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Mandatory versus Discretionary Rule Dichotomy in the Harmonization of Corporate Governance Codes: Lessons for Nigeria

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Abstract

Harmonizing corporate governance systems can potentially level the playing field for businesses, as it would increase financial and economic interconnections, including market integration, between countries. Although harmonization at the regional level such as the EU seems challenging because systems are so diverse, the reverse is the case at the national level. A critical issue in the harmonization effort is whether to adopt the "comply or explain" approach or the mandatory compliance approach. Although mandatory compliance is necessary in certain circumstances, particularly in cases of corporate pseudo-reporting that occasions corporate failures, the predominant approach involves "comply or explain". Given competing interests in the business community, the inclination for flexibility and the regulatory authority's disposition for an oversight function, this article argues that a hybrid approach should be followed, which will internalize the merits of both the "comply or explain" and mandatory compliance approaches while eschewing their disadvantages.

Keywords
Corporate governance, harmonization, code, comply or explain, mandatory rule, hybrid

INTRODUCTION

The separation of corporate governance models has been analysed deeply in the context of international convergence.[1] However, a time-hallowed issue

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1 J Armour et al "The basic governance structure: The interests of shareholders as a class" (2017, Oxford Legal Studies research paper no 11/2017) at 1, available at: <https://ssrn.com/abstract=2901416> (last accessed 3 September 2019).

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in the province of corporate governance appears to be the probability of the polarized models converging towards a single system.[2] The European Union (EU) has been of particular interest, given the level of corporate governance sophistication including its progressive approach to the harmonization process among member states.[3] From the orthodoxy of corporate governance taxonomy, the competing models are the Anglo-American "outsider" system, the continental "insider" system characterized by Germany and the Asia-Pacific model exemplified by the Japanese approach.[4] Given national histories, cultural backgrounds and financial traditions, each framework is exemplified by varying managerial strategies, structural approaches and ownership patterns.[5] In the wake of the last global financial crisis, there has been renewed interest in legal and economic arenas regarding the harmonization of "best practices" within corporate governance codes.[6] This has resulted from pressure for globalization and financial integration, including the major proliferation of global governance principles and codes.[7] The harmonization of corporate governance systems has the potential to level the playing field for

2 JN Gordon "Convergence and persistence in corporate law and governance" (2017) at 1, available at: <http://ssrn.com/abstract_id=3038742> (last accessed 3 September 2019); R Dore "Financialization of the global economy" (2008) 17 *Industrial and Corporate Change* 1097 at 1112.

3 G Suder and J Payte "European corporate governance: Harmonisation through knowledge management?" (2007) 3/1 *Journal of Contemporary European Research* 79 at 94.

4 These corporate governance systems are also known as the Anglo-American model (market-based system), the continental European model (bank-based and block-holder model) and the Asian Pacific system. Each model identifies the following constituent elements: key players in the corporate environment; share ownership pattern; composition of the board of directors; regulatory framework; disclosure requirements for publicly-listed stock corporations; corporate actions requiring shareholder approval; and interaction among key players. See C Elson et al "FMA roundtable on new developments in European corporate governance" (2017) 29/1 *Journal of Applied Corporate Finance* 50; R La Porta et al "Law and finance" (1998) 106 *Journal of Political Economy* 1113.

5 Comparatively, the Anglo-American system is also regarded as the market-oriented model, common law model, shareholder-centred model or liberal model. The continental model is variously labelled as the bank-oriented model, civil law model or stakeholder-centred model. There is also the Asian model represented by the Japanese system, which is network-oriented and emphasizes long-term relationships and communitarian values among corporate stakeholders. See I Haxhi and RV Aguilera "An institutional configurational approach to cross-national diversity in corporate governance" (2017) 54/3 *Journal of Management Studies* 261; R La Porta et al "Corporate ownership around the world" (1999) 54/2 *Journal of Finance* 471.

6 M Gelter "EU company law harmonization between convergence and varieties of capitalism" (30 May 2017) at 1–5, available at: <http://www.ssrn.com/abstract_id=2977500> (last accessed 3 September 2019); J Coffee "The future as history: The prospects for global convergence in corporate governance and its implications" (1999) 93/3 *Northwestern University Law Review* 641.

7 J Liu "Globalisation of corporate governance depends on both soft law and hard law" (2017) at 275, available at: <https://www.springerprofessional.de/en/globalisation-of-corporate-governance-depends-on-both-soft-law-a/12232442> (last accessed 3 September 2019).

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businesses because of the increasing financial and economic interconnections and market integrations between countries.[8] Given the difficulty in attaining a large-scale corporate governance harmonization framework at the regional level, the EU approach has been to work towards a flexible strategy of alternative mechanisms that permits members to adopt their various national codes. The corporate governance code-based approach, which is bolstered by the "comply or explain"[9] framework, is termed "procedural harmonization".[10] The EU experience offers illuminating guidance for emerging economies such as Nigeria from which useful lessons can be drawn.

Indeed, Nigeria's corporate governance landscape is underpinned by a multiplicity of overlapping regulatory frameworks. The Financial Reporting Council (FRC) tried to address this issue and unify the sectoral corporate governance codes with the 2016 Nigerian Code of Corporate Governance (NCCG). In January 2017 the federal government suspended the NCCG (which was intended to regulate the private sector, public sector and not for profit organizations) following stiff opposition from various stakeholders.[11] This suspension coincided with that of the FRC executive secretary / chief executive. The suspension, which was widely criticized and condemned, had more to do with politics and power-play than anything else. Nevertheless, the entrenchment of mandatory compliance in the suspended private sector code and the code's resultant rigidity was the principal reason the code was rejected by investors and the business community.[12] A similar rigidity underlies the "apply and explain" model in the 2018 draft NCCG, leading to disquiet among some investors.[13] Arguably, a necessary balance should be sought that satisfies the

8 E Poulton et al "The labyrinth of international governance codes: The quest for harmonization" (2017) 51/3 *The Journal of Developing Areas* 425; J Williamson "Globalisation, convergence and history" (1996) 56/2 *Journal of Economic History* 277.

9 The notion of "comply or explain" first came to recognition in 1992 following the Cadbury Report on the Financial Aspects of Corporate Governance. In the UK code, a prominent position is given to the functioning and remuneration of the board of directors, naming independent directors and the role of non-executive directors. See A Cadbury *The Report of the UK's Committee on the Financial Aspects of Corporate Governance* (1992) (the Cadbury Report). Other related models are: "comply and explain", "apply or explain" and "apply and explain".

10 MM Siems and OS Alvarez-Macotela "The G20/OECD Principles of Corporate Governance 2015: A critical assessment of their operation and impact" (2017) *Journal of Business Law* 310.

11 R Alex "Jim Obazee: 7 sins of fired secretary of Financial Reporting Council" (10 January 2017) *Nigeria Bulletin*, available at: <https://www.nigerianbulletin.com/threads/jim-obazee-7-sins-of-fired-secretary-of-financial-reporting-council.230414/> (last accessed 3 September 2019).

12 C Nwachukwu "Capital market investors reject new FRCN corporate governance code" (3 November 2016) *The Guardian* (Nigeria), available at: <http://guardian.ng/business-services/capital-market-investors-reject-new-frcn-corporate-governance-code/> (last accessed 3 September 2019).

13 M Adewale "Code of corporate governance 2018 supersedes CBN, SEC rules, says FRCN" (19 July 2018) *The Guardian* (Nigeria), available at: <https://guardian.ng/news/code-of-corporate-governance-2018-supercedes-cbn-sec-rules-says-frcn/> (last accessed 3 September 2019).

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inclination of investors and the business community towards flexibility, as well as the government's drive for an oversight function. This will be achieved by adopting a broad based hybrid model that internalizes the advantages of both the "comply or explain" and mandatory compliance approaches, while eschewing their disadvantages.

This article is divided into six main sections. Following this introduction, the next section provides an overview of corporate governance. The article then evaluates the Anglo-American model of corporate governance in comparison with the continental model and the Asian-Pacific model from the prism of culture, stock markets and convergence. The next section makes a panoramic analysis of diverse contours of harmonization, including the drive towards convergence evidenced in the "comply or explain" approach. The article then discusses the efforts at harmonizing different codes in Nigeria and the useful lessons Nigeria can learn from experiences in other jurisdictions, before offering some concluding remarks.

CORPORATE GOVERNANCE: AN OVERVIEW

As a contextual construct embedded in institutions, the term "corporate governance" has no universally accepted definition. Nevertheless, it may be described as a set of processes and structures for controlling and directing an organization.[14] Shleifer and Vishny view corporate governance in terms of the economic interests of the participants.[15] Former World Bank President James Wolfensohn views corporate governance as all about promoting corporate fairness, transparency and accountability.[16] Corporate governance seeks to ensure a fair return on investment and establishes incentives and procedures that meet the interests of shareholders while respecting other stakeholders' interests in the organization.[17] The Organisation for Economic Cooperation and Development (OECD) Principles of Corporate Governance stipulate that corporate governance provides the structure through which a company's objectives are set, and the means by which attaining those objectives and monitoring performance is determined.[18]

The fundamental arguments that underlie corporate governance can be traced back to the pioneering work of Berle and Means.[19] These corporate theorists observed that modern corporations have grown very large, necessitating the need to separate ownership from control. In essence, Berle and Means observed the difference between the owners and the people actually in control

14 The Cadbury Report, above at note 9.

15 See A Shleifer and R Vishny "A survey of corporate governance" (1997) 52/2 *Journal of Finance* 737.

16 J Wolfensohn "Corporate governance" (4 August 1997) *Financial Times* (London) at 24.

17 V Raffiee and J Sarabdeen "The cultural influence in the practice of corporate governance in the emerging markets" (2012) *Communication of IBIMA* 1.

18 See the G20/OECD *Principles of Corporate Governance* (2015).

19 A Berle and G Means *The Modern Corporation and Private Property* (1932, Macmillan).

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of corporations. Their observation led to a renewed emphasis on the behavioural dimension of the theory of the firm.[20]

The importance of corporate governance arises as a result of possible conflicts of interest among the various stakeholders in corporate management.[21] These potential conflicts of interest, often regarded as agency problems, are brought to bear from two notable sources. First, different stakeholders in a corporation have different objectives and preferences. Secondly, information asymmetry exists among the various participants in relation to their goals and preferences; the problem then arises from the separation of ownership and control because of the misalignment of interests between the principal and the agent.[22] Berle and Means identified these problems by examining the separation of corporate ownership from corporate control in public corporations and noting that the separation has the potential to provide executives with the ability to act in their own self-interest rather than in the interest of the principal (shareholders).[23] This fundamental argument is a major influence in every modern organization.[24] The agency issues arose from the diffusion of share ownership, leading to the owners' inability to observe the agent properly so as to ensure adequate returns on their investment.[25]

In light of the above, a model for reducing the agency problems became necessary.[26] Shareholder primacy theory, the stakeholder theory and the Asian-Pacific approach emerged in response to these conceptual governance issues.[27] From the perspective of shareholder primacy theory, which is prevalent in the US and the UK, it would appear that the corporation's sole objective is to maximize the interests of the shareholders, which means that the governance mechanism must prioritize shareholder value. However, the weakness of this system lies in the corollary of its strength. The inherent volatility, short-termism and inadequate governance procedures associated with the model have often led to periodic financial crises.[28]

On the other hand, the stakeholder theory, which is evident in continental Europe and epitomized by Germany, contends that corporations exist to cater for the wider interests of the affected constituencies, including shareholders,

20 Ibid.

21 Ibid.

22 See R La Porta et al "Investor protection and corporate valuation" (2002) 57/3 *Journal of Finance* 1147.

23 Ibid.

24 Ibid.

25 See T Clarke "The impact of financialization on international corporate governance" (2014) 8/1 *Law and Financial Markets Review* 39; J Parkinson et al *The Political Economy of the Company* (2001, Hart Publishing).

26 See M Iskander and N Chamlou *Corporate Governance: A Framework for Implementation* (2000, The World Bank Group) at 3.

27 T Clarke "Deconstructing the mythology of shareholder value" (2013) 3/1 *Accounting, Economics and Law* 15.

28 Ibid.

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creditors, employees and suppliers.[29] The German two-tier system, comprising a management board and a supervisory board, is typical of co-ordinated market economies and long term industrial strategies supported by capital investment.[30] However, the lack of flexibility and inadequate investment for new business remains a major source of concern in the system.[31]

The Asia-Pacific model of corporate governance systems is the most networked of all, with the firm at the middle of long and lasting economic relationships with investors, employees, suppliers and customers.[32] This insider system has encouraged the long term investment horizons and trust relationships in Asian economies.[33] However, one principal distinction between the western-oriented models, particularly the shareholder-oriented model and the Asia-Pacific model, is the "institutional rigidities" that underlie the latter, which neutralize shareholders' rights.[34] These "institutional rigidities" are reflected in Japan (where a powerful business lobby, Keidanren, and the judiciary balance shareholders' primacy rights to a certain extent), in China (where the prevalence of state-owned enterprises makes effective shareholder-based governance difficult), in Korea (where the influence of the large corporate groups, or *chaebol,* complicates shareholders' rights) and in India (where "pyramidal" business groups create similar challenges to shareholder governance).[35]

In Africa, the prevailing corporate governance system is generally a shareholder-centred model, with a stakeholder model becoming increasingly relevant. The prevalence of the shareholder-centred model is explained by English law influences on former colonies including Ghana, Kenya, Nigeria, South Africa, Zambia and Zimbabwe and the dominance of this model in financial development and capital market financing. Hence, a survey of corporate governance development in 13 major economies in Africa, including Nigeria,[36] indicates the predominance of the Anglo-American market-based

29 JJ du Plessis "An overview of German business or enterprise law and the one-tier and two-tier board systems contrasted" in JJ du Plessis et al *German Corporate Governance in International and European Context* (2017, Springer) 1 at 1–2.

30 Ibid.

31 M Goyer and K Jung "Diversity of institutional investors and foreign blockholdings in France" (2011) 19 *Corporate Governance: An International Review* 562.

32 T Seki and T Clarke "The evolution of corporate governance in Japan: The continuing relevance of Berle and Means" (2014) 37 *Seattle University Law Review* 717.

33 Ibid.

34 K Kato et al "Is Japan really a buy? The corporate governance, cash holdings, and economic performance of Japanese companies" (2017) 44/3–4 *Journal of Business Finance and Accounting* 485.

35 Ibid.

36 The economies were selected on the basis of corporate governance development and the availability of data. The countries surveyed were: West Africa: Nigeria and Ghana; North Africa: Egypt and Tunisia; Southern African: Malawi, Mauritius, Mozambique, South Africa, Zambia and Zimbabwe; and East Africa: Kenya, Uganda and Tanzania. For details, see *State of Corporate Governance in Africa: An Overview of 13 Countries* (2016, African

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system, where market forces strongly influence adherence to sound corporate governance. Nevertheless, the stakeholder model has an increasing influence, entailing gradual convergence between the shareholder-centred model and stakeholder model. This is typified by the King IV Code (King IV) applicable to South Africa. The stakeholder approach of King IV has permeated the corporate governance of other African countries, including the 2018 Draft NCCG. Also, stakeholder consideration forms a core objective of the African Union's Africa Peer Review Mechanism. The convergence of the shareholder-centred model with the stakeholder model in African corporate governance practices is congruent with emerging global practice.[37]

In addition, standard-setting institutions play a major role in shaping corporate governance in Africa. Development finance institutions, such as the International Finance Corporation, influence corporate governance in high debtor countries such as Ghana, Malawi and Uganda through incentives set out in development targets to strengthen the role of the private sector in stimulating economic activity and overall economic development. Similarly, the World Bank's Reports on Standards and Codes provide country-level reports on corporate governance to assist countries to improve.

The following section examines the influence of culture, stock markets, the convergence debate and board structure on Anglo-American jurisdictions, continental European countries, the Asia-Pacific economies and African economies.[38]

CULTURE, STOCK MARKET AND CONVERGENCE

Culture

Culture is reflected in various aspects of life, collective beliefs and value systems that influence corporate organization.[39] Values are the foundation of culture, as they shape attitudes and are instrumental in the design of state rules and governance structures.[40] It has been argued that the values and organizational structure of a corporation reflect the national culture in which that organization operates.[41] Culture influences organizational policies and corporate attitudes through the values held by the decision-makers.[42] This

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Corporate Governance Network) at 114–15, available at: <https://www.afcgn.org/wp-content/uploads/2016/03/ACGN-Corporate-Governance-Report-Feb-2016.pdf> (last accessed 3 September 2019).

37 See G20/OECD *Principles*, above at note 18 at 34.

38 M Roe *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (2006, Oxford University Press) at 204.

39 D Griffin et al "National culture: The missing country-level determinant of corporate governance" (2017) 48/6 *Journal of International Business Studies* 740.

40 H Hofestede *Culture's Consequences: Comparing Values, Behaviour and Institutions and Organisations Across Nations* (2nd ed, 2001, Sage Publications).

41 Ibid.

42 A Licht "The mother of path dependencies: Toward a cross-cultural theory of corporate governance systems" (2001) 26 *Delaware Journal of Corporate Law* 147.

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value system affects the relationship between individuals and institutions that ultimately shapes the corporate governance structure in a country.[43] Therefore, a corporate governance code is a reflection of the institutional norms and environment in which it is embedded.[44] For instance, the cultural impact of the continental stakeholder and Asia-Pacific models contrasts sharply with that of the shareholder model. States with a shareholder model, such as the UK and the US, are culturally individualistic, as the firm is managed for the shareholders.[45] By contrast, countries with a stakeholder approach, including the Asia-Pacific model, emphasize the communitarian values and long-term sustainability of firms. In other words, firms are managed with an emphasis on sustaining the interests of all the stakeholders as against the primacy of shareholder value.[46] In Germany and Japan, employees play a major role in the management of the company through their representation on the board.[47] The system promotes a collective egalitarian culture where corporations are managed for the long-term goal of all, not just for the short-term individualistic maximization of profits for the shareholders.[48]

In Africa, culture equally plays an increasing role in shaping the principles of corporate governance. Although the "comply or explain" model remains the predominant paradigm for corporate governance codes, some African countries are adapting this model to suit their cultural peculiarities. This is exemplified by King IV that adopted the "apply and explain" model, which assumes compliance at the outset and requires explanation merely to indicate "practices that have been implemented and the progress made toward giving effect to each principle".[49] Moreover, the notion of *ubuntu* (which generally connotes the African version of social capital), used in King IV in South Africa, is illustrative of cultural influence on corporate governance.[50] This

43 Ibid.

44 The institutional environment includes such things as the political environment, the capital market, the labour market and the legal systems, all of which are part of societal norms. See A Humphries and C Whalen "National culture and corporate governance code" (2017) 17/1 *International Journal of Business in Society* 152.

45 R Ntongho "Culture and corporate governance convergence" (2016) 58/5 *International Journal of Law and Management* 523.

46 Ibid.

47 The collective nature of the German system restricts excessive risk-taking and high executive remuneration, thereby promoting the stability and long-term sustainability of corporations. See J Li and JR Harrison "National culture and the composition and leadership structure of board and directors" (2008) 16/5 *Corporate Governance: An International Review* 375.

48 Ibid.

49 International Finance Corporation "What we learned about corporate governance and code development in sub-Saharan Africa" (2018) at 8–9, available at: <https://www.ifc.org/wps/wcm/connect/0284a64d-8879-4f09-933c-4d200e41c123/What_We_Learned_about_CG_and_Code_Development_in_SSA.pdf?MOD=AJPERES&CVID=mkr5hSj> (last accessed 3 September 2019).

50 Id at 10.

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same idea of *ubuntu* is expressed as *unhu* in Zimbabwe, in Malawi as *uMunthu*, in Burundi and Rwanda as *ubuntu*, and in Uganda and Northern Tanzania as *obuntu*.[51] The notion of *ubuntu* is about entrenching African culture and philosophies within corporate governance codes and practices. The "apply and explain" model of King IV has been adopted in the 2018 Draft NCCG.

Financing

The Anglo-American model relies largely on equity capital as the source of finance for operations.[52] Under this model, the capital markets play a major role in encouraging sound governance practices.[53] In essence, individual and institutional investors own the majority of equity shares and financial development is often rapid.[54] There is a consistent dependence on legal rules and effective legal enforcement of shareholders' rights.[55] On the other hand, the continental European model is structured in such a way that banks play a key role in the funding of companies and so may well be able to exercise some control through the board structure.[56] This model depends mainly on short-term bank loans for running businesses, as opposed to long term equity capital raised through share subscription in the capital market.[57] Major equity holdings in these corporations are owned by the lending banks. Hence, banks are relied upon to enforce sound corporate governance practices on corporations. In Asia-Pacific, the core value of communitarianism, exemplified in Japan, has shaped corporate governance practice.[58] This insider approach has yielded the longest investment of all, and could be the main reason for the resounding success of Japanese businesses in dominating major overseas markets in both the US and Europe with affordable consumer goods.[59]

Broadly speaking, there is general support for the idea that effective corporate governance reduces the cost of equity financing.[60] Similarly, firms with

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51 Ibid.

52 G Krippner *Capitalising on Crisis: The Political Origins of the Rise of Finance* (2012, Harvard University Press); A Licht et al "Culture, law, and corporate governance" (2005) 25 *International Review of Law and Economics* 229; M Ungureanu "Models and practices of corporate governance worldwide" (2012) 3 *CES Working Papers* 625.

53 P Lele and M Siems "Shareholder protection: A leximetric approach" (2007) 7/1 *Journal of Corporate Law Studies* 17.

54 See M Siems "The case against harmonisation of shareholder rights" (2005) 6 *European Business Organization Law Review* 539.

55 B Amable et al "Changing French capitalism: Political and systemic crises in France" (2012) 19/8 *Journal of European Public Policy* 1168.

56 Ibid.

57 M Berndt *Global Differences in Corporate Governance Systems* (2002, Deutscher Universitätsverlag) at 17–18.

58 T Clarke "The continuing diversity of corporate governance: Theories of convergence and variety" (2016) 16/1 *Ephemera Journal of Theory & Politics in Organisation* 19.

59 Ibid.

60 See generally V Mande et al "Equity or debt financing: Does good corporate governance matter?" (2011) 20/2 *Corporate Governance: An International Review* 195.

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stronger shareholders' rights have high share values and enjoy a lower cost of equity capital. While these results provide the link between governance and the cost of equity, they do not provide direct evidence as to whether the quality of governance influences a firm's decision to finance its investment opportunities using equity instead of debt or loan financing. There is an argument that firms with strong governance benefit from higher credit ratings on debt issuances. Further, effective corporate governance is said to reduce the default risk by mitigating the agency cost through better monitoring of managerial performance. Given that corporate governance has a positive connotation with both equity and debt financing, the financing policy to be chosen, whether in the UK, Germany, Japan or emerging markets such as Nigeria, is dependent on empirical analysis.[61] However, firms with high quality governance will prefer equity financing for a few reasons. First, equity compared to debt is more sensitive to information asymmetry given the agency costs. Similarly, the cost of issuing equity is associated with adverse selection issues due to information asymmetry, while the costs of debt financing are largely associated with the expected cost of financial distress. Firms choose equity financing when adverse selection problems are reduced as a result of high quality audits that can lead to true earnings being reported. Moreover, the governance structure is expected to be stronger for equity issuers than for debt issuers. Equity holders depend on a board of directors and other governance mechanisms to monitor managers continually, whereas debt holders generally interfere with management decisions that have an impact on liquidation. This suggests that issuing equity relies more on the effectiveness of corporate governance. Agency theory regards debt financing as a bonding device and bond holders can use covenants to reduce directly any agency risk that they face, which entails that there should be a relatively small effect of corporate governance on the cost of debt financing.[62]

Convergence or divergence: Towards a single model

Aside from culture and financing techniques, intense debate remains regarding which of the three corporate governance models (the Anglo-American, the continental European or the Asia-Pacific) is more robust than the others, and which system will prevail over others, effectively pushing the others towards a single system. In other words, is the system moving towards convergence or divergence? Fanto argued earlier that the globalization of the economy is pushing corporate governance systems internationally towards US-style market capitalism.[63] However, this seems to ignore the efficiency that underpins the continental European model, particularly the German dual-structured

61 X Chang et al "The effect of auditor quality on financial decisions" (2009) 84 *Accounting Review* 1085.

62 Ibid.

63 J Fanto "The role of the corporate law in French corporate governance" (1998) 31/1 *Cornell International Law Journal* 31 at 32.

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and co-determination model and the network-oriented system in Japan.[64] Despite the plethora of theoretical and empirical studies on this controversy,[65] the issue remains inconclusive given that there currently seems to be no agreement as to which corporate model is the best and whether corporate legal convergence should be encouraged.[66] In other words, scholars are not in agreement as to whether global corporate governance is converging towards the US and UK models or otherwise.[67] However it is noteworthy that convergence can move either way. For instance, the enlightened shareholder value enshrined in section 172 of the UK Companies Act 2006 brings UK corporate governance closer to the stakeholder model, particularly its increased emphasis on sustainability and the protection of the interests of non-shareholders.[68]

Superiority debate

Given the lack of agreement on convergence, the debate has extended to the question of the superiority of one system over the others. Strenuous arguments have been advanced to illustrate that the shareholder-oriented system is superior to other systems. The shareholder-oriented system is based on well developed capital markets, institutional investors, effective investor protection, a market for corporate control and shareholder value.[69] This model encourages greater willingness among investors to provide financing, as it attempts to ensure that shareholders get the most from their investment. Arguably, this leads to a more developed and better functioning financial market, which ultimately results in higher company valuation and long-term economic growth.[70] Furthermore, the superiority of this system is premised on the fact that frequent exposure to takeovers acts as a check to managerial

64 G Jackson and R Deeg "The long-term trajectories of institutional change in European capitalism" (2012) 19/8 *Journal of European Public Policy* 1109.

65 B Cheffins "Current trends in corporate governance: Going from London to Milan via Toronto" (1999) 10 *Duke Journal of Comparative & International Law* 5 at 5–6; J Gordon "Pathways to corporate convergence? Two steps on the road to shareholders capitalism in Germany" (1999) 5/219 *Columbia Journal of European Law* 219.

66 G Jackson and A Sorge "The trajectory of institutional change in Germany 1979–2009" (2012) 19/8 *Journal of European Public Policy* 1146.

67 P Chhillar and R Lellapalli "Divergence or convergence: Paradoxes in corporate governance?" (2015) 15/5 *Corporate Governance* 693; R Gilson "Globalizing corporate governance: Convergence of form or function" (2001) 49 *American Journal of Comparative Law* 329; J McCahery et al *Corporate Governance Regimes: Convergence and Diversity* (2002, Oxford University Press).

68 CC Ajibo "A critique of enlightened shareholder value: Revisiting the shareholder primacy theory" (2014) 2/1 *Birkbeck Law Review* 37.

69 M Yeung and W Yu "The information content of stock markets: Why do emerging markets have synchronous prices movement?" (2000) 58 *Journal of Financial Economics* 215.

70 R Levine "Law, finance and economic growth" (1999) 8/1–2 *Journal of Financial Intermediation* 8.

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independence and self-interest.[71] Arguably, this enables the subsequent acquirer to reallocate the target resources in a profitable way.[72] However, this argument remains doubtful, given that there is emerging evidence that managers in the Anglo-American model could behave in a short-sighted way if too much attention is paid to the short-term evolution of stock prices.[73] Nevertheless, Hansmann and Kraakman argue that the growing acceptance of the shareholder-centred system in corporate law by global businesses, governments and legal experts will bring about changes in corporate law, resulting in corporate governance convergence towards the Anglo-American system.[74] Milhaupt notes that Hansmann and Kraakman provided a provocative account of one of the principal devices driving corporate governance convergence in their argument: the ascendancy of the shareholder primacy norm.[75] However, Romano expresses scepticism about the degree of global corporate governance convergence.[76] In a similar vein, Gilson contends that, even if global convergence is unlikely to be attained on account of the regulatory and institutional inhibitions existing in various jurisdictions, there could be contractual convergence of the best corporate practices.[77] For instance, a corporation may decide to avoid its national corporate governance standard by choosing another corporate governance system. This means convergence at the corporate level rather than at the federal, national or state levels.[78] There has been an appreciable increase in such contractual schemes of convergence over the past few decades through cross listings,[79] a switch to the state of incorporation, as well as cross border mergers and acquisitions.[80]

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71 Ibid.

72 MC Jenson "The modern industrial revolution, exit, and the failure of internal control systems" (1993) 48/3 *Journal of Finance* 831 at 831–37.

73 In a survey paper on the economics of mergers and acquisitions, Berglof et al contend that managers protected from the threat of takeovers do not necessarily behave like empire-builders, but instead tend to be sluggish: E Berglof et al "European takeover regulations" (2003) 18/36 *Economic Policy* 171.

74 H Hansmann and R Kraakman "The end of the history for corporate law" (2001) 89 *Georgetown Law Journal* 439.

75 C Milhaupt "Creative norm destruction: The evolution of non legal rules in Japanese corporate convergence" (2001) 149 *University of Pennsylvania Law Review* 2083 at 2128.

76 R Romano "A cautionary note on drawing lessons from comparative corporate law" (1993) 102 *Yale Law Journal* 2021 at 2031.

77 Gilson "Globalizing corporate governance", above at note 67.

78 A Licht "Cross-listing and corporate governance: Bonding or avoiding?" (2003) 4/1 *Chicago Journal of International Law* 141.

79 Ibid.

80 A Bris and C Cabolis "Corporate governance convergence by contract: Evidence from cross-border mergers" (2002) *Yale School of Management Working Papers* 293. Companies may incorporate in countries or states with friendly corporate governance rules. For instance, in the US, Delaware accounts for almost 60% of all incorporations. This may not be unconnected with the fact that a switch to incorporation in Delaware has a positive effect on corporate value. Under international law, when a foreign corporation

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While the proponents of the Anglo-American system may claim its superiority, the advocates of alternative models, such as the state-oriented and other stakeholder-based systems in continental Europe and the Asia-Pacific model, have different views. In other words, the advocates of this alternative model believe that the major benefit of the system is found in the manner in which the system resolves the problem of misalignment of interests between the managers and shareholders.[81] In the common law jurisdictions, this crisis is addressed through effective monitoring, a market for corporate control as well as regulations that mandate managers to pay particular attention to shareholders' interests.[82] Under the stakeholder models epitomized by the German and Japanese models, the role of the stock market in the provision of financing is played down and a harmonious stakeholders' relationship is emphasized,[83] with the bank considered the major source of capital.[84] For instance, there is relative underdevelopment of the capital market in Germany compared to the stock markets in the US, UK and other similar jurisdictions.[85] Similarly, the market for corporate control remains weak and takeovers tend to be rare in jurisdictions with a stakeholder model. The ownership structure is concentrated, unlike in jurisdictions with a shareholder model, where ownership remains dispersed.[86] Further, large national banks hold substantial shares in corporations under the stakeholder model.[87] In the Asia-Pacific model, in particular the Japanese model, the "Keiretsu" system consists of an interconnected web of banks that act as the lenders, which could engage in a monitoring role including intervening in firms to avert corporate collapse.[88]

A further perspective is based on the international competition hypothesis, which contends that the major competing systems should borrow from one another, which is likely to end up with a "hybrid model" giving room for

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acquires 100% of a domestic firm, the nationality of the firm changes. Hence, the target corporation usually adopts the accounting standards, disclosure practices and governance structures of the acquiring firm. See M Pagano et al "The geography of the equity listing: Why do companies list abroad?" (2002) 57/6 *Journal of Finance* 2651; R Daines "Does Delaware law improve the firm value?" (2001) 62/3 *Journal of Financial Economics* 525.

81 See M Becht "European corporate governance: Trading off liquidity against control" (1999) 43/4–6 *European Economic Review* 1071.

82 Ibid.

83 C Searcy "Corporate sustainability performance measurement system: A review and research agenda" (2012) 107/3 *Journal of Business Ethics* 239.

84 Ntongho "Culture and corporate governance", above at note 45.

85 Ibid.

86 Ibid.

87 Ibid.

88 In Japan, "Keiretsu" is a set of companies with interlocking business relationships and shareholdings: a conglomeration of businesses linked together by cross-shareholdings that form a robust corporate structure.

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the right mix of market discipline, corporate stakeholder power and corporate regulation.[89] This view is in line with the position of the European Commission, which advocates that corporations should be given the space to choose the practice that best suits their needs. Accordingly, corporations in various countries should channel their attention towards addressing the observed weaknesses that should form the basis of their reforms, without attempting to converge to one model.[90] In effect, each system appears to enjoy certain comparative advantages with regard to solving the agency problem.[91] Since the long-term interests of the shareholders and stakeholders may not necessarily conflict, it is only reasonable to expect the monitoring devices to produce related outcomes in the form of long-term wealth creation for corporations.[92] Consistent with this argument, the empirical literature shows mixed evidence about the relative benefits of the models, indicating that the alternative systems illustrated by the Japanese and German models are as efficient as the Anglo-American system.[93] Consequently, the diversity of national cultures and cultural practices among countries entails that corporate governance rules and practices around the world will remain largely divergent in the foreseeable future, but with a greater emphasis on integration and convergence.

Unitary versus two-tier board structure

Divergence in the corporate governance model is also reflected in board structures. The Anglo-American systems operate a unitary or one-tier board structure.[94] A unitary board structure has also permeated other jurisdictions, including Australia, Nigeria, Singapore and South Africa. It is characterized by a single board made up of the executive and non-executive directors, with the active participation of the shareholders in nominating members. The board structure benefits from collaborative meetings of all members,[95]

89 J Koke "The market for corporate control in bank-based economy: A governance device?" (2004) 10/1 *Journal of Corporate Finance* 53.

90 L Bebchuk and A Ferrell "A new approach to takeover law and regulatory competition" (2001) 87/1 *Virginia Law Review* 111.

91 See D Branson "The very uncertain prospect of 'global' convergence in corporate governance" (2001) 34/2 *Cornell International Law Journal* 321.

92 Ibid.

93 See M Becht and E Boehmer "Voting control in German corporations" (2003) 23/1 *International Review of Law and Economics* 1 at 1–2; E Boehmer "Business groups, bank control and large shareholders: An analysis of German takeovers" (2000) 9/2 *Journal of Financial Intermediation* 117.

94 See N van der Zwan "Making sense of financialization" (2014) 12/1 *Socio-Economic Review* 99.

95 N Ofo "Much ado about independent directors in Nigeria" (2011) *International Company and Commercial Law Review* 250; N Osemeke and L Osemeke "The effect of culture on corporate governance practices in Nigeria" (2017) 14/4 *International Journal of Disclosure and Governance* 318.

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but appears to suffer from a lack of independence provided by the supervisory boards.

In contrast, the continental model represented by the German corporate structure is underpinned by a two-tier board structure consisting of the management board (*Vorstand*) and a supervisory board (*Aufsichtsrat*).[96] Both shareholders and employees participate in appointing members.[97] Unlike the unitary board structure, the two-tier board structure ensures better monitoring of the executive board. However, the German supervisory board lacks adequate power to direct the management board, as its power is merely advisory.[98]

In Asia-Pacific, the board structure reflects both the cultural peculiarities and influences of the western-oriented approach. In China, a two-tier board structure is generally practised, comprising a supervisory board and an executive board of management.[99] The supervisory board monitors the executive, while the latter undertakes the day-to-day management of the corporation. In Japan, the Commercial Code (as amended in 2002) permits corporations to elect to adopt either a one-tier or a two-tier board structure.[100] In accordance with Japan's Corporate Governance Code, which became effective in 2015, corporations are required to appoint at least two independent directors to the board.[101] In order to protect the non-identical stakeholders in the corporation, the culture of lifetime employment and employee participation through board membership remains a cardinal feature of Japanese corporate practice. In keeping with the tradition of rewarding the loyalty of employees, board members are chosen from within companies, among the senior managers who have served the company over a long period.[102] In return, employees feel valued and incentivized to improve performance as they regard themselves as equal partners and residual claimants in the firm. Even in the instances where a shareholder-style form of governance is being instituted, it is carried out within the framework of Japanese culture.[103] As an

96 The collective nature of German corporate culture is determined in co-determination law, which allocates seats to employees on the supervisory board: du Plessis "An overview of German business", above at note 29 at 1–4.

97 C Mallin *Corporate Governance* (2nd ed, 2007, Oxford University Press).

98 P Abels and T Martelli "Corporate governance and transparency" (2013) 7/1 *Journal of North American Management and Society* 1.

99 CH Yun Tan "The one-tier and two-tier board structures and hybrids in Asia: Convergence and what really matters for corporate governance" (May 2014) at 4, available at: <https://www.ssrn.com/abstract=2140345> (last accessed 3 September 2019).

100 Seki and Clarke "The evolution of corporate governance", above at note 32.

101 T Hiura and J Ishikawa "Corporate governance in Japan: Board membership and beyond" (February 2016) *Bain Insights*, available at: <http://www.bain.com/publications/articles/corporate-governance-in-japan-board-membership-and-beyond.aspx> (last accessed 3 September 2019).

102 R Gilson and J Milhaupt "Choices as regulatory reforms: The case of Japanese corporate governance" (2005) 53/2 *American Journal of Comparative Law* 343.

103 Ibid.

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illustration, the Japanese Commercial Code carefully gave employees a voice in decision-making to ensure that their rights are strongly protected.[104] Unlike the shareholder primacy jurisdictions, where the position of independent director may not be mandatory in most corporate codes, independence in this model is widely defined to permit executive directors to sit on the board to protect employees' interests.[105] In sum, Japan appears to be creating a hybrid that incorporates certain shareholder-oriented principles that are believed to enhance their investment, as well as some aspects of stakeholder-oriented principles. The following section examines the code-based harmonization of corporate governance.

DIVERSE CONTOURS OF HARMONIZATION DEBATE

Harmonization does not strictly mean unification. For the sake of clarity, unification aims for the total substitution of the existing legal arrangement with a new order through regulation.[106] On the other hand, harmonization seeks to effect an approximation or co-ordination of different legal provision or systems by eliminating major differences so as to create minimum requirements or standards.[107] Harmonization can be seen as a step towards unification and, in a way, it strives towards unification.[108] A well-coordinated corporate governance structure through harmonization has the potential to create a more favourable climate for investment and economic revival.[109] At the EU level as well as at the national level, harmonizing the corporate governance framework can encourage investor and lender confidence, including the ability to promote both local and foreign investment, which ultimately inspires corporate competitiveness.[110] However, given existing polarization, it is doubtful whether the desired harmonization of corporate governance frameworks is

104 Ibid.

105 Ibid.

106 B Fagbayibo "Towards the harmonisation of laws in Africa: Is OHADA the way to go?" (2009) 42/3 *Comparative and International Law Journal of Southern Africa* 309.

107 See J Faria "Future directions of legal harmonisation and law reform: Stormy seas or prosperous voyage" (2009) 14/1–2 *Uniform Law Review* 5.

108 In the EU, harmonization aims at the formation of a common set of rules characterized by directives designed to allow for differentiation by member states, contextualizing the union-level legislative arrangement in local practice, including the possibility of opting out of the order: N Ferreira "The harmonisation of private law in Europe and children's tort liability: A case of fundamental and children's rights mainstreaming" (2011) 19/3 *The International Journal of Children's Rights* 571.

109 The EU minimum harmonization concept began with the notion of the Single European Act and has been particularly prominent since Maastricht, with its gains of allowing flexibility and diversity in the regulatory system. The Maastricht Treaty created the European Union and the so-called "three-pillar" structure consisting of the European Communities, a common foreign and security policy, and police and judicial cooperation in criminal matters. See J Steiner and L Woods *EU Law* (10th ed, 2009, Oxford University Press).

110 D North "Economic performance through time" (1994) 84 *American Economic Review* 359.

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attainable. These polarized boundaries of governance systems present a harmonization conundrum.[111]

Models of harmonization and diversity of regimes

Demands for the harmonization of laws are generally based on the belief that legal diversity causes transactional costs, leads to legal uncertainty and lowers economic trade and welfare. Hence, different shades of harmonization are deployed to address national legislation, national control procedures or cross-border rules typified by the EU approach.

Total harmonization

This occurs when no derogation is permissible, except safeguard measures as needed.[112] For instance, the European Community Council directive of 1970 relating to additives in foodstuffs is an example of total harmonization.[113] Total harmonization was the preferred approach in the early days of the European Community's harmonization programme when the specific and detailed provisions eliminating barriers to trade were still being defined.[114] However, total harmonization lacks the flexibility needed to regulate at the national level. Indeed, such flexibility and power to administer rule at the national level were lacking under this concept.

Optional harmonization

Unlike total harmonization, optional harmonization offers an option to follow either the harmonizing rules or the national rules. Products traded cross-border must meet the harmonized standards or standard of the country of destination. The main benefit of this is that businesses operating within a customs union can establish one product type.[115] An example of optional harmonization is the approximation of laws of EU member states regarding approved standards for the sound levels and exhaust systems of motor vehicles. The provision provides for free movement within member states as long as there is compliance with these standards, but there is an option to

111 Practice shows that the EU harmonization effort has tried to shape a mutual pattern comprising best practices from the Anglo-American and continental models. Similarly, many international agencies encourage hybrid convergence by arguing for the common standard to be adopted, but previous theoretical development does not seem to indicate that even the move towards best practices can absorb all possible variations. However, from the standpoint of strong voices, one might be tempted to argue that, with the desired end result of harmonization still unclear in the field of corporate governance, it is doubtful whether minimum harmonization is attainable in short-term.

112 A Keay "Harmonisation of avoidance rules in European Union insolvencies: The critical elements in formulating a scheme" (2018) 69/2 *Northern Ireland Legal Quarterly* 85.

113 Directive No 70/458/EEC, art 3, para 1.

114 Until the end of 1974, 30 out of a total of 70 acts involving the harmonization of laws enshrined total harmonization. Thereafter, total harmonization has been restricted to a few legal areas, such as product standards.

115 See Council Directive 70/157 of 1970, art 2.

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adhere to national rules instead. Optional harmonization provides greater flexibility in comparison with total harmonization.

Partial harmonization

Unlike optional harmonization, which is underpinned by two sets of rule (one for intra-community transactions and the other for domestic trade), in partial harmonization the harmonizing rule applies to cross-border transactions.[116] This requires cross-border businesses to be regulated by community rules. Nonetheless, the problem with partial harmonization is that it does not provide the necessary options for manufacturers when compared with optional harmonization. Similarly, partial harmonization is rarely used at national level given that the subject matter to be regulated can sometimes involve setting a rule beyond transnational movement.[117]

Minimum harmonization

Minimum harmonization is set as an overarching framework but member states in a custom union have the option individually or collectively to provide for stricter rules.[118] Whether a member state can exercise the option to establish higher standards depends on the country's policy priorities and industry's strategic interests, as countries with a strong bias towards safeguarding critical national industries may find it politically wise to make stricter rules to ensure such protection.

Diversity of codes in application

In a study of 15 African countries selected on the basis of the strength of their GDP and the availability of corporate governance instruments, it was found that diversity underpins the application of harmonized codes. Hence, the "comply or explain" approach obtains in Egypt, Ethiopia, Malawi, Morocco, Rwanda, Tanzania and Zambia; the "voluntary" approach applies to Ghana, Mozambique, Tunisia and Uganda; the "apply and explain" approach obtains in Mauritius, Nigeria and South Africa; and "apply or explain" applies to Kenya.[119] The model adopted by these countries is far from total harmonization, given the continued application of sector-specific and / or subject-matter-specific codes operating alongside the national code.[120] In Nigeria, the existing sector-specific codes, such as the Central Bank of Nigeria (CBN) code, and the Securities and Exchange Commission (SEC) code, will continue to apply in areas not provided for by the 2018 Draft NCCG.

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116 P Slot "Harmonisation" (1996) 21 *European Law Review* 378 at 378–79.

117 Ibid.

118 Ibid.

119 *Balancing Rules and Flexibility for Growth: A Study of Corporate Governance Requirements Across Global Markets: Phase 2 - Africa* (2017, KPMG-ACCA) at 11, available at: <https://home.kpmg.com/content/dam/kpmg/sg/pdf/2017/06/balancing-rules-and-flexibility-for-growth.pdf> (last accessed 3 September 2019).

120 *State of Corporate Governance*, above at note 36 at 114–15.

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Harmonization of substantive law

It should be noted that no real effort was made towards harmonizing the corporate governance framework until the 1990s.[121] At the regional level, the concept is only an integral part of the EU harmonization process.[122] Before this, the existing EU structure on governance models was intended for total harmonization based on the legal systems of member states.[123] The integral part of the directive relating to the governance of companies was substantially influenced by the German model exemplified by the two-tier board system.[124] The criticism the draft directive received was an indication of the difficulty that underpins the harmonization of various corporate governance practices.[125] Because of the unsuccessful attempt to impose rigid substantive rules, the EU directive permitted greater flexibility at the national level. A major feature of this directive standard is the introduction of optional or minimal harmonization, including an "opt out" provision in the existing regulatory regimes.[126]

However, it can be argued that this legal co-ordination through a community directive remains inconclusive, principally because other corporate areas outside the confines of cross-border issues were left untouched on account of being domestic in nature.[127] This weakness in the earlier harmonization of substantive rules leaves room for further diversity at the national level.[128] This prompted the need to search for more flexible approaches for interventions in corporate governance issues.[129] Consequently, an element of flexibility is required in the harmonization of the national codes of "best practices".[130] A code-based model predicated on the "comply or explain" approach presents the relevant flexibility but requires bolstering with an

121 T Clark "Cycles of crisis and regulation: The enduring agency and stewardship problems of corporate governance" (2004) 12/2 *Corporate Governance International Review* 153 at 153–57.

122 See B Hannigan *Company Law* (2nd ed, 2009, Oxford University Press) at 43.

123 L Cernat "The emerging European corporate governance model: Anglo-Saxon, continental or still the century of diversity?" (2004) 11/1 *Journal of European Public Policy* 147.

124 J Dine "Implications for the United Kingdom of the EC Fifth Directive" (1989) 38/3 *International and Comparative Law Quarterly* 547; L Enriques "Mandatory bid rule in the take over directives: Harmonization without foundation" (2004) 1 *European Company and Financial Law Review* 440 at 440–41.

125 E Wymeersch "Company law in turmoil and the way to global company practice" (2003) 3 *Journal of Corporate Law Studies* 283.

126 K Hopt "Comparative corporate governance: The state of the art and international regulations" (2011) 59/1 *American Journal of Comparative Law* 1.

127 Ibid.

128 Ibid.

129 Ibid.

130 Unlike standard harmonization, where prescriptive rules and procedures are imposed, the "comply or explain" approach is a non-binding co-ordination tool strategically crafted in corporate governance that is partly based on self-regulation. It is derived from formulated reports and recommendations that have over time metamorphosed into a code of practice.

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element of mandatory prescription,[131] together with effective monitoring and enforcement.

"Comply or explain" code-based approach

The UK pioneered the corporate governance framework based on the "comply or explain" model, following the 1992 Cadbury Report on the Financial Aspects of Corporate Governance (Cadbury Report).[132] Companies are not bound to adopt the rules in the resulting UK Corporate Governance Code (UK Code),[133] as it is non-binding. However, they are required to state the reasons for non-compliance with the recommendations in the UK Code. The UK Code sets standards of good practice in relation to board leadership and effectiveness, remuneration, accountability and relations with shareholders. It further provides that all companies with a premium listing of equity shares in the UK are required under the Listing Rules to report in their annual report and accounts on how they have applied the code.[134] The UK Code contains broad principles as well as more specific provisions. Listed companies are required to report on how they have applied the main principles of the code, and either to confirm that they have complied with the code's provisions or, where they have not, to provide an explanation. Compliance with some of the provisions of the UK Code require disclosures to be made.[135] It is important that companies provide clear and meaningful

131 The Sarbanes-Oxley Act (SOX) (*Public Law* 107, 116 Stat 745, enacted 30 July 2002), officially called the Public Company Accounting Reform and Investor Protection Act, is an act passed by US Congress in 2002 to protect investors from the possibility of fraudulent accounting activities by corporations. SOX mandated strict reforms to improve corporate financial disclosures and prevent accounting fraud. Furthermore, in the aftermath of the global financial crisis of 2007–09, the US enacted a comprehensive new law to deal with its financial institutions and investors entitled the Dodd Frank Wall Street Reform and Consumer Protection Act 2010. Title IX (secs 901–91) of this act ("Investor protections and improvements to the regulation of securities") further strengthened the role of the US SEC relating to corporate governance issues.

132 Since the Cadbury Report in 1992, above at note 9, over 50 codes have been introduced and adopted in different countries. The Cadbury Report has been superseded by many successive reports culminating in a Combined Code and the current UK Code. See V Magnier "Harmonisation process for effective corporate governance in the European Union: From a historical perspective to future prospects" (2014) 41/1 *Journal of Law and Society* 1.

133 The current version of the UK Code (formerly the Combined Code) is available at: <https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF> (last accessed 3 September 2019).

134 The new code applies to accounting periods starting on or after 17 June 2016 and applies to all companies with a premium listing of equity shares regardless of whether they are incorporated in the UK or elsewhere.

135 Companies with reporting periods beginning before 17 June 2016 should continue to report against the 2014 Code but, in the spirit of co-ordination and coherence, they are encouraged to consider whether it would be beneficial to adopt some or all of the new provisions in the revised code earlier than formally expected.

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explanations when they choose not to comply with one or more of the provisions of the code, so that their shareholders can understand the reasons for doing so and judge whether they are content with the approach the company has taken.

Pathways of "comply or explain" approach

Following the UK example, codes of corporate governance best practices predicated on flexibility swept other jurisdictions such as Belgium, France, Germany, Sweden, other EU members states, Japan and some developing countries.[136] In the EU, however, the large-scale uniform application of a code-based approach was jettisoned given that corporate governance influence reflects local realities and the need to uphold a country's idiosyncratic traditions. Indeed, differences in content and structure of codes of corporate governance must be seen in the perspective of the legal systems of different countries.[137] However, the practical reality is that attention has now moved towards harmonizing the implementation process rather than the substance of codes.[138] Because of the changing business environment, the "comply or explain" approach has afforded UK and EU companies the opportunity to deviate from the codes and explain the reasons for non-compliance, which is more flexible than the traditional approach that sought mandatory legislation.[139] Overall, the efficacy of the EU harmonization effort remains debatable, largely because the implementation of the code-based approach is currently differentiated by the diversity of national codes.

Indeed, discrepancies in national codes not only contribute to the implementation of multiple results but also lead to fragmentary applications of corporate governance practices.[140] However, it is considered that a single

136 CJ Milhaupt "Evaluating Abe's third arrow: How significant are Japan's recent corporate governance reforms?" (2017, Columbia Law and Economics working paper no 561) at 1–4.

137 Further corporate governance strategic framework relating to harmonization is contained in the EU Commission Action Plan. EU company law applies in principle to most EU limited liability companies, while EU corporate governance rules only apply to companies listed on a stock exchange. See European Commission "Action plan: European Company law and corporate governance: A modern legal framework for more engaged shareholders and sustainable companies" (12 December 2012), COM (2012) 740 final, available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52012DC0740&from=EN> (last accessed 3 September 2019).

138 While the directives and recommendations apply in some areas, the mandatory aspect of the code was enforced in 2000 in the UK through the Listing Rules before the framework was introduced in the EU. The mandatory aspect only requires companies to offer reasons for non-compliance.

139 See 2006/46/EC, art 46(a).

140 This divergence is particularly prominent where a company is registered in one state but its shares are listed in one or more states. The UK Listing Rules contain the "comply or explain" regime and apply to all listed companies in the jurisdiction no matter the place of incorporation. However, in some other jurisdictions, such as the Netherlands, the obligation to adopt a code-based approach is enshrined in company law and applies

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corporate governance code is not suitable at the EU-wide level given the existing diversity in legal systems and the need to encourage innovation and competition. Conversely, a homogenous code at the national level should be encouraged. The Belgian experience, based on the "comply and explain" model but requiring a rigorous approach,[141] strikes the right chord with the requirement in Nigeria.

HARMONIZING THE CODE-BASED APPROACH IN NIGERIA

The Nigerian corporate governance landscape *is* code-based, drawing from the UK model. Hence, the 2003 Atedo Peterside committee set up by the SEC to develop a Code of Best Practice for Public Companies in Nigeria was partly influenced by developments in the UK.[142] This code remained voluntary and was designed to entrench good business practices and standards for the boards, directors, chief executives and auditors of listed companies.[143] In the banking sector, the CBN developed the Nigerian corporate governance guidelines for the post-consolidated banks in 2006.[144] The SEC and CBN codes have since been revised. The SEC code was initially made a voluntary code while the CBN code was mandatory, although the revised 2014 edition made both codes mandatory for all businesses in Nigeria.[145] Similarly, the FRC introduced the 2016 NCCG, hinged on three main areas: the private sector, public sector and not-for-profit sector.[146] The code aimed to harmonize the

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to local companies listed in the regulated market on the basis of their place of incorporation. The practical effect of this is that a company risks being regulated by both the place of incorporation and the country where it is listed. The fact that companies could totally avoid procedural harmonization basically weakens any possible move towards convergence. See S Arcot et al "Corporate governance in the UK: Is the comply-or-explain approach working?" (2010) 30/2 *International Review of Law and Economics* 193.

141 Belgian laws permit shareholders to demand some explanations from company boards of directors by inserting an item in the agenda of the general meeting that could effectively require the board to account to the company how it has complied with the corporation's corporate governance practices. Such a requirement can increase the level of adherence to the code of best practices by the board and ultimately enhance the firm's performance. See Magnier "Harmonisation process", above at note 132 at 1.

142 The Nigerian SEC Code of Corporate Governance Practices was developed in 2003 (the code has now been replaced by the 2011 code) based on a unitary board structure (as is the case with the UK and US) with an emphasis on the identified triple constraints: the role of the board of directors and management; shareholders rights and privileges; and the audit committee.

143 Ibid.

144 A Afolabi and D Amupitan "Corporate governance in the Nigerian banking sector: Issues and challenges" (2015) 3/5 *European Journal of Accounting Auditing and Finance Research* 64.

145 E Adegbite and C Nakajima "Corporate governance and responsibility in Nigeria" (2011) 8/3 *International Journal of Disclosure and Governance* 252.

146 F Nakpodia "Corporate governance in the Nigerian banking sector: A bounded rationality conundrum" in B Díaz Díaz, S Idowu and P Molyneux (eds) *Corporate Governance in Banking and Investor Protection* (2018, Springer).

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various corporate governance principles and practices existing in the country. However, the controversy that underpinned the provisions led to its suspension.

The private sector code applied to: all public companies (whether listed or not); all private companies that are holding companies or subsidiaries of public companies; and all other companies, excluding companies that routinely file returns only with the Corporate Affairs Commission and the Federal Inland Revenue Service and small private companies.[147] The 2018 Draft NCCG generally maintains the same scope of application. On the other hand, the public sector code applied to: all government ministries, departments and agencies; all state-owned entities; all parastatals; and all government commercial agencies.[148] The not-for-profit sector code, which remains suspended under the 2018 Draft NCCG, applied to the whole gamut of entities and organizations with such appellation and mission, including charitable organizations, educational institutions or entities, professional and scientific entities, religious organisations, literary and artistic outfits, political and administrative groupings, social clubs and associations, and trade unions.[149]

The harmonization of disparate and separately pre-existing frameworks into a single code eliminates fragmentation (where each sector has its own corporate governance framework), which more or less hampers good corporate governance practices and compliance.[150] Harmonization engenders systemic regularity and uniform approaches in the Nigerian corporate governance system. One distinctive feature of the suspended code is prescription of mandatory rules in the private sector code,[151] which created consternation among the business community and reawakened debate regarding the suitability of rules over principles, and the possibility of the two co-existing.

Principles-based and rules-based regulation

The interplay between principles-based regulation and rules-based regulation is not a new phenomenon.[152] Indeed, each of the two regulatory paradigms has been applied in a broad spectrum of areas including securities regulation,

147 Private Sector Code 2016, art 2.1.

148 Public Sector Code 2016, art 5.

149 Not-For-Profit Code 2016, art 7.1–7.2.

150 L Osemeke and E Adegbite "Regulatory multiplicity and conflict: Towards a combined code on corporate governance in Nigeria" (2016) 133/3 *Journal of Business Ethics* 431.

151 Private Code 2016, art 2.2.

152 See L Kaplow "Rules versus standards: An economic analysis" (1992) 42/3 *Duke Law Journal* 557 at 557–60 (noting that rules involve "an advance determination of what conduct is permissible, leaving only factual issues for the adjudicator" while standards (or principles) may involve "leaving both specification of what conduct is permissible and factual issues for the adjudicator"); E Posner "Standards, rules, and social norms" (1997) 21 *Harvard Journal of Law and Public Policy* 101; C Coglianese, EK Keating, ML Michael and TJ Healey "The role of government in corporate governance" (2004) 1 *New York University Journal of Law and Business* 219 at 228–29.

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capital markets regulation and corporate governance frameworks.[153] Similarly, scholars have analysed the dichotomy between rules and principles (also called standards) from broad spectrums, including from legal to economic perspectives and from behavioural to political perspectives.[154] While some lean towards divergence,[155] others contend that there is more convergence than divergence between them.[156] As aptly observed, "there is no polar opposition between rules and standards. It takes a rule to make a standard legal; it may take a standard to make [sic] rule satisfactorily workable. That there can be rules which do not incorporate standards does not show that standards can operate legally without incorporation of rules".[157] Thus, each has essential attributes convergent with the other while maintaining a certain degree of diverging attributes. This has huge implications for the dichotomy between flexible and mandatory rules.

"Comply or explain" versus mandatory rules

As noted above, the suspended corporate governance code adopted the "comply or explain" model for its not for profit code while incorporating mandatory rules for the private sector code. The contemporary paradigm recognizes the interrelationship between the two, on the basis of their relative strengths and weaknesses including the need to balance coercive compliance with constructive engagement.[158] Although the prescriptive rules of corporate governance anchored on mandatory rules and compliance are still obtainable,[159] particularly because of unexpected corporate and accounting failures,[160] the relevance of non-mandatory principles has never been denied and the mandatory prescriptions do not totally eschew principles-based regulation.[161] While mandatory prescriptive rules provide certainty and sanctions, non-mandatory principles leverage in being flexible and less expensive. Indeed, "[r]ules have their virtues, and they have been widely used, but they also may allow corporate actors to find ways to comply with the letter of the law while circumventing its spirit".[162] Thus, there is a trade-off between

153 See CL Ford "New governance, compliance, and principles-based securities regulation" (2008) 45/1 *American Business Law Journal* 1.

154 For an analysis of the diversity of perspectives, see id at 8–9.

155 A Scalia "The rule of law as a law of rules" (1989) 56/4 *University of Chicago Law Review* 1175 at 1176–79.

156 F Schaur "The convergence of rules and standards" (2003) *New Zealand Law Review* 303; N MacCormick "Reconstruction after deconstruction: A response to CLS" (1990) 10 *Oxford Journal of Legal Studies* 539.

157 Ibid.

158 See *OECD Corporate Governance Factbook* (2019, OECD) at 15, available at: <https://www.oecd.org/daf/ca/Corporate-Governance-Factbook.pdf> (last accessed 3 September 2019).

159 See SOX, secs 401–09.

160 The failure of Enron and Worldcom, in part, informed the enactment of SOX.

161 JC Coffee "Gatekeeper failure and reform: The challenge of fashioning relevant reforms" (2004) 84 *Boston University Law Review* 301 at 342–44.

162 Coglianese et al "The role of government", above at note 152 at 222.

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the rules and principles necessitating the conceptualization based on actual or projected outcomes and navigating the maze to create an optimal paradigm that underlies the mandatory rules and the "comply or explain" model. Arguably, such an optimal paradigm would be a hybrid model. As the new technical committee on corporate governance reform is constituted to develop an improved corporate governance code, Nigeria is once again presented with an opportunity to craft a code that is not only consistent with the country's cultural peculiarities but also with global best practice.[163]

Of course, there is no unanimity among scholars on the preferred balance between rules and principles.[164] However the adoption of the "apply and explain" model in the 2018 Draft NCCG essentially reflects the rigidity of mandatory prescriptions. Although the "apply and explain" model would ensure compliance without exceptions and prevent box-ticking, it also entails jettisoning the flexibility that underlies evolving practice.[165] The Chartered Institute of Bankers in Nigeria has already expressed dissatisfaction.

Arguably, the "apply and explain" model is unsuitable where reasonable deviation is necessary based on the circumstances. On the other hand, the implementation of the "comply or explain" model in a country in short supply of social capital such as Nigeria could be challenging. This is because the regulated entities may engage in the habit of circumvention by relying on the loopholes afforded by the code (ie providing explanations for non-compliance rather than indulging in compliance). In essence, the preferred approach should be a hybrid model.[166]

Hybrid model

The hybrid model has been used to refer to convergence between the Anglo-American and German-led continental Europe models of corporate governance. It has also been applied to adaptations of either of these models to Asian or African cultures. Nevertheless, the concept is used here to refer to convergence in the application of principles-based regulation and rules-based regulation in light of the jurisdictional peculiarity.[167] In other words, the proposition refers to hybridization of the "comply or explain" approach and the mandatory prescriptions approach, optimizing the advantages offered by both and eschewing the disadvantages. This proposed hybrid model will be defined by flexibility, robust regulatory oversight, and shareholder and stakeholder monitoring. Regulatory oversight and shareholder monitoring

163 See Kaplow "Rules versus standards", above at note 152 at 559–60.

164 See Ford "New governance, compliance", above at note 153 at 8–9.

165 See also *OECD Corporate Governance Factbook*, above at note 158 at 15.

166 A Keay "Comply or explain in corporate governance codes: In need of greater regulatory oversight?" (2014) 34 *Legal Studies (Society of Legal Scholars)* 279.

167 See *Best Practices in Asian Corporate Governance* (2007, Asian Productivity Organization), available at: <https://www.apo-tokyo.org/publications/ebooks/best-practices-in-asian-corporate-governance-pdf-2-5mb/> (last accessed 3 September 2019).

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would be necessary to avoid explanations for non-compliance taking the place of compliance. This entails that the existence of flexibility regarding compliance should not constitute an excuse for indulging in non-compliance. Regulated entities would be required to comply or provide an explanation for any reasonable deviation. The role of the regulatory authority would be to ensure that the discretion for non-compliance should not be abused. Similarly, the monitoring and enforcement role of shareholders and stakeholders would be through market forces, such as the selling of shares by dissatisfied shareholders, product or service boycotts by customers, employee unrest or resignation, and social backlashes such as probing and critical media, civil society and other stakeholders applying pressure on organizations to desist from abusing their discretion. To achieve this, the regulatory authority must enforce timely disclosure and accessibility by shareholders and stakeholders to corporate reports. Arguably, this will somewhat satisfy the government quest for regulatory oversight, while maintaining a reasonable level of flexibility for the business community.

Certainly, the "comply or explain" model remains the predominant framework in many jurisdictions,[168] but it is not well-suited for outright adoption in Nigeria because of the prevalent abuse of discretion.[169] On the other hand, the adoption of the "apply and explain" model in the 2018 Draft NCCG could re-enact the outrage of capital market investors because of the element of rigidity. Arguably, flexibility and robust regulatory oversight bolstered by shareholder and stakeholder monitoring should be the preferred option. Investors and the business community rejected the mandatory prescriptions of the suspended private sector code on the grounds of too much rigidity stifling entrepreneurial innovation.[170] Investors considered the suspended private sector code to be "anti-investment" and "high-handed" mainly because of the mandatory prescriptions; they would prefer the code to be more flexible in its approach to corporate governance.[171] Hence, the technical committee has a responsibility to ensure a balance between government policy and the interests of the investor community. The outcome of the drafting of the current private sector code should reflect the correct mix of hard and soft law, which will provide an element of flexibility for investors, and attract more investment and economic growth. By all means, the success of the application of the private sector code will be dependent on the legitimacy it enjoys with the regulated entities. The suspended private sector code lost that legitimacy when the business community rejected the mandatory prescriptions.

168 *OECD Corporate Governance Factbook*, above at note 158 at 15.

169 S Apampa "Is there a right corporate governance framework for Nigeria?" (5 July 2014) *Premium Times*, available at: <http://www.premiumtimesng.com/opinion/164425-is-there-a-right-corporate-governance-framework-for-nigeria.html> (last accessed 3 September 2019).

170 Nwachukwu "Capital market investors", above at note 12.

171 Ibid.

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Hence, it is time to consider the adoption of a hybrid code for the private sector that combines the flexibility of the "comply or explain" model and mandatory regulatory oversight, thereby creating a balance amid the dichotomy.

CONCLUSION

Corporate governance practices can be seen from four broad perspectives: the Anglo-American model, the continental European model, the Asian model and an emerging African model. Each is characterized by unique peculiarities while sharing certain attributes with the others. Despite intense debate about the superiority of one model over the others, and the possibility of convergence towards a single model, divergences remain even if contractual convergence exists and the harmonization of best practices obtains. The harmonization of corporate governance codes has become a catchphrase not only among the major corporate jurisdictions but also the emerging economies. Harmonization offers the predictability and certainty of content and application. Harmonization is preferable and more feasible when undertaken at the national level than the regional level, because of the inherent diversities that underpin the latter, as it is the case with the EU effort. Having undertaken the harmonization route, Nigeria has joined the retinue of countries adopting a homogenous code. The adoption of mandatory rules for the private sector has been denounced by investors on account of its rigidity. The same rigidity obtains in the "apply and explain" model. Mandatory rules enjoy a coercive nature, but the inherent disadvantages seem to have been overlooked. Hence, the proposed hybrid model is preferable. This proposed model will foster the optimization of the advantages of both the "comply or explain" and the mandatory rules regimes, while eschewing the disadvantages. This is consistent with the position of investors and the business community who rejected the suspended private sector code on the grounds of its mandatory prescriptions that stifle entrepreneurial innovation.

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