The G-pillar in ESG: how to separate the wheat from the chaff in comply-or-explain approach?

Daniela Venanzi
Roma Tre University – Department of Economics

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Abstract

G-pillar seems to be the underdog of the fashionable ESG paradigm: old topic, no longer in fashion, over-analysed and time-worn matter (except when instrumental to E- and S- pillars). Under this perspective, companies might appear fully compliant to Corporate Governance (hereinafter CG) best practices: nothing more to be studied/discussed. However, many grey areas persist in CG systems under the façade of a full and aware compliance to the best practices: box-ticking and box-checking behaviours are the dark-side of the CG excellence. This study tries to verify if a gap exists between apparent and real compliance to CG Code requirements in a sample of Italian listed financial companies (mostly banks), with reference to two areas (independence of board members and transparency) that mostly make decision-making unbiased by conflicts of interests and are therefore crucial for corporate sustainability. We find opacity/obfuscation in CG narrative and avoidance/concealment strategies also in banks considered "CG champions", more rarely non-compliance clearly declared and appropriately explained. Through the lens of new institutionalist and resource dependence theories, we analyse the observed response strategies to CG Code requirements, try to explain them by means of their predictive factors, highlight visual and thematic manipulations (i.e., misleading rhetoric), and tentatively suggest implications for regulators/supervisors to reduce the gap and trigger more virtuous practices. The sample of Italian banks is only used as a pilot study to test the methodological approach proposed.

1. Introduction

The 2030 Agenda for Sustainable Development by United Nations (2015) considers the adoption of the best practices of Corporate Governance (hereinafter CG) a key-driver for a sustainable behaviour of companies to improve wealth and resilience of economic systems worldwide. In addition, ESG (Environmental, Social, Governance) approach has been becoming important in firms' management.

The G-pillar stresses (among others) the importance of independence of board members and transparency in favouring a decision-making not biased by conflicts of interests and oriented both to protect interests of all stakeholders and to pursue the superior goal of an organization. The internal governance mechanisms are the cornerstone in defence of current/potential minority shareholders' rights against expropriating behaviours from block-holders or all shareholders rights against executive directors/managers pursuing self-interests.
However, the compliance to the CG Code seems to be more apparent rather than real in some areas (Shrives and Brennan, 2015), producing a sort of *box-ticking* and *box-checking* behaviours to the Code requirements (those more easily applicable/verifiable), respectively by operators and supervisory institutions. It is worldwide observed more attention to formal/mechanical requirements and means/processes rather than conscious behaviours and focus on ends.

CG Codes (and the Italian Code among them) based on comply-or-explain approach (according to OECD, 2021, in 94% of the 50 jurisdictions analysed) give much flexibility, with companies able to choose whether to fully comply. Explanations for non-compliance with the Code requirements are the capstone of the 'comply-or-explain' system. The underlying rationale is that in CG practices the principle "*one size fits all*" seems not to be appropriate: CG Codes encourage companies to develop governance processes and practices that are the most suitable for their specific circumstances or characteristics. Some studies, however, rise doubts about the validity of a system that is self-regulated (Wymeersch, 2005) and is therefore open to abuse or favours deviations from the best practices (Arcot and Bruno, 2011).

However, non-compliance (if explained) is considered similar (and therefore legitimate) to full compliance (Codes do not apply sanctions in the case of non-compliance, but simply request explanation). However,

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specific argumentations (e.g., self-tailored) underlying non-compliance should be provided. The study of these explanations has been largely neglected and in general there are no sanctions when the content of these explanations is unsatisfactory, leaving readers to judge their appropriateness. However, the EU Green Paper (2011) on corporate governance framework request member countries to provide detailed guidelines about content and quality of these explanations. Moreover, the UK Financial Reporting Council (FRC, 2021) recently published a document intended to help companies improve transparency when reporting against the 2018 UK Corporate Governance Code and advise them on how to achieve good quality explanations when departing from the Code: these guidelines are a reaction to the emerging findings from a random sample of UK 100 companies, that showed that "*…too many companies strive to declare strict compliance with the Code. Such a formulaic approach leads to boilerplate language, and ineffective reporting that lacks substance and information about governance outcomes".*

In conclusion, *box-ticking*, and *box-checking* behaviours (from companies in complying and from supervisory authorities in controlling, respectively) continue to be preferred over high-quality reporting of good CG practices.

In this context, the objective of this study is twofold:

- to verify if a gap between formal and effective compliance (which represents a recurring feature in corporate scandals in 2000 and in the last financial crisis [1]) exists.
- to define a theoretical framework where the various corporate responses to CG Code requirements can be placed, also assessing quality and transparency of non-compliance explanations and of narrative in CG annual reports in favour of shareholders, stakeholders, and supervisory authorities.

We refer the analysis to:

- two important areas of CG principles: the independence of board members and the awareness/information degree of board decision-making (i.e., the terms of the pre-meeting board information). These aspects are that: *i)* the ESG paradigm focuses on; *ii)* are frequently non-complied (for example in Italy, according to the Italian 2021 CG Committee Report and Consob [2] Relations); *iii)* strongly and directly impact on quality and transparency of board decision-making; in fact, board members independence should guarantee unbiased (by conflicts of interests) decisions and the adequacy/promptness of board information should let the board be informed and aware in assuming decisions; *iv)* require pro-active behaviours: criteria to be set and correctly applied.
- a sample of Italian listed banks/ financial companies and their adhesion to the Italian 2020 CG Code [3]. The analysis is based on the contents of 2022 CG Annual Reports and related documents, manually elaborated. Empirical findings are not statistically significant (due to the small sample considered) but serve as a pilot study to test the methodological framework proposed.

The sample of Italian financial companies provides a very significant pilot case to be analysed for the following reasons:

- the Code adhesion of Italian listed companies appears satisfactory (CICG, 2021): 95% in number and 99% in market capitalization.
- the Code compliance seems good in average (72% of adherents, 78% of financial companies); however, from yearly Consob Reports (i.e., the supervisory authority), we can argue that the compliance to the CG Code appears to be more formal than effective, at least in some areas (box-ticking behaviour) (Balestreri and Venanzi, 2021): compliance to procedural/mechanical requirements more frequently occurs, whereas Code requirements that need substantial choices/behaviours and are crucial for decisions unbiased from conflicts of interests appear less accomplished or show opaque narrative. On the contrary, the storytelling by the issuers' Associations (ABI for banks, ANIA for insurance companies, Assonime for public limited companies, Confindustria for non-financial companies and Assogestioni for institutional investors) who are the dominant members in the Italian CG Committee, who formulate the Code and monitor its compliance, appears more optimistic.
- regulation in banking sector is more cogent than in other sectors: therefore, compliance should be more robust. However, in the past, many defaults of Italian banks (two banks in Veneto region and four banks in Central Italy) were related to their weak CG systems and decision-making biased by conflicts of

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interests; in addition, Bank of Italy is owned by banks under its supervisory authority (rare case in the world) and some past facts instil doubts about its real power (supervisory capture?) to contrast distorted behaviours from banking system (see, for example, the scandal about diamonds sold through bank channels or the 2015 Renzi Reform that obliged the largest cooperative banks to transform into public limited companies as an indirect/soft attempt to overcome their poor corporate governance structures).

- Italian CG Code gives clear as a principle but perhaps generic guidelines (in the Code introduction and related to all Code principles)[4] about the content of non-compliance explanations to be appropriate. This fact could favour behaviours of non-compliance not declared or disguised as compliance, and opacity in CG report narratives.

The paper is organised as follows: sections 2-3-4 analyse and discuss various theories that can explain compliance, non-compliance, and intermediate behaviours to the Code requirements. In section 5 the research design is discussed, and the sample of Italian listed financial companies (used as a pilot study) is presented. Section 6 reports a methodological framework of analysis, which grounds on new institutionalist and resource dependence theories, elaborated under the lens of empirical findings emerging from our analysis. Section 7 concludes and tentatively suggests some policy implications for supervisory authorities (Consob, BCE and Bank of Italy) to reorient their supervisory activities as well as triggering potential more virtuous behaviours in terms of CG practices from operators.

2. Theoretical basis of compliance/not-compliance behaviours

Agency theory is commonly called to explain disclosure, suggesting that company managers will want to provide explanations to suit themselves (managers act in a self-serving manner) but will need to demonstrate to shareholders that their corporate governance practices are appropriate. Many empirical studies (see Shrives and Brennan, 2015 for a short review) analysed the quality of non-compliance disclosures under the predominantly agency theoretical lens. As far as CG compliance is concerned, recent studies (see Fotaki et al., 2020 for a review of this literature field) focus on the mediation role of ethical values and instrumental values to CG effectiveness.

Signalling theory highlights the information asymmetry between users of financial reports and managers about their governance practices. Thus, managers should signal that their own non-compliant practices are of equal value to those required by the Code by providing detailed and bespoke explanations. The credibility of financial disclosures can be inferred from/signalled by governance disclosures.

However, research adopting agency and signalling theory explanations for disclosure tends to measure disclosure in a dichotomous manner. Therefore, if we aim at focusing on the quality of disclosure and the various kinds of organizational behaviours in a continuum from passive conformity to active resistance in response to institutional pressures, we need other theoretical grounds.

Institutional theory (DiMaggio and Powell, 1983) focuses on conformity, which is associated with survival, and therefore tends to suggest compliance. Companies may feel forced into compliance either to follow best practice or they may be reluctant to craft an explanation for non-compliance. This might suggest a long-term equilibrium of compliance among companies, something which could undermine the ‘comply-or-explain’ philosophy. Institutional theory suggests that managers may utilise several devices to make the non-compliance less visible particularly in companies which have high public visibility.

Resource dependence theory (Zahra and Pearce, 1989) suggests that companies (or their managers) will maximise the resources available to them. Resource dependence theory helps researchers understand why certain sections of the Code are not complied with and may predict where non-compliance is most likely. In fact, companies may prioritise certain key resources such as banking or legal expertise over compliance with the Code such as independence of non-executive directors. Resource dependence theory predicts that “*companies will view the function of the non-executive director more in terms of usefulness (to the company) than independence*” (as desired by the Code). If legitimacy is seen as a “resource” (DiMaggio and Powell, 1983), then resource dependence theory also helps to understand the approaches companies may take to hide non-compliance.

Borrowing from the integrated approach of institutional theory and resource dependence theory elaborated by Oliver (1991) and adapting it to CG Code requirements, we can better analyse compliance or non-compliance

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responses and intermediate behaviours, as well as tentatively identify the predictors of the likelihood that organizations will resist or conform to institutional pressures and expectations. We can derive the following five strategies.

The acquiescence strategy may take alternative forms: real compliance (conscious obedience to or incorporation of values/norms/institutional requirements) or imitation (mimetic behaviour). For example, when companies are tempted to mimic the behaviours of other actors or their explanations where they are unsure themselves how best to craft the explanation. The likelihood of acquiescence response is greater when: *i)* context is uncertain and strongly interconnected; *ii)* institutional pressures are voluntary diffuse; *iii)* economic gain perceived to be attainable from conformity to institutional pressures is higher and higher is the degree of consistency of institutional requirements with organizational goals.

The compromise strategy may include various tactics that result in a partial compliance, for example balancing tactics aimed to achieve parity among multiple stakeholders and internal interests or pacifying tactics, when organizations tend to conform to at least the minimum standards of CG requirements. The lower the degree of legitimacy and efficiency issues, the greater the likelihood of partial compliance; partial compliance is also likely when the consistency degree of institutional requirements with internal goals is moderate.

Avoidance and defiance strategies represent increasingly active levels of resistance to institutional pressures. Oliver (1991) defines avoidance as the organizational attempt to preclude the necessity of conformity. Concealment tactics involve disguising nonconformity behind a façade of acquiescence: this is the case of apparent compliance. Shrives and Brennan (2015) shows that a legitimacy issue might occurs when CG Code, notwithstanding the comply-or-explain principle, stresses interest only in compliance or non-compliance (i.e., rather than the explanation), driving companies towards compliance where it is inappropriate (e.g., misaligned with company objectives) or simply false. As far as more active forms of resistance are concerned, as defiance or challenge, companies simply choose to non-comply; therefore, the focus moves to rhetorical strategies of explaining it (see section 4). Manipulation, in Oliver (1991) framework, is the most active response to these pressures because it is intended to actively change or exert power over the content of the expectations themselves or the sources that seek to express or enforce them. Aluchna and Kuszewski (2022) state that in a CG context it is more appropriate to call this response *maneuvering*, that is like to an influence tactic, oriented to shape values and criteria, for example by the formulation of their own standards: their study reveals that companies openly admit non-compliance and explain their choice, more in an effort to convince and persuade stakeholders and justify their decisions than to resort to a strategy of overt manipulation.

Another relevant field of international literature on discretionary narrative disclosure put emphasis on motivations; two are important: opportunistic behaviour, (i.e., impression management), versus provision of useful incremental information. The most studies are preparer-oriented and therefore adopt an impression management perspective. A minority of studies, which include the user-perspective, analogously demonstrate that impression management is effective in the short term. However, although investors are initially susceptible to impression management, they subsequently revise their opinion based on additional information: it also seems that unsophisticated investors are more susceptible to impression management than sophisticated ones. Merkl-Davies and Brennan (2007) provide a systematic review and related annotated bibliography of this strand of literature.

Bowen et al. (2005) (as an isolated voice) find discretionary disclosure strategies to be indicative of both managerial opportunism and the desire to provide value-relevant information, suggesting that firms might pursue a mixed strategy.

In a corporate reporting context, impression management is regarded as attempts to control/manipulate the impression conveyed to users of accounting information. The impression management interpretation of managerial discretionary disclosure strategies is based on a weak form of market efficiency. This assumes that investors are unable to assess managerial bias in the short term. By contrast, the incremental information school is based on a semi-strong/strong form of market efficiency where investors can assess reporting bias. The efficient market hypothesis states that all market participants have rational expectations about future returns, which implies that, on average, the market can assess reporting bias.

Five theories provide the theoretical underpinning for these studies: agency theory, signalling theory, legitimacy theory, stakeholder theory, and institutional theory. Agency theory dominates this field of research.

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Both competing schools of thought (impression management and incremental information) use assumptions rooted in agency theory. The incremental information school presumes that managers provide discretionary narrative information to overcome information asymmetries between insiders and outsiders to lower the cost of capital, thereby enhancing share performance. By contrast, the impression management school explains managerial discretionary disclosure strategies as opportunistic and regards information provided by management as driven by self-interest. This opportunistic managerial behaviour has given rise to the so-called obfuscation hypothesis (Courtis, 1998), which assumes that managers tend to obfuscate failures and emphasize successes. Signalling theory fits in the context of the obfuscation hypothesis: whereas agency theory focuses on poorly performing firms, signalling theory focuses on the behaviour of managers in well-performing firms who signal this superiority by greater transparency in their disclosure and presentation of information. Within legitimacy theory, disclosures (particularly social and environmental disclosures) are hypothesized to alter perceptions about the legitimacy of the organization. Stakeholder theory is like legitimacy theory in that it regards firms' corporate reporting as a response to the demands and expectations of various stakeholders, such as employees, customers, government agencies, lobby groups, etc. Firms are assumed to engage in impression management to manipulate the perceptions of a particular stakeholder group. Institutional theory assumes that firms will conform to institutional expectations by adopting institutional norms. By adopting such norms, firms reduce inspection by internal and external constituents. Many differences exist among the five theories:

a) managerial incentives: they differ depending on whether managers are assumed to act opportunistically or to provide information-relevant discretionary disclosures.
b) addressed audience: in the case of both agency theory and signalling theory, investors are the audience for disclosures, whereas legitimacy theory, stakeholder theory, and institutional theory take society/stakeholders as the audience for disclosures.
c) performance: agency theory and signalling theory focus on financial performance, whereas legitimacy theory, stakeholder theory, and institutional theory focus more on social and environmental performance.

Some useful insights can be derived from this strand of literature in terms of disclosure quality applied to narrative used in CG reports.

If we focus on impression management strategy from the preparer perspective, we could presume that managers engage in one of two types of behaviour (both biased from self-serving motives):

- concealment, by either obfuscating non-compliance or diverting to positive aspects (bolstering)
- attribution: a sort of defensive tactic that shifts the blame for negative outcomes away from themselves.

Adapting the framework of Merkl-Davies and Brennan (2007) to CG report narrative, four strategies can be identified for concealment. Two of these obfuscate bad news by manipulating verbal information, either by increasing reading difficulty or adopting rhetorical manipulation; two strategies emphasise good news by manipulating verbal information, by means of thematic manipulation (manipulation of disclosure of information) and visual and structural manipulation (the way in which information is presented and the disclosure location into narrative). The reading difficulty is a proxy for obfuscation (Courtis, 2004a). In sum, preparers manipulate transparency by reducing clarity when they wish to disclose less about their underlying circumstances. Research focusing on rhetorical manipulation regards persuasive language as a proxy for obfuscation. It assumes that managers conceal negative organizational outcomes using rhetorical devices (see below section 4).

Thematic manipulation assume that managers conceal bad news by not reporting it, or by not reporting it to the same extent as good news; non-compliance that has not explicitly declared or disguised as compliance can be included in this kind of manipulation. Visual/structural manipulation can use different means: *i)* repetition, that adds noise to the reporting process; *ii)* reinforcement, when a piece of information is emphasised; *iii)* visual emphasis: firms use visual effects to make a piece of information more obvious to readers (for example, emphasis by highlighting, font style and size, bullet points, bold text, colour, etc.) (Courtis, 2004b); *iv)* ordering or physical location of information is used to direct readers' attention to or away from specific items of information.

Lastly, attribution (when interpreted from a self-serving perspective) tend to attribute positive organizational outcomes to internal factors and negative organizational outcomes to external factors; moreover, negative

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organizational outcomes are explained shortly and by using technical terminology, whereas positive organizational outcomes are fully explained by clear cause-effect statements.

3. Quality of CG Report narrative and rhetorical strategies of non-compliance explanations

In a comply-or-explain approach, the focus of analysis moves to the quality of non-compliance explanations.

This quality analysis builds on the more general "quality assessment" of corporate non-financial reporting.

Worldwide, narrative communication in annual reports is viewed as the crucial element in achieving the desired step-change in the quality of corporate reporting and regulators focus attention on the management discussion and analysis in the annual report. The extant literature adopts a variety of approaches to the analysis of narratives in annual reports: the implicit underlying construct of interest is generally the "quality" of disclosure.

Many ways of measuring disclosure have been employed: a long history approach has been to use researcher-constructed disclosure indices where the amount of disclosure is used as a proxy for disclosure quality. The major distinction to be made is that between subjective analysts' ratings and semi-objective approaches. Of the semi-objective approaches, some specify ex ante a list of items and scrutinise the text for their presence, ignoring sections of the text that do not relate to this list. This is the approach taken by the large body of disclosure index studies. It is a quite objective, form-oriented content-analytic method. Other approaches encompass all the text (textual analyses). They include thematic, meaning-oriented content analysis (where the whole text is analysed), readability studies and linguistic analysis. Beattie et al. (2004) elaborate a good synthesis of these different approaches and therefore attempt to identify some of the attributes of quality, suggesting observable proxies for measuring them and offering a tentative summary measure of disclosure quality, by using a detailed set of coding procedures and a computer-assisted methodology for implementation.

Considering more directly the quality of non-compliance explanations, Arcot and Bruno (2005 and 2011) identify (in a sample of 245 UK companies over seven years) six typologies of explanations of non-compliance, from the less informative to the most one: 1) no explanation; 2) generic explanation; 3) in-line: vague reference to the Code; 4) generic and poor details, not referred to the company; 5) transitory (temporary circumstances); 6) genuine: transparent and detailed explanation of non-compliance.

Shrives and Brennan (2015) propose a quality framework including seven components that impact understandability, comparability, readability, and completeness of disclosure: location, comprehensiveness, extent of mimicry, length, complexity, specificity, and attestation (i.e., verification as a stamp of quality).

A recent international field of studies (Shrives and Brennan, 2017 on UK firms; Achtenhagen et al., 2018 on Swedish firms; Thanasas et al., 2018 on Greek firms) try to identify the rhetorical strategies underlying the non-compliance explanations.

They implicitly hypothesise that the information content and the meaningful attitude of non-compliance explanations measure the CG quality better than checking the mostly formal compliance. CG quality is often measured through composite indexes, as for example Gomper et al. (2003) and Aggarwal et al. (2009). In Italy, The European House Ambrosetti *EG index* (2021) is considered a benchmark of CG quality[5]. However, this index necessarily tends to measure CG quality in terms of compliance to the most easily applicable and verifiable CG Code requirements. It is based on 5 key-areas (1-ownership structure; 2-board composition/functioning; 3-compensation/incentives system; 4-auditing and risk management; 5-sustainability governance), each one broken in a certain number of *key performance indicator*s (KPI), differently weighted to measure the total score. Obviously, many KPIs are related to the mostly formal and easily verifiable requirements, that is, process-oriented behaviours, that are applicable by companies and monitorable by supervisors in a mechanical way. For example, board composition/functioning area includes: *i)* number of independent board members; *ii)* board diversity; *iii)* number of board meetings; *iv)* participation rate to board and board committee meetings; *v)* average number of positions held by directors; *vi)* board self-evaluation.

The CG quality assessed by these indexes can hide a compliance more apparent than real (at least in some areas), favouring box-ticking and box-checking behaviours to the Code requirements (those more easily applicable/verifiable), respectively by operators and supervisory institutions.

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Shrives and Brennan (2017) taxonomy (built by analysing two samples of 100 UK companies in two different periods, when regulation and CG Code are changed) identifies nine rhetorical strategies in non-compliance explanations, in a continuum from meaningful rhetoric to misleading one: *i)* corrective action (already taken or promised); *ii)* bolstering: diversion to positive issues to overshadow the non-compliance; *iii)* minimization of negative feelings: non-compliance is likely to cause little damage, and the Code provision not complied with is trivial; *iv)* transcendence (i.e., "*the end justifies the means*"): the context of the action is altered by taking the view that non-compliance is necessary (i.e., see the bigger picture); *v)* attribution to external circumstances or internal factors; *vi)* ingratiation of regulators/supervisory institutions: to the audience this generates a type of legitimacy, because it implies the management/board are aligned with the developers of Codes; *vii)* self-promotion: where organizations promote themselves by claiming a level of competence or claiming that their behaviour is an example to others; *viii)* intimidation/challenge; *ix)* concealment/denial. Concealment is concerned with hiding or disguising non-conformity. Denial implies the event of non-compliance did not occur or that managers claim to be innocent of the event. This can make non-compliance appear to mimic compliance. Four concealment rhetorical sub-strategies are included in this typology: *i)* no reason given; *ii)* weasel words (words or statements that are intentionally misleading); *iii)* hunt the thimble (disclosure strategy where non-compliance explanations must be searched for); *iv)* no provision of code number.

4. Research framework and pilot study on Italian listed banks

The breakdown structure of this research is as follows.

Firstly, we try to verify if a gap exists between formal and effective compliance. We keep our analysis to two important areas of CG principles: the independence of board members and the awareness/information degree of board decision-making (i.e., the timing of the pre-council board information). These are aspects that: *i)* the ESG paradigm focus on (in addition to the compensation system); *ii)* are frequently non-complied (for example in Italy, according to the Italian 2021 CG Committee Report and various year Consob[6] Relations); *iii)* strongly and directly impact on quality and transparency of board decision-making: board members' independence should guarantee not biased (by conflicts of interests) decisions and adequacy/promptness of board information should let the board be informed and aware in assuming decisions; *iv)* require pro-active behaviours: criteria to be set, correctly applied and appropriately explained/monitored.

We consider a sample of 12 Italian financial companies that resulted as "CG champions" according to the CG *excellence index* elaborated by The European House Ambrosetti (2021). In detail, 9 financial companies that are classified at the top three places of the total index in the corresponding stock market segments [Generali, Unicredit and Intesa Sanpaolo in FTSE MIB, Anima Holding, Italmobiliare and UnipolSai in MID-CAP, and Banca Sistema, Equita Group and Dea Capital in SMALL-CAP], and further 3 companies among the top three positions of the partial index referred to board composition-functioning area [Finecobank in FTSE MIB, in addition to Generali e Unicredit, already included, Farmafactoring in MID-CAP (with Credito Valtellinese and Anima Holding)[7] and Banca Finnat in SMALL-CAP (together Banca Sistema and Equita Group, already included]. Banca Generali (Generali group) is also included since the Ambrosetti report doesn't say if it refers to the bank or to the group.

The assumed hypothesis is that the Ambrosetti index, like other composite indexes on CG quality, tends to focus on the more formal/procedural Code requirements (box-ticking), neglecting the more substantial ones, which demand for further analysis and active behaviour to be implemented. They are also requirements easily monitorable by supervisory authorities (box-checking). If a gap between formal and effective compliance would emerge, it can be interpreted as an early warning sign, useful to suggest an in-depth analysis of the real behaviours by banks and to derive policy implications, from the regulators and supervisors' perspective, to change course and introduce tools/incentives that better favour a real and not cosmetic compliance to the best CG practices.

The 2022 CG Reports of these companies are in-depth analysed[8], with reference to the last CG Code version (current from the 2021 financial year). The CG Code applies to all companies with shares listed on the Italian main market (MTA) managed by Borsa Italiana. Adoption of the Code is voluntary and is disclosed in the report on CG and ownership structures[9].

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The focus on financial companies (predominantly banks) allows to increase the robustness of the excellence score, because banking sector regulation is more cogent (than in other sectors) and many Italian Code principles are also rules of the sector regulatory framework (TUB[10], TUF[11], Bank of Italy 285 Circular, the implementing regulation of IV EU Directive on *fit & proper* and EBA-*European Banking Association* and ESMA-*European Securities and Market Authority* recent guidelines).

Empirical findings are not statistically significant (due to the small sample considered) but serve as a pilot study to test the methodological framework proposed.

The Code states the principles/recommendations shortly illustrated as follows.

As far as the board member independence is concerned (art.2, Principle 6, Recommendations 5-6-7), it defines a minimum number of independent directors[12] and lists in a very detailed manner the circumstances that jeopardise, or appear to jeopardise, the independence of a director as follows:

a) if he or she is a significant shareholder of the company.
b) if he or she is, or was in the previous three financial years, an executive director, or an employee: *i)* of the company, of its subsidiary having strategic relevance or of a company subject to joint control; *ii)* of a significant shareholder of the company.
c) if he or she has, or had in the previous three financial years, a significant commercial, financial or professional relationship, directly or indirectly (for example through subsidiaries, or through companies of which he or she is an executive director, or as a partner of a professional or a consulting firm): *i)* with the company or its subsidiaries, or with their executive directors or top management; ii) with a subject who, also together with others through a shareholders' agreement, controls the company; or, if the control is held by a company or another entity, with its executive directors or top management.
d) if he or she receives, or received in the previous three financial years, from the company, one of its subsidiaries or the parent company, significant remuneration other than the fixed remuneration for the position held within the board and for the membership in the committees recommended by the Code or required by law.
e) if he or she has served on the board for more than nine years, even if not consecutive, of the last twelve years.
f) if he or she holds the position of executive director in another company whereby an executive director of the company holds the office of director.
g) if he or she is a shareholder, quota-holder or director of a company or other legal entity belonging to the network of the external auditor of the company.
h) if he or she is a close relative of a person who is in any of the circumstances set forth in previous letters.

In addition, it asks the board to define ex ante the quantitative and qualitative criteria for assessing the significance of the situations set forth above in letters c) and d). If the director is also a partner of a professional or consulting firm, the board assesses the significance of the professional relationships that may influence his/her position and role within the professional or the consulting firm and in any event of those pertaining to important transactions of the company and the group it heads, even regardless of the quantitative parameters. Obviously, our attention is on: *i)* the ex-ante definition of appropriate criteria to assess the significance of both commercial, financial, and professional relationships and the additional received remuneration; *ii)* the adequate information to shareholders/financial market and transparency about their analytical application. In fact, the outcome of the assessments of independence of directors referred to in recommendations 6 and 9 should be disclosed in the CG Report. In both cases, the outcome of the assessment provides information about the criteria used for the assessment of the significance of the relationships and, in case of any deviation from the circumstances set forth in Recommendation 7, a clear and detailed reason for this choice motivated by the individual situation and characteristics of the director concerned.

As far as the adequate terms of pre-meeting information is concerned, the Code asks the board to define rules and procedures for its functioning, ensuring an efficient flow of information to directors (art. 3, Principle IX, Recommendation 11). These procedures identify the prior notice for the submission of the documentation, ensuring that confidentiality issues are properly managed without affecting the timeliness and completeness of the flow of information. The CG report should provide adequate information on these internal rules and on

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compliance with the procedures aimed at ensuring the timeliness and adequacy of the information provided to the directors.

Two further principles complete the explored areas:

a) the Code asks (Recommendations 13 e 14) that an independent director is appointed as lead independent director (LID) director if : *i)* the chair of the board of directors is the chief executive officer or holds significant managerial powers; *ii)* if the office of chair is held by the person who controls, also jointly, the company; *iii)* in large companies (capitalization larger than 1 billion euros), even in the absence of the conditions indicated before, if requested by the majority of independent directors;
b) the Code asks (Recommendation 5) that in large companies, independent directors meet, in the absence of the other directors, on a periodic basis and at least once a year to evaluate the issues deemed of interest to the functioning of the board of directors and to the corporate management.

The rationale underlying the last two requirements is to build communality and coordination of actions/behaviours among the independent directors, favouring their independence of mind, as wonderfully defined in EBA-ESMA guidelines (2018): "*Acting with independence of mind includes having the courage, conviction and strength to effectively assess and challenge the proposed decisions of other members of the management body, to ask questions to the members of the management body in its management function where the member judges it appropriate in the light of the issues and risks involved, and to be able to resist 'group-think"*. Reasonably, collective and coordinated actions/behaviours as well as resistance to group-thinking are stronger and can express with more courage and conviction than individual and isolated ones.

More in detail, the responses to the following questions are looked for in CG Reports:

1. is the numerical threshold of independent directors fulfilled?
2. are the qualitative-quantitative criteria to assess the significance of commercial-financial-professional relationships ex-ante defined?
3. are they consistent with the assessment of independence?
4. are the criteria to assess the significance of additional compensation (with respect to the remuneration for the appointment under evaluation) ex-ante defined and explicated?
5. are they consistent with the aim to assess the independence?
6. are provided clear and detailed information about the application of these criteria, at least for board directors whom any deviation from the circumstances set in the Code could be potentially hypothesised about?
7. is clearly communicated the appointment duration of the independent directors and the compliance to the 9-year threshold?
8. are the meetings reserved to independent directors planned/organized?
9. was the LID appointed? Is it clearly explained the reason of non-compliance or avoidance?
10. are non-compliance (total or partial) or avoidance clearly declared when it occurs?
11. are the pre-meeting information terms ex-ante fixed?
12. are they appropriate, if compared with proxies of complexity (size, number, duration) of board meetings?
13. are they ex-post complied?
14. in which situations are they not complied?
15. are any offsetting mechanisms provided in these cases?
16. is the annual CICG letter discussed in detail[13]?
17. are compliance, non-compliance, partial compliance, or avoidance/concealment highlighted comparing current practices with CICG letter? are any corrective actions adopted because of this comparison?

Secondly, we try to place the emerging behaviours in response to the considered CG code requirements into a theoretical framework, using the lens of theories discussed before in section 2. An integrated approach of new institutionalism and resource dependence theory is adopted and the observed breaches/quasi-breaches by the CG Code are placed in it, also discussing if and how they could be explained in terms of predictive factors that theories assume. In this step, we add to the above sample further 10 Italian listed banks[14] that declare their adhesion to the CG Code, maintaining the distinction between champions and non-champions (Banco BPM, Banco Desio-Brianza, Bper, Banca Mediolanum, MPS, Banca Profilo, Mediobanca, Credito Emiliano, Banca Intermobiliare, Illimity Bank).

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Therefore, we try to highlight in parallel: *i)* the main rhetorical strategies utilised in CG reports narratives, following the taxonomy by Shrives and Brennan (2017) as forms of thematic manipulation; *ii)* the quality of non-compliance explanations and, from a more generally perspective (since in our pilot study rarely non-compliance is explicitly declared) the transparency degree of narrative in CG annual reports; in sum, the quality of disclosure in CG reports (with reference to the Code areas here analysed). We interpret flaws in quality (in terms of location, completeness, complexity/readability, specificity, etc.) as forms of manipulation in presentation by using visual/structure tactics. We prefer to qualitatively assess these features, avoiding quantitative indicators (often adopted in literature) for two reasons: the sample is limited in number (i.e., a manual assessment is feasible and likely unbiased) and a qualitative assessment might be more accurate although more subjective.

5. Empirical findings and discussion

5.1. Formal or effective compliance?

The main emerging results are here discussed, with prevailing attention, at this step, to the "CG champions" according to the Ambrosetti excellence index. However, information about the "non-champions" are provided (but distinguishing), to complete the picture.

Numerical threshold of independent directors

The numerical threshold is generally fulfilled (as expected); in many cases the number of independent directors exceeds the Code threshold. In the analysed reports the strong presence of independent directors is emphasized (impression strategy). However, often some directors are independent according to regulation (TUB and TUF), but not according to the Code (where requirements are more strictly and defined in a more detailed manner): therefore, in some cases the abundance is more apparent than effective. Some CG reports confuse/mismatch the independence requirements from difference sources and various inconsistencies are observed in different report sections. In two cases, the independence is doubtfully assigned since a shareholder (whom independent-defined director relates to) is considered not significant. This seems a weakness of the Italian Code, that doesn't fix quantitative threshold (Balestreri and Venanzi, 2022) for shareholder significance: this approach favours flexibility but, meanwhile, leaves too room to discretion that might become avoidance. According to the Italian Code, a significant shareholder is generically defined as "*…the person who directly or indirectly (through subsidiaries, trustees or third parties) controls the company or is able to exercise significant influence over it or who participates, directly or indirectly, in a shareholders' agreement through which one or more persons exercise control or significant influence over the company*". In these cases, the shareholder holding more than 5% of voting rights is considered not significant, although he/she is a relevant shareholder (among three), and 5% is the threshold adopted to define the related party transactions.

Definition of qualitative-quantitative criteria to assess the significance of both commercial-financial-professional relationships and additional compensation and their appropriateness/consistency.

In general, both quantitative and qualitative significance criteria are defined, except in a few cases (the two largest banks among them), where only generic and qualitative criteria are reported: quantitative thresholds are omitted (they explain) since they would prompt inadvisable automatisms. This is an example of challenge strategy, which highlights alleged weakness of Code requirements and opposite their own standards.

The quantitative thresholds are variously defined in terms of absolute amounts or relative amounts, referred to various kinds of reference basis. Often the reference basis is not appropriate: the significance of financial/ professional/commercial relationships should be related to revenues/assets/liabilities of the independent directors, not of the company or in absolute terms: the capture effect that undermines the independence regards board members. Analogously, the significance of the additional compensation should be linked to the fixed compensation for the position under assessment: relevant and pecuniarily gratifying internal appointments can lead the independent directors to pander the executive directors/decision-makers (who frequently assign the internal positions). In some cases, while the reference basis is appropriate, the threshold exceeds the reasonable value suggested by the CICG. Cases of non-compliance or partial compliance or apparent compliance are never explicitly declared.

Transparency and details about the application of the significance criteria

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The application of these criteria is narrated in a very opaque manner in many “CG champions”. The storytelling often uses a notarial and peremptory style: attestations are provided that the criteria have been applicated, independence declarations have been collected, details are provided about timing/scheduling of the conducted audits, etc. Except rare cases, no information is provided about the criteria application to the concrete profiles of directors defined independent. The reader is left alone to look for the necessary information inside the CG report to check the respect of the declared criteria: sometimes, the profiles of board members aren’t even provided into the report (or provided in different sections of the CG report: scattered location). Obfuscation prevails, also in the cases when doubts about independence might arise, for example directors who are CEOs/top managers of non-financial firms, potentially borrowers of the bank, or when several roles (over a long time) in subsidiaries/associated companies within the group are listed in their curricula.

Disclosure on appointment duration of the independent directors and compliance to the 9-year threshold

According to supervisory authorities (from various years CICG and Consob Reports) the 9-year threshold is the most violated circumstance in independence assessment. In our analysis, rarely it has declared as a requirement and no information are generally provided. The reader (if aware about the provision) should look for the date of the first appointment inside the report: some banks give the date, two “non-champions” give erroneous dates (dates of birth instead of first appointment). Often the distinction of independence according to law or code hides this requirement (TUF doesn’t request the 9-year constrain). In one “champion” company, the threshold is violated in the tail of the appointment for two directors.

Meetings reserved to independent directors

In 10 cases on 13 only one meeting is done. Among the champions: in a bank the frequency is the same of board meetings; another bank refers none meeting and doesn’t declare the non-compliance (no code reference is provided) but diverts attention to positive issues: many independent directors are already present in the board and internal board committees (rhetorical strategies of bolstering and minimization or negative feelings). In general, among the “non-champions” more meetings than one is the rule. The emerging impression is that this instrument is seen more as a constraint rather than an opportunity (see the following point).

LID appointment

LID seems to be a tool scarcely used by CG excellent banks. Only one (not large) appoints him to comply to the Code. The other non-large banks do not name him since not requested by the Code. Even six large companies do not name him, complying with the Code (four detail what are the requirements, among which it is also included the non-request by the independent directors). One company does not appoint him despite its chairman is non-independent and has been holding executive roles in the parent company for over 10 years (the same occurs in two non-champions banks). Finally, it is surprising the case of a large and concentrated company (among champions) which, in explaining the non-appointment of the LID, refers to the (looser) requirements of the previous version of the Code: non-compliance occurs (neither recognized nor highlighted) by the company due to the more detailed version in force from 2021 (to which the company declares to adhere), since the chair is CEO of the parent company. Compliance for eight non-champions: present in four cases, not present in the remaining four.
Although the strict compliance to this requirement is generally observed, the spirit of the Code seems to be neglected. As said above, in large companies LID is recommended as a reference tool/coordination of the independent directors. The evidence here reported (absence of LID, also when chair is not independent) seems to reinforce what said earlier about meetings of independent directors only, to which these tools is related: it is perceived by companies more as a constraint to be respected rather than an opportunity to be seized to make the action of independent directors more incisive and coordinated.

Ex-ante setting and appropriateness of pre-meeting information terms

The adequacy of the terms for providing information to support the decision-making of the board members is a crucial variable for the quality and transparency of the decisions taken, also considering the complexity of the board agenda. All the companies in the sample report to set ex-ante the terms (not in one fifth of the non-champions): in the most virtuous cases 5 days, on average 2-3 days. Given that the adequacy depends on how dense the agenda of the board meeting is and how complex the decisions to be taken, it is surprising that longer terms are not adopted by the larger companies, in which, moreover, the complexity of the issues dealt with and the decisions to be taken can be inferred by the frequency of the board meetings and their duration. All mention the exception in cases of urgency: closer terms, even the day before or generically "as soon as possible" or

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even during the meeting, assigning to the chairman (even when not independent) the information to the members of the board. Interestingly, some companies (including those with shorter terms) ensure that the terms have been assessed adequate by the board itself (as an attestation).

Ex-post compliance of terms and explanations/offsetting mechanisms when not complied

The picture does not improve if we look at the ex-post compliance with the terms: some companies do not report about it, in fact being non-compliant with the Code, but hiding the non-compliance. Others use generic formulas: as normally, on average, generally, substantially respected, or except in cases of justified reasons. Two companies cite, minimizing, some exceptions to compliance with the terms occurred during the year, which, alas, concern crucial decisions such as the evaluation of the strategic plan, the financial results of the period, key phases of extraordinary transactions, when timeless information seems essential. Explanations of non-compliance with deadlines are either omitted or related to general confidentiality reasons, which are inconsistent in themselves, as the 2021 CICG Report clearly points out, since the confidentiality obligations that already weigh on the members of the corporate bodies and incongruous with expressly declared practices to use online platforms to ensure additional level of protection. Weasel words are used by a non-champion: it refers the change of its internal standards to comply with the Code that refuses confidentiality as reason of violating timeliness, but the new rule (external to CG Report) contradicts the Code provision and emphasizes the urgency exception.

Clear declaration of (total or partial) non-compliance or avoidance

As said above, despite our analysis regards CG champions according to the Ambrosetti excellence index, there are still many areas of non-compliance, which concern the director independence, the criteria for ascertaining it and their application, the tools for coordinating the action of the independents (exclusive meetings and LID), the terms of the pre-board disclosure. Non-compliance, however, is only rarely declared with explicit reference to the recommendation/principle of the Code violated. And this even in cases when the text of the Code or the relevant legislation is reported in detail. The explanations provided when adherence does not comply with the Code are generic, give reasons not relevant to the *rationale* underlying the principle, minimize negative feelings.

Discussion on annual CICG letter and detailed follow-up

This event could be considered a litmus test of how the process of adherence to the Code is consciously pursued or, rather, a formality to be fulfilled: the feedback (although not specifically referred to the recipient of the letter but to the majority of observed behaviours) by the CICG could in fact represent an important opportunity for self-verification and fine-tuning of own adherence to the Code. It could belong to the implementation/administration steps of a code process, that international literature considers factors influencing the code effectiveness (Schwartz, 2004). Four different types of behaviour on this point are observed. The most opacity (about 40% of both champions and non-champions companies) consists of a few lines of reference to the letter without comments other than a generic reference to compliance with the various principles, as detailed in the Report (Shrives and Brennan speak in this case of *hunt-the-thimble disclosure,* as a variant of the concealment strategy): we can call this behaviour “quite quitting”, since it represents the minimum effort to comply the CG Code. One champion, however, doesn’t give any information; as a variant (in two champions), a generic and strict reference to the letter is done, used as a self-promotion strategy (such as: we-are-the-best). The more virtuous case (40% champions vs 20% non-champions) shows maximum transparency and disclosure: the indications provided in the letter and the actions taken in response are explained in detail. The third case (40% of non-champions) is somewhere in between: more or less generic indication of the areas recalled in the letter, affirmation of absence of criticality and of total compliance. One bank (non-champion) adopts and ingratiation strategy: it praises the new version of Code for its innovative scope but defers to the future a better compliance to it.

The analysis conducted has obvious limitations: limited sample and only two areas of CG analysed in depth. Nevertheless, as regards the “champions” companies, the reality that emerges (not at all reassuring) could at least instil doubts about how effective the compliance to the Code of Italian financial companies and the quality of their CG are (ten years after similar results by Di Battista et al., 2014). In fact, despite the high score achieved by the companies investigated in the Ambrosetti EG index and the fact that they are financial companies, under the regulatory radar, many areas of limited (only formal?) application of the principles/criteria of the Code emerge, or at least frequent behaviours of opacity/obfuscation in informing

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shareholders and financial market about it as well as in explaining the reasons for avoidance/non-compliance: the gap between effective and formal compliance to CG Code incontrovertibly exists.

5.2. Response behaviours to CG Code pressures and predictive factors

As discussed in § 2, many theories are available to explain compliance/non-compliance to CG principles/recommendations. It is no coincidence that in this field a "*pick'n' mix*" approach by academics is frequently reported.

Figure 1 shows a theoretical framework to locate the response behaviours emerging from the empirical analysis conducted on a sample of 23 Italian listed financial companies (predominantly banks), based on their 2022 CG Reports, as discussed in § 6.1. It proposes an integrated framework, by mixing the new institutionalist and resource dependence theories. These two theories, in fact, better than others (agency or signalling), can explain intermediate behaviours from full compliance to non-compliance, more frequently observed in our analysis on Italian banks rather than the behaviours at the extremes of the continuum. As just said before, the empirical findings only serve as a pilot study (i.e., exemplifications) to contribute to the definition of a methodological taxonomy. We consider here the whole sample (champions and non-champions companies), put attention only on independence and transparency areas of the Italian CG Code and focus the representation in the scheme on the not fully compliant behaviours. For the areas of Code analysed above (in the rows) and response behaviours/strategies (in columns), in a continuum from full compliance to non-compliance explicitly declared, the breaches/quasi-breaches are placed, distinguishing champions from non-champions, when significant differences are observed. In addition, we indicate the predictive factors corresponding to the different behaviours, adapting them to our analysis on CG practices.

The acquiescence may be real compliance or mimetic behaviour. Mimetic behaviour seems to be inconsistent with "comply-or-explain" framework since the act of non-compliance implies the company is unlike other typical companies. Since the circumstances of each company are inevitably different, behaviours should be tailored, and disclosures/explanations should be bespoken and specific. However, we can observe mimicry in a compliant behaviour: number of independent directors larger than Code threshold, although for some of them the independence is based on regulation (TUF) requirements, looser than Code. We can define this occurrence as an impression behaviour: the presence of independent directors appears a diffuse, consistent, and legitimating attribute of an unbiased decision-making process, which cannot but be complied, no matter how really independent.

The compromise strategy may include partial compliance, for example balancing tactics aimed to achieve parity among multiple stakeholders and internal interests: in the case of banks, regulators are one of the main stakeholders and their goals (i.e., safety and soundness) may collide with those of the other stakeholders (i.e., value maximization). Multiplicity of conflicting pressures is a predictor of response to institutional pressures: when multiplicity is high, compromise, avoidance, defiance are likely responses to institutional pressures. From a resource dependence perspective, an organization also will be driven by its own interests to reduce the uncertainty, conflict, and instability that multiplicity generates. In the same vein, pacifying tactics can be observed when organizations tend to conform to at least the minimum standards of CG requirements, for example "quiet quitting" behaviours in LID appointment or exclusive meetings of independent directors: companies strictly respect the Code principles, but don't seize the opportunities underlying the Code recommendations, enhancing the potential advantages. Analogously, we can classify in this strategy the observed cases of banks that state significance criteria for independence of directors, but apply them with opacity, balancing among Code recommendations (criteria are requested, but requirements in application/implementation are vaguer), demand of transparency by shareholders and internal interests (a few deviations or case-by-case application can give the necessary flexibility to avoid). Similarly, exceptions to the pre-meeting information terms (shorter terms or ex post violations) leaves some discretionary power to the company.

Avoidance includes a range of possible behaviours: obfuscation in terms of non-compliance not explicitly declared or disguised as compliance (this is the case of apparent compliance). Many observed behaviours in Italian listed banks can be classified in this strategy, both for independence and transparency areas: significance criteria omitted but not declared as omissions, inconsistent criteria, etc. Relevant predictors of avoidance/concealment (with respect to full or partial compliance) are diffusion, consistency, and efficiency.

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The legitimacy goal shouldn't be relevant in this context since non-compliance (when appropriately explained) is entirely legitimate within the "comply-or-explain" framework. Legitimacy issues, however, would arise if explanations are defective or missing. The diffusion (voluntary in our case) of a consistent basis to define significance criteria for independence is moderate: not formal/explicit guidelines are indicated by the Code, only some vague suggestions are provided by the CICG.

As far as efficiency (positive impact on performance/risk) and consistency (to the organizational goals) are concerned, we can have practices driven by self-interest of executives/managers: apparently independent and uninformed directors favour approval/consensus to their decisions, according to agency theory approach.

However, the choice of avoidance/concealment strategy can also be explained when behaviours are not distorted by conflicts of interests but motivated by perceived inconsistency of good CG practices with the goals of organization. Pressures impose a loss of decision-making discretion to an organization: organizations will be more willing to acquiesce to external pressures when these pressures or expectations are compatible with internal goals.

Generally speaking, the international evidence shows statistically significant positive effects of good practices of CG on market performance (equity returns, M/B ratio, Tobin's Q, etc.) and quality of decision-making (see Balestreri and Venanzi, 2021, for a systematic review). However, in the case of banks, empirical findings are less univocal (Fernandes, 2018). Banks have special characteristics that increase corporate governance problems and might reduce the effectiveness of many traditional governance mechanisms. First, banks are generally more opaque than non-financial firms and their activity is more complex. Moreover, banks can alter the risk composition of their assets more quickly than most non-financial industries and such change might not be immediately noticeable to directors or to outside investors. In sum, both the complexity and opacity of the banking business increase the asymmetry of information and diminish the capacity of stakeholders to monitor the decisions of bank managers. Hence the role of boards as a mechanism for corporate governance of banks takes on particular importance in these circumstances: the board becomes a crucial mechanism to monitor and advise managers.

Empirical literature shows a not univocal impact of board characteristics on performance. In other words, certain features of boards reflect the motivation and ability of directors to effectively perform their supervisory (monitoring and advising) and advisory duties (coordination, control, and decision-making problems). The trade-off perspective on board capabilities argues that firms attempt to balance monitoring and advising functions primarily by adjusting the proportion of inside versus outside directors. Outside directors contribute mainly to the monitoring role because they are independent of management. On the other hand, inside directors contribute primarily to the advising function because they have more firm-specific knowledge, critical to mitigating problems arising from information asymmetry between board and management. Therefore, no significance impact of number of independent members on bank performance or an inverted U-shaped relation (negative sign beyond a certain weight of independents) are observed. Similarly, in the case of CEO duality (or a non-independent chair), the entrenchment theory conflicts with the efficiency theory; in critical scenarios, duality may offer a clear direction of a single leader and a faster response to external events; in addition, CEO duality negatively affects bank risk-taking due to his/her non-diversifiable wealth (human capital and fixed compensation). Furthermore, we can agree that the strict and effective performance of both the monitoring and advisory roles depends on the experience of directors particularly from the point of view of risk management. Effective monitoring of bank managers may involve industry-specific knowledge which depends on experience. Director experience depends on tenure, and this is a possible (assuming good faith) explanation for considering the 9-year threshold as a requirement inconsistent with the organization goals (as far as the director busyness).

Compromise and avoidance strategies are predicted to be most common when there is only moderate consistency between organizational goals and institutional pressures; defiance and manipulation strategies are predicted to occur most frequently when consistency is low. The loss of organizational freedom implied by conformity to institutional pressures is also hypothesised to predict the likelihood of organizational resistance or compliance to conforming pressures: compliance is a loss of discretion, a constraint, and an admission of limited autonomy. It is interesting to see that in our analysis, the most resistant behaviours come from the larger financial companies, that have bargaining power to contrast Code requirements, in defining only

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qualitative criteria (i.e., more flexible to specific circumstances) to assess significance of relationships/additional compensation and explicitly declare their non-compliance, challenging the CICG provisions and opposing their behaviours, promoted as more virtuous.

Manipulation can be included in this strategy, in terms of presentation tactics (visual manipulation) or rhetorical strategies (thematic manipulation), that contribute to hide non-compliance or disguise it as compliance. Biased presentation of disclosures refers to the various aspects of quality of CG narratives (see § 3 above); thematic manipulation refers to rhetorical strategies (Shrives and Brennan, 2017) and persuasive language oriented to the same objective: both are instrumental to obtain obfuscation.

Visual manipulation refers to quality of disclosure presentation, considering various aspects that can influence understandability, readability, completeness of the provided information, specificity of argumentations to explain not full compliance. In this study the text analysis has been manually conducted and many practices are observed in our sample as examples of visual manipulation, that alter the readability of disclosures: *i)* scattered vs unique information: the same topic is analysed in different sections, providing in different points of the Report (sometimes not precisely identified) the necessary information; *ii)* less/no conformity to the available Consob facsimile of CG Report, which also indicates the styles of the boxes where to respond to the different principles/criteria and indicate/explain any total or partial disapplication. Larger companies are those which less conform to the Consob facsimile: a negative link between adherence rate and size has emerged; the largest financial companies adopt a flashy layout of their CG Report, as a sort of marketing tool; *iii)* the hunt-the-thimble and CVs hunting strategies: generic references (unspecified points) to report text or external documents make hard for readers to find disclosures and the company is not completely transparent. Quality is often linked to the length of disclosure narrative: telegraphic disclosure could be omissive, longer disclosure requires more effort. In our sample the average length is 102 pages, and a positive link has emerged between report length and company size, with exceptions: the longest report of 150 pages from a small bank (FarmaFactoring) and a minimum of 50-60 pages from two large banks (Anima and Italmobiliare). However, more than length, the narrative structure affects readability: the use of schemes, summary tables, etc. (for example, Banco Desio Brianza) could make the narrative more understandable rather than long, chatty, repetitive narratives (for example, Banco BPM).

Thematic manipulation refers to bias of themes or emphasis on positive aspects and omission/weak information on negative aspects. Some strategies from Shrives and Brennan (2017) taxonomy are indicated in the framework, as far as they are observed in CG reports (see § 6.1 above).

As far as more active forms of resistance are concerned, as defiance, companies simply choose to non-comply; *maneuvering* response is like to an influence tactic, oriented to shape values and criteria, for example by the formulation of their own standards: companies openly admit their non-compliance and explain their choice, to convince/persuade stakeholders and justify their decisions: the case of the two largest banks that refuse to state quantitative criteria of significance and (simultaneously) promote their own datasets on relationships/positions of board members.

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Figure 1 – Response behaviours to CG Code requirements

Emerging breaches/quasi-breaches from total sample of 23 Italian listed financial companies (mainly banks) are reported in correspondence to various areas of CG Code (in rows) and response behaviours/strategies (in columns), according to institutionalist/resource dependence theories. Orange colour is used if "CG champions" prevail, blue if "CG non-champions" prevail. Green colour when difference is not significant. The colour intensity shows how much each behaviour is frequent. Predictive factors are also indicated in correspondence to the categories of responses to Code provisions.

	acquiescence		compromise	avoidance/concealment				defiance/ maneuvering	
	full compliance	mimicry	partial compliance	obfuscation (non-compliance not declared)	obfuscation (non-compliance disguised as compliance)	visual/structural manipulation	thematic manipulation	non-compliance explicitly declared	superiority of own standards/practices
independence of directors						no conformity to facsimile/special effects	self-promotion		
significance criteria for commercial, financial or professional relationships			defined but opacity in application (attestation)	not defined/omitted as code requirement	defined but not explicit/inconsistent criteria	curricula hunting	challenge	quantitative criteria not defined	qualitative analysis/own dataset
significance criteria for remuneration other than the fixed remuneration for the position			defined but opacity in application (attestation)	not defined/omitted as code requirement	inconsistent criteria				
number of independent (TUF vs Code)		over threshold			mismatching on independence requirements	confusing/contradictory definitions /scattered info			
nine years threshold				omitted requirement no info		hunt the thimble (first appointment data)/erroneous info	bolstering	corrective action planned	
lead independent director			absent when chair is not independent	absent when chair is a significant shareholder			erroneous code version		
meeting reserved to independent directors			quiet quitting				bolstering/challenge		
terms of pre-meeting information						no conformity to facsimile/special effects			
ex-ante settlement			shorter for urgency/ confidentiality	case-by-case basis no information	not adequate				
ex-post respect			normally	no information	not always (key-topics)		weasel words (change of practice disguised as compliance)		
offsetting mechanism			non-independent chair (during the meeting)						
predictive factors									
uncertainty	high		high	high				low	
interconnectedness	high		high	moderate				low	
multiplicity	low		high	high				high	
diffusion	high		high	moderate				low	
consistency	high		moderate	moderate				low	
efficiency	high		low	low				low	
legitimacy	high		low	low				low	

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6. Main findings and policy implications

The analysis above shows that a gap between effective and formal compliance in the sample of Italian listed financial companies, which are considered "CG champions" by The European House Ambrosetti EG index exists: many areas of partial compliance, obfuscation (non-compliance not declared or disguised as compliance), visual and rhetorical manipulation, non-transparency in CG narrative. Therefore, it is time to overcome box-ticking and box-checking behaviours and to assess the effective responses to Code requirements and to go beyond the formal verification, catching the reality/seriousness of behaviours.

We observed more occurrences of avoidance/concealment or partial compliance rather than non-compliance explicitly declared. Probably, the legitimacy issue is perceived as relevant, although it shouldn't be in a comply-or-explain approach. We think that more focus by regulators/supervisors about requirements of a good explanation of non-compliance and related guidelines could favour full disclosure of non-compliance: companies might be uncertain how/when to be legitimate to non-compliance. However, companies could prefer to simulate compliance, since to craft convincing explanations is time-spending or since obfuscation allows to maintain grey areas, case-by-case approach, flexibility in application, degrees of freedom.

We observed partial compliance in assessing independence: significance criteria are stated, but opacity in application is frequent: notarial and peremptory style is used, attestations are provided that the criteria have been applicated. Supervisors should demand companies to explain with maximum transparency in their CG Report the detailed and specific application of the predefined criteria of relationships/additional compensation significance to each director, at least in grey areas: better a smaller number of independents, but really independent.

In general, avoidance/concealment strategy could be driven by self-interests or biased goals, but not necessarily: also, by lack of conviction that some CG best practices are consistent with organization goals or favour better performance, less risk or higher quality of decision-making. Shifting attention from the means to the ends might be a solution of this problem, for example by increasing awareness/verification of the virtuous effects of best practices on performance/risk, asking companies to define, measure and monitor (over an appropriate time span) the expected impact (by macro-areas of GC principles and practices) on performance, risk reduction, quality of decisions taken: it is certainly not an easy task, but it could induce and stimulate banks to pay greater attention to the opportunities that a good governance could allow. In parallel, supervisory authorities should stimulate/develop empirical studies/research useful to support the beneficial impacts on organization of CG best practices and virtuous behaviours suggested by Code principles.

"Quite quitting" behaviours prevail in adopting LID and only independent meetings (although strict compliance to the Code requirements occurs). The Code should emphasise the benefits from these two tools: to build communality and coordination of actions/behaviours among the independent directors, favouring their independence of mind; in fact, collective and coordinated actions/behaviours as well as resistance to group-thinking can be stronger and can be expressed with more courage and conviction than individual and isolated ones. Moreover, Code should strengthen the use of these tools, suggesting stricter recommendations, for example, to appoint a LID when chair is not independent, to do more only independent meetings than one in a year, to apply the same provision also to non-large companies (does risk of apparent independence depend on company size?).

A few tactics of visual manipulation occur, as curricula hunting, scattered disclosures, hunt the thimble, code provision number omitted, code version erroneous, etc. Consob/CICG could define which relevant information should necessarily be disclosed in CG Reports. Is the Consob facsimile of CG Report (which indicates the styles of the boxes where to respond to the different principles/criteria and indicate/explain any total or partial disapplication) useful to improve readability/completeness of CG narrative? Might it be perceived yet as another formal requirement to mechanically comply with?

As far as the CICG President yearly letter is concerned: could its discussion be considered a litmus test of how the process of adherence to the Code is consciously pursued or, rather, a formality to be fulfilled? A virtuous example is the case of Banca Desio Brianza, a non-champion in our sample, which: *i)* discussed in-depth the letter during a meeting of only independent directors; *ii)* compared it with CG practices adopted; *iii)* derived actions to improve compliance; *iv)* reported feedback to the board. Feedback by the CICG could represent an important opportunity for self-verification and fine-tuning of own adherence to the Code: this virtuous

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behaviour should be stimulated by the Code. However, in this vein, the letter could be not generic but tailored to the specific non-compliance/avoidance/concealment behaviours of the recipient.

Finally, it should be noted that the independence verified according to the criteria defined by the Code (and on the basis of the significance criteria set by the company) does not guarantee an effectively independent behaviour of the directors. On this point, the EBA-ESMA (2018) guidelines go further, introducing the criterion of "independence of mind" that all board members should possess, whether they have been defined independent or not according to the Code. The EBA-ESMA guidelines state: "*The fact that a member is considered 'independent' does not mean that the member of the management body should automatically be considered 'independent of judgment', as the member may not have the required behavioural skills*."

In particular, the reference to the behavioural skills of the board member seems to be a stimulus for assessing the effective independence, going beyond the formal verification, and catching the reality/seriousness of behaviours. The guidelines state that in assessing a member's behavioural competences, their past and present conduct, particularly within the institution, should be considered. In other words, it is time to shift the attention to the actual behaviours assumed within the bodies, the activism developed in controlling and evaluating the decisions proposed by the top executives, the strength, consistency, continuity, and quality of the arguments advanced with respect to group-thinking (Balestreri and Venanzi, 2017). In the case of banks, for example, under ECB supervision, this control could be carried out by the so-called JSTs (joint supervisory teams) by analysing the minutes of the board meetings, at least on the most important issues, or through direct interviews with independent directors and with the members of the supervisory body or by participating in scheduled periodic meetings. It would seem an "unrealistic" proposal and not feasible for the enormous amount of work it requires. However, two aspects should be considered: *i)* it would not be necessary to read all the minutes, but it would be sufficient to read those that deal with "litmus test" topics in the board agenda, for example the CEO's remuneration system (the member who competently expresses criticism or proposes alternative solutions/corrections shows maximum independence of judgment, because it is a topic that directly touches the interests – the pockets – of the CEO, who is the one who dispenses positions/roles within the group and draws up the list of the board of directors at the time of its renewal), or opinions on extraordinary transactions, such as mergers or acquisitions; *ii)* there are, even at a good price, content analysis software that allows in a short time the control and statistical analysis of thousands of pages of documents.

Notes

[1] In Enron, the ethical rhetoric was the most issue of its CEO, the Code of Ethics counted several hundred pages, but the ethical tone of behaviours was completely absent (Di Miceli da Silveira, 2013).

[2] Consob is the public authority responsible for regulating the Italian financial markets.

[3] The Italian CG Committee is promoted by issuers' associations (ABI, ANIA, Assonime, Confindustria), the Italian Stock Exchange (Borsa Italiana S.p.A.) and investors' association (Assogestioni) and is composed of top representatives of the promoters, of the listed companies and of the asset management companies. The Committee approves and updates the CG Code and monitors, on annual basis, Italian listed companies' compliance with the Code. The last version of the Code (2020) is applicable from 2021 financial year.

[4] *"The application of the Code implies, however, that each deviation is clearly indicated in the corporate governance report and that companies: (a) explain how the best practice recommended by the Code has been disregarded; (b) describe the reasons for the deviation; (c) describe how the decision to depart from the recommendations has been made within the company; (d) if the deviation is limited in time, indicate when they plan to apply the related best practice; (e) describe any action adopted as an alternative to the best practice which they have not implemented and explain how this choice helps the company achieving the objective underlying the Code's principles and in any case contributes to good corporate governance".*

[5] It is measured annually by the Ambrosetti Observatory on the Excellence of Governance Systems in Italy (The European House-Ambrosetti, 2021). The most recent data refer to 2020 and relate to a sample that includes 33 companies in the FTSE-MIB segment, 59 companies in the MID-CAP segment and 44 SMALL-CAP companies, for a total of 136 companies, financial and not, based on data taken from public sources, such as financial statements and GC reports of companies in the sample.

[6] Consob is the public authority responsible for regulating the Italian financial markets.

[7] In the MID-CAP segment, Credito Valtellinese is at the top of the partial index, but it has excluded from the sample because from 2021 it has been acquired and incorporated into Credit Agricole.

[8] When recalled in the report, other corporate documents (company bylaws, regulation on board functioning, etc.) were also analysed.

[9] CG Reports refer to 2021, the last available CG excellence index to 2020 (we assume that excellence score doesn't change in a year).

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[10] The Italian Consolidated Banking Act.

[11] The Italian Consolidated Law on Finance.

[12] At least two independent directors, other than the chair; in large companies with concentrated ownership, independent directors account for at least one third of the board; in other large companies, independent directors account for at least half of the board.

[13] Yearly, the CICG President sends a letter to adherents, highlighting/discussing the more critical aspects observed in CG Reports (the letter is general, i.e., not tailored to the singular recipient compliance).

[14] The total sample includes all the listed banks under Italian law, except Popolare di Sondrio, which doesn't adhere to the Code in 2021.

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