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## Postprint

This is the accepted version of a paper published in *International Journal of Disclosure & Governance*. This paper has been peer-reviewed but does not include the final publisher proof-corrections or journal pagination.

Citation for the original published paper (version of record):

Achtenhagen, L., Inwinkl, P., Björktorp, J., Källenius, R. (2018)  
More than two decades after the Cadbury Report: How far has Sweden, as role model  
for corporate-governance practices, come?  
*International Journal of Disclosure & Governance*, 15(4): 235-251  
<https://doi.org/10.1057/s41310-018-0051-1>

Access to the published version may require subscription.

N.B. When citing this work, cite the original published paper.

Permanent link to this version:

<http://urn.kb.se/resolve?urn=urn:nbn:se:hj:diva-41978>

Published in: *International Journal of Governance and Disclosure*, 15(4), 235-251, 2018.

## **More than two decades after the Cadbury Report – How far has Sweden, as role model for corporate-governance practices, come?**

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### **Abstract**

The purpose of this study is to follow up on the ‘comply-or-explain’ principle more than two decades after the Cadbury Report was published. We investigate the rate of compliance and quality of explanations provided in case of non-compliance in the context of Sweden. This country has been pointed out as a role model for corporate-governance practices. The empirical study comprises the 241 companies listed on Nasdaq OMX Stockholm in 2014. We analyze the quality of the explanations in the light of the Swedish Corporate Governance Code.

Our findings confirm that the comply-or-explain principle in Sweden is effective. Around half of the companies use the possibility to deviate from the code. A clear majority of the explanations, 71.8%, are informative. This study provides insights for academic scholars and policy-makers alike how the comply-or-explain principle works in a country that is viewed as a role model for how corporate governance should be implemented. In addition, the high-quality explanations provided by listed companies on Nasdaq OMX Stockholm

can serve as an inspiration for other listed companies in European countries, thereby outlining a contribution to business practice.

*Key words:* Comply-or-explain, Swedish Corporate Governance Code, Nasdaq OMX

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## **More than two decades after the Cadbury Report – How far has Sweden, as role model for corporate-governance practices, come?**

### **Introduction**

In 1992, the Cadbury Report from the UK set the starting point for corporate-governance codes to become a prominent tool for preventing corporate misconduct (Aguilera and Cuervo-Cazurra, 2009; Cadbury, 1992). Since its inception, similar codes regulating (listed) companies' corporate governance and their management have been introduced in many countries (Zattoni and Cuomo, 2008; Seidl et al, 2013). These codes provide guidelines on how to deal with issues such as composition of boards, directors' remuneration and board independence (Hooghiemstra, 2012), reflecting the interests of international capital funds and other institutional investors (Tagesson and Collin, 2016; Thomsen, 2006): Academic scholars and policy-makers alike assume that investors' trust in the company's management is enhanced if relevant information about its corporate governance is disclosed (cf. von Werder et al., 2005).

The Cadbury Report propagated the voluntary compliance to corporate-governance codes in a flexible approach, acknowledging that companies are not a homogenous group (Seidl et al., 2013). The deriving 'comply-or-explain principle' (CEP) obliged that listed companies 'should state in the report and accounts whether they comply with the Code and identify and give reasons for any areas of non-compliance' (Cadbury, 1992, p. 17). This principle became a milestone in the development of a framework for European corporate governance, guiding listed companies toward adopting what leading market participants consider good practice (Demirag and Solomon, 2003). Supported by the High Level Group of Company Law Experts, and promoted by the European Commission (EC) for its member states, the concept ultimately triggered Directive

2006/46/EC. This directive made it mandatory for all listed companies in the European Union (EU) to include a corporate-governance statement in their annual reports, where they explain whether they departed from parts of the corporate-governance code and to provide the reason for each non-compliance (cf. Inwinkl et al., 2014). The CEP is based on the assumption that shareholders act as a market force that monitors the accuracy of the compliance statements and, in case of non-compliance, assesses the quality of the explanations given (Arcot et al., 2010). Non-compliance would be penalized by a declining share price, if not justified by company-specific reasons. Thus, it could be expected that the market requires informative explanations to be able to evaluate whether the deviations are justified (MacNeil and Li, 2006). Despite the legal implementation of the principle across the EU, there are no regulations regarding the content of those explanations (Shrives and Bannon, 2015).

In the years following the introduction of the CEP in different countries, numerous studies were conducted to assess compliance rates as well as the quality of explanations for non-compliance – typically attempting to answer the question whether the CEP performs as intended (e.g. Arcot et al., 2010; Salterio et al., 2013). To date this research has delivered inconclusive results concerning compliance rates and quality of explanations for non-compliance (Lou and Salterio, 2014; Shrives and Brennan, 2015). While some scholars identified increasing levels of compliance over time (MacNeil and Li, 2006; Arcot et al., 2010), most of the – even recent – publications are based on rather old datasets, typically covering data for the year 2005 and only sometimes reaching up to the year 2010. Thus, there is a need for a detailed exploration of whether companies' compliance rates and quality of explanations really continued to increase over the years, not least to assist policymakers in determining whether the conditions put in place for

such flexible form of regulation are effective. The aim of this paper is to assess how the comply-or-explain principle is used more than two decades after the Cadbury Report initiated its implementation. For this, we draw on recent data from Sweden, which is a country that has been presented as role model regarding its corporate-governance code (e.g. European Commission, 2011), but rarely has been empirically studied.

The remainder of this paper is structured as follows. Next, we will present a literature review of prior research conducted in relation to the comply-or-explain principle. We will then provide an overview of corporate governance in Sweden as the context of our research, leading to a method section describing our empirical data and analysis. Our findings are presented and discussed, before concluding the paper. We aim to make two contributions: Firstly, we provide an expansion of the main taxonomy of deviations from the code established by Seidl et al. (2013). This additional category is relevant as it captures almost one fourth of the deviations. Secondly, we provide an assessment of the rate of compliance and quality of non-compliance explanations in Sweden. Prior research has focused on either the UK as the country from which the Cadbury Report originated, recent EU member states as well as a range of other countries, while rarely addressing the specificities of the Swedish context.

## **Literature Review**

In order to gain a comprehensive overview of prior research on the ‘comply-or-explain’ principle, we conducted a thorough literature search. We searched the academic online database Scopus for the notion “comply or explain” and downloaded all articles where CEP was in focus (i.e. not just a side notion). We then cross-checked the derived list with the list of publications appearing in Google Scholar for the same search term. Through this search, we identified 25 publications about CEP, which are summarized

along a number of relevant dimensions in Table 1 below. This large number of publications is interesting per se, as it is in contrast to a recent publication by Shrives and Brennan (2015), who had only identified six such studies (for a literature review on corporate-governance codes more generally, see Cuomo et al., 2016).

- Please insert Table 1 about here -

The largest number of studies is based on the UK, from where the Cadbury Report originates. The other studies spread over nine countries and some studies cover different EU countries more generally. Different studies find different results regarding compliance rates. Akkermans et al. (2007) report that overall compliance in the Netherlands 2005 was high, while Lou and Salterio (2014) find that the rate of compliance in Canada was generally low in 2006. Seidl et al. (2013) find that the majority of the firms in the UK and in Germany deviated from at least one code provision in 2006. Furthermore, MacNeil and Li (2006) and Arcot et al. (2010) note that compliance rates in the UK in general have increased over time.

Several studies indicate that companies tend to provide standardized or general explanations in case of non-compliance (Akkermans et al., 2007; Arcot et al., 2010; Hooghiemstra and van Ees, 2011; MacNeil and Li, 2006). Seidl et al. (2013) find 52% of the explanations in the UK to be justified, i.e. referring to the companies' specific circumstances. However, 41% of the explanations lacked explanatory power. For Germany, 56% of the explanations were found not to be justified, and only 24 % of the firms explained deviations based on company specific circumstances. The differences

between the countries are explained by the fact that German firms had no legal requirement to provide explanations when that study was undertaken (Seidl et al., 2013).

Hooghiemstra and van Ees (2011) problematize that the code does not provide guidance as to when it is considered appropriate to deviate. Their study showed that Dutch companies were uncertain of how their explanations would be perceived by their stakeholders and that this uncertainty seduced companies to imitate explanations provided by other companies in similar situations. Over time, this led to standardized explanations (Hooghiemstra and van Ees, 2011), as companies mimicked other non-complying companies in order to enhance their legitimacy (cf. Lieberman and Asaba, 2006).

Lou and Salterio (2014) find a positive relationship between informative explanations given in case of non-compliance and financial performance and firm value. In accordance with MacNeil and Li (2006), they argue that market monitors cannot determine whether deviations are justified when these are insufficiently argued for.

### **Corporate governance in Sweden**

The Swedish corporate-governance framework consists of three key elements. The Companies Act, as a ‘hard law’ principle, regulates the composition of boards and the positions of the CEO and chairperson. The board of directors and the CEO form together with the shareholders’ meeting the three main decision-making bodies within a company (Swedish Corporate Governance Code, 2010). The Companies Act stipulates Swedish listed companies to have a one-tier board system, where non-executives dominate (Lekvall, 2009), which is in contrast to other countries (such as Austria or Germany) where a two-tier board system prevails. Listed companies in Sweden are characterized by a relatively concentrated ownership of shares, i.e. one or few major actors tend to hold the majority of shares (Gabrielsson, 2012). Companies with controlling



shareholders are expected to demonstrate long-term commitment, including to maintain their ownership even when financial performance is weak (Lekvall, 2009). This is very different to the case of e.g. the UK and the US, where ownership tends to be more dispersed.

The rules of the stock exchange form a second part of the Swedish corporate-governance framework. While the Swedish Corporate Governance Code itself is supervised and managed by the Swedish Corporate Governance Board, all listed companies within the Swedish market apply the Swedish Code as it is ‘indirectly a part of the rules of Nasdaq Stockholm’ (Nasdaq, 2016). Thus, the obligation to comply-or-explain is indirectly included in the listing requirements in accordance with Directive 2006/46/EC and it is mandatory for all listed companies to include a corporate-governance statement in their annual reports, which follows the CEP.

As a third part of the corporate-governance framework, the Swedish Code stipulates a form of self-regulation with a focus on internal control, the board’s responsibility for reporting, organizing and ensuring an independent audit function in the company (Svernlöv, 2005). The Code was first introduced in 2005 and updated four times since (in 2008, 2010, 2015, and 2016), aiming to achieve international harmonization through inclusion of EU recommendations, while adhering to Swedish legislation and Swedish legal and social traditions (SOU, 2004, p. 130; Tagesson and Collin, 2016).

This study draws on data from the reporting year 2014 and thus the Swedish Code issued in 2010 which contains ten chapters. Each chapter consists of a number of provisions, amounting to 49 provisions in total. Chapters one to nine state the ‘norms for good corporate governance’ and the final chapter outlines the rules regarding disclosure of corporate-governance information (Swedish Corporate Governance Code,

2010)<sup>1</sup>. One aspect of the Code as indirect part of the listing rules is particularly interesting in relation to the CEP. The Code explicitly mentions that deviations from Code provisions are encouraged as long as the company provides informative explanations (Swedish Corporate Governance Code, 2010). Adequate explanations allow firms to exhibit the benefits of their corporate-governance system, rather than simply complying with all Code provisions (Lou and Salterio, 2014). This signals that the company has considered its corporate-governance practices and found a solution suiting its particular circumstances (cf. Swedish Corporate Governance Code, 2010). The option of deviation from the Code can be seen both as an advantage and disadvantage. The advantage of this flexibility is that the Code can be adapted to the specific conditions prevailing in the industry or market in which the company operates and to the governance demands of its dominant stakeholders (Tagesson and Collin, 2016). The downside is that it could be used by CEOs and/or influential shareholders to implement a governance structure directed at maximizing their wealth and utility, rather than the utility of other principals (Tagesson and Collin, 2016).

The Swedish Code has been suggested as a role model regarding its way of describing how companies should act in terms of non-compliance (European Commission, 2011). A study of informative explanations within the European Union was conducted by RiskMetrics Group, finding that companies registered in Sweden provided ‘the high-

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<sup>1</sup> Chapter 1: The shareholders’ meeting, 2: Nomination committee, 3: The tasks of the board of directors, 4: The size and composition of the board, 5: The tasks of the director, 6: The chair of the board, 7: Board procedures, 8: Evaluation of the board of directors and the chief executive officer, 9: Remuneration of the board and executive management, 10: Information on corporate governance.

est proportion of informative explanations' (2009: 170). However, their sample consisted of only 15 Swedish listed companies, calling for a more comprehensive investigation, which will be introduced in the following section.

## **Method**

This study assesses the rate of compliance and quality of explanations in case of non-compliance provided with respect to the Swedish Corporate Governance Code. Data were collected from the annual and/or corporate governance reports of the companies. The analyzed compliance statements were published in 2015, representing the financial year of 2014 – based on the Swedish Corporate Governance Code applicable from 2010.

Our initial sample consisted of all companies listed on the large, medium and small cap on Nasdaq OMX Stockholm. Out of these, we excluded 17 companies that were not subject to the rules outlined by the Swedish Corporate Governance Code, and 26 companies that were newly listed in 2015 and thus did not implement the code in 2014. All remaining 241 companies were included into our sample. Out of these, 69 were listed on large cap, 78 were listed on mid-cap and 94 were listed on small-cap. This distinction is relevant as prior research has found compliance to vary with company size (Akkermans et al., 2007; Seidl et al., 2013; von Werder et al., 2005).

We use content analysis to examine the explanations given by companies in terms of non-compliance, following Hooghiemstra and van Ees (2011) and Seidl et al. (2013). The explanations are evaluated to assess whether there is a justified reason for non-compliance. Data are analyzed using the established taxonomy developed by Seidl et al. (2013) as a coding scheme. This taxonomy consists of three main categories, with several sub-categories. *Deficient justifications* lack meaningful explanations; companies

simply state that they have deviated from the code, without providing any justification for doing so. There are three subcategories: *Pure disclosure* is a declaration of deviation without any reason provided. Descriptions of *alternative practice* are more informative than pure disclosure as they describe what solution the company has decided to adopt instead of complying with the code, without however justifying its choice. *Empty justification* means that the provided reason lacks explanatory power (Seidl et al., 2013).

The second category contains *context-specific explanations*, which are informative explanations justified with the company's specific circumstances. The subcategories are: *size of the company or board*, *company structure*, *international context of company*, *other company-specific reason*, *industry-specific reason* and *transitional justification*. For instance, if the board consists of just a few members, it may affect the organization's ability to comply with certain code provisions. International context can be of relevance if a company has subsidiaries in countries where other codes are applicable. Transitional justifications might apply if a company recently has been involved in a merger and therefore has not yet implemented certain provisions (Seidl et al., 2013).

The final category is *principled justification*, where explanations criticize the code as such, with three subcategories: *effectiveness/efficiency*, *general implementation problems* and *conflicts with laws or societal norms* (Seidl et al., 2013).

After a first round of analysis, we added a new category because several explanations referred to decisions made by the annual general meeting (AGM) or instances where the largest shareholders exerted major influence over the company (see Table 2 below). To help us determine how to categorize and evaluate these explanations, we contacted the Swedish Corporate Governance Board and followed its recommendation:

As the AGM is the highest decision-making body, the company is required to implement the governance practice favored by the AGM. As the largest shareholders often hold the majority of the votes, the decisions regarding governance practices favored by them will be implemented. This new category was labelled *shareholder justification* and it contains two sub-categories, '*decision made by the AGM*' and '*referring to largest shareholders*'.

- Please insert Table 2 about here -

Data analysis was based on the governance section of the annual reports or the separate governance reports. For each company, two authors independently evaluated all explanations and documented any instances of non-compliance. Ten companies were analyzed at a time and then the results were compared. All cases of disagreement were discussed until agreement regarding the coding was reached.

As the governance statements are published within a company's annual report, the information can be regarded as reliable, as management is held accountable for it by share- and stakeholders (Groenewald, 2005). However, while an external auditor needs to confirm that the company's governance statement is provided, the auditor is not required to verify its content.

## **Findings and discussion**

Our findings reveal that 109 out of 241 companies, or 45.2%, deviated from at least one code provision. Interestingly, no clear pattern emerged regarding the relationship between firm size and the number of deviations (see Table 3 below). Previous research in other countries had found smaller firms to deviate more frequently than larger firms

(Akkermans et al., 2007; Hooghiemstra and van Ees, 2011; Seidl et al., 2013; von Werder et al., 2005). In our study, the average number of deviations made by each firm was lower among smaller companies; companies listed on small cap deviated only on 51 occasions. The total number of deviations for all listed companies corresponds to an average of 0.65 deviations per company (see Table 3). These results differ from earlier research: Hooghiemstra and van Ees (2011) reported that firms in the Netherlands deviated from 5 code provisions on average. Seidl et al. found (2013) that in Germany, each company made an average of 4.46 deviations, while in the UK, the same number was 1.07. Arcot et al. (2010) and MacNeil and Li (2006) suggested that compliance rates would increase over time, which appears to be confirmed in our study, showing higher compliance rates than earlier research.

- Please insert Table 3 about here –

Of the 49 provisions of the Swedish Corporate Governance Code, 27 were deviated at least once, corresponding to 55.1%. Thus, the flexibility provided by the CEP was used for the slight majority of code provisions, indicating that companies deviate when they find it appropriate to do so.

Earlier research suggested that actual compliance could be overstated, as there are no requirements regarding disclosure if the company complies with all provisions (Akkermans et al., 2007). Instead, we found that almost all Swedish listed companies provided detailed descriptions about their governance practices even when they were fully compliant. This practice can be assumed to increase investors' trust in the information also of fully-compliant companies.

The provisions companies most often deviated from relate to establishing and staffing of committees (see Table 4 below), especially the composition of the nomination committee with 41 deviations and its establishment with 12 deviations. This can be explained with the high level of concentrated ownership in Sweden (Gabrielsson, 2012), which leads to the desire of majority shareholders to combine their role in the nomination committee with an active role on the board.

Provision 7.3, outlining that a company should have an audit committee, had the second largest number of deviations (9% of deviations). However, the Swedish Companies Act stipulates that the board can jointly perform this duty, if found more suitable. Provision 9.8, related to share-based incentive programs, recorded 12 deviations. 11 companies deviated from provision 9.2, which outlines the guidelines for the remuneration committee. The board may, as in the case with the audit committee, perform the duty of the remuneration committee (Swedish Corporate Governance Code, 2010). For a full list of the recorded deviations from each code provision, see Appendix 1.

- Please insert Table 4 about here -

Our results indicate that Swedish listed companies frequently use the flexibility of the comply-or-explain principle. Next, we further analyze the explanations provided for non-compliance along the categories presented in the method section.

### ***Non-compliance explanations in Sweden***

#### ***Deficient justification***

We find that 26.3% of the explanations for non-compliance are deficient justifications, breaching the rules outlined by the Swedish Corporate Governance Code and making it

impossible for investors and other stakeholder to evaluate if the deviations are justified or not (cf. MacNeil and Li, 2006).

Among the explanations for non-compliance, 16 explanations can be regarded as *pure disclosures* (see Table 5 below). For instance, Svedberg AB (2015: 26) declared that ‘*Sune Svedberg (board chairman) is the chairman of the nomination committee*’ (our translation). This is a deviation from code provision 2.4, since one person is not allowed to chair both the nomination committee and the board (Swedish Corporate Governance Code, 2010). Svedberg AB’s statement about the deviation is only a disclosure of non-compliance, without providing any explanation for it.

A description of *alternative practice* was identified in five cases. For example, SKF AB (2015: 187) deviated from code provision 2.6, stating that ‘*in relation to the AGM held in the spring of 2014, information regarding one new candidate was missing at the time when the notice was published. [...] The nomination committee’s proposal in the notice was later supplemented with details of the new candidate in a separate press release*’. This type of explanation is more informative than pure disclosure, but it does not address why the company chose this alternative practice.

*Empty justifications* represented the most commonly used form of deficient justifications, used by 12.8% of the deviating companies. For example, Arcam AB (2015: 64) deviated from code provision 7.3, stating that ‘*Arcam did not have an audit committee in 2014. The board of directors was of the opinion that there was no need for such a function*’. At first sight, this may seem like a valid deviation as Arcam AB presents an explanation, but the company does not address *why* the board of directors found it appropriate not to have an audit committee. Companies listed on the small cap most frequently failed to provide explanations (see Table 5).



- Please insert Table 5 about here -

Hooghiemstra and van Ees (2011) found that firms in the Netherlands mimicked each other's explanations as a tactic to gain legitimacy. Our findings differ in that the explanations categorized as deficient justification were not similar across firms, and thus such imitation rarely seems to take place in Sweden. Rather, it appears like some companies fail to provide informative explanations, because they do not know how to interpret the code provisions. This could be related to the fact that the Swedish Corporate Governance Code does not specify how to formulate alternative solutions. Hence, companies might believe that their explanations are informative enough.

#### *Context-specific justification*

Context-specific explanations relating to the *size* of the company or the board recorded 8.3% of the total deviations. For example, Duroc AB (2015: 21) explains its deviation from code provision 4.5 as follows: *'The directors Sture Wikman, Thomas Håkansson and Carl Östring are not considered independent in relation to the major shareholders. This deviation is justified by the company's current size, performance and development and therefore, is best handled by a small, active board indicating that the current composition is appropriate'* (our translation). Deviations with reference to size were all made by companies listed on small and mid cap (see Table 5).

Explanations with reference to *company structure* represented 8.3% of the total deviations. A common reason provided was concentrated ownership. For instance, *'Fenix Outdoor International AG intends to deviate from the Code's provisions regarding*

*the Nomination Committee (Code 2.1). The reason for doing so is that the Nordin family, along with its related companies, represents 62% of the Company nominal share value, corresponding to 86% of the votes at the Annual General Meeting, if all their shares are represented at the Meeting. In light of this concentration of shareholders, having a Nomination Committee did not appear necessary'* (2015: 25).

Explanations based on the *international context* of a company were used when a company performed its business internationally or had offices abroad, requiring them to adopt other laws or codes. Oriflame AB (2015: 2) deviated from code provision 1.5 as follows: *'Oriflame does not host its General Meetings in Swedish language as it is a Luxembourg Company, the location for Oriflame General Meetings is Luxembourg and as the majority of voting rights is held by individuals and entities located outside of Sweden. General Meetings are therefore hosted in English'*. Oriflame's explanation clarifies that the use of Swedish language at their AGM would be inappropriate considering the company's particular circumstances and a deviation from the code is therefore justified. No companies listed on the small cap provided any explanation with reference to international context, as due to their small size their international activities tend to be more limited.

A total of 29 companies used *other company specific reasons* to explain their deviations from the code. Many companies faced unexpected or unique circumstances. An example is Handelsbanken (2015: 52): *'In addition, a majority of the members of the Board are not independent of the Bank and its management (as required by code 4.4), according to the criteria of the Code. The reason for this deviation is that one Board member declined re-election such a short time before the 2014 AGM that the nomination committee did not have time to take the requisite action to recruit a new Board*

*member*'. Another example is Fabege's (2015: 91) deviation from code provision 7.5: *'Fabege deviates from the Code when it comes to the recommendation that all Board Members have to meet with the company's auditors without the presence of the CEO or another member of the management team. After consulting with the auditors, the Board has not found it necessary to arrange such a meeting, partly because the auditors have, on several occasions, presented reports to the Audit Committee without the presence of the CEO'*. Explanations within this category indicate that the companies adequately have considered their specific circumstances.

*Industry-specific circumstances* were only used in 1.9% of the cases, indicating that the industry does not have much impact on compliance with the code. Oasmia Pharmaceutical AB (2015: 23) explains a deviation from code rule 4.3 with reference to the need for specific knowledge of board members within their industry: *'Two members of the company's Board who have been elected by the general meeting of shareholders work in the company's management team. The reason for this is that the company needs the company-specific industrial knowledge that Julian Aleksov and Hans Sundin possess both on the Board and in the management team. This enables the company to make both the operational and the long-term strategic decisions necessary in the phase that the company is currently in'*.

Transitional justifications were used in 3.8% of the cases. These were applied when either the code provision was new or when the company was newly listed, meaning that they were unable to implement certain code provisions into their governance practices due to a transition period. ComHem (2015: 43) explains a deviation from code provision 4.3 accordingly: *'In 2014, both the company's CEO Anders Nilsson and the*

*company's CFO Joachim Jaginder were members of the Board. Anders Nilsson and Joachim Jaginder were members of the Board before the IPO in June 2014 and in view of their knowledge of the company, the market and the requirements placed on listed companies, it was deemed appropriate that they continued to sit on the Board. Joachim Jaginder left ComHem in February 2015 and therefore also his position as Board member'.*

Overall, 48.1% of the explanations of non-compliance were classified as *context-specific*, making these types of explanations the most commonly used. These explanations are legitimate as they explain a deviation from the code in favor of an alternative solution based on the company's specific circumstances. Such explanations are within the spirit of the comply-or-explain principle. Thus, our results indicate that many listed companies in Sweden are utilizing the flexibility of the code in the intended way.

#### *Principled justification*

Only three deviations were explained by principled justifications (see Table 5), suggesting that Swedish companies do not depart from the code as a consequence of how the provisions are formulated.

#### *Shareholder justification*

Explanations referring to decisions made by the AGM were used in 9% of the deviations (see Table 5). Traction AB (2015: 5) clarifies its deviation from provision 2.1: *'At the 2014 Annual General Meeting, it was resolved that Traction should not have a nomination committee, which is a deviation from the Code'*. Deviations with reference to

concentrated ownership typically refer to majority shareholders exercising their control over the company by maintaining a position on the board, in the management or both. This type of explanation was used 23 times. Elanders AB (2015: 55) explains its deviating from code provision 2.4: *'The Chairman of the Board is also the chairman of the nomination committee, which is a deviation from the Code. Elanders believes it is reasonable that the shareholder with the largest number of votes be the chairman of the nomination committee since he ought to have a decisive influence on the composition of the nomination committee because he has a majority of the votes at the Annual General Meeting'*.

Wallenstam AB (2015: 109) uses a similar explanation for deviating from code provision 2.3: *'The Code states that the Chief Executive Officer (CEO) shall not be a member of the nomination committee. Wallenstam does not follow this rule as the CEO Hans Wallenstam is a member of the nomination committee. The reason for the deviation is that because the CEO Hans Wallenstam is also the principal shareholder in the company, he is a member of the nomination committee in that capacity'*.

In total, 23.7% of the explanations were in the category of *shareholder justifications*, often formulated in rather similar terms. While at first sight this could suggest that firms mimic each other's explanations to gain legitimacy (e.g. Hooghiemstra and van Ees, 2011; Lieberman and Asaba, 2006), the underlying reason here appears to be that these companies have similar structures of concentrated ownership. Their explanations can be regarded as justified as the Swedish code explicitly states that governance practices shall reflect that the company is run on 'behalf of their shareholders' (Swedish

Corporate Governance Code, 2010: 3), which are represented at the AGM. Thus, explanations within this category suggest that the intended flexibility of the comply-or-explain principle is functioning in the Swedish context.

## **Conclusions**

The aim of this paper was to assess how the comply-or-explain principle is used in Sweden more than two decades after the Cadbury Report initiated its implementation. We found that listed companies in Sweden frequently make use of the explain option and that the comply-or-explain principle is effective, considering that a clear majority of the explanations were categorized as informative. Only 26.3% of explanations were categorized as deficient, which in comparison to prior research (e.g. Seidl et al., 2013) is a low percentage. This result may reflect the effect of time, as our data represents the fiscal year of 2014, compared to earlier studies being based on older data (see Table 1). The CEP has become an established part of listed companies' governance practices in Sweden. Especially smaller listed companies in Sweden tend to comply more frequently compared to the results found in earlier studies (Akkermans et al., 2007; Hooghiemstra and van Ees, 2011; Seidl et al., 2013; von Werder et al., 2005), which is an indication of a learning effect over time.

Prior research had criticized that the code would not clarify when deviations are justified (Hooghiemstra, 2012; Seidl, 2007) and this seems to be an issue even in Sweden, considering that some companies fail to provide informative explanations. This might happen due to the difficulty of companies to interpret the code. Consequently, the Swedish Corporate Governance Code could be improved in this regard (cf. Inwinkl et al., 2015). For example, the Swedish Corporate Governance Code could outline that an

explanation is informative when it is used to describe an alternative practice referring to the company's particular circumstances and clarifies why this alternative practice is considered as better than the Code's suggestion.

A main contribution of this study is the new category of *shareholder justifications*, expanding the taxonomy developed by Seidl et al. (2013) and found to be prominent in our data. This new category accounted for almost one fourth of the explanations for non-compliance. While situation-specific explanations are to be evaluated by external stakeholders, shareholder justifications are based on shareholders' demands and thus provide immediate legitimacy. As the shareholders are the highest decision-making body of a company, their decisions have to be obeyed by the managers, as long as they are not against the law (Swedish Corporate Governance Code, 2010).

Our findings differ substantially from earlier research conducted within the European Union (e.g. Akkermans et al., 2007; Arcot et al., 2010; Hooghiemstra and van Ees, 2011; MacNeil and Li, 2006; Seidl et al., 2013; von Werder et al., 2005), and confirm that Sweden could be seen as an inspirational example of functioning governance practices. The results of this study can thereby be of value for policy makers in countries aiming to improve their corporate governance, but also to managers of listed companies aiming to enhance the legitimacy of their reporting.

This study has two limitations. While our study is based on high-quality data, it only covers one year (2014). As a fourth revised version of the Swedish Code was released in November 2016, this creates the opportunity to investigate whether explanations will improve even further with the new amendments. Also, our findings are limited to one country. A comparative analysis could help to establish whether there have been similar improvements within the European Union.





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## Appendix 1: Deviations from each provision

Code Provision		Number of deviations	Percentage of total deviations
2.4	Composition of nomination committee	41	26.3%
7.3	Audit committee	14	9.0%
2.1	Establishment of a nomination committee	12	7.7%
9.8	Share based incentive programmes	12	7.7%
9.2	Remuneration committee members	11	7.1%
2.3	Nomination committee independence	9	5.8%
7.6	Audit of six- or nine- month report	8	5.1%
2.5	Announcement of nomination committee	7	4.5%
1.5	Language of shareholder meeting	6	3.8%
4.2	Deputy directors	5	3.2%
7.4	Internal control function	5	3.2%
4.4	Director independence towards company	4	2.6%
2.6	Proposal of new board members	3	1.9%
4.3	Combined board and executive membership	3	1.9%
1.1	Time and venue of shareholder meeting	2	1.3%
7.5	Meeting with statutory auditor	2	1.3%
9.1	Establishment of an audit committee	2	1.3%
1.3	Annual general meeting attendance	1	0.6%
1.7	Minutes from annual general meeting	1	0.6%
2.2	Appointments of nomination committee members	1	0.6%
4.1	Board composition	1	0.6%
4.5	Director independence towards shareholders	1	0.6%
6.1	Election of board chairman	1	0.6%
8.2	Evaluation of chief executive officer	1	0.6%
9.4	Predetermined criteria on variable pay	1	0.6%
9.5	Predetermined limits on variable pay	1	0.6%
9.9	Severance pay	1	0.6%
<b>Total</b>		<b>156</b>	<b>100.0%</b>

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## Appendix 2: Governance information 2014

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**Table 1: Prior research on the comply-or-explain principle**

Author(s) (year)	Country studied	Main research question	Empirical basis	Theory applied	Main findings
<i>UK-based studies</i>					
MacNeil and Li (2006)	UK	What is the nature of explanations given by companies with a record of serial non-compliance and what is the role of the market in permitting deviations from the code?	522 FTSE All Share companies, data from 2004	Agency theory	Benefits of the flexibility generally associated with the self-regulatory status of the Code are overstated; Code could be integrated into mainstream corporate law
Arcot et al. (2010)	UK	Is the 'comply or explain' approach working in the UK?	Database of 245 non-financial companies for the period of 1998-2004	None	The authors find an increasing trend of compliance with the Combined Code, but a frequent use of standard explanations in case of non-compliance. They show how the Combined Code has been interpreted and applied and discuss the existence of enforcement and monitoring problems.
Haxhi et al. (2013)	UK	What is the role of institutional actors and business elites the development of UK corporate governance codes?	UK codes from Cadbury Report onwards	Institutional theory	Codes have different meanings depending on national contexts and political constituencies; the approach of different constellations of actors to codes and strategic interests are suggested to be as important to know as the content of the codes
Keay (2014)	UK	Should the present approach in voluntary codes implementing the CEP stand as it is at the moment or should some form of regulatory body be empowered to determine whether companies are in fact complying with code provisions?	Conceptual	None	Two problems in relation to CEP are identified: The first is that there is a lack of shareholder engagement with the principle. Second, statements by companies that are designed to explain why the company has not complied are often very brief and uninformative. Thus, it is suggested that serious consideration should be given to making provision for a regulator/monitor to oversee the corporate government statements of companies.



Shrives and Brannon (2015)	UK	To develop a typology based on seven quality characteristics from the prior literature and the International Accounting Standards Board's (IASB) Conceptual Framework	UK FTSE 350 companies; two periods (2004/5 and 2011/12)	Institutional theory	Although compliance increased over the period examined, explanations were found to be of variable quality.
Elmagrhi et al. (2016)	UK	To investigate the level of compliance with, and disclosure of, good corporate governance (CG) practices and ascertain whether board characteristics and ownership structure variables can explain observable differences in the extent of voluntary CG compliance and disclosure practices	100 UK firms, data for 2008-2013	Neo-institutional theory	The results suggest that there is a substantial variation in the levels of compliance with, and disclosure of, good CG practices among the sampled UK firms. Firms with larger board size, more independent outside directors and greater director diversity tend to disclose more CG information voluntarily. Additionally, the results indicate that block ownership and managerial ownership negatively affect voluntary CG compliance and disclosure practices.
Elgharbawy and Abdel-Kader (2016)	UK	Is there a possible trade-off between accountability and corporate entrepreneurship in the context of comply or explain governance?	113 UK-listed companies for 2010	Contingency theory	The results suggest no conflict between compliance with the corporate governance code and corporate entrepreneurship in the UK, which can be attributed to the flexibility of the CEP
<i>Studies about more recent EU-member states</i>					
Campbell et al. (2009)	Poland	What are the reasons for non-compliance by Polish listed companies with elements of the Polish code of corporate governance?	250 publicly available compliance statements filed by listed companies in 2005	None	Despite a high level of overall compliance, three out of 50 code principles attract high levels of non-compliance. These principles concern the independence of supervisory board members, the composition of supervisory board committees and the appointment of auditors. The most contentious principle concerns the independence of supervisory board members, due to the presence of many majority-owned companies on the Warsaw Stock Exchange.

Cankar et al. (2010)	Slovenia	How far has the implementation of the Code in Slovenia resulted in 'reflexive' learning processes which the CEP aims to bring about?	26 companies listed on Slovenian stock market in 2006	None	The study finds compliance strategies to be strikingly uniform across firms in terms of the content of deviations as well as in types of disclosure and explanations for deviations. Moreover, the quality of corporate reporting is low, with effective explanations representing only a small minority of disclosures. Thus there is little evidence that the Code has stimulated organizational learning.
Albu and Gîrbina <sup>~</sup> (2015)	Romania	What is the attitude of listed Romanian companies towards the CEP?	14 listed companies for 2010 and 32 companies for 2011	None	Applicable laws and regulations in emerging economies contain confusions and unclear provisions, which deter the application of the CEP. Emerging economies are characterized by low enforcement mechanisms and less demanding users of information. These create an environment where local companies get away with unsanctioned non-compliance instances, and general type of explanations. Larger, first-tier companies with larger boards are found to have better corporate governance practices.
<i>Studies about non-European countries</i>					
Spraggon et al. (2013)	Canada	To explore the important role that information transparency plays in strengthening the national corporate governance regime	Comparison of 403 proxy circulars issued after 2007	NA	Study identifies cross-firm variations in the type and format of disclosed information on executive compensation and corporate boards of directors.
Luo and Salterio (2014)	Canada	Do firms take advantage of the flexibility of the CEP to adopt governance practices that are best suited to their needs and value-added to the firms as predicted by economic theories of the firm?	655 Canadian-only listed firms, data from 2006	Agency theory	Results support the proposition that the flexibility of the CEP provides tangible financial benefits to shareholders in terms of higher firm value and returns on shareholders' equity investment
<i>Studies about different long-term EU member states</i>					

Andres and Theisen (2008)	Germany	What are the characteristics of the firms that complied with the code requirement?	cross-sections of 146 (for 2002 and 2003) and 140 (for 2005) German listed firms	Agency theory arguments	The results indicate that firms that paid higher average remunerations to their management board members were less likely to comply.
Van de Poel and Vanstraelen (2011)	Netherlands	To study the relationship between internal control reporting and accruals quality in an alternative internal control regime	All Dutch firms listed on the Amsterdam stock exchange (171 firm-year observations), data for 2004/5	None	The noncompliance rate of providing a statement of effective internal controls is relatively high, and that companies give generic explanations for noncompliance or no explanation at all
Nerantzidis (2015)	Greece	To provide evidence regarding the efficacy of the CEP in Greece	144 Greek listed firms, data for 2011	none	The results show that although the degree of compliance is low (the average governance rating is 35.27%), the evaluation of explanations of non-compliance is even lower (from the 64.73% of the non-compliance, the 40.95% provides no explanation at all)
Nerantzidis et al. (2015)	Greece	What is the impact of international/supranational codes on the national ones in Greece?	219 Greek listed companies	none	22 practices were selected to investigate compliance and a quite low rate was revealed, an average percentage of 30.46%. These findings indicate that while exogenous forces trigger the development and adoption of a code in Greece, in line with the UK's, the endogenous forces tend to avoid the compliance with that 'exogenous practices.
Hooghiemstra and van Ees (2011)	Netherlands	To examine how firms have dealt with the trade-off between flexibility and uncertainty that is characteristic for the decision-making of firms in coping with self-regulatory initiatives in general and the comply-or-explain principle in corporate governance in particular.	126 listed Dutch firms; data for 2005	Institutional theory	Firms respond by largely complying with the code recommendation, possibly out of fear that the firm's reputation may be damaged. Evidence suggests that firms confine themselves to adopting a specific set of code recommendations and use similar arguments to explain non-compliance. The findings indicate uniformity in adopting the standard of good governance which is not in line with the logic of corporate-governance codes and casts doubt on the effectiveness of this form of soft law.

Hooghiemstra (2012)	Netherlands	What are the explanations for deviations from a corporate governance code?	Sample of Dutch listed firms for the period 2005-2009,	Agency theory; voluntary disclosure literature	Study finds that ownership concentration and number of analysts following the firm are positively associated with informativeness. Furthermore, there is indicative evidence that board strength and informativeness are positively associated. The study also finds a negative association between leverage and informativeness. Institutional investors, however, do not seem to affect this type of disclosure.
Holm and Schøler (2010)	Denmark	To examine how differences in 'ownership dispersion' and 'exposure to the international capital market' affect the particular use of the corporate governance mechanisms 'transparency' and 'board independence' in listed companies.	100 companies listed in Denmark; data from 2004	Agency theory	Transparency is a more important corporate-governance mechanism for companies with exposure to the international capital market, while differences in ownership dispersion do not affect the use of the transparency mechanism. In contrast, board independence in the context of a two-tier board member system is found to be an important corporate-governance mechanism for companies with widely dispersed ownership and not for companies with exposure to the international capital market.
Rose (2016)	Denmark	To investigate the degree of Danish firm adherence to the Danish Code of Corporate Governance and analyze if a higher degree of comply or explain disclosure is related to firm performance	158 listed companies in Denmark, data for 2010	none	The article's findings suggest that soft law may be an efficient way of increasing the quality of corporate governance among listed firms. However, in order to strengthen investor confidence, national code authorities/committees should be more active in penalizing poor explanations as well as cases where firms wrongfully state that they comply with a specific recommendation.
<i>Studies across different countries</i>					
Seidl et al. (2013)	UK and Germany	To explore the ways in which the CEP is used	257 listed companies in the UK and Germany	Legitimacy theory	The authors derive a taxonomy of the explanations, examine the underlying logic and identify various legitimacy tactics
Salterio et al. (2013)	Canada and Australia	What is the rate of compliance by Canadian public firms with corporate governance recommendations imposed by the	742 Canadian public companies and	none	The study finds a complete compliance rate of 74 percent of Australian companies compared to Canada's 39

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		Canadian Securities Administrators? How does this compare to Australia?	1334 Australian companies		percent complete compliance rate. Compliance by adoption of best practice is more common in Canada, whereas compliance by explanation is more common in Australia.
Galle (2014)	Belgium, Germany, Italy, the Netherlands, and the UK	To analyze the level and quality of the application of the CEP for listed companies in Belgium, Germany, Italy, the Netherlands and the UK	237 annual accounts for the years 2005-2007	Legitimacy theory; theory on market failure	The results show that company size and the period of time the CEP has been applicable in a country predict the level and quality of compliance. Although the level of code compliance is high, the quality of the explanations for code provisions not complied with is insufficient. Further fine-tuning of the CEP is necessary to achieve the most effective application in order to make the principle work in practice as intended
Magnier (2014)	EU countries	What are the major advantages and flaws of the CEP?	Conceptual	Shareholder oriented corporate governance	Soft European intervention to harmonize culture of governance in Europe called for
Inwinkl et al. (2015)	EU countries	To examine to what extent and in what way stakeholders agree that the 'explain' option should be used to provide a detailed explanation for a departure from the provisions of a code	244 stakeholder responses to an EC consultation	Legitimacy theory	The analysis across different stakeholder responses and national contexts reveals that the majority of stakeholders are clearly in favor of requiring companies to provide detailed explanations of non-compliance.

Table 2: Categories of explanations

<b>Categories of explanation</b>	
<b>1</b>	<b>Deficient justification</b>
1.1	Pure disclosure
1.2	Description of alternative practice
1.3	Empty justification
<b>2</b>	<b>Context-specific justification</b>
2.1	Size of company or board
2.2	Company structure
2.3	International context
2.4	Other company specific reason
2.5	Industry specific
2.6	Transitional justification
<b>3</b>	<b>Principled justification</b>
3.1	Effectiveness/efficiency
3.2	General implementation problems
3.3	Conflicts with laws or social norms
<b>4</b>	<b>Shareholder justification</b>
4.1	Referring to decision made by the AGM
4.2	Referring to largest shareholders

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**Table 3: Average number of deviations made by each company**

<b>Market Cap</b>	<b>Number of companies</b>	<b>Deviations</b>	<b>Average number of deviations</b>
Small	94	51	0.54
Mid	78	62	0.79
Large	69	43	0.62
<b>Total</b>	<b>241</b>	<b>156</b>	<b>0.65</b>

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**Table 4: The five codes with most recorded deviations**

<b>Code Provision</b>		<b>Number of deviations</b>	<b>Percentage of total deviations</b>
2.4	Composition of nomination committee	41	26.3%
7.3	Audit committee	14	9.0%
2.1	Establishment of a nomination committee	12	7.7%
9.8	Share based incentive programmes	12	7.7%
9.2	Remuneration committee members	11	7.1%



**Table 5: Frequency of non-compliance explanations across categories and market cap**

Categories of explanations		Small	Mid	Large	Total	Total %	Small %	Mid %	Large %
<b>1.</b>	<b>Deficient justification</b>	<b>18</b>	<b>13</b>	<b>10</b>	<b>41</b>	<b>26.3%</b>	<b>43.9%</b>	<b>31.7%</b>	<b>24.4%</b>
1.1	Pure disclosure	14	2	0	16	10.3%	87.5%	12.5%	0.0%
1.2	Description of alternative practice	2	2	1	5	3.2%	40.0%	40.0%	20.0%
1.3	Empty justification	2	9	9	20	12.8%	10.0%	45.0%	45.0%
<b>2.</b>	<b>Context-specific justification</b>	<b>23</b>	<b>29</b>	<b>23</b>	<b>75</b>	<b>48.1%</b>	<b>30.7%</b>	<b>38.7%</b>	<b>30.7%</b>
2.1	Size of company or board	7	6	0	13	8.3%	53.8%	46.2%	0.0%
2.2	Company structure	4	3	6	13	8.3%	30.8%	23.1%	46.2%
2.3	International context	0	9	2	11	7.1%	0.0%	81.8%	18.2%
2.4	Other company specific reason	8	7	14	29	18.6%	27.6%	24.1%	48.3%
2.5	Industry specific	2	1	0	3	1.9%	66.7%	33.3%	0.0%
2.6	Transitional justification	2	3	1	6	3.8%	33.3%	50.0%	16.7%
<b>3.</b>	<b>Principled justification</b>	<b>1</b>	<b>2</b>	<b>0</b>	<b>3</b>	<b>1.9%</b>	<b>33.3%</b>	<b>66.7%</b>	<b>0.0%</b>
3.1	Ineffectiveness/inefficiency	1	1	0	2	1.3%	50.0%	50.0%	0.0%
3.2	General implementation problem	0	1	0	1	0.6%	0.0%	100.0%	0.0%
3.3	Conflicts with law or social norms	0	0	0	0	0.0%	0.0%	0.0%	0.0%
<b>4.</b>	<b>Shareholder justification</b>	<b>9</b>	<b>18</b>	<b>10</b>	<b>37</b>	<b>23.7%</b>	<b>24.3%</b>	<b>48.6%</b>	<b>27.0%</b>
4.1	Referring to decision made by the AGM	1	8	5	14	9.0%	7.1%	57.1%	35.7%
4.2	Referring to largest shareholders	8	10	5	23	14.7%	34.8%	43.5%	21.7%
	<b>Total</b>	<b>51</b>	<b>62</b>	<b>43</b>	<b>156</b>	<b>100%</b>	<b>32.7%</b>	<b>39.7%</b>	<b>27.6%</b>