria	1	0	0	0	0	0	0	0	1	1	0	0	0	0	0	0	0
Germany	0	0	0	0	0	1	0	1	7	0	3	0	2	0	2	0	2
Japan	0	0	0	1	0	0	0	0	3	0	0	0	2	0	0	1	1
Korea	1	0	0	0	0	0	0	0	1	1	0	0	0	0	0	0	0
Switzerland	0	0	0	1	0	0	0	0	2	1	0	0	1	0	0	0	0
All	2	0	0	2	0	1	0	1	14	3	3	0	5	0	0	3	3
Common-law legal system, total (15 countries)																	
	7	1	2	3	0	2	0	2	90	26	9	10	7	14	14	24	24
Civil-law legal system, total (20 countries)																	
	7	3	3	5	0	2	0	2	51	14	9	4	13	1	10	10	10
All countries, total (35 countries)																	
	14	4	5	8	0	4	0	4	141	40	18	14	20	15	34	34	34
Common-law legal system, % (15 countries)																	
	46.7	6.7	13.3	20.0	0.0	13.3	0.0	13.3	100.0	28.9	10.0	11.1	7.8	15.6	26.7	26.7	26.7
Civil-law legal system, % (20 countries)																	
	35.0	15.0	15.0	25.0	0.0	10.0	0.0	10.0	100.0	27.5	17.6	7.8	25.5	2.0	19.6	19.6	19.6
All countries, % (35 countries)																	
	40.0	11.4	14.3	22.9	0.0	11.4	0.0	11.4	100.0	28.4	12.8	9.9	14.2	10.6	24.1	24.1	24.1

Source: Authors' calculation using data from CAGN (1999), ECGI (2003), ECGN (2000), Gregory (1998, 1999), Gregory and Simmelkjaer (2002), Van den Berghe and de Ridder (1999), and World Bank (2000).

TABLE 14.2 *Variables and measures*

Variable	Measure	Sources
Speed of development of first code	Years between the first code of good governance was developed in the country and 2003.	Database of codes of good governance by country based on data from CAGN (1999), ECGI (2003), ECGN (2000), Gregory (1998, 1999), Gregory and Simmeljaer (2002), Van den Berge and de Ridder (1999), and World Bank (2000)
Common-law legal system	Dummy: 1 if the legal system is common-law based (English), 0 otherwise.	Data from La Porta <i>et al.</i> (1998) based on data from Reynolds and Flores (1989).
Anti-director measures in the legal system	An index aggregating shareholder rights labeled as 'anti-director rights'. The index is formed by adding one when: (i) the country allows shareholders to mail their proxy votes to the firm; (ii) the shareholders are not required to deposit their shares prior to a general shareholder meeting; (iii) cumulative voting or proportional representation of minorities in the board of directors is allowed; (iv) oppressed minorities mechanism is in place; (v) the minimum percentage of share capital that entitles a shareholder to call an extraordinary shareholders meeting is less than or equal to 10%; (vi) shareholders have pre-emptive rights that can be waived only by a shareholder vote. The index ranges from 0 to 6.	Data from La Porta <i>et al.</i> (1998)
Number of public domestic firms	Number of domestic companies in the stock market, in hundreds.	Data from World Bank (2003) WDI database
Size of capital markets	Market capitalization at the end of the year as a percentage of GDP.	Data from World Bank (2003) WDI database
Trade openness	Imports and exports as a percentage of GDP.	Data from World Bank (2003) WDI database
Investment openness	Inward foreign portfolio investment flow in equity as a percentage of gross domestic capital formation.	Data from World Bank (2003) WDI database
Level of development	GDP in PPP terms per capita in thousand of US\$.	Data from World Bank (2003) WDI database

and in terms of market capitalization as a percentage of gross domestic product (GDP). Finally, we operationalize the exposure to foreign knowledge in two ways, through trade, measuring the importance of trade as a percentage of GDP, and through investment, measuring the importance of inward foreign portfolio investment as a percentage of gross capital formation.

We control for the level of development of the country by measuring the level of GDP per capita in power purchasing parity terms. Countries with wealthier populations are more inclined to develop codes of good governance more quickly because people are more likely to save and invest, either directly as part of individuals' savings strategy by directing their saving into investment funds in the stock market, or indirectly within the pension system by directing premiums into pension funds in the stock market. Using the alternative control of GDP for country size yields similar results.

The results of the analysis are subject to some limitations. We have restricted the set of countries that we analyze to thirty-three, and excluded Cyprus and Malta from the list in Table 14.1. We do this because we are using the measure on deficiencies in the legal system from La Porta *et al.*'s (1998) dataset, which includes only thirty-three of the thirty-five capitalist countries with codes of good governance. To ensure consistency among the independent variables, we analyze them in the same year, 2001, except for the legal system and its deficiencies, which we obtained from La Porta *et al.* (1998) dataset. We acknowledge that the variables are likely to change over time, but in this chapter we are interested only in getting a good sense of the influences on the speed of development rather than the specific impact of each variable on the speed. Hence, we will not discuss the size of the coefficients but rather their sign and statistical significance. The limited number of countries precludes an in-depth analysis of all potential influences.

We use a Poisson regression to analyze the determinants of the speed of the development of the codes of good governance because our dependent variable is constructed as a count variable: number of years passed from the adoption of the first code in the country until 2003. A positive (negative) coefficient of the independent variable indicates a higher (lower) likelihood of a rapid development of the first code of good governance in the country. We also analyze the determinants of the speed of the development of the codes of good governance using alternative duration models (Weibull, lognormal, log-logistic) to check for the robustness of the results of the Poisson model. The results, not reported, are in line with the ones of the Poisson model. We use the following specification:

$$\begin{aligned} \text{Speed of development of the code} = & \beta_0 + \beta_1 * \text{common-law legal system} + \beta_2 * \text{Anti-director} \\ & \text{measures in the legal system} + \beta_3 * \text{Number of public domestic companies} + \beta_4 * \text{Market} \\ & \text{capitalization} + \beta_5 * \text{Inward foreign equity investment} + \beta_6 * \text{Openness of country to trade} \\ & \text{flows} + \beta_7 * \text{Control for development of country} + \varepsilon \end{aligned}$$

Speed of Diffusion: Results and Discussion

Table 14.3 provides the means, standard deviations, and correlation matrix of the variables used in our analyses. The correlation matrix appears to indicate some correlations between the independent and the dependent variable. There is a high correlation between the legal system and the anti-director measures. We conducted further analyses to check for potential problems this correlation may have on the reported results. The analyses, not presented here, indicate that the presented results are valid.

Table 14.4 shows the results of the analysis of the determinants of the speed of development of the codes. The coefficients tend to be in line with our expectations. They provide support for the arguments that codes are more likely to develop faster in countries where there is more understanding of, willingness of, and exposure to foreign knowledge. The coefficients of the common-law system, of the size of capital markets in number of firms and in economic importance, and of the openness of the country to foreign investment are positive and statistically significant, as expected. The coefficient of the anti-director measures is positive but not significantly different from zero. The coefficient of the openness to trade is negative and statistically significant, contrary to expectations.

We check the robustness of our findings by examining the effects that the United States has. The United States was the earliest country to develop codes and has by far the largest capital markets and economic development. Its sheer size may be pulling the results of our analysis (Model 1 in Table 14.4). Model 2 presents the analysis of the model excluding the United States from the computations. Our results hold when we exclude the United States case, although the number of public companies ceases to be statistically significant.

In sum, the speed of development of the codes of good governance depends on the understanding of foreign knowledge, the willingness to use foreign knowledge, and exposure to foreign knowledge: that is, understanding of foreign knowledge coming from similar institutional environments, particularly the legal system, willingness to use foreign knowledge provided by the expected benefit in terms of the protection of minority shareholders of public companies, and exposure to foreign knowledge through equity flows.

There is an unexpected finding from our predicted variables of influence on speed of development. Openness to foreign trade appears to have a negative influence on the speed of the development of codes of good governance. An explanation for this unexpected result is that countries with greater trade openness are not necessarily going to be exposed to innovative corporate governance practices because the exchange tends to be around goods. Firms are exposed to foreign knowledge on the quality of product or productive processes only. However, in the investment of capital,

TABLE 14.3 Summary statistics and correlation matrix

	Mean	Std. dev.	(1)	(2)	(3)	(4)	(5)	(6)	(7)
1. Speed of first code	6.757	4.623	1						
2. Common-law legal system	0.424	0.501	0.422*	1					
3. Anti-director measures	2.424	1.250	0.504***	0.700***	1				
4. Number of domestic public firms	10.231	15.422	0.574***	0.369*	0.413*	1			
5. Economic size of capital markets	78.322	67.244	0.451**	0.199	0.323+	0.111	1		
6. Trade openness	90.500	70.401	0.050	0.290	0.068	-0.272	0.473**	1	
7. Investment openness	23.493	31.842	0.289	0.025	-0.119	-0.192	0.132	0.469**	1
8. Control for level of development	18.323	10.169	0.492**	-0.185	0.050	0.136	0.516**	0.206	0.410*

***, **, *, and + indicate statistical significance at 0.1%, 1%, 5%, and 10% respectively.

Source: Cuervo-Cazurra and Aguilera (2003).

TABLE 14.4 *Analysis of the speed of development of codes of good governance worldwide*

		Dependent variable: Speed of development of first code	
		Model 1. All countries	Model 2. All countries except US
Understanding of foreign knowledge	Common-law legal system	0.400 * (0.200)	0.451 * (0.204)
Willingness to use foreign knowledge	Anti-director measures	0.029 (0.105)	0.004 (0.105)
	No. domestic public firms	0.009 ** (0.003)	0.005 (0.003)
	Economic size capital markets	0.002 * (0.001)	0.003 * (0.001)
Exposure to foreign knowledge	Investment openness	0.007 *** (0.001)	0.007 *** (0.001)
	Trade openness	-0.002 ** (0.001)	-0.002 ** (0.001)
	Control for level of development	0.015 ⁺ (0.008)	0.013 ⁺ (0.008)
	Intercept	1.010 *** (0.191)	1.118 *** (0.203)
	Loglikelihood	-70.459	-67.477
	Wald Chi2 (7)	204.63 ***	153.26 ***
	N	33	32

Note: White's heteroskedasticity-consistent standard errors are given in parentheses.

***, **, *, and ⁺ indicate statistical significance at 0.1%, 1%, 5%, and 10% respectively.

Source: Cuervo-Cazurra and Aguilera (2003).

there is exposure to corporate governance practices as there is an important link between capital and good governance.

Overall, the speed of the development of the first code is explained by the transfer of knowledge across countries, transfer that is difficult because of the limitations on the use of practices developed in one legal system in another (Cuervo-Cazurra 1998; Cuervo 2002). Codes developed in each country tend to deal with similar aspects of corporate governance, particularly the need for checks and balances in the firm and the benefits from transparency and disclosure. However, their particular recommendations differ across countries in order to deal with differences in terms of corporate governance systems (Shleifer and Vishny 1997), ownership patterns (Bergloff 1990; Bebchuck and Roe 1999; Barca and Betch 2001), or stakeholder rights (Aguilera and Jackson 2003). The codes of good governance should not be taken as an indication of the convergence of corporate governance systems in different countries towards the Anglo-Saxon or any other model in particular. All countries need to improve their prevailing corporate governance system, enjoying different speeds in the development of the first code as a result of their particular characteristics.

The Issuers of Codes of Good Governance

Finally, we complement the analysis of the worldwide diffusion of codes of good governance with a description of the issuers of the codes. 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 types of issuer of codes of good governance into six categories: (i) stock exchange, when the issuer is the stock exchange or the overseer of the stock exchange (securities and exchange commission); (ii) government, when the issuer is the central or federal government or one of its ministries; (iii) directors' association, when the issuer is an association of directors; (iv) managers' association, when the issuer is an association of managers; (v) professional association, when the issuer is an association of accounting or law professionals; and (vi) 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.

Although codes of good governance are sets of governance practices that aim to improve corporate governance in the firm, the main objectives and the specific recommendations vary with the issuers. The power to enforce the practices in the firm also varies with the issuers, with different coercive, normative, and isomorphic pressures helping diffuse the codes across firms (DiMaggio and Powell 1983).

We divide issuers into four groups according to their perceived objectives in developing the codes. First, the stock exchange and the government are interested in promoting the development of practices that facilitate growth of capital markets in particular or of the economy in general. Unlike other issuers, these two actors have the power to impose codes of good governance on firms. They can enforce their recommendations when they transform codes into requirements for the listing of public firms or into laws for the creation of companies.

Second, investor associations are interested in the adoption of practices that facilitate their evaluation of the companies in which they invest. They can force firms to adopt the recommendations on the codes through their fiduciary power as representatives of shareholders, either themselves or individuals who provide the investment firms with money to manage. In addition to having the power to voice their disagreement with the way in which the company is run, they have the ability to exit the relationship with the firm if they dislike the current corporate governance. This second option, however, is not always available to passive investing firms that diversify their portfolio according to pre-established indexes.

Third, professional associations are interested in practices that aid their work and establish standards across companies, especially in areas of transparency and reporting. They have the normative power of imposing the

codes on the firm through the requirements of the professionals who work for the firm.

Fourth, directors' associations and managers' associations are interested in facilitating their work in the firm. Although on some occasions managers and directors clash, directors who are not direct representative of shareholders tend to be managers in other firms. This double nature of the directors, in many cases, aligns the objective of both groups towards developing codes that improve the governance of the company by establishing norms that reduce internal conflicts between the board and management. The double nature also helps in the transmission of corporate governance practices across companies related through common directors (Davis and Thompson 1994). Codes developed by directors' and managers' associations are normative in character. Alternatively, directors' and managers' associations may develop codes of good governance as a way to reassure shareholders of the ability of managers and director to police themselves, tying their own hands (Jensen and Meckling 1976). Their adoption across companies may be done, in addition to the normative pressures, as part of an isomorphic movement in which firms copy the practices of the better firms.

We analyze the relationship between the evolution of codes and the types of issuers in two ways: by the type of issuer of the first code in the country, and by the type of issuer of all codes in the country. Figure 14.2 shows the development of codes of good governance by type of first issuer in

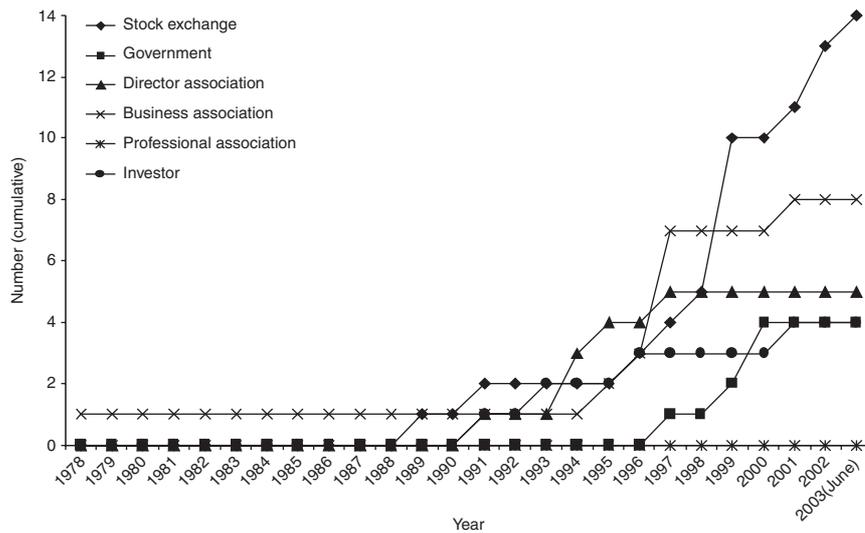


FIGURE 14.2 Dynamics of codes of good governance worldwide: Type of issuer of first code, 1978–2003.
Source: As for Fig. 14.1.

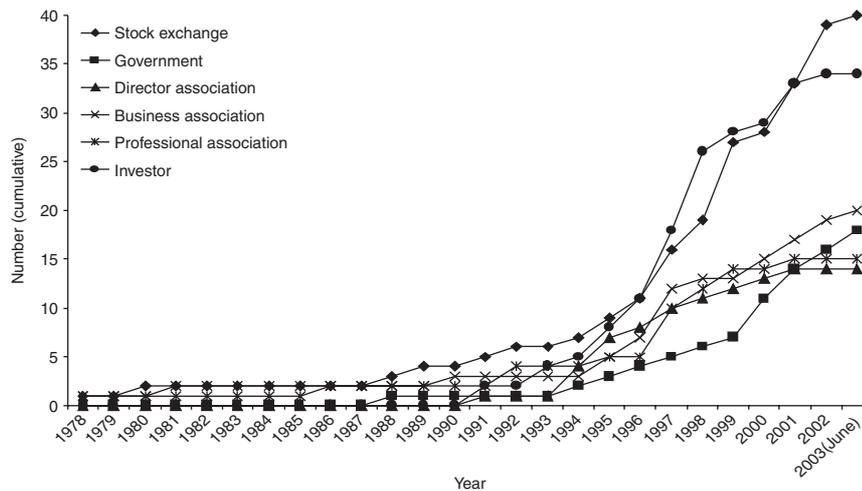


FIGURE 14.3 Dynamics of codes of good governance worldwide: cumulative type of issuer of code, 1978–2003

Source: As for Fig. 14.1.

the country. The analysis of Fig. 14.2 reveals that the type of first issuer has shifted over time as codes are developed in different countries. Managers' associations and stock exchanges conceived the initial codes, and they were succeeded by investors and professional and directors' associations that played a very active role particularly after 1992. Only in the late 1990s have governments issued codes of good governance; governments are more likely to issue enforceable laws than voluntary codes. Moreover, the issuer of the first code of good governance in each country reveals the active role of coercive issuers, particularly the stock market. The first codes in the country were issued by the stock market in fourteen countries, by managers' associations in eight countries, by directors' associations in five countries, and by investors' associations and government in four countries. Professional associations did not issue any first code. Therefore, the popular claim that institutional investors were the primary instigators of good governance (Useem 1996) is not supported by our data, though these investors may have pressured the stock exchange commissions to issue a code 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.

However, the analysis of the types of issuers of all codes—not only the first code of each country, as discussed before—reveals the active role of investors and investors' associations. Figure 14.3 illustrates the cumulative development of all issued codes of good governance. The main difference

from the conclusions of the previous arguments is the very active role of investors in developing codes of good governance. Although investors have generally not taken the lead in developing the first code, they have nevertheless showed great interest in the improvement of corporate governance systems through the use of the codes. Of the 141 codes developed by mid-2003, the stock exchanges had developed 40 codes while investors' associations had produced 34 codes. The other types of issuers had generated considerably fewer codes. Managers' associations issued 20 codes, a remarkable number given that the codes establish, in many cases, controls over managers' own behavior. Governments developed 18 codes, which do not include laws that were also created to accompany the changes in corporate governance in the country. Professionals associations generated 15 codes. Finally, directors' associations issued 14 codes, despite being the body that was subject to regulation with the development of the codes.

The importance of one or another type of issuer may depend on the legal system in which the code is developed. In the common-law system, 'good' business practices tend to reach the level of enforceability in courts, whereas in civil-law legal systems such practices do not have the enforceability in courts unless they become codified into law or are among the requirements for public firms (Cuervo 2002). This differential in enforceability may be reflected in the nature of the issuers. We explore this by looking at the information presented at the last three rows in Table 14.1. We study two aspects: the type of issuer of the first code in each country, and the type of issuer of all the codes. First, when we compare the nature of the first code issuers, we see that stock exchanges are by far the most common type of issuer in both groups of countries, although more often in countries with a common-law legal system, where they issued almost one in every two first codes. In countries with a civil-law legal system, managers' associations, directors' associations, and, especially, the government take a more active role in developing the first code, while in countries with a common-law legal system investors are more active. Second, when we compare the nature of the issuer of all the codes, we observe also differences across legal systems. The stock exchange takes a similar active role regardless of the legal system in the country, issuing almost three out of every ten codes. In countries with a common-law legal system, investors', directors', and professionals' associations take a more active role, however, while in countries with a civil-law legal systems, the government and, particularly, managers' associations take the lead in developing codes of good governance.

The type of issuer differs not only across groups of countries by legal system but also within each country. Twenty-four countries have more than one code of good governance. Only in two countries is the type of issuer the same. In the rest, the type of issuer varies within the country.

In sum, whereas the forces that influence the development of codes of good governance affect several countries, the specific nature of the codes

of good governance, in particular the type of issuer, varies across and within countries. Despite the apparent similarities in the development of codes across different countries, however, this does not indicate a convergence across corporate governance systems. All countries need to improve their prevailing corporate governance system. The codes help each country improve its current corporate governance system rather than converge towards another system. The continual development of codes among those countries that have already developed them and the differences in speed of development and types of issuers illustrate this argument.

Conclusion

In this chapter, we have analyzed different issues surrounding the diffusion of corporate governance practices around the world. In particular, we explore the worldwide diffusion of one corporate governance practice, namely, codes of good governance. These are voluntary guidelines with different levels of enforcement depending on the country where they are issued. Generally speaking, codes are developed in order to improve the country's corporate governance system to promote investment and growth. Even though there is a convergence in the issuance of codes in the 1990s, partly motivated by the spread of the focus on shareholder value and the internationalization of capital markets, our analysis goes beyond the convergence-divergence debate and looks at the specific mechanism triggering the development of codes, the speed of their development, and differences in types of code issuers. The study of these three dimensions demonstrates that, despite common environmental factors affecting all countries, each country is embedded in its individual path-dependent trajectory that will influence the reasons to enact codes, how fast, and by whom. In addition, from a preliminary content analysis of the different codes, we could also appreciate that the emphasis in their content is significantly different depending on the particular issues that they aim to address, ranging from family firms to shareholder relations. Finally, it is also noticeable that good corporate governance is a dynamic process requiring constant updates and improvements over time.

We argue that codes of good governance help to solve deficiencies in a country's corporate governance system (Aguilera and Cuervo-Cazurra 2004), although there is no indication that they are designed in light of a particular 'ideal type'. Moreover, we discuss the difficulties in the diffusion of practices across countries and demonstrate empirically that the speed in the adoption of the first code depends on the understanding of foreign knowledge, on the willingness to use foreign knowledge, and on the exposure to foreign knowledge, a factor not commonly discussed in knowledge transfer studies (Cuervo-Cazurra and Aguilera 2003).

This chapter is an important first step in the examination of the forces influencing the diffusion of new corporate practices around the world and

a test, as well as an extension, of the work of La Porta and colleagues (La Porta, Lopez-de-Silanes, and Shleifer 1999; La Porta *et al.* 1997, 1998, 2000) on corporate governance and control across countries. We explore these issues drawing on institutional theory and the knowledge-based view. These theoretical approaches allow us to explain diffusion patterns in terms of more than simple convergence-divergence arguments. In effect, we believe that the explosion of codes in the 1990s is a consequence of both divergence and convergence and the relevant questions are about the factors determining these organizational innovations at the country level. Finally, we provide a comprehensive analysis of the codes of good governance that complements previous studies on the determinants of development of the codes of good governance worldwide (Aguilera and Cuervo-Cazurra 2004). As such, this chapter opens new ground for research on the codes of good governance in particular and corporate governance practices in general.

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