Comply or explain: exemplifying 'reasonably' good corporate governance

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Abstract: Attempts to determine what constitutes “good” corporate governance have become mired in the quicksand of the ethical conflict between duty and utility, virtue and rights, as well as the fight over for *whose good* the organization exists. This paper takes a different tack. Drawing upon evidence from the efforts to build and develop the UK code of corporate governance, it argues that the nature of “good” is intractable, but that in the practical world a philosophically pragmatic approach applies, exemplified in the preference for a comply or explain approach rather than more formal modes of regulation. Using Toulmin’s (2001) advocacy the reasonable, in opposition to the rational, and evidence about the principle of “comply or explain”, it argues that in codifying corporate governance, the UK has in effect opted for “reasonably” good governance, rather than best practice. In so doing, the code reflects concerns embodied in competing views of contributors about the contingent nature of organizational life and strategies and the uncertain benefits of corporate governance mechanisms.

Keywords: Codes; corporate governance; ethics; rationality; reasonableness; Toulmin

Once upon a time …

The story of corporate governance is often told as a fable of good and evil: the good journalists at Mirror Group Newspapers and the evil Robert Maxwell who stole their pensions to prop up his failing business empire, the good shareholders of Enron defrauded by the omnipotent and "unfettered" CEO, or the poor fisherman in the Gulf of Mexico deprived of their livelihoods by the greedy oilmen (and a few oil women) at BP, Halliburton and the rest. For many boards of directors, much of the time, the story is a more mundane one: forms to fill in, boxes to tick, time wasted in compliance that might be better spent strategizing or negotiating access to valuable and scarce resources. Has the striving for good corporate governance given itself a bad name?

Evidence of the bad name is often more anecdotal, more evident in unguarded remarks than verifiable data, for corporate governance is a good that people find difficult to deny. But in private conversations, corporate directors complain:

> A non-executive director of one of the world's largest corporations, who chairs its remuneration committee, meets an old acquaintance from earlier in their business careers. "What are you doing now?" the non-exec asks. "I'm working in corporate governance," his former colleague replies. "If I had my gun now I would shoot," the non-exec says and walks away.
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> Or of the chairman of a major financial services firm who meets a complete stranger at a social event, someone who also expresses an interest in corporate governance. Few publications would print the sentence that followed – both for its diction and lest the slander it voiced became libel.

These tales suggest that these directors take corporate governance very seriously. They care about their companies and resent the intrusions by what they see as do-gooding outsiders trying to impose ways of thinking and standards of action on others, when those others are responsible, in a legal sense, for the decisions to be made.

Yet directors like these are also responsible, in a moral sense, for cases of malfeasance at all too many corporations. Their excesses, over several decades, have fostered a movement to identify good or even best practice in corporate governance, reinforced by mechanisms, structures and procedures, whether in the form of rules or principles. Scholars have attempted to discover a formula for good board performance by assessing the correlation of one or several mechanisms of governance, with one or another measure of performance. Such efforts seem to yield ambiguous results, even if we could agree that the measures selected were the ones that somehow mattered.

This paper takes a different approach. It argues that good governance is historically situated (Bird, 2009) and contingent upon factors that cannot be controlled, that is, factors the directors cannot reasonably control, however rational their thought processes are. This argument recalls – and in its detail is based upon – the distinction in Toulmin (2001) between what is reasonable and what is rational. It is analogous to but not the same as the bounded rationality in the work of Simon (1955, 1959, 1978). Toulmin argues that ontological as well as epistemological limits to certainty make the rational, as we have come to understand it in modern thought, impossible. The limits of human intelligence alone do not create the problem, but rather the complexity of the problem itself.

If the problems of governing a corporation or other types of organizations are inherently and intractably complex, then the lessons of cybernetics suggest that efforts to control them – to construct mechanisms of governance – must falter when they encounter the law of requisite variety (Ashby, 1958, 1968/2011). The most regulation can reasonably expect of directors and boards is that they are reasonable, recognize the contingency of their situation, and be – in the philosophic sense – pragmatic in their decisions (cf. Rorty, 1989). That involves trading off one set of norms for another, when the one no longer seems to suit the circumstances and the other holds out hope of something better.

Let us first consider the thinking of Toulmin (1992, 2001, 2003) on rationality, reasonableness and the nature of argument. We will then explore the landscape of corporate governance, paying particular attention to the UK, where the code of conduct promulgated in

1992 became a model for much of the world (Aguilera & Cuervo-Cazurra, 2009). Within the UK, elements of its prescriptions have been embedded in recommendations for a wide variety of non-corporate entities, including mutual organizations (Myners, 2014), charities (Governance Code Steering Group, 2010) and the public sector (Nordberg, 2014).

We will look at the conflicting aims and logics that actors bring to the argumentation. Next we examine briefly attempts to identify formal characteristics of good governance before seeking evidence of contingent approaches. The paper then considers how contingency is embodied in the principle called "comply or explain", as developed in UK corporate governance. Through doing so, the paper will demonstrate how corporate governance, in the UK and then elsewhere, came to institutionalize a logic grounded in Toulmin's type of reason. If we accept this type of argument, then we can see reason for the disagreements evident in both the debate over the code and the way scholars attempt to theorize what constitutes good governance.

Reason, rationality and contingency

In the wake of near-meltdown of the financial system in 2008, various commentators blamed the crisis in corporate governance on excessive faith among bank directors in the rationality of efficient markets and in managers to account for risk. Evidence of this is in the popularity of the Black Swan concept of Nassim Nicholas Taleb (2007), which seemed in hindsight to have predicted the turmoil.

The notion of market efficiency developed in the 1950s assumed that rational investors would, through the wisdom of markets, find the right price for assets, provided all relevant information was freely and widely available (Fama, 1970). At the same time, however, doubts about rationality were emerging elsewhere in the literatures of economics and epistemology. Herbert Simon wrote of rationality as being bounded by our ability to compute the values at stake (Simon, 1955, 1959); his insights led to a new field of behavioural economics.

This period, too, saw doubts about rationality emerge in a rather different setting. The philosopher Stephen Toulmin published the book *The Uses of Argument* in 1958 (republished 2003). In it he drew the distinction between the formal argument familiar in the abstract world of mathematics and what he called the substantive argumentation that constitutes discussion in the practical world of ordinary life.

Substantive argumentation involves a claim, supported by grounds, which are then linked by a warrant, the justification that leads us to accept the claim. This approach makes sense when the warrant itself is clear: Ground: X was born in New York; Claim: X is a US citizen; Warrant: The US grants citizenship to all people born on US soil. Here, the warrant can arguably be accepted at face value; its logic does not vary by specific circumstances. Such warrants are sometimes left unspoken, understood by those concerned. But warrants are also historically situated and may need to be qualified: Before a certain date, people born on US soil might lose US nationality, for example by taking the nationality of their non-US parents. Moreover, the more complex the field, the less likely that a claim and its associated warrant would be what Toulmin calls “field-invariant”. With “field-dependent” ones, qualifications and counter-claims are possible, creating ambiguity in argumentation.

The importance of field-dependent variables is not just that they limit the ability of people to determine what is rational. They make the arguments contingent on circumstances, preventing actors from coming to a single rationality. This argument was controversial at the time, running counter to mainstream analytic philosophy. But it resonated with many other thinkers, contributing to the sense of an inherent non-rationality arising in physics since Einstein and Heisenberg, and evident in the sociology that came to be called post-modernism.

In *Cosmopolis*, Toulmin (1992) traced excessive faith in rationality in the modern era to Descartes and the resulting narrow conception of scientific inquiry that followed in the tradition he helped to establish. Returning to these themes in *Return to Reason* (2001), he argued that the best we could expect in an uncertain and contingent world was that people acted reasonably. It resonates with the contingency associated with the pragmatists Thomas Dewey and William James and is central to the work of Richard Rorty (1989).

Reasonableness is an important concept in law and business. Juries are asked to find evidence of guilt "beyond reasonable doubt". Directors – of corporations based in Delaware and other jurisdictions that have accepted its prevailing logic – might call it "business judgement", the rule that prevents shareholders for using hindsight to sue board members when a decision goes wrong (cf. Pearlstein, 2014; Sharfman, 2012).

Among management theorists, Sandberg and Tsoukas (2011) invoke Toulmin's doubts about the rational in arguing for what they term "practical" rather than "scientific" rationality. The idea of reasonableness has attracted attention in a number of fields, though often without specific use of Toulmin. Scholars in Finland studied perceptions of reasonableness and unreasonableness in a business network, linking them to trust and mistrust (Kohtamäki, Vesalainen, Varamäki, & Vuorinen, 2006). Li and colleagues (2012) measured reasonableness as perceived by Chinese non-executive directors, associating it with expectations of director performance. Lydenberg (2014) advocates reasonableness over rationality in considering the fiduciary duties of investors. In healthcare, some studies tie reasonableness to a Rawlsian sense of justice (Daniels & Sabin, 1997; Reeleder, Goel, Singer, & Martin, 2008).

Philosophers have long separated the reasonable from the rational. Rawls (2005, p. 48n)[1] traces it to Kant's distinction between the categorical and hypothetical imperative in his *Groundwork* (1785/1964). Sibley (1953) distinguished between the rational and the reasonable on the grounds that rational behaviour involved reflective consideration of one interests, while reasonable behaviour, at least in its moral sense, involve some element of objectivity. Philosophers have debated whether this distinction can be supported. For example, Gewirth (1983) argues that the reasonable is included within the rational, though superior to the self-referencing version of rationality in Sibley's formulation. These notions informed Rawls's argument about how we achieve political stability in liberal democracies. In his view, being reasonable is part of a political ideal, rather than an epistemological idea. It "includes what free an equal citizens as reasonable can require of each other" (Rawls, 2005, p. 62). Linked to his theory of justice as fairness (Rawls, 1958, 1999), the reasonable involves, in effect, a willing suspension of belief in comprehensive doctrines, making possible the creation of liberal institutions. While Rawls argues that reasonableness involves acceptance of the limitations of doctrine, Sen (2009) contends Rawls's political ideal, like his invocation of the "original position", nonetheless involves a transcendental stance. Sen questions whether it is possible "to identify 'just' institutions for a society without making them contingent upon actual behaviour" whether or not that behaviour is just or reasonable (Sen, 2009, p. 68).

Reasonableness, in Toulmin's terms, avoids ideals and the transcendental. He calls reasonableness "the possibility of living, as in pre-modern times, without any absolute necessities or certainties" (2001, p. 1). Rationality, associated with positivism and certainty, falters at the hurdle of describing what happens in practice. Since Toulmin's early work, the analytic philosophy of the 1930s to 1950s has been in retreat and moral problems (he uses the example of medical practice) "are being handled less by strictly theoretical analysis than on a 'case-by-case' basis" (Toulmin, 2001, p. 167). In the face of complexity, of the sort of complexity that defies calculation, multiple answers may apply to the same situation, and what's best is impossible to determine.

Toulmin suggests the appeal of the rational arose from its formal, mathematical proof, which became compelling because its abstractness conveyed universality. The power of the proof lies in its formality, that is, its separation from the messiness of the world. Coping with that world, however, requires something else, what he calls “substantive arguments”. They involve three distinctions from formal inquiries: first, that evidence from the real world is historical and therefore becomes dated; second, that rival interpretations of such data are possible; and third, that the concepts involved in interpretation can be ambiguous (Toulmin, 2001, pp. 20-21). The best substantive arguments can claim to do “is to put a conclusion ‘beyond a reasonable doubt’ and establish the ‘strongest possible presumption’” (Toulmin, 2001, p. 19). These expressions are familiar in criminal law as well as the philosophical discussion that followed his *Uses of Argument* in the 1950s. This is not a relativist approach to determining the right thing to do. It is, rather, an argument based on contingency: In these circumstances, at this time, it is what reasonable people can agree.

These ideas resonate with the themes of corporate governance, as we shall see. For corporate governance itself lacks clear definition, its concepts are ambiguous, and actors from various disciplines take very different stances not only as to what is the right answer but even as to what is the right question.

Corporate governance as a landscape

Corporate governance scholars sometimes describe their subject as a field, but it isn’t, not in a conventional way. Even as metaphor, fields have boundaries – limits where they abut other fields or paths – with dividing lines that define their shape and delineate ownership, even if those boundaries are sometimes fuzzy and open to dispute. In sociology, fields have members who share a common language, making communication possible, and common understandings, making communication sometimes unnecessary. That is, they have norms, rules of the game, creating institutional arrangements with their own logics (Thornton

& Ocasio, 2008) that members understand even when they might not articulate them (Green, 2004). Institutional logics are, therefore, less like the formal logic in mathematics and more like the substantive argumentation in Toulmin (2003). They may invoke warrants to support their claims. But as they become institutionalized, the warrant is often unspoken, taken for granted by those to adhere to the institution.

A field that isn't

Corporations share a broadly common form and a logic of supplying goods and services to customers for a profit. The field they inhabit overlaps with the field of institutional investors (some of which are themselves corporations), but the investors' field involves the primacy of investor interests: the corporation exists to produce returns for investors – capital gains and dividends, not products and services. Logics of investment markets guide and direct the interaction between investors and investee companies. Their advisers inhabit other fields, the professions of law and accountancy prominent among them.

These fields arise in different broad social domains, what Puxty and colleagues (1987) call organizing principles, or what Friedland and Alford (1991) and Thornton (2004) call institutional orders, where deeply held beliefs are rooted. Principal among them are the belief in the efficiency of *markets*, the knowledge of the *profession*, or the natural justice of *families*; the immanent power of *religion*, the hierarchy of the *corporation*, or the bureaucracy and sovereignty of the *state*.

In corporate governance the state is an important actor, setting out the legal basis for corporations and the regulatory regimes they follow. But as we will see, there are reasons to believe it is a weakened actor, and was a particularly weak one as UK corporate governance became codified. Actors from other fields, arising in other orders, play a prominent role, too. Institutional investors populate the field of capital markets with a power that overwhelms the "savers" who co-habit it. Theirs is a logic of shareholder value (Lok, 2010), rooted in markets. For Thornton (2004), the prevalence of the corporate form means that corporations warrant an order of their own, one giving rise to a logic based on strategic choice. Advisers, especially those in law or accountancy, sit in fields governed by professional logics, with their commitment to a body of knowledge that (at least, notionally) takes precedence over the merely commercial. There are many other actors, less powerful, in other fields, too. Corporate governance looks different to different actors, depending on where they stand (Ahrens, Filatotchev, & Thomsen, 2011).

In increasingly global investment markets, even the geographic boundaries of fields have become blurred, and as that happens questions arise about whose rules apply, which can throw the legitimacy of the rules themselves into doubt. Indeed, that globalization of markets diminished the power of the state, reducing the constraints on corporations as well as markets.

Let’s call corporate governance something else, then, a landscape. The view it frames includes a number of fields. Some common understandings may prove, therefore, to be common misunderstandings, where actors use the same words to mean something different, and where meanings may be translated to fit with the actors’ individual meaning systems (Czarniawska & Joerges, 1996), leading to differing interpretations that may remain without articulation, because in this non-field actors still, almost, understand each other.

An example of near understanding comes in a defining statement in the Cadbury Code. Sir Adrian Cadbury had been asked by the London Stock Exchange and the accounting profession to examine the “financial aspects” of corporate governance, after perceived failings in audit at several large corporations. But Cadbury went beyond that brief. In an oft-cited paragraph, the Cadbury Commission calls corporate governance “the system by which companies are directed and controlled”. The next sentence added: “Boards of directors are responsible for the governance of their companies” (Cadbury, 1992, Section 2.5). This seemingly uncontroversial statement was the subject of controversy during the drafting. The draft text published in May 1992 described corporate governance as “the system by which companies are run” adding: “At the centre of the system is the board of directors whose actions are subject to laws, regulations and the shareholders in the general meeting” (CAD-02229[2]). In the draft, the board was not in charge, merely at the centre of a complete web of governance arrangements.

Many, often hostile voices, mainly from corporations, insisted boards do not “run” companies – that is the job of management. And they urged that the external actors – the state through law and regulation, and even shareholders – be kept out of the definition (Spira & Slinn, 2013). The change to the text made the board preeminent and yet not in charge. Still, the language remained that of a “system”, with interacting components, but it left unstated until later which components mattered. The resulting ambiguity created scope in the definition itself for differing interpretations.

The landscape framed by the Cadbury Code contained fields from institutional orders of the market and to a lesser extent the state. The market appeared in Cadbury’s emphasis on accountability to shareholders (Nordberg & McNulty, 2013) and in the disciplinary effects of shareholder scrutiny of compliance. Regulation was present, too, but in the hands of market-led bodies, the UK Listing Authority, at the time the Stock Exchange’s self-regulatory arm, and the accountancy profession’s self-regulator, the Financial Reporting Council. Following a change in government in 1997, both became state-controlled bodies. But in 1992, a weakened and fractious government, led by the Conservative John Major, seemed unable to act on corporate affairs. And as the code institutionalized, the order of the corporation was the dominant object in view.

Logics in the landscape

The various fields in the landscape of corporate governance each come with their own sets of rituals and routines, and the institutions they constitute have their own logics. In the institutional logics perspective (Thornton, Ocasio, & Lounsbury, 2012), social action is governed through the interplay of logics, as institutions, often from different orders, contest for attention. Actors in the various fields in the corporate governance landscape bring different logics to the debate. Three are particularly important: first, the managerialism of corporations; second, shareholder primacy, with large fund management firms *primus inter pares*; and third, the expert knowledge of professional advisers.

Corporations and their boards might be expected to be guided by logics that give primacy to the manager at the top of the internal hierarchy. This is a logic of managerialism (Lok, 2010), which in its beneficial manifestation has links to stewardship theory (Davis, Schoorman, & Donaldson, 1997). But managerialism is also associated self-serving managers, whose neglect of shareholder interests provided the springboard for corporate governance reform in the US and the rise of shareholder activism in the 1970s and 1980s (Pearlstein, 2014).

That change in thinking involved an assumption of shareholder primacy, in evidence in the recipes of agency theory (Fama & Jensen, 1983; Jensen & Meckling, 1976). The assumption here is that shareholders use a different logic, based in agency theory (Westphal & Graebner, 2010), governing interactions with companies, emphasizing the primacy of market principles and with shareholder legitimacy validated by property rights. Following the precepts of the efficient market hypothesis (Fama, 1970), oversight of corporations involves the use of ever greater transparency and disclosure, and governance mechanisms to align managerial pay with shareholder returns.

Professional advisers to both corporations and investment firms include lawyers and accountants. They gain their special place in corporate affairs and capital markets by virtue of specialist knowledge and their adherence to professional norms, as well as powers invested in them by the state through institutional arrangements arising in law. The logics of these professions, and their endorsement in law, presume such norms take precedence over commercial benefit. But the recurrent crisis in corporate governance has been traced, at least in part, to the failure of these professionals to give sufficient primacy to the norms (Toffler & Reingold, 2003). The accounting profession, for example, faced a competing logic from the commercial imperatives of running what had themselves become large organizations (Hinings, Brown, & Greenwood, 1991; Suddaby, Gendron, & Lam, 2009; Thornton, Jones, & Kury, 2005).

These logics may bring different understandings to bear on the specific recipes of the new proto-institution that embraces all three fields. A managerial logic might value the service role of directors over their control function. It would tend to value the decisive power of a unified leader implied by embodying the chairman and CEO in one person. A market-based, agency logic might favour a more controlling board with strong supervisory powers, equity incentives to motivate management, and a separation of the chairman and CEO. A professional logic would look for standards to be applied, albeit with discretion given on the basis of expertise. It might also advocate a clear evidence-base for the decision. As we shall see, the evidence is somewhat less than clear.

Normative and contingent corporate governance

The search for solutions to the problems of governance led to prescriptions of various kinds, some legal remedies, others through principles-based codes that become more rule-based over time (cf. Toulmin, 1981; Weaver, 1995). Rationalist prescriptions of agency theory led to the use of equity-linked rewards, and in particular stock options. But then came scandals of backdating of option grants and other ruses to benefit corporate elites (Bebchuk, Grinstein, & Peyer, 2009). An alternative, equally rationalist approach came in mandatory measures, with the force of law. But attempts to legislate for good corporate governance, like those in the US Sarbanes-Oxley and Dodd-Frank Acts, have been called examples of the law of unintended consequences (Fletcher & Miles, 2004; NACD, 2012; Wong, 2009). Moreover the development of commercial corporate governance metrics services, which once guided mainly voting decisions of investment managers, have morphed into rationalist metrics of risk management, despite ambiguous evidence of their validity (Bhagat & Bolton, 2008; Brown & Caylor, 2006; Renders, Gaeremynck, & Sercu, 2010; Rose, 2007).

By contrast, practice-led studies have tended to show that boards of directors adopt different approaches to corporate governance, on behavioural and structural levels, depending on the circumstances of the company. For example, some showed different emphases in board behaviour depending on life-cycle stage and firm size (Filatotchev, Toms, & Wright, 2006; Huse & Zattoni, 2008), suggesting value from more contingent approaches to structure and process.

The governance mechanisms introduced in the Cadbury Code (1992) were more reasonable than rational. They sought to ensure that no one person or group had “unfettered power” in the boardroom, though more than 20 years later, we still lack firm evidence that its prescriptions, like ending CEO duality, work (Krause, Semadeni, & Cannella, 2014). Some studies find that splitting the roles of chairman and CEO is a double-edged sword (Finkelstein & D'Aveni, 1994); others see its value as contingent of various other factors (Elsayed, 2007; van Essen, Engelen, & Carney, 2013). Arguing in Toulmin’s (2003) terms, the *claim* that good practice requires separating the roles of chairman and CEO is based on the *grounds* of the collapse of major UK corporations with all-powerful leaders, and on a *warrant* that generalizes the value of a fettered CEO. The argument it entails is reasonable.

The UK code had from its outset envisaged, however, that codification of such practices was unlikely to solve the problems and captured that in the principle that came to be called "comply or explain". After a discussion of methods, we will turn to examining how pressures, principally from boards of corporations, reinforced a contingent approach through the UK code's approach to compliance.

Methods

The analysis presented here concerns the recurring debate about the nature of compliance in the UK codes of corporate governance. It examines contributions to the debates the led to the formulation of the Cadbury Code in 1992 and then the subsequent major revisions involved in the Combined Code of 2003 and the renamed UK Corporate Governance Code in 2010. These versions of the code were selected because they were motivated by specific crises of legitimacy, rather than being the product of a simple periodic review. The work involved reading all available submissions to the final consultation for Cadbury, the "fatal flaws only" review after publication of the Higgs Review (2003) of the effectiveness of non-executive directors in 2003, and all three phases of consultation in 2009-10, which ran in parallel to the Walker Review (2009).

In 1992, 2003 and in each phase in 2009-10, more than 100 people or organizations responded, with contributions ranging from one to 35 pages in length. From that a sample of contributions was selected, based on salience (Mitchell, Agle, & Wood, 1997), for more detailed coding and analysis. Rhetorical devices and forceful diction were used in the textual analysis as signals of urgency, alongside conventional views of legitimacy and power in the Mitchell et al. (1997) definition. That work was then supplemented by iterative reading of other texts as thematic links to them emerged from analysis of the sample.

What follows is a substantive argument, that is, an interpretation of events, though not a proof, concerning the origins and development of what came to be an influential concept. Its impact on UK corporate governance and the effect it has had both abroad and in non-corporate forms of governance give the concept particular resonance.

Explain, or just comply?

The Cadbury Code was an institution in the making, a proto-institution (Lawrence, Hardy, & Phillips, 2002; Zietsma & McKnight, 2009) seeking to legitimate certain structures and procedures and through codification and dissemination diffuse their prescribed practices. Subsequent revisions built on that base, but even before Cadbury certain aspects of corporate governance had an institutional character. For example, unitary boards were the norm in the UK, although not in law. Applying distinctions developed in DiMaggio and Powell (1983), we can see the unitary board pre-Cadbury as the result of mimetic isomorphism, its value often taken for granted. Separation of the roles of chairman and CEO, one of the major thrusts of the Cadbury reforms, was already commonplace in the UK but far from universal. Post-Cadbury, it became rare, a sign of normative isomorphism, and subsequent enforcement by major investors and their agents meant isomorphism took on a coercive character. Consider the investor outcry when Stuart Rose sought to become executive chairman of Marks & Spencer after having been CEO (Burgess, Rigby, & Braithwaite, 2008).

Another example is the role of non-executive directors. When the Higgs Review (2003) recommended at least half of boards should be non-executive directors independent of management, that they should have their own leader, and that they should control the main board committees, a storm erupted (Nicholson, 2008). This new norm was a violation of accepted, institutionalized practice in which the company and specifically its chairman had discretion over such matters. Yet the power of the code meant that norm, too, became institutionalized.

A third debate, one that recurred over the two decades of the code but without generating quite the same heat, concerned the nature of compliance. That it was not particularly controversial was because it provided the logic that made the code work for all: the principle that complying with the code included non-compliance when accompanied by an explanation, or “comply or explain”. It appears to have arisen largely spontaneously from within the Cadbury Committee. Through the rest of the consultations over two decades dissenting voices argued that “comply or explain” left the code with no teeth, or worse: that it had led to a false sense of security that “good” corporate governance was in place. These were minority views, however, mainly from actors in more peripheral parts of the landscape. In this section we examine the treatment of the concept during the consultations involved in each of the three main versions of the code.

Cadbury 1992

Early records in the Cadbury Archive give little hint of this elegant solution to the heated debate they document between proponents of regulation and those who feared heavy-handed regulatory intervention in response to the shocks to the system in the early 1990s. When it emerged in the draft code in May 1992, it came with aggressive language that implied compliance should be the norm: “to state whether they are complying with the Code and if not, why not”. That phrase arose in a paragraph about enforcement through the listing regime, which would “require” as a “continuing obligation” a statement of compliance. The London Stock Exchange would “draw public attention” to “inadequate disclosure”. The final code softened the language to “or give reasons for non-compliance”, which nonetheless left the rhetorical emphasis on compliance. Moreover, the section in which it appeared was headed simply “Compliance”. The phrase “comply or explain”, which came to symbolize the voluntary nature of the code, did not appear in either the draft or the final document.

Some respondents to the draft, in particular from the corporate side, praised its flexibility, but many argued for more. J.B.H. Jackson, a self-described “professional” chairman, welcomed the link to the listing rules and noted: “No listed company should be afraid of disclosing non-compliance for good cause" (CAD-02143). But Stanley Kalms, chairman of Dixons whose role at the company in 1992 breached Cadbury's proposed separation of chairman and CEO,[3] argued that "non-compliance … should not be outlawed" and wanted a "flexible framework", not a "straight jacket" (CAD-02167). The language suggests the strength of his feeling. His metaphor associates the implicit alternative – a mandatory code, based in company law – with madness. Cadbury received support as well from the investor side for a voluntary approach, now explicitly linked to the alternative of a change in law:

> ABI welcomes the emphasis on compliance with a voluntary Code of best practice rather than a statutory Code. The former should encourage greater consistency with the spirit rather than just the letter; the latter is only likely to impose minimum standards. The framework of the Code with accompanying recommendations should enable responsible shareholders to identify deficiencies more readily and take appropriate action at an early stage (ABI, CAD-02467).

The argument here – that voluntarism will bring compliance with higher standards – echoes the self-disciplinary effects of institutions that come to be accepted through normative rather than coercive isomorphism, relying upon a common cognitive base and a professional network for self-enforcement (DiMaggio & Powell, 1983) from among the company-investor constituents in field of corporate governance. These actors and others like them pushed the committee towards a stance more accommodating of the corporate wish for greater board discretion within the new framework. As such their debates can be seen simultaneously as seeking to repair the proto-institution of the code while undermining the legitimacy of a more extreme interpretation of its meaning.

2003 Combined Code

By the time of the first major revision of the code, the phrase "comply or explain" had become part of the language of corporate governance around the world. It was used to describe the approach used in countries ranging from South Africa to Sweden. In Germany, the first code of corporate governance incorporated this type of voluntarism despite considerable legal and other structural differences between Germany and the UK. Even in the US, where the legal requirements of Sarbanes-Oxley formed the central response to the Enron collapse, both Nasdaq (2002) and the New York Stock Exchange (NYSE, 2003) used comply or explain to introduce their new listing recommendation separating the roles of chairman and CEO.

In the consultation in the UK following the Higgs Review, the mechanism of a voluntary provision was not widely debated; it was evidently not considered a “fatal flaw” but rather one of the strong points of the corporate governance regime. But respondents worried in unusually vivid language that market developments had morphed its application in ways unanticipated in Cadbury. Viewed from the corporate side, the more prescriptive elements of the Higgs draft code, combined with the enforcement through proxy voting advisers, had led to a risk of “comply or disdain” (BAT, 05 March 2003) or “comply or else” (CBI, 16 April 2003). The CBI added in the code it “should be clearly stated that **to explain is to comply**” [emphasis in the original]. Several respondents used terms similar to those of Sir Brian Moffat, chairman of the steelmaker Corus writing as senior independent director of HSBC. He blamed both the proxy voting firms and the media for the deterioration of meaning in the phrase:

> … we have real concern with adopting all the Higgs recommendations as a result of experience from the influence of voting recommendations of commercial service providers and the attitude of the U.K. media. Their recommendations and attitude appear to be based on acceptance of “Comply” but rejection of “Explain” - a “box ticking” approach (Corus, 20 March 2003).

Moffat then states that the UK “is fortunate to have a HSBC Holdings plc registered here”, citing a “real risk” that investors outside the UK might misinterpret UK corporate governance, an implicit warning that the bank could move its headquarters abroad if the regulatory regime became too uncomfortable. In these examples, the iconic language is used to undermine how the code had been used in practice, rather than its letter or spirit. In so doing, these respondents, arguing from the centre of the landscape, reject the way gatekeepers on the periphery had bent the code's symbolic language to purposes other than those of more central actors. Their responses were attempts to return the code to what they saw its original purpose, as voluntary guidance, not a performance metric.

Making this defence of the code simultaneously attacks the extension of it proposed by Higgs to include many more provisions, on the grounds it would lead to even more box-ticking. Lord Weir, chairman of Balfour Beatty, for example, invokes irony to undermine the Higgs recommendations by attacking the enforcers. His letter uses the terms "the reality is that …" and "the fact is that ..." in the same paragraph, seeking to dismiss the Higgs recommendations as being detached from reality and lacking evidence. The depiction of the corporate governance staff at investment institutions in that paragraph as "low-level box-ticking fonctionaires" undermines the legitimacy of investors through a pejorative designation of their roles, suggesting the people, not just the approach they take, are "low-level". The structure of the phrase invites a reading of "box-ticking" as an attribute of individuals, not as a description of an activity they happen to perform. Moreover, selection of "fonctionaires" mocks both the old enemy (France) and its new replacement (Brussels, that is, the European Union) with just a single word. That sentence goes on, however, to voice its strongest rebuke against investors who do not hire their own "fonctionaires" but "even" outsource the process to the "unadmirable PIRC". PIRC, the firm called Pension & Investment Research Consultants, was founded in 1986 to advise local authority pension funds on their investments. It was often associated with both shareholder activism and left-wing causes.

This is language that disdains those who measure compliance and ignore explanations. In just four short paragraphs, Lord Weir has used irony to disrupt the attempt to institutionalize practices he sees as counterproductive (the “unintended consequences” he fears). He seeks to support the code, as he and others like him interpret it, while disrupting the interpretations of other actors from other parts of the corporate governance landscape.

2010 UK Corporate Governance Code

In the consultations in 2009-10, a wider set of voices arose contesting the appropriateness of the “comply or explain” provision. Corporate actors in large numbers urged a change in language to “apply or explain”. Other respondents, however, remarked that the UK response in 2003 to the crisis of Enron and others had been timid in comparison to changes introduced in the US under the Sarbanes-Oxley Act of 2002 and urged less voluntarism and more compulsion. The CBI’s second submission in 2009 addressed both points, while supporting the corporate stance:

> There must be a strong awareness of the need to avoid over-reactions and unintended consequences, and we are mindful of the difficulties that arose in the US as a result of Sarbanes-Oxley (CBI, October 2009, p. 3).
>
> The CBI is aware that a number of representations have [been] made that the phrase “apply or explain” more accurately reflects the spirit of the Combined Code and we would support that view (CBI, October 2009, p. 8).

GC100, an association of corporate general counsels, and therefore legal professionals with close ties to corporate interests and values, argued the case for “apply-or-explain” even more forcefully:

> We are concerned that some investors may choose to simply apply the voting recommendations of a proxy agent to their holdings without examining the issues themselves (and indeed we recognise that some investors feel they are not resourced to undertake comprehensive analysis of each company in which they invest during the AGM season, particularly smaller firms). Again, this demonstrates why the Code should encourage “apply or explain” (rather than comply or explain) as it compels greater engagement and dialogue between companies and their owners on the governance performance of boards (GC100, October 2009, p. 7).

Moreover it warned against the FRC or the stock market regulators at the Financial Services Authority becoming directly involved in enforcement:

> This is why “apply or explain” is a better mantra in this context (and one which Derek Higgs himself had wished he had adopted) (GC100, October 2009, p. 6).

The various submissions lined up on each side of the debate: Several pointed out that the Netherlands corporate governance code had used “apply”, thus invoking a legitimacy inherited from a nearby and closely aligned corporate environment and financial market. Others noted that South Africa, too, had chosen to use the term “apply”, having been one of the first countries to follow the UK down the route of codifying corporate governance and in some submission held up as a paragon that had overtaken the UK as a model of best practice.

The CG100 submission’s reference to Higgs’s comments involved an association with a person regarded with considerable reverence by those actors in the field who argue for tighter regulation. By invoking the name of the person who had come to symbolize the other side of the argument, GC100 undercuts the moral position those actors might make that a change in this iconic language would signal a significant softening the code’s stance.

Contingency, reasonableness and trust

Across the debate about the substance of the code, corporations seek to maintain the discretion associated with a managerialist logic in the face of competing claims, first, of a shareholder primacy logic, with roots in market mechanisms, to expand information and reduce asymmetries, second, of a professional logic based in normative approaches to behaviour, and third, a regulatory logic advanced by what we might call the near-outsiders, looking to constrain the discretion of managers, markets and the professions. They make competing, substantive arguments over the value of one mechanism versus another based on differing claims, resting on different warrants but rooted in the same grounds: recurrent corporate failures. In Toulmin’s terms, the mechanisms of governance shaped in the code involve field-dependent understandings and field-dependent warrants to the competing claims, sometimes articulated, sometimes not.

The process of code-writing, through consultation, drafting and renewed consultation, allows the differing warrants to blend. The label of the relevant section of the Cadbury report is “Compliance”, placing the weight on one side of the equation. But after the consultation the committee then moderates its language from the aggressive “if not, why not” of the draft to “give reasons for non-compliance” in the final version. The concept then develops in public discourse to an even more evenly weighted “comply or explain”. And in 2010, the code reverses the weight by scolding investors and advisers and by giving companies and their boards greater leeway: Explanations of non-compliance, it urges “should not be evaluated in a mechanistic way and departures from the Code should not be automatically treated as breaches” (FRC, 2010, p. 4). The weight of the argument has shifted, in part because time has moved on and experience has shown the limitations of codification (Nordberg & McNulty, 2013). The arguments over the nature of compliance were rarely strident. Almost every actor near the centre of the landscape seemed willing to accept that rule-writing would be counter-productive; more at issue was the nature of enforcement. The nuances concern the degree of contingency, not the question of whether there was one right and rational way forward.

Participants seemed to accept that the people involved in corporate governance – boards and their directors, fund managers, advisers and experts – would not act or be able to act in a mechanical way, whatever mechanisms the code specified. They seemed, with a few exceptions, to acknowledge that rigid rules and orthodox procedures would not be appropriate. On the issue of compliance, the argument concerned a claim that embodied contingency, accommodating multiple warrants related to the same grounds. As a result, actors from different fields can accept even when they cannot agree on specific measures.

New practices developed after the Cadbury Code, including the “box-ticking” especially dreaded by corporations, involved monitoring less by investors than by the governance rating firms and proxy voting agencies they employ. Supported by academic studies seeking links between firm performance and governance structures, these practices can be seen as seeking, in Toulmin’s terms, a rationalist answer, a formula for good governance, at odds with the spirit of the code as understood by many corporate actors, investment firms and advisers. Those in more peripheral fields argued for even stronger mechanisms to enforce compliance, and some for legislation, to reduce the discretion of more powerful actors at the centre. Might their longing for rational justifications be an emotional response to their lack of power over other actors and events?[4]

Following Toulmin’s argument, rationality cannot deal with the uncertainties inherent in complex situations. Reasonableness in corporate governance may then involve recognition that in the complexity of corporate affairs, circumstances may arise where discretion is advisable and others where it is less so. Reasonable people will continue to disagree, but reasonableness itself fosters and supports trust.

Some reasonable inferences

The present analysis points to a number of reasonable inferences. The attempt to codify and institutionalize good corporate governance involves the search for an ideal. The process of consultation shows, however, that this ideal is, however, albeit a limited and “political” one in the sense the Rawls (2005) has in mind. Having arrived at a reasonable outcome, the code grows more articulated and specific over time, approaching something of like the comprehensive doctrine that Rawls sees as imperilling liberal institutions. The principle of comply-or-explain, however, provides an escape, and one that permits deviation beyond the overlapping political consensus in the limited Rawlsian ideal. That is, it accepts, with *reasoned* explanations on all matters, embodying the contingency of corporate decision-making, bringing it more in line with Toulmin's approach.

If we accept that Toulmin's view applies in corporate governance, then attempts to find correlations, even causality between variables of governance and performance are likely to be frustrated. Such relationships, if they exist, may have some predictive value at the level of the portfolio. They may, therefore, be of use to institutional investors, who monitor the performance of, say, 2,000 companies to select a portfolio of, say, 500 investments. They are much less likely, however, to have predictive value at the level of individual boards and appointments of directors, where interpersonal relations and social complexity come into play. Worse, using such relationships as targets is likely to have perverse outcomes, through managing to targets rather than making reasonable arguments in reasoned debate. If that's the case, then "comply or explain" is a reasonable compromise, giving boards discretion and portfolio managers a tool to manage risk.

Some wider inferences are these: If we accept Toulmin's view, then macro-level associations – while useful for seeing the big picture – are of much less use in prescribing micro-level decisions. The rules of the game embodied in field-level institutional arrangements may be handy short cuts in boundedly rational contexts, but they are less likely to provide guidance in complex or rapidly changing situations, where thoughtfulness is needed in application. And in a landscape of overlapping fields and competing institutions, openness to narrative and transparency during debate may be a better way to foster trust.

Reasonableness as accountability

In conclusion, this discussion suggests a common issue joining the fables of corporate ill-doings mentioned at the beginning of this paper and the bad name corporate governance has acquired in more mundane practice. Attempts to control through structures, rationally devised, limit the freedom of action of those responsible for corporate excess. But they also threaten the discretion needed for experimentation, innovation and coping with the complexities that uncertainty entails. Compliance with institutional norms limits the goal of distinctiveness. Yet both have value. Someone with reasonable oversight of the business should be able to tell shareholders and others where, when and why discretion is needed, and in what ways the standard formula doesn't fit. That is, directors should be able to provide a narrative of what matters and why.

In explaining his discomfort with the modernist project of Descartes and later philosophers, Toulmin (2001, p. 15) writes that the "reasonableness of narratives" came to be dismissed as a "soft-centered notion". Reasonableness is a middle way between the dichotomy of relativism and rationality. He contrasts the "soundness" of substantive argumentation – the approach, for example, of the essays of Montaigne, to the "validity" of formal arguments, with their reliance on deduction.

Read as a plea rather than an argument, Toulmin is urging accountability, but not the accountability of perfect scores on a questionnaire. This is the type of accountability envisaged (if perhaps often abused) in the business judgement rule in Delaware law. This is also what Toulmin might term "substantive argumentation" against tyranny of box-ticking and against the symbolic management (Bednar, 2012; Westphal & Zajac, 1998) of formal compliance instead of considered explanation. This suggests that through the mechanism of "comply or explain" the UK code of corporate governance has identified a logic that unites most, though not all, the actors in the landscape of corporate governance, providing the freedom needed to deal with contingency.

Reasonably good corporate governance, then, involves the ability to look one's fellow directors in the eye and explain, or demand an explanation of, why this course of action is, somehow, best: best, that is, not of *necessity*, as in a mathematical proof, but, in Toulmin's terms, through substantive argumentation. Reasonably good corporate governance would involve doing that in public as well, but also without pretending to have the formal proofs. This suggests that accountability, at least as envisaged in the UK code, is the ability to give a reasonable account, after thoughtful consideration and substantive argumentation, of one's decisions about an uncertain world.

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[1] References to Rawls are to the revised versions of his books.
[2] CAD- numbers refers to the document identification at the Cadbury Archive in the library of the Judge Business School at the University of Cambridge.
[3] Dixons appointed John Clare as group managing director in 1992 and group chief executive in 1994. Kalms was executive chairman at the time, a title often regarded as involving CEO duality, and was deeply involved in the business he had joined, aged 16, in 1948; he had become chairman in 1971.
[4] In *Cosmopolis*, Toulmin (1992) suggests such a basis for Descartes' adoption of rationalism after the chaos of the Thirty-Years' War.

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