

Real compliance with the Corporate Governance Code or box-ticking?

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Daniela Venanzi

Full Professor of Corporate Finance

Roma Tre University

Dept. of Economics

orcid: 0000-0002-0232-6798

e-mail: daniela.venanzi@uniroma3.it

Abstract

Despite 20 years of regulation (from the corporate scandals of the earlier 21st century), many grey areas persist in corporate governance (hereinafter CG) systems under the façade of a full compliance with the best practices: box-ticking and box-checking behaviours (by operators and supervisors, respectively) are the dark-side of an apparent excellence, as measured by CG quality indices, which are frequently focused on formal compliance. This study: i) verifies if a gap exists between apparent and real compliance with the Code requirements in a sample of Italian listed banks; ii) generalises the empirical findings, by analysing the responses to Code requirements through the lens of new institutionalist/resource dependence theories and explaining them through predictive factors. We find opacity in CG narrative and avoidance/concealment strategies also in banks considered CG “champions”, rarely non-compliance clearly declared and explained. Implications for regulators/supervisors to reduce the gap and trigger more virtuous practices are therefore analysed.

JEL codes: G21, G34, G28

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1. Introduction

The 2030 Agenda for Sustainable Development by United Nations (2015) considers the adoption of the best practices of CG a key-driver for a sustainable behaviour of companies to improve wealth and resilience of economic systems worldwide. Focus on sustainability stresses, among other aspects of CG, 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 blockholders or all shareholders rights against executive directors/managers pursuing self-interests.

However, the compliance with 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 responsible 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 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 2006) and is therefore open to abuse or favours deviations from the best practices (Arcot and Bruno, 2011). From a more general approach, Mitchell et al. (2023) argue that the ‘goodness’ of governance is subjective, that means that its effectiveness depends on the objectives of the organisation. Therefore, there are no universal standards for ‘good’ governance, but the effectiveness of governance must be made on a case-by-case basis. Whereas institutional pressures promote isomorphy toward specific governance practices, such isomorphic standardisation may promote governance inefficiencies to the extent that they are designed without due consideration of the specific needs and goals of the organisation.

However, non-compliance 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, 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.

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*”. Subsequently, FRC (2022), in reporting on compliance with the Code of UK companies, asks companies to behave actively, i.e. not to limit themselves to reporting on (formal) adherence to the Code, but on the application of the principles of the Code for the purposes of the organization, shifting the focus from means to outcomes: “*High-quality reporting should show in a clear manner how the board has successfully applied the Principles of the Code to achieve effective outcomes for the company, shareholders and other stakeholders*”. It should be emphasized that in reporting on adherence to the Code, it positively evaluates the increase (compared to previous years) in the number of non-compliant companies (with adequate explanations of non-compliance) as a sign of real and non-apparent application of the principle of comply-or-explain, as already highlighted by EcoDA (2015) in other European countries. Finally, confirming that the effectiveness of the European banks' CG is still a critical issue, the aggregated results of the ECB's Supervisory Review and Evaluation Process (SREP) 2022 show that none of the significant banks achieves a score of 1 (maximum value on the scale from 1 to 4) of the internal governance score (which evaluates, among other things, the effectiveness of the board, also in terms of independence of its members) and that as many as 73% has a score of 3.

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: *i*) to verify if a gap between formal (apparent) and substantial (real) compliance persists in Italian listed financial firms, over ten years after similar results by Di Battista et al. (2014): the case of Italian financial firms (as explained below) is insightful to test conflicts/biases that could favour this gap; in addition, this study tries to provide (with respect to previous studies) an original and tangible proof of this gap, by comparing the ranking of CG quality of financial companies that are defined “CG champions” measured by CG indexes (in this study, the Ambrosetti EG index), that mainly focus on a “mechanical adhesion” to code principles/requirements that are more easily implemented/verified, and the CG practices effectively adopted by these companies, on the basis an in-depth analysis of their CG reports, when code principles require constructive/pro-active behaviours and awareness/responsiveness in their implementation; *ii*) to define a theoretical framework where the various corporate responses to CG Code requirements can be placed, also assessing quality/transparency of non-compliance explanations and of narrative in CG annual reports in favour of shareholders, stakeholders, and supervisory authorities and trying to explain why companies prefer to disguise compliance rather than to appropriately explain the non-compliance. The contribution of this framework is to systematically integrate (and operationally test in the Italian pilot case) different theories that better than other explain intermediate responses to institutional pressures (between the extreme cases of compliance, on one side, and clearly declared/explained non-compliance, on the other side), also bringing together visual and thematic manipulation strategies in CG reports that the international literature on transparency and quality of CG narrative identifies. Since many theories are available to explain compliance/non-compliance with CG principles/recommendations (a “*pick n' mix*” approach by academics is frequently reported in this field), often more or less mutually overlapping, the systematization effort here proposed could be useful to make the framework of responses/behaviours to CG Code requirements more organic and the relative reasons/incentives of their adoption frequency clearer, with useful implications for regulators/supervisors.

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 relevant since: *i*) are frequently non-complied (for example in Italy: CICG, 2021 and Consob¹ Relations); *ii*) 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/aware in assuming decisions; *iii*) 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 Code². The analysis is based on the contents of their 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 case 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 various yearly Consob Reports, we can argue that the compliance with the CG Code is more formal than substantial, at least in some areas: compliance with procedural/mechanical requirements more frequently occurs, whereas Code principles that need substantial choices/behaviours appear less accomplished or show opaque narrative. Analogously, Bianchi et al. (2011), as far as Related Parties Transactions (RPTs) are concerned (that represent a Code concern on how companies manage potential conflicts between insiders and outsiders: RPTs are particularly important in Italy where conflicts of interest between controlling and minority shareholders are common because of the high ownership concentration in listed companies), demonstrate how (on a sample of all the 262 companies listed on the Italian MTA at the end of 2007) an important gap exists between apparent vs real compliance: against a formal compliance of 87% (enthusiastically noted by Assonime), only 33% of companies show effective compliance, in terms of effective implementation of good practices. 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 (which formulates the Code and monitors its compliance), appears more optimistic, instilling some doubts about the presence of potential conflicts of interests inside the CICG.
- regulation in banking sector is more cogent than in other sectors: therefore, compliance with the Code 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 interests; in addition, the 2015 Renzi Reform, which obliged the largest cooperative banks to transform into public limited companies, was an indirect/soft attempt to overcome their poor corporate governance systems, considered by the Bank of Italy more effective than a direct intervention on their CG practices.
- the Italian CG Code gives clear as a principle but generic guidelines about the content of non-compliance explanations to be appropriate. This fact could favour behaviours of non-compliance not declared or disguised as compliance, rather than non-compliance openly declared, and appropriately explained, with the consequent opacity in CG report narratives.

Since the above reasons, the analysis could provide potentially useful insights to different national contexts, by highlighting grey areas, behaviours biased by conflicts of interests, “*does and don'ts*” in supervising the adhesion to the CG Code. For example, the risk that monitoring bodies can be captured by the monitored companies: the presence of potential conflicts of interest in the CICG, whose members are the professional representatives of the companies subject to the assessment; other countries – i.e., Germany, France, Denmark and Belgium – have adopted other solutions, for example, independent/public institutions in the monitoring body as well as the constant dialogue between the self-regulation body and the supervisors, etc., even if it is highlighted by several parties that the CG Code is a self-regulation and the regulation has other tools – laws and related sanctioning mechanisms – to intervene.

The paper is organized as follows: sections 2-3 analyse and discuss theories that can explain compliance, non-compliance, and intermediate behaviours to the Code requirements. In section 4 the research design is discussed, and the sample of Italian listed financial companies (used as a pilot study) is presented. Section 5 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 6 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 (Shrives and Brennan, 2015). Smallmann (2004) explains the fundamental problems with the key assumptions of governance models built on agency theory, the first of which is that the investor-board relations are linkages between complex organisations, and not unitary actors, which contradicts the assumption of a dyadic relationship between principals and boards. In addition, the information and power asymmetries that mark complex organisations exacerbate the difficulties associated with dense networks of principal-agent relationships. Summing up, agency theory has been criticised as an inaccurate reflection of human behaviours, for failing to communicate complexity and because it does not properly consider the impact of social variables. Finally, the so-called “rational” decision-making is rarely such, for cognitive, behavioural, and cultural factors, as well as communication problems, information asymmetries, and time constraints combined to bound rationality.

Signalling theory, highlighting the information asymmetry between users of financial reports and managers about their governance practices, says that 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.

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. Resource dependence theory (Zahra and Pearce, 1989) suggests that companies will maximize 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 prioritize 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 responses and intermediate behaviours (with respect to the extreme behaviours of compliance/non-compliance suggested by agency and signalling theories), as well as tentatively identify the predictors of the likelihood that organizations will resist or conform to institutional pressures and expectations. We can derive five strategies.

The acquiescence strategy may take alternative forms: real compliance (conscious obedience to values/norms/institutional requirements) or imitation (mimetic behaviour). 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. Concealment tactics involve disguising nonconformity behind a façade of acquiescence: this is the case of apparent compliance. Shrivies and Brennan (2015) shows that a legitimacy issue might occur 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 *manoeuvring*, that is like to an influence tactic, oriented to shape values and criteria, for example by the formulation of their own standards.

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.

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: 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. 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 by self-

serving reasons); first, concealment, by either obfuscating non-compliance or diverting to positive aspects (bolstering); secondly, attribution, i.e. 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 emphasize 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, 2004). 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 3).

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. 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. 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; Thanasis et al., 2018 on Greek firms) try to identify the rhetorical strategies underlying the non-compliance explanations. They implicitly hypothesize 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 quality³. However, this index unfortunately tends to measure CG quality in terms of compliance with 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 indicators* (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. Very important is also in Italy the Spencer Stuart Board Index⁴, which considers the first (per market capitalization) 100 Italian listed companies (mainly from nonfinancial industries: over two third of the sample market capitalization) and focuses on their board composition/functioning characteristics. Analogously, Rizzato et al. (2018) built a CG index of compliance, consisting of 14 items grouped into categories (composition of the board of directors, composition of internal committees and the role of representatives of minority shareholders, and auditors) and measured in terms of compliance degree to both the Italian Code requirements and the internationally recognized standards developed by the International CG Network in 2014. However, the CG quality assessed by these indexes can hide a compliance more apparent than real, favouring box-ticking and box-checking behaviours to the Code requirements, respectively by operators and supervisory institutions.

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 financial companies

Firstly, we try to verify if a gap exists between formal and substantial 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-meeting board information).

We consider a sample of 23 Italian listed financial companies, split into two sub-samples.

The first sub-sample includes 13 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)⁵ and Banca Finnat in SMALL-CAP (together with Banca Sistema and Equita Group, already included)]. Banca Generali (of Generali Group) is also included since the Ambrosetti report doesn’t say if it refers to the bank or to the group⁶. 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 introduce tools/incentives that better favour a real rather than cosmetic compliance with the best CG practices.

The second sub-sample includes further 10 Italian listed banks, that declare their adhesion to the CG Code: Banco BPM, Banco Desio-Brianza, Bper, Banca Mediolanum, Banca Profilo, Banca Intermobiliare, Credito Emiliano, Mediobanca, MPS, and Illimity Bank. In this way, all the listed banks under Italian law are analysed, except Popolare di Sondrio, which doesn’t adhere to the Code in 2021.

The 2022 CG Reports of these companies are in-depth analysed⁷, with reference to the last CG Code version. 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 structures⁸.

The focus on financial companies (predominantly banks) allows to increase the robustness of the excellence score, because banking sector regulation is more cogent and many Italian Code principles are also rules of the sector regulatory framework (TUB⁹, TUF¹⁰, 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 but serve as a pilot study to test the methodological framework proposed.

As far as the board member independence is concerned, the Code defines a minimum number of independent directors¹¹ and lists in a very detailed manner the circumstances that jeopardize the independence of a director (see CICG, 2020). Among them, it asks the board to define *ex ante* the quantitative and qualitative criteria for assessing the significance of both commercial, financial or professional relationships that the board member (whose independence is under scrutiny) has/had directly or indirectly with the company and the added remuneration (other than the fixed remuneration for the position held within the board) received by the company to compensate other positions held within the group. Our attention is therefore focused 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 the analytical application of these criteria. In fact, the outcome of the assessments of independence of directors should be disclosed in the CG Report.

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. These procedures identify the prior notice for the submission of the documentation, ensuring that confidentiality issues are properly managed without affecting the timeliness/completeness of information. The CG report should provide adequate information on these internal rules and on compliance with the procedures ensuring the timeliness and adequacy of the provided information.

Two further principles complete the explored areas: the appointment of an independent director as lead independent director (LID)¹² and (in large companies) meetings among independent directors, 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 (2021): “*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’*”. In fact, it is reasonable that 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.

In sum, 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. is provided clear/detailed information about the application of these criteria?
7. is clearly communicated the appointment duration of the independent directors and the compliance with the 9-year threshold?
8. are the meetings reserved to independent directors organized?
9. was the LID appointed? Is it clearly explained the reason of avoidance?
10. are the pre-meeting information terms ex-ante fixed?
11. are they appropriate, if compared with proxies of complexity (size, number, duration) of board meetings?
12. are they ex-post complied?
13. in which situations are they not complied?
14. are any offsetting mechanisms provided in these cases?
15. are non-compliance (total or partial) or avoidance clearly declared when it occurs?
16. is the annual CIG letter discussed in detail¹³?
17. are compliance, non-compliance, partial compliance, or avoidance/concealment highlighted comparing current practices with CIG letter? Are any corrective actions adopted because of this comparison?

To reach the second objective, the emerging behaviours (that will be discussed in detail in Section 5.1 below) are placed into a theoretical framework, built by integrating new institutionalism and resource dependence theories (see Section 2 above): 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 the predictive factors assumed by the theory, where these factors seem to be appropriately interpreted in this analysis. In addition, we integrated in the framework the insights by the international literature about transparency and quality of CG narrative (see Section 3 above). Firstly, the main rhetorical strategies utilized in CG reports narratives, following the taxonomy by Shrivies and Brennan (2017), interpreted as forms of “thematic manipulation”; they are used to qualify the transparency degree of narrative in CG annual reports, in sum the quality of disclosure in CG reports, by adopting a more generally perspective (in fact, in the original study, these strategies are used to assess the quality of non-compliance explanations but in our pilot study rarely non-compliance is explicitly declared); secondly, we interpret flaws in narrative quality, in terms of information location, completeness, complexity/readability, specificity, etc., as forms of “visual/structural” manipulation through visual/structure tactics used in CG reports. 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” is provided (but distinguishing), to complete the picture.

Numerical threshold of independent directors (question 1 above).

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 one case (Generali Group), the independence is doubtfully assigned since two shareholders (whom independent-defined directors relate to) are 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 this case, two shareholders holding more than 5% of voting rights (i.e., the threshold used in related party transactions) are considered not significant, although they are relevant shareholders (together with other two) and entered in a shareholders' agreement, whose share reaches the main shareholder's one.

Definition of qualitative-quantitative criteria to assess the significance of both commercial-financial-professional relationships and additional compensation and their appropriateness/consistency (questions from 2 to 5 above).

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 automatism. 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 (as frequently referred to): 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, not to revenues/costs of the company: 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 CICG¹⁴. Cases of non-compliance or partial compliance or apparent compliance are never explicitly declared.

Transparency and details about the application of the significance criteria (question 6).

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 (examples of visual manipulation: curricula hunting or 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 with the 9-year threshold (question 7).

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 is 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 vs 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, but no information about this non-compliance is provided.

Meetings reserved to independent directors (question 8).

In 10 cases on 13 only one meeting is done. Among the champions: in a bank (UniCredit) the frequency is the same of board meetings; another company (Anima) 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 of 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 (question 9).

LID seems to be a tool scarcely used by CG excellent banks. Only one (not large) appoints him to comply with 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 companies 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 with this requirement is generally observed, the spirit of the Code seems to be neglected. 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) reinforces what said earlier about meetings of independent directors only, to which these tools is related: it is perceived by sample financial 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 (questions 10 and 11).

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 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 (an example of attestation).

Ex-post compliance of terms and explanations/offsetting mechanisms when not complied (questions from 12 to 14).

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 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 company: 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) paradoxically contradicts the Code provision and emphasizes the urgency exception.

Clear declaration of (total or partial) non-compliance or avoidance (question 15).

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 and/or the relevant legislation are 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 (questions 16 and 17).

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. 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 with 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 with 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 could at least instil doubts about how effective the compliance with 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 shareholders/financial market about it as well as in explaining the reasons for avoidance/non-compliance: the gap between effective and formal compliance with CG Code incontrovertibly exists.

Many previous studies emphasized this gap: however, the analysis here conducted, and the emerging empirical findings discussed above in this section, systematically shows that, when an in-depth analysis is conducted on the effective practices adopted, particularly as regards the Code principle applications that request active/aware behaviours, many Italian financial companies, that are considered “CG champions” by the Ambrosetti EG index (i.e. positioned in high rankings of the index), that (as other widespread CG quality indexes) is mainly focused on mechanical, easily applicable and verifiable CG Code requirements, present many flaws in terms of non-compliance not declared and therefore not explained, non-compliance disguised as compliance, low transparency and frequent recourse to opaque/misleading rhetorical narrative. This result tangibly proves the gap between effective and formal compliance.

5.2. Response behaviours to CG Code pressures and predictive factors

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

Table 1 shows a theoretical framework to locate the response behaviours emerging from the empirical analysis here conducted, as discussed in § 5.1. It proposes an integrated framework, by mixing the new institutionalist and resource dependence theories, as illustrated in Section 2 above. These two theories can better explain intermediate behaviours from full compliance to non-compliance (explicitly declared), more frequently observed in our analysis on Italian banks rather than the behaviours at the extremes of the continuum. In addition, the insights by international literature on CG narrative quality (as illustrated in Section 3 above) are also integrated in the framework, considering visual and thematic manipulations as forms of avoidance/concealment responses to the code requirements. Response behaviours/strategies are indicated in the columns of Table 1 in a continuum from full compliance to non-compliance explicitly declared. The rows of the Table list the areas of Code analysed in this study by directly reading and manually elaborating¹⁵ the 2022 CG Annual Reports and related documents (more than 2.500 pages) of the sample financial companies, as presented in section 4. On the basis of the emerging findings, discussed in detail in Section 5.1, the breaches/quasi-breaches are placed in the Table 1, distinguishing champions from non-champions, when significant differences are observed (measured in terms of number of occurrences of the responses/behaviours).

As just said before, the empirical findings only serve as a pilot study to contribute to the definition and preliminary test 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. In addition, in the bottom of the table, the predictive factors corresponding to the different behaviours (as identified by the adopted theories) are indicated, adapting them to our analysis on CG practices.

The taxonomy of response strategies/behaviours, the placement in the framework of the observed responses to Code requirements as well as the predictive factors and their interpretation to this specific context are explained and discussed here to follow.

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. 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 requirements (TUF), looser than CG Code. We can define this occurrence as an impression behaviour: the presence of independent directors appears a diffuse, consistent, and legitimating attribute (consistent with the related predictive factors “high diffusion” and “high legitimacy”) 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 only 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 (see the predictive factor in Table 1), compromise, avoidance and 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 in number of 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 the 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, significance criteria defined in an inconsistent manner (see Section 5.1 for findings regarding questions from 2 to 5), etc. Relevant predictors of avoidance/concealment (with respect to full or partial compliance: moderate vs high) are diffusion, consistency, and efficiency. 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.

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 and quality of decision-making (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 (Kusi et al., 2018). 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 CG 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. 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): this could be a good explanation of the frequent occurrence of avoidance/concealment responses to this requirement (intensity of colours.)

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 hypothesized to predict the likelihood of organizational resistance or compliance with 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 (Intesa Sanpaolo and Unicredit among them), that have bargaining power to contrast Code requirements, in defining only qualitative criteria, that are more flexible to specific circumstances, to assess significance of relationships/additional compensation in the directors independence assessment 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 Section 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. In this study, 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 banks are those which less conform to the Consob facsimile: a negative correlation 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 correlation 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 the 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 Section 5.1 above).

As far as more active forms of resistance are concerned, as defiance, companies simply choose to non-comply; *manoeuvring* 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: it is an example 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.

Table 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 (derived by theory) 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 | | | | low |
| interconnectedness | | high | | | moderate | | | | low |
| multiplicity | | low | | | high | | | | high |
| diffusion | | high | | | moderate | | | | low |
| consistency | | high | | moderate | moderate | | | | low |
| efficiency | | high | | | low | | | | low |
| legitimacy | | high | | | low | | | | low |

6. Preliminary conclusions, policy implications and limits of the analysis

As far as the first objective of this study is concerned, the emerging findings show 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 for operators/supervisors to overcome box-ticking and box-checking behaviours and to assess the real responses to Code requirements and to go beyond the formal verification, catching the seriousness/responsiveness of behaviours. In this vein, the EBA-ESMA (2021) guidelines about the criterion of “independence of mind” should be followed. In particular, the reference to the behavioural skills of the board member seems to be a stimulus for assessing the real independence, going beyond the formal verification. The guidelines state that in assessing behavioural competences of a board member 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 programs, that allow in a short time the control and statistical analysis of thousands of pages of documents.

As regard the second objective, we can affirm that the elaborated taxonomy of responses/behaviour strategies seems to be effective in classifying the emerging breaches/quasi-breaches from our total sample. We observed more occurrences of avoidance/concealment or partial compliance rather than non-compliance explicitly declared. These two results prove that theories adopted in the framework (new institutionalist and resource dependence, integrated with the insights by studies on quality/transparency of CG narrative) better than others can explain intermediate behaviours from full compliance to declared non-compliance. Future research avenues could expand the application/adaptation of this approach (by testing on different samples and different areas of CG principles) to understand the responses/behavioural strategies to the CG Code principles and better qualify the suggested predictive factors.

Probably, the legitimacy issue is perceived as relevant, although it shouldn't be in a comply-or-explain approach. Here, the implications for regulators/supervisors are to put more focus on the requirements of a good explanation of non-compliance and to provide related guidelines to implement it: companies might be uncertain how/when to be legitimate to non-compliance. The Italian Code, in fact, clearly defines the principle of what must be explained in the case of non-compliance, but it does so in the introduction and only in a generic manner for all principles/recommendations, while it could give more specific guidelines/examples on the individual good practices required, following the statements/actions implemented by FRC (2021, 2022) in UK. However, companies could prefer to simulate compliance, since to craft convincing explanations is time-consuming 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: criteria to assess the significance of relationships/added compensation are stated, but opacity in application is very frequent; notarial and peremptory style is used, attestations are provided that the criteria have been applied. Here supervisors should take action to ask 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 (the processes) to the ends (the outcomes) might be a solution of this problem. For example, regulators/supervisors should try to provide companies with guidelines/incentives that weaken the current focus on processes and rather push for greater attention to the virtuous effects that can be obtained/have been obtained with the adoption of good practices. For example, by asking companies to define, measure and monitor the expected impact of CG principles and practices, on performance, risk reduction, quality of decisions taken; it is certainly not an easy task, but it could induce/stimulate banks to pay greater attention to the opportunities that good governance could allow, instead to the constraints that it imposes. In parallel, regulators/supervisors should develop and provide to the companies empirical studies/analyses that show the consistency

of the principles/recommendations of the Code with the improvement of performance, risk reduction, the better quality of decision-making processes, as recently done for example by OECD (2022) in the reformulation of GC principles: the public consultation of the new version (being released) was accompanied by studies/analyses that support the consistency of the principles with the quality of the decision-making processes.

“Quite quitting” behaviours prevail in adopting LID and only independent meetings (although strict compliance with the Code requirements occurs). The Code should emphasize 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, by suggesting stricter recommendations, for example, to appoint a LID when chair is not independent (and better explaining when it is the case), to arrange more independent meetings than one in a year, to apply the same provision also to non-large companies, differently from the current requirements: does the risk of apparent/simulated 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 should define more clearly 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 behaviour should be stimulated by the Code and by supervisors. However, to be more effective as an incentive, the letter should be not generic but tailored to the specific non-compliance/avoidance/concealment behaviours of each recipient (for example, by clustering the observed violations/flaws and tailoring the letter on groups of similar recipients).

Finally, some considerations follow about the limitations of this study, that can be considered also its weaknesses in terms of the findings ‘generalizability.

The sample is small: however, all the listed Italian banks that adhere to the code are included; moreover, the Italian case seems to be very interesting and therefore potentially useful insights to other national contexts could be derived, since grey areas are highlighted, behaviours biased by conflicts of interests are identified and “*does and don'ts*” in supervising the adhesion to the CG Code are provided.

Only two areas of the Italian Code principles are analysed, the independence of board members and the awareness/information degree of board decision-making (i.e., the terms of the pre-meeting board information), but they are very crucial aspects and strongly impact on quality and transparency of board decision-making. Moreover, they require pro-active behaviours (in comparison to mechanical fulfilments): criteria should be appropriately set and correctly applied. The extension of the analysis to other Code principles with the same characteristics could test and eventually strengthen the empirical findings.

The CG annual reports of the sample banks are manually and mostly qualitatively analysed. This could implicate subjectivity in the assessment of the observed responses and in their placement in the taxonomy of Table 1. However, it is important to note that the assessment was made easier by the fact that many kinds of emerging breaches/quasi breaches frequently occur in groups of banks, therefore slightly different examples of the same behaviours strengthen/confirm their identification/classification. Moreover, the sample is limited in number, therefore a manual assessment is feasible and likely unbiased (better than use of content analysis software). Section 5.1 provides many details (also with occurrences/frequencies) about the observed responses to the code requirements and the breaches/quasi-breaches placed in Table 1 can be easily related to them, and therefore open to be checked/verified.

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- ¹ Consob is the public authority responsible for regulating the Italian financial markets.
- ² The Italian CG Committee (CICG) 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.
- ³ It is measured annually by the Ambrosetti Observatory on the Excellence of Governance Systems in Italy (The European House-Ambrosetti, 2021). It refers to 2020 and relates 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.
- ⁴ See <https://www.spencerstuart.com/research-and-insight/italy-board-index>
- ⁵ 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.
- ⁶ Therefore, nine out of thirteen financial companies are ranked in the top three positions of the partial index referred to board composition-functioning area (narrowly consistent with the CG aspects here analysed).
- ⁷ When recalled in the report, other corporate documents (company bylaws, regulation on board functioning, etc.) were also analysed.
- ⁸ CG Reports refer to 2021, the last available CG excellence index to 2020 (we assume that excellence score doesn’t change in a year).
- ⁹ The Italian Consolidated Banking Act.
- ¹⁰ The Italian Consolidated Law on Finance.
- ¹¹ 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.
- ¹² The Code asks LID: *i*) if 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), if requested by the majority of independent directors.
- 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 Which is defined by Assonime as equal to/greater than remuneration for the appointment.
- ¹⁵ By summarising them in a comprehensive worksheet, where the observed responses of the financial companies, in the rows, are referred to the code principles, in the columns.