Why do firms voluntarily comply with the Codes of Best Practice?[*]

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Abstract: This paper attempts to analyze the determinants that affect compliance with voluntary Codes of Best Practice by firms when no mandatory disclosure is required. More precisely, it studies company characteristics that influence both the decision to comply and the decision to inform of such compliance with the Spanish Code of Best Practice, dubbed the Olivencia Code, by using a sample of firms listed on the Spanish Stock Exchange in the late 1990s. Firms with higher levels of free-float, larger companies and companies that have recently made public offerings are shown to be more willing to comply on both the above counts. Our results cast doubt on the effectiveness of self-enforceable Codes in the absence of a mandatory disclosure of corporate governance related information.

Keywords: Corporate Governance, Board of Directors, Codes of Best Practice, Disclosure of information, Self-regulation.

JEL: G30, G32

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1. Introduction

Corporate governance plays an important role in the development of capital markets, influencing financing provided by outside investors and the cost of capital (Shleifer and Vishny, 1997; La Porta *et al.*, 1998). Boards of Directors are undoubtedly key units in this field, being responsible for monitoring, advising, punishing and rewarding managers and with mitigating manager-shareholder agency conflicts (Fama and Jensen, 1983). In the wake of a raft of corporate bankruptcies and scandals during the 1990s and the Enron and Worldcom debacles that heralded the beginning of the present century, corporate boards have become the targets of unprecedented public attention in the debate on corporate governance. Pressure from regulatory authorities, institutional investors and the financial press has led to a whole range of proposals for reform and Codes of Best Practice worldwide, of which there are a myriad of examples: the Cadbury Report (1992), the Greenbury Report (1995), the Hampel Report (1998), the Higgs Report (2002), the Smith Report (2003) and the Combined Code (2003) in the U.K.; the Codes drawn up by the Toronto Stock Exchange Committee (1994, 2002) for Canada; the Australian Investment and Services Association (1995) and the ASX Corporate Governance Council (2003) in Australia; CALPERS, the American Law Institute (1994, 2002), the Business Roundtable (2002) and the Breeden Report (2003) in the United States. Similarly, Continental Europe has witnessed the two Viénot Reports (1995, 1999), the Bouton Report (2002) and the Consolidation Report of these three reports (2003) in France; the Peters Report (1997) and the Dutch Corporate Governance Code (2003) in the Netherlands; the Preda Report (1999) and the Corporate Governance Code (2003) in Italy, or the Olivencia Report (1998) and the Aldama Report (2003) in Spain. Codes have also been published by international organizations

such as the OECD (1999, 2004) or the International Corporate Governance Network (1999).

All the above Codes drafted by committees appointed by national governments, Stock Exchanges, institutional investors or international organizations sought to enhance Board surveillance and thereby improve the performance of listed companies. Most are self-enforceable, voluntary codes whereby firms voluntarily restrain their own conduct. This kind of self-regulation aims to increase investors' uncertainty about firms corporate governance structure, and may preempt stricter government regulation. Frequently, the codes include the proviso that firms publish annual compliance reports among their recommendations in an attempt to improve disclosure of information to the markets. This self-enforceable disclosure regulation aims to solve the problem of asymmetric information between the firm and the investors in corporate governance related matters and relays on the economic literature that shows that even, without mandatory disclosure laws, there are market mechanisms that provide incentives for firms to disclose information (Grossman, 1981; Milgrom, 1981). However, Stock Exchanges and governments in some countries have not believed fully in these voluntary disclosure laws and went on to make the compliance report mandatory, as happened in the U.K. with the Cadbury Report (1992), the recommendations of which were adopted in 1993 by the London Stock Exchange, requiring companies to "comply or explain".

When no legal rule or organism oblige companies to publish a compliance report, both compliance with the Codes of Best Practice and disclosure of information is purely a question of self-enforcement. Whether self-regulatory-based Codes of Best Practice have fulfilled their objective of improving Board monitoring capabilities is an empirical question, being the studies on the above issues both limited and inconclusive. Results

for the U.K., for example, are contradictory. Peasnell *et al.* (2000) state that the Cadbury Report had a positive impact on the quality and integrity of companies' financial reporting and Dahya *et al.* (2002) document that CEO turnover increased after poor performance in the wake of the Cadbury Report. Moreover, the link between CEO turnover and corporate performance showed a post-Cadbury Report strengthening. Contrariwise, Buckland (2001) indicates that compliance or non-compliance with the Cadbury Report is not associated with the survival of firms that went public (IPO firms) and Weir and Laing (2000) fail to uncover any evidence that full compliance with the model of governance proposed by the Cadbury Committee ties in with better performance. In the Netherlands, where companies were not required either to comply or to publish a mandatory compliance report, Jong *et al.* (2004) find that the issuance of the 1996 Peters Report failed to significantly influence either Dutch firms' corporate governance characteristics or firm value as perceived by the markets. For Spain, Fernández *et al.* (2004) show that the market reacts positively to announcements of compliance with the Olivencia Report that imply a major restructuring of the Board of Directors, whereas no wealth effects are observed for announcements that relate to isolated recommendations in the Code[i].

This study sets out to add to the literature on the subject by analyzing what type of firms opt to comply with the Spanish Code of Best Practice and why they decide to do so when they are required neither to comply with the Code nor to publish an annual compliance report or information about corporate governance structure. As Easterbrook and Fischel (1991) observe, we still know very little about the effects of mandatory disclosure or other regulations. In this respect, this paper studies why firms voluntarily restrain their own conduct and "self-regulate" and why, under a voluntary disclosure regime, there is a unraveling of information. By complying with the Codes firms may

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signal to the investors their commitment with good governance practices and by disclosing the information firms may reduce investors´ uncertainty about the firms' governance structure quality and likewise preempt stricter government regulations[ii]. Thus, the paper attempts to analyze to what extent market forces and self-regulation are sufficient to promote changes in corporate governance structures, or whether legal and political action is called for in order to draw up and enforce contracts to implement the code's recommendations (Alchian, 1950; Stigler, 1958; Shleifer and Vishny, 1997).

The Olivencia Report - the Spanish Best Practice Code issued in 1998 - provides a good scenario to test how effective self-enforcement of good corporate governance practices and disclosure of information is. It sets out 23 recommendations on the responsibilities, structure and organization of the Board of Directors with the aim of improving its monitoring role. Compliance is voluntary; no law or organisation obliges quoted companies to fill in a compliance report. Its success has been questionable according to the surveys carried out by the Spanish Supervisory Agency in 2000 and 2001. We find that firms with a higher percentage of free-float, larger firms and firms that have recently made public offerings tend not only to comply to a greater extent but also to voluntarily provide the market with information on their compliance levels and corporate governance characteristics. Such results thus fail to confirm the effectiveness of Codes of Best Practice across the board for all companies, thereby casting doubt on the effectiveness of self-regulation as a way to foster implementation of the Codes and as a way to promote voluntary disclosure.

The rest of the paper is organized as follows. Section 2 deals with the theoretical background and hallmarks of Spain's 1998 Olivencia Report. Section 3 describes how the sample was built up, the methodology and the variables used in the analysis. Results are discussed in section 4, and section 5 presents the paper's main conclusions.

2. Corporate Governance and Codes of Best Practice

Corporate governance aims at striking a balance between economic and social goals and at fostering the efficient use of resources. Good corporate governance, in which Boards of Directors play a key role (Jensen, 1993), is a source of competitive advantage and is critical to economic and social progress. As part of corporate governance, the role of the Board includes disciplining managers, contracting new ones and establishing their financial rewards and benefits (Baysinger and Butler, 1985; Hermalin and Weisbach, 1991). Thus, factors influencing a Board's effectiveness will likewise influence a firm's market value. Board composition (Weisbach, 1988; Rosenstein and Wyatt, 1990), CEO duality (Brickley et al. 1997; Shivdasani and Yermack, 1999), board size (Jensen, 1993; Yermack, 1996), and the existence of internal committees (Klein, 1998; Kose and Lemma, 1998) all figure amongst the factors that determine monitoring capacity.

Most of the above issues are catered for in the raft of Codes of Best Practice approved in different countries, including the Olivencia Report, which was made public in Spain on February 26th 1998 by a Committee appointed by the government in 1997 and presided over by Prof. Dr. M. Olivencia. Although the Committee recognized the special ownership structure of Spanish firms and made certain recommendations regarding the protection of minority shareholders[iii], the Report's recommendations were very similar to those of the Cadbury Report, dealing with the need to establish a majority of non-executive directors within the Board, with the setting up of specialized committees made up exclusively of non-executive directors (i.e. the auditing, remuneration or appointment committees) and with the need to disclose managers' and directors' pay deals. Recommendations calling for a maximum and minimum Board size of between five and fifteen directors respectively and the setting of a retirement age for directors also figured in the Report. Given the institutional nature of Spanish

companies, a hallmark of which is high shareholder concentration, the Report also established three types of directors: non-executives who are, or who represent, large shareholders, non-executive, independent directors and executive directors.

As has already been mentioned, the success of the Olivencia Report was limited. According to a questionnaire by the Spanish Supervisory Agency in 2000, mean compliance with the Code recommendations stood at 81% among the 61 firms that answered the questionnaire[iv]. However, only two firms complied with all recommendations. For the year 2001, mean compliance was 77% for the 67 firms that answered the questionnaire, with only five firms implementing all 23 recommendations. Furthermore, the final recommendation of the Report, which referred to the need to publish information about firms' corporate governance structures and their degree of compliance with the Code as part of the Annual Report, in line with the British "comply or explain" rule, was poorly adhered to. Two questionnaires by the Olivencia Committee in 2000 polling 200 experts and 800 shareholders revealed that the Report was well known to the experts, who valued it positively. In contrast, it was almost unknown to the shareholders. Both the experts and the shareholders considered that the amount of information regarding corporate governance structures provided to the market and investors was clearly insufficient. These questionnaires thus pointed to a lack of disclosure of information in corporate governance-related matters. This evidence, along with the results of the questionnaires on compliance with the Olivencia Report, was considered both by the Aldama Committee that issued the Aldama Report in 2003 and by the government when reforming Spanish Company Law in 2003. The new rules oblige firms that issue securities in the Spanish Stock Markets to write an Annual Corporate Governance Report that has to be sent to the Spanish Supervisory Agency and to be posted on firms' web pages.

Since compliance and provision of information regarding corporate governance structure and compliance with the Olivencia Code was not mandatory, the experience of this Report provides a clear indication of the contribution of self-regulation and disclosure of information to the governance process. Different hypothesis can be established regarding the decision to comply or not. First, if self-regulation and market forces do indeed work, not only "well governed firms" but also "poorly governed firms" should comply with the recommendations set out in the Code. Secondly, from the point of view of agency theory (Jensen and Meckling, 1976), entrenched managers should be reluctant to restructure their corporate governance structures in order to comply with the Code and therefore firms with higher agency costs, i.e. "poorly governed firms", will comply with the Code to a lesser extent. Finally, from the point of view of the signaling theory (Akerlof, 1970), compliance is expected to be seen by the market as a signal of good corporate practices by complying firms, and therefore firms that are already "well governed" and for whom the costs of compliance are expected to be lower (Verecchia, 1983) should be more willing to demonstrate to investors their commitment to corporate governance by complying to a greater extent. Firms with lower levels of information asymmetry should also comply more often.

As for the decision to inform the market of corporate governance structures and levels of compliance, regulators typically assume that public disclosure is necessary for the efficient functioning of capital markets and the protection of investors. In contrast, economists support that firms may have incentives to disclose information voluntarily. A company's decision about the amount of information to be disclosed depends on balancing the cost against the benefits of disclosing (Amihud and Mendelson, 2000). Theoretical studies argue that voluntary disclosure reduces information asymmetry among investors by reducing transactions and information costs, which in turn increases

investor confidence and therefore increases stock liquidity (Diamond and Verrechia, 1991; Kim and Verrechia, 1994). Consistently, Greenstein and Sami (1994) have shown that the provision of more informative statements in SEC filings increased the liquidity of companies that did so, as measured by a reduction in the bid-ask spread; Welker (1995) finds a negative relationship between analysts' rankings of disclosure and bid-ask spreads, a proxy for transaction costs and information costs that is positively correlated with a security's expected return (Amihud and Mendelson, 1986)[v]. Thus, by disclosing more information than is necessary by law or regulation, firms may improve liquidity of the stocks and bonds and lower capital costs, that is raise the prices of their securities (Amihud and Mendelson, 2000).

When disclosure is unregulated, there is no mandated minimum level of public financial disclosure. As reputation models require, by disclosing information firms incur in costs (Ross, 1977). Among these costs one may mention that disclosure provides information that can be profitably used by competitors. Also, the provision of more detailed information may expose the disclosing firms and its managers to lawsuits in the event of errors or to frivolous lawsuits by disenchanted stockholders. The production of information is also costly in terms of compiling and disseminating the information. These cost, as there is a large element of fixed cost in the production of information, may be proportionally greater for smaller firms compared to large firms. Moreover, in order to prevent the "lemons problem" (Akerlof, 1970) and the adverse selection against firms that do not disclose corporate governance information, firms, specially "well governed" firms, will attempt to distinguish their quality by conveying information to the market (Grossman, 1981). Thus, we would expect firms with better corporate governance structures and lower levels of information asymmetry, firms for which the cost of signaling are lower, to be more eager to reveal information to investors.

3. Sample and database

Our initial database comprised all companies quoted on the Electronic Market of the Madrid Stock Exchange between 1998 and 2000. Compliance with the Olivencia Report started in 1998 after its issuance in February of that year. The information provided by the Spanish Supervisory Agency (C.N.M.V.) about company compliance with the Olivencia Report, the Rules of the Boards of Directors, the voluntarily Annual Compliance Reports and the Baratz press database formed the platform from which the sample was constructed.

Observations for financial companies (SIC codes 60-64) were excluded from the initial database due to their different regulatory and governance environments[vi] (92 observations), as also were those for foreign companies (18 observations), companies that were taken over, merged or went bankrupt (11 observations), companies that complied or informed of their level of compliance the same year they went public (36 observations) and companies for which one or more of the independent variables included in the analyses (48 observations) could not be estimated. After applying these filters, the number of non-financial companies included in the sample stood at 110, with a total number of 270 observations. Table 1 shows the distribution of the firms in the sample according to their industrial activity (SIC codes at the two digit level). 56.35% of the firms in the sample and 57.42% of the observations correspond to the following industries: the construction industry (15 SIC code); food industry (20 SIC Code); paper industry (26 SIC code); stone, clay, glass and concrete products (32 SIC code); water, electricity, gas and health services industries (49 SIC code) and real estate (65 SIC code).

[Table 1]

Different sub-samples were filtered out of the general database as follows: companies that pushed through Corporate Governance reforms in order to comply with the Olivencia Code and companies that informed the Spanish Supervisory Agency of their Corporate Governance structures and their degree of compliance with the recommendations set out in the Code by publishing an Annual Compliance Report. Within the companies that implemented reforms in order to comply with the Code we differentiated between those that approved internal Rules for the Board of Directors encompassing the key recommendations of the Code ("total compliance firms") and those that merely implemented one or more recommendations of the Code without significantly modifying the firm's statutes ("partial compliance firms").

Table 2 shows the number of firms that comply with the Olivencia Report for each of the three years considered in the study and whether the firms voluntarily published information about their corporate governance structure and their degree of compliance with the Code by publishing an Annual Compliance Report. 36 firms approved Rules for the Board of Directors that reflected the key recommendations of the Code, 17 firms simply adopted some of the recommendations of the Code and 57 firms (slightly more than 50% of the sample) made no declaration regarding complying with the provisions of the Code. Furthermore, 57 companies informed the Spanish Supervisory Agency by remitting an Annual Compliance Report for at least one of the years covered by the database; the remaining 53 firms (48.18%) never informed. These figures cast doubt about the impact of the Code on quoted companies[vii].

[Table 2]

Observations are distributed almost evenly across the three years covered by the study (Table 3). 67 observations are for companies that approved Rules for the Board of

Directors in line with the key recommendations of the Code, 53 are for companies that have merely adopted certain of the Code's recommendations and 150 are for firms that have not responded to any recommendations (Panel A, Table 3). The propensity to comply with the Code increases as time passes after the issuance of the Code of Best Practice. While the ratio of firms that comply neither completely or partially stands at 77.38% for 1998, this percentage falls to 55.10% for 1999 and to 38.64% for 2000. Consequently, the percentage of firms that comply increases from 1998 to 2000 145.55%. Moreover, this enhanced fulfillment is more significant for complete compliance. Whilst for 1998 only 9.5% and 13.09% of the observations belong to the full and partial compliance sub-samples respectively, these figures stand at 37.50% for the full compliance sub-sample and at 23.86% for the partial compliance sub-sample for 2000. Thus, the percentage of increase of complying firms from 1998 to 2000 stands at 293.75%. These figures suggest the existence of a bandwagon effect associated to the Codes of Best Practice as firms seem to choose to comply on a larger extent with the passing of time following the route initiated by other firms. Consequently, Codes could be categorized as "bandwagon norms" (Kübler, 2001), as it seems that once a critical number of firms follow the norm, the reputational value of the norm or the social pressure exercised by it over non-complying firm increases sharply. This bandwagon effect is associated to firms size as larger firms are the first ones to comply. Regarding the disclosure of information, 105 observations (38.89%) correspond to firms that inform the Spanish Supervisory Agency of their corporate governance structure and Code compliance levels (Panel B, Table 3). The percentage of firms that inform remains almost constant and even declines slightly over the period considered (from 42.86% of the observations in 1998 to 38.64% of the observations in 2000), so no bandwagon effect seems to take place for disclosure.

As for whether a firm complies with the Code and whether it informs by publishing an Annual Compliance Report, 66 observations are for firms that comply with the Code and inform (24.44%), 44 are for firms that comply but do not inform (16.30%), 39 are for firms that do not comply but inform (14.44%) and slightly less than half of the observations, 121 (44.81%), are for firms that neither comply nor inform (Panel C, Table 3).

[Table 3]

4.- Methodology, variables and hypothesis to be tested

4.1.- Methodology

In order to analyze the type of firms that opt to comply with the recommendations of the Code of Best Practice or/and to inform about their corporate governance structure and their degree of compliance, we estimated different limited dependent variable models. Firstly, we studied the determinants of the decision to comply with the Code. This decision, represented by the first branch of Graph 1, was estimated using a logit model. The dependent variable of the model (COMPL) is a binary variable that takes value 1 when a company complies and adopts one or more of the provisions of the Code and 0 otherwise. As firms may comply fully or partially (second branch of Graph 1), we estimated a second limited dependent variable model, an ordered logit model, that aims to capture this second decision. The dependent variable of this model, COMPLFP, takes value 2 if a firm approves Rules for the Board of Directors that incorporate the key recommendations set out in the Code, 1 if the firm only adopts one or certain recommendations of the Code and 0 if the firm does not adopt any recommendations of the Code.

[Graph 1]

Secondly, in order to test the determinants of firms' decisions to inform about their degree of compliance with the recommendations set out in the Code and their corporate governance structure, we estimated a second logit model (Graph 2). Its dependent variable (INF) takes value 1 if the firm discloses information about its degree of compliance with the Code and its corporate governance structure by publishing an Annual Compliance Report that is sent to the Spanish Supervisory Agency, and 0 otherwise.

[Graph 2]

Finally, we analyze jointly the determinants of both decisions: compliance and disclosure of information about the degree of compliance and the firm's corporate governance structure. This analysis is undertaken by estimating another ordered logit model (Graph 3). Its dependent variable (COMPLINF) takes value 3 if the firm adopts one or more provisions of the Code and informs, value 2 if the firm adopts one or more provisions but does not inform, value 1 if the firm does not adopt any recommendations set out in the Code but informs about its degree of compliance and value 0 if the firm neither adopts any provisions nor informs.

[Graph 3]

4.2.- Variables of the study

We considered variables related to the firms' corporate governance structures (ownership structure, Board of Directors' characteristics and financial structure)[viii], and to the firms' degree of information asymmetry as determinants of all these decisions represented in the limited dependent variable models. We also considered the possible influence of firms' prior performance and certain control variables on their decisions to comply, to inform and finally to jointly comply and inform (Table 4).

The variables representing the firms' ownership structure include the percentage of free-float (FFLOAT) and the percentage of shares held by internal owners, i.e., the directors and the managerial team (INT). Due to the free-riding problem associated with dispersed ownership (Grossman and Hart, 1980), firms with higher levels of free-float should be subject to more acute agency problems between managers and shareholders[ix]. However, empirical studies (Demsetz 1983) do not always find a significant influence of ownership concentration on firm value. Indeed, the studies of Demsetz and Lehn (1985) and La Porta *et al.* (1999) suggest that corporate ownership may be endogenously determined. Jensen and Meckling (1976) proposed that ownership would provide managers with an incentive to reduce private perquisite consumption, thereby enhancing a firm's value. Morck *et al.* (1988) were the first to document a significant non-linear relation between managerial ownership and firm value. At low levels, managerial ownership has a positive impact on corporate value, while at high levels it has a negative impact. This change in sign is due to managerial entrenchment; for high levels of ownership, managers would have enough power to pursue their own objectives at the expense of shareholders. This non-linear relationship between managerial ownership and firm value is backed up by the evidence of McConnell and Servaes

(1990), Hermalin and Weisbach (1991) for the U.S. or Short and Keasy (1999) and Faccio and Lasfer (1999) for the U.K.[x] According to the free-riding problem associated with dispersed ownership, we would expect "well governed firms" to have lower levels of ownership concentration. Moreover, we must also consider both the alignment and the entrenchment effect of managerial ownership on firms' governance.

The variables that refer to Board of Directors' characteristics are Board size (BSIZE), measured as the logarithm of the number of Directors, and the percentage of executive directors sitting on the Board (BINT). Economic theory suggests there are benefits associated with small Boards of Directors (Rosenstein and Wyatt, 1990; Jensen, 1993; Kose and Lemma, 1998). Empirical evidence tends to support this prediction. Thus, Yermack (1996) documents a higher market value for large U.S. companies with small Boards of Directors. The same relationship is found for a sample of small and medium-sized Finnish companies by Eisenberg et al. (1998). The results of Berger *et al.* (1997), indicating an inverse relationship between Board size and leverage, also suggest that small Boards monitor managers more closely. As for the composition of the Board, those dominated by outside directors would be expected to monitor more effectively (Rosenstein and Wyatt, 1990; Jensen, 1993), although the empirical evidence regarding the effectiveness of independent Boards of Directors is not conclusive (Baysinger and Butler, 1985; Weisbach, 1988; Byrd and Hickman, 1992; Mikkelson and Partch, 1997, Bhagat and Black, 2002). In line with these arguments, "well governed firms" are expected to boast smaller boards and a higher percentage of outside directors.

The level of financial leverage is considered through the variable LEV, defined as the ratio of debt to total assets. This variable attempts to capture the monitoring role exercised by debt (Jensen, 1986). Accordingly, "well governed firms" should have higher levels of debt. The degree of a firm's information asymmetry is represented by

two variables: RESERV and PO. RESERV is a binary variable that takes value 1 if the firm's audit report presents reservations, and 0 otherwise. Firms presenting reservations in the audit report are expected to have greater information asymmetry. PO is also a binary variable that takes value 1 if the firm has gone public or made public offerings during the last five years, and 0 otherwise. If the firm has made a Public Offering, the information it has been required to provide to the market is greater and its level of information asymmetry is thus expected to be lower.

The firm's prior performance is represented by variable PERF. This variable is represented as the firm's return minus its industry market return. If we accept that corporate governance influences firm value (Shleifer and Vishny, 1997; McKinsey, 2002), "well governed firms" should achieve higher performance. Finally, we included as control variables the variable (SIZE), defined as the logarithm of the firm's assets, and the market to book value ratio of common equity (MB) as a proxy variable of the q ratio, a variable that aims to capture the firm's future investment opportunities. All the explanatory variables were defined as they stood at the end of the year prior to the observations of the dependent variables.

Firms' accounting data supplied by the Madrid Stock Exchange, stock quotes published by the Daily Stock Bulletin of the Madrid Stock Exchange and data on significant shares and Board composition published by the Spanish Supervisory Agency were used to define the above variables. Additionally, the following directories were consulted: Spain: The Shareholder's Directory; Who's Who in Spain; Duns 50,000; Dicodi and the special editions of the "Nueva Empresa" magazine.

[Table 4]

Table 5 presents summarised statistics for the variables included in the analyses. The firms in the sample exhibit a relatively low free-float (mean of 49.99%). Therefore, on average, the five largest shareholders hold 50% of the firms' shares. This figure, higher than that reported in studies for the U.S. (32.4%; McConnell and Servaes, 1990) or for the U.K. (around 35%; Faccio and Lasfer, 1999, and Hillier and McColgan, 2001), highlights the high ownership concentration of quoted companies in Spain. Internal ownership (INT) has a mean value of 11.40 and a median value of just 0.36%. These values are low compared to figures for the Anglo-Saxon markets. In the U.S., the average managerial holding for Fortune 500 firms ranges between 10.6% and 12.4% (Jensen and Warner, 1988; Morck et al., 1988 and Cho, 1998), while for medium-sized companies it stands at 20% (Denis and Kruse, 2000). In the U.K., average managerial ownership ranges between 10% reported by Peasnell *et al.* (2003), 13.3% by Short and Keasy (1999) and 16.7% by Faccio and Lasfer (1999).

Average Board size (BSIZE) stands at 10 directors, which is lower than the maximum of 15 directors established by the Olivencia Code. This figure is similar to the one reported for the U.S. market by Barnhart *et al.* (1994) and Yermack (1996) (approximately twelve directors). For IPO firms, Baker and Gompers (2003) report a mean Board size of just six directors. For the U.K, Franks and Mayer (1997) report a mean board size of 8 directors[xi]. The proportion of internal or executive directors (BINT) is relatively low (32.02%), indicating that the average firm's Board has a majority of external directors. For example, Peasnell *et al.* (2003) report a proportion of outside directors for the U.K. of 38% in the pre-Cadbury period and 44% in the post-Cadbury period. Baker and Gompers (2003) report a proportion of internal directors of about half of the Board for IPO firms.

The mean leverage ratio is 37.65%, with 14.44% of the observations corresponding to firms that have reservations in the audit report. Due to the intense privatisation movement that Spain underwent in the 1990s (Cabeza and Gómez, 2004) and the high number of firms that decided to go public in the late 1990s, one third of the observations correspond to firms that had made a Public Offering within the previous five years. Mean firm size amounts to 1,475.65 million euros and the majority of the firms have a slightly inferior market performance compared to their industry peers, with mean market to book value of common equity ratio standing at 2.91.

[Table 5]

Table 6 shows the correlation matrix between the explanatory variables of the models. Ownership structure and Boards' of Directors characteristics are strongly correlated, as reported by Denis and Sarin (1999) for the U.S. market. In line with several studies that highlight a negative linear association between managerial ownership and the proportion of outside board members (Weisbach, 1988; Zajac and Westphal, 1994; Denis and Sarin, 1999), internal ownership (INT) is positively correlated to the proportion of internal directors sitting on the Board (BINT). Internal ownership is also negatively related to Board size (BSIZE). Moreover, the proportion of internal directors (BINT) is negatively correlated to Board size (BSIZE). Firm size (SIZE) is also correlated to the corporate governance variables. Larger firms establish larger boards (BSIZE) and have greater levels of free-float but lower levels of internal ownership (INT) and internal directors (BINT). Firms that have recently made Public Offerings show higher internal ownership. The correlation matrix also shows that firms with larger boards tend to present reservations to a lesser extent. This negative correlation does not support the argument of the inefficiency of large boards (Jensen, 1993; Yermack, 1996). The results also suggest that larger firms underperform and have less

growth opportunities than their industry peers. Firms that have recently made a Public Offering also boast a higher market to book value of common equity ratio. Overall, these correlations suggest that ownership, board structure and firm size are strongly interrelated.

[Table 6]

5. Results

5.1.- Analysis of the decision to comply with the recommendations of the Code of Best Practice

Table 7 shows the results of the study regarding the logit model that analyses firms' decisions to comply with the Code of Best Practice. The results of the regression models are shown for a sub-sample of observations formed by eliminating observations of firms that do not comply for a given year, but comply in the years that followed[xii]. The models were run firstly considering all the independent variables and afterwards eliminating certain non-significant variables in order to avoid possible multicollinearity problems. The results do not vary significantly. All the regressions turn out to be significant at a 1% level.

According to the results shown in Table 7, variables that significantly influence a firm's decision to comply with the Olivencia Report are free-float (FFLOAT), internal ownership (INT), whether a firm has undertaken a Public Offering (PO) in the recent past and firm size (SIZE). The variables that represent boards' characteristics (BSIZE and BINT), the firms' leverage (LEV), whether the firms present reservations in the audit report (RESERV), firm performance (PERF) and the market to book value of common equity ratio (MB) do not turn out to be significant.

The variable FFLOAT presents a positive, significant coefficient at the 1% level. Firms with a lower percentage of shares in the hands of large shareholders seem to comply to a higher degree with the Code. If ownership concentration were considered as a firm's monitoring mechanism, this relationship would suggest that firms with higher agency costs, i.e. "poorly governed firms", would comply to a larger degree with the Code and modify their governance structure. However, there is another potential explanation for this relationship. Firms with higher levels of free-float would be more interested in supplying information to their disperse shareholders and in signaling their commitment towards good corporate governance practices to investors. Complying with the Code would be a way to achieve this.

Variable INT turns out to be significant when we consider the possible non-linear relationship between internal shareholdings and a firm's decision to comply with the Olivencia Report. In Reg. 4 and Reg. 5 the linear term (INT) turns out to be negative and the quadratic term (INT2) positive. Both coefficients are statistically significant. For low levels of internal ownership additional levels of managerial ownership seem to decrease the level of compliance. In contrast, the relation turns out to be positive for high levels of internal ownership. This U relationship is inverse to the relationship reported in the literature between internal ownership and firm value (Morck *et al.*, 1988; Himmelberg *et al.*, 1999; Short and Keasey, 1999), but is similar to the one reported by Peasnell *et al.* (2003) for the relationship between internal ownership and the demand for outside directors and between internal ownership and the adoption of the Cadbury Report's recommendation on outside directors. The U relationship suggests that, at high levels of managerial ownership, managers tend to have incentives to establish good corporate governance practices and to signal their commitment towards minority shareholders and their lack of entrenchment[xiii] to the market.

The variable Public Offerings (PO) presents a positive, significant coefficient, suggesting that firms that have gone public – many of which have become privatised firms - comply with the Code to a greater extent. These firms have to file considerable information before going public and frequently restructure their governance structure before making the Public Offering in order to attract new shareholders. Thus, it would be less costly for them to comply, as they would have already restructured their corporate governance structures, and by complying they would be sending a signal to their shareholders.

When running the ordered logit model that takes into account not only the decision to comply or not with the Code but also whether a firm complies completely or partially, the explanatory variables that turn out to be significant are the same, except for firm size. Firms with a higher percentage of free-float that have recently made a public offering tend not only to comply more often but also to comply to a greater degree, approving Rules for the Board of Directors that incorporate the main recommendations of the Code of Best Practice. Although not shown, the coefficients between variable FFLOAT and whether firms comply completely or partially with the Code are for both cases positive and statistically significant at a 1% level. However, the coefficient between variable PO and compliance is only statistically significant when firms comply completely with the Code. The same holds when defining a dummy variable that takes value 1 if the firm has been privatised during the 1990s and 0 otherwise. These results suggest that firms that comply completely are firms with larger percentages of free-float that have recently made a Public Offering. The variable representing firm size is only significantly correlated to the firm's decision to comply partially, that is, to adopt certain recommendations of the Code. Thus, larger firms would tend to merely adopt certain recommendations of the Report, maybe those that are not costly for them to

implement, but would not be willing to undertake an in-depth restructuring of their corporate governance structures in order to comply with the Code.

Summing up, these results suggest that firms with higher free-float tend to comply with the Code both fully and partially to a larger extent. Firms that have recently made Public Offerings, among them privatised firms, also tend to comply more often, although they tend to do it fully, i.e., approving Rules for the Board of Directors that incorporate the main recommendations set out in the Code. In contrast, large firms tend more often to comply only partially, and do not tend to undertake voluntary major restructuring of their corporate governance structures. Moreover, the relationship between internal ownership and compliance is a U form, suggesting that at high levels of managerial ownership, when the risk of expropriation of minority shareholders' wealth is larger, managers may have incentives to signal their commitment towards corporate governance to the market. These results seem to support the signaling hypothesis. Firms with larger percentages of free-float that have recently made public offerings would be willing to comply with the Code and to give the market an indication of their commitment towards "good corporate practices".

[Table 7]

5.2.- Analysis of the decision to inform about the degree of compliance and firms' governance structure

Table 8 shows the results of the logit models representing firms' decisions to inform about their degree of compliance with the Olivencia Report and their corporate governance structure by submitting a compliance report to the Spanish Supervisory Agency. Regressions 1 to 4 employ observations from the whole sample and regression 5 considers only the first year that a firm decides to disclose information. The variables

that turn out to be significant are almost the same as those that proved to be relevant to firms' decisions to comply with the Code: level of free-float (FFLOAT), whether the firm has been subject of a Public Offering within the last five years (PO) and firm size (SIZE). The variable FFLOAT presents a positive, significant coefficient at a 1% level in all regression models, variable PO presents a positive, significant coefficient at a 1% level (Reg. 1 to 4) and 10% level (Reg. 5) and variable SIZE presents a positive coefficient, statistically significant at a 1% level (Reg. 1 to 4) and 5% level (Reg. 5). Only the level of internal ownership turns out not to be significant for either a linear or non-linear relationship. Moreover, the variable PERF in Reg. 1 and 5, representing the firm's prior performance, also turns out to be positive and significant at a 10% and 5% level, respectively.

The signaling hypothesis explains the above relationships. Larger firms with a larger percentage of free-float that have recently made a public offering tend to be more willing to indicate their transparency in the field of corporate governance to the market. As suggested by Diamond and Verrechia (1991) larger firms would benefit more from reduced information asymmetry associated to voluntary disclosure as for them it is more important to attract large holdings from institutional investors who make large trades and are thus concerned about future liquidity. Moreover, if there is a cost to increased disclosure, one that is proportional to firm size (or less than proportional), then larger firms will disclose more information. On the contrary, small firms with a reduced level of free-float that have not recently made public offerings, among them family firms[xiv], would be reluctant to communicate this same information. Firms that are performing well would also be eager to send signal their "good quality" and send a positive signal to the market.

[Table 8]

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5.3.- Analysis of the joint decision to comply with the provisions of the Code of Best Practice and to inform about the degree of compliance.

Table 9 shows the results of the ordered logit models that were estimated for analysis of the joint decision to comply and to inform. As before, regressions 1 to 4 employ observations from the whole sample and regression 5 only considers observations for the year of each firm's maximum compliance level. We again find that the significant variables are FFLOAT, PO and SIZE. The percentage of shares held by internals is only significant for one of the models considered when using the non-linear specification. Consistent with the results obtained when analysing firms' decisions to comply, the linear term is negative (INT) and the quadratic term (INT2) positive (Reg. 4)[xv]. Besides, the variable PERF turns out to be positive and significant in only one of the models, Reg. 5, although for all models the coefficient of this variable is positive.

These results suggest that firms with a greater proportion of free-float that have recently made a Public Offering and that are of larger size tend to jointly comply and to inform to a greater degree. A significant percentage of the firms that went public and made public offerings in the 1990s in Spain are privatised firms. These firms now boast a greater free-float than "old private" firms, and have a market capitalization that stands at 168,347.085 millions euros, 56% of the market capitalization of the firms that make up the Ibex-35 Index, and 54% of the market capitalization of the Madrid Stock Exchange General Index (Cabeza and Gómez, 2004). The evidence regarding compliance agrees with the questionnaires sent by the Spanish Supervisory Agency to the quoted companies about their degree of compliance with the Olivencia Code. According to these questionnaires, privatised firms and firms that had recently gone public exhibited greater compliance rates, whereas "old companies", i.e., those with a long history of quoting, were more reluctant to change their corporate governance structures. Thus, this

evidence highlights that the Code of Best Practice has been complied with extensively by privatised firms and by firms that have captured funds from the market through Public Offerings in the recent past. The results also suggest that the kind of firms that comply and decide to inform tend to coincide. In fact, the correlation coefficient between a dummy variable representing full compliance and the variable representing whether the firms inform turns out to be positive (0.333) and statistically significant at a 1% level. On the contrary, the correlation coefficient between a dummy variable representing partial compliance and the variable representing whether the firms inform turns out to be non-significant and negative. These correlations suggest that firms that comply with the majority of the recommendations set out in the Code tend to inform the market about their degree of compliance, while firms that comply only partially do not tend to inform the market. Firms that comply completely would be willing to differentiate themselves from the rest of firms and to send the market a signal of their commitment to good corporate governance practices, while firms that only adopt one or a few recommendations set out in the Codes would not be interested in providing the market with further information about their corporate governance structures or in explaining why they do not comply with the rest of the Code's recommendations. These results are in line with the positive revaluation associated with the announcements of full compliance and the non-significant revaluation of partial compliance announcements reported previously by Fernández *et al.* (2004).

Thus, summing up, the evidence from our study casts doubt on the effectiveness of corporate governance self-regulation, i.e. when the "comply or explain" rule is not imposed by regulation. Firms that show a commitment towards good practices would disclose information to the market, while firms that are not committed to governance practices set out in the Codes would simply not inform investors. Market forces do not

seem to be sufficient to convince companies of the necessity to disclose information about corporate governance. Moreover, when firms are not required to inform the market about their degree of commitment towards the Codes' governance practices, the success of the Codes is doubtful. Firms that already comply with a significant part of the recommendations and that were already committed to good corporate governance practices would be the ones that would mainly comply, as for them the benefits of compliance and disclosure may out weight the costs.

The results of our study helps explain the different results obtained by Jong *et al.* (2004) for the Netherlands and by Dahya *et al.* (2002) for the U.K. While the former authors document that the Peters Report, for which no compliance report was legally required, had no significant effect on the corporate governance characteristics of Dutch firms, the latter authors find significant changes in board structures in the wake of the Cadbury Report, whose recommendations were adopted by the London Stock Exchange, who imposed a compliance report as a requirement to quote.

Moreover, according to our study, firms that tend to voluntarily comply and to inform are larger firms with higher free-float that have recently made Public Offerings. The fact that smaller firms with lower percentages of free-float tend to comply and inform to a lesser extent is of particular interest in countries where a significant number of quoted firms are controlled by family groups. Family controlled firms are usually of smaller size and tend to have lower free-float. For these companies, agency problems arise between majority and minority shareholders (Morck, 2000) rather than between managers and shareholders (Jensen and Meckling, 1976).

[Table 9]

6. Conclusions

This paper attempts to analyse the effectiveness of the Codes of Best Practice that rely on self-enforcement by quoted companies and of voluntary disclosure. Although during the last fifteen years a considerable number of Codes have been issued all over the world, their effectiveness is not clear. Most of the Codes rely on self-enforcement by listed companies and include amongst their recommendations that a compliance report should be published by incumbent firms. In some countries, for example the U.K. after 1993, publishing a compliance report in which companies should comply or explain their degree of compliance with the Codes is enforced by regulation, while in other countries the compliance report is voluntary. In the latter case, both compliance and disclosing information to the market is based on self-enforcement.

The study of compliance with a voluntary Code of Best Practice in a single country, Spain, where the compliance report was not mandatory in the late 1990s and early years of this century allows us to test the effectiveness of the Codes of Best Practice based on self-regulation and firms' willingness to encompass disclosure of information. The paper highlights the characteristics of Codes as "bandwagon norms" as it shows that the number of norm followers increases over time, once a significant percentage of quoted firms adopt the norm. The results of the study also suggest that larger-sized firms with a higher percentage of free-float that have recently made Public Offerings, thus firms for whom compliance and disclosure would be less costly, tend to be those that comply and publish a compliance report. This evidence suggests that compliance and disclosure of corporate governance related information is used by firms as a way to send a signal to the market about their commitment with good governance practices.

The results of our study also cast doubt on corporate governance self-regulation when no disclosure of information is legally required. Contrariwise, when disclosure is mandatory, the empirical evidence seems to support the effectiveness of the Codes of Best Practice (Dahya *et al*, 2002). Authorities in some countries seem to have been conscious of this situation and have enforced a compliance report. This was the case in the U.K. where, since 1993, the London Stock Exchange has required listed firms to publish a compliance report of best governance practices. In Spain, the Reform of the Company Law undertaken in 2003 also requires companies to publish an Annual Corporate Governance Report.

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Table 1: The Sample's industry distribution.

The sample is formed by 270 observations that correspond to 110 non-financial companies quoted on the Madrid Stock Exchange over the period 1998-2000.

Industry (SIC Codes)	Nº of firms	Percentage of firms	Nº of observations	Percentage of observations
15	8	7.27	19	7.04
16	2	1.82	5	1.85
17	1	0.91	3	1.11
20	12	10.91	27	10.00
21	1	0.91	2	0.74
22	2	1.82	4	1.48
23	3	2.73	6	2.22
24	1	0.91	3	1.11
26	7	6.36	16	5.93
27	1	0.91	1	0.37
28	6	5.45	15	5.56
29	2	1.82	6	2.22
32	10	9.09	26	9.63
33	7	6.36	19	7.04
34	1	0.91	3	1.11
35	3	2.73	9	3.33
36	1	0.91	3	1.11
37	1	0.91	3	1.11
38	2	1.82	6	2.22
47	4	3.64	12	4.44
48	1	0.91	3	1.11
49	11	10.00	27	10.00
50	2	1.82	5	1.85
51	2	1.82	3	1.11
53	3	2.73	6	2.22
58	1	0.91	3	1.11
65	7	6.36	21	7.78
67	1	0.91	1	0.37
70	2	1.82	5	1.85
72	1	0.91	1	0.37
73	3	2.73	6	2.22
75	1	0.91	1	0.37
Total	110	100.00	270	100.00

Table 2: Degree of compliance of firms in the Sample.

The sample is formed by 270 observations that correspond to 110 non-financial companies quoted on the Madrid Stock Exchange over the period 1998-2000. Firms either comply, full or partially, with the Code or do not comply (at least during one of the years considered). Firms may also inform about their corporate governance structure and their degree of compliance with the Code for at least one year during the period considered.

Industry (SIC code)	Nº of firms	Full Compliance	Partial Compliance	No Compliance	Inform	Do not Inform
15	8	3	0	5	3	5
16	2	0	1	1	1	1
17	1	0	0	1	1	0
20	12	4	0	8	6	6
21	1	1	0	0	1	0
22	2	0	0	2	0	2
23	3	1	1	1	2	1
24	1	0	0	1	0	1
26	7	2	2	3	4	3
27	1	0	0	1	0	1
28	6	2	1	3	3	3
29	2	1	0	1	1	1
32	10	3	0	7	3	7
33	7	2	2	3	6	1
34	1	1	0	0	1	0
35	3	2	1	0	2	1
36	1	0	0	1	1	0
37	1	0	0	1	0	1
38	2	2	0	0	1	1
47	4	0	1	3	3	1
48	1	1	0	0	1	0
49	11	1	5	5	4	7
50	2	0	0	2	0	2
51	2	2	0	0	2	0
53	3	2	0	1	3	0
58	1	0	1	0	1	0
65	7	2	1	4	5	2
67	1	0	0	1	0	1
70	2	2	0	0	1	1
72	1	1	0	0	0	1
73	3	1	1	1	1	2
75	1	0	0	1	0	1
Total	110	36	17	57	57	53

Table 3: Distribution of observations.

The sample is formed by 270 observations that correspond to 110 non-financial companies quoted on the Madrid Stock Exchange over the period 1998-2000. Firms either comply, full or partially, with the Code or do not comply (Panel A). Firms may also inform about their corporate governance structure and their degree of compliance with the Code (Panel B). Panel C combines both decisions (compliance and providing information to the market).

Panel A: Compliance

Year	Nº of observations	Full compliance	Partial compliance	No compliance
1998	84	8 (9.52%)	11 (13.10%)	65 (77.38%)
1999	98	26 (26.53%)	21 (21.43%)	51 (52.04%)
2000	88	33 (37.50%)	21 (23.86%)	34 (38.64%)
Total	270	67 (24.81%)	53 (19.63%)	150 (55.56%)

Panel B: Information

Year	Nº of observations	Inform	Do not inform
1998	85	36 (42.86%)	48 (57.14%)
1999	96	35 (35.71%)	63 (64.29%)
2000	85	34 (38.64%)	54 (61.36%)
Total	266	105 (38.89%)	165 (61.11%)

Panel C: Compliance and information

Year	Nº of observations	Comply and inform	Comply, but do not inform	Do not comply and inform	Do not comply and do not inform
1998	85	14 (16.67%)	4 (4.76%)	22 (26.19%)	44 (52.38%)
1999	96	28 (28.57%)	16 (16.33%)	7 (7.14%)	47 (47.96%)
2000	85	24 (27.27%)	24 (27.27%)	10 (11.36%)	30 (34.09%)
Total	266	66 (24.44%)	44 (16.30%)	39 (14.44%)	121 (44.81%)

Table 4: A description of the variables.

Dependent variables	Definition
COMPL	Binary variable that takes value 1 if the firm complies, fully or partially, with the Code of Best Practice and 0 otherwise.
COMPLFP	Ordered variable that takes value 2 if the firm complies fully with the Code of Best Practice (approves Rules for the Board of Directors that include the main recommendations of the Code), 1 if the firm complies partially (adopts one or various recommendations of the Code without approving new Rules for the Board of Directors) and 0 it the firm does not comply.
INF	Binary variable that takes value 1 if the firm informs about its degree of compliance and corporate governance structure and 0 otherwise.
COMPLINF	Ordered variable that takes value 3 if the firm complies, totally or partially, and informs, 2 if the firm complies, totally or partially, but does not inform, 1 if the firm does not comply, but informs, and 0 if the firm does not comply neither informs.

Explanatory variables	Definition
FFLOAT	Percentage of free-float (100% minus the percentage of shares held by the five largest shareholders).
INT	Percentage of shares owned by the firm's managers and directors.
BSIZE	Number of directors.
BINT	Percentage of executive directors sitting on the Board.
LEV	Leverage ratio: total debt/total liabilities
RESERV	Binary variable that takes value 1 if the firm's audit report presents reservations and 0 otherwise.
PO	Dummy variable that takes value 1 if the firm has made a Public Offering within the last five years.
SIZE	Logarithm of the firm's total assets.
PERF	Adjusted firm performance defined as the difference between the firm's market return and its industry market return (the firm's industry is defined using the SIC code to the two-digit level).
MB	Market to book value of common equity ratio.

Table 5: Summary Statistics of the explanatory variables.

The sample is formed by 270 observations that correspond to 110 non-financial companies quoted on the Madrid Stock Exchange over the period 1998-2000.

Variables	N	Mean	Median	Minimum	Maximum	Standard Deviation
FFLOAT (%)	270	49.99	48.08	1.97	100.00	26.00
INT (%)	270	11.40	0.36	0.00	86.64	19.96
BSIZE	270	10.32	9.00	3.00	27.00	4.31
BINT (%)	270	32.02	28.57	0.00	100.00	18.83
LEV (%)	270	37.65	38.54	1.00	90.00	19.20
SIZE (total assets, mill. euros)	270	1,457.11	288.51	22.89	30,327.12	4,061.27
PERF (%)	270	1.78	-4.25	-122.00	449.00	59.42
MB	270	2.91	1.84	0.26	32.29	3.28
Dummy variables	N	Percentage of observations				
RESERV	270	14.44				
PO	270	33.33				

	FFLOAT	INT	BSIZE	BINT	LEV	RESERV	PO	SIZE	PERF
INT	-0.090								
BSIZE	0.128**	-0.136**							
BINT	0.039	0.438***	-0.414***						
LEV	-0.099	0.079	-0.133**	0.057					
RESERV	0.040	-0.051	-0.137**	-0.027	0.085				
PO	0.085	0.182***	-0.002	0.031	0.084	-0.022			
SIZE	-0.069	-0.290***	0.616***	-0.297***	0.177***	-0.011	0.022		
PERF	0.003	0.052	-0.103*	0.065	0.231***	0.120**	0.052	-0.130**	
MB	0.111*	0.168***	-0.079	0.071	0.260***	-0.079	0.241***	-0.131**	0.336***

*   Statistically significant at a 10% level.
**   Statistically significant at a 5% level.
***   Statistically significant at a 1% level.

Table 7: Determinants of the decision to comply with the Code of Best Practice.

The data refers to 110 non-financial firms listed on the Spanish Electronic Market (1998-2000). COMPL is a dummy variable that takes value 1 when a firm complies with the Olivencia Report and 0 otherwise. COMPLFP takes value 2 if the firm complies completely with the Olivencia Report, that is approves a Rule for the Board of Directors that includes the main recommendations set out in the Report, 1 if it complies partly with the Code, that is, adopts just one or a few of the recommendations set out in the Code and 0 if a firm does not comply. The regression models are estimated using a sub-sample that excludes the observations of no compliance in a given year for firms that comply in subsequent years.

Model	Bivariate Logit	Bivariate Logit	Bivariate Logit	Bivariate Logit	Ordered Logit
Dependent variable	COMPL	COMPL	COMPL	COMPL	COMPLFP
Explanatory variables	Reg. 1	Reg. 2	Reg. 3	Reg. 4	Reg. 5
Constant	-4.496 (8.794)***	-4.457 (12.943)***	-4.921 (18.319)***	-4.546 (15.248)***	-3.835 (-2.913)***
FFLOAT	0.030 (12.331)***	0.030 (13.552)***	0.030 (13.166)***	0.035 (16.438)***	0.309 (3.161)***
INT	0.012 (1.109)	0.012 (1.227)	0.008 (0.632)	-0.070 (4.140)**	-0.071 (-2.259)**
INT2				0.001 (5.634)**	0.001 (2.662)***
BSIZE	0.030 (0.002)				
BINT	-1.138 (0.685)	-1.157 (0.782)			
LEV	-0.827 (0.619)	-0.842 (0.712)	-0.860 (0.742)	-1.080 (1.091)	-0.709 (-0.634)
RESERV	0.067 (0.016)	0.065 (0.015)	0.107 (0.042)	0.083 (0.025)	0.148 (0.288)
PO	1.035 (6.919)***	1.033 (6.990)***	1.034 (7.011)***	1.115 (7.798)***	1.358 (3.561)***
SIZE	0.337 (2.988)*	0.343 (5.381)**	0.377 (6.792)***	0.301 (4.063)***	0.199 (1.253)
PERF	0.377 (1.108)	0.378 (1.125)	0.404 (1.306)	0.403 (1.264)	0.364 (1.212)
MB	0.087 (1.337)	0.087 (1.348)	0.083 (1.400)	0.108 (2.285)	0.052 (0.686)
χ^2	35.739	35.737	34.930	34.930	39.230
Log-likelihood	187.224	187.226	188.033	182.218	-127.453
Statistical significance	0.000***	0.000***	0.000***	0.000***	0.000***
Observations	187	187	187	187	187
% of correct classification	74.3	74.3	72.2	73.8	71.7

*   Statistically significant at a 10% level.
**   Statistically significant at a 5% level.
*** Statistically significant at a 1% level.

Table 8: Determinants of the decision to inform about the degree of compliance with the Code of Best Practice and the firm's corporate governance structure.

The data refers to 110 non-financial firms listed on the Spanish Electronic Market (1998-2000). The dependant variable INF is a dummy variable that takes value 1 if a firm submits a voluntary compliance report with the Olivencia Report to the Spanish Supervisory Agency and 0 otherwise. The observations are computed for the 110 firms considered along the three years included in the study.

Model	Bivariate Logit	Bivariate Logit	Bivariate Logit	Bivariate Logit	Bivariate Logit
Dependent variable	INF	INF	INF	INF	INF
Explanatory variables	Reg. 1	Reg. 2	Reg. 3	Reg. 4	Reg. 5
Constant	-3.703 (10.270)***	-4.241 (20.876)***	-4.428 (25.735)***	-4.354 (23.848)***	-4.742 (12.602)***
FFLOAT	0.035 (27.976)***	0.034 (28.213)***	0.034 (28.022)***	0.034 (27.376)***	0.036 (16.262)***
INT	0.005 (0.279)	0.003 (0.101)	0.001 (0.010)	-0.011 (0.126)	0.008 (0.035)
INT2				0.000 (0.159)	0.000 (0.040)
BSIZE	-0.395 (0.589)				
BINT	-0.775 (0.667)	-0.495 (0.318)			
LEV	-0.880 (1.090)	-0.686 (0.731)	-0.721 (0.812)	-0.739 (0.847)	-0.264 (0.059)
RESERV	0.178 (0.183)	0.235 (0.328)	0.249 (0.369)	0.246 (0.359)	0.077 (0.020)
PO	1.072 (11.892)***	1.082 (12.155)***	1.087 (12.276)***	1.090 (12.347)***	0.832 (3.737)*
SIZE	0.401 (7.282)***	0.328 (8.468)***	0.340 (9.428)***	0.327 (7.955)***	0.375 (4.933)**
PERF	0.435 (2.837)*	0.420 (2.662)	0.415 (2.585)	0.419 (2.585)	0.800 (5.324)**
MB	0.018 (0.140)	0.018 (0.135)	0.019 (0.165)	0.022 (0.213)	-0.052 (0.458)
χ^2	62.704	62.115	61.793	61.948	35.749
Log-likelihood	298.151	298.740	299.061	298.906	164.486
Statistical significance	0.000***	0.000***	0.000***	0.000***	0.000***
Observations	270	270	270	270	162
% of correct classification	70.4	70.0	70.0	70.0	74.1

*   Statistically significant at a 10% level.
**   Statistically significant at a 5% level.
***   Statistically significant at a 1% level.

Table 9: Determinants of the joint decision to comply and to inform about the degree of compliance and the firm's corporate governance structure.

The data refers to 110 non-financial firms listed on the Spanish Electronic Market (1998-2000). The dependant variable COMPLINF is an ordered variable that takes value 3 if the firm complies, totally or partially, and informs; 2 if the firm complies, totally or partially, but does not inform; 1 if the firm does not comply, but informs, and 0 if the firm does not comply neither informs.
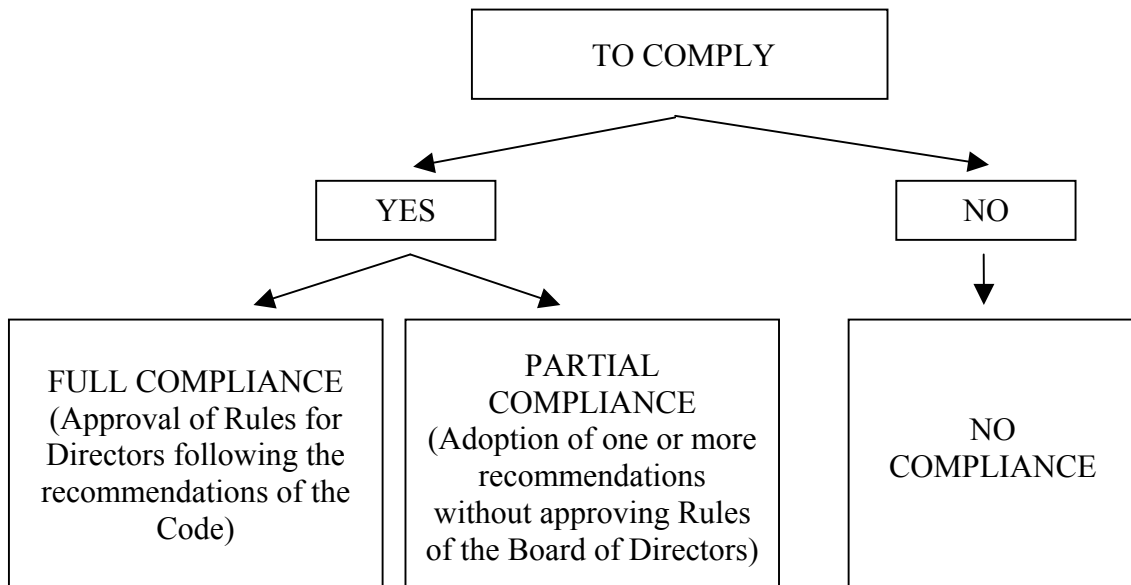
Model	Ordered Logit	Ordered Logit	Ordered Logit	Ordered Logit	Ordered Logit
Dependent variable	COMPLINF	COMPLINF	COMPLINF	COMPLINF	COMPLINF
Explanatory variables	Reg. 1	Reg. 2	Reg. 3	Reg. 4	Reg. 5
Constant	-4.078 (-3.692)***	-4.122 (-4.703)***	-4.365 (-5.290)***	-4.056 (-4.792)***	-4.631 (-3.631)***
FFLOAT	0.036 (5.679)***	0.035 (5.767)***	0.035 (5.768)***	0.038 (6.146)***	0.025 (2.844)***
INT	0.003 (0.363)	0.002 (0.356)	-0.000 (-0.043)	-0.051 (-2.073)**	-0.035 (-0.756)
INT2				0.001 (2.068)**	0.001 (0.735)
BSIZE	-0.032 (-0.070)				
BINT	-0.697 (-0.869)	-0.674 (-0.910)			
LEV	-0.426 (-0.561)	-0.410 (-0.579)	-0.444 (-0.632)	-0.533 (-0.746)	0.597 (0.532)
RESERV	-0.065 (-0.178)	-0.060 (-0.165)	-0.053 (-0.148)	-0.043 (-0.121)	0.122 (0.246)
PO	1.288 (4.822)***	1.288 (4.840)***	1.306 (4.932)***	1.333 (4.991)***	1.039 (2.377)**
SIZE	0.441 (3.292)***	0.434 (4.090)***	0.449 (4.328)***	0.391 (3.640)***	0.430** (2.589)*
PERF	0.187 (0.883)	0.186 (0.884)	0.180 (0.877)	0.200 (1.026)	0.907 (2.349)**
MB	0.014 (0.355)	0.014 (0.356)	0.016 (0.402)	0.030 (0.758)	-0.029 (-0.342)
χ^2	91.773	91.768	91.013	95.497	27.148
Log-likelihood	-299.496	-299.499	-299.876	-297.634	-112.111
Statistical significance	0.000***	0.000***	0.000***	0.000***	0.001***
Observations	270	270	270	270	128
% of correct classification	54.4	54.4	55.2	54.8	68.7

*   Statistically significant at a 10% level.
**   Statistically significant at a 5% level.
***   Statistically significant at a 1% level.

Graph 1: Decision to comply with the Code of Best Practice.

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                        ┌──────────────────────┐
                        │      TO COMPLY       │
                        └──────────────────────┘
                         ╱                    ╲
              ┌───────────┐              ┌───────────┐
              │    YES    │              │    NO     │
              └───────────┘              └───────────┘
               ╱         ╲                     │
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FULL COMPLIANCE (Approval of Rules for Directors following the recommendations of the Code)	PARTIAL COMPLIANCE (Adoption of one or more recommendations without approving Rules of the Board of Directors)	NO COMPLIANCE

Graph 2: Decision to inform about the degree of compliance with the Code of Best Practice and the firm's corporate governance structure.
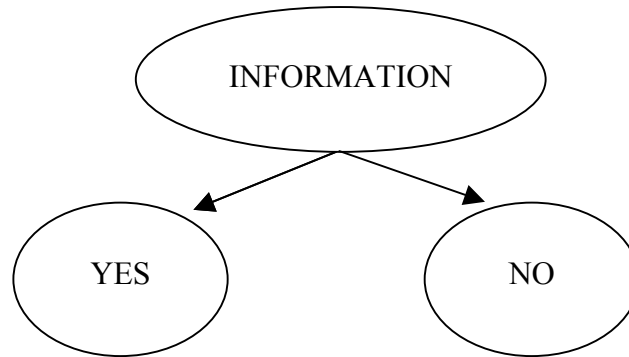
Graph 3: Joint decision to comply with the Code of Best Practice and to inform about the degree of compliance and the firm's corporate governance structure.

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                    ┌─────────────────┐
                    │  COMPLIANCE /   │
                    │   INFORMATION   │
                    └─────────────────┘
        ┌─────────┬─────────┴──────────┬──────────┐
        ▼         ▼                    ▼          ▼
┌───────────┐ ┌──────────┐ ┌─────────────┐ ┌───────────┐
│ COMPLIES  │ │ COMPLIES │ │  DOES NOT   │ │  NEITHER  │
│AND INFORMS│ │ AND DOES │ │ COMPLY AND  │ │ COMPLIES  │
│           │ │NOT INFORM│ │   INFORMS   │ │NOR INFORMS│
└───────────┘ └──────────┘ └─────────────┘ └───────────┘
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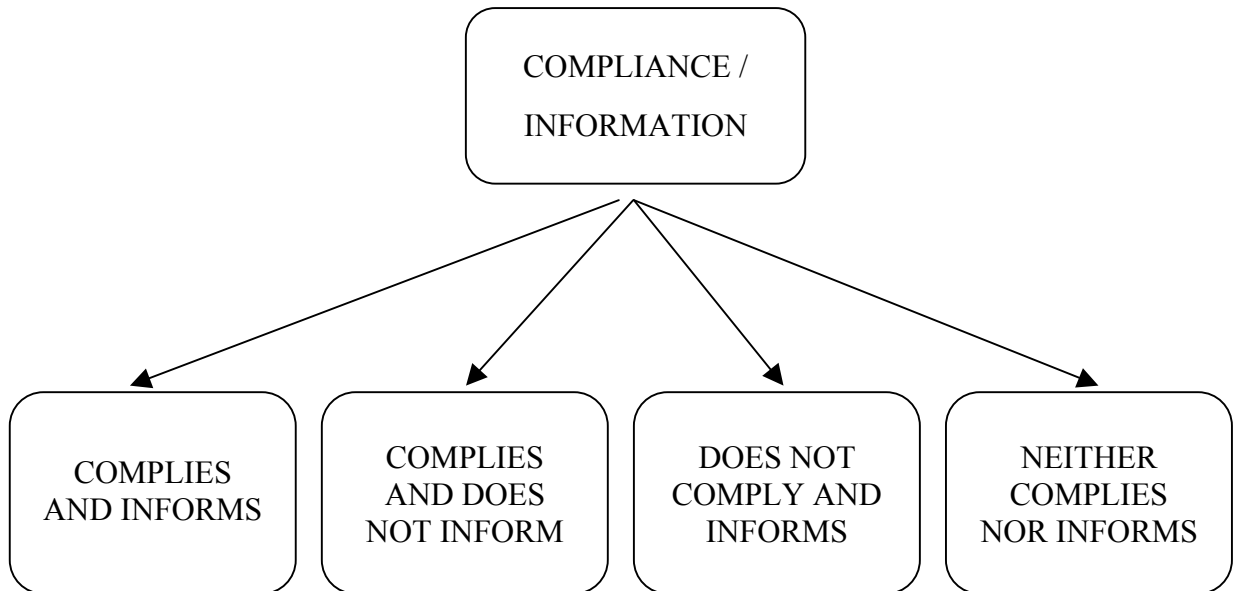
[i] Wu (2004) documents that the emergence of CalPERS led to reductions in firms' Board sizes and the number of inside directors. This evidence supports a relationship between shareholder activism and the evolution of boards.

[ii] Other examples of firms self-regulation include establishment of financial exchange, setting of safety standards, advertisement restrictions and voluntarily pollution abatement.

[iii] Spanish companies have a high ownership concentration. According to La Porta *et al*. (1999), while in Spain, the three largest shareholders hold 50% of the firm's shares, this figure stands at just 20% in the U.S., the U.K. and Japan. The proportion of firms with no controlling shareholder (that is a shareholder whose voting rights exceeds 20%), is 35% for listed large companies and 0% for medium-size listed companies. For the U.S. these percentages are 80% and 90% respectively. For Faccio and Lang (2002), for the whole sample of companies listed on the Spanish Stock Market, widely held companies stand at only 10 % when a 10% ownership is used as the threshold. The majority of large shareholders are family groups (67%) and widely-held financial companies (15.07%). State ownership, due to the privatisation process of the last decade of the 20th century, is almost negligible.

[iv] These 67 firms represented 70% of the Spanish Stock Market capitalisation.

[v] For an analysis of the relationship between disclosure and information intermediaries see Healy and Palepu (2001).

[vi] Several studies report the differences between financial and non-financial firms (Prowse, 1997; Stoney and Winstanley, 2001; Macey and O'Hara, 2003).

[vii] Codes of Ethics seem also to have had littel impact on firms' decision making (Lere and Gaumnitz, 2003).

[viii] Initially other corporate governance, asymmetry of information-related variables and control variables were included in the study: the presence of family groups as large shareholders, whether the Chairman of the Board also held the post of CEO, the ratio of pay-out and the age of the firms. Due to multicollinearity problems these variables were finally not included in the analyses.

[ix] Ownership concentration may also lead to corporate governance problems. When there are large shareholders, conflicts of interests are most likely to arise between majority and minority shareholders (Gugler 2001). These conflicts include agency problems, managerial entrenchment and tunnelling (Morck, 2000).

[x] Other studies, for example, Demsetz and Villalonga (2001) point out to the endogeneity of managerial ownership.

[xi] Nevertheless, one has to consider that, given the smaller size of Spanish listed firms, board sizes are larger than for the comparable company in the U.S.

[xii] The results of the analyses did not vary significantly when all the observations were considered.

[xiii] Nevertheless, although this non-linear relationship turns out to be statistically significant we must point out that the relation does not hold when considering all observations. Besides, the fact that the median value of internal ownership (0.36%) differs significantly from the mean value (11.40%) limits the reliability of the observed relation.

[xiv] In fact, the correlation coefficient between a dummy variable representing the presence of family groups and whether the firms inform voluntarily is negative and statistically significant at a 5% level.

[xv] This relationship does not turn out to be significant when considering the reduced sub-sample (Reg. 5).